These minutes are Approved and Final. Full Board review and decision took place at the August 21 & 22, 2012 Regular Meeting of the Board.

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

MINUTES OF THE MEETING
May 22-23, 2012

BOARD MEMBERS PRESENT:

Gary Buchanan, Chairman
David Aageson
Bob Bugni
Karl Englund
Mark Noennig
Quinton Nyman
Jack Prothero
Jon Satre
Jim Turcotte

LEGISLATIVE LIAISONS PRESENT:

Senator Joe Balyeat
Representative Franke Wilmer arrived at 2:15 p.m.

STAFF PRESENT:

Jason Brent, CFA, Alternative Investments Analyst
Geri Burton, Deputy Director
Richard Cooley, CFA, Portfolio Manager, Fixed Income/STIP
Dana Chapman, Board Secretary
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
Gordon Hoven, Piper Jaffray
David Senn, Montana Teachers' Retirement System
Roxanne Minnehan, Public Employees' Retirement System
Kris Wilkinson, Legislative Fiscal Division

CALL TO ORDER

Board Chairman Gary Buchanan called the regular meeting of the Board of Investments (Board) to order at 12:30 PM in the Board Room on the third floor at 2401 Colonial Drive, Helena, Montana. As noted above, a quorum of Board Members was present. Senator Joe Balyeat was present; Representative Franke Wilmer arrived at 2:15 PM.

> Board Member Jack Prothero made a Motion to approve the Minutes of the April 3, 2012 Board Meeting; Member David Aageson seconded the Motion. The Motion was carried 9-0.

ADMINISTRATIVE BUSINESS

Audit Committee Report

Audit Committee Chair Jim Turcotte reported that the Board's Audit Committee met February 22 to discuss the FY12 Internal Control review and Risk Assessment Model; no changes were required. The Committee also met with Galusha, Higgins & Galusha regarding the Procedure Audit performed upon Carroll South's retirement, as is required after any major staff member departs. The Legislative Audit Division will be conducting the Performance Audit in the near future.

Human Resource Committee Report

Committee Chairman Karl Englund reported that the Committee will continue its meeting tomorrow morning prior to the reconvening of the Board meeting.

Loan Committee Report

Loan Committee Chair Jack Prothero reported that the Committee discussed Montana Science and Technology loan write offs which will be presented during Herb Kulow's Loan Report. The Committee postponed any discussion of the Veteran's Home Loan Mortgage Policy due to recent revisions submitted by the Board of Housing. The Committee approved INTERCAP loans which Louise Welsh will present during the Bond Program Report.

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 reviewed his general comments memo to the Board and called for any questions on the memo. Member Bob Bugni noted he did not have any recommendations at this time regarding his suggestion of a comprehensive review of BOI.

Director Ewer advised the budget will be presented at the August Board meeting; however, Board members will be sent a budget "primer" prior to the meeting. The legislature limits BOI to a total budget of $4.8 million for each fiscal year 2012 and 2013 but not all expenses are in the legislative budget. The Bond Program is paid through the Enterprise Fund, the custodial bank is paid by a statutory appropriation and the cost of external managers is paid under the Unified Investment Act.

Director Ewer reported staff is in the process of hiring another certified public accountant, a deputy financial manager, due to the Board's scope and complexities of duties.

Director Ewer advised staff recommends continuing with the CEM Benchmark study to produce the cost and return analysis report for 2011. Further discussion and decision will occur later in this afternoon's agenda item.

Director Ewer presented the Budget Status Report with year to year comparisons of April 30, 2012 and April 30, 2011.

Mr. Jim Voytko and Mr. Mark Higgins from RV Kuhns discussed the Monte Carlo Analysis follow-up requested by Member Bugni at the April 3, 2012 meeting which looked at the probability of attaining a 7.75% return. Mr. Voytko explained that regardless of the specific return assumption, there is nothing to say you cannot attain it; it's just a question of the probability of doing so. He also noted in response to a question that in general, long term return assumptions are down for 2012. Markets remain volatile and increased risk always exposes the plans to the possibility of lower returns. There was a question asked by Member Turcotte regarding the inflation assumption imbedded in the return assumptions used by RV Kuhns, and it was noted that a 2.5% general inflation rate was assumed which compares to a 3.5% rate used by the TRS actuary, the difference having some potential effect on nominal returns.

