REGULAR MEETING OF THE

MONTANA BOARD OF INVESTMENTS - DEPARTMENT OF COMMERCE

2401 Colonial Drive, 3rd Floor Helena, Montana
February 10 & 11, 2009

AGENDA

I.	**CALL TO ORDER**		**10:30 a.m.**
	A.	Roll Call	
	B.	Approval of the November 12 & 13, 2008 Regular Meeting Minutes	
	C.	Approval of the December 18, 2008 Special Meeting Minutes	
	D.	Administrative Business	
		1. Audit Committee Report	
		2. Loan Committee Report	
	E.	Public Comment - *Public Comment on issues with Board Jurisdiction*	**11:00 a.m.**
	EXECUTIVE DIRECTOR REPORTS – Carroll South		**11:05 a.m.**
	A.	Legislative Update – Informational/Verbal	
	B.	Hedge Fund of Funds – Informational/Verbal	
	C.	Internal Auditor – Informational/Verbal	
	D.	Pension Fund Investments – Informational/Handout	
	E.	TRS annual report to the Board, Dave Senn, Executive Director	
	F.	PERS annual report to the Board, Roxanne Minnehan, Executive Director	
	BREAK FOR LUNCH		**12:30 p.m.**
	CONSULTANT REPORTS – R.VK KUHNS AND ASSOCIATES		**1:15 p.m.**
	A.	Quarterly Investment Performance	
	B.	The financial markets – how we got here – where do we go from here.	
II.	**INVESTMENT ACTIVITIES/REPORTS – Cliff Sheets, CFA, CIO**		**2:30 p.m.**
	A.	Retirement System Asset Allocation Report	
	B.	Investment Pool Strategies	
		1. Domestic Equity (MDEP)	
		2. International Equity (MTIP)	
		3. Manager Watch List	
		4. Fixed Income Strategy Statements	
		i. Bond Pools (RFBP and TFBP)	
		ii. Short-term (STIP) and Other Fixed Income Portfolios	
		iii. Below Investment Grade Holdings Report	
	C.	Private Equity (MPEP)	
		1. Portfolio Holdings and Recent Activity	
		2. Private Edge Reports (as of September 30, 2008)	
	D.	Real Estate	
		1. Portfolio Holdings and Recent Activity	
		2. Private Edge Reports (as of September 30, 2008)	
	E.	Securities Lending Report	
	F.	Investment Policy Statements - Decision	
		1. Core Internal Bond Portfolio	
		2. Clark Fork Site Response Action Fund	
		3. Clark Fork Restoration Fund	
		4. Smelter Hill Uplands Restoration Fund	
		5. Butte Area One Restoration Fund	
	ADJOURNMENT		**5:00 p.m.**

REGULAR MEETING OF THE
MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE

AGENDA – DAY 2

	RECONVENE AND CALL TO ORDER	**8:30 a.m.**
	A. Roll Call	
III.	**BOND PROGRAM – Louise Welsh**	**8:35 a.m.**
	A. INTERCAP 1. Activity Report 2. Staff Approved Loans Report 3. Loan Requests	
	B. QZAB Bond Resolution No. 222 – Geri Burton	
	EXTERNAL MANAGER PRESENTATIONS	
	Rainier Investment Management o Daniel Brewer, CFA, Principal Senior Equity Portfolio Manager o Greg Best, CFA, Director, Client Service and Consultant Relations	**8:45 a.m.**
	BREAK 15 Min.	
	INTECH o Jason Trow, Vice President – Client Services o Jason Greene, Senior Investment Officer	**10:00 a.m.**
	BREAK 15 Min.	
IV.	**MONTANA LOAN PROGRAM – Herb Kulow**	**11:30 a.m.**
	A. Commercial and Residential Portfolios Report	
	ADJOURNMENT	**12:00 p.m.**

The Board of Investments makes reasonable accommodations for any known disability that may interfere with a person's ability to participate in public meetings. Persons needing an accommodations must notify the Board (call 444-0001) or write to P.O. Box 200126, Helena, Montana 59620) no later than three days prior to the meeting to allow adequate time to make needed arrangements.

Call to Order

Final – approved May 12, 2009

MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE

2401 Colonial Drive, 3rd Floor
Helena, Montana
February 10 & 11, 2009

MINUTES

BOARD MEMBERS PRESENT:

Terry Moore, Chairman
Elouise Cobell
Teresa Cohea
Karl Englund
Maureen Fleming
John Paull
Jack Prothero
Jon Satre
Jim Turcotte
Representative Tom McGillvray

BOARD MEMBERS ABSENT:

STAFF PRESENT:

Jason Brent, Investment Analyst
Geri Burton, Deputy Director
Richard Cooley, CFA, Portfolio Manager
Kim Dallas, Program Assistant/Board Secretary
Tim House, Chief of Investment Operations
Ed Kelley, Portfolio Manager
Teri Kolnik, Equity Investment Analyst
Herb Kulow, Portfolio Manager
Gayle Moon, Accounting Fiscal Manager
Rande Muffick, CFA, Portfolio Manager
Jon Putnam, Investment Analyst
Nancy Rivera, Credit Analyst
John Romasko, Fixed Income Investment Analyst
Nathan Sax, CFA, Portfolio Manager
Clifford A. Sheets, CFA, Chief Investment Officer
Jon Shoen, Investment Analyst
Carroll South, Executive Director
Steve Strong, Investment Analyst
Louise Welsh, Bond Program Officer
Dan Zarling, CFA, Director of Research

GUESTS:

Chris Phillips, Montana Board of Investments
Becky Gratsinger, R.V. Kuhns and Associates
Ryan Cunningham, R.V. Kuhns and Associates
Dave Senn, Executive Director, Teachers' Retirement System
Roxanne Minnehan, Executive Director, Public Employees' Retirement System
Daniel Brewer, CFA, Principal Senior Equity Portfolio Manager, Rainier Investment Management
Greg Best, CFA, Director, Client Service and Consultant Relations, Rainier Investment Management
Jason Trow, Vice President – Client Services, INTECH
Jason Greene, Senior Investment Officer, INTECH

CALL TO ORDER

Chairman Terry Moore called the regular meeting of the Board of Investments (Board) to order at 10:30 a.m. in the conference room at 2401 Colonial Drive, 3rd Floor, Helena, Montana. As noted above, the meeting convened with nine members of the Board present. Representative Tom McGillvray was also in attendance.

Member Karl Englund motioned for approval of the November 12 & 13, 2009 Regular Meeting Minutes and the December 18, 2009 Special Conference Call Meeting Minutes; Member Terry Cohea seconded the motion and the motion was passed 9-0.

ADMINISTRATIVE BUSINESS

Chairman Moore presented the following Administrative Business:

Audit Committee Report
Member Jim Turcotte, Audit Committee Chairperson, reported that the Audit Committee met with the Legislative Audit Division staff on December 1, 2008. The purpose of the meeting was an audit exit conference to discuss the draft audit report.

The Legislative Audit Division performed a financial/compliance audit for fiscal year 2007-2008 as required by law. A draft audit report has been prepared with two recommendations:

1. Short Term Investment Pool (STIP). Gayle Moon provided information about two investments in the STIP portfolio that defaulted on their maturity dates. The Board of Investments recorded these investments as Long-term Receivables in accordance with the accounting transactions made by the custodial bank. The custodial bank was relied upon as a resource because of their familiarity with similar portfolios held by other states. Gayle Moon stated these defaulted investments had been moved in SABHRS from Long-term Receivables to Long-term Investments in October 2008 by staff.

2. State Fund building. The Legislative Auditors did not agree with the Board of Investments recording the building as an investment in the State Fund portfolio. Given the intended use of the building, the auditor believed the building should be recorded as a capital asset. At the request of the Auditor's Office, the Board of Investment staff made the SABHRS accounting entries in November 2008 to record the building land and construction-work-in-progress as a capital asset for the State Fund.

Loan Committee Report
Member Jack Prothero, Loan Committee Chair, reported that the Loan Committee reviewed and approved three INTERCAP loan requests during its committee meeting, and the Loan Committee authorized staff to proceed with processing and closing these loans using the Board's standard Bond Program Office procedures.

Borrower:	Cooke City Park County Water District (Livingston)
Purpose:	An interim loan in anticipation of Rural Development (RD) long term financing for costs associated with constructing a water transmission main.
LC Approval Date:	February 10, 2009
Board Loan Amount:	$1,550,000
Term:	1 year

Borrower:	Dept. of Natural Resources and Conservation (DNRC)
Purpose:	Revenue Anticipation Note in anticipation of DNRC's Drinking Water State Revolving Fund program loan repayments.
LC Approval Date:	February 10, 2009
Board Loan Amount:	$3,500,000

Term:	Up to 3 years

Borrower:	Dept. of Natural Resources and Conservation (DNRC)
Purpose:	Revenue Anticipation Note in anticipation of DNRC's Water Pollution Control State Revolving Fund program loan repayments.
LC Approval Date:	February 10, 2009
Board Loan Amount:	$2,000,000
Term:	Up to 3 years

Member Jack Prothero reported that the Loan Committee reviewed and approved a QZAB request during its committee meeting. Ms. Geri Burton will present the QZAB Loan Request to the full board for discussion and decision tomorrow during the Bond Program agenda items.

Member Jack Prothero reported that the Loan Committee reviewed and approved a Montana Loan Program loan request by email on January 26, 2009 and the Loan Committee authorized staff to proceed with processing and closing these loans using the Board's standard Bond Program Office procedures.

Borrower:	Missoula Garden, LLC.
Lender:	Treasure State Bank, Missoula
Purpose:	To provide long term financing for the purchase and renovation of an existing restaurant building.
LC Approval Date:	January 26, 2009
Total Loan Amount:	$1,625,000
Board Loan Amount:	$1,300,000
Term:	20 year

<u>Staff Introduction</u>
Ms. Gayle Moon introduced Ms. Linda Christopher as the newest member of the Board of Investments accounting staff.

<u>Public Comment</u>
Chairman Moore called for Public Comment of Board-Related Items. *No Public Comment made*.

<u>ADJOURNED</u>
The meeting adjourned at 10:45 a.m. in order for the Board to have a photo taken with Governor Schweitzer.

<u>RECONVEYNE</u>
The meeting reconvened at 11:45 a.m.

<u>EXECUTIVE DIRECTOR REPORTS</u>

<u>Legislative Update</u>
Executive Director Carroll South updated the Board on recent Legislative activity. Legislation is being monitored on a daily basis and at this time the only bill currently that has been drafted that is being closely watched and is causing a great deal of concern is a Sudan divestiture bill. This bill would be a major distraction for staff in terms of managing the pension funds. The bill has been drafted but it has not been introduced at this time.

The two bills (LC0033 and LC0659) that had been drafted to address the Short-Term Investment Pool (STIP) will not be introduced.

Hedge Fund of Funds

Executive Director Carroll South updated the Board on the status of the Hedge Fund of Funds RFP. Twenty four responses were received and since the last board meeting staff has completed a first round vetting of the responses. Staff has been monitoring the respondents to determine any exposure to the Madoff situation or if they are freezing redemptions. Staff is also updating the performance of the top responses since the RFP requested performance as of June 30th and given the events of the last six months and the effect on hedge funds.

Mr. South also reported that Congress may enact Legislation to regulate Hedge Funds and Private Equity, to some degree. To the extent and level of regulation, Hedge Funds of the past may not be the Hedge Funds of the future. Staff will continue to monitor the activities taking place in the area of hedge funds.

Internal Auditor

Executive Director Carroll South reported that a Limited Solicitation has been issued for Internal Auditor Services. The Board of Investments is seeking a qualified, independent accounting firm to perform a thorough review of and provide a comprehensive report on the effectiveness of the Board's internal control processes; the efficiency and effectiveness of its financial reconciliation procedures; and to recommend how frequently and by what methods the internal control processes and reconciliation procedures should be monitored by a third party in the future. This solicitation does not include ongoing monitoring. Responses must be received by 5:00 p.m. on February 27, 2009.

All services provided by the contract must be completed by June 30, 2009. A complete report will be presented to the Audit Committee by June 30.

Pension Fund Investments

Executive Director Carroll South provided to the Board an in-depth educational report on Pension Funds and Investments.

Mr. South explained the three Pension Fund Components of a Defined Benefit Plan –

1. Employer/employee contributions:
   a. Legislature sets contribution levels by law
   b. Normal cost to fund future benefits
   c. Additional contributions if necessary to pay off unfunded liabilities
2. Benefits:
   a. Legislature sets formula for individual benefits
   b. Future cost of benefits impacted by salary growth and age at retirement
   c. Total cost of future benefits significantly impacted by beneficiary longevity
3. Invested assets:
   a. Invested assets valued at June 30
   b. Assets are "smoothed" to obtain "actuarial value"
   c. Invested assets expected to return 7.75% - 8% annually
   d. Financial markets ultimately determine future asset levels

It is important to note that the invested assets component is slice in time information as of June 30. It does not matter what the value of the asset are on June 25th or July 5th. Perhaps more important than the value of the assets on June 30 is the actuarial assumptions that the assets will earn 7.75 percent to 8.00 percent annually for the next 30 years. That assumption is built in to all pension fund evaluations.

Unfunded Actuarial Liability is the difference between actuarial liability and actuarial assets. If the assets are more than the liabilities, a surplus exists. If liabilities are greater than the assets, an unfunded liability exists.

Actuarial value of assets:

- The “smoothed” value of asset values on June 30
- Assets are smoothed to reduce year-to-year volatility
- There is a “built-in” return assumption for the assets
- Returns are volatile but return assumptions seldom change.

Since Fiscal Year 1995, the Board’s Custodial Bank has calculated the annual investment return of pension funds. From Fiscal Year 1995 through Fiscal Year 2008, a 14-year period, investment returns of pension fund investment portfolios have exceeded the actuarial return assumptions.

Even though investment return assumptions were met during the period, unfunded liabilities of the Teachers’ and Public Employees’ Pensions (TRS/PERS) increased. Unfunded liabilities are impacted not only by investment return but also by increases in benefits and revised estimates of benefit liabilities based on experience.

Mr. South discussed why pension funds invest in publicly-traded stock:

- History has demonstrated that these pension return assumptions cannot be met without a significant investment in publicly-traded stock. Despite the higher volatility of stocks compared to other investments, over long periods of time return on stocks have exceeded pension fund return assumptions, while other liquid investments have not.
- Excluding stock investments in the state’s pension funds poses a “risk” to public employers participating in the pensions and ultimately to state taxpayers.
- While US Government bonds are perceived to be totally “risk free” to the investor, historically the return on these bonds have never been sufficient to meet pension fund return assumptions. In the investment world “Risk” and “Return” are directly related.
- Consequently, if the state’s pension investments are comprised entirely of low-risk government bonds actuarial unfunded liabilities will increase, necessitating an increase in public employer contributions to keep the systems actuarially sound.

The financial market meltdown this fiscal year has significantly impacted the state’s pension funds. They were negatively impacted not only by the general performance of public equity investments but fixed income investments as well. During the last six months of the year, investors dumped investments with perceived risk and flocked to US Treasury Bonds/Bills, causing stock and Corporate bond prices to plummet while the price of Government Bonds/Bills soared. Additionally, diversification into other asset classes has not been that helpful during the period as almost all traditional asset classes have performed poorly.

Board staff has had a measured, disciplined response to the financial market meltdown and have attempted to keep the assets within the ranges approved by the Board. While it may seem counter intuitive to sell stocks when stock allocation hits the top of the range or buy stocks when the allocation falls through the bottom of the range, it is that discipline that shields an investor from buying high and selling low. Complicating this balancing act is a shrinking denominator when one portion of the market melts down much more than others.

<u>Teachers’ Retirement System and Public Employees’ Retirement System Annual Report to the Board</u>

Pursuant to 19-20-215, MCA, the retirement board shall annually at a public meeting present to the board of investments established a financial and actuarial report of the retirement system and brief the board of investments on any benefit changes being considered by the retirement board that may affect trust fund obligations.

Mr. Dave Senn presented the report on behalf of the Teachers’ Retirement System and Ms. Roxanne Minnehan presented the report on behalf of the Public Employees’ Retirement System.

CONSULTANT REPORTS

Quarterly Investment Performance Reports

Ms. Becky Gratsinger presented the Q4 2008 performance report to the Board. Net of fees, the Public Employees' Retirement plan returned -13.29% for the fourth quarter and -26.05% for 2008, beating the plan's custom benchmark by 51bps and 48bps respectively. This performance ranked in the 54th percentile of a universe consisting of over 120 public plans. Performance and ranking for the other retirement plans was similar. The attached summary (included with a copy of these minutes) contains performance data for each retirement plan, investment pool, equity composite, and equity sub-composite.

The Financial Markets – How we got here – Where we go from here?

Ms. Becky Gratsinger and Mr. Ryan Cunningham next presented to the Board a presentation on current economic conditions. The presentation provided background on how the economy got to this point, data on the historical duration of previous recessions, and an assessment of what happens next. The presentation closed by comparing Montana performance to other public funds and endowments during the recent down market. The data showed Montana performance has generally been in-line with other large public funds during this time.

INVESTMENT ACTIVITY

Asset Allocation Report

Mr. Cliff Sheets presented the Retirement Systems Asset Allocation Report as of December 31, 2008. The report highlighted the significant decline in total equity assets, particularly both domestic and international public equity. This has in turn led, via the so-called "denominator effect," to higher allocations to alternative assets (private equity and real estate) which did not decline as rapidly. Mr. Sheets also discussed recent efforts to re-balance asset allocations, however noted the difficulty of doing this in a period of scarce liquidity.

Domestic Equity (MDEP)

Mr. Rande Muffick presented the Montana Domestic Equity Pool Report as of December 31, 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 December 31, 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**
Principal Global	International – LC Growth	Performance	March 2008
Western Asset	Domestic - LC Enhanced	Performance, Tracking Error	March 2008
NorthPointe	Domestic- SC Growth	Performance	August 2008
Acadian Asset	International – LC Value	Performance, Process	February 2009
Hansberger Global	International – LC Growth	Performance, Risk Controls	February 2009
Martin Currie	International – LC Growth	Performance, Risk Controls	February 2009

During the quarter, Goldman Sachs Enhanced Large Cap was removed from the Watch List. Performance relative to the benchmark has improved and organizational concerns have largely been resolved. There were no manager terminations during the quarter. Added to the Watch List were three style-based international managers: Acadian, Hansberger, and Martin Currie.

Fixed Income

Mr. Nathan Sax presented the Fixed Income Overview and Strategy. This report included portfolio characteristics for the external manager, Reams, which was hired as a core-plus manager during October, as well as for the combined Retirement Funds Bond Pool.

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

Private Equity (MPEP)

Mr. Cliff Sheets reviewed the September 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 December 31, 2008. There were no new fund commitments made to the MPEP since the November Board Meeting. However, an additional $10M commitment was added to the prior commitment to Lexington Partners Fund VII, L.P. for a total commitment of $30M.

Real Estate (MTRP)

Mr. Cliff Sheets reviewed the September 30, 2008 reports by Private Edge showing the real estate fund commitments made to date and holdings as of December 31, 2008. There were no new investment commitments made by staff to report since the November Board meeting.

ADJOURNED

The meeting adjourned for the day at 5:15 p.m.

CALL TO ORDER

The meeting was reconvened Wednesday, February 11, 2009 at 8:00 a.m. with six members of the Board present. Member Elouise Cobell arrived immediately following roll call. Member Karl Englund, Member John Paull and Representative Tom McGillvray were absent from the second day of the meeting.

Securities Lending Report

Mr. Cliff Sheets presented to the Board a status report on the securities lending program.

The recent year-end financial news from State Street Bank and Trust (SSBT), our custodian and securities lending agent, highlighted some of the ongoing challenges faced by the bank. While these problems may be symptomatic of wider banking problems, nevertheless the rating agencies downgraded SSBT to high single A. Also noted was the unrealized investment losses within the collateral pools used by SSBT for cash collateralized securities loans. Yet, SSBT is the one major custodial bank that has yet to incur any realized losses in its collateral pools. The investment risks imbedded in the collateral pools are the biggest risks to the program. SSBT indemnifies us against borrower defaults but not investment losses.

The Securities Lending Program continued with strong earnings growth in the second-half of 2008, following a big increase in fiscal year 2008. There was a 51% increase in earnings to $7.4 million during the second half of the calendar year. The biggest increase was in earnings on US Government securities, which have been in strong demand because of the flight to quality seen in the second half of 2008. A large part of the earning increase is the widening gap between investment yields and the rebate rate, or what the borrower of the securities receives as a rebate on the loan.

In conclusion, the Board asked R.V. Kuhns and Mr. Sheets to provide at a future meeting an additional in-depth education on the risks related to the Securities Lending Program.

Investment Policy Statements

Mr. Cliff Sheets presented the following Investment Policy Statements. The Clark Fork Site Response Action Fund regards an existing policy which has been modified and requires Board approval. The remaining three Statements are new accounts and also require Board approval.

- **Clark Fork Site Response Action Fund:** This investment policy statement was approved in December 2008. Since that time, EPA has re-reviewed and asked for minor revisions. The revisions are changes in verbiage only and do not impact the objectives of the statement.
- **Clark Fork Restoration Fund:** This investment policy statement is new and applies to one of the new accounts opened recently pursuant to the ARCO Settlement Consent Decree which empowers the Department of Justice to implement the restoration action on the Clark Fork River and associated riparian areas.
- **Smelter Hill Uplands Restoration Fund:** This investment policy statement is new and applies to one of the new accounts opened recently pursuant to the ARCO Settlement Consent Decree which empowers the Department of Justice to implement the restoration action of the environment, vegetation and soils on lands affected by the Anaconda smelter.
- **Butte Area One Restoration Fund:** This investment policy statement is new and applies to one of the new accounts opened recently pursuant to the ARCO Settlement Consent Decree which empowers the Department of Justice to implement projects that restore, replace or acquire the equivalent of injured natural resources or lost services in the Butte area.

Motion: Member Maureen Fleming motioned for approval of the staff recommendations as presented; Member Elouise Cobell seconded the motion and the motion was unanimously approved 7-0.

Mr. Nathan Sax presented the following Investment Policy Statements for Board approval:

- **Core Internal Bond Portfolio:** This investment policy statement will provide a broad strategic framework for fixed income investments within the Core Internal Bond Portfolio (CIBP). The CIBP is managed internally on behalf of the Retirement Funds Bond Pool (RFBP) which is now the name used for the overall fixed income pool which also includes any externally-managed portfolios.

Motion: Member Jack Prothero motioned for approval of the Investment Policy Statement for the Core Internal Bond Portfolio (CIBP) as recommended by staff and with emphasis on an understanding that the current portfolio exceptions to the policy ranges will be addressed over time depending on market conditions with the objective of moving within compliance; Member Jim Turcotte seconded the motion and the motion was unanimously approved 7-0.

MONTANA LOAN PROGRAMS

Commercial and Residential Portfolios Report

Mr. Herb Kulow presented and the Board reviewed this report for the period ending December 31, 2008.

BOND PROGRAM

Activity Report

The Board reviewed this report for the period ending December 31, 2008.

Staff Approved Loans Report

The Board reviewed this report for the period of October 1 – December 31, 2008:

Borrower:	Cascade County
Purpose:	Bob Marshall Place Rural Improvement District (RID) road improvements

Staff Approval Date	October 2, 2008
Board Loan Amount:	$101,270
Term:	15 years

Borrower:	Bull Mountain Rural Fire District (Boulder)
Purpose:	Construct fire truck garage
Staff Approval Date	October 20, 2008
Board Loan Amount:	$50,000
Term:	10 years

Borrower:	Moore Elementary School District
Purpose:	Repair/replace roof and related site improvements
Staff Approval Date	October 29, 2008
Board Loan Amount:	$90,000
Term:	10 years

Borrower:	Moore High School District
Purpose:	Repair/replace roof and related site improvements
Staff Approval Date	October 29, 2008
Board Loan Amount:	$90,000
Term:	10 years

Borrower:	Ravalli County
Purpose:	Roofing courthouse and related improvements
Staff Approval Date	November 3, 2008
Board Loan Amount:	$196,364
Term:	10 years

Borrower:	Independent School District (Billings)
Purpose:	Interim loan to purchase land in anticipation of issuing $3.5 million general obligation (GO) bond.
Staff Approval Date	November 14, 2008
Board Loan Amount:	$350,000
Term:	1 year

Borrower:	Deer Lodge Elementary School
Purpose:	Wood-fired heating plant and distribution lines
Staff Approval Date	November 17, 2008
Board Loan Amount:	$335,000
Term:	10 years

Borrower:	Lewis and Clark County
Purpose:	Purchase a scraper for the County Landfill
Staff Approval Date	December 17, 2008
Board Loan Amount:	$649,900
Term:	15 years

QZAB Bond Resolution No. 221

Ms. Geri Burton presented to the Board a request from Lewistown Elementary School District #1 to issue a Qualified Zone Academy Bond in the amount of $2,087,250 to finance the purchase of the District's general obligation bonds.

The proceeds of the District bonds would be used to finance the following: replace the roof on the junior high school, renovate and upgrade all or a portion of the heating, ventilation and air conditioning systems at Garfield School, Highland Park School and Lewis & Clark School.

The District would like to be in a position to enter into the Purchase Agreement with the Board and the purchaser of the QZAB to facilitate the issuance of the District's bonds and the QZAB in an amount up to $2,087,250.

The process to issue the QZAB for the District is being done in two steps. This is different from staff's standard QZAB process. Normally, staff does not bring a resolution to the Board until the entire allocation has been authorized by OPI.

Step One - The tax credit rate is determined on the day the Purchase Agreement is signed by all parties. Since entering into the Purchase Agreement is time sensitive, staff is requesting the Board approve Resolution No. 222, allowing staff the flexibility to enter into the Purchase Agreement prior to the Board's next scheduled meeting in May should it be determined market conditions are favorable to do so.

The resolution states that entering into the Purchase Agreement will not occur until all conditions set forth in Section 1.5 of the resolution are satisfied. One of those conditions, Section 1.5(i), reflects that the District has received QZAB allocations equal to the amount reflected in the Purchase Agreement; thus staff would not enter into the Purchase Agreement for the entire amount requested, $2,087,250, until authorization for the additional $773,250 has been obtained from OPI.

If the 2008 and 2009 national QZAB allocation is not authorized by federal legislation, staff could proceed with entering into the Purchase Agreement in an amount up to $1,314,000; the amount currently authorized for the District.

Step Two – A final resolution that will authorize the issuance and sale of the QZAB's as well as authorize the remaining bond documents will be submitted to the Board at a later date.

Recommendation

In an effort to accommodate the District in obtaining financing for their proposed project, staff recommends moving forward in the process by authorizing Resolution No. 222, which would allow staff to enter into the Purchase Agreement once all conditions stated in the Resolution are satisfied.

Issuance of the proposed QZAB is subject to the Board's adoption of a final resolution that will authorize the issuance and sale, fix the terms and conditions and authorize the various documents of the QZAB.

Motion: Member Jack Prothero reported that the Loan Committee has approved Resolution No. 222. 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 7-0.

PRESENTATIONS

Rainier Investment Management

Mr. Rande Muffick introduced Mr. Daniel Brewer and Mr. Greg Best. Mr. Brewer and Mr. Best reviewed their firm and management style. Rainier Investment Management manages a domestic large cap growth portfolio held in the Domestic Equity Pool.

INTECH

Mr. Rande Muffick introduced Mr. Jason Trow and Mr. Jason Greene. Mr. Trow and Mr. Greene reviewed their firm and management style. INTECH manages a domestic large cap enhanced index account held in the Domestic Equity Pool.

NEXT MEETING

The next regularly scheduled meeting of the Board will be May 12 & 13, 2009.

ADJOURNMENT

There being no further business, the meeting was adjourned at11:15 a.m.

BOARD OF INVESTMENTS

APPROVE:____

Terry Moore, Chairman

ATTEST:____

Carroll South, Executive Director

DATE: ____

Executive Director Reports

A Report on Pension Funds & Investments
Montana Board of Investments
February 10, 2009

Presented by:

Carroll South, Executive Director

Montana Board of Investments

Montana

Board Of Investments

Pension Fund Components

- **Employer/employee contributions**
  - Legislature sets contribution levels by law
  - Normal cost to fund future benefits
  - Additional contributions if necessary to pay off unfunded liabilities

- **Benefits**
  - Legislature sets formula for individual benefits
  - Future cost of benefits impacted by salary growth and age at retirement
  - Total cost of future benefits significantly impacted by beneficiary longevity

- **Invested assets**
  - Invested assets valued at June 30
  - Assets are “smoothed” to obtain “actuarial value”
  - Invested assets expected to return 7.7% - 8% annually
  - Financial markets ultimately determine future asset levels

What is an Unfunded Actuarial Liability?

- Actuarial liabilities less asset actuarial asset value
  - If actuarial assets are greater than actuarial liabilities there is a surplus

- Actuarial liabilities
  - An estimate of the future cost of benefits
  - Less the present value of normal cost employee/employer contributions
  - Liabilities may change from year-to-year based on benefit experience

- Actuarial value of assets
  - The “smoothed” value of asset values on June 30
  - Assets are smoothed to reduce year-to-year volatility
  - There is a “built-in” return assumption for the assets
  - Returns are volatile but return assumptions seldom change

Unfunded Actuarial Liabilities as of 06/30/08

(Liability)/Surplus in $Millions		Funded Ratio	
Public Employees	(439.4)	Public Employees	90.25%
Teachers	(794.6)	Teachers	79.90%
Police	(115.2)	Police	64.82%
Sheriffs	(5.1)	Sheriffs	97.51%
Firefighters	(81.1)	Firefighters	71.77%
Highway Patrol	(33.2)	Highway Patrol	75.36%
Game Wardens	(5.9)	Game Wardens	92.88%
Judges	22.6	Judges	157.32%
Vol. Firefighters	(5.2)	Vol. Firefighters	84.14%

How do Unfunded Liabilities Impact Pensions?

- The state constitution requires that pensions be funded on an "actuarially sound" basis.
- While an unfunded actuarial liability may be a measure of pension fund soundness, it is not the sole determinate of pension fund soundness.
- In order to be "actuarially sound" the actuarial unfunded liability must be amortized in 30 years or less with the contribution revenue stream.

- **<u>Years to Amortize</u>**

Public Employees	24.8
Teachers	31.3
Police	18.6
Sheriffs	16.3
Firefighters	11.3
Highway Patrol	17.4
Game Wardens	13.0
Judges	NA
Vol. Firefighters	5.0

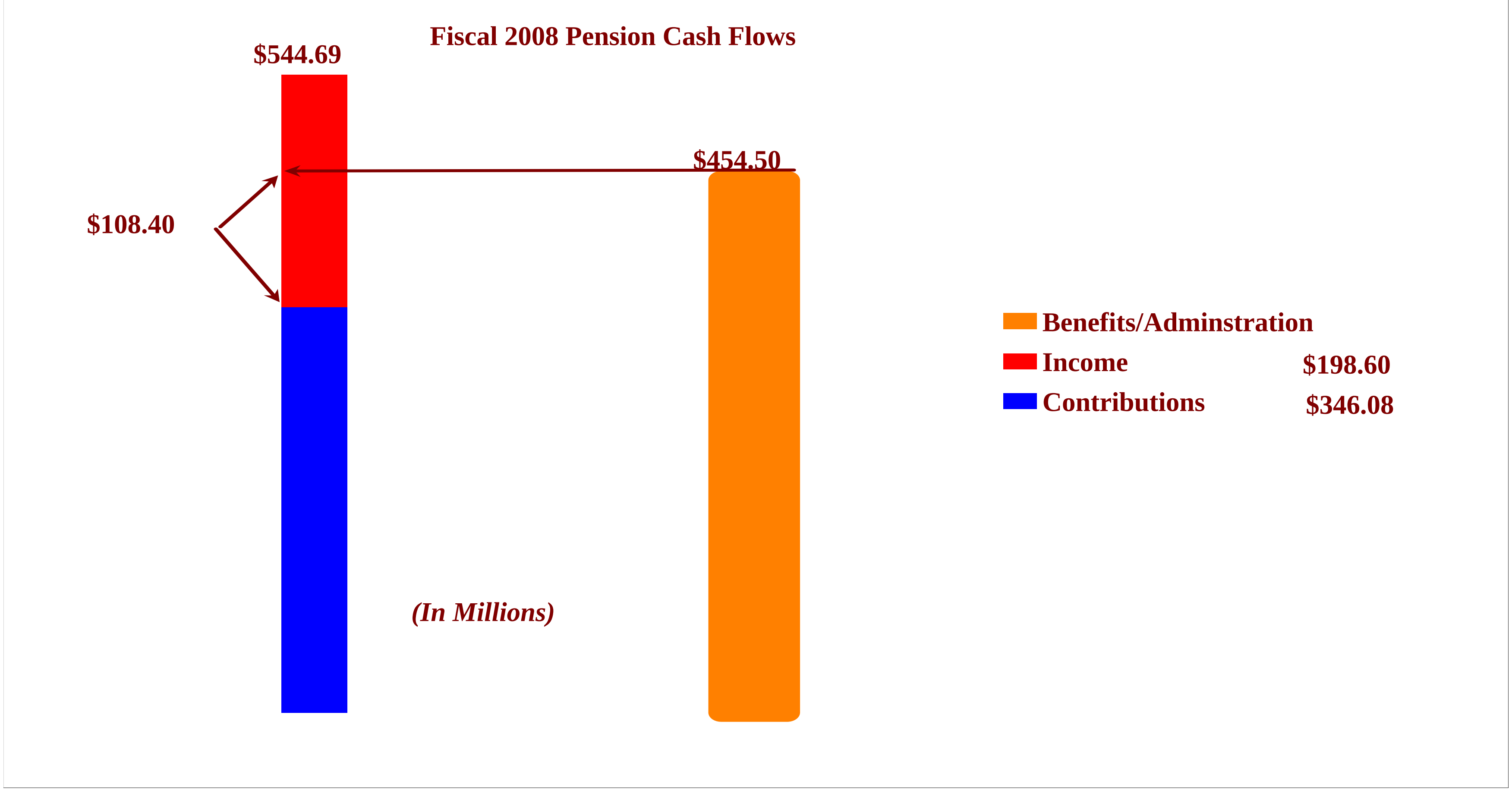
2008 Contribution/Benefit Cash Flow (Millions)

Fund	Contributions	Benefits	Difference
Public Employees	145.5	197.8	(52.3)
Teachers	141.0	203.6	(62.6)
Police	17.6	18.1	(0.5)
Sheriffs	9.6	8.0	1.6
Firefighters	17.2	13.6	3.6
Highway Patrol	5.3	6.9	(1.6)
Game Wardens	6.6	3.0	3.6
Judges	1.7	1.8	(0.1)
Vol. Firefighters	1.6	1.8	(0.2)
Total	346.1	454.5	(108.4)

Investment Return Versus Income

- Pension invested assets are assumed to return 8% annually, except for Teachers which has a 7.75% assumption.
- If the return assumptions are not met over long periods of time, employer contributions may have to be increased to keep the funds "actuarially sound."
- Investment "return" is not the same as investment "income."
- Investment return is a combination of portfolio value changes and actual income.
- If the portfolio value declines more than the income generated by the portfolio, the investment return will be negative, but income will still be generated.
- If the portfolio value increases during the period, the investment return will be greater than the income generated by the portfolio.
- While pension fund investment return for Fiscal 2008 was negative, the portfolios generated "real" income that was used to pay benefits as shown on the next slide. Approximately $108.4 million of 2008 investment income was used to pay benefits.

