These minutes are Approved and Final. Full Board review and decision took place at the October 4, 2012 Regular Meeting of the Board.

MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE
2401 Colonial Drive, 3rd Floor
Helena, Montana

MINUTES OF THE MEETING
August 21 - 22, 2012

BOARD MEMBERS PRESENT:

Gary Buchanan, Chairman
David Aageson – Arrived 8/21/12 11:10 AM
Bob Bugni
Karl Englund
Mark Noennig
Quinton Nyman – Absent 8/22/12
Jack Prothero
Jon Satre
Jim Turcotte

LEGISLATIVE LIAISON PRESENT:

Representative Franke Wilmer

STAFF PRESENT:

Jason Brent, CFA, Alternative Investments Analyst
Geri Burton, Deputy Director
Richard Cooley, CFA, Portfolio Manager, Fixed Income/STIP
Dana Chapman, Board Secretary
Frank Cornwell, Deputy Financial Manager
David Ewer, Executive Director
Tim House, Investment Operations Chief
Ethan Hurley, Portfolio Manager, Alternative Investments
Ed Kelly, Alternative Investments Analyst
Herb Kulow, MCMB, Portfolio Manager, In-State Loan Program
Rande Muffick, CFA, Portfolio Manager, Public Equities
Chris Phillips DeFranco, CFA, Investment Staff
Jon Putnam, CFA, FRM, Fixed Income Investment Analyst
Nancy Rivera, Credit Analyst
John Romasko, CFA, CPA, Fixed Income Investment Analyst
Nathan Sax, CFA, Portfolio Manager, Fixed Income
Clifford A. Sheets, CFA, Chief Investment Officer
Steve Strong, Equity Investment Analyst
Louise Welsh, Bond Program Officer
Dan Zarling, CFA, Director of Research

GUESTS:

Jim Voytko, RV Kuhns and Associates
Mark Higgins, RV Kuhns and Associates
Becky Gratsinger, RV Kuhns and Associates
Bill Hoffman, Department of Commerce
Dore Schwinden, Department of Commerce, Director
Roxanne Minnehan, Public Employees' Retirement System
Kris Wilkinson, Legislative Fiscal Division
Angus Maciver, Legislative Audit Division
Michelle Barstad, Montana Facility Finance Authority
Hollie Koehler, Internal Auditor, Teachers' Retirement System
Brad Sanders, Department of Administration, Procurement Bureau

CALL TO ORDER

Board Chairman Gary Buchanan called the regular meeting of the Board of Investments (Board) to order at 11:00 AM in the Board Room on the third floor at 2401 Colonial Drive, Helena, Montana. As noted above, a quorum of Board Members was present. Member David Aageson arrived at 11:10 AM. Representative Franke Wilmer was present.

> Board Member Karl Englund made a Motion to approve the Minutes of the May 22 and 23, 2012 Board Meeting; Member Bob Bugni seconded the Motion. The Motion was carried 9-0.

Executive Director David Ewer introduced Frank Cornwell, CPA, the new Deputy Financial Manager. Mr. Cornwell was previously with the Legislative Auditor's Office.

ADMINISTRATIVE BUSINESS

Audit Committee Report

Audit Committee Chair Jim Turcotte reported that the Board's Audit Committee met prior to the Board meeting to review the FY12 Internal Control Review Report performed by Galusha, Higgins & Galusha. Staff concurred with the three recommendations. Where appropriate, and based on the recommendations, staff will make revisions to the Internal Control Policy. The Committee reviewed and approved changes to the Internal Control Policy (the "Policy"). The Policy will be posted on the Board's website and distributed to the Board following final draft.

The Committee also reviewed the Audit Committee Charter (Charter) and had one change. The Charter currently states the Audit Committee is to report "annually" to the Board's constituent groups. Since Audit Committee reports and information are published more often than "annually," the Committee agreed to change the Charter to report "regularly." The change was approved by the Audit Committee.

> Jim Turcotte moved that the Board accept the Audit Committee's recommendation to change the Audit Committee Charter to state that the Audit Committee will "Report regularly to the Board's constituent groups, describing the committee's composition, responsibilities and how they were discharged, and any other information required by rule." Quinton Nyman seconded. The motion carried unanimously.

Angus Maciver of the Legislative Audit Division reported that preparations are still underway for the Performance Audit.

Human Resource Committee Report

The Human Resource Committee also met prior to the board meeting. Committee Chair Karl Englund reported on two items that came before the Committee. The first item was the review of the revised Organizational Chart. The chart has been revised to reflect the new Deputy Financial Manager position.

The second item was the Committee's review of the salary disparities for exempt staff which were noted after the hiring of the last Portfolio Manager. The salaries of the Public Equities and Fixed Income/STIP Portfolio Managers, who have been on staff the longest, have fallen behind their counterparts due to salary negotiations for newer staff. The Committee recommends a disparity adjustment which increases the salaries of the two managers by 7.5%, retroactive to January 1, 2012. This will begin the process of salary reviews, which will be ongoing by the Committee.

Karl Englund made a motion to approve the Human Resource Committee's recommendation to increase the salaries of the Public Equity and Fixed Income/STIP Portfolio Managers by 7.5%, retroactive to January 1, 2012. Bob Bugni seconded. The motion carried unanimously.

Loan Committee Report

Loan Committee Chair Jack Prothero reported that the Committee had a conference call meeting on July 24 to address two loans. The Committee approved a $3 million loan for the Board of Regents (on behalf of the University of Montana) for the Curry Health Center renovations for a term of 15 years. The second loan is for $2,846,000 to the Town of Sheridan in anticipation of the Rural Development Services (RD) long term financing for a wastewater improvement project. The loan will be in the form of a bond anticipation note (BAN) with a term of one (1) year or less. The Committee approved both loans. No Board action required.

Investment Consultant Committee Report

Committee Chair Karl Englund reported that the Committee met after the last Board meeting to discuss progress on the investment consulting services RFP. Brad Sanders from the Procurement Bureau will come before the Board tomorrow to answer any questions regarding the ongoing process. Six responses were received, one of which was disqualified for failing to meet the requirements which prohibited firms that also offer asset management services from applying as stated in the RFP. The Committee will meet again on September 6th at which time staff will report to the Committee the results of the detailed scoring of the candidates. The final scores and ranking of the applicants will be used to determine which candidates will be interviewed by the entire Board at the October 4th Board meeting.

Public Comment

Chairman Buchanan called for public comment on Board issues. There was no public comment.

EXECUTIVE DIRECTOR'S REPORT

Overall Comments

Director David Ewer noted the work plan was included in the Board handouts and asked if there were any questions. Mr. Ewer then reviewed the revised organizational chart and noted the two changes: the addition of the Deputy Financial Manager; and including the three currently vacant analyst positions to show all legislatively authorized FTEs. Of the vacancies, at least two of the positions are slated to be filled, however no set time line has been determined. The plan is to fill the vacant accountant and bond program specialist vacancies.