MONTANA LOAN PROGRAMS

Commercial and Residential Portfolios Report

Mr. Herb Kulow reported that the commercial and residential loan portfolios continue to hold a lot of cash. While refinances are plentiful, they do not fulfill the goal of creating economic development. The past dues remain constant.

As of April 30, 2012 the commercial loan portfolio totaled $136,679,661; this included five outstanding reservations in the amount of $6,135,000 and three loan commitments in the amount of $8,986,025. Our two past due loans are SBA guaranteed, totaling $205,452 or 0.15% of the total portfolio.

As of April 30, 2012 the residential loan portfolio totaled $21,236,570 with no outstanding reservations. Eight loans were past due totaling $549,645 or 2.59% of the portfolio, down from 3.08% at January 31, 2012. Of those past due loans, five were past due over 90 days totaling $387,011, four of those loans were guaranteed totaling $301,828 and one was a conventional loan totaling $85,183.

As of April 30, 2012 the Veterans Home Loan Mortgage Program has funded 13 loans totaling $2,180,786 which is the outstanding balance of this portfolio; there are currently 11 outstanding reservations totaling $1,945,140.

The Montana Veterans' Home Loan Mortgage Policy is pulled from consideration due to pending revisions and will be presented at the August Board meeting.

Mr. Kulow explained the history of the Montana Board of Science and Technology Alliance (MSTA). Originally created by the 1985 Legislature to encourage science and technology in Montana, the MSTA made high-risk investments as venture capital loans or loans to start-up companies. Abolished by the 1997 Legislature, MSTA became the responsibility of the Department of Commerce. The 1999 Legislature then transferred MSTA's portfolio to the Montana Board of Investments which then became the successor and responsible for the management and collection of MSTA's portfolio. There are eight entities currently in the MSTA portfolio reflecting a $12,153,215 balance. After very little activity since 1999, Mr. Kulow was directed to develop a plan of action regarding the MSTA portfolio.

Mr. Kulow's recommendations, as approved by the Loan Committee, propose the following write off of $1,496,265.86 of the MSTA Portfolio:

MSTA Entities			
as of May 3, 2012			
		Recommended	**Remaining**
Entity	**Balance**	**Write Off**	**Balance**
Montana University System	8,380,992.43	0.00	8,380,992.43
Schmitt Industries, Inc. (TMA Tech)	1,170,607.15	(1,170,607.150)	0.00
Glacier Venture Fund Manager LP	1,000,000.00	0.00	1,000,000.00
Gateway Software Corp.	174,999.99)	(174,998,99)	1.00
Northern Rockies Venture Fund LP	150,659.72	(150,659.72)	0.00
Deaconess Research Institute	161,603.40	0.00	161,603.40
Emerald Bio (Mycotech, Inc.)	739,509.83	0.00	739,509.83
McLaughlin Research Institute	271,958.76	0.00	271,958.76
	12,050,331.28	(1,496,266.86)	10,554,064.42

Mr. Kulow noted previously recorded income from Northern Rockies Venture Fund, LP of approximately $1.4 million, will offset the bulk of the write off. Loan Committee Chair Jack Prothero moved to accept the Committee's recommendations. The motion passed 7-0. Board Chair Gary Buchanan and Member Jon Satre abstained from the vote due to conflicts of interest. Any future payments received from the loans approved to be written off will be treated as income.

Bond Program Reports

Activity Report
Ms. Louise Welsh announced the 25th Anniversary of INTERCAP. From a small start, the program has grown over the years. A total of $42 million in commitments may be realized by the end of this fiscal year. The new logo and remarketing plan of INTERCAP are in place and plans to attend various promotional opportunities throughout the state are underway. The new INTERCAP rate has been set. The rate to borrowers dropped from 1.95 to 1.25 as of March 1, 2012.

Board Member Jack Prothero commended Ms. Welsh on the continued success of the program.

Ms. Welsh presented the INTERCAP report for the period ending March 31, 2012.

Staff Approved Loans Report
The Board reviewed this report for the period of January 1, 2012 through March 31, 2012.