Pension Fund 2008 Cash Flow



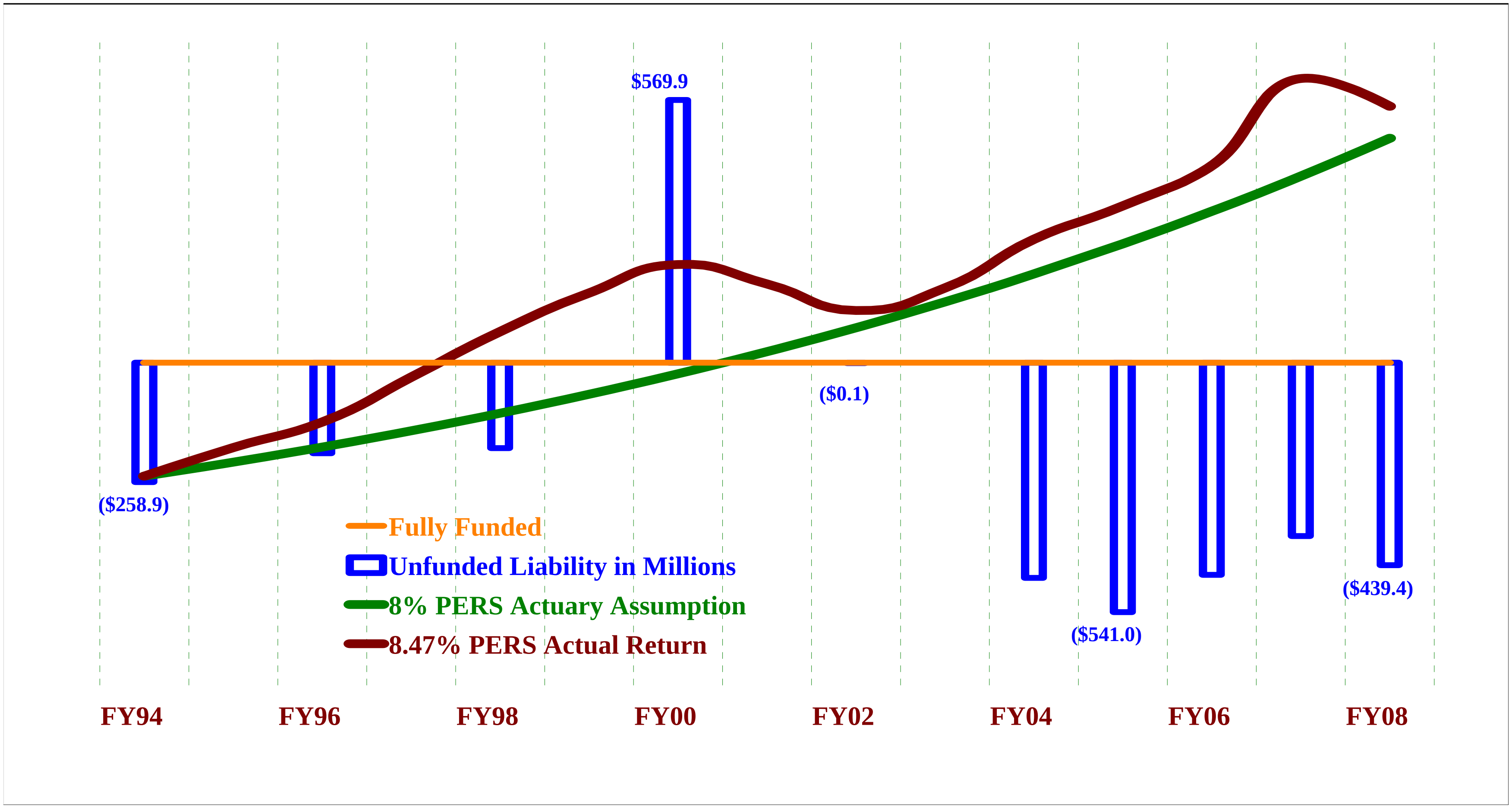
Have Actuarial Return Assumptions Been Met?

- Since Fiscal Year 1995, the Board's Custodial Bank has calculated the annual investment return of pension funds. From Fiscal Year 1995 through Fiscal Year 2008, a 14-year period, investment returns of pension fund investment portfolios have exceeded the actuarial return assumptions.

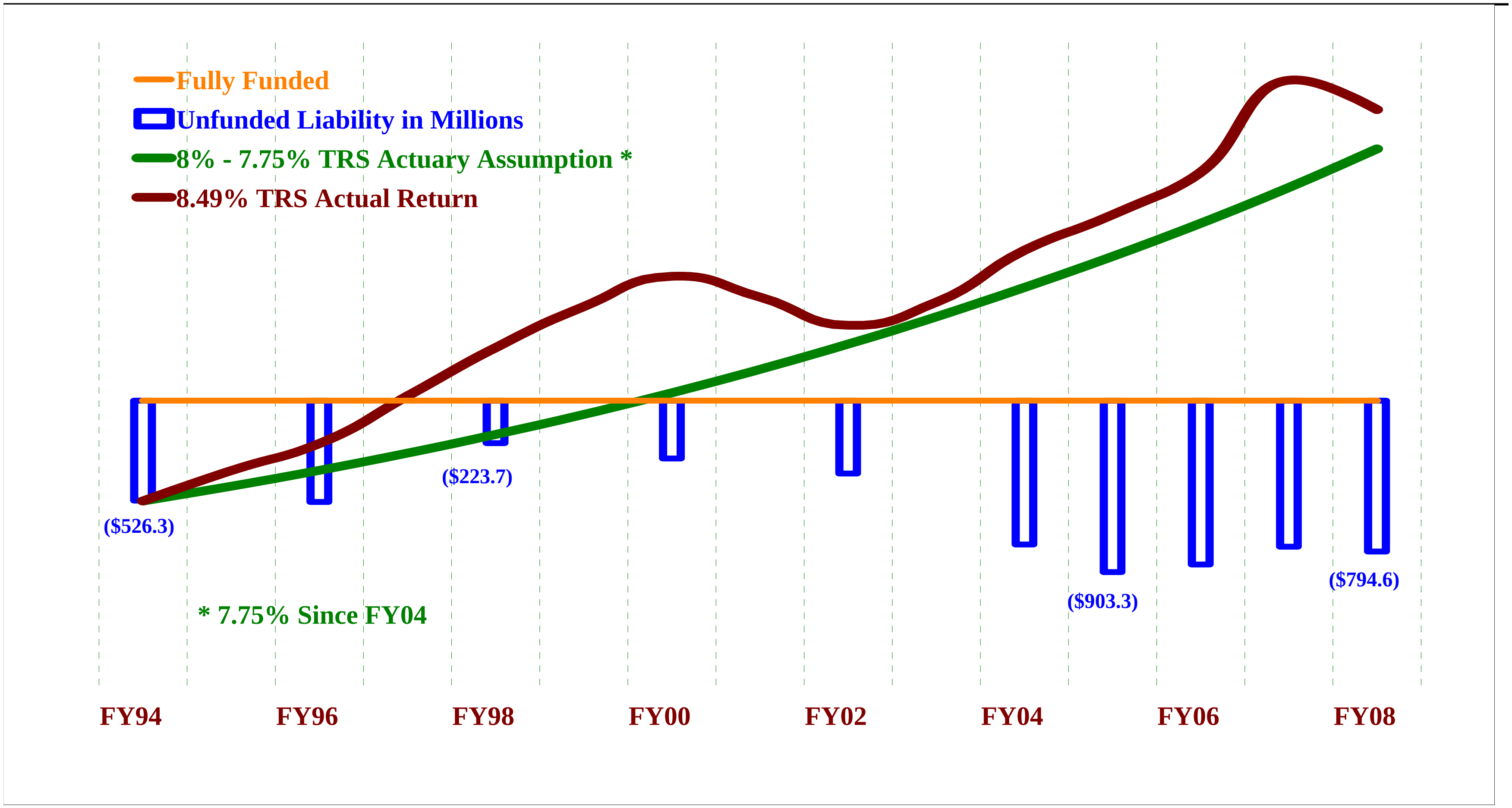
- Even though investment return assumptions were met during the period, unfunded liabilities of the Teachers' and Public Employees' Pensions (TRS/PERS) increased. Unfunded liabilities are impacted not only by investment return but also by increases in benefits and revised estimates of benefit liabilities based on experience.

- The next two slides depict annual investment returns and unfunded liabilities of TRS and PERS. The third slide compares the differences in unfunded liabilities for the two funds during the period. Despite nearly identical investment returns for both funds, the unfunded liabilities changed quite differently.

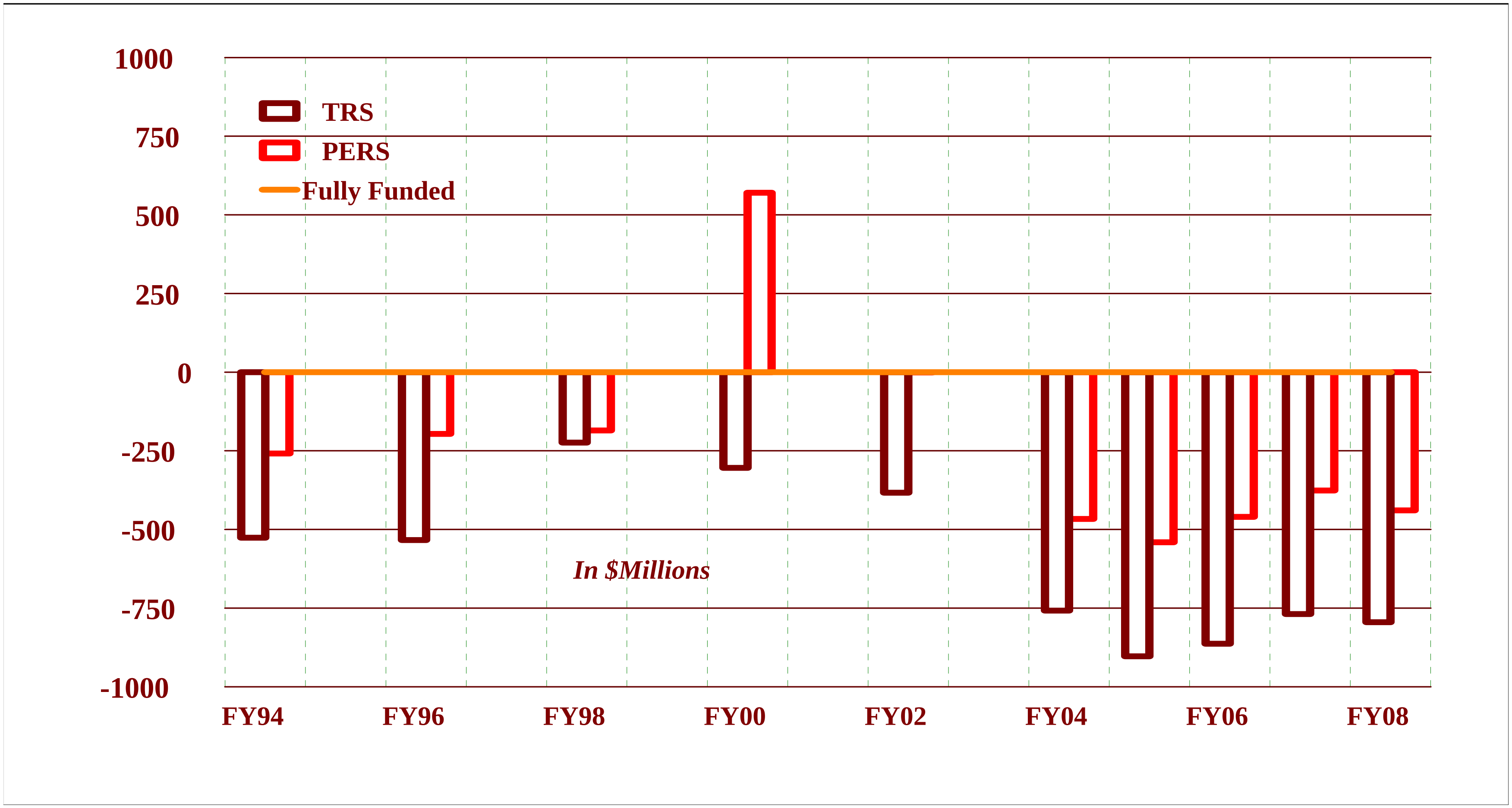
PERS Annual Returns/Unfunded Actuarial Liabilities



TRS Annual Returns/Unfunded Actuarial Liabilities



TRS/PERS Unfunded Actuarial Liabilities



Why Invest Pension Funds in Stock?

- Annual pension fund valuations determine pension fund "soundness." In order to be "actuarially sound" any unfunded actuarial liability that exists on June 30 must be amortized in 30 years or less with the contribution revenue stream.

- A "soundness" determination is based on the assumption that the invested assets as of June 30 will generate a minimum annual return indefinitely. If they do not, any unfunded actuarial liabilities will increase.

- Currently the asset return assumptions are 8.00% for the eight pensions administered by the Public Employees' Retirement Board and 7.75% for the pension administered by the Teachers' Retirement Board.

- History has demonstrated that these pension return assumptions cannot be met without a significant investment in publically-traded stock. Despite the higher volatility of stocks compared to other investments, over long periods of time, return on stocks have exceeded pension fund return assumptions, while other liquid investments have not.

Why Invest Pension Funds in Stock?

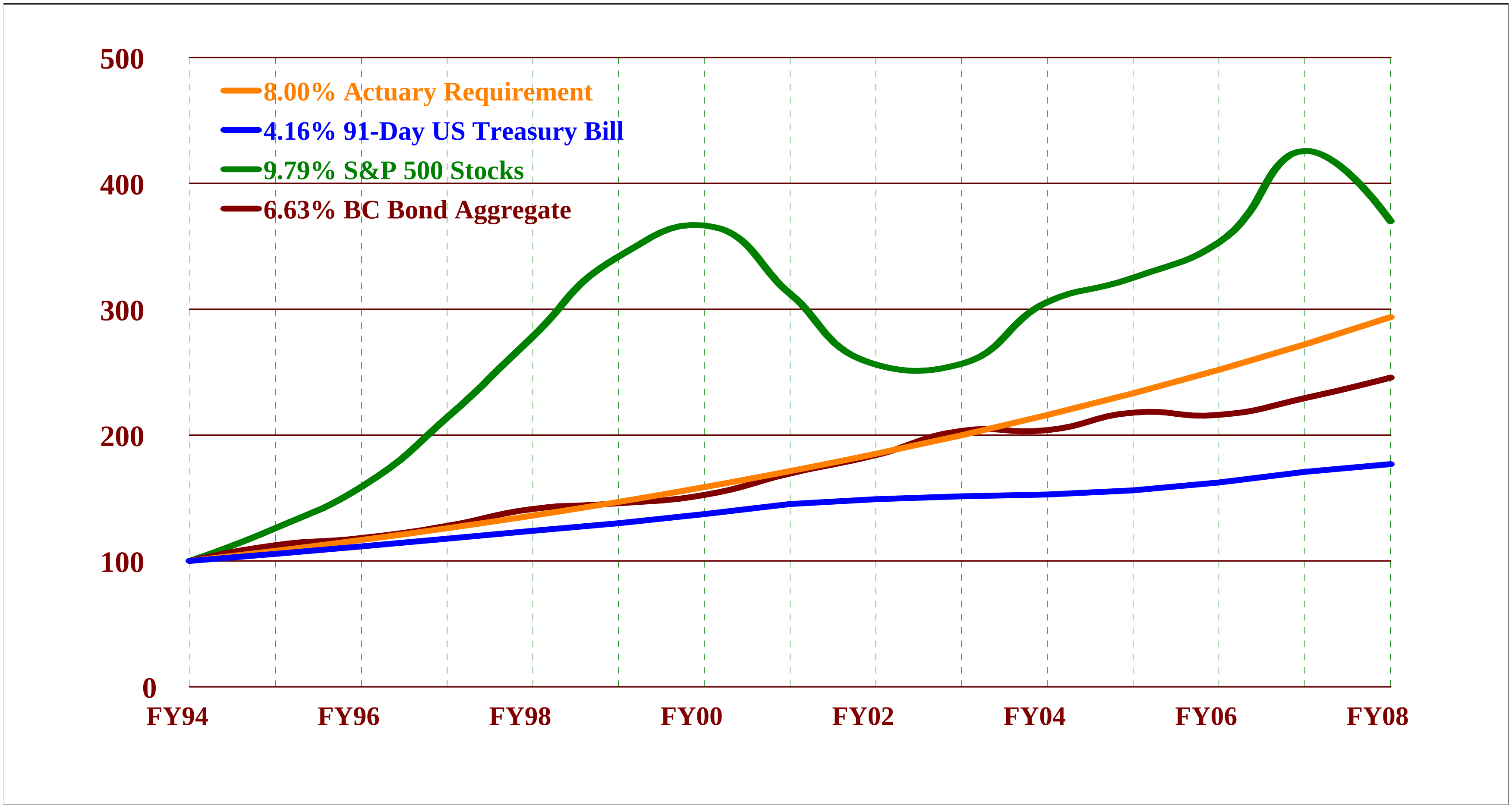
- Excluding stock investments in the state's pension funds poses a "risk" to public employers participating in the pensions and ultimately to state taxpayers.

- While US Government bonds are perceived to be totally "risk free" to the investor, historically the return on these bonds have never been sufficient to meet pension fund return assumptions. In the investment world "Risk" and "Return" are directly related.

- Consequently, if the state's pension investments are comprised entirely of low-risk government bonds actuarial unfunded liabilities will increase, necessitating an increase in public employer contributions to keep the systems actuarially sound.

- The next slide compares the actual returns of US large company domestic stock (S&P 500), a mix of government and corporate bonds (BC Aggregate), and the 91-Day US Treasury Bill to an 8% actuarial return requirement. The slide shows that non-stock investments did not meet actuarial return requirements during the period. While stocks were much more volatile, at the end of the period stock returns exceeded the actuarial return requirements.

Why Invest Pension Funds in Stock?



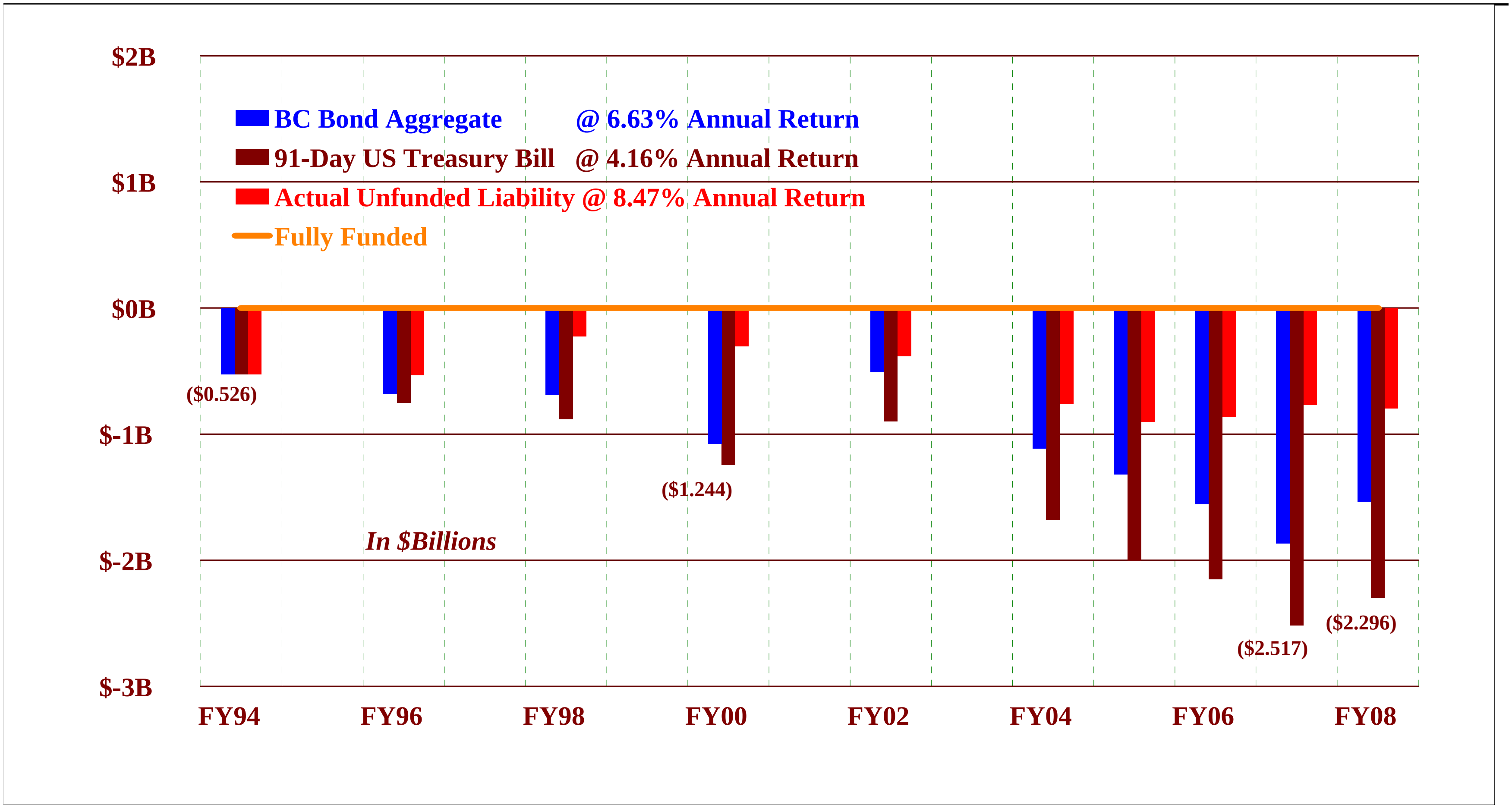
Why Invest Pension Funds in Stock?

- The next slide depicts an approximation of the impact an exclusive corporate/government bond portfolio or a 91-Day Treasury Bill portfolio would have had on TRS actuarial unfunded liabilities during the Fiscal Years 1995 - 2008 period. The approximations are compared to the unfunded liabilities incurred with the actual investment portfolio that included domestic and international stocks. The comparison assumes that the accrued liabilities for benefit payments were the same in all three scenarios.

- As the slide shows, a totally “risk free” portfolio comprised of nothing but 91-Day Treasury Bills, would have significantly increased unfunded liabilities during the period with all other things being equal.

- While the increase in unfunded liability seems extraordinarily large, given the “time value” of investing money it is not surprising. The 91-Day Treasury Bill generated annual return of only 4.16% during the period while the TRS diversified portfolio generated 8.47% annually. The second slide shows the difference “time value” makes with a $1.0 billion investment at the beginning of the period.

Why Invest Pension Funds in Stock? (TRS Example)



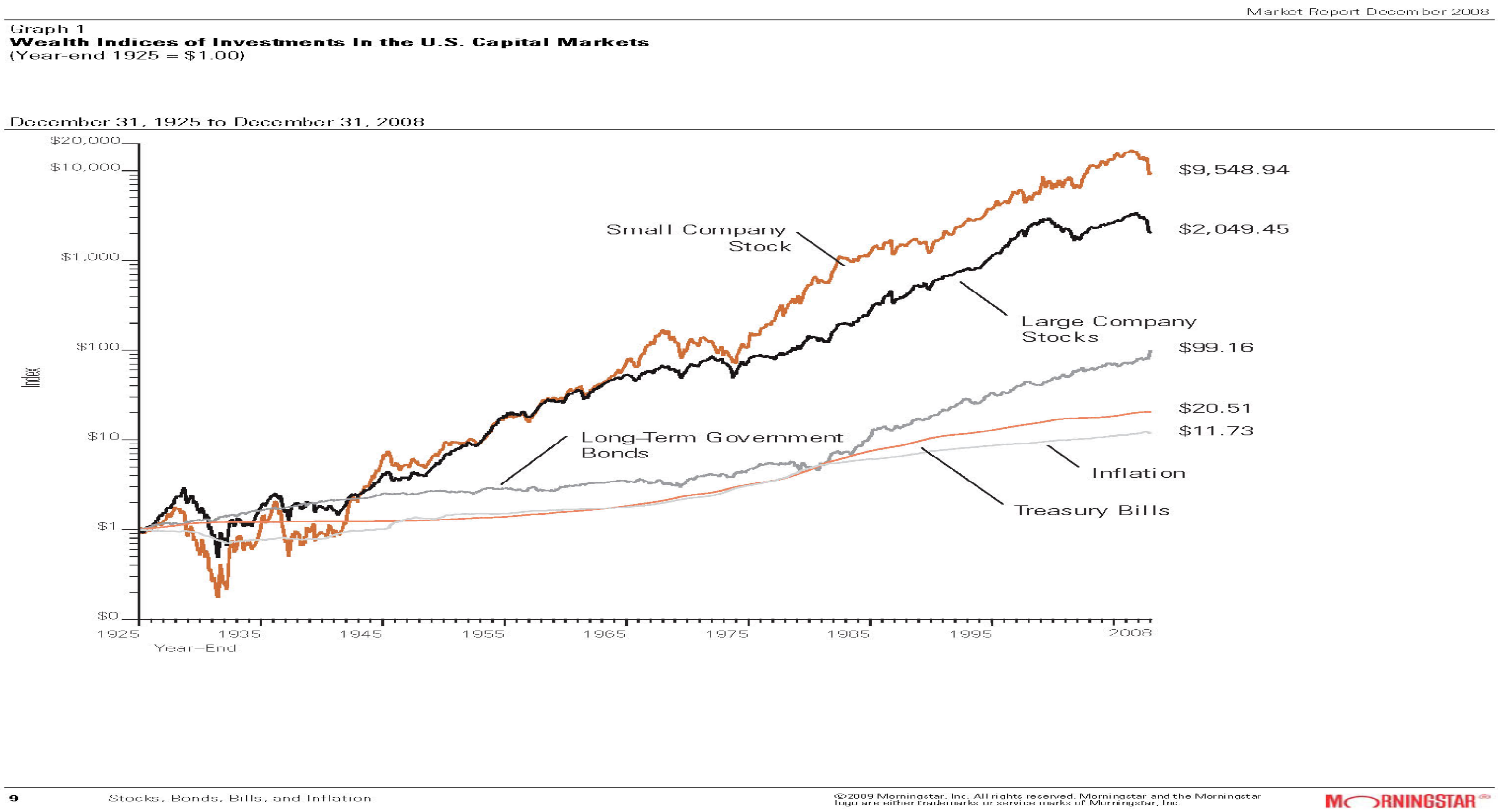
Why Invest Pension Funds in Stock?

Year	Actual TRS Return		BC Bond Aggregate		91-Day T-Bill	
06/30/94	1,000,000,000	**8.47**	1,000,000,000	**6.63**	1,000,000,000	**4.16**
06/30/95	1,164,600,000	16.46	1,125,500,000	12.55	1,056,200,000	5.62
06/30/96	1,311,688,980	12.63	1,182,000,100	5.02	1,115,875,300	5.65
06/30/97	1,569,304,696	19.64	1,278,333,108	8.15	1,176,690,504	5.45
06/30/98	1,831,378,580	16.7	1,413,069,418	10.54	1,238,937,432	5.29
06/30/99	2,054,623,629	12.19	1,457,581,104	3.15	1,299,397,578	4.88
06/30/00	2,218,582,594	7.98	1,524,192,561	4.57	1,371,254,264	5.53
06/30/01	2,105,656,740	-5.09	1,695,359,385	11.23	1,452,021,140	5.89
06/30/02	1,952,575,495	-7.27	1,841,668,900	8.63	1,490,209,296	2.63
06/30/03	2,078,516,615	6.45	2,033,202,466	10.4	1,513,009,499	1.53
06/30/04	2,359,324,209	13.51	2,039,708,714	0.32	1,527,836,992	0.98
06/30/05	2,552,552,862	8.19	2,178,408,907	6.8	1,560,685,487	2.15
06/30/06	2,783,558,896	9.05	2,160,763,794	-0.81	1,622,800,769	3.98
06/30/07	3,282,929,362	17.94	2,293,002,539	6.12	1,707,348,690	5.21
06/30/08	3,122,394,116	-4.89	2,456,493,620	7.13	1,769,325,447	3.63
	Difference		(665,900,497)		(1,353,068,669)	

Why Invest Pension Funds in Stock?

- While one could argue that the 14-year period of time covered by the previous slides is relatively short when pension fund horizons reach 30 years and beyond, records of the returns on different types of investments have been kept since 1926 by Morningstar.
- Even though this period of time included the "great depression" and the great stock market crash, stocks did recover. These records clearly show that during the good times and the bad times stocks have outperformed other types of liquid investments by large margins over long periods of time.
- Morningstar states that the 2008 Calendar year performance of large-company stocks was the second worst in history at negative 37.00%, second only to 1931 when the return was negative 43.34%. Despite these negative returns last year, large company stock, as measured by the S&P 500 stock index, returned 9.6% annually from 1926 through 2008.
- The next slide depicts the 2008 value of $1.00 invested in 1925 in different types of investments as recorded by Morningstar. The second slide shows the annual return of each investment type and inflation during the period.

Why Invest Pension Funds in Stock?



Why Invest Pension Funds in Stock?

Large Company Stock	9.6%
Small Company Stock	11.7%
Long-Term Corporate Bonds	5.9%
Long-Term Government Bonds	5.7%
Intermediate Government Bonds	5.4%
U.S. Treasury Bills	3.7%
Inflation	3.0%

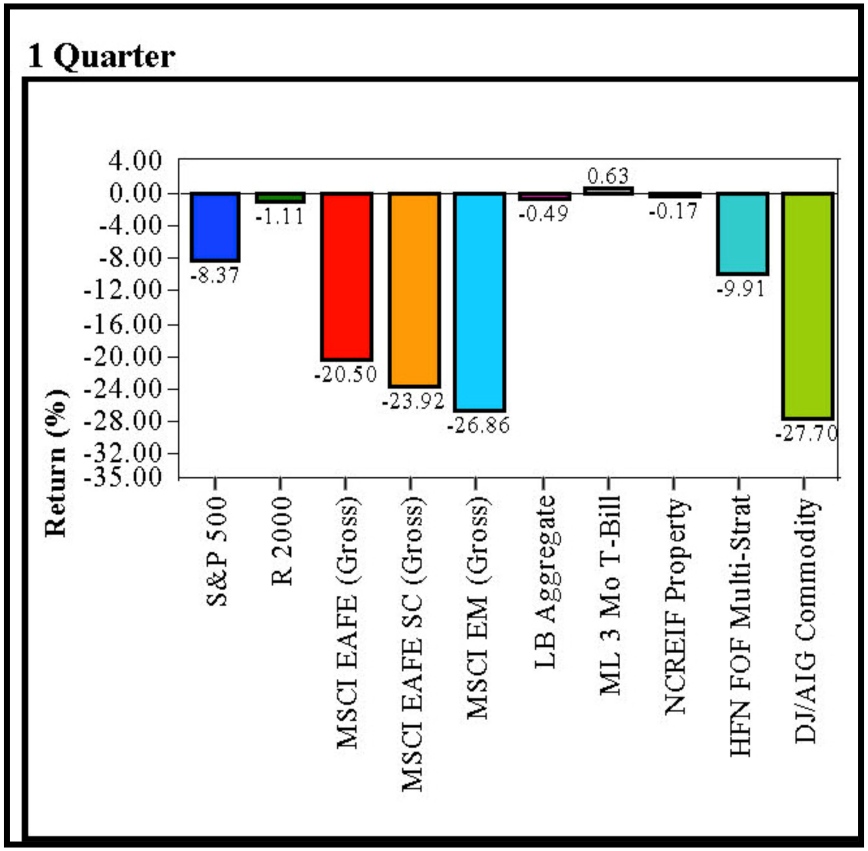
- *Source – Morningstar SBBI Market Report, December 2008*

Impacts of Current Financial Markets

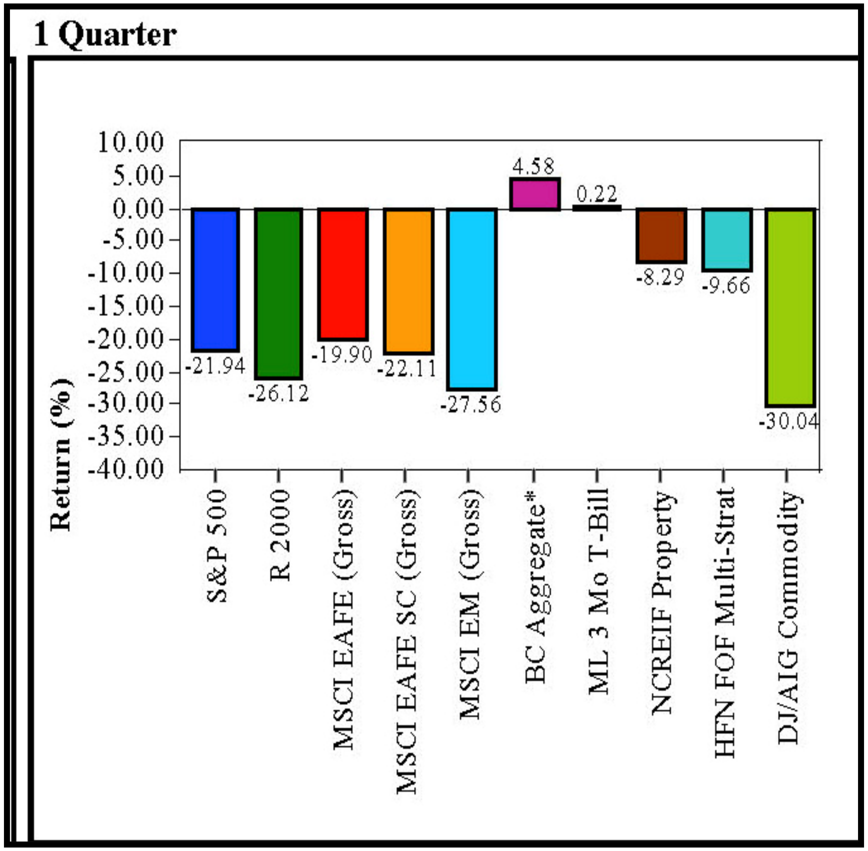
- The financial market meltdown this fiscal year has significantly impacted the state's pension funds. They were negatively impacted not only by the general performance of public equity investments but fixed income investments as well.
- During the last six months of the year, investors dumped investments with perceived risk and flocked to US Treasury Bonds/Bills, causing stock and Corporate bond prices to plummet while the price of Government Bonds/Bills soared. Additionally, diversification into other asset classes has not been that helpful during the period as almost all traditional asset classes have performed poorly.
- This "nowhere to hide" scenario is depicted in the next slide. Pension fund investors, regardless of the portfolio asset mix, lost serious ground relative to return assumptions embedded in the actuarial valuations during the last 6 months of Calendar 2008.
- The second slide depicts performance of the public equity and public bond markets, and the state's pension fund performance so far in Fiscal 2008.
- The third slide depicts the widening corporate bond spread (the difference in yield between similar corporate and US Government Bonds) as investors fled perceived risk and sought security in US Government bonds.

