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

February 26 - 27, 2013

NEW BOARD MEMBER ORIENTATION

ORIENTATION

A. **Board of Investments** — **8:00 AM**
Overview and History

B. **Adjournment** — **9:30 AM**

AGENDA – DAY 1

COMMITTEE MEETINGS

A. **Human Resource Committee – (*Tentative, may not need to meet)*** — **10:00 AM**
Public Comment – *Public Comment on issues with Committee Jurisdiction*

B. **Audit Committee** — **10:30 AM**
1. Legislative FY12 Financial/Compliance Audit Report
2. Legislative Performance Audit Update
3. Emergency Preparedness

Public Comment – *Public Comment on issues with Committee Jurisdiction*

C. **Loan Committee** — **11:00 AM**
1. INTERCAP Loan Request – Decision
2. Coal Tax Trust Loan Request – Decision

Public Comment – *Public Comment on issues with Committee Jurisdiction*

BREAK — **11:30 AM**

Tab 1 CALL TO ORDER – Mark Noennig, Chairman — **11:40 AM**
A. Roll Call
B. Approval of the November 2012 Meeting Minutes
C. Approval of the February 12, 2013 Special Board Meeting Minutes
D. New Board Member Welcome and Introductions
E. Public Comment – *Public Comment on issues with Board Jurisdiction*
F. Department of Commerce Director, Meg O'Leary, Introduction – *Tentative*
G. Administrative Business
   1. Audit Committee Report
   2. Loan Committee Report
   3. Human Resource Committee Report

LUNCH SERVED — **12:00 PM**

Tab 2 EXECUTIVE DIRECTOR REPORTS – David Ewer — **12:30 PM**
A. FY12 Annual Report and Financial Statements
B. Quarterly Cost Report
C. 2013 Work Plan
D. Client Outreach
E. Code of Ethics
F. Legislative Session (Including comments from Board's Legislative Liaisons)
G. Board Member Training

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

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Tab 3 MONTANA LOAN PROGRAM – Herb Kulow, CMB **1:00 PM**
- A. Commercial and Residential Portfolios Report

Tab 4 BOND PROGRAM – Louise Welsh **1:20 PM**

- A. INTERCAP Program
  1. Activity Report
  2. Staff Approved Loans Report
  3. Loan Committee Approved Loans Report
  4. 2013 Bond Issue Update

Tab 5 STATE FUND – Real Estate Allocation – Rich Cooley, CFA, **1:40 PM**
Cliff Sheets, CFA, Mark Barry, VP, Corporate Support, MT State Fund
- A. Investment Policy Statement – Decision

CONSULTANT REPORT – R. V. Kuhns and Associates **2:10 PM**
- A. Quarterly Performance Report

BREAK **2:40 PM**

Tab 6 INVESTMENT ACTIVITIES/REPORTS – Cliff Sheets, CFA and Staff **2:55 PM**
- A. Retirement System Asset Allocation Report
- B. Fixed Income Reports
  1. Bond Pools (RFBP and TFIP) – **Nathan Sax, CFA**
  2. Short Term (STIP) and Other Fixed Income Portfolios – **Richard Cooley, CFA**
- C. Public Equity Pool Reports – **Rande Muffick, CFA**
  1. Domestic Equity (MDEP)
  2. International Equity (MTIP)
- D. Private Asset Pool Reports – **Ethan Hurley**
  1. Private Equity Pool (MPEP)
  2. Real Estate Pool (MTRP)

ADJOURNMENT **4:30 PM**

AGENDA – DAY 2

RECONVENE AND CALL TO ORDER – Mark Noennig, Chairman **8:30 AM**
- A. Roll Call
- B. Public Comment – *Public Comment on issues with Board Jurisdiction*

Tab 7 SECURITIES LENDING – Cliff Sheets, CFA, and **8:45 AM**
R.V. Kuhns and Associates

Tab 8 BENCHMARKS – R.V. Kuhns and Associates, Cliff Sheets, CFA, and Staff **9:25 AM**

RECAP OF STAFF TO DO LIST AND ADJOURNMENT – Mark Noennig, Chairman **10:40 AM**

Tab 9
- A. Acronym Index
- B. Annual Board Meeting Schedule

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MONTANA BOARD OF INVESTMENTS
NEW BOARD MEMBER ORIENTATION
2401 Colonial Drive, 3rd Floor
Helena, Montana

February 26, 2013

A. **Board of Investments – Board Chairman/Executive Director Ewer** **8:00 AM**

1. Welcome and Opening Remarks
2. Fiduciary Responsibility – Prudent Expert Principal
3. Board Structure
   a. Governance Manual
   b. Code of Ethics
   c. Board Decisions
   d. Board Committees
   e. Meeting Calendar and 24 Month Work Plan
   f. Organization Chart - Senior Staff

B. **Investments – Cliff Sheets, CFA, Chief Investment Officer** **8:10 AM**

1. Investment Structure
2. Asset Allocation (pensions)
3. Investment Performance: Measurement and Context
4. Investment Staff: Structure and Roles

C. **Accounting – Gayle Moon, CPA, Financial Manager** **8:30 AM**

1. Money Flow
2. Accounting
3. Auditing
4. Internal Controls

D. **In-State Investments – Herb Kulow, CMB, Senior Portfolio Manager** **8:45 AM**

1. History
2. Montana Investments - Coal Tax and Retirement Funds
3. Loan Programs – Prudent Expert Rule
   a. Commercial
   b. Veterans' Home Loan Program (VA)
   c. Residential
4. Non-Traditional Commercial Loans

E. **Municipal Finance – Geri Burton, Deputy Director** **8:55 PM**

1. INTERCAP
2. Credit Enhancement

F. **Board Member Logistics – Dana Chapman, Board Secretary** **9:05 AM**

1. Board Travel
   a. Per Diem
   b. Hotel and Travel Arrangements/Costs
2. Website
   a. Board Meetings/Materials
   b. Board Member Public Contact Information
   c. Wifi

G. **Break** **9:10 AM**

H. **Question and Answer** **9:20 AM**

I. **Adjournment** **10:00 AM**

Return to Agenda

Call to Order

Montana

Board Of Investments

Board Member Orientation

February 2013

www.investmentmt.com

TABLE OF CONTENTS

Welcome to the Board of Investments! This orientation covers only the basics of what the Board of Investments does and how it is governed. Hopefully it will give you enough "beginnings" so you will feel comfortable to jump right in…or ask a lot of questions! Again, welcome aboard one of the most important jobs in state government: investing the state's money.

BOARD MEMBER/STAFF FIDUCIARY RESPONSIBILITIES

As a Board member, you, your colleagues on the Board and the staff that works for you MUST adhere to Montana's constitution and its laws. While there will be numerous legal concepts, laws, and policies you will encounter during your service on the Board, there are two recurring and paramount concepts that are particularly germane to the Board.

***Fiduciary Responsibility* -** Everyone involved with the Board, members, its staff, its agents, all of us have a responsibility to serve the interests of our beneficiaries (our "customers"), whether they be retirees or state agencies, first. The investment benefits are theirs, not ours. How we meet our responsibilities and what is the range of our considerations depends on the specific beneficiaries. For example, the Board has wide latitude in considering investments for the pension funds, but Montana's constitution explicitly prohibits the Board from investing in equities of public companies for its trust funds.

Prudent Expert Principle - The Board of Investments is considered to have expertise in the area of investments. Our ability to take risks is allowed by law to be greater than an ordinary person's because we have Board members such as you, your staff, other resources and a complex system of laws and investment policies to balance achieving returns with risk. The Board is considered to be an 'expert' investor, but we must always act prudently, carefully and deliberately. Here is what the law directs how the Board must act:

- **Discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims;**
- **Diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and**
- **Discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program**.

BOARD COMPOSITION, VOTING REQUIREMENTS & GOVERNANCE

<u>Board Member Appointment Process</u> – As a quasi-judicial Board, the number and qualifications of its members are prescribed by law. At least one member must be an attorney licensed to practice law in Montana. The Governor appoints all voting members and must appoint five members (a quorum) to four-year terms concurrent with the Governor's term. The remaining four members are appointed to four-year terms mid-way through the Governor's term. This process permits a new Governor to impact the governance of the Board by appointing the majority of members at the beginning of his/her term. The members serve until a successor is appointed and may be removed by the Governor only for "cause." The Governor appoints the Chairperson and all members must be confirmed by the state Senate.

<u>Board Membership Criteria</u> – The law specifies member criteria as follows:

- One member from the Public Employees' Retirement Board;
- One member from the Teachers' Retirement Board;

Seven members to provide a balance of professional expertise and public interest and represent

- The financial community;
- Small business;
- Agriculture;
- Labor; and
- Two ex officio, nonvoting legislative liaisons to the Board. One must be a Senator appointed by the President of the Senate and one must be a Representative appointed by the Speaker of the House. The liaisons may not be from the same political party.

<u>Voting Requirements</u> – As a quasi-judicial Board, there must be a quorum (5) present to conduct business and all substantive action taken by the Board must be approved by a majority (5) of the entire Board, regardless of the number of members present at the time the action is taken. In other words, if there are only five members present at the meeting they all must approve a substantive action.

Board Governance – the Board clearly spells out its fiduciary responsibilities as an entity and how those responsibilities will be delegated to its staff or reserved to the Board through its Governance Manual, which is Board policy. You are strongly encouraged to become familiar with the Board's Governance Manual, which is included with orientation material.

Board Staff – State law authorizes the Board to employ an Executive Director and a Chief Investment Officer who have general responsibility for selecting and managing the Board's staff and for the day-to-day investment and economic development activities. The Board prescribes the duties and salaries of the Executive Director and Chief Investment Officer and six other staff positions and the eight staff "serve at the pleasure of the Board."

<u>Exempt Staff</u> – In personnel terms the eight positions that serve at the pleasure of the Board are called "exempt" positions, meaning that they are exempt from the state classification and pay plan system to which most state employees are subject. The Board sets exempt employee salaries and is not subject to the state's rather rigorous recruitment and selection process when it recruits and hires these employees. The trade-off for the exempt employees is that they serve at the pleasure of the Board, which means they do not have the full range of protocols available to classified staff in terms of discipline and termination.

BOARD COMPOSITION, VOTING REQUIREMENTS & GOVERNANCE CONTINUED

Classified Staff – Except for the exempt staff, all other Board employees are "classified", which means that the selection/hiring process; the discipline/termination process; and the salary-setting process are all spelled out clearly in state law and regulation.

BOARD ALLOCATION & AUTHORITY

All state Boards must be allocated to a State Agency for certain purposes. The Board is a "quasi-judicial" Board allocated to the Department of Commerce for administrative purposes and operates under the following legal parameters.

The Board:

- Exercises its quasi-judicial and policymaking functions independently of the Department and without approval or control of the Department;
- Submits its budgetary requests through the Department; and
- Submits reports required of it by law or by the Governor through the Department.

The Department of Commerce:

- Directs and supervises the budgeting, recordkeeping, reporting, and related administrative and clerical functions of the Board;
- Includes the Board's budgetary requests in the departmental budget;
- Collects all revenues for the Board and deposits them in the proper fund or account;
- Provides staff for the Board, unless otherwise directed by law; and
- Prints and disseminates for the Board any required notices, rules, or orders adopted, amended, or repealed by the Board.