Borrower:	Town of Pinesdale
Purpose:	Pilot study/report for surface water treatment system
Staff Approval Date:	January 3, 2012
Board Loan Amount:	$38,000
Other Funding Sources:	$60,000
Total Project Cost:	$98,000
Term:	3 years

Borrower:	City of Conrad
Purpose:	Expand and remodel City Hall
Staff Approval Date:	January 3, 2012
Board Loan Amount:	$320,000
Other Funding Sources:	$0
Total Project Cost:	$320,000
Term:	10 years

Borrower:	Northern Express Transportation Authority (Shelby)
Purpose:	Railroad Spur/Port of Northern Montana Hub Center
Staff Approval Date:	January 10, 2012
Board Loan Amount:	$320,000
Other Funding Sources:	$320,000
Total Project Cost:	$640,000
Term:	10 years

Borrower:	Augusta Rural Fire District
Purpose:	Purchase a new fire pumper truck
Staff Approval Date:	January 30, 2012
Board Loan Amount:	$115,000
Other Funding Sources:	$115,000
Total Project Cost:	$230,000
Term:	10 years

Borrower:	West Helena Valley Fire District
Purpose:	Purchase a new fire pumper truck
Staff Approval Date:	February 1, 2012
Board Loan Amount:	$140,000
Other Funding Sources:	$100,000
Total Project Cost:	$240,000
Term:	10 years

Borrower:	City of Havre
Purpose:	Purchase a New Street Sweeper
Staff Approval Date:	February 21, 2012
Board Loan Amount:	$142,000
Other Funding Sources:	$0
Total Project Cost:	$142,000
Term:	7 years

Borrower:	City of Havre
Purpose:	Purchase a New Refuse Truck
Staff Approval Date:	March 8, 2012
Board Loan Amount:	$235,885
Other Funding Sources:	$0
Total Project Cost:	$235,885
Term:	7 years

Borrower:	City of Livingston
Purpose:	Street Repair Project
Staff Approval Date:	March 5, 2012
Board Loan Amount:	$500,000
Other Funding Sources:	$0
Total Project Cost:	$500,000
Term:	10 years

The Loan Committee is authorized to approve BOI loans from $1-5 million. They authorized staff to proceed with processing and closing the following loans using the Board's standard Bond Program office procedures.

Borrower:	Department of Natural Resources and Conservation (DNRC)
Purpose:	Interim financing – Bond Anticipation Note BAN to finance a RRGL loan to Lockwood Water & Sewer District – Billings
Staff Approval Date:	May 2, 2012
Board Loan Amount:	$1,000,000
Other Funding Sources:	None
Total Project Cost:	$1,000,000
Term:	3 years – historically DNRC issues bonds well before maturity

Borrower:	Department of Natural Resources and Conservation (DNRC)
Purpose:	Interim financing – Bond Anticipation Note BAN to finance various RRGL loans to Montana irrigation districts projects and debt refinancing authorized HB 8 approved by the 2011 Legislature
Staff Approval Date:	May 2, 2012
Board Loan Amount:	$2,000,000
Other Funding Sources:	
Total Project Cost:	$2,000,000
Term:	3 years

Borrower:	Board of Regents of Higher Education of the state of Montana on behalf of Montana State University - Billings
Purpose:	Repairing/Replacing Union Building/Rimrock Hall HVAC
Staff Approval Date:	May 2, 2012
Board Loan Amount:	$1,500,000
Other Funding Sources:	$500,000
Total Project Cost:	$2,000,000
Term:	15 years

Borrower:	Sun Prairie Village County Water & Sewer District (Great Falls)
Purpose:	Bond Anticipation Note BAN in anticipation of USDA long term financing – water system improvement project
Staff Approval Date:	May 2, 2012
Board Loan Amount:	$1,399,000
Other Funding Sources:	$2,177,000
Total Project Cost:	$3,576,000
Term:	3 years

CONSULTANT REPORT

RV Kuhns & Associates

Mr. Mark Higgins and Mr. Jim Voytko presented an overview of the Investment Performance Analysis Report, Quarter Ended March 31, 2012. Mr. Voytko began by reviewing historical capital market returns and commented that the available returns to meet the actuarial needs of the pension plans were limited over the past ten years, with only small cap international, emerging market, and U.S. REIT stocks broaching a 7.75% annualized return. There was also discussion of valuation metrics, with reference to the Shiller P/E ratio and that stocks are not cheap by this measure, but perhaps justified given the very low level of Treasury yields.