Member Jon Satre made a motion to approve the revised Organizational Chart, with the correction showing the Deputy Financial Manager connected to the Financial Manager. Member Englund seconded. The motion passed unanimously.

MONTANA LOAN PROGRAMS

Commercial and Residential Portfolio Reports

Mr. Herb Kulow reported one small loan was approved internally. He will be traveling to Great Falls with Ms. Rivera to look at a Canadian manufacturing firm. The past dues for both commercial and residential are under control. Residential loans continue to pay down. The Montana Veterans' Home Loan Mortgage Program (the "VA Program") is up to almost $3 million as of the end of July and there are $3.1 million in reservations, all of which is processed through the Board of Housing (BOH). The total allocation allowed for the VA Program is $15 million; Mr. Kulow believes there will be a bill before the 2013 Legislature requesting a higher allocation than the current $15 million.

Mr. Kulow reviewed the VA Program Policy (the "Policy"). State law designates BOH as the Program Administrator. BOH wanted to use their rules; but as the funds are the Board's, the Policy was written using the Board's rules.

While the Coal Tax Trust shows inactivity, staff has processed 64 State Small Business Credit Initiative Program (the "SSBCI Program") loans in the past eight months. Staff has been processing one loan a week.

Member Satre inquired about what kind of businesses are included in the SSBCI Program, and what geographical areas are covered by the loans. Mr. Kulow noted they are done through local economic development groups. Geographically there is $2.5 million for Missoula, $2.5 million for Billings and almost $2 million for Great Falls. The Department of Commerce also has application reservations from a Native American grocery store, and another from the Bakken oil field. Most loans are for expansion of existing small businesses and many create or save jobs. As the loans are repaid, the local economic groups get to keep the money, which assists them in obtaining additional United States Department of Agriculture or Economic Development Administration funding. The Department of Commerce requires that 2% of the $13 million be granted to the Consolidated Native American Council (the "Council") for equity for their small businesses and requires that the Council match funds, so the funding goes directly to tribal businesses.

Mr. Kulow noted no other states are utilizing the SSBCI Program. Staff is requesting the third draw; there are no other states up to the third draw. The US Treasury is providing the money as part of the Obama 2010 Stimulus program. Executive Director Ewer added that this is money provided through Governor's Economic Development and Department of Commerce who are relying on the expertise of our staff, Mr. Kulow and Ms. Rivera, who have assisted Commerce in taking advantage of this opportunity by vetting these projects.

Member Englund requested clarification as to whether financing for condominiums is allowed under the VA Program.

Mr. Kulow advised the maximum loan amount under the VA Loan Program changes every year; Board of Housing comes up with the maximum loan amount. Because there are too many complications associated with condominiums, they are not allowed under the VA Program.

> Jack Prothero made a motion to accept the Veteran's Home Loan Mortgage Policy. Member Englund seconded. Member Bugni inquired what the policy is to allow protection in the event of default. Mr. Kulow advised under our service contract with Board of Housing, all past due loan collections are BOH responsibility. Any past due loan, within the first 180 days could require repurchase by the lenders, which protects BOI interests. Additionally, past due reports will reflect any past due loans on a monthly basis. The motion passed unanimously.

Member Englund requested clarification on what type of business KJR, LLP is; the one staff approved loan. Ms. Rivera explained it's a real estate investment company which purchased the property for a land trust in Missoula.

Bond Program Reports

Activity Report

Ms. Louise Welsh reported no Board actions were needed on INTERCAP loans. Commitments have been skyrocketing as staff is handling a lot of interim financing requests. At the end of fiscal year 2012 we have $40 million in commitments. The detail report compares the past two fiscal years showing outstanding loan amounts and geographical information. Geographically, loans are diversified throughout the state.

Borrower:	Clinton Rural Fire District
Purpose:	Used Fire Engine
Staff Approval Date:	April 4, 2012
Board Loan Amount:	$140,000
Other Funding Sources:	$ 50,000
Total Project Cost:	$190,000
Term:	10 years

Borrower:	Missoula County
Purpose:	Seeley Lake Refuse District Office Water/Septic Facilities
Staff Approval Date:	April 6, 2012
Board Loan Amount:	$35,000
Other Funding Sources:	N/A
Total Project Cost:	$35,000
Term:	5 years

Borrower:	City of Thompson Falls
Purpose:	Asphalt Grinder
Staff Approval Date:	April 11, 2012
Board Loan Amount:	$65,000
Other Funding Sources:	N/A
Total Project Cost:	$65,000
Term:	10 years

Borrower:	Town of Alberton
Purpose:	Used Sanding Truck
Staff Approval Date:	April 13, 2012
Board Loan Amount:	$20,000
Other Funding Sources:	N/A
Total Project Cost:	$20,000
Term:	5 years

Borrower:	City of Roundup
Purpose:	Sewer Lagoon UV Disinfection System
Staff Approval Date:	April 27, 2012
Board Loan Amount:	$286,000
Other Funding Sources:	$221,000
Total Project Cost:	$507,000
Term:	10 years

Borrower:	Stillwater County
Purpose:	New Asphalt Grinder
Staff Approval Date:	April 28, 2012
Board Loan Amount:	$152,990
Other Funding Sources:	N/A
Total Project Cost:	$152,990
Term:	5 years

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Borrower:	Target Range School District #23 (Missoula)
Purpose:	Various Building Improvements (i.e. heating, cooling, plumbing, flooring, security, etc.)
Staff Approval Date:	May 2, 2012
Board Loan Amount:	$850,000
Other Funding Sources:	N/A
Total Project Cost:	$850,000
Term:	5 years

Borrower:	City of Columbia Falls
Purpose:	New Sewer Cleaner Truck
Staff Approval Date:	May 4, 2012
Board Loan Amount:	$124,625
Other Funding Sources:	N/A
Total Project Cost:	$124,625
Term:	5 years

Borrower:	Richey Elementary School District #78J
Purpose:	School Building Structural Rehabilitation
Staff Approval Date:	May 29, 2012
Board Loan Amount:	$ 850,000
Other Funding Sources:	$ 200,000
Total Project Cost:	$1,050,000
Term:	10 years

Borrower:	City of Belgrade
Purpose:	City Library Roof Replacement/Exterior Wall Repairs
Staff Approval Date:	June 19, 2012
Board Loan Amount:	$75,000
Other Funding Sources:	N/A
Total Project Cost:	$75,000
Term:	15 years

Borrower:	Polson Elementary School District #23
Purpose:	Reroofing High School (Multi-District Agreement 20-3-363 MCA)
Staff Approval Date:	June 22, 2012
Board Loan Amount:	$164,000
Other Funding Sources:	N/A
Total Project Cost:	$164,000
Term:	3 years

Borrower:	City of Ronan
Purpose:	Various Used Equipment
Staff Approval Date:	June 26, 2012
Board Loan Amount:	$150,000
Other Funding Sources:	$ 30,000
Total Project Cost:	$180,000
Term:	7 years

MONTANA UNIVERSITY SYSTEM

Borrower:	UM-Missoula
Purpose:	Washington Grizzly Stadium Lights
Staff Approval Date	April 4, 2012
Board Loan Amount:	$1,000,000
Other Funding Sources:	N/A
Total Project Cost:	$1,000,000
Term:	10 years

The Loan Committee met via conference call on July 24th and approved the University of Montana and Town of Sheridan loans.