The Director of the Department of Commerce:

- Represents the Board in communications with the Governor; and
- Allocates office space to the Board as necessary, subject to the approval of the Department of Administration.

In practical, day-to-day terms this means that the Board acts totally independent in its role as investment manager – determining when and how public funds will be invested. It also acts independently as it manages the Coal Tax Trust and INTERCAP loan programs. The Board's activity in these roles is governed only by the state constitution and state law. To assist the Board in its investment responsibilities, it retains an investment consultant that provides guidance, educational activities, performance analytics, and assistance in hiring and monitoring external investment managers.

The Department of Commerce handles most of the Board's purely administrative functions, such as personnel, invoice payment, budgeting, and budget documentation. The Board exercises sole discretion when hiring and setting salaries of its eight non-classified (exempt) staff. The Board also hires its classified staff, but the process is subject to Department approval and the salaries are governed by state law as interpreted by the Department.

Although the Department occasionally provides legal services to the Board, most of the Board's investment-related legal services are provided by outside legal counsel by contract. Although the law states that the Department Director will represent the Board in communications with the Governor, in practice, the Board's Executive Director communicates directly with the Governor, the Legislature, and the media. The Board issues its Annual Report independent of the Department and Board staff deals directly with the Legislative Auditor during and after the annual audit of the Board's operations. Board staff reports directly to the Legislative Audit Committee when the audit is presented to the committee.

BOARD MEETINGS & COMMITTEE STRUCTURE

The full Board meets quarterly at regularly scheduled meetings and may meet for specific purposes at the call of the Chair. Board packets, containing the meeting agenda and staff reports, are mailed to members approximately one week prior to the meetings and are posted on the Board's web site. All meetings are open to the public and the entire meeting is recorded to facilitate the preparation of minutes. Most meetings are held in Helena but occasionally meetings are held in other locations in the state.

Members receive $50.00 per diem for each meeting day and $50.00 for reviewing the Board packet. All Board member travel expenses are reimbursed per state policy.

The Board has created three committees for specific purposes.

Human Resources Committee – The Committee is comprised of at least three Board members appointed by the Chair. The Committee's primary responsibilities are:

- Establishing, maintaining, and updating the pay plan for the Board's eight exempt staff by utilizing compensation data from other public pension plans and/or investment boards.
- Reviewing the performance of the exempt staff and submitting exempt salary recommendations to the full Board for final approval.
- Recommending to the Board a process for filling vacant exempt positions.
- Hearing written appeals and grievances from exempt staff if the Executive Director is unable to resolve differences.

Loan Committee – The Committee is comprised of at least three Board members appointed by the Chair. The Committee's primary responsibilities are:

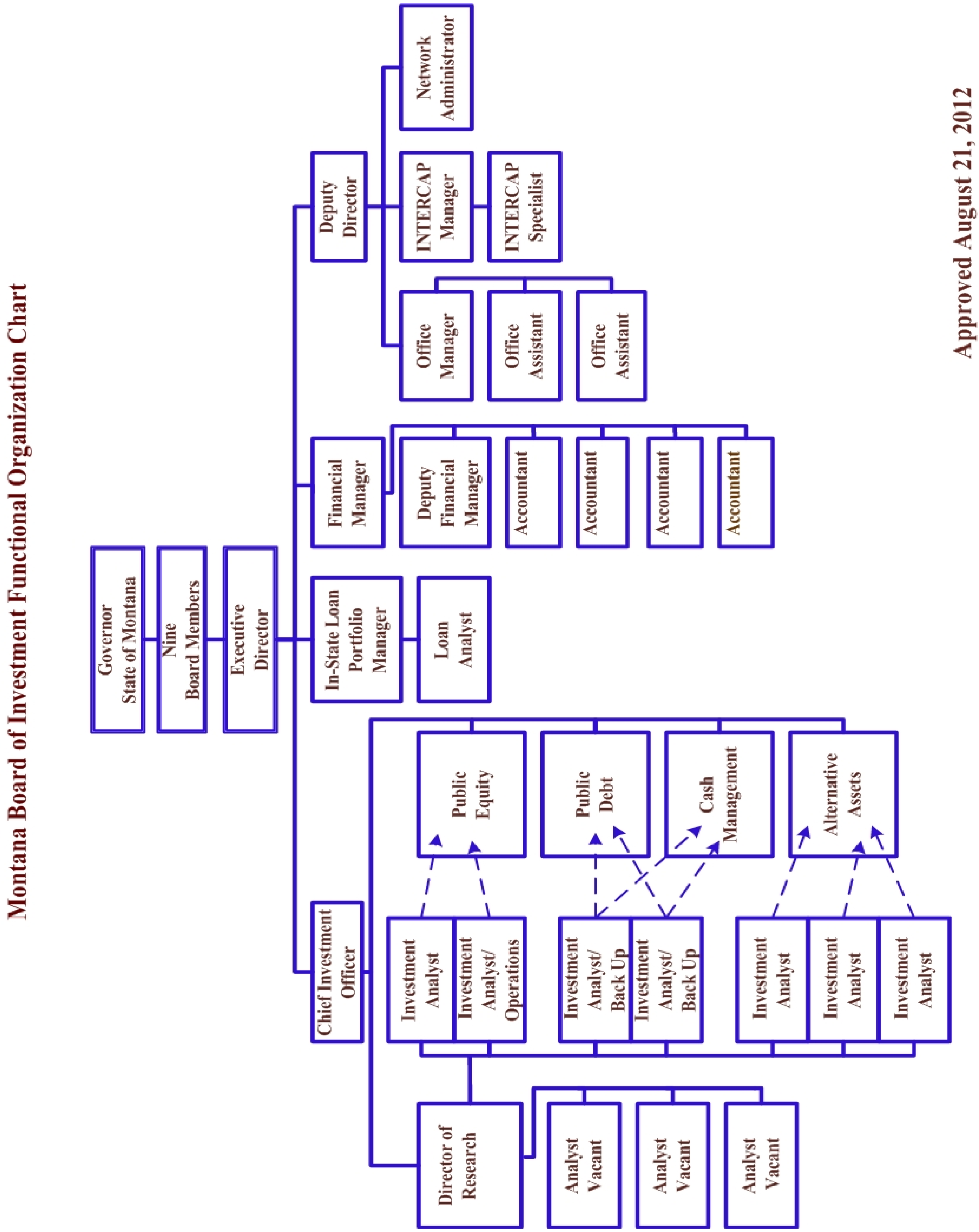
- Reviewing and approving/disproving staff recommendations for non federally-guaranteed Coal Tax Trust loans, INTERCAP loans, and the enhancement of INTERCAP bonds and Montana Facility Finance Authority bonds in excess of $1.0 million and up to $5.0 million.
- Reviewing staff recommendations for non federally-guaranteed Coal Tax Trust loans and INTERCAP loans in excess of $5.0 million and the enhancement of INTERCAP bonds and Montana Facility Finance Authority bonds in excess of $5.0 million and making a recommendation to the full Board for approval/disapproval.
- Reviewing staff recommendations to issue additional INTERCAP bonds and making a recommendation to the full Board for approval/disapproval.
- The Board has delegated to staff the authority to approve loans up to $1.0 million.

Audit Committee – The Committee is comprised of at least three Board members appointed by the Chair. The Committee's primary responsibilities are:

- Monitoring the Board's internal control policy and supervising the Board's Internal Auditor contractor.
- Meeting with the Legislative Auditor and reviewing its Audit Report.
- Authorizing Board staff to file for lead or co-lead plaintiff status in securities class action litigation.
- Authorizing Board staff to opt out of class action securities litigation in which it is a member.

The entire Board acts as an Investment Committee and must approve all asset allocation recommendations made by staff.

BOARD STAFF ORGANIZATION



BOARD'S THREE MISSIONS

Manage the Unified Investment Program – The Board's original and primary mission is to prudently manage the constitutionally-created Unified Investment Program, which includes all the state's day to day cash, its trust funds, and the pension funds as well as local governments funds invested in the Program. The Board manages the Program pursuant to constitutional and legal provisions, which restrict equity investments to the nine retirement funds and the State Workers' Compensation Fund. The Program is managed under the "prudent expert principle", which requires the Board to:

- **Discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims;**
- **Diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and**
- **Discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.**

The Program is managed with a mix of Board investment staff and external investment managers.

Manage the Coal Tax Trust Loan Program – The Board manages four distinct loan programs authorized by law and funded from the Coal Tax Trust. As of June 30, 2012, the Board had loaned $654.4 million since inception of the first loan program.

State law declares that the purpose of the Coal Tax Trust is to:

- **Compensate future generations for the loss of a valuable and depletable resource and to meet any economic, social, and environmental impacts caused by coal development not otherwise provided for by other coal tax sources; and**
- **Develop a stable, strong, and diversified economy which meets the needs of Montana residents both now and in the future while maintaining and improving a clean and healthful environment as required by Article IX, section 1, of the Montana constitution.**

All loan programs are limited to Montana businesses and the Program is managed exclusively by Board staff.

Manage the Bond Programs – Under this Program, the Board issues tax-exempt bonds and lends the proceeds to eligible governmental entities for a broad variety of projects (INTERCAP). The Program has been used extensively by local governments due to a user-friendly process and low interest rates. As of June 30, 2012, the Board had loaned $369.4 million since the Program's inception. The Board also manages other smaller bond programs authorized by law.

All bond programs are limited to Montana entities and the Program is managed exclusively by Board staff.

BOARD FUNDING

The Board is considered a "proprietary" entity in state government, which means that its funding is derived from fees charged for services it provides, similar to private sector entities. Within the proprietary category there are two types of entities: 1) an **internal services** entity that provides most or all of its services/products to state entities; and 2) an **enterprise** entity that provides most or all of its services/products to non-state entities.

Board funding is provided by both **internal services** and **enterprise** accounts. Because the Board's investment function primarily serves state entities, the investment function is funded by an **internal services account**. The Board's INTERCAP Program primarily serves non-state entities and is funded by an **enterprise account**.

Internal Services Account – To prevent one state entity from overcharging another, the Legislature sets the maximum fee the entity may charge as a part of the biennial budgeting process. In most instances, the fee is based on a "per" service cost, such as state Motor Pool charges for daily and per-mile use of its vehicles. The fee-for-use process makes Motor Pool revenues totally dependent upon other state entities using its vehicles.

The Board's fee authorized by the Legislature is rather unique in that it is set as a total lump-sum fee based on the Board's anticipated expenditures during the next biennium. Consequently, the Board's investment revenue is not impacted by the size of the investment portfolio or the number of accounts it invests. To ensure that the fees closely match expenditures, the Legislature requires that the Board's account balance not exceed a "60-day" working balance. In other words, the Board is permitted to retain sufficient funds in its account to pay for 60 days worth of its operations. If the balance exceeds that limit, the Board must reduce its fees.

If expenditures exceed the fees charged during the year, the 60-day working balance will shrink. Conversely, if expenditures are less than the fees charged during the year, the balance will increase up to the 60-day maximum at which time fees must be reduced.

Enterprise Account – The Legislature does not set fees for these accounts because an enterprise entity provides few if any services/products to state entities. The Board's INTERCAP program derives its revenues from the "spread" between the interest rates on the bonds it issues and the interest rates charged on loans made from the bond proceeds. Although budgeting information is included in the Governor's budget and reviewed by the Legislature no action is taken on this information. The Board replenishes the account annually when INTERCAP bonds are remarketed with funds sufficient to meet one year's expenditures from the account.