Pension returns were reviewed, with Mr. Voytko noting that returns vs. benchmark provided limited information since these are “floating” benchmarks as opposed to a “policy” benchmark with fixed allocations by asset class. When asked, he explained the meaning of a policy benchmark as having point specific targets by asset class that allows an allocation effect to be explicitly measured. The peer comparisons looked favorable over recent years, with a noticeable trend of improving relative ranking over the past 10, 5, 3, and 1 year periods. Mr. Voytko also discussed peer comparisons in the context of risk/return scatter grams over two different timeframes, seven and three years. The return for Montana has moved up during the past three year period while remaining slightly lower risk. He cautioned, however, not to put too much emphasis on peer comparisons given the unique situations many plans are facing.

Mr. Higgins then discussed the performance of the various asset pools beginning with the domestic equity pool. He noted that the pool has underperformed modestly vs. the benchmark index, however compared favorably vs. other public fund peers during the past five years. This has bearing on the active vs. passive management debate, but does suggest that relative to peers Montana was selecting good managers. With respect to the international equity pool, relative performance vs. the benchmark index was poor over the past five years, though improving during more recent time periods. Unlike domestic equities, however, performance vs. public fund peers was poor, even for shorter periods. Also, the median public plan had outperformed the international benchmark markedly over the past one year which begs the question as to comparability of benchmarks used by the various plans represented in the survey. Further investigation of the peers and their international equity exposure was contemplated by RV Kuhns to shed more light on these comparisons. The fixed income pool (RFBP) was discussed as having strong relative performance vs. benchmark over multiple time periods. Member Bugni posed the question of whether a “custom” benchmark as opposed to the Barclays Aggregate index should be considered both for the RFBP and TFIP given the use of high yield within the pool in the past couple years. Mr. Voytko said they could work with staff to help create such a custom benchmark if deemed appropriate. Mr. Higgins then discussed the real estate pool, noting the benchmark (ODCE Index, net, one quarter lagged) was not a good match, and the timing of the initial investments made in the pool was unfavorable. Mr. Voytko noted that absolute performance had improved recently and that the diversification benefit of real estate was apparent as shown in the portfolio beta chart relative to the S&P 500 stock index. The private equity pool was discussed in terms of its strong return relative to its public equity benchmark over the past five years and its low correlation with public stocks. *(A complete copy of this report is kept on file with the documents of this meeting.)*

INVESTMENT ACTIVITIES/REPORTS

Montana Domestic Equity Pool Restructuring

Mr. Cliff Sheets and Mr. Rande Muffick presented an overview of the history of the Domestic Equity Pool (MDEP) and a proposed restructuring plan. Mr. Sheets began by noting that although relative returns have improved during the past five years compared to earlier history, the pool return expectations have not been met. With the different approach to be proposed, it is believed that the pool's performance will track closer to the benchmark and have a better chance of outperforming the benchmark over time while also being more cost efficient. Mr. Muffick then discussed the history of the pool's composition over time, as it transitioned from an internally-managed primarily mega cap biased active core portfolio combined with a minimal external small cap active component, to a fully externally-managed pool with several different actively managed components during the 2006 to 2008 timeframe. During both eras the returns did not meet expectations, due to a variety of reasons. The primary reasons included the failure of active management to provide incremental net returns, particularly in the large cap component of the pool, combined with some poor individual manager performance among the limited number of managers representing the mid and small cap components of the pool. Lessons learned were that large cap stocks are very efficient, making active management more challenging, and that although active management is more likely to succeed in non-large cap stocks, our manager selection was too concentrated. We also needed passive vehicles available in all market cap buckets to more easily facilitate allocation adjustments.