Quarterly Performance by Asset Type

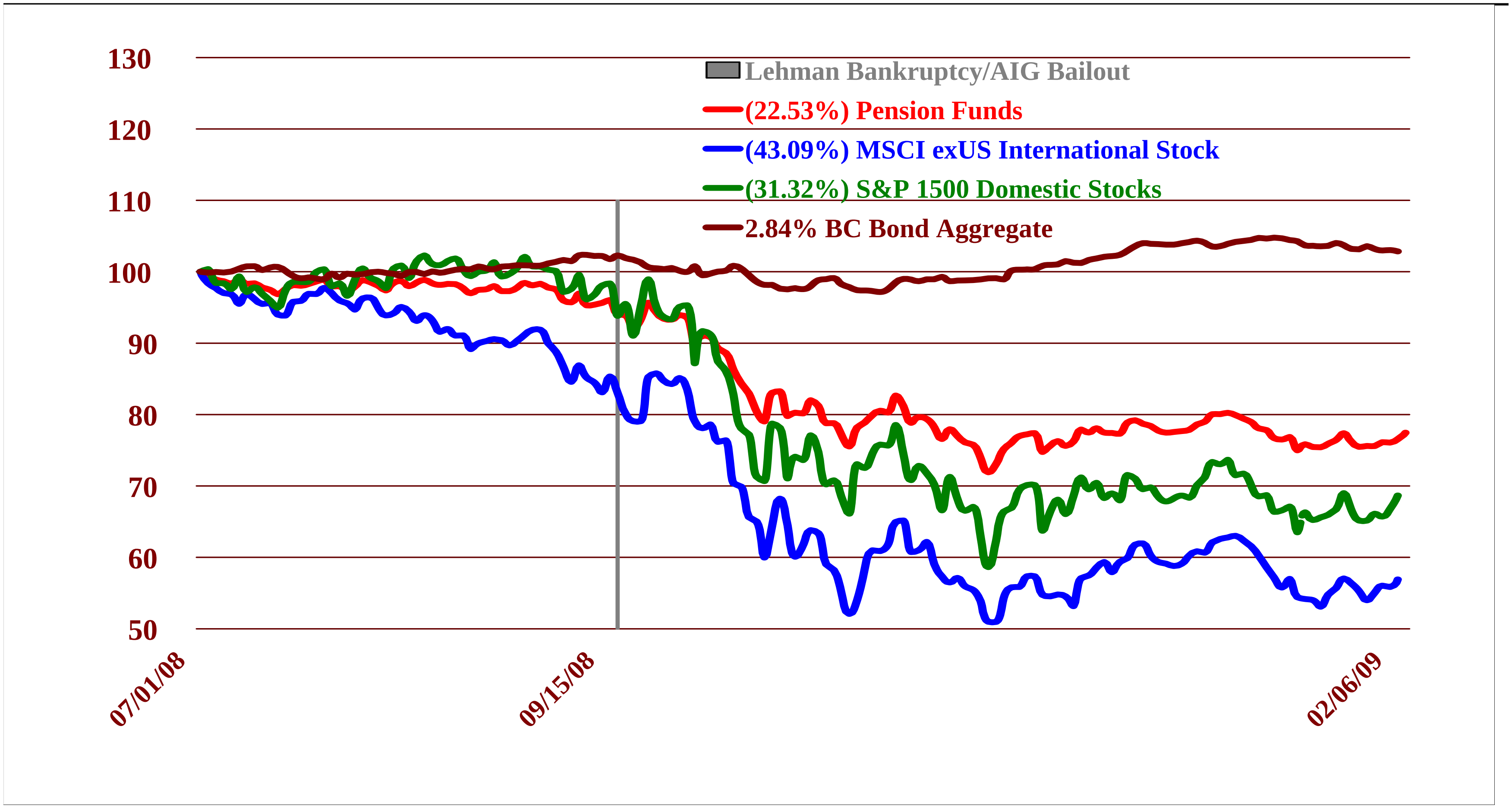
- **September 30, 2008**



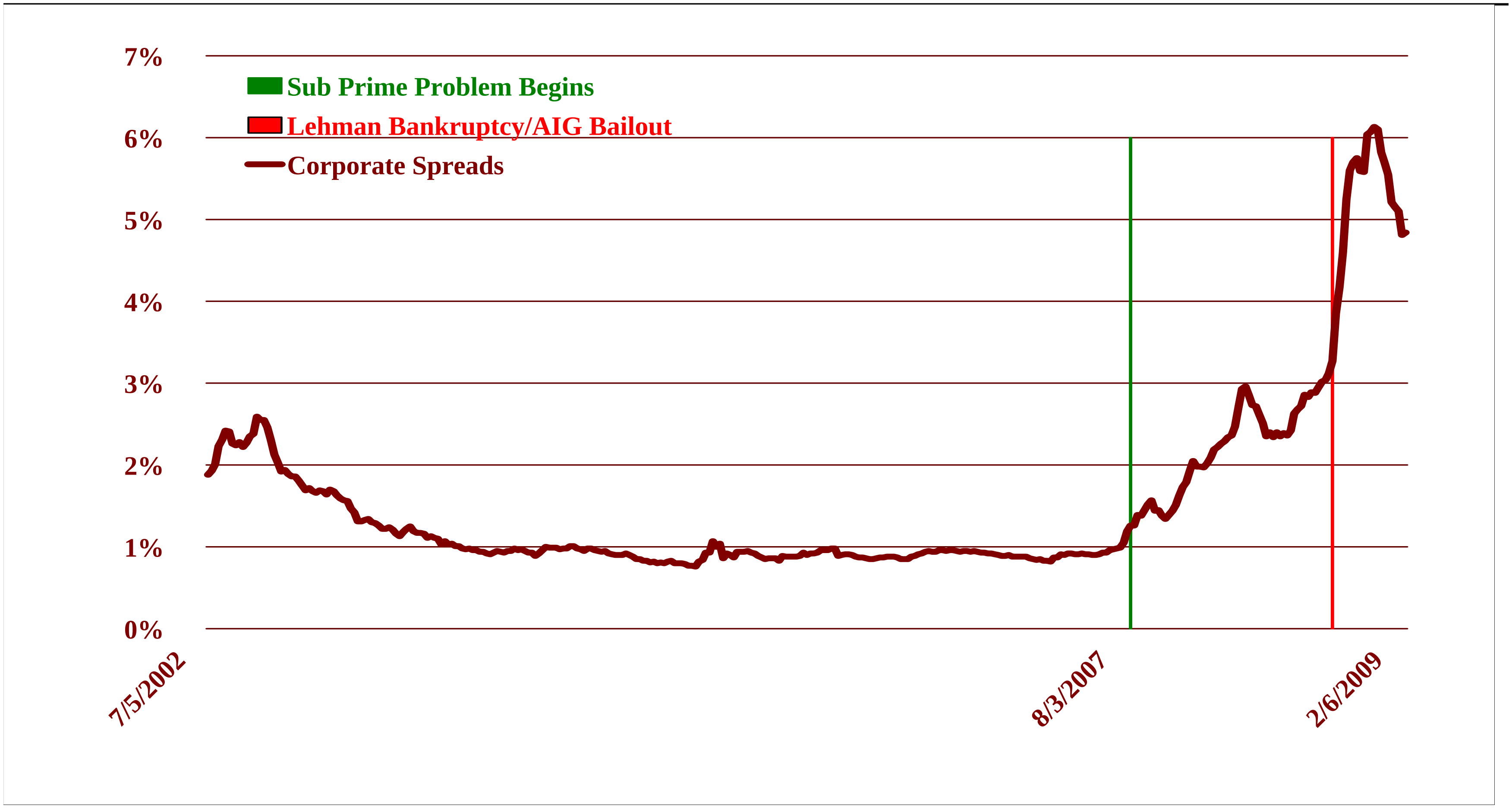
- **December 31, 2008**



Major Bond/Stock Index Performance



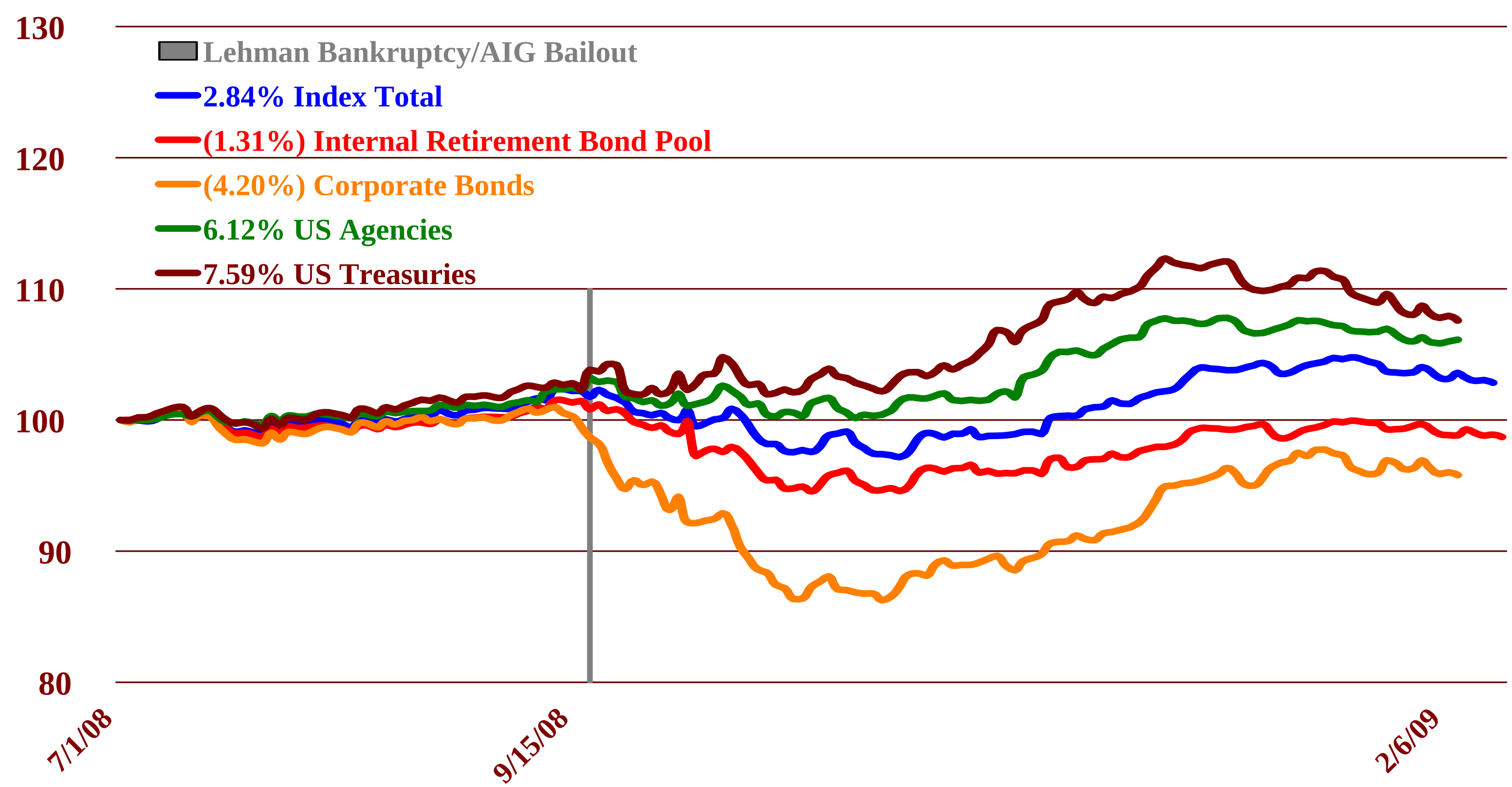
Corporate Bond Spreads Over Treasuries



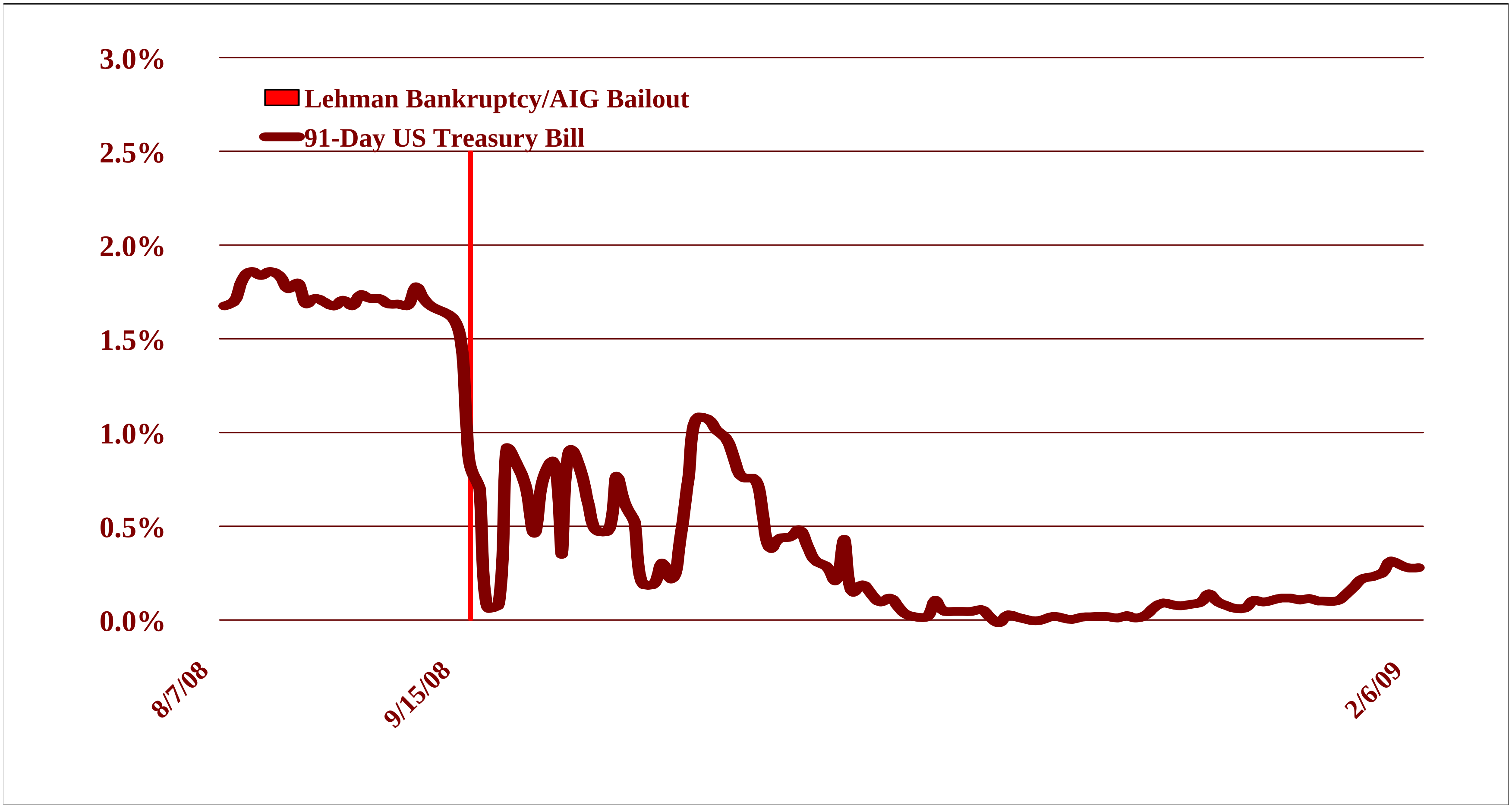
Impacts of Current Financial Markets

- Investors who held significant amounts of US Treasuries at the beginning of the fiscal year were fortunate as the rush to safety forced government bond prices up. However, if investors had to purchase them during the period, they paid a high price and received reduced yield.
- At the beginning of the fiscal year, fixed-income portfolios that were overweight in Corporate bonds and underweight in US Treasuries compared to the index under performed the index as Corporate bond prices plummeted and US Treasury prices soared.
- On July 1, 2008, the Retirement Funds Bond Pool (RFBP) was significantly overweight in Corporate bonds and significantly underweight in US Treasuries compared to the BC Aggregate Bond Index. While the index was comprised of 22% Treasuries and 20% Corporate bonds, the RFBP held only 4% in Treasuries and 42% in Corporate bonds. Consequently, the RFBP has significantly under performed the index so far this fiscal year.
- The next slide depicts the BC Aggregate Index performance by sector and the RFBP performance during the period.
- The second slide depicts the yield on the 91-Day US Treasury Bill. There were two days during the last three months when investors purchased these securities at a negative yield. On those days, some investors were so risk averse that they were willing to “pay” the federal government to keep their principal safe.

Bond Performance by Major Sector



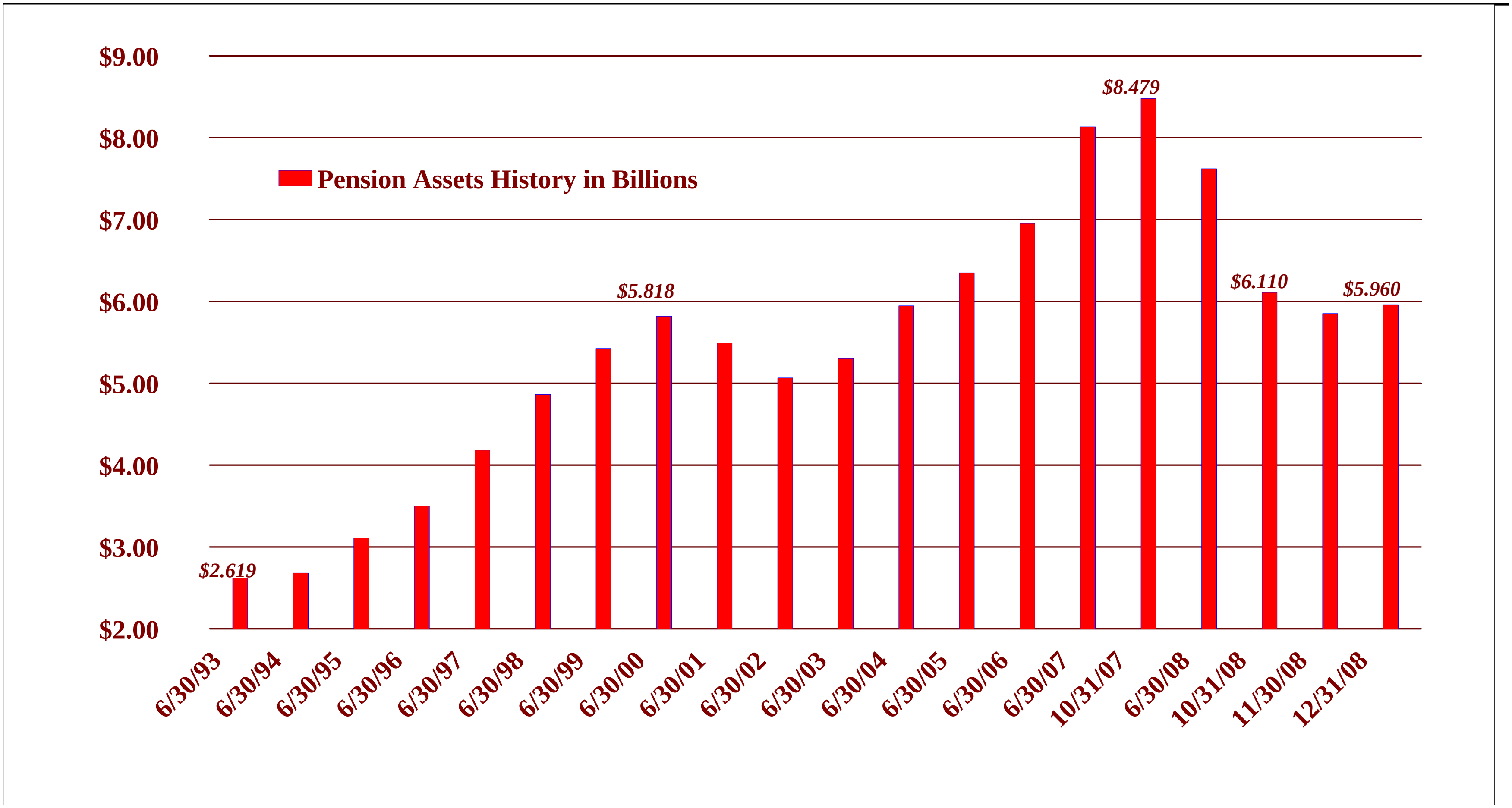
91-Day US Treasury Bill Yields



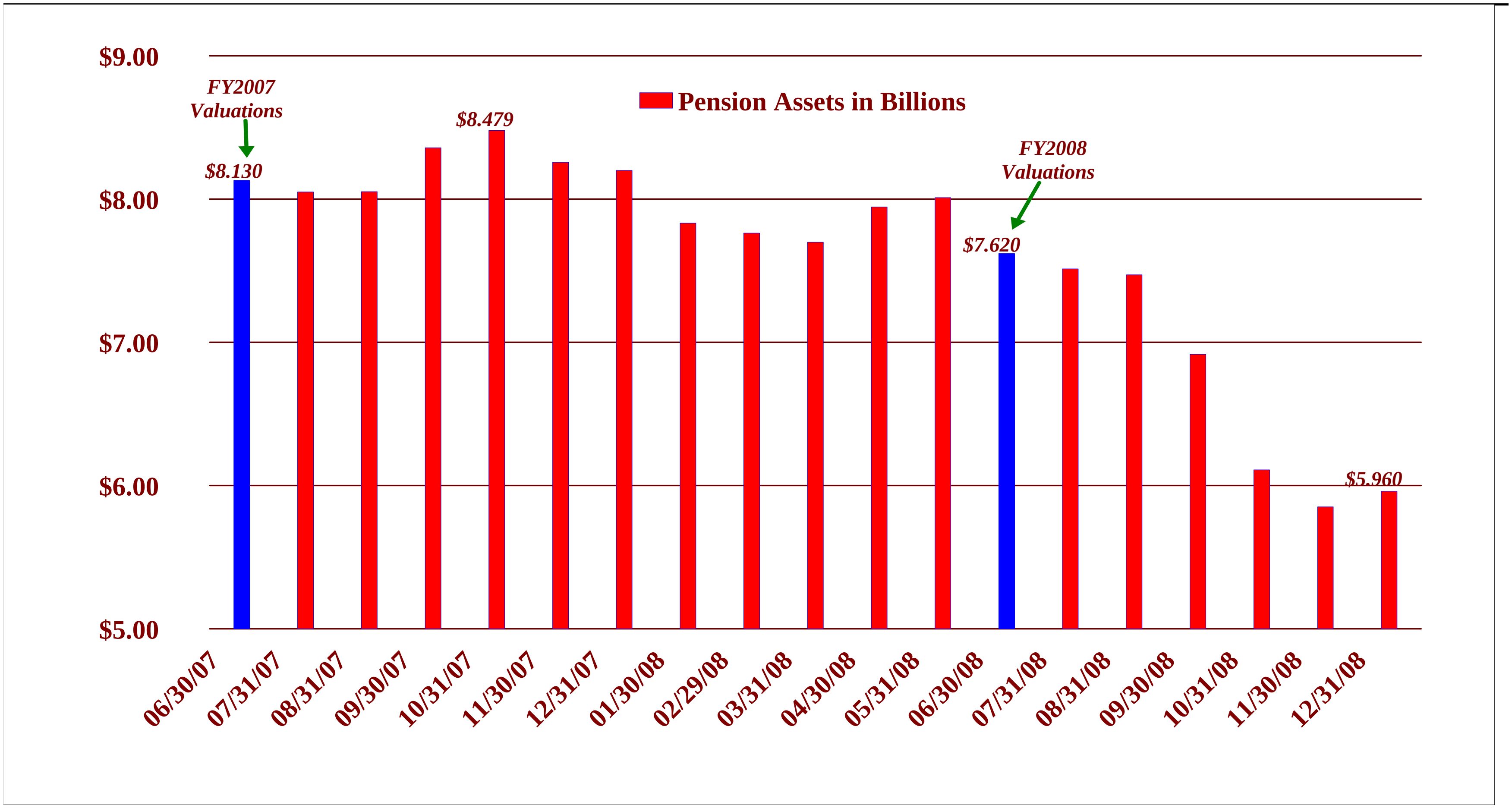
Market Impacts on Pension Portfolios

- The value of pension fund portfolios grew rapidly during the 1990's as stock markets yielded double digit returns. The growth came to a screeching halt in 2000 when the stock market bubble broke.
- After two years of negative returns the markets took off again and the value of pension fund portfolios began to grow once again. Pension values peaked in October 2007 but have since declined sharply as the financial markets meltdown took its toll.
- The next slide depicts the fair value of the state's nine pension funds from June 30, 1993 through June 30, 2008. The ups and downs depicted by the graph resemble a roller coaster ride that sends a clear message – pension fund values are extremely sensitive to financial market performance. Even a totally diverse portfolio will not generate the pension fund return requirements when the public equity markets perform negatively. In order to generate the actuarial requirements over long periods of time, the funds must have significant investments in public stock and as the slide shows it has been and will likely always be a rough ride.
- The second slide depicts the recent monthly value of the nine pensions with the blue bars denoting the date at which actuarial valuations are performed. The valuations ignore the ups and downs that occur between June 30 of each year.

Pension Asset History at Fair Value



Pension Asset Values by Month



Board Response to The Meltdown

- Board staff have had a measured, disciplined response to the financial market meltdown and have attempted to keep the assets within the ranges approved by the Board. While it may seem counter intuitive to sell stocks when stock allocation hits the top of the range or buy stocks when the allocation falls through the bottom of the range, it is that discipline that shields an investor from buying high and selling low. Complicating this balancing act is a shrinking denominator when one portion of the market melts down much more than others.
- The next two slides depict the actual asset allocation and approved ranges prior to the meltdown and after the meltdown. A stark example of the shrinking denominator effect is the fact that fixed income (RFBP) increased from 21% pre-meltdown to 31% post-meltdown despite staff selling $135.0 million in fixed income during the period.
- The third slide depicts pension fund investments made from July 1, 2006 through February 1, 2008. Investments in Private Equity and Private Real Estate have ramped up while fixed income investments have been sold. A small allocation has been made to International Equities to try to maintain an allocation within the approved range. The sale of MDEP (domestic stock) occurred when the stock allocation hit the 70% top of the range

Allocations & Ranges Pre-Meltdown

Allocations and Approved Ranges as of 09/30/07										
								Direct	Pooled	
				Total				Real	Real	
Pension Fund	**MDEP**	**MTIP**	**MPEP**	**Equity**	**RFBP**	**STIP**	**Mtgs**	**Estate**	**Estate**	**Total Assets**
PUBLIC EMPLOYEES	41.9%	20.1%	8.0%	69.9%	23.8%	1.8%	0.8%	0.2%	3.4%	4,203,115,739
TEACHERS	42.4%	19.9%	7.8%	70.2%	23.8%	1.4%	0.9%	0.3%	3.5%	3,259,175,625
POLICE	41.0%	19.1%	7.7%	67.8%	24.1%	4.8%			3.3%	215,218,721
SHERIFFS	42.3%	19.4%	7.8%	69.4%	24.8%	2.4%			3.4%	202,601,854
FIREFIGHTERS	41.0%	19.1%	7.7%	67.8%	24.1%	4.7%			3.3%	204,666,677
HIGHWAY PATROL	41.8%	20.1%	8.0%	70.0%	24.9%	1.6%			3.5%	105,280,677
GAME WARDENS	41.8%	19.7%	7.9%	69.5%	24.4%	2.7%			3.4%	76,190,660
JUDGES	42.0%	19.7%	7.9%	69.6%	24.8%	2.1%			3.4%	63,633,532
VOL FIREFIGHTERS	42.3%	20.2%	8.0%	70.5%	23.7%	2.3%			3.5%	27,889,006
TOTAL	**42.0%**	**20.0%**	**7.9%**	**69.9%**	**23.9%**	**1.8%**	**0.8%**	**0.2%**	**3.4%**	**8,357,772,490**
Approved Range	30.0%	15.0%	5.0%	60.0%	22.0%	1.0%	0.0%	0.0%	0.0%	
	50.0%	30.0%	10.0%	70.0%	32.0%	5.0%	4.0%	1.0%	8.0%	

Allocations & Ranges Post-Meltdown

Allocations and Approved Ranges as of 12/31/08										
								Direct	Pooled	
				Total				Real	Real	
Pension Fund	**MDEP**	**MTIP**	**MPEP**	**Equity**	**RFBP**	**STIP**	**Mtgs**	**Estate**	**Estate**	**Total Assets**
PUBLIC EMPLOYEES	34.4%	14.6%	13.4%	62.4%	29.8%	0.5%	1.0%	0.3%	6.0%	3,005,232,503
TEACHERS	34.4%	14.6%	13.1%	62.1%	29.9%	0.6%	1.1%	0.4%	5.9%	2,299,415,137
POLICE	33.5%	14.6%	13.1%	61.2%	30.4%	2.5%			5.9%	154,831,304
SHERIFFS	33.8%	14.6%	13.2%	61.6%	30.9%	1.5%			5.9%	149,244,799
FIREFIGHTERS	34.5%	14.6%	13.4%	62.6%	30.8%	0.6%			6.0%	151,204,701
HIGHWAY PATROL	34.5%	14.7%	13.2%	62.4%	31.0%	0.7%			5.9%	74,891,564
GAME WARDENS	33.5%	14.6%	13.1%	61.2%	30.4%	2.5%			5.9%	59,560,839
JUDGES	34.0%	14.7%	13.3%	62.0%	31.0%	1.0%			5.9%	46,282,756
VOL FIREFIGHTERS	34.7%	14.6%	13.1%	62.4%	31.2%	0.6%			5.8%	19,679,522
TOTAL	**34.2%**	**14.6%**	**13.2%**	**62.0%**	**30.6%**	**1.2%**	**1.1%**	**0.3%**	**5.9%**	**5,960,343,125**
Approved Range	30.0%	15.0%	9.0%	60.0%	22.0%	1.0%	0.0%	0.0%	0.0%	
	50.0%	30.0%	15.0%	70.0%	32.0%	5.0%	4.0%	1.0%	8.0%	

Pension Fund Investment Activity

Pension Funds Investment Activity July 1, 2006 - February 1, 2009

Pool	**Value of Units/ Purchased**	**Value of Units/ Sold**	**Net Transactions**
Retirement Funds Bond Pool (RFBP)	112,470,000	(135,088,243)	(22,618,243)
Montana Domestic Equity Pool (MDEP)	15,889,997	(138,720,302)	(122,830,305)
Montana International Equity Pool (MTIP)	55,970,000	(309,317)	55,660,683
Montana Private Equity Pool (MPEP)	297,150,000	-	297,150,000
Montana Real Estate Pool (MTRP)	336,380,000	-	336,380,000
Total	**817,859,997**	**(274,117,861)**	**543,742,136**

Investment Activity

ASSET ALLOCATION REPORT

Retirement Systems Asset Allocations as of 12/31/08										
								Direct	Pooled	
				Total				Real	Real	
Pension Fund	**MDEP**	**MTIP**	**MPEP**	**Equity**	**RFBP**	**STIP**	**Mtgs**	**Estate**	**Estate**	**Total Assets**
PUBLIC EMPLOYEES	34.4%	14.6%	13.4%	62.4%	29.8%	0.5%	1.0%	0.3%	6.0%	3,005,232,503
TEACHERS	34.4%	14.6%	13.1%	62.1%	29.9%	0.6%	1.1%	0.4%	5.9%	2,299,415,137
POLICE	34.7%	14.8%	13.4%	62.9%	30.7%	0.3%			6.1%	154,831,304
SHERIFFS	33.8%	14.6%	13.2%	61.6%	30.9%	1.5%			5.9%	149,244,799
FIREFIGHTERS	34.5%	14.6%	13.4%	62.6%	30.8%	0.6%			6.0%	151,204,701
HIGHWAY PATROL	34.5%	14.7%	13.2%	62.4%	31.0%	0.7%			5.9%	74,891,564
GAME WARDENS	33.5%	14.6%	13.1%	61.2%	30.4%	2.5%			5.9%	59,560,839
JUDGES	34.0%	14.7%	13.3%	62.0%	31.0%	1.0%			5.9%	46,282,756
VOL FIREFIGHTERS	34.7%	14.6%	13.1%	62.4%	31.2%	0.6%			5.8%	19,679,522
TOTAL	**34.4%**	**14.6%**	**13.3%**	**62.3%**	**30.0%**	**0.6%**	**0.9%**	**0.3%**	**5.9%**	5,960,343,125
Approved Range	30.0%	15.0%	5.0%	60.0%	22.0%	1.0%	0.0%	0.0%	0.0%	
	50.0%	30.0%	10.0%	70.0%	32.0%	5.0%	4.0%	1.0%	8.0%	

The table above shows the asset allocation broken down by individual plan and in aggregate as of December 31. The total value of the pension assets declined by $956 million during the quarter. For the fiscal year-to-date period the decline was $1,660 million. This decline reflected negative returns in all asset classes during the quarter with the exception of fixed income. As compared to September the following observations can be made:

- Total equity holdings declined to 62.3% from 66.0%. Public equity values suffered dramatic declines during the quarter with both domestic and international indices suffering by almost the same amount, negative 22%.
- The broad domestic equity index, the S&P 1500, was down 22.4% for the quarter, and the allocation to domestic public equity fell from 38.6% to 34.4%.
- International equity exposure fell from 15.9% to 14.6%. Returns were (22.5)% for our custom international benchmark, almost identical to the same return in the prior quarter. The U.S. dollar strengthened early in the quarter but ended up only slightly and did not have any material impact on the returns for international equities during the quarter. The allocation ended the quarter slightly below the bottom of the range and minor additions to the allocation have been made since quarter end.
- Private Equity holdings increased from 11.5% to 13.3%. The increased weighting during the quarter reflects additional purchases of pool units totaling $54.53 million and the shrinking denominator of total pension assets caused by the negative returns in public securities. The pool return turned negative for the quarter at (7.3)% as valuations began to adjust downwards in sympathy with the public equity market.
- Pooled fixed income holdings increased from 27.0% to 30.0% at the end of the quarter. After suffering negative returns in the prior quarter largely caused by weakness in corporate securities, bond returns turned positive during the quarter as the decline in Treasury rates offset further weakness in corporate bonds. Sales of $65.38 million of RFBP units were made during the quarter to raise needed liquidity.
- The pooled real estate holdings increased to a 5.9% weighting from 5.1% at the end of September. The return turned negative for MTRP during the quarter at (3.6)%, while additional allocations of $25.88 million were made to fund ongoing capital calls.
- Cash invested in STIP edged down to 0.6%. The low level of cash reflects the ongoing need to fund benefit payments and private asset fund capital calls.