Custodial Bank Fees – In addition to the Board's investment management fee, it charges a fee for custodial bank services. The fees are not approved by the Legislature because the Board deposits the fees in the state general fund from which a statutory appropriation is made. (Fee authority is not required when the funds are appropriated.) A statutory appropriation is made by law and is not subject to legislative approval.

External Investment Manager Fees – External manager fees are paid from investment income and are not included in the Board's budget or approved by the Legislature. These fees, based on externally-managed asset values, are too volatile to be subject to an inflexible biennial budget.

BOARD FEES & FEE ALLOCATIONS

Board staff utilizes a cost allocation system to equitably allocate the Legislatively-approved Board fees and the Custodial Bank fees to the various accounts in the investment portfolio as depicted in the adjacent table. The cost allocation centers consist of the seven investment pools, fixed income/equity investments not held in the pools, and loans/mortgages.

Cost Allocation Centers	Board Fee	Bank Fee
Retirement Funds Bond Pool	13.65%	14.03%
Trust Funds Bond Pool	9.29%	8.19%
Domestic Equity Pool	10.97%	37.09%
International Equity Pool	11.37%	10.38%
Private Equity Pool	15.49%	3.74%
Real Estate Pool	10.89%	1.89%
Short Term Investment Pool	11.59%	14.09%
All Other Funds	6.47%	10.07%
Loans/Mortgages	10.27%	0.53%
Total	**100.00%**	**100.00%**

Board Fees – Board fees are allocated based on the number of staff working in each cost center. Non personnel costs are allocated directly to cost centers based on where the services are provided. For example, fixed income analytical services are allocated to fixed income centers and equity analytical services are allocated to public equity centers. Non personnel costs that cannot be specifically targeted to one of the cost centers are prorated based on the number of staff deployed to that cost center.

Custodial Bank Fees – Custodial Bank fees are allocated 60.0 percent based on the number of yearly transactions in each center with the remainder allocated based on the asset values within the center. There were more than 76,000 transactions recorded in the custodial bank's accounting system during a 12 month period. The total fees charged are based on a fixed amount in the Custodial Bank contract.

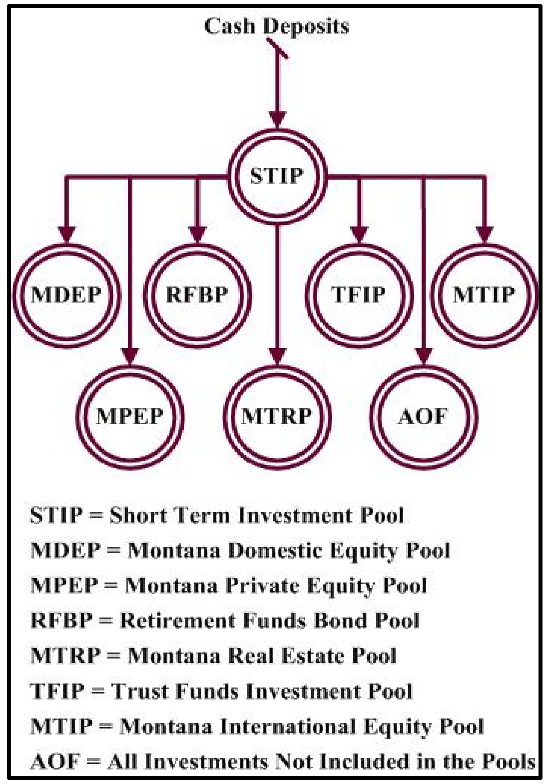
External Manager Fees – External investment manager fees are charged directly to the cost centers in which the services are provided. For example, domestic equity manager fees are charged to the Domestic Equity Pool and international equity manager fees are charged to the International Equity Pool.

The table below shows the total fees charged to each center in Fiscal 2012.

Pool	Board	Custodial Bank	External Managers	Total
Retirement Funds Bond Pool (RFBP)	$ 628,331	$ 210,492	$ 1,506,845	$ 2,345,668
Trust Funds Investment Pool (TFIP)	428,978	126,445	1,564,946	2,120,369
Montana Domestic Equity Pool (MDEP)	506,725	556,285	9,483,507	10,546,517
Montana International Equity Pool (MTIP)	525,356	155,820	3,626,673	4,307,849
Montana Private Equity Pool (MPEP)	715,836	110,148	15,779,225	16,605,209
Montana Real Estate Pool (MTRP)	503,241	65,633	7,985,684	8,554,558
Short Term Investment Pool (STIP)	535,595	211,284	-	746,879
All Other Funds (AOF) Investments Managed	775,721	158,963	26,805	961,489
Total	**$ 4,619,783**	**$ 1,595,070**	**$ 39,973,685**	**$ 46,188,538**

Fees charged to the investment pools are deducted from investment income prior to the distribution of income to the pool participants. The Legislative Auditor reviews the cost allocation procedure annually.

INVESTMENT STRUCTURE



All funds deposited with the Board are initially invested in the Short Term Investment Pool (STIP). State and local agencies buy and sell STIP units at their discretion with 24-hours notice. The STIP is the only investment option available for local governments and is the primary investment vehicle for most state accounts. The Board has developed other special purpose investment pools that operate similar to mutual funds as depicted in the adjacent chart.

While Board staff exercise no control over local and state agency purchases/sales of STIP units, staff exercises total control over investments in the other pools and the "All Other Funds" portfolio. The transfer of investments from the STIP to other investment pools is conducted monthly by staff based on pre-determined criteria for the account. Most state agency accounts will remain in the STIP due to liquidity or other requirements, but STIP balances are kept to a minimum in retirement and non-expendable trust funds.

The investment pool process simplifies investing and accounting and provides diversification and safety for smaller accounts that would otherwise have to invest in individual securities. The All Other Funds (AOF) is not an investment pool but rather a "bucket" created to hold all investments not held in the investment pools. The largest account in the AOF fund is the State Fund that primarily holds intermediate-term bonds that are a better fit for its maturity requirements than the long-term bond investment pools. The Coal Tax Trust loans and Veterans' Home Loan Program mortgages are also held in the AOF.

The investment pool creation date and the type of funds eligible to participate are shown below:

Pool/Investments Managed Name	Creation Date	Eligible Participants
Retirement Funds Bond Pool (RFBP)	04/01/95	Nine Retirement Funds Only
Trust Funds Investment Pool (TFIP)	10/01/95	Various State Trust Funds
Montana Domestic Equity Pool (MDEP)	07/01/80	Nine Retirement Funds/Small Trusts
Montana International Equity Pool (MTIP)	06/01/96	Nine Retirement Funds Only
Montana Private Equity Pool (MPEP)	05/01/02	Nine Retirement Funds Only
Montana Real Estate Pool (MTRP)	06/01/06	Nine Retirement Funds Only
Short Term Investment Pool (STIP)	07/01/74	All State Funds and Local Governments
All Other Funds (AOF) Investments Managed	NA	Non-Pool State Agency Investments

<u>Investment Pool Procedures</u> – Net investment income (after fees) is distributed monthly to investment pool participants, while capital gains/losses are retained in the pools and reinvested. Reinvesting net capital gains in the pools is a much more efficient process than distributing the capital gains to participants and then repurchasing units in the pools. Except for the STIP that operates with a $1.00 share value, pool shares must be priced when participants buy or sell pool shares.

INVESTMENT PROCESS

Montana law directs that the Board shall "determine the type of investment to be made". In choosing the type of investment, the Board must determine whether to use a public or private equity external manager to invest funds. The Board has delegated to staff the responsibility to hire, monitor, and terminate all external investment managers.

Fixed Income and Public Security Investment Managers – Investment managers who actively manage the Board's fixed income investments and publicly-traded stocks/bonds are selected by Board staff after going through a thorough due diligence process. The Board's consultant, R.V. Kuhns, provides extensive data-gathering activities and guidance during the selection process, but the ultimate manager selection is made by Board staff. The managers are hired under a standard state contract and can be terminated with five days notice with or without cause.

Alternative Investment Managers – Investments in private equity and real estate are structured as Limited Partnerships managed by a General Partner who has the responsibility to raise funds and invest those funds over a specified period of time. Board staff can only invest in these funds when they are in the "fund raising" stage.

The funds are typically closed-end and structured as Limited Partnership Agreements to which limited partners subscribe and make a "commitment" of funds that are drawn down over a three to five year investment period. The General Partners invest the funds in various types of underlying private investments during the investment period and are expected to return the committed funds and profits over the life of the funds. Because a fund's anticipated life may be as long as 10 to 12 years and there are limited opportunities for Limited Partners to exit the fund during its legal life, these investments are considered illiquid. Because the draw down schedule of these funds cannot be predicted with any accuracy, Board staff must ensure that adequate cash is available at all times to fund commitments on short notice.

The table below shows the percentage of the Unified Investment Program invested by Board staff and external managers as of June 30, 2012.

Pool/Investments Managed Name	Board Staff	External Managers	6/30/12 Total
Retirement Funds Bond Pool (RFBP)	71.0%	29.0%	$ 1,934,409,921
Trust Funds Investment Pool (TFIP)	89.8%	10.2%	$ 2,057,752,617
Montana Domestic Equity Pool (MDEP)	0.0%	100.0%	$ 2,890,073,262
Montana International Equity Pool (MTIP)	0.0%	100.0%	$ 1,234,550,534
Montana Private Equity Pool (MPEP)	0.0%	100.0%	$ 1,017,274,831
Montana Real Estate Pool (MTRP)	3.9%	96.1%	$ 625,321,924
Short Term Investment Pool (STIP)	100.0%	0.0%	$ 2,332,644,094
All Other Funds (AOF) Investments Managed	91.3%	8.7%	$ 1,624,484,456
Weighted Percentages	51.5%	48.5%	$ 13,716,511,640

Most of the portfolio is actively managed, but there are passive components in the MDEP and MTIP to provide stability and reduce tracking error to the respective benchmarks. There is also a passive component in the AOF, reflecting the equity index investments of the State Fund. The passive components closely track the major domestic and international equity indexes. As of June 30, 2012, 81.0 percent of the total assets were actively managed, while 19.0 percent was passively managed.

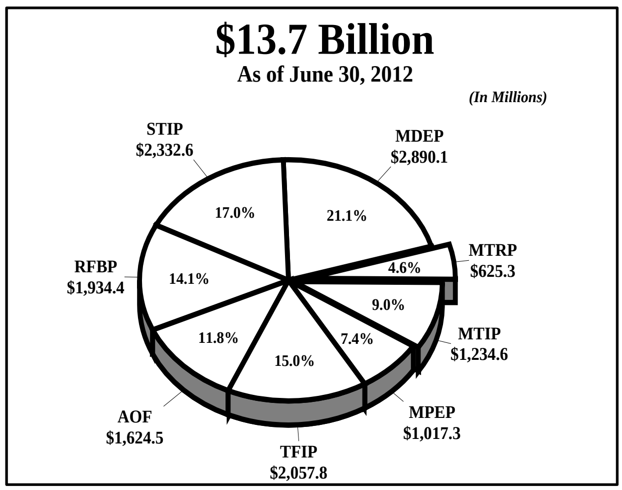
UNIFIED INVESTMENT PROGRAM

The table below shows the value of the Unified Investment Program portfolio as of June 30, 2012 by major fund type and asset type. This table has historically been published in the Board's annual report and provides a good snapshot of the Board's total investment portfolio. The trust investment under the Loans category represents the in-state loans funded from the Coal Tax Trust.