Borrower:	University of Montana – Missoula
Purpose:	Curry Health Center renovations
LC Approval Date:	July 24, 2012
Board Loan Amount:	$3,000,000
Other Funding Sources:	$1,000,000
Total Project Cost :	$4,000,000
Term:	15 years

Borrower:	Town of Sheridan
Purpose:	Interim financing in anticipation of a $2,846,000 USDA Rural Development Services long-term loan for wastewater improvements.
LC Approval Date:	July 24, 2012
Board Interim Loan Amount:	$2,846,000
Other Funding Sources:	$6,000,000
Total Project Cost :	$6,000,000
Term:	1 year

Ms. Welsh reported there are no past due loans. It is anticipated that a bond anticipation note may have to be issued in the fall, with additional bonds issued in the spring of 2013 to provide additional funding for the INTERCAP Program.

Member Bugni inquired if we have any concerns on reaching the upper limit of bonds we can issue?

Executive Director Ewer advised no. The work plan reflects discussion on INTERCAP at the November meeting, at which time the INTERCAP Program will be discussed in more detail.

BOARD EDUCATION

Executive Director Ewer reported on the Market Makers Conference in Carlsbad, California, which he and members Jon Satre and Jim Turcotte attended. Topics covered included current issues with pension funds, macroeconomic, micro investment, secular trends, phenomenon of higher correlations, the outlook for Europe, risk parity investing, stock volatility, higher dividends as an alternative to fixed income, Private Equity and Fixed Income. Hedge Funds were discussed, along with Real Estate and the outlook for Fixed Income, which remains grim. Many pension funds have lowered their assumed target returns. In general, the tone at the conference was serious, earnest and generally somber. Reliance on consultants was also discussed.

Member Turcotte added the conference was one of the better ones he has attended, very well put together. All presenters were from the private sector, but the sales pitch aspect was prevented, as presenters had to stay on topic. The conference was small, with 50 or so attendees. Ontario Municipal Employees Retirement Scheme (OMERS) pension fund has $50 billion, all in Private Equity, which is unusual, invested in airports, toll roads, etc. They don't invest in any standard vehicles as BOI does. Idaho's plan is in good shape, so they have decreased their risk ratio substantially as they don't need excessive returns to cover costs. Most plans, however, were concerned with their actuarial rate of return.

Member Satre added he thought the conference was beneficial. One benefit was the number of trustees in attendance, and there was a specific trustee session, which was very beneficial. He agreed, the outlook in general was not optimistic. The discussion on actuarial return assumption showed attendees have between 7% and 8% assumed return.

Chairman Buchanan asked for a general take away from the conference. Member Satre noted there was a lot of talk about changing the paradigm of how we rate ourselves, away from peer comparisons and benchmarks, and more on focusing attention to evaluating ourselves in terms of absolute returns to more clearly reflect our actual financial obligations. With maturing pension plans, you can't fund out of returns, you must fund out of contributions.

Executive Director Ewer had previously distributed some conference options to Board members. He noted that Ethan Hurley, Portfolio Manager for Alternative Investments would be traveling to Portland, Oregon to attend a timberland conference and asked if any Board member was interested in joining Mr. Hurley. No member was interested at this time. Mr. Ewer encouraged Board members to keep an eye out for beneficial educational opportunities.

Representative Wilmer asked for classification on the question of higher correlations? How to avoid them?

Executive Director Ewer stated the crash of 2008 was a unique experience in that all asset classes went down. In investments, positive correlations are bad. The notion of trying to protect assets by diversifying into differing classes failed, suggesting diversity is not all it's cracked up to be. We do still need to diversify however. Real Estate is an example of a defensive asset class.

CEM BENCHMARK STUDY

CEM - Mike Heale

Mr. Mike Heale presented the CEM Benchmark Study and summarized the key results in the portfolio for a two year period ending December 31, 2011, and reviewed key trends in the US Universe. Growth of the data base over the past 21 years of its existence now includes 163 US funds with an average fund size of $11.9 billion. CEM currently includes up to 190 US surveys, some of which were not included because data was not yet received or was not ready in time for inclusion in the BOI report. However, the data of the 163 funds included has critical mass for a comprehensive picture. The returns and value added focus includes a combination of public, corporate and multi employer US funds, so is not dependent on only the public sector.

The cost analysis uses a peer group of 20 US public sponsors ranging in size from $3.1 to $13.6 billion with the median hitting close to MBOI. Peer group focus is used for the detailed cost benchmark analysis. Staff does have the names of the peer groups, but names are not included in the formal report. This measures policy return vs. asset mix returns compared to other public funds. Value added is your active management decisions and their contribution to your total returns, and analyzes costs to see if they are reasonable. In effect, does paying more get you more in added value?

The two year total return for the Montana pensions was 8%, which is below the US median of 8.5%, but above peer returns of 7.2%. Median US policy returns are for a mix of public and corporate plans, though we are starting to see public and private sector plans becoming more divergent. Looking at the asset mix position for Montana shows a policy return of 7.3% for the two year period, which is very close to median, and above the peer median policy return of 6.4%. The policy return reflects what you could have earned by investing all assets in a passive manner according to your policy mix.

The drivers in relative return are market performance and asset mix. The two best performing benchmarks were Real Estate (REITS) and Barclay's Long Bonds as interest rates came down, an unusual result over what you'd expect. Private Equity was one of better performing assets, and as BOI policy weights are higher in Private Equity at 12% vs. 7% for peers, this had a positive effect on boosting both the policy return and the actual returns. However this was offset by having no dedicated allocation to long bonds, similar to public peers, while the overall US average is a 12% allocation. Since this was the other best performing class the lack of a dedicated allocation acted to detract from both the policy return and actual returns. The net added value over the 2-year period was 10 basis points: 2010 was not so good, however 2011 was much better in value added. BOI was close to the peer median of 20 basis points. The returns are net of fees which includes all costs.

When compared to the US average returns, the BOI Private Equity and Real Estate portfolios showed positive relative returns over the past two years, while Fixed Income and Public Stocks were below the US average. All of these asset classes posted positive returns, with Real Estate and Private Equity the highest. Two years is not a long enough time period, and total returns will need to be looked at over the long term. In general, active management shows a positive long term trend of net value added, adding 18 basis points over the past 21 year period for US plans.

Investment management costs for 2011 equaled $50.2 million or 64.9 basis points, with 2.4 basis points attributed to total oversight, custodial and other costs. Mr. Heale noted the default fee cost assumed for diversified Private Equity fund-of-funds is 165 basis points ($6.5 million) as most funds cannot provide those fees.