The magnitude of the decline in public equity prices during the quarter and general lack of liquidity in all markets made asset allocation changes more difficult to accomplish during the period.

Montana Domestic Equity Pool

12/31/2008 Domestic Stock Pool By Manager			
Manager Name	**Market Value**	**%**	**Approved Range**
BGI EQUITY INDEX FUND	532,953,850	26.00%	
STATE STREET SPIF ALT INV	6,049,695	0.30%	0-5%
LARGE CAP CORE Total	**539,003,546**	**26.29%**	10-30%
ENHANCED INVEST TECHNOLOGIES	129,401,508	6.31%	
GOLDMAN SACHS ENHANCED LARGE	91,061,803	4.44%	
T ROWE PRICE ASSOCIATES INC	140,049,426	6.83%	
WESTERN ASSET US INDX PLUS LLC	88,709,224	4.33%	
LARGE CAP ENHANCED Total	**449,221,961**	**21.91%**	20-30%
BARROW HANLEY MEWHINNEY + STRS	135,390,229	6.60%	
QUANTITATIVE MANAGEMENT ASSOC	90,951,332	4.44%	
LARGE CAP VALUE Total	**226,341,561**	**11.04%**	
COLUMBUS CIRCLE INVESTORS	96,067,746	4.69%	
RAINIER INVESTMENT MGMNT INC	91,552,498	4.47%	
RENAISSANCE GROUP LLC	100,325,801	4.89%	
LARGE CAP GROWTH Total	**287,946,046**	**14.05%**	
LARGE CAP STYLE BASED Total	**514,287,607**	**25.09%**	20-30%
ANALYTIC INVESTORS MU3B	78,686,436	3.84%	
JP MORGAN ASSET MGMT MU3E	140,330,229	6.85%	
MARTINGALE ASSET MGMT MU3D	53,644,592	2.62%	
PARTIAL LONG/SHORT (130/30) Total	**272,661,257**	**13.30%**	10-20%
COMBINED LARGE CAP Total	**1,775,174,370**	**86.59%**	82-92%
ARTISAN MID CAP VALUE	43,593,512	2.13%	
BGI MIDCAP EQUITY INDEX FUND	14,324,233	0.70%	
MARTINGALE ASSET MGMT MID CAP	64,277,996	3.14%	
TIMESSQUARE CAPITAL MGMT	53,963,284	2.63%	
MID CAP Total	**176,159,025**	**8.59%**	5-11%
DIMENSIONAL FUND ADVISORS INC	39,143,699	1.91%	
NORTHPOINTE CAPITAL SMALL CAP	23,853,815	1.16%	
VAUGHAN NELSON INV	35,732,641	1.74%	
SMALL CAP Total	**98,730,155**	**4.82%**	3-8%
TOTAL MDEP	**2,050,063,551**	**100.00%**	

The table above displays the Montana Domestic Equity Pool (MDEP) allocation at quarter end across market cap segments and manager styles. At this time, all weightings are within approved ranges. There were no significant allocation changes during the quarter. The $2 billion market value of MDEP shows the effects of the worst calendar year performance of the equity market since the 1930's.

Likewise returns across cap sizes reflect the most difficult market environment we have seen in several years. Declines in the quarter were broad-based without much difference in performance by cap size. This is typical of a broad market sell-off caused by investors' desires to leave the equity market in general. With that said large caps fared somewhat better with a return of -21.9% compared to mid caps returning -25.5% and small caps -

25.2%. No doubt large caps benefited from a moderate flight to quality within the mayhem. MDEP is slightly underweight large caps and slightly overweight mid caps and small caps.

COMPARATIVE RETURNS Page 1/ 6

Range 9/30/08 - 12/31/08 Period D Daily 92 Day Period

	Securities	Crncy	Prc Appr	Total Ret	Difference	Annual Eq
1	SPX Index	USD	-22.56 %	-21.94 %	3.61 %	-62.58 %
2	MID Index	USD	-25.99 %	-25.55 %		-68.98 %
3	SML Index	USD	-25.49 %	-25.17 %	.38 %	-68.35 %

(* = No dividends or coupons)

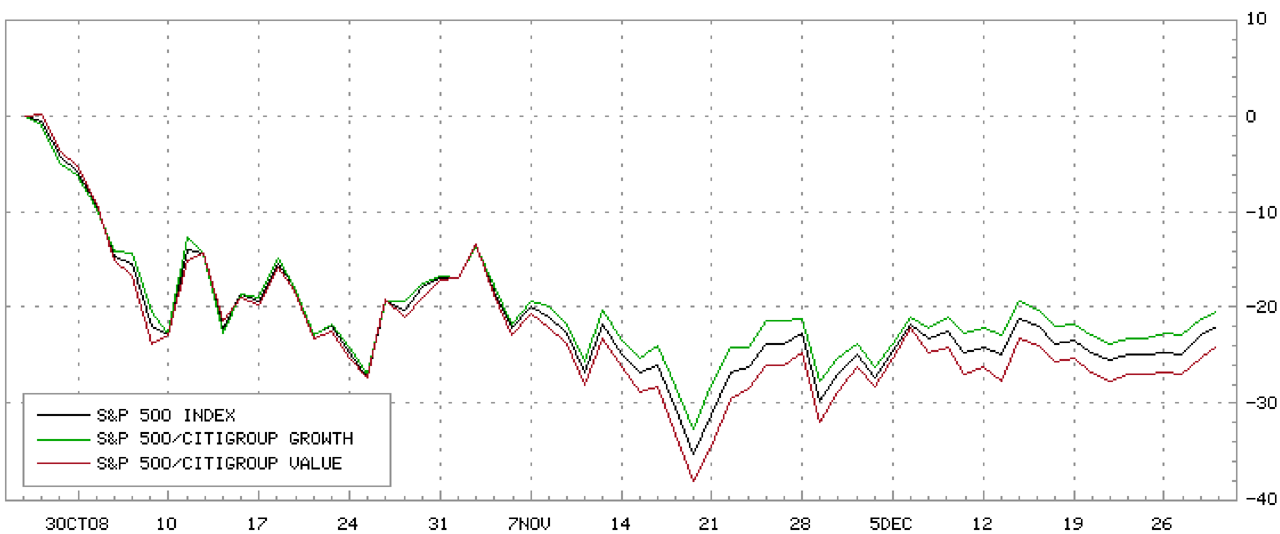
Looking at style categories, growth outperformed value, as the traditional value areas of commodities and financials suffered the most from a sector perspective. MDEP continues to have a tilt toward growth over value which helped boost otherwise dismal returns for the pool. For the quarter, growth stocks returned -20.2% while value stocks returned -23.8%.

COMPARATIVE RETURNS Page 1/ 6

Range 9/30/08 - 12/31/08 Period D Daily 92 Day Period

	Securities	Crncy	Prc Appr	Total Ret	Difference	Annual Eq
1	SPX Index	USD	-22.56 %	-21.94 %	-1.70 %	-62.58 %
2	SGX Index	USD	-20.64 %	-20.24 %		-59.24 %
3	SVX Index	USD	-24.66 %	-23.81 %	-3.57 %	-66.01 %

(* = No dividends or coupons)



Volatility has declined substantially since the extremes reached early in the fourth quarter yet remains at a very high level. Such high levels of the VIX will remain until the government is successful in rescuing the economy.

The manager performance within MDEP was mixed. The enhanced and growth style buckets underperformed while the value style, partial long/short, mid cap, and small cap buckets outperformed. Overall the pool slightly underperformed the benchmark on a net basis by 55 basis points.

Going forward the strategy is to remain slightly overweight growth versus value and to remain fairly neutral in relation to cap size.

DOMESTIC EXPOSURE-MARKET CAP %

December 31, 2008

MANAGERS	MEGA $200B+	GIANT $100-$200B	LARGE $50-$100B	LARGE $20-$50B	LARGE $10-$20B	MID $2.5-$10B	SMALL $500MM-$2.5B	MICRO < $500MM	WTD AVG MARKET CAP ($B)
Analytic Investors, Inc	6.7	18.4	13.9	17.1	21.4	14.6	2.7	-0.2	78.1
Artisan Partners	--	--	--	--	10.1	51.9	38.0	0.0	4.4
Barrow Hanley	--	10.7	8.3	23.2	14.3	39.5	4.0	0.0	33.9
Columbus Circle Investors	8.1	10.0	24.1	21.1	27.3	9.4	0.0	0.0	64.3
Dimensional Fund Advisors	--	--	--	--	--	0.0	57.4	42.4	0.7
Enhanced Invest Technologies	6.6	17.8	13.7	17.9	20.3	20.4	3.2	0.0	72.4
Goldman Sachs Enhanced Large Cap	6.6	18.3	16.7	24.2	16.7	12.2	4.0	0.0	77.1
J.P. Morgan	7.1	14.3	25.1	22.4	24.5	4.3	0.2	0.0	80.8
Martingale Asset Mgmt	--	--	--	--	7.0	61.2	31.6	0.2	4.2
Martingale Enhanced Alpha	8.3	17.6	17.1	15.9	14.2	18.7	6.4	0.1	78.3
NorthPointe Cap	--	--	--	--	--	8.6	53.7	37.7	1.0
Quantitative Management	7.8	22.2	10.3	16.7	16.2	21.8	4.8	0.3	80.8
Rainier Investment Mgt	2.1	4.2	28.7	28.3	23.5	11.3	1.9	0.0	49.4
Renaissance Investment Mgt	2.5	6.0	12.7	21.9	38.8	18.1	0.0	0.0	38.9
T. Rowe Associates	7.2	19.9	14.8	22.9	16.8	16.8	1.5	0.0	78.7
TimesSquare Cap Mgmt	--	--	--	0.6	11.7	68.9	17.8	0.9	5.4
Vaughan Nelson Mgmt	--	--	--	--	--	28.9	68.9	2.1	2.0
Western Asset US Index Plus	6.8	19.6	17.1	22.5	17.4	15.3	1.4	0.0	78.5
BGI Equity Index Fund	6.8	19.6	17.1	22.5	17.4	15.3	1.4	0.0	78.5
BGI Midcap Equity Index Fund	--	--	--	--	--	40.7	58.0	1.3	2.3
ALL DOMESTIC EQUITY PORTFOLIOS	**5.2**	**14.1**	**14.3**	**19.0**	**18.0**	**20.1**	**7.3**	**1.3**	**61.3**
Benchmark: S&P Composite 1500	**6.0**	**17.4**	**15.2**	**20.0**	**15.4**	**16.6**	**8.4**	**1.0**	**69.9**
Over/underweight(-)	**-0.8**	**-3.3**	**-0.8**	**-1.0**	**2.6**	**3.5**	**-1.1**	**0.3**	

DOMESTIC EXPOSURE-SECTOR %

December 31, 2008

MANAGERS	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Technology	Materials	Telecom Services	Utilities
Analytic Investors, Inc	5.4	14.1	12.1	11.0	15.0	9.8	17.5	1.7	4.5	3.6
Artisan Partners	21.5	--	7.1	20.5	3.3	26.9	19.9	--	--	0.9
Barrow Hanley	12.7	6.1	10.4	16.7	17.9	14.8	7.5	1.0	4.0	9.0
Columbus Circle Investors	7.2	11.7	7.4	13.4	20.3	9.5	23.6	2.2	1.1	--
Dimensional Fund Advisors	11.8	4.9	3.6	18.1	14.9	19.8	17.2	4.5	0.9	4.1
Enhanced Invest Technologies	10.6	12.1	14.4	13.5	12.8	12.9	13.6	2.7	3.5	3.7
Goldman Sachs Enhanced Large Cap	9.0	12.2	14.1	14.3	14.7	10.5	14.3	2.3	4.1	3.4
J.P. Morgan	9.6	13.5	11.5	13.0	15.4	6.8	17.8	3.4	3.6	3.1
Martingale Asset Mgmt	13.7	9.5	6.6	18.0	8.9	14.0	15.2	5.8	0.4	8.0
Martingale Enhanced Alpha	8.7	14.1	13.1	10.1	16.4	11.9	16.2	3.1	2.1	2.6
NorthPointe Cap	15.8	5.6	2.1	7.0	27.2	22.5	18.3	1.6	--	--
Quantitative Management	11.5	5.0	19.9	18.4	14.7	8.3	2.2	4.8	7.7	7.4
Rainier Investment Mgt	11.6	13.8	4.4	6.7	18.0	13.0	25.0	4.6	1.5	1.4
Renaissance Investment Mgt	17.2	13.0	8.1	1.3	22.7	15.3	17.2	5.1	--	--
T. Rowe Associates	8.9	12.7	13.5	12.9	14.9	10.4	15.6	3.0	3.9	4.1
TimesSquare Cap Mgmt	10.7	2.6	6.8	9.1	20.0	19.4	20.7	4.9	5.7	--
Vaughan Nelson Mgmt	7.6	4.3	2.2	20.0	10.7	17.4	14.1	12.4	1.5	4.9
Western Asset US Index Plus	8.4	12.9	13.3	13.3	14.8	11.1	15.3	2.9	3.8	4.2
BGI Equity Index Fund	8.4	12.9	13.3	13.3	14.8	11.1	15.3	2.9	3.8	4.2
BGI Midcap Equity Index Fund	14.0	4.5	6.3	20.4	11.3	14.3	13.1	6.7	0.6	8.8
All Domestic Equity Portfolios	**10.2**	**10.8**	**11.4**	**13.1**	**15.5**	**12.2**	**15.6**	**3.3**	**3.3**	**3.9**
Benchmark: S&P Composite 1500	**9.0**	**11.9**	**12.5**	**14.1**	**14.5**	**11.6**	**15.1**	**3.3**	**3.5**	**4.6**
Over/underweight(-)	**1.2**	**-1.1**	**-1.1**	**-1.0**	**1.0**	**0.6**	**0.4**	**0.0**	**-0.2**	**-0.7**

Domestic Portfolio Characteristics

December 31, 2008

MANAGERS	Market Value (mm)	Number of Securities	5Yr Historical EPS Growth	Price/ Earnings	Price/ Book	Dividend Yield
Analytic Investors, Inc	83.0	400	14.5	9.4	1.8	2.9
Artisan Partners	43.8	50	27.9	8.3	1.2	2.2
Barrow Hanley	137.3	86	8.9	10.0	1.4	3.9
Columbus Circle Investors	96.2	46	24.2	14.3	2.0	1.7
Dimensional Fund Advisors	39.1	2,913	11.6	12.1	1.2	1.7
Enhanced Invest Technologies	129.8	385	17.8	11.2	1.9	3.0
Goldman Sachs Enhanced Large Cap	90.4	365	18.1	11.4	1.8	3.0
J.P. Morgan	142.8	236	22.8	10.9	1.8	2.9
Martingale Asset Mgmt	64.4	154	16.5	9.4	1.4	2.4
Martingale Enhanced Alpha	54.6	287	14.6	10.3	1.9	3.0
NorthPointe Cap	23.6	84	14.8	12.5	1.5	0.6
Quantitative Management	91.1	136	5.2	9.4	1.2	4.4
Rainier Investment Mgt	91.9	65	29.9	13.4	2.7	1.3
Renaissance Investment Mgt	100.4	55	19.2	11.6	3.1	1.8
T. Rowe Associates	140.4	299	18.5	11.5	1.8	3.0
TimesSquare Cap Mgmt	54.0	69	21.2	14.2	2.2	1.8
Vaughan Nelson Mgmt	35.7	72	19.3	11.9	1.6	1.4
Western Asset US Index Plus	88.7	500	17.5	11.3	1.8	3.3
BGI Equity Index Fund	533.0	500	17.5	11.3	1.8	3.3
BGI Midcap Equity Index Fund	14.3	400	22.9	10.8	1.4	2.5
All Domestic Equity Portfolios	**2,050.5**	**3,847**	**18.2**	**11.1**	**1.7**	**2.8**
BENCHMARKS						
S&P Composite 1500		**1,499**	**17.7**	**11.3**	**1.7**	**3.2**
S&P/Citigroup 1500 Pure Growth		409	30.4	9.4	1.5	1.5
S&P/Citigroup 1500 Pure Value		342	1.3	7.2	0.4	12.0
S&P 500		500	17.5	11.3	1.8	3.3
Russell 1000		989	18.1	11.2	1.7	3.2
Russell 1000 Growth		643	26.8	11.9	2.6	2.1
Russell 1000 Value		654	6.1	10.6	1.3	4.3
Russell Midcap		798	18.8	10.7	1.4	2.8
Russell Midcap Growth		504	23.9	11.0	2.1	1.4
Russell Midcap Value		537	10.6	10.3	1.0	4.3
Russell 2000		1,934	14.6	12.3	1.2	2.4
Russell 2000 Growth		1,197	21.3	12.8	2.0	0.9
Russell 2000 Value		1,293	9.2	11.8	0.9	3.7

Montana International Equity Pool

International Stock Pool By Manager as of 12/31/2008			
Security Name	**Market Value**	**%**	**Approved Range**
-	-	-	
ARTIO GLOBAL MU1G	113,602,740	13.02%	
BATTERYMARCH INTL EQUITY	107,460,164	12.32%	
BGI GLOBAL EX US ALPHA TILT FD	70,296,899	8.06%	
EAFE STOCK PERFORMANCE INDEX	43,085,030	4.94%	0-10%
CORE Total	**334,444,833**	**38.33%**	25-50%
ACADIAN ACWI EX US VALUE	75,557,778	8.66%	
BERNSTEIN ACWI EX	73,637,452	8.44%	
VALUE Total	**149,195,230**	**17.10%**	15-25%
HANSBERGER INTL EQUITY GROWTH	65,057,750	7.46%	
MARTIN CURRIE ACWI X	72,204,505	8.28%	
PRINCIPAL GLOBAL	37,602,560	4.31%	
GROWTH Total	**174,864,815**	**20.04%**	15-25%
BGI MSCI EQUITY INDEX FD EUROPE	95,006,096	10.89%	0-12%
NOMURA ASSET MGMT INC	57,228,346	6.56%	0-8%
REGIONAL Total	**152,234,442**	**17.45%**	
AXA ROSENBERG INTL SMALL CAP	27,351,542	3.14%	
DFA INTL SMALL CO PORTFOLIO	34,362,585	3.94%	
SMALL CAP Total	**61,714,127**	**7.07%**	5-15%
TOTAL MTIP	**872,453,447**	**100.00%**	

The table above shows the quarter end allocation within the Montana International Equity Pool (MTIP). At this time, all weightings are within the approved ranges. There were no major strategic re-allocations implemented within MTIP during the quarter. The pool did receive a net amount of $29.04 million during the quarter in an effort to increase the pension allocation to international equities. This amount was allocated to the EAFE Stock Performance Index Fund (ISPIFF).

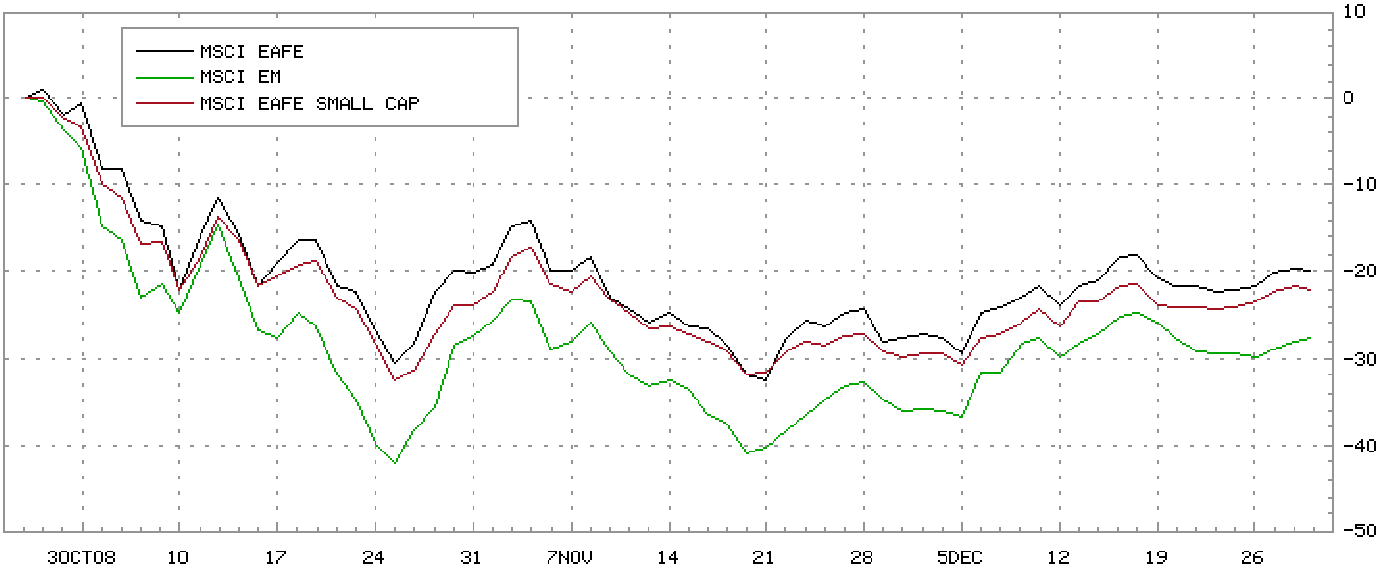
The overall value of the pool reflects the difficult market environment as the market value of MTIP has fallen below $1 billion. During the quarter, large cap stocks fell -19.9% while small cap declined -22.1% and emerging market stocks collapsed 27.7%. There was more a more pronounced flight to quality in the international equity markets than in the domestic markets. After a wild ride in the currency markets, the effect of the U.S. dollar was rather neutral overall during the quarter.

COMPARATIVE RETURNS Page 1/ 6

Range 9/30/08 - 12/31/08 Period D Daily 92 Day Period

	Securities	Crncy	Prc Appr	Total Ret	Difference	Annual Eq
1	MXEA Index	USD	-20.33 %	-19.92 %	7.82 %	-58.58 %
2	MXEF Index	USD	-27.94 %	-27.74 %		-72.44 %
3	MXEASC Index	USD	-22.46 %	-22.14 %	5.60 %	-62.95 %

(* = No dividends or coupons)



Relative to the benchmark MTIP is underweight emerging markets (EM). The weighting of the pool in emerging markets at quarter end stood at 12.8% compared to 17.4% for the benchmark. Recall that MTIP's weighting in EM is determined by the collective decisions of the individual managers within the pool. With respect to market capitalization, MTIP is slightly underweight small cap stocks versus the custom benchmark.

Across style categories, there was virtually no difference between growth and value, yet returns of both styles were disappointing. International growth stocks fell -22.5% while international value was down -22.2%. At this time, MTIP continues to carry a slight growth bias.

MTIP's managers as a whole struggled in the quarter with only three of the actively managed portfolios outperforming. Performance of the style-based managers was particularly disappointing. Overall, MTIP lagged the pool benchmark by 53 basis points in the quarter.

Going forward the pool is positioned relatively close to the benchmark in relation to cap size and style weights so manager performance collectively will be the more significant driver of MTIP performance. Also, a larger role for a passive component within the pool is being contemplated for tracking purposes as well as for liquidity advantages.

INTERNATIONAL EXPOSURE-MARKET CAP %

December 31, 2008

Managers	MEGA $200B+	GIANT $100-$200B	LARGE $50-$100B	LARGE $20-$50B	LARGE $10-$20B	MID $2.5-$10B	SMALL $500MM-$2.5B	MICRO < $500MM	WTD AVG MARKET CAP ($B)
Acadian Asset Management	--	4.1	16.3	16.8	16.5	29.7	14.3	1.7	28.2
Artio Global - Intl Equity II with look throughs	--	22.0	23.1	27.3	13.0	12.3	2.0	0.4	54.6
AXA Rosenberg	--	--	--	--	1.0	19.5	49.6	28.1	1.7
Batterymarch Financial Mgmt	1.0	12.3	14.7	17.1	14.3	36.8	3.4	0.1	38.5
Bernstein Inv Mgt & Research with look throughs	--	10.1	17.4	24.8	14.0	26.4	5.4	1.0	38.0
BGI Global Ex US Alpha Tilt Fd	0.6	11.9	12.9	25.4	14.4	23.6	9.8	0.6	37.8
DFA International Small Cap	--	--	--	0.0	0.0	3.1	56.8	39.3	0.8
Hansberger Global Investors	--	11.3	11.2	19.3	23.0	30.5	4.7	0.0	32.5
Martin Currie with look throughs	0.9	17.0	13.9	25.7	18.2	21.1	2.3	0.2	46.0
Nomura Asset Management	2.8	2.9	7.6	23.1	18.3	26.3	17.7	1.2	26.1
Principal Global Investors	--	13.4	10.4	25.3	16.1	22.3	10.7	1.0	37.3
BGI MSCI Europe Index Fund	--	20.6	17.6	29.1	11.8	18.4	2.4	0.0	51.5
ALL INTERNATIONAL EQUITY PORTFOLIOS	**0.5**	**12.3**	**14.1**	**22.0**	**14.5**	**23.8**	**9.9**	**3.0**	**37.5**
International Custom Benchmark	**0.6**	**11.3**	**12.0**	**27.2**	**15.7**	**25.6**	**7.1**	**0.5**	**36.6**
Over/underweight(-)	**-0.1**	**1.0**	**2.1**	**-5.3**	**-1.2**	**-1.8**	**2.8**	**2.5**	

INTERNATIONAL EXPOSURE-SECTOR %

December 31, 2008

MANAGERS	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Technology	Materials	Telecom. Services	Utilities
Acadian Asset Management	8.1	4.3	10.1	28.4	5.9	9.6	7.3	4.4	13.5	7.9
Artio Global - Intl Equity II with look throughs	5.8	11.6	11.0	7.2	10.1	10.0	2.3	8.7	11.4	9.2
AXA Rosenberg	14.1	12.3	2.7	16.4	3.5	23.8	9.4	10.0	2.1	3.1
Batterymarch Financial Mgmt	9.1	10.1	12.3	18.8	11.8	8.2	5.6	6.7	10.6	6.5
Bernstein Inv Mgt & Research with look throughs	9.3	2.5	15.5	23.9	5.9	6.6	9.0	13.5	9.1	3.7
BGI Global Ex US Alpha Tilt Fd	8.9	8.9	10.5	22.6	8.4	11.1	5.3	9.3	7.8	6.4
DFA International Small Cap	17.1	8.8	4.7	14.5	6.1	26.4	8.3	10.5	0.6	2.1
Hansberger Global Investors	10.5	7.1	6.6	18.9	11.3	11.5	10.7	9.5	10.3	3.6
Martin Currie with look throughs	6.9	11.4	8.0	18.7	12.6	9.5	9.5	6.4	8.8	7.4
Nomura Asset Management	10.7	7.0	4.5	25.1	2.9	14.6	10.9	11.3	8.9	4.2
Principal Global Investors	7.0	14.6	9.9	12.4	12.4	13.6	8.3	9.3	4.4	7.2
BGI MSCI Europe Index Fund	7.8	12.1	11.9	20.9	11.7	9.6	3.0	6.8	8.2	8.0
All International Equity Portfolios	**8.8**	**9.1**	**9.9**	**19.0**	**9.2**	**11.2**	**6.7**	**8.4**	**9.0**	**6.3**
International Custom Benchmark	**8.5**	**9.0**	**10.8**	**23.2**	**8.0**	**10.6**	**6.0**	**9.4**	**7.9**	**6.7**
Over/underweight(-)	**0.4**	**0.1**	**-0.9**	**-4.3**	**1.2**	**0.6**	**0.7**	**-0.9**	**1.2**	**-0.3**

International Portfolio Characteristics

December 31, 2008

	Market Value	Number of Securities	5Yr Hist EPS Growth	Price/ Earnings	Price/ Book	Dividend Yield
International Accounts with look throughs	**829.5**	**6,352**	**20.6**	**7.7**	**1.1**	**4.94**
International Equity Managers						
Acadian Asset Management	75.5	322	8.8	6.3	0.9	5.37
Artio Global - Intl Equity II with look throughs	113.7	185	16.8	8.1	1.4	4.69
AXA Rosenberg	27.4	1,129	12.2	6.4	0.6	5.96
Batterymarch Financial Mgmt	107.0	214	21.7	8.6	1.5	4.43
Bernstein Inv Mgt & Research with look throughs	73.4	213	13.2	5.4	0.8	7.54
BGI Global Ex US Alpha Tilt Fd	70.7	1,674	23.3	7.3	1.2	5.40
DFA International Small Cap	34.7	4,057	14.0	7.3	0.8	4.75
Hansberger Global Investors	65.2	69	39.7	10.1	1.8	2.98
Martin Currie with look throughs	72.1	134	25.0	9.3	1.4	4.07
Nomura Asset Management	57.4	196	24.3	8.8	1.1	3.76
Principal Global Investors	37.5	199	27.3	9.2	1.6	3.54
BGI MSCI Europe Index Fund	95.0	494	12.2	7.1	1.1	6.24
Benchmarks						
MSCI All Country World Ex-United States		1,832	19.5	7.7	1.2	5.18
MSCI All Country World Ex-United States Growth		943	25.3	10.1	1.8	3.37
MSCI All Country World Ex-United States Value		1,171	9.8	6.2	0.8	7.09
MSCI EAFE Small Cap		2,276	19.3	6.2	0.8	5.42
MSCI World Ex-United States Small Cap		2,482	19.0	6.1	0.8	5.35
MSCI All Country Pacific		886	20.9	9.2	1.1	3.97
MSCI Europe		494	12.2	7.1	1.1	6.24
International Custom Benchmark		5,987	19.5	7.7	1.2	5.18

INTERNATIONAL EQUITY
Region and Market Exposure
December 31, 2008

Developed Countries	Aggregate Int'l Portfolio Weight (%)	International Custom Benchmark Weight	difference	3 Month Return	FYTD Return	Calendar YTD Return	1 yr Return
Asia/Pacific	**24.6%**	**26.3%**	-1.79%				
Australia	3.4%	4.5%		-28.4	-47.6	-52.1	-52.1
Hong Kong	1.8%	1.5%		-19.5	-38.8	-52.7	-52.7
Japan	18.4%	19.4%		-7.8	-24.0	-28.1	-28.1
New Zealand	0.1%	0.1%		-22.8	-34.3	-50.4	-50.4
Singapore	0.9%	0.8%		-26.7	-44.3	-49.2	-49.2
European Union	**33.7%**	**27.7%**	6.00%				
Austria	0.3%	0.2%		-39.4	-63.5	-65.2	-65.2
Belgium	0.6%	0.6%		-36.7	-55.7	-64.6	-64.6
Denmark	0.8%	0.6%		-29.5	-48.8	-50.4	-50.4
Finland	1.0%	1.1%		-21.2	-43.0	-55.6	-55.6
France	10.4%	8.0%		-21.1	-36.2	-43.9	-43.9
Germany	7.8%	6.7%		-20.7	-37.5	-45.9	-45.9
Greece	0.4%	0.4%		-40.5	-54.9	-66.4	-66.4
Ireland	0.4%	0.2%		-39.0	-62.6	-69.1	-69.1
Italy	2.8%	2.8%		-23.0	-40.2	-50.0	-50.0
Netherlands	3.7%	1.9%		-23.6	-40.0	-48.2	-48.2
Portugal	0.3%	0.3%		-20.6	-34.9	-50.8	-50.8
Spain	4.0%	3.5%		-17.2	-32.2	-41.5	-41.5
Sweden	1.3%	1.5%		-26.8	-44.5	-51.6	-51.6
Non-EU Europe	**7.5%**	**6.9%**	0.67%				
Norway	0.4%	0.5%		-40.1	-64.4	-64.3	-64.3
Switzerland	7.1%	6.4%		-14.0	-25.6	-31.2	-31.2
North America	**4.4%**	**6.4%**	-1.97%				
Canada	4.3%	6.4%		-33.5	-48.7	-47.1	-47.1
USA	0.2%	0.0%		-22.9	-29.6	-37.4	-37.4
United Kingdom	**14.2%**	**15.2%**	-1.00%				
United Kingdom	14.2%	15.2%		-27.3	-42.7	-49.1	-49.1
Other							
Luxembourg	0.2%	0.3%					
DEVELOPED TOTAL	**84.6%**	**82.8%**	1.81%				
Emerging Market Countries							
Asia/Pacific	**8.2%**	**7.9%**	0.22%				
China	2.8%	3.1%		-10.4	-33.6	-51.1	-51.1
India	0.6%	1.1%		-30.4	-40.6	-66.2	-66.2
Indonesia	0.1%	0.3%		-35.7	-53.4	-58.0	-58.0
S. Korea	2.3%	2.3%		-26.2	-44.8	-55.6	-55.6
Malaysia	0.3%	0.5%		-14.3	-30.3	-42.6	-42.6
Philippines	0.1%	0.1%		-26.7	-27.2	-54.8	-54.8
Taiwan	1.5%	0.2%		-22.9	-43.2	-46.5	-46.5
Thailand	0.4%	0.2%		-28.2	-44.3	-49.7	-49.7
European Union	**1.5%**	**0.5%**	0.96%				
Czech Republic	0.5%	0.1%		-30.8	-48.4	-43.3	-43.3
Hungary	0.3%	0.1%		-46.0	-56.5	-61.3	-61.3
Poland	0.6%	0.3%		-40.2	-50.6	-57.3	-57.3
Non-EU Europe	**0.5%**	**1.0%**	-0.48%				
Russia	0.5%	1.0%		-51.6	-73.5	-74.0	-74.0
Latin America/Caribbean	**2.1%**	**3.6%**	-1.48%				
Argentina	0.0%	0.0%		-39.3	-64.6	-52.5	-52.5
Brazil	1.4%	2.2%		-37.2	-61.3	-56.8	-56.8
Chile	0.0%	0.2%		-25.2	-33.5	-37.5	-37.5
Colombia	0.0%	0.1%		-16.7	-23.9	-25.8	-25.8
Mexico	0.6%	0.9%		-30.3	-43.7	-43.5	-43.5
Peru	0.1%	0.1%		-18.0	-45.3	-41.1	-41.1
Mid East/Africa	**1.5%**	**2.5%**	-0.99%				
Egypt	0.0%	0.1%		-32.3	-51.4	-51.7	-51.7
Israel	0.3%	0.6%		-23.5	-35.6	-33.2	-33.2
Morocco	0.0%	0.1%		-12.5	-31.0	-10.5	-10.5
Pakistan	0.0%	0.0%		-46.5	-66.1	-73.7	-73.7
South Africa	0.9%	1.5%		-16.4	-29.2	-38.9	-38.9
Turkey	0.2%	0.3%		-38.5	-40.0	-63.4	-63.4
EMERGING TOTAL	**13.8%**	**15.6%**	-1.76%				

MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
Helena, MT 59601 (406) 444-0001

To: Members of the Board

From: Rande R. Muffick, CFA
Portfolio Manager

Date: February 3, 2009

Subject: Public Equity External Managers Watch List - Quarterly Update

During the quarter Goldman Sachs Enhanced Large Cap was removed from the Watch List. Performance relative to the benchmark has improved and organizational concerns have largely been resolved.