Fund Type	Cash Equivalents	Public Stock	Fixed Income	Loans	Other (1)	6/30/2012 Total
Pensions	72,292,061	4,123,364,708	1,934,409,921		1,642,596,756	7,772,663,446
Trusts	214,294,603		2,092,513,127	151,797,368		2,458,605,098
Insurance	127,249,142	141,839,697	1,173,341,170			1,442,430,009
Treasurer's	1,067,069,893		34,722,741			1,101,792,634
Local Gov.	450,226,142					450,226,142
Agency Cash	227,075,813		13,631,221			240,707,035
Universities	155,011,872	1,259,087	66,651,058			222,922,017
Debt Service	27,165,259					27,165,259
Total	2,340,384,785	4,266,463,493	5,315,269,238	151,797,368	1,642,596,756	13,716,511,640

(1)Private Equity and Real Estate

The adjacent chart depicts the Unified Investment Program portfolio by structure as of June 30, 2012. The Loans investments and the insurance investment under Public Stocks in the top table are included in the AOF in the adjacent table.



Investment Pool Operations – The table below shows the June 30, 2012 status of the investment pools and AOF, including the value and number of securities, the number of transactions in a 12-month period, and the number of participants.

Pool	6/30/12 Total	Holdings	Transactions *	Participants
Retirement Funds Bond Pool (RFBP)	1,934,409,921	1,011	11,900	9
Trust Funds Investment Pool (TFIP)	2,057,752,617	280	2,646	35
Montana Domestic Equity Pool (MDEP)	2,890,073,262	1,364	37,557	12
Montana International Equity Pool (MTIP)	1,234,550,534	962	6,239	9
Montana Private Equity Pool (MPEP) **	1,017,274,831	103	1,388	9
Montana Real Estate Pool (MTRP) **	625,321,924	38	651	9
Short Term Investment Pool (STIP)	2,332,644,094	103	9,169	498
All Other Funds (AOF)	1,624,484,456	249	6,599	19
Total	13,716,511,640	4,110	76,149	600

* Number of Security Transactions During 12-month Period - Does Not Include Income Transactions

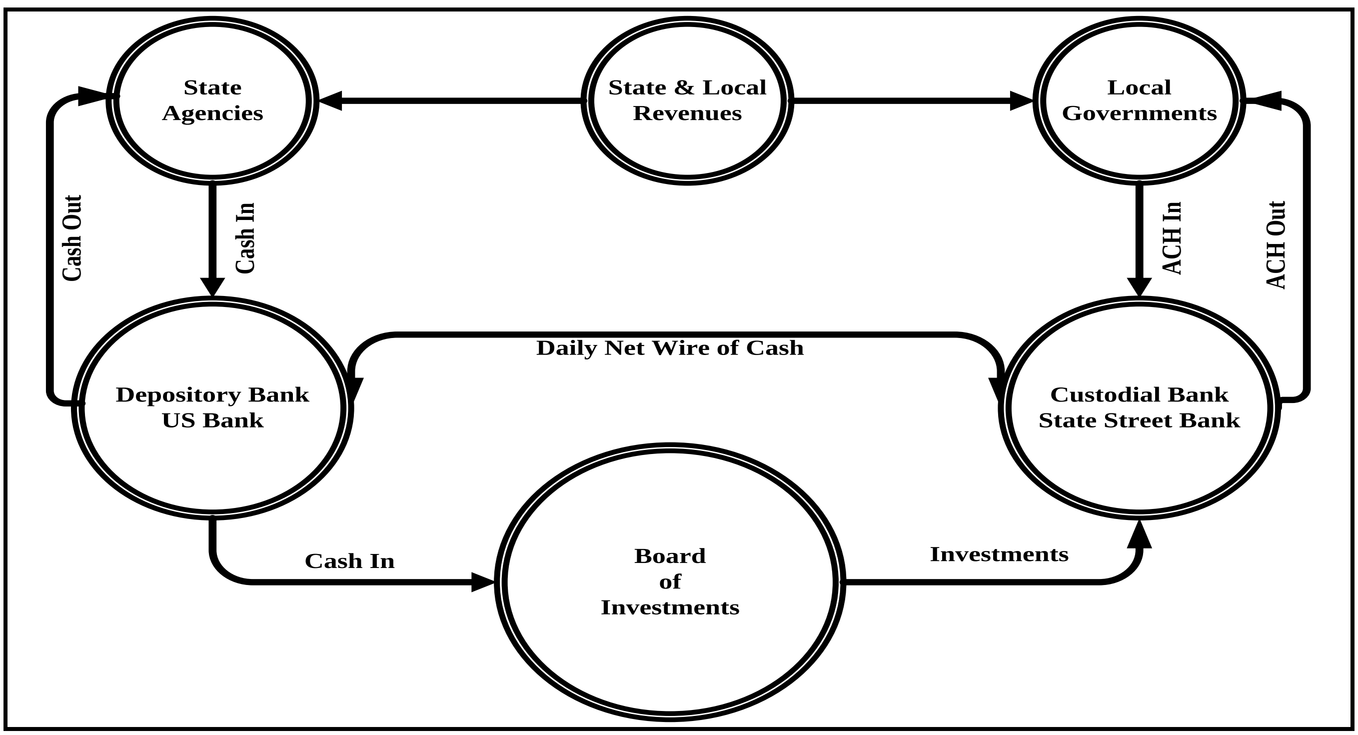
** Individual Fund Partnerships

DOMESTIC/CUSTODIAL BANKS

The Custodial Bank provides the following services for the Board:

- Custody for all publicly-traded securities;
- Complete securities accounting system, including foreign stocks/bonds;
- Participant (mutual fund) accounting system for the investment pools;
- Accounting system for private equity & real estate investments;
- A direct interface from the Board's computer network to the Bank's systems;
- Daily pricing of all publicly-traded securities and foreign currency exchange;
- Automated Clearing House (ACH) function for local government STIP investments;
- Notifies the Board of all corporate actions;
- Receives all proxy notices and distributes to appropriate parties;
- Files on behalf of the Board as a member in all class action securities litigation;
- Calculates total return performance investment pools and major funds;
- Calculates internal rates of return for closed-end private equity & real estate investments;
- Lends Board securities to increase investment income; and
- Sends or receives daily wires to/from Depository Bank to "net" out cash.

The chart below provides a simplified illustration of the daily flow of cash as it is received by the Board; invested by the Board; and then liquidated and sent back to state/local entities.

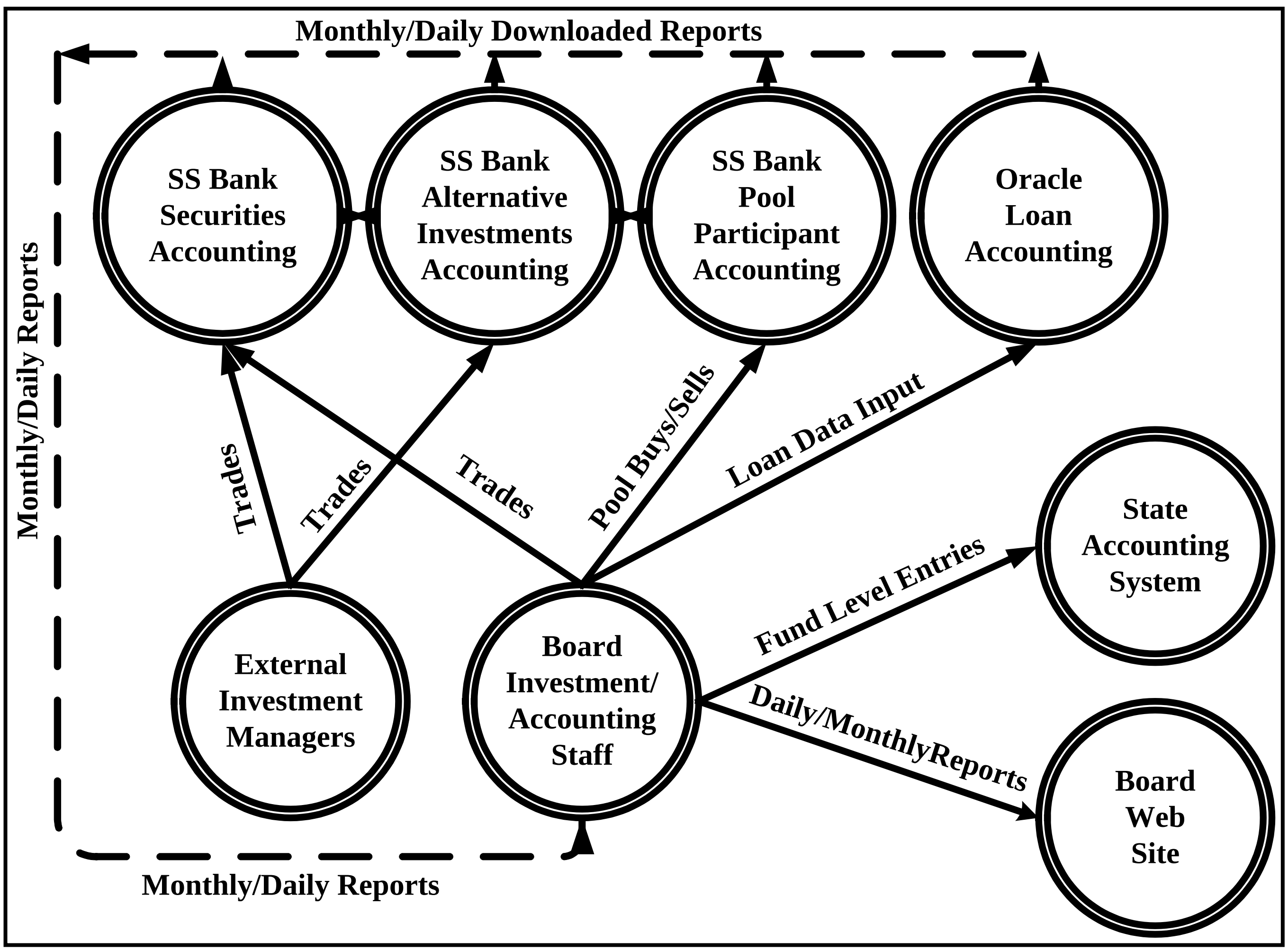


The Depository Bank is the official bank of the state and handles its cash transactions. State/local entities are able to invest and withdraw their cash with 24 hours notice from the Short Term Investment Pool. Depending upon the daily cash flow and daily investment activity there is a "net" daily wire of cash between the banks.

INVESTMENT ACCOUNTING

Board staff interface with five unique accounting systems, three of which are provided by the custodial bank, State Street Bank. The in-state loan and INTERCAP accounting system was custom designed and is housed at the state's computer center. The state accounting system is the "official" book of record for auditing purposes but is not capable of tracking daily security transactions; daily investment pool transactions; or daily loan activity. It is a "fund" level accounting system, which means that Board staff enters end-of-day data into the system reflecting the day's activity at the fund level. A fund is established by the state accounting division to track a specific program or activity, such as a retirement or trust fund.