Chairman Buchanan asked about accounting for the fund-of-funds fees. As these are real costs, it would be to our advantage to have that information provided by the managers rather than having to estimate them, as it is a hidden cost

Mr. Sheets noted we could probably obtain those costs, although how many we could receive in an explicit way is not known. We are deemphasizing fund-of-funds in general, and use them when they are advantageous in situations where staff doesn't have the practical ability to otherwise attain the desired exposure offered by a fund-of-funds.
Executive Director Ewer advised the costs come out via the state's accounting system with the realized returns and accounting takes what can be determined. We assume that fund-of-funds have costs, however an argument could be made that other asset classes also have additional internal costs that wash out against yields. We aren't paying an additional fee, as we pay the fund-of-funds manager and costs are overlaid.

BOI costs have come down this year vs. last year from 68.7 basis points in 2010 to 64.9 basis points this year, which places BOI slightly above the median of 61.4 basis points for peers. Asset mix and size affect costs and when adjusting for the asset allocation at BOI using median peer costs for similar assets, the BOI is below this benchmark cost by 4 basis points, which represents $3.1 million in savings.

Mr. Heale continued, regarding style, BOI has 64% external active management vs. 71% for peers, and 72% for U.S. Funds. Since external active management is more expensive generally, BOI has a structural cost advantage vs. peers. This is primarily attributable to having less external active management for Fixed Income. The amount of fund-of-funds also makes a difference, but BOI is comparable to peers. Overall, BOI saved 2.6 basis points relative to peers based on differences in implementation style.

Regarding oversight of custody and other costs, BOI saved 0.9 basis points relative to peers. BOI is paying somewhat more for custodial, but saving on oversight, consulting/performance, audit and other fees.

Executive Director Ewer asked for elaboration on the difference of custodial costs for BOI vs. our peers, noting although we have higher custodial fees, we have a different relationship than many pension funds do as they serve several functions for us.

Mr. Heale advised that among our peers, a broad range of costs are included, and he doesn't believe our higher cost for custodial services is a concern considering all the services they provide. Hiring and retaining good staff to have oversight over assets is vital, and overall we pay less than our peers, showing a two year net added value of 0.1%. Paying more doesn't necessarily give better results. The total cost savings for BOI vs. peers of 4 basis points or $3,102,000, was due mainly to lower cost implementation style and less cost for investment management and oversight, custodial services and other costs.

Executive Director Ewer inquired how CEM keeps their results accurate, how quality control is assured, as our staff spends a tremendous amount of time providing the information.

Mr. Heale stated the BOI staff does a great job providing CEM with the needed information and they deserve a pat on the back for the quality of information provided. CEM has a 21 year historical data base of costs, and adheres to a screening process where all incoming data is sorted through and examined and anything out of the ordinary is flagged for further scrutiny. Data is compared year to year as well, and any data not up to standard is not entered into the data base. There is difficulty collecting data, but costs should be known as they are an important driver of results. True costs should be known and transparent.

Chairman Buchanan inquired if a fiscal year comparison is possible, and whether our peers report fees on fund of funds?

Mr. Heale stated our peers do not report on fund of funds costs and the default amount is determined using an average of direct costs. At this time, fiscal year reporting is not an option, only a calendar time frame is available.

Member Noennig stated it appears our recent May strategy restructure of the domestic equity pool of transitioning to more passive management will be beneficial regarding reduced costs for fees.

Mr. Sheets agreed that although reduction of fees was not the main factor for the transition, we will realize beneficial savings. While CEM data is for 2011, the changes we made in May and the proposed changes to MTIP at this meeting should result in savings.

Mr. Heale addressed the question of CEM having bias on management implementation style, but as they are not money managers, the goal is to look at the facts and determine the driving factors that affect returns and/or savings.

Member Bugni asked about the custom peer group, why are other funds, especially corporates, included in the peer group? Why not just compare us to public peers only? Corporates are liability and asset driven.

Mr. Heale advised next year the reporting will have a public sector peer group and a public universe comparison as well. Historically they've been included to give robustness to returns, but now that depth is available with both public and corporate separately. The peer group is all public funds. Costs have gone up dramatically, from 37 basis points to 61 basis points, driven in part by alternatives, (Hedge Funds, Real Assets and Private Equity) doubling in the past ten years, and also implementation style as external active management has gone from 64% to 72% in the past ten years. Key US pension funds over the last 21 years have net added value of 18 basis points, which is positive but modest; where you pursue active managers is key. For the best net value large caps are not your best option; small cap, foreign and emerging markets have all had positive value added. Fixed Income and Private Equity perform better with internal management due to the lower cost. Large funds did better than small ones, as in general they do more internal management. Defined Contribution funds have lower returns vs. Defined Benefit funds in part because of asset mix differences. For Example, DB funds have holdings in Private Equity and Real Estate, which have performed well, to which DC plans do not have exposure.

BUDGET

Executive Director David Ewer introduced the Director of the Department of Commerce (Commerce), Dore Schwinden and Bill Hoffman, Budget Manager of Commerce. Director Ewer thanked Mr. Hoffman and Director Schwinden, and Deputy Director Geri Burton for all of their valuable input into the budget process. Mr. Ewer stated it was pertinent to repeat the concept of costs. Costs are broken are broken out four different ways: external investment management costs are paid as authorized under the Unified Investment Act; custodial bank fees which are paid by charges against the Board's investment pools; operations are paid through a biennial maximum charge against the Board's investment pools; and bond program bond interest and issuance expenses are paid through a general statutory authority. Bond program staff is paid from the Board's bond program enterprise fund.

The BOI investment program is an internal service fund; it recovers its costs from the entities that use its services. The maximum amount is set by the legislature, and is currently set at $4,831,041 a year for both FY 2012 and FY 2013. This maximum fee covers operational costs and a 60 day working capital allowance. To help bring the working capital balance down, no charge against the investment pools was taken for the month of July. The Bond Program is funded through an enterprise fund which charges fees, mostly coming from the INTERCAP program.

The executive budget process is complex. The legislature starts with the base year budget and every penny is voted on. Rules dictate what can go into the base budget. Motions are made to accept the base budget, then add-ons are considered. Allowable adjustments are considered, such as present law adjustments for inflation and new proposals are considered.

The BOI budget is then submitted to the Department of Commerce which submits it to the Governor's Office of Budget and Program Planning. Mr. Hoffman stated Department of Commerce numbers are very close to the BOI estimated budget. Submission of the finalized budget is not due until January 6.

Chairman Buchanan asked how the Fiscal Year 2012 pay increase will affect the budget.

Director Schwinden explained the Broad band market adjustment pay matrix is set after completing a two year salary survey of public, private competitive pay salaries nationwide and includes hundreds of occupational codes. Then the market rate was determined for each code for Montana with a focus on benefiting the lowest paid positions considering the four year pay freeze. According to the salary survey of May 2012, pay bands two through six were moved to the minimum pay zone and payband sevens were given a 7.5% increase. The cost to BOI for the salary increase will total approximately $86,000 per year.