With that said, three style-based managers within the international pool have been added to the Watch List. Hansberger Global Investors International Growth has been added due to issues of performance and concerns over portfolio risk controls. Martin Currie International Growth was added for similar reasons. Acadian Asset Management International Value has been added based upon issues of performance and concerns over the effectiveness of their quantitative process at this time.

Principal Global International Growth, Western Asset Management Enhanced Plus, and NorthPointe Capital Small Cap Growth remain on the Watch List as well.

There were no manager terminations during the quarter. For reference, the manager evaluation policy approved in May, 2008 is attached.

Manager	**Style Bucket**	**Reason**	**Inclusion Date**
Principal Global	International – LC Growth	Performance	March 2008
Western Asset	Domestic - LC Enhanced	Performance, Tracking Error	March 2008
NorthPointe	Domestic- SC Growth	Performance	August 2008
Acadian Asset	International – LC Value	Performance, Process	February 2009
Hansberger Global	International – LC Growth	Performance, Risk Controls	February 2009
Martin Currie	International – LC Growth	Performance, Risk Controls	February 2009

FIXED INCOME OVERVIEW & STRATEGY

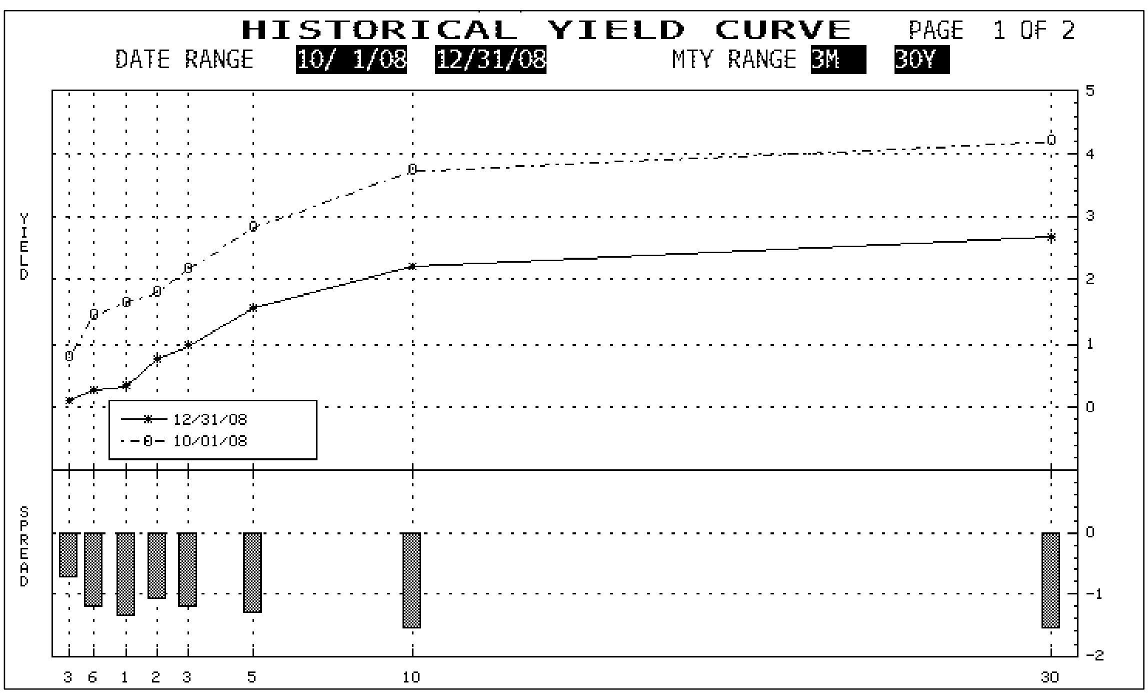
February 10, 2009

RETIREMENT & TRUST FUNDS BOND POOLS

The yield curve flattened dramatically in the fourth quarter. The yield differential between 3-month Treasury Bills and thirty year Treasury bonds fell by 81 basis points. The yield on the 3-month Bill declined from 91 basis points on September 30th to just 8 basis points by year-end. The 30-year Treasury bond ended the year at a yield of 2.67%, 166 basis points lower than its yield of 4.31% at the end of the third quarter. The long bond has since sold off and retraced to a yield of 3.38% as of January 30, 2009.

In tandem with longer term interest rates, the price of crude oil futures plummeted from $101.10 per barrel at the end of September to $48.59 at year-end. Oil has since fallen further to $45.73 on January 30, 2009. It peaked at $146.94 on July 14th. The 180-degree change from inflationary fears and a bull market in commodities to deflationary fears and falling commodities prices caught many hedge funds and other institutional investors off guard.

The Federal Funds interbank lending rate was cut to an unprecedented target range of 0-0.25% following the FOMC meeting of December 16th. The central bank's target rate is down more than 500 basis points from its 5.25% target of September 2007. Additional, extraordinary measures were announced by the Fed on November 25th. This would include a program to purchase Treasury, Agency and mortgage backed securities. Market observers refer to these practices as "quantitative easing" given that rates are effectively at zero. Lower interest rates on mortgage loans prompted a sizable increase in applications for refinancing late in the year.



Treasury bonds continued to perform well in relation to other sectors (+8.75% in the fourth quarter). However, yield spreads did improve on corporate bonds, in both the high yield (see chart on following page) and investment grade sectors. Financial issuers fared better in the fourth quarter (+8.07%), beating utilities (-0.10%) and industrials (+1.58%). Mortgage pass through securities (+4.45%) held up well, although asset backed securities (-6.82%) and commercial mortgage backed bonds (CMBS) (-13.52%) performed poorly. Despite the weak quarter, CMBS yield spreads narrowed in December, enabling them to show excess returns of 15.14% in just the one month.

Barclay's U.S. High Yield Index – 2% Issuer Cap (Average OAS)

The new Administration is expected to be supportive of efforts to create a bank to take on "bad assets" to isolate certain illiquid securities banks have on their balance sheets. The FDIC has been mentioned as a possible manager of this program. An $819 billion stimulus bill was approved by the House and is on its way to the Senate as of this writing, where it could increase to $900 billion. Much of that spending will be delayed to as late as 2010. The $350 billion in TARP money not yet released was requested by Obama of outgoing President Bush and was approved. That money is reportedly slated for homeowner assistance as well as for financial institutions.

The dollar has been strengthening as capital has flowed into assets perceived as safe for the preservation of principal. The same has generally been true of the yen, although the UK pound Sterling has been weakening. As investors become more willing to increase exposure to risk assets, look for the dollar to go back down. Other indicators that risk and liquidity are improving should include money leaving the U.S. Treasury market and a decrease in the price of gold.

The Fed continues to work on a clearinghouse for the credit default swaps market. Participants would contribute to a common fund that guarantees payment on any transaction even if one participant fails. Such a facility would increase market transparency and alleviate counterparty risk. According to *Pensions and Investments*, "the CDS market's notional value exploded from $631 billion in 2000 to a record $62 trillion in 2007, but has been shrinking almost as fast, down to $29 trillion at the end of 2008." The CDS market has been a focal point for concern regarding counterparty risk. AIG and Lehman were big sellers of credit protection and were major players in the market meltdown.

The following tables show statistical characteristics of the Core Internal Bond Portfolio (CIBP) versus those of the Barclays Capital Aggregate Index. For comparison, we also show the Reams portfolio and the combined portfolio, which represents the Retirement Funds Bond Pool. The Trust Funds Bond Pool (TFBP) is also shown. Reams was funded on October 1st as a Core Plus manager. Their emphasis has been on spread product. They have eschewed Government and Agency bonds in favor of corporate credits, high yield and a significant over weight to commercial mortgage backed securities (CMBS). The market value of the Reams portfolio was approximately $192mm at year-end, roughly 11% of the Retirement Fund Bond Pool (RFBP).

Benchmark Comparison Analysis

All Portfolios vs. Govt/Corp/Mtge on 12/31/2008

	CIBP Portfolio (%)	Reams Portfolio (%)	RFBP Portfolio (%)	TFBP Portfolio (%)	Benchmark (%)
Sovereign	**5.30**	**1.30**	**4.87**	**7.50**	**24.62**
Treasuries	5.30	1.30	4.87	7.50	24.62
Quasi & Foreign Government	**8.73**	**0.00**	**7.78**	**15.88**	**11.83**
Foreign Sovereign	0.00	0.00	0.00	0.00	0.63
Government Guarantee	0.43	0.00	0.38	2.98	1.26
Agency	8.30	0.00	7.40	12.91	9.08
Local Authority	0.00	0.00	0.00	0.00	0.04
Supranational	0.00	0.00	0.00	0.00	0.81
Securitized	**46.03**	**33.88**	**44.67**	**34.68**	**46.46**
Asset Backed	3.04	1.33	2.86	1.19	0.58
Mortgage Backed	36.47	0.00	32.53	29.22	42.39
CMBS	6.51	32.54	9.29	4.27	3.49
Financial	**10.81**	**17.55**	**11.52**	**14.62**	**6.44**
Banking	3.08	6.15	3.41	3.93	3.40
Brokerage	0.95	1.07	0.96	0.67	0.71
Finance & Investment	3.27	3.91	3.34	5.62	1.45
Insurance	3.51	6.42	3.81	4.40	0.88
Industry	**21.24**	**23.89**	**21.50**	**19.46**	**9.26**
Basic Industry	2.08	1.05	1.97	1.73	0.71
Capital Goods	0.00	0.68	0.07	0.00	0.75
Media	1.73	2.46	1.80	1.22	0.87
Consumer Cyclical	0.62	2.59	0.83	0.46	0.74
Consumer Non-Cyclical	1.19	0.20	1.09	1.27	1.92
Energy	4.36	8.49	4.79	5.42	1.49
Real Estate	2.72	1.28	2.57	1.94	0.21
Services Cyclical	5.36	4.36	5.25	4.97	0.45
Services Non -Cyclical	1.12	0.00	1.00	0.74	0.15
Telecommunications	1.44	2.77	1.58	1.37	1.39
Technology & Electronics	0.61	0.00	0.55	0.33	0.58
Utility	**5.22**	**2.89**	**4.96**	**5.16**	**1.40**
Utility	5.22	2.89	4.96	5.16	1.40
Other	**2.68**	**20.50**	**4.70**	**2.70**	**0.00**
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Benchmark Comparison Analysis CIBP vs. Govt/Corp/Mtge on 12/31/2008						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	93.197	5.31	6.6	6.16	3.88	5.12
Benchmark	102.919	5.24	5.18	4.04	3.92	2.21
Difference	-9.721	0.08	1.42	2.13	-0.04	2.91

Benchmark Comparison Analysis Reams vs. Govt/Corp/Mtge on 12/31/2008						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	80.982	5.39	7.62	10.12	4.01	9.02
Benchmark	102.919	5.24	5.18	4.04	3.92	2.21
Difference	-21.937	0.16	2.44	6.08	0.08	6.81

Benchmark Comparison Analysis RFBP vs. Govt/Corp/Mtge on 12/31/2008						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	91.659	5.32	6.73	6.6	3.89	5.55
Benchmark	102.919	5.24	5.18	4.04	3.92	2.21
Difference	-11.26	0.09	1.55	2.56	-0.03	3.34

Benchmark Comparison Analysis TFBP vs. Govt/Corp/Mtge on 12/31/2008						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	87.06	4.67	5.46	5.5	3.85	4.24
Benchmark	102.919	5.24	5.18	4.04	3.92	2.21
Difference	-15.858	-0.57	0.28	1.46	-0.07	2.02

Summary

The housing market is still weak and commercial real estate is now suffering the next leg down in property values. Employment has been contracting and wages have, in many cases, been frozen or cut outright. The business and consumer sectors are striving to reduce debt levels and increase liquidity, capital and savings. The federal government is leading a fiscal charge through a combination of new spending and tax cuts.

The Christmas retail season was weak. Consumer sentiment is sagging because of the dismal outlook for job security, losses in wealth (because of declines in housing prices and investment portfolios) and high debt levels. Despite lawmakers' desires to stimulate lending, business investment and consumer spending, they may be forced to wait for deleveraging and the replenishment of savings, which could take years.

The effect on the bond portfolios has been that our traditional buy and hold strategy with an emphasis on income to the exclusion of liquidity and safety has suffered. The MBOI will be moving to an investment policy framework that should reduce our volatility of returns in future years, especially in the Core Internal Bond Portfolio (CIBP).

BELOW INVESTMENT GRADE FIXED INCOME HOLDINGS
December 31, 2008
(in millions)

	Par	Book	Market	Price	Name	Coupon %	Maturity	Ratings M/S&P	Comments
A	$25.000	$10.000	$2.500	$10.00	Galena CDO	4.313	01/11/13	Caa2/B-	
	$50.000	$50.000	$40.116	$80.23	DOT Headquarters II Lease	6.001	11/15/11	NR/BB	The bond is Insured by XL Capital. Financial stress at XL resulted in a downgrade of the bond.
	$15.000	$6.000	$1.406	$9.37	Lehman Brothers	2.951	05/25/10	NR/NR	Currently in default and liquidation
	$5.000	$1.978	$0.475	$9.50	Lehman Brothers	5.000	01/14/11	NR/NR	Currently in default and liquidation
	$15.000	$15.003	$13.200	$88.00	Ford Motor Credit Corp	7.375	10/28/09	Caa1/CCC+	Negative outlook due to deteriorating industry fundementals
	19.550	19.684	1.369	7.00	Kellwood Co	7.625	10/15/17	NR/NR	Agencies removed rating after buyout
	$129.550	$102.665	$59.066						

A = Additions since 9/30/2008

D = Deletions since 9/30/08 (none)

In default

	Par	Book	Market	Price	Name	Coupon %	Maturity	Ratings	Comments
A	$15.000	$6.000	$1.406	$9.37	Lehman Brothers	2.951	05/25/10	B3/NR	Currently in default and liquidation
A	$5.000	$1.978	$0.475	$9.50	Lehman Brothers	5.000	01/14/11	B3/NR	Currently in default and liquidation
	$20.000	$7.978	$1.881						

STATE FUND INSURANCE- $861 million fixed income as of 12/31/08.
(Benchmark = Lehman Government/Credit Intermediate Index)

Benchmark Comparison Analysis MU26 vs. Int Govt/Corp on 12/31/2008						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	96.775	4.95%	5.70%	5.48%	3.62	4.39
Benchmark	104.086	4.65%	4.55%	3.27%	3.7	1.95
Difference	-7.311	0.30%	1.16%	2.21%	-0.08	2.44

The portfolio has an overweight in agencies, mortgage backed securities (MBS), corporate bonds and commercial mortgage backed securities (CMBS) and is underweighted in Treasuries. The new sector table on the following page provides more detail on the differences between the portfolio and the benchmark. The benchmark has no exposure to securitized bonds (ABS, MBS, CMBS) while the portfolio has 13% in these securities. Securitized bonds have historically offered additional yields without much credit risk, but in the current environment these bonds have underperformed due to credit concerns. Spread product ended the quarter at wider levels as compared to the end of the third quarter but in substantially from the extreme wide levels of November.

The overweight in spread product (all non-Treasuries) has been a drag on performance over the past year, especially the portfolio's overweight in financials. The account was under the benchmark by 30 basis points for the quarter and over by 94 basis points for the month of December as spreads tightened.

During the fourth quarter, there were purchases of $52 million including: $22 million of corporate bonds, $20 million of agencies and $10 million of Treasuries. Corporate purchases were in the five year maturity range, in these names: Occidental Petroleum, Burlington Northern, Caterpillar and DuPont. A ten year Altria was purchased at a yield of 9.65%.

The portfolio has a 221 basis point yield advantage over the benchmark with only a one notch lower quality rating. Client preferences include keeping the STIP balance of 1-3 percent (currently 3.0%) and limiting holdings rated lower than A3 or A- to 20 percent of fixed income (currently 16.9%).

Benchmark Comparison Analysis

MU26 vs. Int Govt/Corp on 12/31/2008

	Portfolio (%)	Benchmark (%)	Difference
Sovereign	**7.69**	**45.58**	**-37.88**
Treasuries	7.69	45.58	-37.88
Quasi & Foreign Government	**31.03**	**24.99**	**6.04**
Foreign Sovereign	0.00	1.09	-1.09
Government Guarantee	0.38	2.80	-2.42
Agency	30.65	19.25	11.40
Local Authority	0.00	0.07	-0.07
Supranational	0.00	1.78	-1.78
Securitized	**13.15**	**0.00**	**13.15**
Asset Backed	0.04	0.00	0.04
Mortgage Backed	7.52	0.00	7.52
CMBS	5.58	0.00	5.58
Financial	**26.93**	**12.69**	**14.24**
Banking	12.05	6.72	5.33
Brokerage	1.79	1.49	0.30
Finance & Investment	7.02	2.96	4.07
Insurance	6.06	1.52	4.54
Industry	**14.72**	**14.82**	**-0.11**
Basic Industry	1.16	1.21	-0.05
Capital Goods	0.24	1.27	-1.03
Media	0.96	1.29	-0.33
Consumer Cyclical	0.00	1.22	-1.22
Consumer Non-Cyclical	3.24	3.19	0.05
Energy	3.61	2.08	1.53
Real Estate	0.00	0.49	-0.49
Services Cyclical	3.76	0.64	3.12
Services Non -Cyclical	0.31	0.28	0.04
Telecommunications	1.44	2.05	-0.61
Technology & Electronics	0.00	1.12	-1.12
Utility	**1.82**	**1.92**	**-0.11**
Utility	1.82	1.92	-0.11
Other	**4.67**	**0.00**	**4.67**
Total	**100.00**	**100.00**	**0.00**

TREASURER'S FUND- $851 million including $30 million in fixed income as of 12/31/08. During December, two short Agency bonds were sold at a yield to maturity of .397% and provided a realized gain. The strategy is to let maturities roll into STIP, at which point the account will hold only STIP.

Richard Cooley, CFA
Portfolio Manager- STIP/Fixed Income

MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
Helena, MT 59601 (406) 444-0001

To: Members of the Board

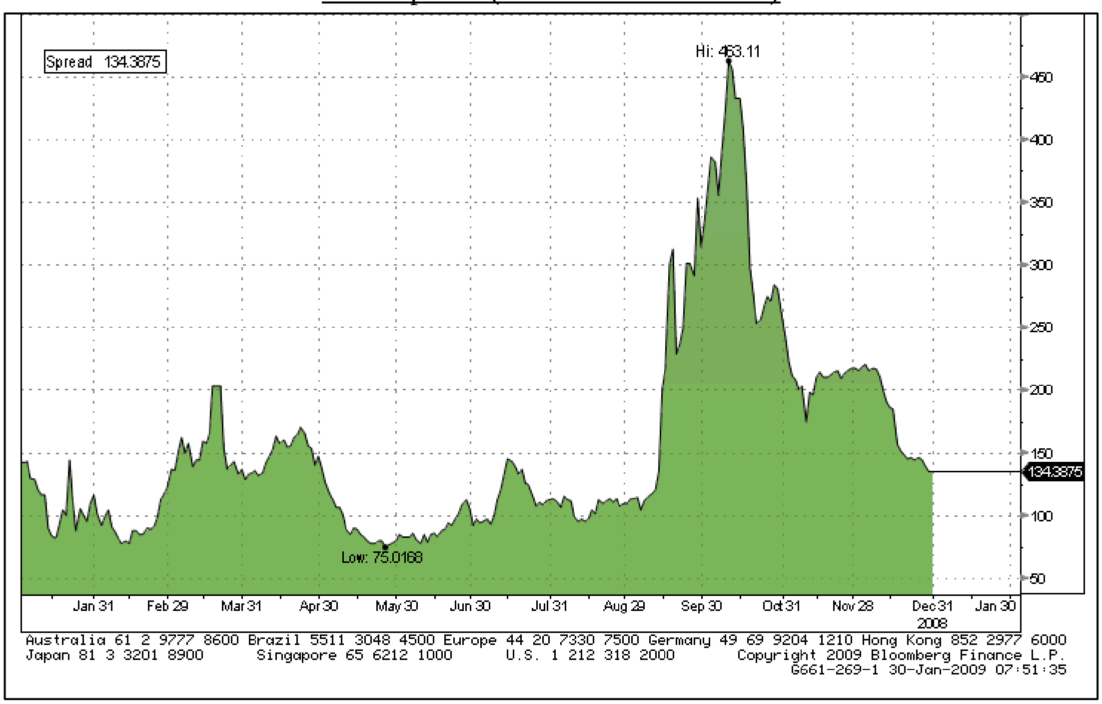
From: Richard Cooley, CFA

Date: January 30, 2009

Subject: Short Term Investment Pool (STIP)

During the fourth quarter, money markets were rescued by the numerous Fed programs that were put in place to provide liquidity for money market funds and insure the safety of public money market funds. The Fed cut the fed funds rate from 2.00% to 0-.25% during the quarter. Credit spreads exploded after the Lehman bankruptcy and the failure of the Reserve Fund as evidenced by the spread between three month Treasury bills and three month LIBOR rates (TED spread). This spread ended the third quarter at about 315 basis points, and peaked in mid October at 463 basis points as Treasury bill yields collapsed towards zero and even negative yields. Market participants became less concerned about inflation as everyone's attention shifted to surviving the credit and liquidity crunch. The Fed and Treasury have been successful implementing different programs to unfreeze the money markets.

TED Spread (Jan 2008 – Dec 2008)

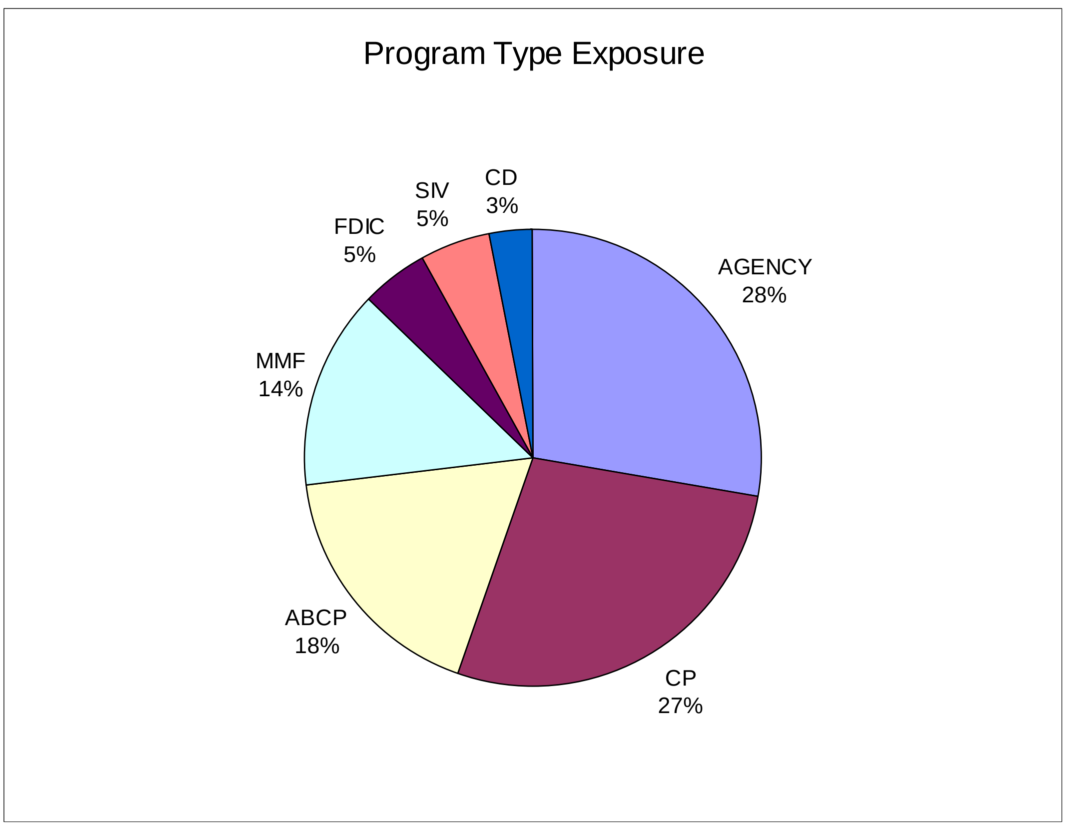


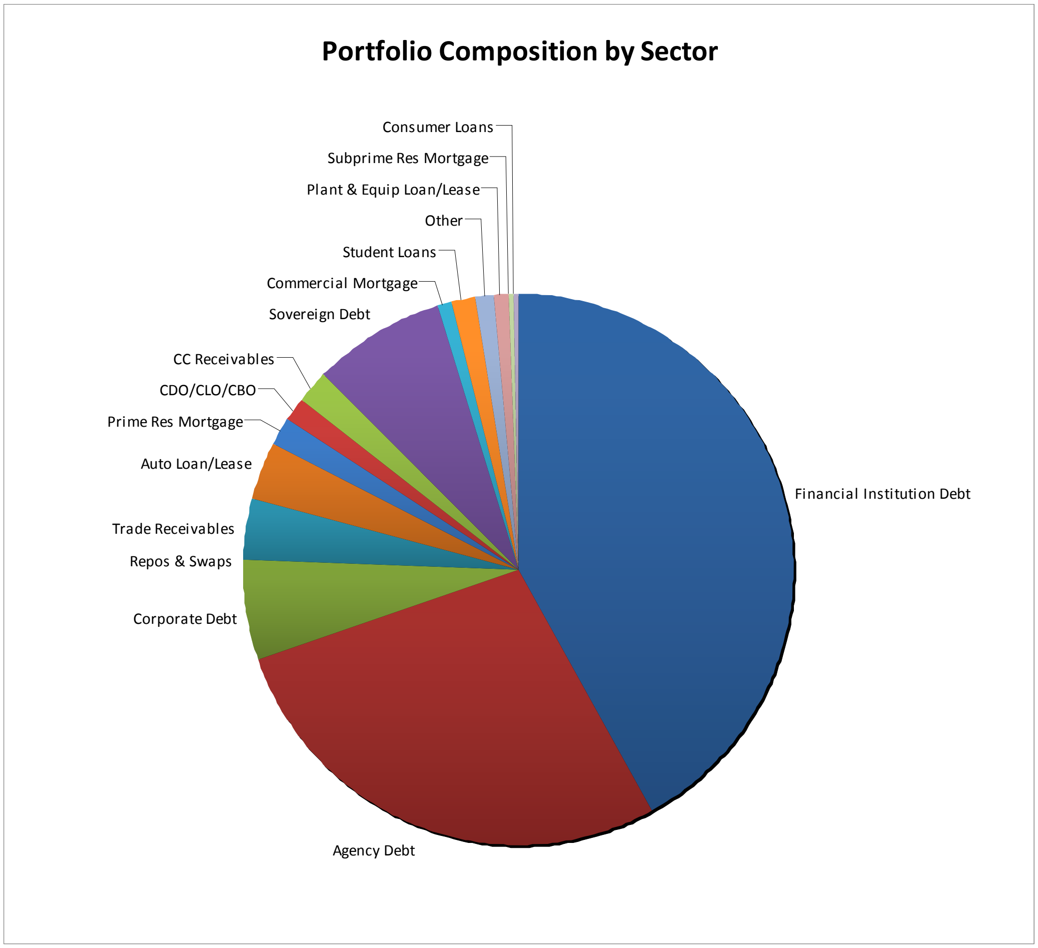
The STIP portfolio is currently well diversified and is operating within all the new guidelines adopted by the Board at the February 2008 meeting. Daily liquidity is at a minimum of $200 million and weekly liquidity is at a minimum of $350 million. The average days to maturity are about 52 days as compared to a policy maximum of 60 days. All securities purchased are from the approved list and are below the 2% maximum per name. Asset-backed commercial paper is about 18% of holdings (40% max) and corporate exposure is around 27% (40% max). We currently have approximately 28% in agency paper and 15% in four institutional money funds.

During the fourth quarter there were purchases of $315 million of one year securities to take advantage of a still elevated three month LIBOR rate. We bought $165 million of Agency floating rate securities and $130 million of corporate floating rate securities that are pegged to three month LIBOR as well as $20 million of fixed rate corporate notes. During the third quarter, a new program called the FDIC Temporary Liquidity Guarantee Program (TLGP) was introduced. This allows bank holding companies to issue full faith and credit FDIC- backed bonds with a maturity not past June 2012. We started buying three month floating rate securities with a maximum maturity of two years under this program.

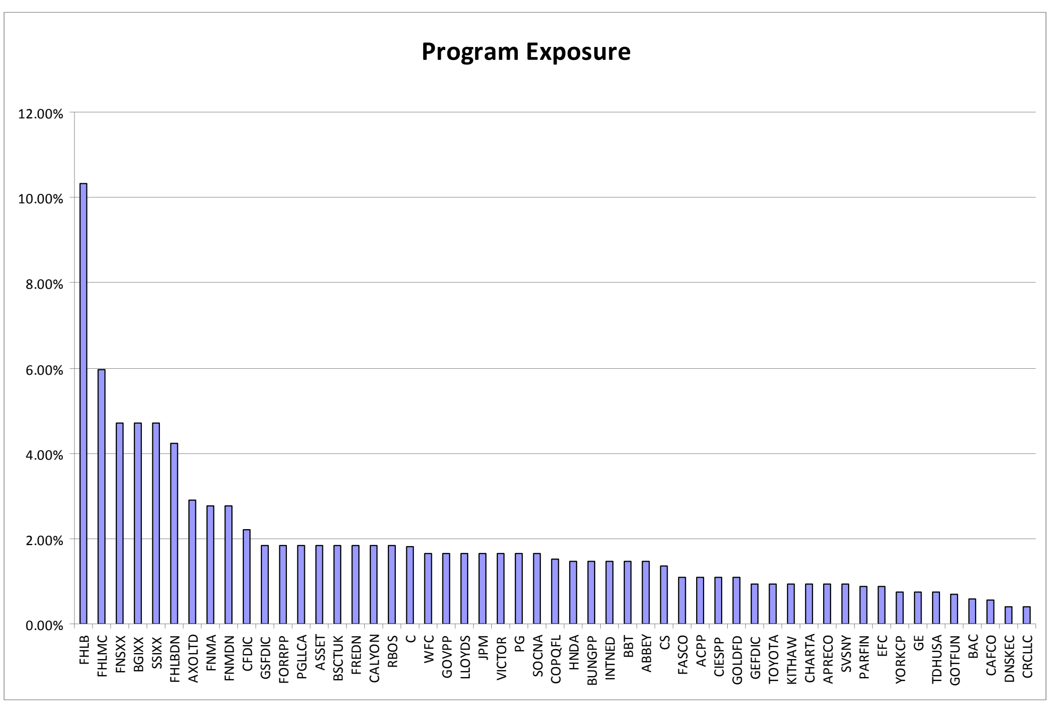
The net yield on STIP is currently 1.27% as compared with the current one month LIBOR rate of 0.42% and current fed funds rate of 0.25%. The portfolio is currently $2.63 billion in assets.