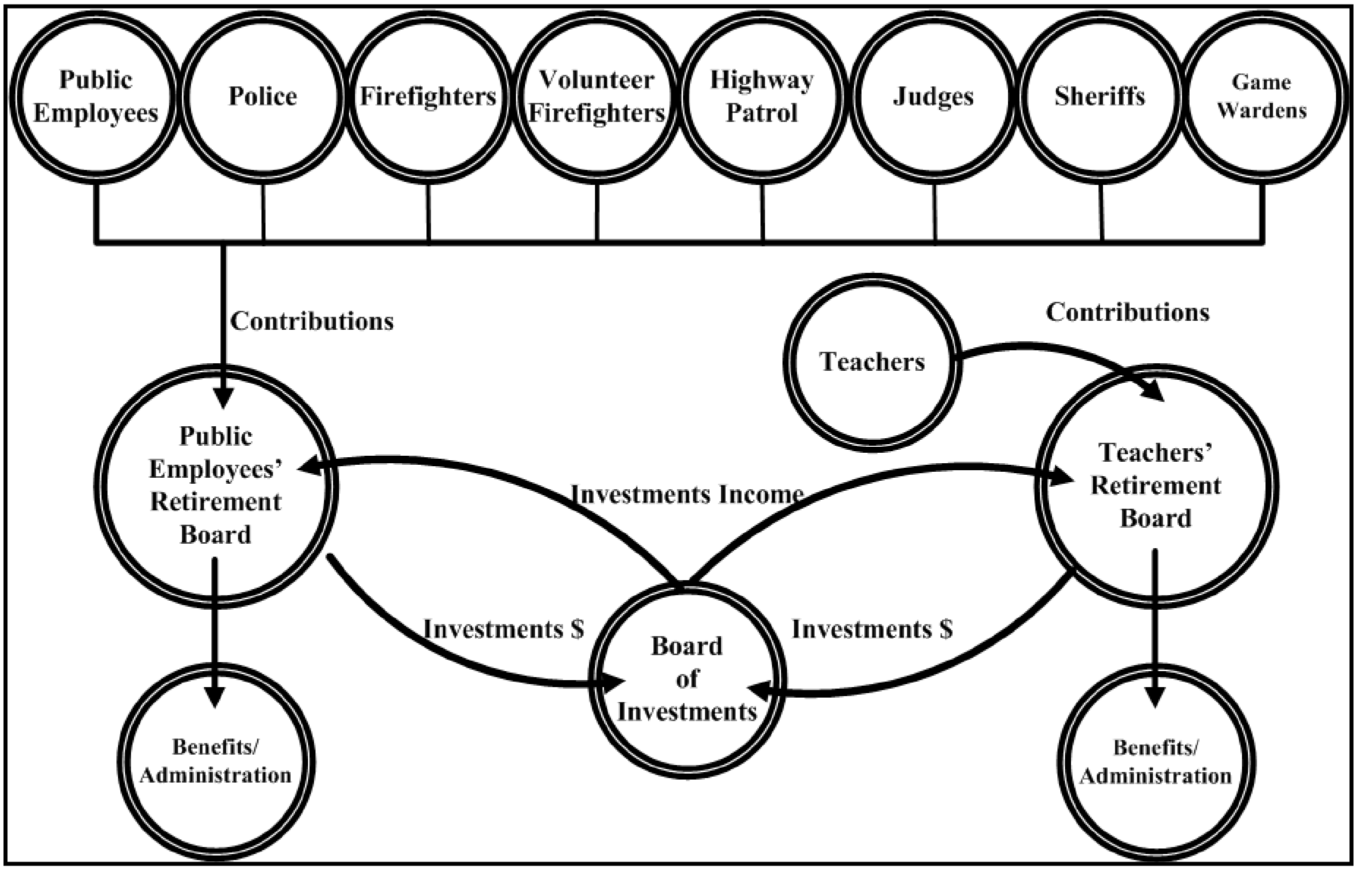
As of June 30, 2012, the Board recorded end-of-day data for 498 funds, comprised of 329 state funds and 169 local government funds. Each state fund requires an individual entry in the state's accounting system if there has been investment activity in the fund. Local government funds are rolled up into one state accounting fund. The following chart illustrates a simplified flow chart of the daily investment and accounting activity.



In addition to accounting/portfolio reports downloaded from the custodial bank, the bank also provides investment performance reports for individual funds, the investment pools, and investment managers. Reports are posted to the Board's website daily and monthly.

DEFINED BENEFIT RETIREMENT SYSTEMS

The state's defined benefit retirement plans include all state agencies and most local government entities and school districts. The Board is solely responsible for investing retirement system assets, while two boards appointed by the Governor manage the benefits and liabilities. The chart below depicts the relationship of the two retirement boards and the Board in managing the state's nine pension fund assets and liabilities.



The market values of the nine retirement systems as of June 30, 2012 are shown in the adjacent table. The assets are priced daily by the Custodial Bank and are very sensitive to stock market movements given the large allocation to equities. Depending upon the volatility of the stock markets, the retirement systems comprise between 55.0 percent and 65.0 percent of the Unified Investment Program. Because the Board may invest retirement funds in any type of investment it considers prudent, retirement fund investments are much more complex than are investments of other fund types that have limited investment options. Further, retirement funds have both assets and liabilities, which other state funds do not have. Ideally, retirement system assets should match the liabilities if the systems are to be fully funded.

System	Market Value	%
Public Employees	3,912,330,268	50.33%
Police	225,865,253	2.91%
Game Wardens	99,345,298	1.28%
Sheriffs	216,137,461	2.78%
Judges	64,631,082	0.83%
Highway Patrol	98,991,746	1.27%
Teachers	2,902,903,488	37.35%
Volunteer Firefighters	27,063,167	0.35%
Firefighters	225,395,683	2.90%
Total	7,772,663,446	100%

DEFINED BENEFIT RETIREMENT SYSTEMS CONTINUED

Defined Benefit Retirement System Liabilities – Liabilities exist in the state's defined benefit retirement systems because a pre-determined "retirement benefit" is promised to employees when they are hired by employers participating in the systems. The benefit formulas are codified in state law as are the contributions required of employees and employers. These systems are distinct from defined contribution retirement systems, which impose no future obligation on the employer. While the employer may make contributions to an employee's defined contribution account during his/her career, when the employee retires the employer's obligation ceases.

Calculating liabilities accurately is difficult because the formulaic benefit is based on years of service and highest average salaries. No one really knows how long an employee will work, what his/her highest average salary will be at retirement, and how long he/she will draw benefits after retirement. An under-calculation of liabilities early in a system's life will have detrimental impacts on the system as it matures.

Defined Benefit Retirement System Assets – Defined benefit retirement system assets are generated by "positive" cash flow – the excess of contributions received over benefits/expenses paid – plus investment income not used to pay benefits. When a defined benefit retirement system is created, the employer and/or employees begin contributing to the system and since there are no retirees drawing benefits in the early years, the contributions accumulate and are invested. Even after the original employees begin to retire there will be positive cash flow because there will be more contributing employees than retirees collecting benefits. The positive cash flow will continue to build the assets into a "nest egg" used to pay benefits when employees retire. As long as contributions exceed benefits paid, the income on the assets are reinvested and add to the growth of the assets.

Normal Cost Concept – The concept behind a defined benefit system is that the cost to fund the benefits should be related to when the benefits are earned, rather than when they are paid. In other words, each generation of employees should fund their retirement benefits during their working careers, rather than depending upon the next generations to fund them. This concept requires that employee/employer contributions are sufficient when invested to pay the employee's benefits upon retirement. The contribution rate calculated to achieve this goal is called the "Normal Cost." The simplest way to explain Normal Cost is to envision an employer creating a new defined benefit system that is limited to only the employees working for the firm at the time the plan is created (a closed system). After the benefit levels are set, the contributions required to fund the benefits are calculated as a percentage of employee salaries that must be set aside each payday and invested to fund future benefits. If the Normal Cost calculation is correct at the outset, after the last benefit payment to the last survivor in the closed system, the invested assets would be completely liquidated.

Normal Cost Calculations – The Normal Cost calculation is complicated by several factors. First, the employer must assume the level of annual investment income the contributions will generate until they are used to pay benefits. Second, an assumption must be made as to how long employees will work before they retire and how long they will draw benefits after retirement. Third, an assumption must be made for salary increases employees will receive during their working career. Salary increases not only impact contributions made during the employee's career but also impact benefit levels since they are based on the highest salary levels prior to retirement.

DEFINED BENEFIT RETIREMENT SYSTEMS CONTINUED

The Normal Cost theory falls short of funding benefits when benefit increases are granted midway through an employee's career. The additional Normal Cost required to fund the increased benefit can only be collected during the remainder of the employee's career, when in theory it should have been collected from the date of hire to fully fund the increased benefit. If benefits are increased for employees already retired, the increased benefit costs cannot be funded by the Normal Cost. The Normal Cost contributions made during the retiree's working career will not have paid for the increased benefit costs.

Negative Cash Flow – As defined benefit retirement systems mature, the ratio of retirees to contributing active members increases and the positive cash flow eventually turns "negative" – benefit payments exceed contributions. When this occurs, a portion of investment income must be used to pay benefits and is not available for reinvestment in the pool of assets. Once negative cash flow begins, the only revenue available to "grow" the assets is income generated by the assets. If the negative cash flow continues to grow at a faster rate than investment income, at some point in the future all investment income will be used to pay benefits. Once negative cash flow exceeds investment income, assets will have to be sold to pay benefits and the pool of assets will begin to shrink as will the income generated by the assets.

What is an Unfunded Liability – An unfunded liability exists when a defined benefit retirement system's actuary calculates that the present value of system liabilities exceeds the system's assets available to fund the liabilities. An unfunded liability in and of itself does not make a retirement system actuarially unsound. Under state law, if the unfunded liability can be amortized in 30 years or less by the current contribution stream, the system is actuarially sound. The contribution available to amortize any unfunded liability is that portion of the legislatively-set contribution in excess of the Normal Cost as calculated by the system's actuary. Because the total contribution rate is set by law and does not change, if the Normal Cost rate calculated by the actuary increases, it reduces the level of contributions available to amortize the unfunded liability. Conversely, if the Normal Cost rate decreases, the level of existing contributions available to amortize the unfunded liability increases. As of June 30, 2012, four of the state's nine defined benefit retirement systems were actuarially unsound because their unfunded liabilities could not be amortized in 30 years.

The Investment Return Assumption – The most difficult and important of all assumptions utilized by a system's actuary to value the system is the investment return assumption. Predicting financial market performance year-to-year is difficult if not impossible so assumptions have to be based on very long term investment performance. The assumption is extremely important to the perceived actuarial soundness of the systems because just a small difference in the assumption will increase/decrease system liabilities significantly. In order to derive the "present value" of liabilities so they can be compared to the present value of assets, future liabilities are discounted to the present using the assumed rate of investment return. A higher investment return assumption lowers the present value of liabilities, while a lower investment return assumption increases the present value of liabilities.

Any year, in which the actual performance of the invested assets falls short of the actuarial assumption, an "actuarial" investment loss occurs, even though the assets increased in value. For example, if the annual actuarial investment return assumption is 7.75 percent and the assets earn only 7.0 percent, the system's assets may have earned millions but the system incurred an "actuarial" investment loss.