Chairman Buchanan inquired if we were late getting the budget process started.

Executive Director Ewer noted Commerce submits the budget approximately September 1, so discussion and action at the August meeting is appropriate timing. Director Schwinden confirmed yes, we were right on track. Mr. Hoffman added our year over year budget increases are in line and reasonable.

Mr. Dan Zarling gave an overview of research costs. He explained investment research services are important tools which are essential to have access to, including real time markets, risk portfolios, a system for trade activity, the ability to monitor external managers and a searchable manager data-base. For Fixed Income, effective information is needed for in-house management. Bloomberg and Factset are used to load our portfolios to view characteristics and Wilshire Axiom analyzes our portfolios. An in-house credit service helps to manage portfolios internally. Prices generally go up each year for these services; however Moody's has been decreased due to streamlining and cutting back on subscribed services. Services are constantly monitored and evaluated with adjustments made to discontinue any redundancies. All of the services used have different methodologies, so do not directly overlap one another, they are stand alone with unique features. Mr. Zarling noted he confers with other pension funds to compare which services are customarily used.

Mr. Voytko added the slate of services used by BOI is typical for funds that manage their Fixed Income assets in-house.

Executive Director Ewer recapped staff recommendations for the proposed budget.

> Member Satre made a motion to approve the proposed budget amounts for FY 2013 for Investments and the Bond Program as detailed in Table I and Table II of the Board packet. Member Noennig seconded the motion. The motion passed unanimously.
>
> Member Prothero made a motion to approve the preliminary maximum rates presented for FY 2014 and FY 2015 to cover operational expenses and keep working capital amounts within permissible levels; to accept Commerce's final maximum rates; and to direct staff to promptly notify the Board of any significant changes in the rates and explain such changes. Member Noennig seconded. The motion passed unanimously.
> Member Englund made a motion that the Board reaffirm the current total staffing level as authorized by the legislature and by statute of 8 exempt and 24 classified FTEs. Member Aageson seconded. The motion passed unanimously.

INVESTMENT ACTIVITIES/REPORTS

Montana International Equity Pool Restructuring

Mr. Cliff Sheets and Mr. Rande Muffick presented an overview the proposed restructuring of the International Pool.

Mr. Muffick explained that many of the same factors were considered as with the Montana Domestic Equity Pool restructuring at the May Board Meeting. The public equity market has been difficult. Mr. Sheets noted the goals of the pool restructuring include: achieving better absolute returns; improving relative performance; increasing flexibility when moving assets in and out of the pool; and, being mindful of costs.

Mr. Muffick noted hearing the CEM presentation was very informative and reaffirmed the need to pay for outside managers where they can offer the most benefit, and he reviewed the background of the international pool. Pre-2005 there was a regional approach with two external Asian managers, one European internal and one external manager, Pyrford. It was determined more diversification among managers was needed and in 2006 a move to 100% external managers was made which provided better diversification within market cap categories and better use of internal resources.

Still, international equity performance did not meet expectations. This leads to several changes in structure that have been made over the last three years. Several active managers were terminated with assets going into passive funds. The passive allocation weight has increased to a current level of approximately 50% of the pool. An emerging market index and small cap index fund were added to provide more allocation flexibility. Exposure to quantitative methodologies, which performed particularly poor during the bear market, has been reduced.

Some of the premises behind the changes to date and staff's recommendations include: developed international large caps remain less efficient than domestic large caps; more small cap manager diversification was needed; and active managers are expensive and tend to be more cost effective and liable to beat the benchmarks with non-US small caps and emerging markets than with large caps.

Member Satre inquired if international large caps would benefit from active management?

Mr. Muffick advised in general, international stocks are less efficient than domestic large cap stocks which suggests active management has more potential in international vs. domestic large caps. This can be attributed to less liquidity, Wall Street coverage is not as developed, the political environment, and information on companies is less available.

Mr. Muffick outlined staff's recommendations for the Montana International Pool going forward: decrease reliance on developed market active large cap portfolios: eliminate existing active large cap core reliance but retain some style-based mandates for growth and value, tilting towards value over time (which will decrease the active weight from 49% to 36% of total large caps); and increase the ranges for non-large cap exposure and dedicated emerging markets. In addition, staff recommends the adoption of a new benchmark, the MSCI ACW ex-US IMI, once the transition to the new structure is implemented. Staff also recommends adding 2-3 developed market small cap active managers and 1-2 emerging market active managers to improve manager diversification in these areas where active management is expected to add value over time. The new structure will provide less developed market active large cap management, more diversification in active portfolios within developed market small cap and emerging markets, a more flexible pool infrastructure, more potential for size and value premium effects and increased alpha generation within a similar fee structure. There will be transition costs of implementing the new structure, along with an estimated $200,000 to $400,000 increase in annual fees depending on the actual allocation to small cap and emerging markets.

Member Satre asked for clarification on how the new structure will affect risk.

Mr. Muffick stated there will be more risk with a corresponding return assumption increase of 12 basis points.

Mr. Sheets confirmed small cap and emerging markets are more volatile, but it's a net plus overall as higher returns from these markets are expected to continue over the long term.

Representative Wilmer asked if the increase in passive allocation increases risk.

Mr. Sheets stated manager risk will increase as proposed given an assumption of two thirds of small cap and 60% of emerging market exposure would be actively managed; passive does reduce tracking error.

Member Bugni questioned if reducing large cap active from 49% to 36% was enough, as perhaps we should not have any active large caps. He asked Mr. Jim Voytko of R.V. Kuhns to comment on what might be prudent given staff has added value in a lot of areas but can't be expert in all areas.

Mr. Voytko remarked analyzing and evolving is a healthy process regarding the restructuring process and R.V. Kuhns supports the new restructuring plan. The odds are better with large cap active vs. the Montana Domestic Equity Pool, and the asset class is very challenging. Risk is consistent with the evidence.

Ms. Becky Gratsinger added small cap and emerging markets can be daunting, but over the long term it will be worth it, although times of underperformance are likely.

Mr. Muffick advised we are firing only two managers but if the need arises to terminate additional managers it will be done. Picking new managers takes time. Mr. Voytko agreed, picking successful managers is a challenge and it depends on the pot you're picking from.

Chairman Buchanan inquired on savings due to the recent change in strategy for the Montana Domestic Equity Pool and Mr. Sheets reported savings of $2.6 million is expected from the recent restructuring accomplished during June. As for the international pool, the fees are now estimated at 29 basis points and would increase to 35 basis points if we go to the middle of the target ranges being proposed for the allocation to small cap and emerging markets. Mr. Sheets also advised that significant savings have already been realized for the Montana International Equity Pool due to the historical move to more passive management. Market timing of the transition could be favorable, as both emerging markets and small cap are underperforming large cap developed stocks of late.