All charts below are as of January 29, 2009.





Portfolio Composition by Sector
Consumer Loans
Subprime Res Mortgage
Plant & Equip Loan/Lease
Other
Student Loans
Commercial Mortgage
Sovereign Debt
CC Receivables
CDO/CLO/CBO
Prime Res Mortgage
Auto Loan/Lease
Trade Receivables
Repos & Swaps
Corporate Debt
Agency Debt
Financial Institution Debt



Program Exposure
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
FHLB
FHLMC
FNSXX
BGIXX
SSIXX
FHLBDN
AXOLTD
FNMA
FNMDN
CFDIC
GSFDIC
FORRPP
PGLLCA
ASSET
BSCTUK
FREDN
CALYON
RBOS
C
WFC
GOVPP
LLOYDS
JPM
VICTOR
PG
SOCNA
COPQFL
HNDA
BUNGPP
INTNED
BBT
ABBEY
CS
FASCO
ACPP
CIESPP
GOLDFD
GEFDIC
TOYOTA
KITHAW
CHARTA
APRECO
SVSNY
PARFIN
EFC
YORKCP
GE
TDHUSA
GOTFUN
BAC
CAFCO
DNSKEC
CRCLLC

MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
Helena, MT 59601 (406) 444-0001

To: Members of the Board

From: Edward J. Kelly

Date: February 10, 2009

Subject: Montana Private Equity Pool [MPEP]

Attached to this memo are the following reports:

(i) **Private Edge - Graph: Strategy Total Exposure by Market Value & Remaining Commitments**. This report summarizes the total market value of invested capital commitments plus the capital commitments remaining to be invested broken out by investment strategy as of 09/30/08.

(ii) **Private Edge - Graph: Investment Geography Exposure by Market Value & Remaining Commitments**. This report summarizes the total market value of invested capital commitments plus the capital commitments remaining to be invested broken out by geography as of 09/30/08.

(iii) **Private Edge - Table: LP's by Family of Funds All Investments.** This report provides details of the underlying funds and their reported values and Investment performance from inception to 09/30/08.

(iv) **Private Equity Pool Holdings**. This report summarizes all portfolio fund holdings by shares, book value and market value as of 12/31/08.

(v) **New Commitments**. There were no new fund commitments made to the MPEP since the November Board Meeting. However, an additional $10M commitment was added to Lexington Partners Fund VII, L.P. for a total commitment of $30M. A copy of the original Board Brief presented at the November Board meeting is attached for your reference.

Items i to iii will be provided at the meeting.

12/31/2008 Private Equity Pool Holdings

Fund Name	Shares	Book Value	Market Value	%
MEDASSETS INC	12,245	179,144	178,777	0.02%
UNIVERSAL AMERN FINL CORP	21,569	234,326	190,239	0.02%
0 Total	**33,814**	**413,470**	**369,016**	**0.05%**
ADAMS ST PART FUND 2003 US	13,911,349	13,911,349	15,111,398	1.90%
ADAMS ST PART FUND 2004 NON US	3,719,468	3,719,468	3,875,916	0.49%
ADAMS ST PART FUND 2004 US	10,322,922	10,322,922	10,317,853	1.30%
ADAMS ST PARTNERS FUND 2002 US	24,156,518	24,156,518	26,287,654	3.31%
ADAMS STR GLOBAL OPPORTUNITES	14,112,920	14,112,920	14,549,997	1.83%
ADAMS STREET FUND V	29,828,534	29,828,534	31,573,891	3.98%
ADAMS STREET PARTNERSHIP	3,376,621	3,376,621	3,198,903	0.40%
ADAMS STREET PARTNERSHIP FUND	14,903,934	14,903,934	14,090,984	1.78%
ADAMS STREET PTNRSHP FND	3,943,307	3,943,307	5,039,211	0.63%
ALTA SUB DEBT PARTNERS III	1	0	192	0.00%
AUSTIN VENTURES III	214,255	214,255	16,947	0.00%
BRIN NON US TRUST 2001 PRIM	594,076	594,076	744,100	0.09%
BRIN VEN CAP III SECONDARY	1	1	104,483	0.01%
BRIN VEN PART III SECONDARY	1,517,128	1,517,128	298,638	0.04%
BRINSON NON U.S. TRUST 2000	832,015	832,015	1,041,152	0.13%
BRINSON NON US 1999 PRIMARY FD	279,000	279,000	483,734	0.06%
BRINSON NON US PARTNERSHIP FND	1,090,463	1,090,463	1,712,146	0.22%
BRINSON NON US PARTNERSHIP TR	656,323	656,323	863,174	0.11%
BRINSON NON US TRUST 2002 SEC	158,767	158,767	162,108	0.02%
BRINSON NON US TRUST 2003 PRIM	791,223	791,223	1,629,963	0.21%
BRINSON PART FUND TRUST 1996	1,347,645	1,347,645	283,085	0.04%
BRINSON PARTNERSHIP	11,245,609	11,245,609	10,501,037	1.32%
BRINSON PARTNERSHIP	6,319,079	6,319,079	7,728,448	0.97%
BRINSON PARTNERSHIP FUND	336,495	336,495	795,326	0.10%
BRINSON PARTNERSHIP FUND TR	9,558,771	9,761,707	12,374,574	1.56%
BRINSON PARTNERSHIP FUND TRUST	1,333,562	1,333,562	444,023	0.06%
BRINSON PARTNERSHIP FUND TRUST	2,974,620	2,974,620	1,044,773	0.13%
BRINSON PARTNERSHIP FUND TRUST	142,679	142,679	15,777	0.00%
BRINSON PARTNERSHIP FUND TRUST	4,580,647	4,580,647	2,576,710	0.32%
BRINSON PARTNERSHIP FUND TRUST	11,772,363	11,772,363	13,156,616	1.66%
BRINSON PARTNERSHIP FUND TRUST	10,449,535	10,449,535	12,606,100	1.59%
BRINSON PARTNERSHIP FUND TRUST	1,489,081	1,489,081	1,781,123	0.22%
BRINSON VEN CAP FUND IV	6,052,410	6,052,410	8,771,473	1.11%
BRINSON VENTURE CAPITAL FD III	1	1	104,483	0.01%
BRINSON VENTURE PARTNR FD III	1,285,662	1,285,662	298,229	0.04%
SPROUT CAPITAL VI	244,756	244,756	7,913	0.00%
SUMMIT VENTURE II	128,881	128,881	2,816	0.00%
VENTURE PARTNERSHIP ACQUIST	190,080	190,080	18,174	0.00%
WCAS CAPITAL PARTNERS II	261,141	261,141	106,946	0.01%
ADAMS STREET Total	**194,121,842**	**194,324,778**	**203,720,069**	**25.67%**
AFFINITY ASIA PACIFIC FUND III	3,048,654	3,048,654	3,018,326	0.38%
AFFINITY Total	**3,048,654**	**3,048,654**	**3,018,326**	**0.38%**
ARCLIGHT ENERGY PTNRS FUND III	21,345,608	21,345,608	21,516,928	2.71%
ARCLIGHT ENRGY PARTNERS FD II	12,775,969	12,775,969	17,116,247	2.16%
ARCLIGHT Total	**34,121,577**	**34,121,577**	**38,633,174**	**4.87%**
AVENUE SPECIAL SITUATIONS V	23,087,428	23,087,428	20,030,306	2.52%
AVENUE CAPITAL Total	**23,087,428**	**23,087,428**	**20,030,306**	**2.52%**
BUERK DALE VICOTR II L.P.	5,550,000	5,550,000	5,032,274	0.63%
BUERK DALE. Total	**5,550,000**	**5,550,000**	**5,032,274**	**0.63%**
CARLYLE PARTNERS IV, L.P.	30,813,472	30,813,472	32,282,566	4.07%
CARLYLE VENTURE PARTNERS III	11,875,445	11,875,445	11,678,586	1.47%

12/31/2008 Private Equity Pool Holdings

Fund Name	Shares	Book Value	Market Value	%
CARLYLE Total	**42,688,917**	**42,688,917**	**43,961,152**	**5.54%**
CCMP II	7,438,176	7,438,176	6,142,520	0.77%
CCMP Total	**7,438,176**	**7,438,176**	**6,142,520**	**0.77%**
FIRST RESERVE FUND XII	7,138,666	7,138,666	7,025,225	0.89%
FIRST RESERVE XI	20,506,174	20,506,174	21,972,365	2.77%
FIRST RESERVE Total	**27,644,840**	**27,644,840**	**28,997,591**	**3.65%**
DOVER STREET	3,400,000	3,400,000	3,400,000	0.43%
HARBOURVEST 2007 DIRECT	5,400,000	5,400,000	4,536,740	0.57%
HARBOUR VEST Total	**8,800,000**	**8,800,000**	**7,936,740**	**1.00%**
HFCP VI	15,178,957	15,178,957	14,613,526	1.84%
HELLMAN FRIEDMAN Total	**15,178,957**	**15,178,957**	**14,613,526**	**1.84%**
HIGHWAY 12 VENTURE II	2,793,305	2,793,305	2,624,838	0.33%
HIGHWAY 12 VENTURES Total	**2,793,305**	**2,793,305**	**2,624,838**	**0.33%**
INDUSTRY VENTURES FUND IV	7,646,643	7,646,643	8,421,347	1.06%
INDUSTRY VENTURES Total	**7,646,643**	**7,646,643**	**8,421,347**	**1.06%**
JCF II LP	22,558,579	22,558,579	20,759,059	2.62%
J.C. FLOWERS Total	**22,558,579**	**22,558,579**	**20,759,059**	**2.62%**
JLL PARTNERS FUND V LP	14,924,148	14,924,148	19,476,461	2.45%
JLL PARTNERS Total	**14,924,148**	**14,924,148**	**19,476,461**	**2.45%**
KKR 1987	2,021,493	2,021,493	201,646	0.03%
KKR 1993	1,285,300	1,285,300	70,692	0.01%
KKR 1996	18,967,917	18,967,917	12,395,060	1.56%
KKR EUROPEAN FUND	9,053,964	9,053,964	14,505,003	1.83%
KKR Total	**31,328,674**	**31,328,674**	**27,172,400**	**3.42%**
LEHMAN BROS MERCHANT BANK IV	3,471,692	3,471,692	3,444,734	0.43%
LEHMAN BROTHERS CO	17,796,240	17,796,240	21,145,012	2.66%
LEHMAN BROTHERS Total	**21,267,932**	**21,267,932**	**24,589,746**	**3.10%**
LEXINGTON CAPITAL PARTNERS VIB	31,504,435	31,504,435	29,734,674	3.75%
LEXINGTON CAPITAL PTRS V LP	5,293,748	5,293,748	25,976,358	3.27%
LEXINGTON MID MARKET II LP	655,962	655,962	655,962	0.08%
LEXINGTON Total	**37,454,145**	**37,454,145**	**56,366,993**	**7.10%**
MADISON DEARBORN CAP PART IV	18,371,401	18,371,401	20,880,310	2.63%
MADISON DEARBORN CAP PTNRS VI	2,735,009	2,735,009	2,654,619	0.33%
MDCP V	19,073,168	19,073,168	19,089,266	2.41%
MADISON DEARBORN Total	**40,179,578**	**40,179,578**	**42,624,195**	**5.37%**
MATLIN PATTERSON GLB OPP	14,078,557	14,078,557	14,624,242	1.84%
MATLIN PATTERSON Total	**14,078,557**	**14,078,557**	**14,624,242**	**1.84%**
MHR INSTITUTIONAL III	14,686,883	14,686,883	9,431,564	1.19%
MHR INSTITUTIONAL Total	**14,686,883**	**14,686,883**	**9,431,564**	**1.19%**
OAK HILL CAPITAL PARTNERS II	21,861,607	21,861,607	27,055,640	3.41%
OAK HILL III	5,095,786	5,095,786	5,026,279	0.63%
OAK HILL Total	**26,957,393**	**26,957,393**	**32,081,920**	**4.04%**
OAKTREE CPTL MGMT OPPTY FD VII	24,408,582	24,408,582	23,233,309	2.93%
OCM OPPORTUNITIES FD IVB LP	1	1	291,253	0.04%
OAK TREE Total	**24,408,583**	**24,408,583**	**23,524,562**	**2.96%**
ODYSSEY INVT PARTN FD III	16,613,903	16,613,903	18,842,276	2.37%
ODYSSEY INVESTMENTS Total	**16,613,903**	**16,613,903**	**18,842,276**	**2.37%**
PERFORMANCE VENTURE CAPITAL II	633,000	633,000	633,000	0.08%

12/31/2008 Private Equity Pool Holdings

Fund Name	Shares	Book Value	Market Value	%
PERFORMANCE EQUITY MANA(	**633,000**	**633,000**	**633,000**	**0.08%**
PORTFOLIO ADVISORS FUND V(B)	2,496,676	2,496,676	2,496,676	0.31%
PORTFOLIO ADVISORS IV (B)	15,237,938	15,237,938	15,972,802	2.01%
PORTFOLIO ADVISORS IV (E)	6,262,093	6,262,093	6,033,977	0.76%
PORTFOLIO ADVISORS Total	**23,996,707**	**23,996,707**	**24,503,456**	**3.09%**
QUINTANA ENERGY PARTNERS TE LP	9,872,030	9,872,030	9,423,721	1.19%
QUINTANA ENERGY Total	**9,872,030**	**9,872,030**	**9,423,721**	**1.19%**
SIGULER GUFF SM BUYOUT	9,550,520	9,550,520	8,617,969	1.09%
SIGULER GUFF Total	**9,550,520**	**9,550,520**	**8,617,969**	**1.09%**
TERRA FIRMA III LIMITED PART	8,669,862	12,340,119	11,351,099	1.43%
TERRA FIRMA Total	**8,669,862**	**12,340,119**	**11,351,099**	**1.43%**
WCAS CAPITAL PARTNERS FUND IV	15,573,652	15,573,652	17,892,133	2.25%
WCAS IX	8,217,444	8,072,728	16,218,596	2.04%
WCAS X LP	19,486,677	19,486,677	21,810,054	2.75%
WELSH CARSON Total	**43,277,773**	**43,133,057**	**55,920,782**	**7.05%**
STATE STREET SPIF ALT INV	82,443	9,494,062	10,234,441	1.29%
STATE STREET Total	**82,443**	**9,494,062**	**10,234,441**	**1.29%**
Grand Total	**732,694,861**	**746,214,613**	**793,678,763**	**100.00%**

MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
Helena, MT 59601 (406) 444-0001

To: Members of the Board

From: Edward J. Kelly

Date: February 10, 2009

Subject: Montana Real Estate Pool [MTRP]

Attached to this memo are the following reports:

(i) **Private Edge - Graph: Strategy Total Exposure by Market Value & Remaining Commitments.** This report summarizes the total market value of invested capital commitments plus the capital commitments remaining to be invested broken out by investment strategy as of 09/30/08.

(ii) **Private Edge - Graph: Portfolio Characteristics – Geographic Diversification.** This report summarizes the Gross Market Value of MTRP's share of the partnerships' interests in properties exclusive of any underlying debt used to acquire each property broken out by geography relative to the NCREIF Property Index as of 09/30/08.

(iii) **Private Edge – Graph: Portfolio Characteristics – Property Type Diversification.** This report summarizes the Gross Market Value of MTRP's share of the partnerships' interests in properties exclusive of any underlying debt used to acquire each property broken out by property type relative to the NCREIF Property Index as of 09/30/08.

(iv) **Private Edge - Table: Real Estate Portfolio Status Report.** This report summarizes the total market value of invested capital commitments plus the capital commitments remaining to be invested broken out by investment strategy as of 09/30/08.

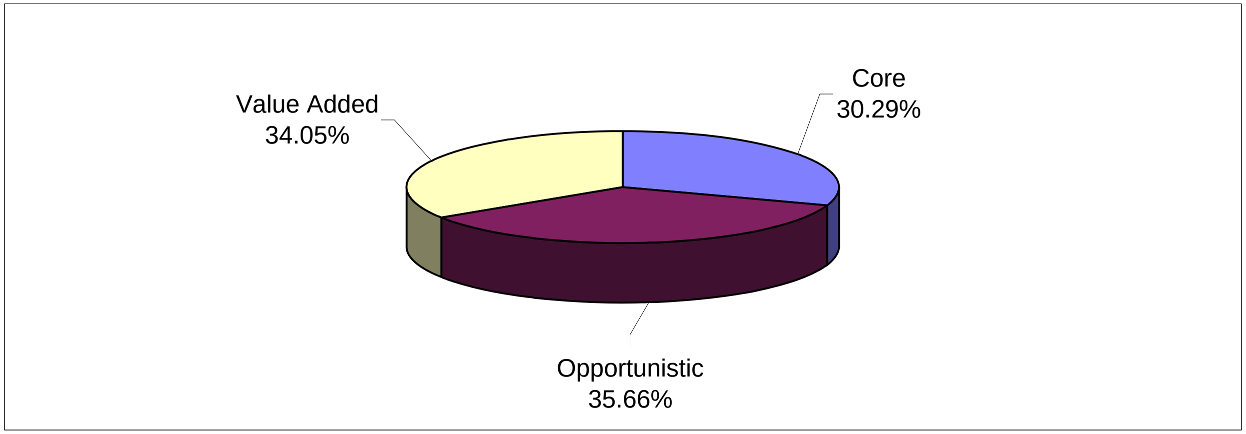
(v) **Real Estate Pool Holdings.** This report summarizes all MTRP portfolio fund holdings by shares, book value and market value as of 12/31/08.

(vi) **New Commitments**. There were no new fund commitments made to the MTRP since the November Board Meeting.

Real Estate Portfolio Status

Strategy Exposure by Net Asset Value & Remaining Commitments

(Since inception through September 30, 2008)



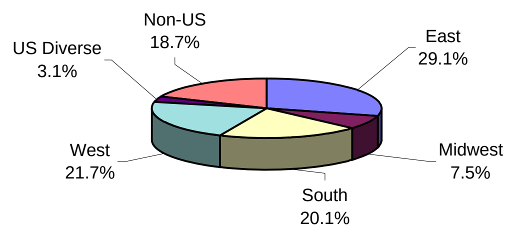
Strategy	Remaining Commitments	Net Asset Value	Total Exposure	Percentage
Core	$0	$167,401,228	$167,401,228	30.29%
Opportunistic	$129,831,019	$67,248,784	$197,079,803	35.66%
Value Added	$87,419,383	$100,774,790	$188,194,173	34.05%
Total	$217,250,402	$335,424,802	$552,675,204	100.00%

Total Portfolio Characteristics

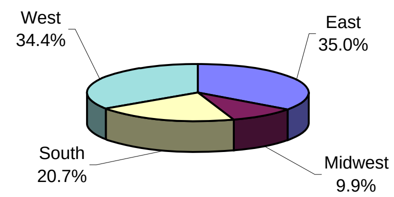
Geographic Diversification[1]

(as of September 30, 2008)

Montana Total Portfolio



NCREIF Index



Geographically, Montana's domestic investments were overweighted in the East and South regions and underweighted in the Midwest and West regions when compared to the NCREIF Property Index as of September 30, 2008.

	East	Midwest	South	West	US Diverse	Non-US	Total
Montana Total Value[2]	$212.3	$54.9	$145.7	$158.2	$22.4	$136.7	$730.2
Montana Total[1]	29.1%	7.5%	20.0%	21.7%	3.1%	18.7%	100.0%
Montana US Value[2]	$212.3	$54.9	$145.7	$158.2	$22.4	-	$593.5
Montana US Total[1]	35.8%	9.3%	24.5%	26.7%	3.8%	-	100.0%
NCREIF Value[2, 3]	$116,017	$32,664	$68,713	$114,216	-	-	$331,610
NCREIF[1]	35.0%	9.9%	20.7%	34.4%	0.0%	-	100.0%
Difference	0.8%	-0.6%	3.8%	-7.8%	3.8%		

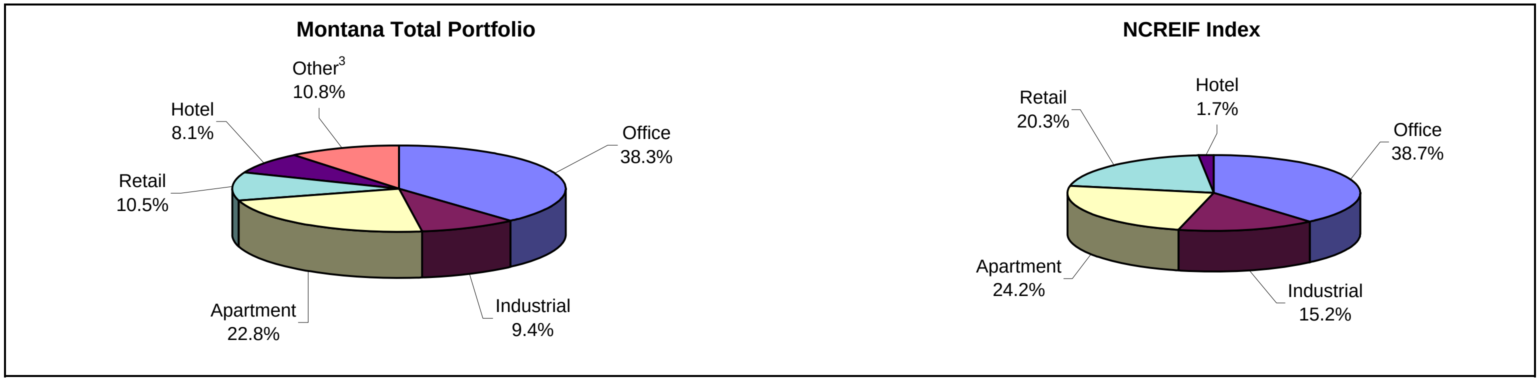
[1] *Diversification percentages are based on the Gross Market Value, which represents the MBOI share of the partnerships' interests in properties exclusive of any underlying debt used to acquire each property.*

[2] *Values shown are in Millions.*

[3] *The NCREIF gross market values represent the total gross asset values of the participating funds exclusive of any underlying debt.*

Total Portfolio Characteristics

Property Type Diversification[1]
(as of September 30, 2008)



Relative to the NCREIF Property Index, Montana's domestic investments were overweighted in the apartment and hotel sectors yet underweighted in the office, industrial, and retail sectors, as of September 30, 2008.

	Office	Industrial	Apartment	Retail	Hotel	Other[3]	Total
Montana Total Value[2]	$279.9	$69.0	$166.4	$76.6	$59.2	$79.1	$730.2
Montana Total[1]	38.3%	9.4%	22.8%	10.5%	8.1%	10.8%	100.0%
Montana US Value[2]	$211.4	$69.0	$159.5	$68.8	$44.2	$40.6	$593.5
Montana US Total	35.6%	11.6%	26.9%	11.6%	7.4%	6.8%	100.0%
NCREIF Value[2,4]	$128,288	$50,274	$80,106	$67,344	$5,598	-	$331,610
NCREIF[1]	38.7%	15.2%	24.2%	20.3%	1.7%	-	100.0%
Difference	-3.1%	-3.5%	2.7%	-8.7%	5.8%	6.8%	
Montana Non-US Value[2]	$69.3	$0.0	$7.2	$2.0	$15.2	$44.1	$137.8
Montana Non-US Total	50.3%	0.0%	5.2%	1.5%	11.0%	32.0%	100.0%

[1] *Diversification percentages are based on the Gross Market Value, which represents the MBOI share of the partnerships' interests in properties exclusive of any underlying debt used to acquire each property.*

[2] *Values shown are in Millions.*

[3] *Other consists of $57,403,777 in mixed-use assets, $13,677,110 in healthcare/senior living, and $6,372,886 in land.*

[4] *The NCREIF gross market values represent the total gross asset values of the participating funds exclusive of any underlying debt.*

Real Estate Portfolio Status Report
All Investments
(as of September 30, 2008)

	Since Inception						
	Vintage Year	Commitment	Capital Contributed	Remaining Commitment	Capital Distributed	Net Asset Value	Investment Multiple
Core		**155,000,000**	**155,000,000**	**-**	**5,469,659**	**167,401,228**	**1.11**
Clarion Lion Properties Fund	2006	45,000,000	45,000,000	-	3,064,646	49,020,908	1.15
INVESCO Core Real Estate-USA	2007	45,000,000	45,000,000	-	1,238,327	47,097,828	1.07
JP Morgan Strategic Property Fund	2007	65,000,000	65,000,000	-	1,166,685	71,282,493	1.11
Opportunistic		**224,662,100**	**91,071,285**	**129,831,019**	**8,832,600**	**67,248,784**	**0.82**
AG Realty Fund VII L.P.	2007	20,000,000	3,600,000	16,400,000	-	3,058,003	0.85
Beacon Capital Strategic Partners V	2007	25,000,000	15,000,000	10,000,000	-	11,298,194	0.75
Carlyle Europe Real Estate Partners III	2007	30,902,305	9,091,652	21,810,652	-	7,178,250	0.75
CIM Fund III, L.P.	2007	25,000,000	1,074,902	23,925,098	77,632	856,057	0.49
JER Real Estate Partners - Fund IV	2007	20,000,000	20,000,000	-	5,054,633	12,045,801	0.86
Liquid Realty IV[2]	2007	30,000,000	16,571,423	13,428,577	2,926,620	13,868,731	0.98
Macquarie Global Property Fund (Asia)	2007	30,000,000	3,794,964	26,205,036	13,198	3,013,883	0.80
MSREF VI International	2007	25,000,000	14,260,713	10,739,287	688,145	8,522,512	0.65
O'Connor North American Property Partners II	2008	15,000,000	7,677,631	7,322,369	72,371	7,407,353	0.94
Value Added		**189,200,000**	**101,780,617**	**87,419,383**	**5,775,438**	**100,774,790**	**1.04**
ABR Chesapeake Fund III	2006	20,000,000	16,000,000	4,000,000	241,917	16,512,968	1.05
AG Core Plus Realty Fund II	2007	20,000,000	5,200,000	14,800,000	508,403	4,573,472	0.98
Apollo Real Estate Finance Corp.	2007	20,000,000	6,263,000	13,737,000	305,028	6,449,455	1.08
DRA Growth & Income Fund VI	2007	35,000,000	12,969,607	22,030,393	3,649,749	10,191,368	1.04
Hudson Realty Capital Fund IV	2007	25,000,000	25,000,000	-	133,858	25,208,563	1.01
Realty Associates Fund VIII	2007	20,000,000	19,000,000	1,000,000	469,069	19,549,299	1.05
Rothschild FARS Fund V LP	2007	30,000,000	2,135,771	27,864,229	467,415	1,934,320	1.11
Strategic Partners Value Enhancement Fund	2007	19,200,000	15,212,239	3,987,761	-	16,355,345	1.08
Montana Real Estate		**$ 568,862,100**	**$ 347,851,903**	**$ 217,250,402**	**$ 20,077,697**	**$ 335,424,802**	**1.01**

1 Capital contributed does not include contributions for expenses outside of the commitment amounts.
2 Liquid Realty's net asset value was cash adjusted due to the GP not having completed their financial reporting for September 30, 2008.

12/31/2008 Private Real Estate Holdings

Fund Name	Shares	Book Value	Market Value	%
ABR CHESAPEAKE III	15,775,408	15,775,408	16,442,865	4.65%
AG REALTY FUND VII LP	4,400,000	4,400,000	3,858,004	1.09%
AG CORE PLUS REALTY FD II	7,381,597	7,381,597	7,073,474	2.00%
APOLLO REAL ESTATE FINANCE COR	6,263	6,263,000	6,449,455	1.82%
BEACON CAPITAL PARTNERS FUND V	16,562,500	16,562,500	12,860,698	3.64%
CIM FUND III	1,074,902	1,074,902	856,057	0.24%
CLARION LION PROPERTIES FUND	31,957	45,000,000	48,901,756	13.83%
DRA ADVISORS VI	10,741,356	10,741,356	10,933,368	3.09%
JP MORGAN CB	37,804	69,408,773	69,203,560	19.58%
HUDSON REALTY CAPITAL FUND IV	25,000,000	25,000,000	25,208,575	7.13%
INVESCO CORE REAL ESTATE USA	309	45,000,000	46,645,878	13.19%
MORGAN STANLEY REAL ESTATE	16,796,265	16,796,265	11,735,802	3.32%
JER REAL EST PARTNERS FUND IV	14,961,499	14,961,499	12,045,802	3.41%
LIQUID REALTY FUN IV	14,921,471	14,921,471	15,292,255	4.33%
MACQUARIE GBL PROP III ASIA	4,444,524	4,444,524	3,663,443	1.04%
OCONNOR NTH AMER PROP PTNRS II	8,245,199	8,245,199	7,974,921	2.26%
STRATEGIC PARTNERS VALUE	14,492,239	14,492,239	16,355,347	4.63%
ROTHSCHILD FIVE ARROWS REALTY	4,280,659	4,280,659	4,079,206	1.15%
TA ASSOCIATES REALTY FUND	19,000,000	19,000,000	19,549,290	5.53%
CARLYLE EUROPE R E P III L P	5,686,485	8,844,179	7,106,820	2.01%
REAL ESTATE Total	**183,840,436**	**352,593,570**	**346,236,579**	**97.94%**
SHORT TERM INVESTMENT POOL	7,290,890	7,290,890	7,290,890	2.06%
CASH EQUIVALENT Total	**7,290,890**	**7,290,890**	**7,290,890**	**2.06%**
Grand Total	**191,131,326**	**359,884,460**	**353,527,468**	**100.00%**

STATE STREET

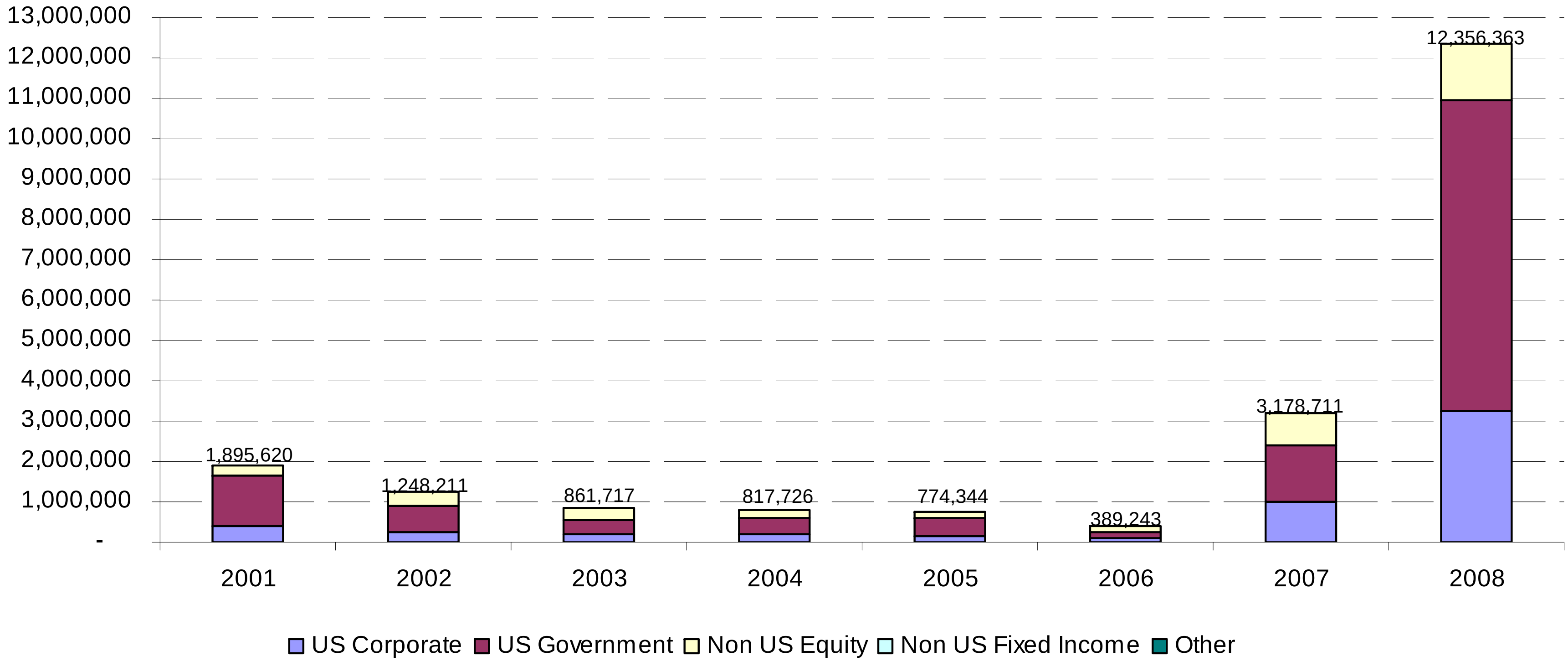
Securities Finance
Performance Summary – Earnings

Montana Board of Investments	2008	Jan - Jun 2008	Jul - Dec 2008	% Change
Average Lendables ($)	6,259,005,742	6,281,335,876	6,074,991,273	-3.29%
Average On-Loan Balance($)	2,317,221,851	2,162,869,998	2,442,866,806	12.95%
Average Utilization (%)	37.0%	34.4%	40.2%	16.78%
Earnings by Program				
US Equity & Corporate Bond ($)	3,227,377	1,438,789	1,788,588	24.31%
US Government ($)	7,710,293	2,593,848	5,116,444	97.25%
Non-US Equity ($)	1,418,693	877,057	541,637	-38.24%
Total ($)	12,356,363	4,909,694	7,446,669	51.67%
Components of Spread - QD				
Demand Spread (bps)	39	46	20	-57.25%
Reinvestment Spread (bps)	103	78	135	73.70%
Total Spread (bps)	142	123	154	25.15%
Components of Spread - SLQT				
Demand Spread (bps)	7	16	13	-19.02%
Reinvestment Spread (bps)	102	69	128	85.87%
Total Spread (bps)	109	85	141	66.28%
Return on Lendables (bps)	19.74	15.63	24.52	56.82%

STATE STREET

Securities Finance
Performance Summary

> Historical Trend of Earnings: All Assets (Calendar Year)



MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
Helena, MT 59620-0126
406-444-0001

TO: Board Members

FROM: Clifford A. Sheets, CFA; Chief Investment Officer

DATE: February 3, 2009

RE: Investment Policy Statements

There are five investment policy-related items for the Board's consideration and approval at this time. These are summarized below.