All nine retirement systems currently utilize a 7.75 percent annual investment return assumption and the Board's current asset allocation of the systems' assets has been structured to meet the assumptions. The table below shows the current asset allocation ranges approved by the Board for all nine retirement systems. The table also shows the asset allocation within each of the investment pools in which the systems participate. The Board has set a range of 60.0 percent to 70.0 percent for total equity investments, which includes public/private equity. The Board has not authorized investments in Hedge Funds or Commodities.

Pension Fund
Asset Allocations
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 Passive	42% - 66%
Large Cap Active	22% - 32%
Small Cap	10% - 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

The Board sets the asset allocation ranges and delegates to staff the responsibility of maintaining the assets within the approved ranges. At the end of each month, staff may move assets from one investment pool to another to rebalance the assets and/or to ensure that cash is available to pay benefits and fund draw downs of commitments in the Private Equity and Real Estate Pools.

COAL TAX TRUST

Coal Severance Tax Revenues – Fifty percent of coal severance tax revenues are constitutionally dedicated to the Coal Tax Trust. The remaining 50.0 percent is allocated by state law for specific purposes as shown in the adjacent table. The allocations to entities other than the Coal Tax Trust (Trust) are authorized by law and may be changed by the Legislature. The 50.0 percent dedicated to the Trust is required by the state constitution and can only be changed by constitutional amendment approved by the voters.

Coal Tax Trust	50.00%
Long-range Building	12.00%
Combined Account	5.46%
Coal Natural Resource	5.80%
State Parks Trust	1.27%
Renewable Resources Debt Service	0.95%
Cultural Trust	0.63%
Coal & Uranium	$250,000
General Fund	The Remainder

Article IX, Section 5. of the state constitution states:

> **"Severance tax on coal--trust fund. The legislature shall dedicate not less than one-fourth (1/4) of the coal severance tax to a trust fund, the interest and income from which may be appropriated. The principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature. After December 31, 1979, at least fifty percent (50%) of the severance tax shall be dedicated to the trust fund."**

While there is a common perception that the Trust is one large account, it has been subdivided over the years for specific purposes. While each of the sub-funds is a part of the Trust and cannot be spent (appropriated) without a ¾ vote of the members of each house, the income from each sub-fund is used for different purposes. Since the Trust was created, it has been referred to as either a "rainy day" fund or an endowment. In practice, it has become more of an endowment because the ¾ vote requirement has prevented it from being used to fill budget shortfalls.

The adjacent table shows the sub-funds; the percentage of dedicated coal tax revenues currently allocated to each sub-fund; and the book value of each sub-fund as of June 30, 2012. Coal severance taxes flowing to the Trust back outstanding severance tax bonds and must first flow through the Severance Tax Bond Fund. The Fund must hold sufficient funds to pay one year's worth of principal and interest on outstanding coal severance tax bonds. After that condition is met, the excess tax revenues are allocated as shown in the table.

Severance Tax Bond Fund	100%	$ 4,277,125
Treasure State Endowment	50%	210,091,607
Treasure State Regional Water	25%	64,214,692
Economic Development Fund	25%	60,422,774
Permanent Fund	0%	527,624,268

All investment income from the Severance Tax Bond Fund and the Permanent Fund are deposited in the state general fund. Investment income from the other three sub-funds is appropriated by the legislature for grant programs. The Severance Tax Bond Fund is invested exclusively in the STIP to ensure liquidity. The Treasure State Endowment, Treasure State Regional Water, and the Economic Development funds are fully invested in the TFIP, except for a small liquid portion in the STIP. All in-state loans are funded from the Permanent Fund. Except for maintaining a STIP balance sufficient to fund loans, the Permanent Fund is invested in the TFIP.

COAL TAX TRUST IN-STATE LOAN PROGRAMS

There are four distinct loan programs authorized by law and funded from the Trust.

Commercial Loans – Any Montana business is eligible to apply for these loans through a Board-approved lender. The loans provide fixed-rate Board financing for terms up to 25 years. The lender services the loans and must participate in at least 20% of the total loan, unless it is federally-guaranteed. The Board sets the interest rates for these loans.

- Maximum Board participation for individual loans is 10% of the Trust
- Lenders must participate at least 20% if Board share is less than 6% of the Trust
- Lenders must participate at least 30% if Board share is more than 6% of the Trust
- Job creation credits may reduce interest rate up to 2.5%
- Total outstanding loans limited to 25% of the total Trust, including all sub-funds

Value-Added Business Loans – A Montana business that conducts a value-added business as defined by the Board and creates/retains at least 10 jobs is eligible to apply for these loans through a Board-approved lender. The lender services the loans and must participate in 25% of the total loan. Interest rates are set by law.

- 15 jobs created/retained qualifies for a loan rate of 2% for the first 5 years
- 10-14 jobs created/retained qualifies for a loan rate of 4% for 5 years
- Interest rate for second five years on all loans is set at 6%
- Interest rate at the Board's posted rate for the final five years of a 15-year term
- Minimum Board participation $250,000 – maximum Board participation 1% of the Trust
- Total outstanding loans limited to $70.0 million

Infrastructure Loans – A local government entity may apply directly to the Board for a loan to fund infrastructure in their jurisdiction to support a business in the basic sector of the economy. The business must create at least 15 jobs and pay a "user fee" to the local government for the use of the infrastructure. The user fee may be credited against the firm's state income tax. The user fee is pledged to the Board for loan repayment. The definition of "infrastructure" is defined in state law. The Board sets the interest rates for these loans.

- Minimum loan size $250, 000
- Loan size is based on number of jobs created over a four year period times $16,666
- There is no lender participation and the Board services the loans
- Job creation credits may reduce interest rate up to 2.5%
- Total outstanding loans limited to $80.0 million

Intermediary Relending Loans – Loans are made directly to Board-approved local economic development organizations. Interest rates are set by law.

- Interest rate at 2% for 30 year term
- Interest only payments for the first 3 years of term
- Maximum individual loan size $500,000
- Borrower must use the loan as matching funds toward other government revolving loan funds
- Total outstanding loans limited to $5.0 million

In certain circumstances a business may be eligible for loans under more than one loan program.

BOND PROGRAMS

The Board administers several bond programs under the Montana Economic Development Bond and the Municipal Finance Consolidation Acts, created as part of the "Build Montana" program in 1984.

INTERCAP – The INTERCAP Program is the most active of the Board's bond programs and is used extensively by local government entities, the University System, and certain eligible state agencies. The Board issues tax-exempt bonds and lends the proceeds to eligible governmental entities for a variety of purposes. Although the bonds are issued as long-term, they are remarketed annually (investors are only required to hold the bonds for a one-year period). Since the Program's inception in 1987, the Board has issued $136.0 million in INTERCAP bonds with $95.0 million outstanding at June 30, 2012.

The bonds are backed by the Board in two different ways:

- If for any reason investors do not purchase the bonds when they are remarketed annually, the Board is legally obligated to purchase them.
- The Board guarantees payment of principal and interest to the bond holders.

The Board charges a fee for backing the bonds and since the Program's inception has never been required to purchase the bonds or make principal and interest payments. The Program has never suffered a loss. When the bonds are remarketed annually, the bond interest rates are reset and the Board sets the borrower interest rates based on the reset bond interest rate plus up to 1.5 percent to cover administrative costs. The table below shows the borrower interest rate history.

87	5.625		92	4.950		97	4.750		02	3.150		07	4.850		12	1.250
88	6.625		93	4.350		98	4.850		03	2.850		08	4.250			
89	7.950		94	4.500		99	4.300		04	2.700		09	3.250			
90	7.500		95	6.400		00	5.600		05	3.800		10	1.950			
91	6.350		96	4.850		01	4.750		06	4.750		11	1.950			

Qualified Zone Academy Bond Program – This program allows qualifying school districts to borrow low-cost funds by issuing certain federally-authorized special purpose bonds. Bond proceeds may be used to rehabilitate or repair certain eligible public schools, but may not be used to acquire or construct new public schools. The district must obtain a commitment from a private business to contribute certain equipment, property, services or cash with a value equal to at least 10.0 percent of the principal amount of the bonds. To be eligible, the schools must be located in an empowerment zone; an enterprise community; or have reasonable expectation that at least 35.0 percent of the students attending such school will be eligible for free or reduced cost lunches. Federal law limits the amount of bonds that may be issued each calendar year by state. The Board serves as a facilitator in this process and is not pecuniary liable for the repayment of the bonds. As of June 30, there was $10.1 million in bonds outstanding.

Qualified School Construction Bonds – This program, that also allows qualifying school districts to borrow low-cost funds by issuing certain federally-authorized special purpose bonds, is no longer active due to federal law revisions. Bond proceeds were used to rehabilitate or repair certain eligible public schools; but unlike Qualified Zone Academy Bonds, the proceeds could be used to construct new public schools and acquire the land required for construction. There were no requirements that the district receive private contributions or that the schools be located in an empowerment zone; an enterprise community; or have reasonable expectation that at least 35.0 percent of the students attending the schools were eligible for free or reduced cost lunches. Federal law limited the amount of bonds issued each calendar year by state.

BOND PROGRAMS CONTINUED

The Board served as a facilitator in this process and is not pecuniary liable for the repayment of the bonds. As of June 30, there was $8.0 million in bonds outstanding.

Economic Development Bond Program – This program that provides qualifying businesses access to tax-exempt funds is no longer very active due to federal law revisions. The Board has issued bonds to finance several projects under this program and acts as a legal funding conduit only and is not pecuniary liable for the repayment of the bonds. As of June 30, there was $151.4 million in bonds outstanding

Montana Conservation Reserve Payment (CRP) Enhancement Program – This program provides loans to Montana farmers to refinance outstanding loans and/or to purchase additional land and farm equipment. The borrowers assign their remaining federal CRP contract payments to the Board to repay the loans. Although bonds were initially issued to provide funding, the loans are currently funded from the Trust Funds Investment Pool and loan interest rates are typically set 0.50 percent higher than the interest charged by TFIP. A total of 264 loans, totaling $33.6 million have been funded under this program.

Bond Enhancement Program – As described earlier, the Board backs (enhances) the INTERCAP bonds in two different ways – a guarantee to purchase the bonds if other investors do not; and a guarantee of principal and interest payments to the bond holders.

The Board also enhances certain bonds issued by the Montana Finance Facility Authority. The Authority issues tax-exempt bonds and lends the proceeds to non-profit health care facilities and non-profit community correction/treatment facilities. For a fee, the Board guarantees the principal and interest payments to the bond holders. Because these bonds are long-term and not remarketed annually, there is no need for the Board to be a purchaser of last resort.

BOARD HISTORY

1964 – Prior to the creation of the Board, a 1964 Legislative Council report concluded that there were major deficiencies in the state investment process. Investment administration was decentralized and there was a lack of professional, qualified staff. At the time of the report, state agencies utilized their internal staff to invest their funds.

1971 – The 1971 Legislature created the Board of Investments (Board) to manage the investment of state funds as a part of state reorganization efforts. At the Board's first meeting in August 1971 the Board established four major goals:

- Centralize the state's investments;
- Invest the state's idle cash;
- Increase earnings on the state's investments; and
- Establish a sound system of control over the investment process, including provisions for systematic financial reporting, measurement of investment results, and a regular independent audit.