Member Turcotte expressed concern making the allocation changes with such a short history to base the changes on, as this seems like a major reversal of policy.

Mr. Muffick noted while the structure is changing, a lot of changes have been made already. While more small cap introduces more risk and the benchmark is being changed, value can be added in inefficient markets and international stocks offer more opportunities.

> Member Prothero moved that the Board accept staff recommendation and approve the proposed revised Investment Policy Statement for the Montana International Equity Pool. Member Satre seconded the motion. The motion passed 8-1, Member Turcotte voted nay.

These minutes are Approved and Final. Full Board review and decision took place at the October 4, 2012 Regular Meeting of the Board.

Exhibit A
60 -70% Equities Range

Domestic Equity Pool

30% - 50%

Investment Type	Range
Large Cap Core (passive)	45% - 70%
Large Cap Enhanced	8% - 12%
Partial Long/Short (130/30)	8% - 12%
Total Large Cap	72% - 91%
Mid Cap	6% - 17%
Small Cap	3% - 11%

Real Estate Pool

4% - 10%

Investment Type	Range
Core/Timberland *	35% - 65%
Value Added	20% - 45%
Opportunistic	10% - 30%

* Timberland may not exceed 2% of total pension assets

International Equity Pool

15% - 30%

Investment Type	Range
Large Cap ~~Core (active &~~ Passive)	~~50~~42% - ~~70~~66%
Large Cap ~~Growth~~ Active	~~10~~22% - ~~20~~32%
~~Large Cap Value~~	~~10% - 20%~~
Small Cap ~~Core~~	~~5~~10% - ~~15~~16%
Dedicated Emerging Markets	2% - 10%

Private Equity Pool

9% - 15%

Investment Type	Range
Leveraged Buyouts	40% - 75%
Venture Capital	10% - 50%
Mezzanine Financing	0% - 10%
Distressed Securities	0% - 40%
Special Situtations	0% - 10%

Retirement Funds Bond Pool

22% - 32%

Investment Type	Range
Domestic High Yield	0% - 15%
International	0% - 10%
Total High Yield/International	0% - 20%
Domestic Core(investment grade)	80% - 100%

Short Term Investment Pool

1% - 5%

Short-term liquid investments
High-quality Investments
24 Hour Liquidity for Participants

ADJOURNED
Chairman Buchanan adjourned the Meeting for the day at 4:28 PM.

CALL TO ORDER – Day 2
August 22, 2012

Board Chairman Gary Buchanan reconvened the meeting Wednesday, August 22, 2012 at 8:30 AM with eight members of the Board and Legislative Liaison Representative Franke Wilmer present. Member Quinton Nyman was absent.

Public Comment
Chairman Buchanan called for public comment on Board issues. There was no public comment.

PERS/TRS Board Updates – Executive Director David Ewer, Board Members Jim Turcotte and Bob Bugni

Member Bugni reported PERS reviewed the budget; the 457 Plan and Defined Contribution Plan have surpluses so fees will be reduced for participants.

CONSULTANT REPORT

RV Kuhns & Associates
Mr. Mark Higgins and Mr. Jim Voytko presented an overview of the Investment Performance. Mr. Voytko presented four major themes of the big picture:

1. The outlooks for returns are somber for all of the reasons mentioned during the overview of the summary of the Carlsbad 2012 Market Makers Conference attended by Executive Director Ewer and Board Members Turcotte and Satre.
2. Central banks are forcing investors to make a choice between earning very low real returns and taking more risk. This means investors are tending to push into riskier investments out of desperation for returns.
3. The return for the last 3 fiscal years has exceeded actuarial benchmarks which will provide a tailwind to the funded ratios of most public plans.
4. Over the last 5-7 years the work of the Board is steady and there has been substantial improvement. Most asset classes exceeded the actuarial benchmarks

With cyclical PE ratios and stocks being expensive, riskier investments are being pushed, but restrained expectations are wise. There is the expectation that the Feds will come to the rescue, but as more stimulus is applied, the economic effect is diminished and benefits becomes more short-lived.

Mr. Voytko reviewed the comparative performance of retirement plans over three years. PERS at 12.08% is way above the actuarial benchmark, however is lagging compared to the actual allocation benchmark of 13.27%. The effect of active management has been negative. The underperformance vs. benchmark is due partly to the asset benchmarks being used, in particular the private equity benchmark which is more challenging than most for this asset class. Performance vs. peers is positive, and has improved over time. Asset allocation across peer groups varies widely though, so can be misleading. Additionally, however, returns are also improving considering the amount of risk taken. It's worth noting, one bad year, such as 2008, can ruin returns over the long term. Mr. Higgins added BOI actually outperformed its pension benchmark in 2008.

Mr. Voytko detailed other positives: in comparing the three and five year time periods, plan return is above the median and better than peers, risk efficiency has improved, the standard deviation has declined slightly, leading to a higher Sharpe ratio, or higher return for the risk taken. Mr. Voytko supported the Board's plan to fine tune the MDEP and MTIP pools.

There was discussion of the fact that the performance for the Private Equity and Real Estate pools is inaccurate in the performance data received by the board, and that these returns are currently being revised by State Street. All pension return numbers are correct, however, and will not change when the corrections are made in the investment pools. The pool returns will go up to varying degrees when the pool level returns are corrected. Mr. Sheets noted the mistake was discovered internally by Chris Phillips, who discovered differences in plan level vs. pool level returns, and she subsequently directed SSB to investigate the matter. Mr. Sheets noted that State Street Bank missed some transactions that affected cash flows which were therefore not included in the return calculations. Revised numbers will be distributed as soon as the corrections are completed. State Street reportedly has made the required adjustments to the internal processes to avoid making similar mistakes in the future.

Executive Director Ewer inquired when the mistake was first flagged. Mr. Sheets stated one year ago there were slight differences noticed, but SSB could not track the cause at the time. Executive Director Ewer noted this is a big deal even though total fund performance was unaffected. Performance is difficult to calculate but is vital information. The problem was detected long ago but only recently was the cause discovered. Ms. Phillips is a CFA and offers a unique combination of accounting and financial acumen and her expertise is invaluable.

Mr. Sheets stated that the revisions will have a cumulative effect given the last five years of transaction activity within these pools. Private Equity, and to a lesser degree, Real Estate returns will be revised upward. The preliminary work shows that the one year return for Private Equity will go up from 9.99% to 11.05%. Even the 10 year numbers for Private Equity will be revised slightly upward.

Mr. Voytko noted accuracy of the book of record is important as R.V. Kuhns depends on the numbers for its analysis and it could affect decisions when evaluating the performance of the team. Member Bugni suggested staff follow up with the Audit Committee. Executive Director Ewer explained the reason the discrepancies only showed up on Private Equity and Real Estate is due to distributions of realized gains; and confirmed the Audit Committee will follow up.