Core Internal Bond Portfolio: This investment policy statement will provide a broad strategic framework for fixed income investments within the Core Internal Bond Portfolio (CIBP). The CIBP is managed internally on behalf of the Retirement Funds Bond Pool (RFBP) which is now the name used for the overall fixed income pool which also includes any externally-managed portfolios. A copy of the new CIBP policy and a copy of the prior policy (then the RFBP which was fully managed internally) are included.

Clark Fork Site Response Action Fund: This investment policy statement was approved in December 2008. Since that time, EPA has re-reviewed and asked for minor revisions. The revisions are changes in verbiage only and do not impact the objectives of the statement. A copy of the policy marked with the revisions is included.

Clark Fork Restoration Fund: This investment policy statement is new and applies to one of the new accounts opened recently pursuant to the ARCO Settlement Consent Decree which empowers the Department of Justice to implement the restoration action on the Clark Fork River and associated riparian areas. A copy of the new policy is included.

Smelter Hill Uplands Restoration Fund: This investment policy statement is new and applies to one of the new accounts opened recently pursuant to the ARCO Settlement Consent Decree which empowers the Department of Justice to implement the restoration action of the environment, vegetation and soils on lands affected by the Anaconda smelter. A copy of the new policy is included.

Butte Area One Restoration Fund: This investment policy statement is new and applies to one of the new accounts opened recently pursuant to the ARCO Settlement Consent Decree which empowers the Department of Justice to implement projects that restore, replace or acquire the equivalent of injured natural resources or lost services in the Butte area. A copy of the new policy is included.

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: Attaining 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.

CORE INTERNAL BOND PORTFOLIO (CIBP MU40)
INVESTMENT POLICY STATEMENT

CONSTRAINTS

Credit quality: Securities must be rated investment grade, or no lower than triple-B-minus, by one nationally recognized securities rating organization at the time of purchase. Split rated securities may not exceed 3% of portfolio market value.

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

Sector: The portfolio sector exposure will be maintained within the ranges highlighted in the table below. Recent exposures by sector for the portfolio and benchmark index are shown for reference.

ASSET ALLOCATION SECTORS & RANGES
12/31/08
(At market)

Sectors	CIBP	Agg Index	**Policy Ranges**
U.S. Treasury	5.30%	25.07%	**10-35**
Government-Related	7.96	13.54	**5-25**
Total Government	13.26	38.61	**20-55**
MBS (Fixed Rate)	36.46	36.63	**20-50**
Hybrid ARMS	0.00	2.95	**0-10**
Asset-Backed Securities	0.00	0.59	**0-5**
CMBS	3.29	3.55	**0-10**
Total Structured	39.75	43.72	**20-75**
Corporate Credit	44.32	17.67	**10-35**
Cash (STIP)	2.67	0.00	**0-10**
Total	100.0%	100.0%	**100.0%**

Current portfolio exceptions to the above policy ranges will be addressed over time depending on market conditions with the objective of moving within compliance.

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.

CLARK FORK SITE RESPONSE ACTION FUND (MU3A) (FUND 08212) INVESTMENT POLICY STATEMENT

INTRODUCTION

The purpose of this investment policy statement is to outline the account objectives, permissible investments, and constraints that will guide the management of the portfolio. The policy is designed to give the investment manager flexibility to achieve in a prudent manner the investment objectives of the client, the Department of Environmental Quality (DEQ) to implement the remedial action ("the Remedy") on the Clark Fork Site in accordance with the Clark Fork Site Consent Decree and the Site Specific Memorandum of Agreement (SMOA) between the United States and the State of Montana.

BACKGROUND INFORMATION

In August 2008, a Consent Decree was entered between the State of Montana, the United States and Atlantic Richfield Company (ARCO), in order to settle certain litigation and to provide for the funding of the remedial action at the Clark Fork River (CFR) Operable Unit. The settlement involves, among other things, payment by ARCO of $83.3 million plus accrued interest from April 1, 2006. Those funds and the earnings from the investment of those funds are to be used by the State with oversight, input and approval from the United States EPA for the purpose of remediating the CFR over an estimated ten to twelve year period. Any funds left over after clean up will be transferred to the Clark Fork State Restoration Account (established under the same Consent Decree). In October of 2008 ARCO paid the entire Remedy settlement amount of $96.2 million to the State of Montana.

Major construction is projected to begin during calendar year 2009 and end during calendar year 2019. At that time, a small fund balance will be needed to fund Operations and Maintenance going forward and the remaining balance with EPA approval will be transferred to the ~~Upper~~ Clark Fork ~~River~~ State Restoration Account ~~Fund~~. The fund balance at that time is expected to be mostly Trust Funds Bond Pool (TFBP) units.

The project being financed through this fund is the remediation of environmental contamination at one operable unit of a federal Superfund site. The nature of construction/remediation work includes the potential for cost overruns and unexpected expenses. DEQ will use its best efforts to inform the Board of Investments of any expected overruns or changes in the cash draw schedule and will attempt to provide notice of such changes as much in advance as possible.

OBJECTIVES

Risk and Return:

Earnings alone will not be sufficient to fund expected expenditures nor will the principle provided by the settlement be sufficient. A combination of current income, total return, and use of principle will be necessary to fund the expected expenditures. It will require a return in excess of the assumed risk free rate to fund current projected expenditures, possible future cost over runs, and leave ~~a meaningful amount of~~ residual funds for future ~~restoration~~ expenses such as operation and maintenance. This account has an average ability to assume interest rate risk. Some risk of loss of principal must be taken to provide a return sufficient to fund objectives. A large allocation to the TFBP will be made to obtain exposure to a diversified fixed income portfolio return while reducing idiosyncratic risk. An allocation to U.S. Treasuries, U.S. Agencies and Corporate securities may be made to provide a greater certainty of cash flows from maturities. Risk tolerance will decline if long-term investments have to be liquidated earlier than estimated to meet the cash draw down schedule.

The risk and return factors along with other considerations result in the expected asset allocation shown on the following page.

CLARK FORK SITE RESPONSE ACTION FUND (MU3A) (FUND 08212)
INVESTMENT POLICY STATEMENT

ASSET ALLOCATION

FIXED INCOME	Range
U.S. Treasury Bonds	0-10%
U.S. Agency Bonds	0-10%
Corporate Bonds	0-10%
Trust Funds Bond Pool (TFBP)	50-95%
Short-term Investment Pool (STIP)	0-25%
Total Fixed Income	100.0%

OTHER CONSIDERATIONS

Liquidity Needs:
Material annual expenditures are projected in each year through 2024 in the initial cash draw down schedule provided by DEQ. The timing of expenditures within the calendar year will be somewhat uncertain, thus necessitating a significant cash balance be available to meet these needs without forcing an inordinate amount of TFBP sales in any one year. There will be significant seasonality in the pattern of expenditures. Liquidity needs will be met with a combination of cash on hand, earnings, maturities and sales of investments. The minimum Short Term Investment Pool (STIP) balance will be the expected next one year of expenditures less expected maturities of individual securities prior to any adjustment to reflect funding needs.

Maturity Horizon:
The maturity horizon of the investments utilized is designed to meet the liabilities of the client with income, maturities and a reasonable amount of sales of securities and TFBP units. The liabilities are the cash needs for remediation expenditures as provided by the DEQ at the outset of the account and as modifications are made in ensuring years. At this time expenditures are expected to occur commencing immediately and each year through 2024, with the majority occurring during years 2012 - 2019.

Investment Limits:
1. To reduce the risk of loss on individual corporate bonds, investment purchases in any one credit will be limited to 1% of the market value of the fund at the date of purchase or 2% of the lowest projected fund balance before the securities mature, which ever is lower.
2. Corporate bond sector (Industrial, Finance, and Utility) exposure shall be constrained to no more than a 4% exposure at the time of purchase, or 6% at any time over the future projected fund balance.
3. The quality rating of any corporate bond shall be in the top of the single-A rating classification or better at the time of purchase. (e.g., A1/A+ or higher), and have at least two ratings.
4. Exposure to the securities of any one U.S. Agency are limited to 5%, and in no event will an agency security be purchased if it carries a rating that is less than top-rated (AAA) at the time of purchase.

Legal Considerations:
This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims; (b) diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is solely prudent not to do so; and (c) discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

The Montana Constitution does not allow equity type investments in non-retirement funds.

CLARK FORK RESTORATION FUND (MU3H) (FUND 08221)
INVESTMENT POLICY STATEMENT

INTRODUCTION

The purpose of this investment policy statement is to outline the account objectives, permissible investments, and constraints that will guide the management of the portfolio. The policy is designed to give the investment manager flexibility to achieve in a prudent manner the investment objectives of the client, the Department of Justice (DOJ), to implement the remedial action ("the Remedy") on the Clark Fork River Restoration in accordance with the ARCO Settlement Consent Decree.

BACKGROUND INFORMATION

In August 2008, a Consent Decree was entered between the State of Montana and Atlantic Richfield Company (ARCO), in order to settle certain litigation and to provide for the funding of the restoration action at the Clark Fork River (CFR) Operable Unit. The settlement involves, among other things, payment by ARCO of $26.7 million plus accrued interest from April 1, 2006. Those funds and the earnings from the investment of those funds are to be used by the State for the purpose of restoration of the CFR over an estimated ten to twelve year period.

Major construction is projected to begin during calendar year 2009 and end during calendar year 2019.

The project being financed through this fund is the restoration of the Clark Fork River and associated riparian areas from Warm Springs Ponds to Milltown Reservoir and related projects. The nature of restoration work includes the potential for cost overruns and unexpected expenses. DOJ will use its best efforts to inform the Board of Investments of any expected overruns or changes in the cash draw schedule and will attempt to provide notice of such changes as much in advance as possible.

OBJECTIVES

Risk and Return:
Earnings alone will not be sufficient to fund expected expenditures nor will the principle provided by the settlement be sufficient. A combination of current income, total return, and use of principle will be necessary to fund the expected expenditures. It will require a return in excess of the assumed risk free rate to fund current projected expenditures, as well as possible future cost over runs. This account has an average ability to assume interest rate risk. Some risk of loss of principal must be taken to provide a return sufficient to fund objectives. An allocation to the Trust Funds Bond Pool (TFBP) will be made to obtain exposure to a diversified fixed income portfolio. An allocation to U.S. Treasuries, U.S. Agencies and Corporate securities may be made to provide a greater certainty of cash flows from maturities. Risk tolerance will decline if long-term investments have to be liquidated earlier than estimated to meet the cash draw down schedule.

There was $26.8 million in the account as of December 31, 2008, invested solely in the Short-term Investment Pool (STIP). The risk and return factors along with other considerations result in the expected asset allocation shown below.

FIXED INCOME	Range
U.S. Treasury Bonds	0-10%
U.S. Agency Bonds	0-30%
Corporate Bonds	0-10%
Trust Fund Bond Pool (TFBP)	40-80%
Short-term Investment Pool (STIP)	0-25%
Total Fixed Income	100%

CLARK FORK RESTORATION FUND (MU3H) (FUND 08221)
INVESTMENT POLICY STATEMENT

OTHER CONSIDERATIONS

Liquidity Needs:
Material annual expenditures are projected in each year through 2019 in the initial cash draw down schedule provided by DOJ. The timing of expenditures within the calendar year will be somewhat uncertain, thus necessitating a significant cash balance be available to meet these needs without forcing an inordinate amount of TFBP sales in any one year. There will be significant seasonality in the pattern of expenditures. Liquidity needs will be met with a combination of cash on hand, earnings, maturities and sales of investments. The minimum Short Term Investment Pool (STIP) balance will be the expected next one year of expenditures less expected maturities of individual securities prior to any adjustment to reflect funding needs.

Maturity Horizon:
The maturity horizon of the investments utilized is designed to meet the liabilities of the client with income, maturities and a reasonable amount of sales of securities and TFBP units. The liabilities are the cash needs for restoration expenditures as provided by the DOJ at the outset of the account and as modifications are made in ensuring years. At this time expenditures are expected to occur commencing immediately and each year through 2019, with the majority occurring during years 2012 - 2019.

Investment Limits:
1. To reduce the risk of loss on individual corporate bonds, investment purchases in any one credit will be limited to 1% of the market value of the fund at the date of purchase or 2% of the lowest projected fund balance before the securities mature, which ever is lower.
2. Corporate bond sector (Industrial, Finance, and Utility) exposure shall be constrained to no more than a 4% exposure at the time of purchase, or 6% at any time over the future projected fund balance.
3. The quality rating of any corporate bond shall be in the top of the single-A rating classification or better at the time of purchase. (e.g., A1/A+ or higher), and have at least two ratings.
4. Exposure to the securities of any one U.S. Agency are limited to 5%, and in no event will an agency security be purchased if it carries a rating that is less than top-rated (AAA) at the time of purchase.

Legal Considerations:
This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims; (b) diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is solely prudent not to do so; and (c) discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

The Montana Constitution does not allow equity type investments in non-retirement funds.

SMELTER HILL UPLANDS RESTORATION FUND (MU3I) (FUND 08222)
INVESTMENT POLICY STATEMENT

INTRODUCTION

The purpose of this investment policy statement is to outline the account objectives, permissible investments, and constraints that will guide the management of the portfolio. The policy is designed to give the investment manager flexibility to achieve in a prudent manner the investment objectives of the client, the Department of Justice (DOJ) to implement the remedial action ("the Remedy") on the Smelter Hill Uplands Restoration in accordance with the ARCO Settlement Consent Decree.

BACKGROUND INFORMATION

In August 2008, a Consent Decree was entered between the State of Montana and Atlantic Richfield Company (ARCO), in order to settle certain litigation and to provide for the funding of the restoration action at Smelter Hill Uplands (SMU). The settlement involves, among other things, payment by ARCO of $13.3 million including accrued interest from April 1, 2006. Those funds and the earnings from the investment of those funds are to be used by the State for the purpose of restoration of the SMU over an estimated seven year period.

Major construction is projected to begin during calendar year 2009 and end during calendar year 2015.

The project being financed through this fund is for the restoration of the environment, vegetation and soils on lands affected by the Anaconda smelter. The nature of restoration work includes the potential for cost overruns and unexpected expenses. DOJ will use its best efforts to inform the Board of Investments of any expected overruns or changes in the cash draw schedule and will attempt to provide notice of such changes as much in advance as possible.

OBJECTIVES

<u>Risk and Return:</u>
Earnings alone will not be sufficient to fund expected expenditures nor will the principle provided by the settlement be sufficient. A combination of current income, total return, and use of principle will be necessary to fund the expected expenditures. It will require a return in excess of the assumed risk free rate to fund current projected expenditures, as well as possible future cost over runs. This account has an average ability to assume interest rate risk. Some risk of loss of principal must be taken to provide a return sufficient to fund objectives. An allocation to the Trust Funds Bond Pool (TFBP) will be made to obtain exposure to a diversified fixed income portfolio. An allocation to U.S. Treasuries, U.S. Agencies and Corporate securities may be made to provide a greater certainty of cash flows from maturities. Risk tolerance will decline if long-term investments have to be liquidated earlier than estimated to meet the cash draw down schedule.

There was $13.3 million in the account as of December 31, 2008, invested solely in the Short-term Investment Pool (STIP).The risk and return factors along with other considerations result in the expected asset allocation shown below.

ASSET ALLOCATION

FIXED INCOME	**Range**
U.S. Treasury Bonds	0-20%
U.S. Agency Bonds	0-80%
Corporate Bonds	0-20%
Trust Fund Bond Pool (TFBP)	10-30%
Short-term Investment Pool (STIP)	0-40%
Total Fixed Income	100%

SMELTER HILL UPLANDS RESTORATION FUND (MU3I) (FUND 08222) INVESTMENT POLICY STATEMENT

OTHER CONSIDERATIONS

Liquidity Needs:
Material annual expenditures are projected in each year through 2019 in the initial cash draw down schedule provided by DOJ. The timing of expenditures within the calendar year will be somewhat uncertain, thus necessitating a significant cash balance be available to meet these needs without forcing an inordinate amount of TFBP sales in any one year. There will be significant seasonality in the pattern of expenditures. Liquidity needs will be met with a combination of cash on hand, earnings, maturities and sales of investments. The minimum Short Term Investment Pool (STIP) balance will be the expected next one year of expenditures less expected maturities of individual securities prior to any adjustment to reflect funding needs.

Maturity Horizon:
The maturity horizon of the investments utilized is designed to meet the liabilities of the client with income, maturities and a reasonable amount of sales of securities and TFBP units. The liabilities are the cash needs for restoration expenditures as provided by the DOJ at the outset of the account and as modifications are made in ensuring years. At this time expenditures are expected to occur commencing immediately and each year through 2015, with the majority occurring during years 2010 - 2013.

Investment Limits:
1. To reduce the risk of loss on individual corporate bonds, investment purchases in any one credit will be limited to 1% of the market value of the fund at the date of purchase or 2% of the lowest projected fund balance before the securities mature, which ever is lower.
2. Corporate bond sector (Industrial, Finance, and Utility) exposure shall be constrained to no more than a 4% exposure at the time of purchase, or 6% at any time over the future projected fund balance.
3. The quality rating of any corporate bond shall be in the top of the single-A rating classification or better at the time of purchase. (e.g., A1/A+ or higher), and have at least two ratings.
4. Exposure to the securities of any one U.S. Agency are limited to 5%, and in no event will an agency security be purchased if it carries a rating that is less than top-rated (AAA) at the time of purchase.

Legal Considerations:
This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims; (b) diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is solely prudent not to do so; and (c) discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

The Montana Constitution does not allow equity type investments in non-retirement funds.

BUTTE AREA ONE RESTORATION FUND (MU3F) (FUND 08219) INVESTMENT POLICY STATEMENT

INTRODUCTION

The purpose of this investment policy statement is to outline the account objectives, permissible investments, and constraints that will guide the management of the portfolio. The policy is designed to give the investment manager flexibility to achieve in a prudent manner the investment objectives of the client, the Department of Justice (DOJ) to implement the remedial action ("the Remedy") on the Butte Area One Restoration in accordance with the ARCO Settlement Consent Decree.

BACKGROUND INFORMATION

In August 2008, a Consent Decree was entered between the State of Montana and Atlantic Richfield Company (ARCO), in order to settle certain litigation and to provide for the funding of the restoration action at Butte Area One (BAO). The settlement involves, among other things, payment by ARCO of $28.0 million including accrued interest from April 1, 2006. Those funds and the earnings from the investment of those funds are to be used by the State for the purpose of restoration of the BAO over an estimated seven year period.

Major construction is projected to begin during calendar year 2009 and end during calendar year 2018.

The project being financed through this fund is for projects that restore, replace or acquire the equivalent of injured natural resources or lost services. The nature of restoration work includes the potential for cost overruns and unexpected expenses. DOJ will use its best efforts to inform the Board of Investments of any expected overruns or changes in the cash draw schedule and will attempt to provide notice of such changes as much in advance as possible.

OBJECTIVES

Risk and Return:
Earnings alone will not be sufficient to fund expected expenditures nor will the principle provided by the settlement be sufficient. A combination of current income, total return, and use of principle will be necessary to fund the expected expenditures. It will require a return in excess of the assumed risk free rate to fund current projected expenditures, as well as possible future cost over runs. This account has an average ability to assume interest rate risk. Some risk of loss of principal must be taken to provide a return sufficient to fund objectives. An allocation to the Trust Funds Bond Pool (TFBP) will be made to obtain exposure to a diversified fixed income portfolio. An allocation to U.S. Treasuries, U.S. Agencies and Corporate securities may be made to provide a greater certainty of cash flows from maturities. Risk tolerance will decline if long-term investments have to be liquidated earlier than estimated to meet the cash draw down schedule.

There was $28.1 million in the account as of December 31, 2008, invested solely in the Short-term Investment Pool (STIP).The risk and return factors along with other considerations result in the expected asset allocation shown below.

ASSET ALLOCATION

FIXED INCOME	Range
U.S. Treasury Bonds	0-10%
U.S. Agency Bonds	0-50%
Corporate Bonds	0-10%
Trust Fund Bond Pool (TFBP)	30-70%
Short-term Investment Pool (STIP)	0-20%
Total Fixed Income	100%

BUTTE AREA ONE RESTORATION FUND (MU3F) (FUND 08219)
INVESTMENT POLICY STATEMENT

OTHER CONSIDERATIONS

Liquidity Needs:
Material annual expenditures are projected in each year through 2018 in the initial cash draw down schedule provided by DOJ. The timing of expenditures within the calendar year will be somewhat uncertain, thus necessitating a significant cash balance be available to meet these needs without forcing an inordinate amount of TFBP sales in any one year. There will be significant seasonality in the pattern of expenditures. Liquidity needs will be met with a combination of cash on hand, earnings, maturities and sales of investments. The minimum Short Term Investment Pool (STIP) balance will be the expected next one year of expenditures less expected maturities of individual securities prior to any adjustment to reflect funding needs.

Maturity Horizon:
The maturity horizon of the investments utilized is designed to meet the liabilities of the client with income, maturities and a reasonable amount of sales of securities and TFBP units. The liabilities are the cash needs for restoration expenditures as provided by the DOJ at the outset of the account and as modifications are made in ensuring years. At this time expenditures are expected to occur commencing immediately and each year through 2015, with the majority occurring during years 2010 - 2018.

Investment Limits:
1. To reduce the risk of loss on individual corporate bonds, investment purchases in any one credit will be limited to 1% of the market value of the fund at the date of purchase or 2% of the lowest projected fund balance before the securities mature, which ever is lower.
2. Corporate bond sector (Industrial, Finance, and Utility) exposure shall be constrained to no more than a 4% exposure at the time of purchase, or 6% at any time over the future projected fund balance.
3. The quality rating of any corporate bond shall be in the top of the single-A rating classification or better at the time of purchase. (e.g., A1/A+ or higher), and have at least two ratings.
4. Exposure to the securities of any one U.S. Agency are limited to 5%, and in no event will an agency security be purchased if it carries a rating that is less than top-rated (AAA) at the time of purchase.

Legal Considerations:
This fund is governed by state regulations, specifically, the "prudent expert principle" which requires the Board of Investments to: (a) discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims; (b) diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is solely prudent not to do so; and (c) discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

The Montana Constitution does not allow equity type investments in non-retirement funds.

Bond Program

INTERCAP Loan Program

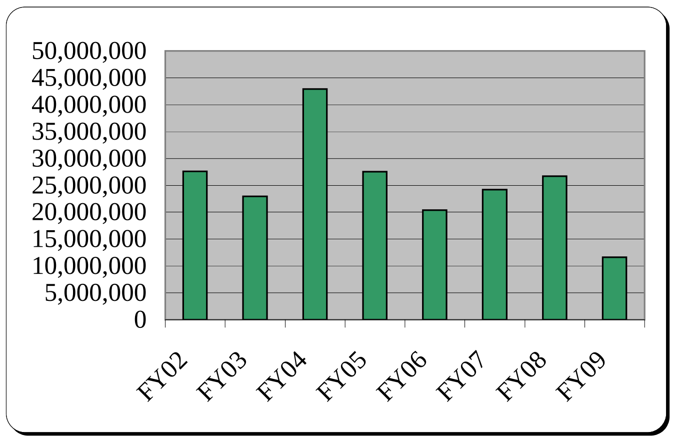
Activity Summary

As of December 31, 2008

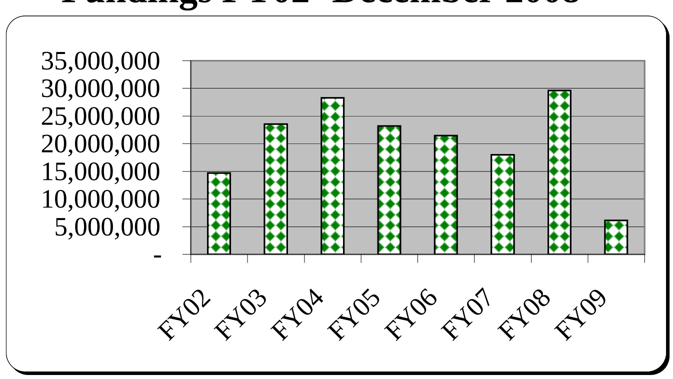
Since Inception 1987 - December 2008

Total Bonds Issued	**124,000,000**
Total Loan Commitments	**312,232,747**
Total Loans Funded	**287,088,586**
Total Bonds Outstanding	**98,045,000**
Total Loans Outstanding	**77,632,655**
Loan Commitments Pending	**25,144,161**

Commitments FY02-December 2008



Fundings FY02- December 2008



FY2009 To Date

Month	Commitments	Fundings
July-08	$ 247,991	$ 1,066,447
August	1,372,958	662,931
September	6,078,958	959,160
October	151,270	952,115
November	3,111,364	2,492,190
December	650,000	8,000
January		
February		
March		
April		
May		
June-09		
To Date	$ 11,612,541	$ 6,140,842

Note: Commitments include withdrawn and expired loans.

Variable Loan Rate History February 16, 2001 - February 15, 2009

February 16, 2001 - February 15, 2002	**4.75%**	February 16, 2005 - February 15, 2006	**3.80%**
February 16, 2002 - February 15, 2003	**3.15%**	February 16, 2006 - February 15, 2007	**4.75%**
February 16, 2003 - February 15, 2004	**2.85%**	February 16, 2007 - February 15, 2008	**4.85%**
February 16, 2004 - February 15, 2005	**2.70%**	February 16, 2008 - February 15, 2009	**4.25%**

L:\INTERCAP\BOARD\ACTIVITY SUMMARY1.xls

MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
(406) 444-0001

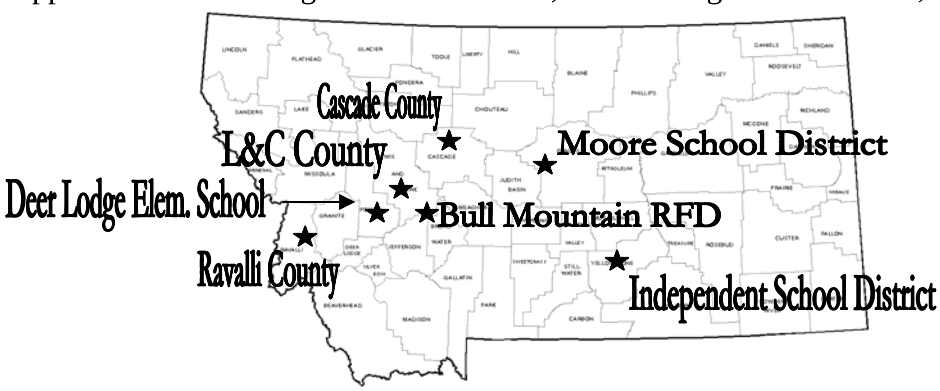
To: Members of the Board

From: Louise Welsh, Bond Program Officer

Date: February 2, 2009

Subject: INTERCAP Staff Approved Loans Committed

Staff approved the following loans – October 1, 2008 through December 31, 2008.



Borrower:	Cascade County
Purpose:	Bob Marshall Place Rural Improvement District (RID) road improvements
Staff Approval Date	October 2, 2008
Board Loan Amount:	$101,270
Term:	15 years

Borrower:	Bull Mountain Rural Fire District (Boulder)
Purpose:	Construct fire truck garage
Staff Approval Date	October 20, 2008
Board Loan Amount:	$50,000
Term:	10 years

Borrower:	Cascade County
Purpose:	Complete the Public Works Facility and remodel the County's downtown campus
Staff Approval Date	October 28, 2008
Board Loan Amount:	$1,250,000
Term:	10 years

Borrower:	Cascade County
Purpose:	Purchase motor graders and a loader
Staff Approval Date	October 28, 2008
Board Loan Amount:	$750,000
Term:	7 years

Borrower:	Moore Elementary School District
Purpose:	Repair/replace roof and related site improvements
Staff Approval Date	October 29, 2008
Board Loan Amount:	$90,000
Term:	10 years

Borrower:	Moore High School District
Purpose:	Repair/replace roof and related site improvements
Staff Approval Date	October 29, 2008
Board Loan Amount:	$90,000
Term:	10 years

Borrower:	Ravalli County
Purpose:	Roofing courthouse and related improvements
Staff Approval Date	November 3, 2008
Board Loan Amount:	$196,364
Term:	10 years

Borrower:	Independent School District (Billings)
Purpose:	Interim loan to purchase land in anticipation of issuing $3.5 million general obligation (GO) bond.
Staff Approval Date	November 14, 2008
Board Loan Amount:	$350,000
Term:	1 year

Borrower:	Deer Lodge Elementary School
Purpose:	Wood-fired heating plant and distribution lines
Staff Approval Date	November 17, 2008
Board Loan Amount:	$335,000
Term:	10 years

Borrower:	Lewis and Clark County
Purpose:	Purchase a scraper for the County Landfill
Staff Approval Date	December 17, 2008
Board Loan Amount:	$649,900
Term:	15 years

MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
(406) 444-0001

To: Members of the Board

From: Louise Welsh, Bond Program Officer

Date: February 2, 2009

Subject: INTERCAP Loan Requests

COOKE CITY PARK COUNTY WATER DISTRICT (LIVINGSTON)

The District requests an interim loan in the amount of $1,550,000 in anticipation of Rural Development (RD) long term financing for costs associated with constructing a water transmission main. The loan term will be for one (1) year in the form of a bond anticipation note (BAN). Standard BAN conditions will apply. The total project cost is $3,710,000; funding sources outlined below.

Treasure State Endowment Program (TSEP) Grant		$ 500,000
Congressional Appropriation (pending)		250,000
Cooke City Park Co. Water District		10,000
Department of Natural Resources and Conservation (DNRC) Grant		100,000
Rural Development (RD) Loan		1,550,000
INTERCAP Interim loan	**1,550,000**	
Rural Development (RD) Grant		1,300,000
Total		$ 3,710,000

Authorization: 7-7-109 (2)(a) Montana Code Annotated (MCA) When… the political subdivision has applied for and received a commitment for a grant or loan of state or federal funds, its governing body may by resolution issue and sell, in anticipation of the receipt of the grant, loan, or bonds in an amount not exceeding the total amount of bonds authorized or the total amount of the loan or grant that is committed, notes maturing within not more than (3) three years from the date on which the notes are issued.

DEPARTMENT OF RESOURCES AND CONSERVATION (DNRC)

The DNRC is requesting to borrow $5,500,000 to finance two (2) separate loans over a three (3) year period. Below is the detail on each loan and supporting information for your consideration.

Loan #1 – Drinking Water State Revolving Fund

The DNRC requests a $3,500,000 loan in anticipation of borrower repayment revenue from its Drinking Water State Revolving Fund (DWSRF) Loan Program (see box). The loan will be in the form of a revenue anticipation note (RAN) for up to a three (3) year period; or such earlier date if sufficient DWSRF repayments are received sooner.

> The DWSRF provides low interest rate loans to finance the entire cost of qualified community water system projects by combining a U.S. Environmental Protection Agency (EPA) capitalization grant with the required state match.

Authorization:

- ☑ The DWSRF was established pursuant to Title XIV of the Safe Drinking Water Act. This federal act established the DWSRF program for states to make loans to community water systems.
- ☑ The 2005 Legislature authorized the DNRC to issue revenue anticipation notes for this purpose by means of House Bill 142 (HB142). Primary statutes affected are as follows:
  - 17-5-805 Montana Code Annotated (MCA) (1) it may…, issue in the name of the state temporary notes in anticipation of:… (c) other money to be received as revenue for the specified program. (2) The notes must be designated… "revenue anticipation notes"… (3) Bond, grant, or revenue anticipation notes maturing not more than three (3) years after the date of issue may be issued from time to time as the proceeds are needed.
  - 75-6-227 MCA The legislature….authorizes the creation of state debt in an amount not to exceed $30 million….from time to time for the purpose of:…(2) funding portions of loans on an interim basis pending receipt of: …(b) other revenue for the program. [Staff Note: DNRC has $19,740,000 available debt authority]

Repayment:

The DNRC funds each DWSRF loan using 80% EPA capitalization grant and 20% state match. Prior to January 2008, the DNRC used INTERCAP to issue bond anticipation notes (BAN) to fund these loans in the interim of issuing general obligation bonds for the match requirement.

- January 2008, the DNRC was able to payoff its Drinking Water INTERCAP 2007C BAN issued August 2007 with recycled funds from existing DWSRF loan repayments instead of needing to issue general obligation bonds.
- January 2008, staff approved a $1,000,000 RAN for the DNRC's DWSRF program. Though approved for a two (2) year term, the DNRC paid the loan off in advance January 2009.

Evidence herein shows the program is financially strong enough to continue in this manner. As in 2008, the DNRC will again pledge the principal repayment revenue from DWSRF loans that arrive semi-annually each January 1 and July 1 to repay the RAN. To date, all DWSRF loans are current.

Repayment on a typical RAN is total principal and interest due at maturity. If the DNRC draws down the full $3,500,000, the proposed three (3) year RAN will have approximately $3,854,679 due in 2012. The following chart lays out the fiscal year actual and projected repayments vs. bond debt service due for the program. One may note that an increase in loan volume boosts expected repayments after 2009. The excess funds shown below are available for new debt service and to pay down Notes or Bonds that are callable. The chart shows at least $4,684,348 total excess available by 2012. As a result, the RAN should payoff in advance.

Ending June 30:	DWSRF Repayments	Debt Service	Excess
2007 actual	$1,444,549	$1,169,215	$ 275,334
2008 actual	$1,704,799	$1,203,665	$ 501,134
2009 actual	$1,892,011	$1,206,117	$ 685,894
2010 expected	$2,354,600	$1,202,096	**$1,152,504**
2011 expected	$2,824,800	$1,196,461	**$1,628,339**
2012 expected	$3,107,280	$1,203,774	**$1,903,506**

The DNRC must deposit all proceeds from the EPA Capitalization Grant, corresponding state matching funds, and *loan principal and interest repayments* into the Revolving Fund under Title XIV of the Safe Drinking Water Act. The following financial report reflects the DWSRF Revolving Fund activity over the last two fiscal years.