The Board, initially consisting of five members appointed by the Governor, hired five staff to manage 40 separate accounts. As of June 30, 1972 the Board managed a portfolio with a book value of $326.2 million invested mostly in corporate and government bonds as depicted in the table. The portfolio generated $16.1 million of investment income during the first fiscal year.

Retirement Funds	**$ 160.6**		
Trust Funds	**66.8**	**Corporate Bonds**	**37.00%**
Treasurer's Fund	**59.2**	**Government Bonds**	**37.00%**
Insurance Funds	**23.6**	**Mortgages**	**15.00%**
Other	**16.0**	**CD's/Corporate Paper**	**11.00%**
Total	**$ 326.2**		**100.00%**

1972 – Montana voters ratified a new constitution that created a Unified Investment Program, encompassing all state funds and authorized 20 percent of retirement fund assets to be invested in stock. (Stock investments were not permitted under the old constitution.)

1973 – The Short Term Investment Pool (STIP) was created by the Legislature on July 1, 1973 as an investment vehicle to manage state and local government cash. Since its creation, the STIP has provided a safe, convenient way for state and local government agencies to invest and withdraw cash with 24-hours notice. Local governments have other investment options as permitted by law and use the STIP at their discretion.

The law creating the STIP and permitting local governments to participate was one of 10 sections contained in legislation to enact the Unified Investment Program created by the new Constitution. While there was no "statement of intent" to determine original legislative intent the language seems to suggest an implicit guarantee of local government funds invested in the STIP:

> **"17-6-204(3) The principal and accrued income, and any part thereof, of each and every account maintained for a [local government] participant in the pooled investment fund shall be subject to payment at any time from the fund upon request. Accumulated income shall be remitted to each participant at least annually."**

The STIP maintains a $1.00 share value for both local governments and state agencies.

BOARD HISTORY CONTINUED

1983 – The 1983 Legislature implemented Initiative 95 (Build Montana Program), approved by Montana voters in November 1982, and created a seven-member Montana Economic Development Board (MEDB) to manage the Program. The legislation created an "In-state Investment" component within the Coal Tax Trust, to which 25.0 percent of coal tax revenues was dedicated. The legislation also created a bonding program by which tax-exempt bonds were issued and the proceeds utilized to make low interest loans to eligible entities. The MEDB was authorized to:

- Invest the in-state investment portion of the Coal Tax Trust;
- Issue INTERCAP bonds and lend the proceeds; and
- Issue Industrial Revenue Bonds for specific projects.

1985 – The 1985 Legislature increased Board of Investment membership from five to seven by requiring that a member from each of the two pension Boards be appointed.

1987 – The 1987 Legislature abolished the MEDB and the existing seven-member Board of Investments and created a new Board of Investments (Board) with nine members. All MEDB staff and duties were transferred to the new Board.

1991 – The 1991 Legislature liquidated the "In-State Investment Fund" component of the Coal Tax Trust and encouraged the Board to invest up to 25.0 percent of the entire trust in Montana businesses.

1993 – The 1993 Legislature, for the first time, authorized the Board to contract directly with an out-of-state bank to provide custodial banking services. In December, the Board contracted with State Street Bank and Trust to provide custodial banking services.

1995 – The 1995 Legislature allocated $50.0 million of the Coal Tax Trust to an "Infrastructure Loan Program" designed to provide long-term financing to local governments to fund the infrastructure required to accommodate businesses wishing to locate within their jurisdiction.

The Legislature also changed the procedure for funding certain state entities (including the Board). Prior to this change, the Legislature appropriated funds for state entities to purchase products/services from other state entities and then appropriated the funds again to the entity providing the services/products. This process resulted in the same dollar being appropriated several times, which had the effect of inflating actual state expenditures. The new procedure authorized state entities providing the services/products to other state entities to charge a fee for the services and eliminated an appropriation to the entity.

1997/1999 – The 1997 Legislature abolished the Science & Technology Board and transferred its existing investment portfolio to the Department of Commerce. The 1999 Legislature then transferred the investment portfolio from the Department of Commerce to the Board.

2000 – The 2000 Legislative Special Session allocated $50.0 million of the Coal Tax Trust to a "Value-added Loan Program" designed to provide subsidized loans to Montana businesses conducting value-added business.

BOARD HISTORY CONTINUED

2007 – The 2007 Legislature increased the allocation for Infrastructure loans to $80.0 million and the allocation for Value-added loans to $70.0 million, and clearly defined the intent of the 25.0 percent language for the In-state Loan Program. The Legislature added two non-voting legislative liaisons to the Board.

2011 – The 2011 Legislature allocated $15.0 million of the Coal Tax Trust to a "Veterans' Home Loan Program" designed to provide low interest loans for first-time home buying Montana Veterans. By law, the Montana Board of Housing administers the Program; however, the Board of Investments approves and funds all loans.

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

MINUTES OF THE MEETING
November 13 - 14, 2012

BOARD MEMBERS PRESENT:
Gary Buchanan, Chairman
David Aageson
Bob Bugni
Karl Englund
Mark Noennig
Quinton Nyman
Jack Prothero
Jon Satre

BOARD MEMBER ABSENT:
Jim Turcotte

LEGISLATIVE LIAISONS PRESENT:
Representative Franke Wilmer – Present November 13, Arrived 2:00 PM, Absent November 14
Senator Ed Buttrey – Present November 13, Absent November 14

STAFF PRESENT:

Jason Brent, CFA, Alternative Investments Analyst
Polly Boutin, Accountant
Geri Burton, Deputy Director
Richard Cooley, CFA, Portfolio Manager, Fixed Income/STIP
Dana Chapman, Board Secretary
Frank Cornwell, CPA, Deputy Financial Manager
Roberta Diaz, Accountant
David Ewer, Executive Director
Julie Flynn, Bond Program Officer
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
April Madden, Accountant
Gayle Moon, CPA, Financial Manager
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, Senior Bond Program Officer
Dan Zarling, CFA, Director of Research

GUESTS:
Jim Voytko, RV Kuhns and Associates
Mark Higgins, RV Kuhns and Associates
Roxanne Minnehan, Public Employees' Retirement System
David Senn, Teachers' Retirement System
Diane Paauwe, Piper Jaffray
John Harrington, Legislative Audit Division

CALL TO ORDER

Board Chairman Gary Buchanan called the regular meeting of the Board of Investments (Board) to order at 11:15 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 Jim Turcotte was absent. Representative Franke Wilmer arrived at 2:00 PM.

> Board Member Bob Bugni made a Motion to approve the Minutes of the October 4, 2012 Board Meeting; Member Jon Satre seconded the Motion. The Motion was carried 8-0.

Chairman Buchanan asked for public comment. There was no public comment.

ADMINISTRATIVE BUSINESS

Audit Committee Report

Audit Committee Chairman Jim Turcotte was absent. Committee Member Jon Satre reported on the three items discussed at the Committee Meeting held prior to the regular Board Meeting. First, staff was asked to report on revisions in pool performance results for FY 2012 as it related to errors made by State Street Bank due to the omission of some cash flows affecting performance in certain pools. Second, the Performance Audit for FY 2012 has been delayed due to Legislative Audit personnel changes. The Audit is expected to commence in March 2013 or later. Third, the Financial Compliance audit will be completed in December 2012. The Annual Report will also be completed by the December 31 deadline. The Committee also voted to accept Staff's recommendation to participate in the Pfizer class action as part of a large investor group rather than as part of the class action. Member Noennig inquired about fees associated with the action. Executive Director Ewer advised fees are on a contingency basis and participating as part of the larger investor group will not hinder later possible participation as a member of the class action.

Loan Committee Report

The Loan Committee met prior to the Board meeting. Committee Chairman Jack Prothero reported there were no commercial loans requiring Committee approval. Ms. Louise Welsh presented two INTERCAP loans. The Committee approved a $1,600,000 loan to the Town of West Yellowstone in the form of a resort tax revenue bond over a period of 13 years to finance the construction of a town hall. INTERCAP is the sole funding source for the project. Repayment of the loan will come from resort tax revenue. The Committee also approved a $4,350,000 loan to the Board of Regents of Higher Education of the State of Montana on behalf of Montana State University (MSU), Bozeman, to finance the costs of an energy retrofit project using energy performance contracting over a 15 year term. The University is contributing $4,750,000 from its Residence Hall/University Food Service and Family Student Housing Funds (Pledged Funds) toward the total project cost of $9,100,000. Repayment will come from the University's surplus net revenue of its Pledged Funds. The Committee approved the two INTERCAP loans.

The Committee also approved the following staff recommendations: to issue INTERCAP bonds in an amount up to $12 million with a term of 25 years; authorization to acquire up to $10 million in Bond Anticipation Notes (BAN); adopt Preliminary Resolution No. 230; authorize the current finance team to issue/underwrite the bonds; and accept continuation of the current enhancement "guaranty" fee. Detailed information will be provided during the INTERCAP report.

Human Resource Committee Report

The Human Resource Committee also met prior to the Board meeting. Committee Chair Karl Englund reported the Committee reviewed and discussed the annual performance appraisals for exempt staff. The Committee agreed it has been a good first year for Executive Director, David Ewer. There was also a decision made not to recommend any pay changes for exempt staff at this time.

EXECUTIVE DIRECTOR'S REPORT

Overall Comments

The Board, at the October 4 meeting, requested Member Jon Satre act as representative for the Investment Consultant Committee contract negotiations with RV Kuhns and Associates. After meeting with senior staff, Member Satre visited with Mr. Jim Voytko to clarify and coordinate staff and Board expectations going forward. Together they came up with four points as detailed in Executive Director Ewer's November 13, 2012 memo:

1. The consultant provides independent and timely advice and information to the Board (as a collective body) regardless of any potential staff disagreement.
2. The consultant is expected, if necessary, to be pro-active in counseling the full Board on any matter the consultant believes is important enough to merit its attention, again, irrespective of any potential staff position to the contrary.
3. On a semi-annual basis, the consultant will provide a presentation on any matter desired, e.g. best practices, governance, what other state pension systems are doing, following up on a Board suggested topic, trend investments, or risk management, etc.
4. The consultant is expected to be a resource for providing material, seminars or other training opportunities for Board member education.

Mr. Voytko relayed that staff and Board members were very cooperative and acknowledged that RV Kuhns is expected to be a future resource for outside educational opportunities. He also advised that he, Ms. Becky Gratsinger, Mr. Mark Higgins and the junior staff had a discussion and agreed they have an almost unlimited supply of topics they could present and encouraged Board and staff to bring requests to them. It was agreed that protocol going forward will be for the Board Chairman to act as liaison for information or educational requests to RV Kuhns. Chairman Buchanan agreed, although he noted he would confer with Executive Director Ewer on these items.

Executive Director Ewer advised he will continue to pass along information on educational conferences and other resources available to the Board.

As directed by Chairman Buchanan, quarterly costs have been included in the Board materials. Executive Director Ewer noted quarterly data will be volatile due to fluctuations in costs pertaining to the external managers based on market changes, or simply the timing recognition of some fees.

Chairman Buchanan suggested fee discussions will be ongoing in line with the long term goal of reducing basis point costs overall.

After a brief discussion on the parameters for the cost report, it was decided by consensus to report the costs to the Board quarterly going forward rather than spend staff time going back and compiling historical data. The data will be kept for future comparisons, allowing consideration of fluctuations which occur on a yearly basis. The CEM Benchmarking Study will also provide valuable information; however, the study covers only the pension investments. The Board will use the reporting to determine trends and to help reduce costs where possible.