He then went on to explain the reasons why large cap active management is so difficult, noting the deleterious impact of fees on returns. He reviewed several graphs provided in the active-passive study done by RV Kuhns which showed data describing the relative performance of active managers in the large, mid and small cap universes for trailing three-year periods over the past 11 years. Small and mid cap active managers have had more success beating the benchmark than large cap active managers over time, though there can be times when the median active manager is unsuccessful even in these categories as well. Further, he discussed the benefits of the size premium in stocks over time, that is, the tendency of smaller cap stocks to outperform large cap stocks, and the persistency of the value premium over time.

Mr. Muffick explained the objectives of any restructuring of the pool, which include the goal of providing reliable beta exposure to U.S. stocks, while reducing tracking error to the benchmark and providing excess return. To attain these objectives a restructuring proposal was made that involves significantly reduced active large cap management, an expansion of the allocation ranges for mid and small cap exposure, and more manager diversification within the mid and small cap segments of the pool. In addition, this is expected to be more cost efficient in that active management fees will be paid in areas where it is likely to be more rewarding and the overall net fees paid will decline noticeably for the pool.

Member Jon Satre inquired about Western Asset Management. Mr. Muffick explained that their strategy involves a "portable alpha" concept which did not work out because of the negative impact from the financial crisis on the fixed income markets they were invested in. During mid-April they were terminated after being on the watch list for some time.

Members Noennig and Satre both inquired about the timing now of making the switch from active to passive management and the original motivation for moving into more active management in 2006. Mr. Sheets noted that in 2006 there was a combination of reasons for the switch. In May 2007 Executive Director Carroll South presented a memo to the board recalling the history with internal management of the pool and the initial use of the S&P 500 Index fund as a way to mitigate the sole dependence on the internally-managed active portfolio after a period of underperformance. It was decided that BOI needed more manager diversification and expertise with outside managers given the perceived advantages they bring given deeper resources; however, if only outside passive managers were used, there was no chance to outperform the benchmark. There was improvement with the changes and diversification away from utilizing only Montcomp and DFA, the sole small cap manager at the time.

Member Turcotte inquired if the justification for cycling back to passive is prompted by the recent market turmoil? Mr. Muffick stated there is more to the proposal than just transitioning from active to passive, and yes, market activity and the impact on active management is always tough to predict. Still, we are remaining at approximately 20% active in large cap under the new proposal.

Member Bugni added his view that if active management is not working out is it better to cut managers loose rather than wait them out. Over the long haul returns will likely improve as it's tough to realize net gains after fees.

Staff recommendations include transitioning to a mostly passive large cap approach, with an approximate target of 20% large cap to remain actively managed within the enhanced index and partial long/short (130/30) strategies, at a 8-12% allocation range for each.

Member Prothero made a Motion to accept staff recommendations, Member Bugni seconded. Mr. Sheets noted the motion should reflect approval of the updated Investment Policy Statement for MDEP. Member Prothero amended his Motion. Member Bugni seconded. The motion passed 8-1. Member Turcotte voted no, citing concerns that such a drastic revision may be premature and that allowing only five years for the prior active strategy to work was an insufficient time period.

The table below reflects the policy changes within the pool in the context of the overall pension allocation policy.

Exhibit A

60 -70% Equities Range

Domestic Equity Pool — 30% - 50%

Investment Type		Range
Large Cap Core (passive)	45%-70%	~~10% - 30%~~
Large Cap Enhanced	8%-12%	~~20% - 30%~~
~~Large Cap Style Based (long only)~~		~~20% - 30%~~
Partial Long/Short (130/30)	8%-12%	~~10% - 20%~~
Total Large Cap	72%-91%	~~82% - 92%~~
Mid Cap	6%-17%	~~5% - 11%~~
Small Cap	3%-11%	~~3% - 8%~~

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% - 70%
Large Cap Growth	10% - 20%
Large Cap Value	10% - 20%
Small Cap Core	5% - 15%

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

CEM Benchmark Study

Executive Director David Ewer presented his recommendation to continue with the CEM Benchmark analysis. The cost and performance data are invaluable as this may be the only accurate peer comparison available. Mr. Sheets concurred, stating that the analysis offers more in depth analysis and compares Montana returns to public, similar sized funds which allows staff to observe returns and analyze costs on an "apples to apples" basis. While staff resources are needed to provide accurate data, the value of the analysis is worth spending the staff time. Mr. Jim Voytko of RV Kuhns added CEM does a good job and they charge the $25,000 because they do a very detailed job and currently have no competition. He added BOI may not need the analysis every year but a second year will give BOI a baseline. Mr. Sheets noted that having the report done over the next two years as well, 2012 and 2013, will be helpful given staff is implementing significant changes to the domestic equity pool as just discussed. The chairman asked how long we had done these and stated he did not like the prior study done by CEM and thought their presentation was "weak."