Mr. Higgins continued reviewing return data. The shift to more passive management should help; active management has been a drag on returns for the Domestic Equity Pool and for the International Equity Pool, though some of the managers who contributed to poor returns have been terminated already. Regarding RFBP and TFBP, Mr. Higgins praised staff on internal management and good choices of external managers which have contributed to positive returns. STIP returns continue to be paltry with a .30% return for the past year; however, this is attributable to the low rate environment supported by the Federal Reserve. The Real Estate Pool has done well for this calendar year and the Private Equity Pool has been a great asset although recovery for PE always lags the rest of the market.

Chairman Buchanan requested that seven year numbers be included in the performance report; Mr. Higgins responded R.V. Kuhns will include them.

Mr. Higgins advised the structural changes to MDEP and MTIP will make it more difficult to significantly underperform given an increase in the passive focus.

Responding to a question by Member Satre, Mr. Voytko stated composite peer groups are more meaningful when doing comparisons. Public funds over $3 billion are included but still vary quite a bit, as an example, one fund had no bond investments until recently.

Mr. Sheets added that the different public fund universes are murky at best, as they all are different and none have transparency. State Street Bank has their own public universe which we also show; the NASIO data base is available for viewing asset allocation but reporting lags. Viewing the different universes over time and triangulating is valuable.

Mr. Higgins reported with the Domestic Equity Pool repositioned at 65% passive, the underperformers are on their way out. The Analytic Investors 130/30 strategy is still trailing although they have improved in the last year. TimesSquare Capital Mgt. has improved and was recently removed from the watch list. For the International Equity Pool watch list, Alliance Bernstein has underperformed, and Martin Currie is a concern due to a regulatory issue that resulted in a $14 million fine; they have complied and since stabilized. And Hansberger Global Investors, a growth strategy, continues to underperform.

Mr. Higgins reviewed the RFPB and TFBP; there is one manager of concern, Post, a high yield manager.

With respect to fixed income Member Bugni suggested a review and possible change in benchmark may be in order. Mr. Higgins said it would be looked at in November, as that is when the fixed income asset class review is scheduled.

INVESTMENT ACTIVITIES/REPORTS

Retirement System Asset Allocation Report

Mr. Sheets presented the Retirement System Asset Allocation Report for the fiscal year ended June 30, 2012. There is a slight decline in assets, although all assets realized positive gains except MTIP which was -15% for the year. Fixed Income was strong at over 8%; Private Equity and Real Estate were over 11%. Overall assets declined 2.4% due mostly to larger fund benefit payouts, a liquidity drain of approximately $45 million each month, resulting in a net decline in assets. The Private Equity allocation increased 0.8%, to represent about 13% of total plan assets due to good performance. Even with the sale of $44 million from MPEP a net gain was realized due to strong returns. In total, equities were down from 67.3% to 66.1% over the year.

In Fixed Income, RFBP had $60 million in sales for the year which was offset by strong performance. Cash remains low at about 1% during the year. The aim has been to keep cash to a minimum due to low returns.

Comparison to State Street Public Fund Universe

Mr. Sheets began by reviewing asset allocation to the State Street public fund universe. Our public stock allocation is very close to the median weight. Allocation to Real Estate is high when shown vs. the State Street universe though looks more average when compared to a broader state-wide plan composite. The Private Equity allocation is above average at about the 25th percentile. Mr. Sheets then reviewed the return comparison to the universe. Performance is positive vs. peers over one year, as BOI is ranked third overall. BOI held less in international stocks and has more domestic equities vs. many of the bigger plans which accounts in part for outperforming our peers. Looking at the big picture the tendency is for a more worldly view of diversification, but that carries other risks such as currency risk. Historically the BOI public equity allocation has been two to one domestic vs. international.

Fixed Income

Mr. Nathan Sax presented the Fixed Income overview. As of June 30, Fixed Income is down 150 basis points. Continued troubles with the Euro caused a flight to safety. Of the 8.9 million jobs lost in 2008 only half of those have been recovered. Slow job creation, coupled with the slow housing recovery, have affected the market. With fear in the market the quest for income and quality continues.

Fixed Income External Manager Watch List
Mr. Sax presented the manager watch list. Post Advisors remain on the list. While performance rebounded nicely in the first quarter, second quarter returns, although respectable, still lagged. Staff recommendation is to keep them on the watch list until sufficient time has passed with continued improvement.

Manager	Strategy	Reason	Amount Invested ($ millions)	Inclusion Date
Post Advisors	Public High Yield	Performance	$57 RFBP $102 TFIP	February, 2012

Short Term Investment Pool, State Fund Insurance and Treasurer's Fund Report
Mr. Richard Cooley reported low rates continue although concern over banks in Europe has quieted down. The fund is well diversified and is operating within guidelines. Daily liquidity is at a minimum of $150 million and weekly minimum is $250 million. There is a shortage of asset backed commercial paper as a lot of sponsors have rolled them into their own balance sheets. So the trend of commercial paper drying up continues. STIP fund size remains at $2.3 to $2.4 billion, just slightly down from last quarter. Daily net yield remains low at just 0.32%.

The Treasurer's Fund total at June 30, 2012 totaled $1.1 billion; current securities holdings are at $34 million. The June General Fund balance is $445 million.

State Fund Insurance portfolio remains underweight in Treasuries and the portfolio has a slightly shorter duration than the benchmark. In the last quarter $13 million in asset backed securities were added. The total Fixed Income portion of the account outperformed the benchmark by 41 basis points for the quarter ending June 30 and outperformed by 90 basis points over the past year.

Private Asset Pool Reviews

Private Equity (MPEP)
Mr. Ethan Hurley reported the private equity portfolio performed well for the quarter ended March 31, 2012. Exposure remains broadly diversified by manager. Distributions continued to eclipse capital calls during the quarter resulting in net positive cash flow. He then reviewed the standard exhibits included in the private equity report.

Chairman Buchanan asked about the option of asking our fund-of-funds for their underlying fund costs, the question that was raised when discussing the CEM Report.

Mr. Hurley remarked that we could request the information of the managers. Staff is researching how BOI can get the needed exposure in direct ways without using fund of funds. All asset classes have costs to keep us fully exposed; going direct is a good option but we need to have the required information. Our strategy is to reduce the use of fund-of-funds where feasible over the long term, therefore reducing the associated costs.

Mr. Hurley reported three new commitments were added. The Tenex Capital Partners commitment was via a secondary purchase from another LP who had over-committed to the fund. We committed $20 million towards this buyout/operational turnaround strategy. Dover Street VIII is a fund which focuses on buying secondary interests to which we committed $10 million. A commitment of $15 million was made to Catalyst Fund Limited Partnership, IV, LP, which is a fund that focuses on distressed-for-control investments in the Canadian debt markets.