Financial Report:

	DWSRF Revolving Fund	
	FY07	FY08
Beginning Fund Balance	$ 74,450,799	$ 83,715,916
Revenues	10,648,826	13,182,608
Expenditures	1,383,709	1,629,971
Ending Fund Balance	$ 83,715,916	$ 95,268,553
Net Change in Fund Balance	$ 9,265,117	$ 11,552,637
Fund Balance Cash	$ 3,314,928	$ 5,519,953
Fund Balance *Unreserved*	$ 4,465,525	$ 4,503,427

- FY07 revenue includes a $9,625,203 Federal Capitalization Grant. The DWSRF program is capitalized by grants from the Environmental Protection Agency (EPA) and 20% state matching funds.

- FY08 revenue includes a $7,888,901 Federal Capitalization Grant

Loan #2 – Water Pollution Control State Revolving Fund

The DNRC requests a $2,000,000 loan in anticipation of borrower repayment revenue from its Water Pollution Control State Revolving Fund (WPCSRF) Loan Program (see box). The loan will be in the form of a revenue anticipation note (RAN) for up to a three (3) year period; or such earlier date if sufficient WPCSRF repayments are received sooner.

> The WPCSRF provides low interest rate loans to finance the entire cost of qualified community water pollution control system projects by combining a U.S. Environmental Protection Agency (EPA) capitalization grant with the required state match.

Authorization:

- ☑ The WPCSRF was established pursuant to Title VI of the Federal Water Quality Act of 1987. The WPCSRF program replaced the construction grants program. Instead of making grants to partially fund wastewater projects the WPCSRF provides low interest loans to finance the entire cost.

- ☑ The 2005 Legislature authorized the DNRC to issue revenue anticipation notes for this purpose by means of House Bill 142 (HB142). Primary statutes affected are as follows:

  - 17-5-805 Montana Code Annotated (MCA) (1) it may…, issue in the name of the state temporary notes in anticipation of:… (c) other money to be received as revenue for the specified program. (2) The notes must be designated… "revenue anticipation notes"… (3) Bond, grant, or revenue anticipation notes maturing not more than three (3) years after the date of issue may be issued from time to time as the proceeds are needed.

  - 75-5-1122 MCA The legislature….authorizes the creation of state debt in an amount not to exceed $40 million….from time to time for the purpose of:…(2) funding portions of loans on an interim basis pending receipt of: …(b) other revenue for the program. [Staff Note: DNRC has $31,160,000 available debt authority]

Repayment:

The DNRC funds each WPCSRF loan using 83.33% EPA capitalization grant and 16.67% state match. Prior to January 2008, the DNRC used INTERCAP to issue bond anticipation notes (BAN) to fund these loans in the interim of issuing general obligation bonds for the match requirement.

- January 2008, the DNRC was able to payoff its Water Pollution Control INTERCAP 2007B BAN issued August 2007 with recycled funds from existing DWSRF loan repayments instead of needing to issue general obligation bonds.

- January 2008, staff approved a $700,000 RAN for the DNRC's WPCSRF program. Though approved for a two (2) year term, the DNRC paid the loan off in advance January 2009.

Evidence herein shows the program is financially strong enough to continue in this manner. As in 2008, the DNRC will again pledge the principal repayment revenue from WPCSRF loans that arrive semi-annually each January 1 and July 1 to repay the proposed RAN. To date, all WPCSRF loans are current.

Repayment on a typical RAN is total principal and interest due at maturity. If the DNRC draws down the full $2,000,000, the proposed three (3) year RAN will have approximately $2,202,673 due in 2012. The following chart lays out the fiscal year actual and projected repayments vs. bond debt service due for the program. One may note that an increase in loan volume boosts the expected repayments after 2009. The excess funds shown below are available for new debt service and to pay down Notes or Bonds that are callable. The chart shows at least $7,299,319 total excess available. As a result, the RAN should payoff in advance.

Ending June 30:	**WPCSRF Repayments**	**Debt Service**	**Excess***
2007 actual	$2,987,155	$1,556,496	$1,430,659
2008 actual	$2,997,944	$1,346,285	$1,651,659
2009 actual	$3,154,547	$1,308,909	$1,845,638
2010 expected	**$3,410,000**	**$1,255,689**	**$2,154,311**
2011 expected	**$3,751,000**	**$1,256,433**	**$2,494,567**
2012 expected	**$3,900,000**	**$1,249,559**	**$2,650,441**

The DNRC must deposit all proceeds from the EPA Capitalization Grant, corresponding state matching funds, and *loan principal and interest repayments* into the Revolving Fund under Title VI of the Federal Water Quality Act. The following financial report reflects the WPCSRF Revolving Fund activity over the last two fiscal years.

Financial Report:

	WPCSRF Revolving Fund	
	FY07	FY08
Beginning Fund Balance	$148,294,500	$153,630,733
Revenues	6,114,388	11,758,453
Expenditures	778,155	2,672,218
Ending Fund Balance	$153,630,733	$162,716,968
Net Change in Fund Balance	$ 5,336,233	$ 9,086,235
Fund Balance Cash	$ 15,336,570	$ 18,380,030
Fund Balance *Unreserved*	$ 15,935,288	$ 18,205,004

- FY07 revenue includes a $3,865,414 Federal Capitalization Grant. The WPCSRF program is capitalized by grants from the Environmental Protection Agency (EPA) and 16.67% state matching funds.

- FY08 revenue includes a $4,714,484 Federal Capitalization Grant

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INTERCAP Debt

Since 1996, the DNRC has obtained over $10.6 million INTERCAP interim financing over the course of time. All of the DNRC's INTERCAP loans are current with zero defaults. To date, the DNRC has no outstanding INTERCAP Debt.

Recommendation

It is our recommendation that the Board authorize staff to proceed with processing and closing the above loans using the Board's standard Bond Program Office funding procedures.

MEMORANDUM

Montana Board of Investments
Department of Commerce
2401 Colonial Drive, 3rd Floor
Helena, MT 59601
(406) 444-0001

To: Members of the Board

From: Geri Burton, Deputy Director

Date: February 11, 2009

Subject: Qualified Zone Academy Bonds
Lewistown Elementary School District #1 – Resolution No. 222

Qualified Zone Academy Bond Program Background

Congress authorized Qualified Zone Academy Bonds (QZABs) in 1997 to promote initiatives between public schools and the private sector. QZABs enable qualified school districts to finance eligible projects at little or no interest cost. QZABs provide a different form of subsidy from traditional tax-exempt bonds. Interest on QZABs is paid by the federal government in the form of tax credits to the purchasers of QZABs. The amount of the annual tax credit a purchaser receives is based on the QZAB rate set by the U.S. Treasury Department on the day a "binding, written contract" (the "Purchase Agreement") is executed for the sale of the tax credit bonds. QZABs must be issued by a state or local government and may be purchased by banks, insurance companies, and corporations actively engaged in the business of lending money. At its June 2000 meeting, the Board authorized the creation of the Qualified Zone Academy Bond Program (QZAB Program). The QZAB Program is administered under the Municipal Finance Consolidation Act. Since the Program's inception, the Board has issued seven QZABs totaling $8,018,500.

There is a national QZAB bond limitation for each calendar year. The annual bond limitation was $400,000,000 for calendar years 1998 through 2007. The bond limitation is allocated among the states on the basis of populations of individuals below the poverty line. Unused allocations can be carried forward for two years. The Montana Office of Public Instruction (OPI) must authorize a school district's request for a QZAB allocation. Montana's allocation was $1,314,000 for both calendar years 2006 and 2007. Allocations for calendar years 2008 and 2009 will be determined by the American Recovery and Reinvestment Tax Act of 2009 (the stimulus package).

Lewistown School District #1

On July 22, 2008, the District voters authorized the issuance and sale of $2,087,250 general obligation bonds. The District has requested the Board purchase the general obligation bonds by issuing a QZAB in the same amount. The proceeds of the District bonds would be used to finance the following: replace the roof on the junior high school, renovate and upgrade all or a portion of the heating, ventilation and air conditioning systems at Garfield School, Highland Park School and Lewis & Clark School.

The District requested OPI authorization of $2,087,250 of QZAB allocation. The State's entire QZAB allocation has been committed/used; therefore, OPI was able to authorize only $1,314,000 of the $2,087,250. The remaining $773,250 allocation will be approved by OPI once the federal government authorizes the 2008 and 2009 national QZAB allocation.

Resolution No. 222

The District would like to be in a position to enter into the Purchase Agreement with the Board and the purchaser of the QZAB to facilitate the issuance of the District's bonds and the QZAB in an amount up to $2,087,250.

The process to issue the QZAB for the District is being done in two steps. This is different from staff's standard QZAB process. Normally, staff does not bring a resolution to the Board until the entire allocation has been authorized by OPI.

Step One - The financial advisor, McLiney & Company, has informed staff there are two purchasers that would like to purchase the QZAB. As stated above, the tax credit rate is determined on the day the Purchase Agreement is signed by all parties. Since entering into the Purchase Agreement is time sensitive, staff is requesting the Board approve Resolution No. 222, allowing staff the flexibility to enter into the Purchase Agreement prior to the Board's next scheduled meeting in May should it be determined market conditions are favorable to do so.

The resolution states that entering into the Purchase Agreement will not occur until all conditions set forth in Section 1.5 of the resolution are satisfied. One of those conditions, Section 1.5(i), reflects that the District has received QZAB allocations equal to the amount reflected in the Purchase Agreement; thus staff would not enter into the Purchase Agreement for the entire amount requested, $2,087,250, until authorization for the additional $773,250 has been obtained from OPI.

If the 2008 and 2009 national QZAB allocation is not authorized by federal legislation, staff could proceed with entering into the Purchase Agreement in an amount up to $1,314,000; the amount that is currently authorized for the District.

Step Two – A final resolution that will authorize the issuance and sale of the QZABs as well as authorize the remaining bond documents will be submitted to the Board at a later date.

Recommendation

In an effort to accommodate the District in obtaining financing for their proposed project, staff recommends moving forward in the process by authorizing Resolution No. 222, which would allow staff to enter into the Purchase Agreement once all conditions stated in the Resolution are satisfied.

Issuance of the proposed QZAB is subject to the Board's adoption of a final resolution that will authorize the issuance and sale, fix the terms and conditions and authorize the various documents of the QZAB.

CERTIFICATE AS TO RESOLUTION

I, the undersigned, being the duly qualified and acting Executive Director of the Board of Investments of the State of Montana (the "Board"), hereby certify that the attached resolution is a true copy of Resolution No. 222, entitled: "RESOLUTION RELATING TO AUTHORIZING THE EXECUTION AND DELIVERY OF AN AGREEMENT FOR THE PURCHASE AND SALE OF UP TO $2,087,250 MUNICIPAL FINANCE CONSOLIDATION ACT BONDS, SERIES 2009 (LEWISTOWN ELEMENTARY SCHOOL QUALIFIED ZONE ACADEMY PROGRAM), SO LONG AS CERTAIN CONDITIONS ARE SATISFIED" (the "Resolution"), on file in the original records of the Board in my legal custody; that the Resolution was duly adopted by the Board at a meeting on February 11, 2009, and that the meeting was duly held by the Board and was attended throughout by a quorum, pursuant to call and notice of such meeting given as required by law; and that the Resolution has not as of the date hereof been amended or repealed.

WITNESS my hand officially as such recording officer this ____ day of February, 2009.

____
Carroll V. South
Executive Director

RESOLUTION NO. 222

RESOLUTION RELATING TO AUTHORIZING THE EXECUTION AND DELIVERY OF AN AGREEMENT FOR THE PURCHASE AND SALE OF UP TO $2,087,250 MUNICIPAL FINANCE CONSOLIDATION ACT BONDS, SERIES 2009 (LEWISTOWN ELEMENTARY SCHOOL QUALIFIED ZONE ACADEMY PROGRAM), SO LONG AS CERTAIN CONDITIONS ARE SATISFIED

BE IT RESOLVED by the Board of Investments of the State of Montana (the "Board"), as follows:

Section 1. Recitals, Authorization of Purchase Agreement; Conditions Precedent.

1.1. The District; District Bonds and the BOI Bonds. School District No. 1 (Lewistown), Fergus County, Montana (the "District"), has requested that the Board issue its revenue bonds under the Municipal Finance Consolidation Act of 1983, Montana Code Annotated, Title 17, Chapter 5, Part 16, as amended (the "Act"), in the aggregate principal amount of up to $2,087,250 (the "BOI Bonds"), and use the proceeds thereof to purchase General Obligation School Building Bonds, Series 2009, in the aggregate principal amount of up to $2,087,250 (the "District Bonds") to be issued by the District. The proceeds of the District Bonds (and of the BOI Bonds) are to be used by the District for the purpose of paying the costs of improving the facilities of the District by replacing the roof on the junior high school; renovating and upgrading all or a portion of the heating, ventilation, and air conditioning systems at Garfield School, Highland Park School and Lewis & Clark School; related improvements; and paying all or a portion of the costs associated with the sale and issuance of the bonds (collectively, the "Project"). Costs of the Project in excess of the amounts available from the proceeds of the District Bonds (and the BOI Bonds) will be paid from amounts on hand or available to the District.

The BOI Bonds will not be secured by the Municipal Finance Consolidation Act Reserve Fund created in Section 17-5-1630 of the Act or by any funds or assets of the Board other than its interest in the District Bonds and the payments to be made by the District thereunder and investment income thereon, if any.

1.2. Qualified Zone Academy Bonds. The BOI Bonds are intended to be issued as "qualified zone academy bonds" within the meaning of the applicable provisions of the Internal Revenue Code of 1986, as amended (the "Code"), and the issuance of the BOI Bonds by the Board will enhance the marketability of such obligations.

1.3. Accommodation to District. The District has received qualified zone academy bond limitation in the amount of $1,314,000, and has been assured that it will be granted an additional $773,250 in qualified academy bond limitation from the 2008 federal allocation that is appropriated to the State of Montana, for a total of $2,087,250. The District cannot ascertain when the 2008 qualified zone academy bond limitation will be available to it. The District desires to be in a position to enter into a binding, written contract with the Board and the purchaser of the BOI Bonds to facilitate the issuance of the District Bonds and BOI Bonds. Under Section 54A(b)(3) of the Code, the credit rate of the BOI Bonds is determined as of the first date on which there is a binding, written contract for the sale or exchange of the tax credit bonds. Subject to satisfaction of the conditions set forth in Section 1.5, the Board is willing to accommodate the District's desire to be in a position to enter into a binding, written contract regarding the sale of the BOI Bonds in a timely manner.

1.4. Purchase Agreement. The sale of the BOI Bonds is being facilitated by McLiney & Company, in the capacity of financial advisor to the District and the Board (the "Financial Advisor"). The BOI Bonds may be sold at a private sale, as provided by Section 17-5-1606(5)(b) of the Act. First Bank of Montana, of Lewistown, Montana (the "Bank"), has indicated a desire to purchase the BOI Bonds. The purchase and sale of the BOI Bonds and of the District Bonds shall be on the terms and conditions to be set forth in an agreement between the District, the Board, and the Bank or another suitable financial institution or purchaser of the BOI Bonds (the "Purchaser"), a form of which will be prepared to memorialize the terms and conditions of the purchase and sale, but only upon satisfaction of the conditions described in Section 1.5 (the "Purchase Agreement"). The Purchase Agreement is intended to constitute the "binding, written contract" for the sale of the bonds referenced in Section 1.3 above. The Chair, Executive Director, Deputy Director, and Vice-Chair of the Board (collectively, the "Authorized Officers"), or any one or more of such officers, are hereby authorized to approve the form and terms of, and execute and deliver, the Purchase Agreement following satisfaction of the conditions in Section 1.5.

1.5. Conditions Precedent to Purchase Agreement. The Authorized Officers shall not proceed with execution and delivery of the Purchase Agreement until they have determined to their satisfaction that:

(a) the terms and conditions of the purchase and sale of the BOI Bonds and District Bonds are known in sufficient detail and the structure of the transaction, including details regarding the maturity schedules of the District Bonds and BOI Bonds and the sinking fund securing the repayment of the BOI Bonds and investment of amounts therein, are agreed upon and are in accord with applicable laws, rules, and regulations.

(b) The school facilities in the District at which the Project will be undertaken (collectively, the "Facilities") constitute a qualified zone academy within the meaning of the applicable provisions of the Code.

(c) The program for students at the Facilities, including the comprehensive education plan that has been or will be approved by the Board of Trustees of the District, has been designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates and better prepare students for the rigors of college and the increasingly complex workforce, and students in the Facilities will be subject to the same academic standards and assessments as other students educated by the District.

(d) The District reasonably expects, as of the date of issuance of the BOI Bonds and for the one-year period from and after such date, that at least 35 percent of the students attending the Facilities will be eligible for free or reduced-cost lunches established under the National School Lunch Act.

(e) The District reasonably expects that it will spend 100 percent or more of the available project proceeds on the costs of the Project within the 3-year expenditure period and that a binding commitment to spend at least 10 percent of such available project proceeds has been incurred or will be incurred by the District by no later than the end of the 6-month period beginning on the date of delivery of the BOI Bonds.

(f) The term of the BOI Bonds will not exceed the maximum term permitted for qualified zone academy bonds.

(g) Not less than 100 percent (100%) of the available project proceeds will be used for a qualified purpose with respect to the Facilities within the meaning of Section 54E(d)(3) of the Code, i.e., rehabilitating or repairing the Facilities or providing equipment for use at the Facilities; provided that up to two percent (2%) of the sale proceeds of the BOI Bonds may be used to pay costs of issuing the BOI Bonds.

(h) The District has received written assurance that the private business contribution requirement of Section 54E(b) of the Code will be met with respect to the Facilities. The contribution shall satisfy, or the District will direct that the contribution be applied to satisfying, one or more of the specified purposes described in Section 54E(d)(4) of the Code, and will certify as much.

(i) The District has received allocations by the Office of Public Instruction of the State of Montana of qualified zone academy bond limitation in an amount at least equal to the total principal amount of the BOI Bonds reflected in the Purchase Agreement, and such allocations have not expired nor been revoked, rescinded or modified and are in full force and effect, and the District has not designated any bonds or obligations as qualified zone academy bonds from such allocations other than the BOI Bonds.

(j) The purchase price of the BOI Bonds shall equal or exceed the amount of the BOI Bonds and shall equal the amount of the District Bonds.

(k) The Purchase Agreement reflects that the State of Montana is not liable for the payment of the principal of or interest, if any, on the BOI Bonds or for the performance of any obligation that may be undertaken by the Board with respect thereto, and that the BOI Bonds do not constitute an indebtedness of the State of Montana and neither the faith and credit are nor taxing power of the State is pledged to the payment of the principal or interest on the BOI Bonds.

1.6. <u>Issuance of BOI Bonds Contingent on Bond Resolution</u>. The Purchase Agreement, if entered into prior to the bond resolution of the Board, shall provide that any obligation of the Board to deliver the BOI Bonds pursuant to the Purchase Agreement is contingent on delivery of various documents described therein and the adoption by the Board of a satisfactory resolution fixing the terms and conditions of the BOI Bonds and further details relating thereto.

Section 2. Effective Date. All resolutions and parts of resolutions heretofore adopted by this Board which are in conflict herewith are hereby amended so as to conform with the provisions of this Resolution, and, as so amended, are hereby ratified and confirmed. This Resolution shall be effective upon passage.

PASSED AND APPROVED by the Board of Investments of the State of Montana on this 11th day of February, 2009.

____
Chair

Attest:

____
Executive Director

Montana Loan Program

MEMORANDUM **Montana Board of Investments**

Department of Commerce

To: Board Members

From: Herb Kulow, CMB
Senior Portfolio Manager

Date: February 3, 2009

Subject: Commercial and Residential Loans

There were 230 outstanding commercial loans as of December 31, 2008, totaling $197,379,004, an increase of $3,096,162 from the previous month and an increase of $25,539,772 from the previous year. Reservations were $34,492,270 and commitments were $14,853,152 as of December 31, 2008.

Type	Units	Amount	
Participation	99	93,868,597.26	47.6%
Guaranteed	90	62,772,054.63	31.8%
Infrastructure	7	20,907,813.20	10.6%
Value Added	15	15,033,042.42	7.6%
IRP	9	2,295,814.92	1.2%
Link	9	1,616,999.88	0.8%
Seasoned	1	884,681.43	0.4%
	230	197,379,003.74	100.0%

There were no unguaranteed loans past due 90 days or more, nor were any loans on non-accrual. There is only one participation loan past due slightly more than 30 days, as of December 31, 2008.

The following chart compares the December 31, 2008 BOI 90-day past due percentages with the State of Montana and National commercial loan past due percentages. The comparison uses the most current FDIC statistical information of September 30, 2008.

Commercial Past Due (000's)

	Past due 90 days + and non-accrual loans	Total commercial loans	Past due %	
BOI ($ in 000's)	0	197,379	0.00%	DEC 31 2008
Montana ($ in 000's)	28,203	2,027,683	1.39%	SEPT 30 2008
National ($ in 000's)	15,222,474	1,503,736,717	1.01%	SEPT 30 2008

As of December 31, 2008, the commercial loan portfolio represents 22.01% of the Coal Tax Trust.

As of December 31, 2008, the residential loan portfolio was $55,121,120. The portfolio was distributed as follows:

CONVENTIONAL-PMI	27,886,866.09	50.59%
CONVENTIONAL UNINSURED	8,594,079.67	15.59%
FHA	16,694,326.50	30.29%
VA	1,945,847.32	3.53%
	$55,121,119.58	100.00%

The conventional categories total $36,480,946 or 66.18% of the total portfolio.

There are seven residential loans past due 90 days or more as of December 31, 2008 in the amount of $328,588. Two of the seven loans are currently in foreclosure and total $68,802. One loan has a balance of $8,017 and is 14 months past due. The collateral was seized by the U.S. government in a drug raid. The lender has entered into a Stipulated Settlement Agreement with the U.S. Attorney for $9,735 plus interest at $2.31/day until the house is sold. The $2.31 of interest per day produces a gross yield to MBOI of approximately 10.37% ($2.31 X 360/$8017). The house was in need of considerable repair and was first listed for sale 6 weeks ago. If the property is not sold within 3 months, the U.S. Attorney will review the sale price and will again review the sale price if the property is not sold within 6 months. This loan will remain on the books until the property is sold. The second loan in foreclosure is a deceased borrower in the probate process. The seven loans include six FHA guarantees and one VA loan. There should be no risk of loss of principal.

There are three residential conventional loans past due (2 months) and total $250,595.

The following chart compares the December 31, 2008 BOI 90-day past due percentages with the State of Montana and National residential loan past due percentages. The comparison uses the most current FDIC statistical information of September 30, 2008.

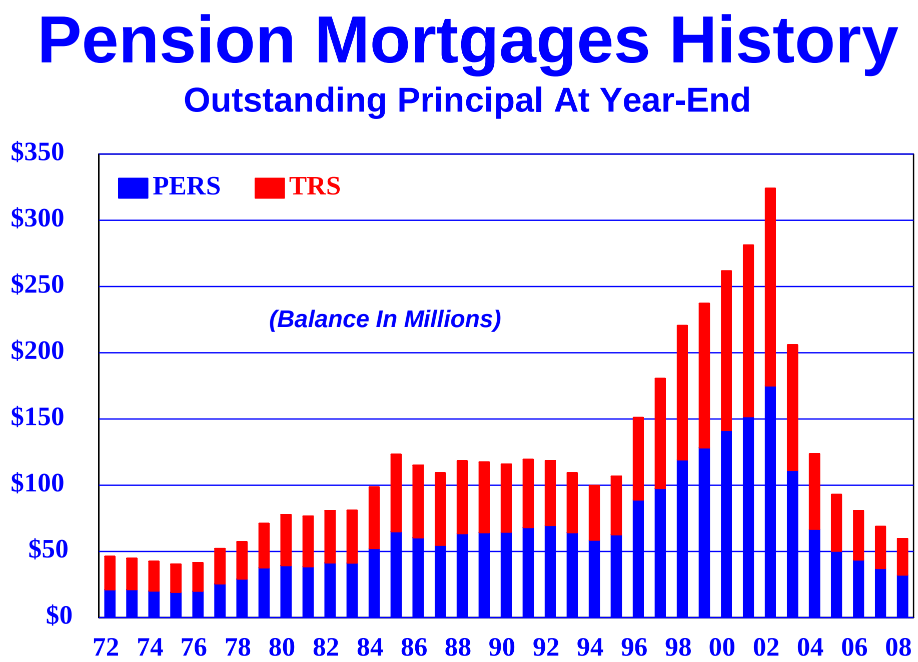
Residential Past Due (000's)

	Past due 90 days + and non-accrual loans	Total residential loans	Past due %	
BOI ($ in 000's)	329	55,121	0.60%	DEC 31 2008
Montana ($ in 000's)	12,874	2,241,738	0.57%	SEPT 30 2008
National ($ in 000's)	79,753,105	2,516,694,647	3.17%	SEPT 30 2008

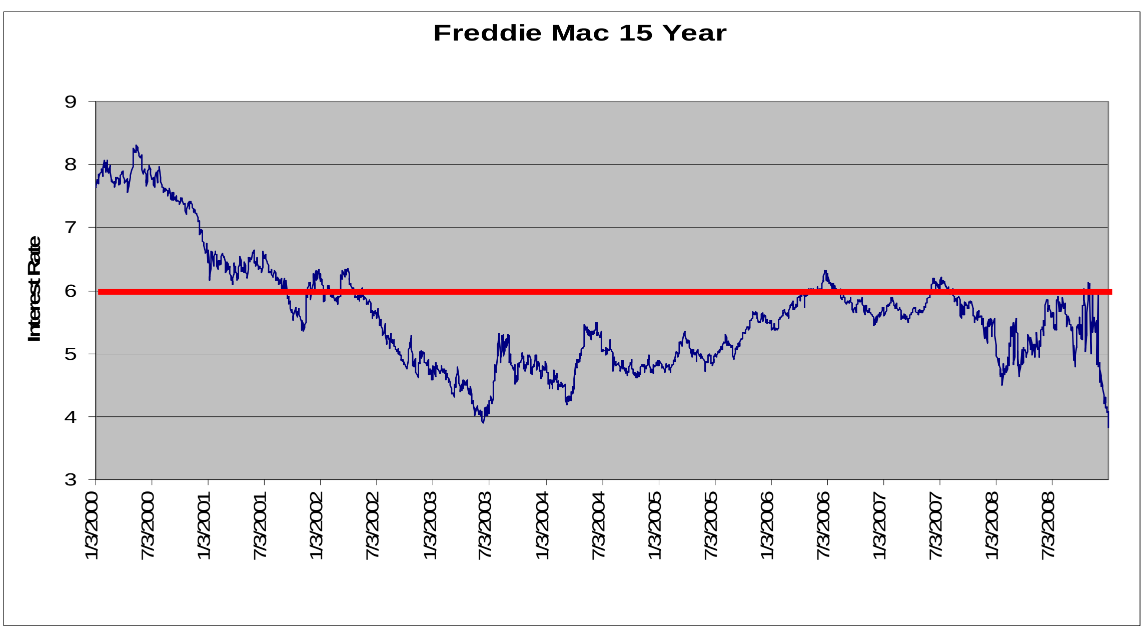
The BOI residential loan portfolio past due percentage is slightly higher than those of the State of Montana and below the National residential past due percentages. The FDIC statistics only reflect past due loans through 9-30-08, while MBOI is through 12-31-08. BOI's current residential interest rates are higher than the market by over 100 basis points. BOI did not offer variable interest rate loans, interest only loans or any other non-traditional type of financing. All of the residential loans are long term with fixed interest rates.

As of December 31, 2008, MBOI had five residential reservations outstanding with the Board of Housing totaling $857,400.

The following is a review of the $55,121,120 residential loan portfolio as of 12-31-08. The following graph is a brief history of the outstanding residential mortgages in the portfolio as of fiscal year-end.



The Montana Board of Investments began purchasing Montana residential mortgages when there was no reasonable secondary market available to Montana lenders. That program was highly successful as can be seen in the preceding graph. In 1972, Montana residential mortgages totaled just under $50,000,000 and grew to a high of $324,000,000 in 2002. Historically, MBOI offered residential mortgage rates at approximately 38 basis points below the prevailing Montana mortgage market. However, in March 2001, the MBOI residential mortgage interest rate briefly dropped below 6.00% for a 15-year mortgage. In April 2002, an arbitrary floor of 6.00% was established and remained in effect until June 2004. The national 15-year residential mortgage interest rate for 2002 averaged 5.45%, for 2003, 4.62% and for 2004, 4.86%.



After reaching a high of $324,000,000 in 2002, the residential mortgage portfolio plummeted to $123,600,000 as of 6-30-04, due to refinancing and loans being paid off. In June 2004, the Board voted to discontinue the residential mortgage program. In August 2004, the Board reinstated the residential mortgage program, due in large part to comments and requests from Montana bankers. In October 2004, the Board issued specific guidelines relative to the residential mortgage program. The Board directed, in part, the residential mortgage department to price loans using the weekly rates set by Freddie Mac. Prior to the implementation of the 6.00% floor, MBOI mortgage interest rates were set from a mortgage rate sheet supplied by First Interstate Bank. In addition, the guidelines stated that in the event Freddie Mac rates fell below 6.00%, staff would set rates sufficiently high, relative to the market, to ensure that MBOI is not inundated with volume. As stated previously, MBOI mortgage interest rates are approximately 100 basis points above the Freddie Mac single-family rate. The mortgage portfolio continues to contract due to refinancing and loans being paid off. As of 2-4-09, the MBOI 15-year mortgage interest rate is 5.50% and is 166 basis points above Freddie Mac which is 3.89%. We currently have 5 reservations outstanding totaling approximately $857,400. The following table is a comparison of Freddie Mac's mortgage rates and MBOI posted mortgage rates as of 2-4-09. MBOI's rates are substantially above the market, as required by the guidelines established at the October 2004 Board meeting.

	Freddie Mac	MBOI	Freddie Mac	MBOI	Freddie Mac	MBOI
Reservation Period	**15 Year**	**15 Year**	**20 Year**	**20 Year**	**30 Year**	**30 Year**
30 Days	**3.890%**	**5.550%**	**4.440%**	**5.650%**	**4.440%**	**5.850%**
60 Days	**4.030%**	**5.600%**	**4.590%**	**5.700%**	**4.590%**	**5.900%**
180 Days (2)	**n/a**	**5.850%**	**n/a**	**5.950%**	**n/a**	**6.150%**
240 Days (2)	**n/a**	**6.000%**	**n/a**	**6.100%**	**n/a**	**6.300%**

Due to lack of volume and the desire to institute more efficiencies within the residential mortgage department, staff began investigating utilizing the Montana Board of Housing (BOH) for the processing of MBOI mortgages. In December 2005, MBOI and BOH entered into an agreement in which BOH will do all of the processing of the MBOI mortgage applications other than approving non FHA and VA appraisals and the actual funding of the loan. In addition, all mortgage applications must conform to all automated underwriting standards established by Freddie Mac.

Only 15.59% of the mortgage portfolio, as of 12-31-08, does not have some sort of mortgage insurance of guarantee.

Type	Balance	Percentage of Total
CONV-PMI	27,886,866.09	50.59%
CONV UNINSURED	8,594,079.67	15.59%
FHA	16,694,326.50	30.29%
VA	1,945,847.32	3.53%
	55,121,119.58	100.00%
Total Conventional	36,480,945.76	66.18%
Total Guaranteed	18,640,173.82	33.82%

Staff has calculated the average weighted yield of the portfolio to be 6.65%, as of 12-31-08. The following table reflects the principal balance maturing per year and the corresponding yield. Loans maturing within 22-24 years total $13,685,430 and represent approximately 17% of the portfolio. These loans were made during 2000-2002, prior to implementing the 6.00% floor and when MBOI was still discounting the market rate by 38 basis points. This was also prior to the dramatic decrease in national interest rates between 2002 - 2004. A large portion of the loans made during 2000-2002 have been paid through refinancing. The current balance of loans made during 2002-2004 is $859,090 and reflects the implementation of the new guidelines and falling national mortgage interest rates.

Total	Yield	Term remaining
10,852.96	9.38%	<1 yr
115,591.33	7.29%	1yr - <2 yr
568,236.32	7.02%	2yr - <3 yr
563,038.55	7.26%	3yr - <4 yr
1,691,216.22	6.70%	4yr - <5 yr
1,647,002.82	6.68%	5yr - <6 yr
622,844.25	6.95%	6yr - <7 yr
4,002,455.04	6.52%	7yr - <8 yr
2,181,925.38	6.53%	8yr - <9 yr
887,364.10	6.84%	9yr - <10 yr
548,316.47	6.62%	10yr - <11 yr
1,802,660.05	5.68%	11yr - <12 yr
1,298,927.74	6.74%	12yr - <13 yr
1,548,974.23	6.70%	13yr - <14 yr
939,516.84	6.18%	14yr - <15 yr
566,449.60	7.31%	15yr - <16 yr
1,312,183.75	6.76%	16yr - <17 yr
1,155,545.94	7.43%	17yr - <18 yr
958,292.55	7.45%	18yr - <19 yr
2,774,811.12	6.93%	19yr - <20 yr
1,816,991.98	7.24%	20yr - <21 yr
1,619,860.84	7.22%	21yr - <22 yr
6,704,244.32	6.83%	22yr - <23 yr
6,981,206.03	6.58%	23yr - <24 yr
602,528.70	6.46%	24yr - <25 yr
256,562.36	6.38%	25yr - <26 yr
3,877,002.73	5.90%	26yr - <27 yr
3,568,789.44	6.51%	27yr - <28 yr
2,348,653.16	6.74%	28yr - <29 yr
2,149,074.76	6.25%	29yr - <30 yr
55,121,119.58		

The largest servicer of mortgages in the portfolio is Streeter Brothers, Billings with 25% of the portfolio, followed by First Interstate Bank with 23%.

Forty-seven percent of our residential mortgages can be found in Yellowstone County 31%, Gallatin County, 10% and Flathead County, 6%.