Member Englund moved that the Board approve staff's recommendation to go ahead with the CEM Analysis. Member Satre seconded. Motion passed 9-0.

Board Training and Education

Director Ewer and Chairman Buchanan reviewed the Board's Education Policy. Director Ewer, and Members Turcotte and Satre will be attending the IFE Market Makers 2012 conference in Carlsbad, California in June. Board members requested as much advance notice on appropriate conferences as possible to allow for scheduling. Chairman Buchanan advised that will be a goal in the future.

ADJOURNED
Chairman Buchanan adjourned the Meeting for the day at 4:14 PM.

CALL TO ORDER – Day 2
May 23, 2012

Board Chairman Gary Buchanan reconvened the meeting Wednesday, May 23, 2012 at 8:36 AM with nine members of the Board present. Legislative Liaison Senator Joe Balyeat was present; Legislative Liaison Representative Franke Wilmer was absent.

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

Human Resource Committee Report
Committee Chair Karl Englund reported that the Committee is doing a periodic review of the exempt employee positions. The Committee recommends transferring a vacant BOI position to the Department of Commerce. Committee Chair Englund made the Motion to accept the Committee's recommendation, Member Quinton Nyman seconded. The Motion passed 9-0.

INVESTMENT ACTIVITIES/REPORTS, continued

Retirement System Asset Allocation Report
Mr. Sheets presented the Retirement System Asset Allocation Report for the quarter ended December 31, 2011. Mr. Sheets noted a strong quarter resulted in total equity increases of 1.8%, which was mostly market driven, overwhelming sales of the equity pools during the quarter. Since quarter end there has been a 6½% decline in US stock markets, so a give back of about half the first quarter return. European markets continue to remain unstable and are expected to remain volatile for the foreseeable future.

Comparison to State Street Public Fund Universe
Mr. Sheets reviewed a comparison of the two large pension plans to the State Street Public Fund Universe in terms of relative performance and asset allocation as a supplement to the RV Kuhns public fund universe return comparison.

With respect to asset allocation compared to peers, Mr. Sheets pointed out that we are overweight in real estate and private equity, but not as much as the allocation chart indicates. Other state-wide only comparisons indicate we are more likely in the middle of the second quartile. Returns have improved over time, with the one year comparative ranking looking especially strong, and in general returns are median or better from five years forward. Member Prothero inquired about any asset allocation implications of the new policy changes. Mr. Sheets cited that his goal has been to maintain total equity exposure in the top half of the range since the economic recovery began and he expects we will continue to sell on strength and buy on weakness. The market will be likely be choppy for awhile and we are limited by liquidity, however cash reserves have been built up slightly over the last four months. The private equity pool is also providing some liquidity as well given distribution activity.

Member Turcotte asked if any policy changes for fixed income were on the horizon. Mr. Sheets responded the international equity pool is slated to undergo the next policy review, and while there are no major changes expected in fixed income, this asset class will be discussed in detail at the November Board meeting.

Member Englund asked about the recent news regarding JP Morgan Chase. Mr. Sheets advised we do own some JP Morgan stock, which has suffered, but while the news may prompt more focus on regulatory questions, and while the market will always offer surprises; this latest news itself was not a major hit to the market.

Fixed Income

Mr. Nathan Sax presented the Fixed Income overview and strategy for the Retirement and Trust Fund Bond Pools. Mr. Sax described the first quarter as a “risk on” environment which supported the relative performance of credit, whereas so far this quarter we’ve seen a “risk off” sentiment which has dampened returns for lower grade securities. He also reviewed the external managers and their recent performance by referencing the RV Kuhns performance report. Lastly, he referenced a list of internally-managed below investment grade holdings and noted there have been no changes.