Fund Name	Vintage	Subclass	Sector	Amount	Date
Tenex Capital Partners SG, LP – Secondary Interest	2011	Buyout – Operational Turnaround	Diverse	$20M	6/30/12
The Catalyst Fund Limited Partnership IV, LP	2012	Distressed Debt for Control	Diverse	$15M	6/30/12
Dover Street VIII, LP	2012	Secondaries	Diverse	$10M	6/12/12

Real Estate (MTRP)
Mr. Ethan Hurley presented an overview of the real estate reports for the quarter ending March 31, 2012. The real estate pool is still experiencing net negative cash flows, due in part to large draw downs from Molpus and other recent commitments while distributions remain subdued. Our exposure remains diversified across the risk spectrum. Mr. Hurley will attend a timberland conference in Oregon next month, giving him additional exposure to a new asset class within the pool. Real Estate returns continue to plug along and were the best performing asset class for us during the fiscal year.

Three new commitments were made since the last Board meeting with the ABR commitment representing an addition to a prior $17 million commitment to the same fund:

Fund Name	Vintage	Subclass	Property Type	Amount	Date
Stockbridge Value Fund, LP	2011	Value – Add	Diverse	$25M	6/15/12
ABR Chesapeake Fund IV, LP	2011	Value – Add	Diverse	$13M	6/30/12
ORM Timber Fund III, LLC	2012	Timberland	Pacific Northwest	$30M	7/31/12

Partnership Focus List
There were no changes to the MPEP Focus list, and one change to the MTRP Partnership Focus List since the May 2012 Board Meeting. Responding to a question from Member Prothero, Mr. Hurley confirmed Beacon Capital Strategic Partners has been added to the watch list. While the manager has done a good job of trying to preserve value, suffering from the impact the recession has had on office properties, the fund is not expected to recover our cost.

Investment Consultant RFP

Investment Consultant RFP – Executive Director David Ewer and Brad Sanders, Procurement Bureau
By consensus of the Board, Public Asset Pool Review was moved to follow the Investment Consultant RFP discussion.

Executive Director Ewer stated there were six respondents to the RFP for consulting services which was issued on June 25 and closed on July 23, 2012:

- NEPC, LLC, Cambridge, MA
- Pension Consulting Alliance, Inc., Portland, OR
- R.V. Kuhns & Associates, Inc., Portland, OR
- Strategic Investment Solutions, Inc., San Francisco, CA
- Summit Strategies Group, St. Louis, MO
- Wilshire Associates, Inc., Santa Monica, CA

One applicant, Wilshire Associates, Inc., was disqualified for not meeting the requirements set out in the RFP. Wilshire also is a money manager which is expressly prohibited in the terms of the RFP.

Executive Director Ewer, Deputy Director Geri Burton and Chief Investment Officer Cliff Sheets will meet tomorrow, August 23, 2012, to jointly score the remaining applicants. Brad Sanders from the Procurement Bureau will also attend the meeting.

The Investment Consultant Committee will meet on Thursday, September 6, 2012 to hear staff recommendations and determine which applicants will be brought before the full Board for interview presentations. Of the total possible earned points of 1000, 250 are determined at the interview process. Fee scores are worth 200 points and the remaining 550 points will be scored at the staff meeting occurring tomorrow.

Member Noennig asked Mr. Sanders if the high scorer is awarded the contract. Mr. Sanders confirmed, yes, the high scorer is awarded the contract.

Mr. Sanders gave an overview of the RFP scoring process. The three staff members have each independently reviewed the five application packets submitted and have scored the applicants for each scoring section. At the meeting, which is a public meeting and has been noticed to the public, staff will go through the process of consensus scoring. The consensus scoring process works well as all staff participants have input and after discussion, they come to a consensus score for each participant for each scored section. Staff from the Procurement Bureau will also attend the meeting. Staff will present the results of the scoring process to the Investment Consultant Committee at the September 6, 2012 committee meeting.

Executive Director Ewer advised the Investment Consultant Committee can accept the staff scoring and decide how many finalists to bring in before the full Board for the presentation/interviews.

Member Noennig asked if the Committee has the option of rejecting staff scoring and starting the RFP process again from scratch. Mr. Sanders stated that was an option and there is no time limit, therefore reposting of the RFP could happen immediately.

<u>PERS/TRS Relationship – Board Member Jim Turcotte</u>
Member Turcotte had an addition to the earlier report. TRS is working on bills for the upcoming legislature. Actuarial changes in assumptions will be done in the off year.

Public Asset Pool Reviews

<u>Domestic Equity (MDEP)</u>
Mr. Rande Muffick reported on the Montana Domestic Equity Pool as of June 30, 2012. The changes in MDEP implemented at the May Board meeting have been completed. Alliance Bernstein small cap was a good addition back in April. He noted that growth stocks have outperformed value stocks for 2012 year-to-date. In discussing the transition done in June pursuant to the restructuring decision, four managers were reduced and four were terminated. A total of $865 million of large cap active exposure was moved to large cap passive. The market moved against us during the day of transition increasing the cost to 19.6 basis points; however BlackRock did a good job trading to mitigate the market impact.

<u>International Equity (MTIP)</u>
Mr. Muffick presented the Montana International Equity Pool Report for the period ending June 30, 2012 and reviewed market trends during the quarter. MTIP is down about 15% this fiscal year.

Public Equity External Manager Watch List

The watch list has dwindled down to two managers. Columbus Circle was terminated as part of the MDEP restructuring. Alliance Bernstein, an international value manager, is a new addition due to performance concerns with their deep value strategy. Times Square was removed from the watch list as they've had four consecutive outperforming quarters. Martin Currie had an issue with regulators which has settled down, though remains on the list for now.

PUBLIC EQUITIES MANAGER WATCH LIST
August 2012

Manager	Style Bucket	Reason	$ Invested (mil)	Inclusion Date
Martin Currie	International – LC Growth	Performance, Risk Controls	$95	February 2009
Alliance Bernstein	International – LC Value	Performance	$88	August 2012

To Do List

Chairman Buchanan called for items to add to the to do list. The Investment Consultant Committee will meet starting at 9:00 AM, Thursday, September 6, 2012. The meeting could last all day. The October 4th Board Meeting will be a one day meeting and will include the interviews/presentations of the RFP finalists. The regular Board meeting will begin in the afternoon after the interviews. Executive Director Ewer added R.V. Kuhns will add seven year numbers to their reporting; the Audit Committee will further review the performance calculation process at State Street Bank which allowed the error in certain pool performance numbers; the Human Resource Committee will be reviewing the policy on exempt positions; and Mr. Ethan Hurley will inquire regarding underlying fee costs from the fund-of-funds managers.

ADJOURNMENT

There being no further business, Chairman Buchanan adjourned the meeting at 12:25 PM.

Next Meeting

The next regular meeting of the Board will be Thursday, October 4, 2012 in Helena, Montana.

Complete copies of all reports presented to the Board are on file with the Board of Investments.

BOARD OF INVESTMENTS

APPROVE: ______________________
Gary Buchanan, Chairman

ATTEST: ______________________
David Ewer, Executive Director

DATE: 10/4/12

MBOI:drc
9/21/12