Fixed Income External Manager Watch List

Mr. Sax presented the manager watch list. Post Advisors remain on the list, but have improved; second quarter returns beat the benchmark by 108 basis points. Despite this improvement, for now they will remain on the watch list.

Manager	Strategy	Reason	Amount Invested ($ millions)	Inclusion Date
Post Advisors	Public High Yield	Performance	$57 RFBP $101 TFIP	February, 2012

Short Term Investment Pool, State Fund Insurance and Treasurer’s Fund Report

Mr. Richard Cooley reported on the Short Term Investment Pool, State Fund Insurance and Treasurer’s Fund portfolios. Mr. Cooley noted overall money markets improved over the first quarter. European banks ability to get credit contributed to the favorable conditions, although Greece remains a concern. Board consensus was reached to improve efforts to promote STIP. Member Bugni commended Mr. Cooley for his management of State Fund which has beaten the index consistently over the long term, 78 basis points over ten years.

The Board discussed STIP holdings in AFF Financing, formerly Axon Financial Funding, and Orion Finance USA, two securities which defaulted in November 2007 and January 2008, respectively, less than a year after being rated AAA. The original par totaled $140 million, of which about $62.4 million in book value remains. The underlying assets of the original Orion security were received during a workout process and are now retained in a segregated custodial account that receives the income and principal payments on those securities. We receive AFF payments monthly and Orion-related payments periodically as they occur. A reserve account, currently about $10.3 million, was set up to buffer STIP participants. In 2009, the Board applied $21 million from the reserve to the AFF and Orion outstanding principal balances. Mr. Cooley advised we should be made mostly whole over the next three to four years, however we still may realize a loss on some of the underlying securities which will be offset with the reserve. All agreed the reserve account was a good strategy. While giving up some yield, the reserve account includes portfolio sale gains or losses, a daily income allocation and all AFF and Orion interest receipts. These transactions are recorded and invested in the custodial bank’s Short Term Investment Fund.

Private Asset Pool Reviews

Private Equity (MPEP)
Mr. Ethan Hurley presented a comprehensive overview of the private equity portfolio for the quarter ended December 31, 2011. Exposure remains broadly diversified by strategy, industry, geographic and investment vehicle. He also discussed returns for the overall portfolio and by fund. The report also showed quarterly cash flow for the portfolio through December 31, 2011.

Chairman Buchanan asked specifically about the Highway 12 and Montlake funds and whether they had made any investments in the state. Mr. Hurley reviewed their respective returns and mentioned one Montana-based company which is held in the Highway 12 portfolio.

One new commitment was made since the last Board meeting:

Fund Name	Vintage	Subclass	Sector	Amount	Date
Northgate Venture Partners VI, LP	2012	Venture	Diverse	$15M	3/29/12

Mr. Hurley compared the performance of the private equity portfolio to the State Street Private Equity Index.

Real Estate (MTRP)
Mr. Ethan Hurley presented a comprehensive overview of the following real estate reports for the first quarter: total exposure by strategy; market value exposure by property type; total exposure by geography; and time weighted return of the portfolio and internal rates of return by fund. The report showed a negative quarterly cash flow for the portfolio through March 31, 2012 with capital calls outpacing distributions received, as expected and consistent with prior quarters.

Mr. Sheets remarked that our primary original objective with the real estate allocation was diversification which is now quite visible. Real estate lagged when the market was going down, and now is lagging as it comes back up. Mr. Hurley added in the context of the summary exposure reports and comparisons to the NCREIF index that our goal is not to match an index when hiring a manager, but rather to keep our exposure well balanced as to property type and other characteristics.

There were no new commitments since the February 2012 Board meeting.

Partnership Focus List
There were no changes to the MPEP and MTRP Partnership Focus lists since the February 2012 Board Meeting. In response to a question by Member Prothero, Mr. Hurley reported Beacon Capital, a real estate fund, is on track to permanent impairment and is likely to be added next quarter.

Public Asset Pool Reviews

Domestic Equity (MDEP)
Mr. Rande Muffick reported on the Montana Domestic Equity Pool as of March 31, 2012, including a summary of recent market trends. Mr. Muffick reported that while the first quarter performance was good, the market is down about 8% since quarter end. Markets could remain volatile for awhile considering European concerns and the upcoming November U.S. election.

In response to a previous question, Mr. Muffick discussed the transition related to the planned restructuring of the pool. Implementing the new pool strategy transition from active to passive large cap holdings will incur some costs, including trade impact and commission fees, with the total cost to performance expected to be about 10 basis points, so minimal transition costs are expected. Mr. Muffick advised the transition will occur in stages and expects the first move of large cap from active to passive by mid June. This will help accommodate the amount of internal accounting required as it relates to year end. Over time the addition of active small and mid cap managers will occur after researching managers and seeing which ones will fit with our current managers.

International Equity (MTIP)
Mr. Muffick presented the Montana International Equity Pool Report for the period ending March 31, 2012 and reviewed market trends during the quarter. Germany led with good returns, Spain is still a concern. Some active managers have been aggressively adding to emerging markets and at this point we are now overweight about 1% versus the benchmark exposure. We expect this weighting to emerging markets to remain about the same and overtime an overweight may be desirable given return expectations from EM. We give managers a range to work with for their EM exposure and currently all weightings are within approved ranges.

Montana International Equity Pool (MTIP) Structure Review
Mr. Muffick advised the current work plan calls for an in-depth discussion of MTIP at the November meeting with staff reviewing the pool for any recommended changes to enhance the structure of the pool. The pool was last restructured in 2006 to include emerging markets. Mr. Sheets noted the pool was previously more regionally structured and had passive segments within each region. Chairman Buchanan inquired if the pool is currently at 48% passive, how easy will it be to fix the strategy to change 10 years of underperformance? Mr. Muffick stated with MTIP fees for external managers at 34 basis points, the passive holdings have already helped performance. He also noted that staff has asked RV Kuhns to help us better understand the portfolio structures used by peers.

After brief discussion, the Board agreed by consensus to move the MTIP review to the August Board meeting.

Public Equity External Manager Watch List
Mr. Muffick presented the Manager Watch List during the quarter. One manager, Western Asset was terminated as staff sought to eliminate the embedded fixed income beta risk that this portfolio carried as part of the domestic equity pool. Martin Currie's performance has improved however they will remain on the list for now given a recent regulatory issue. Columbus Circle will be coming off the list as they will be terminated. TImesSquare is improving after a couple of years with some stumbles.

MANAGER WATCH LIST
May 2012

Manager	**Style Bucket**	**Reason**	**$ Invested (mil)**	**Inclusion Date**
Martin Currie	International – LC Growth	Performance, Risk Controls	$100	February 2009
Columbus Circle	Domestic – LC Growth	Performance, Process	$160	May 2011
TimesSquare	Domestic – MC Growth	Performance	$114	August 2011

PERS/TRS Relationship – Director David Ewer, Board Members Jim Turcotte and Bob Bugni
As the Board composition requires one member each from TRS and PERS, good communication channels exist between staffs and the Boards. Member Turcotte noted TRS has had Board meetings here at BOI including presentations by the Chief Investment Officer and

Executive Director. With the current involvement, Board members agreed there is no need for joint meetings at this time. Member Bugni distributed the PERS Defined Contribution Plan Study memo from the Principal Consulting Actuary. The conclusion of the memo to keep the Defined Benefit Plan, and Member Bugni agreed, is advantageous to the plan. Changing over to a Defined Contribution plan would eliminate the payroll funding to the Defined Benefit Plan incurring a huge funding cost, resulting in less benefit for more cost.

To Do List

Chairman Buchanan called for items to add to the to do list. The Human Resource Committee will be reviewing the exempt positions. Chairman Buchanan highly recommended all Board members make an effort to read Pensions & Investments as it covers all the tough, relevant subjects. If Board members have other suggestions for literature, talk to Deputy Director Geri Burton. Member Bugni inquired if the State Fund and Fixed Income Pool benchmarks needed to be reviewed by RV Kuhns. Mr. Jim Voytko suggested benchmarks be reviewed at the time of the Fixed Income review scheduled for the November Board meeting.

ADJOURNMENT

There being no further business, Chairman Buchanan adjourned the meeting at 11:42 AM.

Next Meeting

The next regular meeting of the Board will be Tuesday and Wednesday, August 21 - 22, 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: ______________________________

MBOI:drc
6/11/12