Executive Director Ewer reviewed the function and purpose of Resolutions 217 and 218. Resolution 217 designates the Executive Director as agent to deal with all investment firms in connection with Board accounts, as well as granting authority to open and close those accounts and to designate authorized personnel who can act on behalf of the Board to execute transactions with authorized accounts. Designated investment firms and authorized staff shown in Appendix A of Resolution 217 are presented annually to the Board along with a report on all added and deleted authorized staff and investment firms occurring in the past year.

Resolution 218 designates the transfer of authority and duties of the Executive Director, due to incapacitation or temporary absence from the office, to the Deputy Director. Further, should the Deputy Director be unable to fulfill the duties in the absence of the Executive Director, the Chief Investment Officer is designated to act in the official capacity.

Executive Director Ewer made note of the Governor's recent memo regarding public participation in agency decisions per 2-3-103, MCA. The memo details the public's right to participate in decisions of government and serves as a reminder to accommodate the public's opportunity to participate in Board Meetings. The Board has been compliant in offering public comment at meetings and will continue to be mindful to do so.

Legislative Liaison Senator Ed Buttrey gave a brief update on legislative matters. Leadership decisions and committee assignments have not been made yet. The Governor's budget has been submitted to Governor Elect Bullock. Legislators will be in Helena to begin meetings and new legislator orientations this week. Revisions in the general budget are expected and the unfunded liability of pensions is a high priority. Member Bugni reported the PERS Board has voted to compare their plan to the Governor's plan, which does not address raising contributions, coal tax funding and employer contributions, as the PERS plan does.

Senator Buttrey confirmed there are a lot of plans to address pension issues.

Executive Director Ewer presented the draft 2013 Board Meeting Calendar. Chairman Buchanan proposed the May 2013 meeting be held in Billings, or another city, to allow for local community participation, and to move the proposed dates to May 29 and 30 to allow the Board to take advantage of educational opportunities which are scheduled for the prior week. Member Jack Prothero noted that any newly appointed Board Members will need Board orientation which can be scheduled after appointment by the new administration.

The 2013 Board Schedule was approved by consensus and dates will be posted on the Board Meeting web page.

Diane Paauwe, Piper Jaffray & Co. and Julie Flynn, newly hired Bond Program Officer were introduced.

MONTANA LOAN PROGRAMS

Commercial and Residential Portfolio Reports

Mr. Herb Kulow reported the commercial loan portfolio continues to decline. All banks are required to write a letter of justification when they request to buy back a mortgage, detailing the benefit to the borrowers.

Mr. Kulow reported Senator Larson is attempting to increase the funding limit from $15 million to $50 million for the Veterans' Home Loan Program during the upcoming legislative session, which would have a significant impact on the program.

Mr. Kulow also noted all past due loans are still within reasonable ranges.

Executive Director Ewer clarified for Senator Buttrey that the Commercial Loan Program's purpose is for economic development and is capped by statute at 25% of the Coal Tax Trust

Fund. Retaining loans through refinancing is not a goal as it does not qualify as economic development. Senator Buttrey will meet with Mr. Kulow after the Board Meeting to discuss the program in more detail.

Chairman Buchanan stated the program has a good history since inception 25 years ago, with almost ¾ of a billion in economic development. Mr. Kulow added there has been only one loan default, in 2000. He also noted any extra funding added to the Veterans' Home Loan Program is a separate allocation and would not impact the 25% ceiling of the Coal Tax Trust Fund.

Mr. Kulow further explained creating more efficiency may qualify as economic development and that job creation is not the only consideration. He also pointed out that for the Value-Added Business Loan Program, there is a minimum requirement of creating or retaining 10 jobs.

Bond Program Reports

Activity Report

Ms. Louise Welsh introduced Ms. Julie Flynn a new Bond Program Officer for INTERCAP. Ms. Welsh reviewed the quarterly Activity Summary report and presented the staff approved loans. With $44 million in pending loan commitments there is a need for additional bonds.

The Loan Committee approved two loans. The first loan is to MSU Bozeman for energy retrofitting of several buildings in the amount of $4,350,000 for a term of 15 years. The loan is in the form of a general promise to pay and the University is contributing $4,750,000 for a total project cost of $9,100,000. The second loan is to the Town of West Yellowstone to finance construction of a town hall in the amount of $1,600,000 for a term of 13 years. The loan is in the form of a resort tax revenue bond and will be paid back by resort tax revenue. INTERCAP is the sole funding source for the project.

Member Bugni inquired on the sunset timeline for the Town of West Yellowstone's resort tax. Executive Director Ewer noted there is not a statutory risk, as the term of the loan is less than the expiration of the resort tax ordinance. Additionally, there is a loan stipulation requiring the Board's written permission before they can take on more debt backed by the resort tax.

Staff approved loans are listed below:

Borrower:	Smith Valley School District #89 (Kalispell)
Purpose:	Replace flooring, exterior doors, cabinetry, etc.
Staff Approval Date:	July 16, 2012
Board Loan Amount:	S30,000.00
Other Funding Sources:	N/A
Total Project Cost:	$30,000.00
Term:	15 years

Borrower:	City of Whitefish
Purpose:	Skating rink improvements
Staff Approval Date:	July 23, 2012
Board Loan Amount:	$140,000.00
Other Funding Sources:	N/A
Total Project Cost:	$140,000.00
Term:	5 years

Borrower:	City of Columbia Falls
Purpose:	2012 Pumper Truck
Staff Approval Date:	August 9, 2012
Board Loan Amount:	$115,365.00
Other Funding Sources:	$205,763.00
Total Project Cost:	$321,128.00
Term:	10 years

Borrower:	City of Three Forks
Purpose:	Used John Deere Grader
Staff Approval Date:	August 10, 2012
Board Loan Amount:	$25,000.00
Other Funding Sources:	N/A
Total Project Cost:	$25,000.00
Term:	3 years

Borrower:	Hebgen Basin Fire District (West Yellowstone)
Purpose:	Purchase Station 3 & construct Station 4
Staff Approval Date:	August 21, 2012
Board Loan Amount:	$345,000.00
Other Funding Sources:	N/A
Total Project Cost:	$345,000.00
Term:	10 years

Borrower:	Savage Elementary School District #7J
Purpose:	Heating/cooling system upgrade and asbestos abatement
Staff Approval Date:	August 23, 2012
Board Loan Amount:	$ 600,000.00
Other Funding Sources:	$ 864,383.00
Total Project Cost:	$1,464,383.00
Term:	10 years

Borrower:	Montana City School District #27
Purpose:	Septic system repair and replacement
Staff Approval Date:	August 23, 2012
Board Loan Amount:	$ 55,600.00
Other Funding Sources:	$ 73,935.00
Total Project Cost:	$129,535.00
Term:	15 years

Borrower:	Arlee Elementary School District #JT 8
Purpose:	Legal claim settlement
Staff Approval Date:	September 6, 2012
Board Loan Amount:	$ 90,000.00
Other Funding Sources:	$ 50,000.00
Total Project Cost:	$140,000.00
Term:	5 years

Borrower:	Mission Mountain Country Club/Lake Co. Water & Sewer District (Ronan)
Purpose:	Purchase/installation of water meters/pits and replacing the pump house/main pump
Staff Approval Date:	September 12, 2012
Board Loan Amount:	$60,000.00
Other Funding Sources:	$10,000.00
Total Project Cost:	$70,000.00
Term:	15 years

Borrower:	Park County Rural Fire District (Livingston)
Purpose:	Station improvements
Staff Approval Date:	September 26, 2012
Board Loan Amount:	$200,000.00
Other Funding Sources:	$200,000.00
Total Project Cost:	$400,000.00
Term:	15 years

Borrower:	Wilsall Rural Fire District
Purpose:	New fire truck
Staff Approval Date:	September 27, 2012
Board Loan Amount:	$30,000.00
Other Funding Sources:	$10,000.00
Total Project Cost:	$40,000.00
Term:	3 years

The Loan Committee approved loans are listed below:

Borrower:	Town of West Yellowstone
Purpose:	Town Hall Construction
LC Approval Date:	November 13, 2012
Board Loan Amount:	$1,600,000
Other Funding Sources:	$0
Total Project Cost :	$1,600,000
Term:	13 years

Borrower:	Montana Board of Regents (BOR) on behalf of Montana State University - Bozeman
Purpose:	Energy Retrofit Project
LC Approval Date:	November 13, 2012
Board Loan Amount:	$4,350,000
Other Funding Sources:	$4,750,000
Total Project Cost :	$9,100,000
Term:	15 years

Ms. Welsh presented the request for up to $12 million in additional INTERCAP bonds and a request for a Bond Anticipation Note (BAN) for up to $10 million from the Coal Tax Trust Fund as a bridge loan in anticipation of the new bond issue as approved by the Loan Committee. The

Committee approved utilizing the current finance team for the new bond issue but directed staff to look at future options with the possibility of issuing a Request for Proposal (RFP). Staff seeks full Board approval on Loan Committee approved items pertaining to the new bond issue.

Executive Director Ewer reviewed the INTERCAP program and the costs and benefits of the Board's guaranty of over $220 million in INTERCAP and Montana Facility Finance Authority (the "Authority") bonds. He also commented on the Board being rated by Moody's and FITCH. He noted that staff will present more on the Authority at a later date. After a brief presentation, the five recommendations contained in the staff memorandum on this matter were taken up by the Board.

> Member Jack Prothero made a Motion to authorize staff to take steps as deemed necessary to issue up to $12 million in INTERCAP bonds for a term of 25 years. Member Satre seconded. The motion passed 8-0.
>
> Member Prothero made a Motion to accept staff recommendation to authorize the Board to acquire up to $10 million in Bond Anticipation Notes (BAN) held within the Coal Tax Trust Fund, the outstanding of which shall bear interest at the daily STIP rate as may be adjusted from time to time, or the current INTERCAP bond rate, whichever is higher. Member Aageson seconded. The motion passed 8-0.
>
> Member Prothero made a motion to adopt INTERCAP Preliminary Resolution No. 230. Member Aageson seconded the motion. The motion passed 8-0.
>
> Member Prothero made a motion to authorize the current INTERCAP Program finance team to provide the expertise to issue/underwrite the bonds and accept the proposed budget for the new bond issue. Member Aageson seconded the motion. The motion passed 8-0.
>
> Member Prothero made a motion directing staff, as part of the work plan, to research market availability of long term options for bond underwriting expertise, including the possibility of issuing a RFP if research determines it necessary. Member Aageson seconded the motion. The motion passed 8-0.

Member Prothero thanked Executive Director David Ewer, Deputy Director Geri Burton and Senior Bond Program Officer Louise Welsh for compiling the comprehensive packet.

Ms. Welsh reported on one delinquency. The Town of Sunburst is $34,000 overdue due to a special improvement district bond for street improvements which experienced a cost overrun. They borrowed enterprise funds using assessments coming in to pay contractors. The Town of Sunburst is in the process of obtaining a bank loan to cover the additional costs and they are expected to bring the INTERCAP loan current next week.

INVESTMENT ACTIVITIES/REPORTS

Retirement System Asset Allocation Report

Mr. Cliff Sheets presented the asset allocation report for the quarter ending September 30, 2012 for the nine pension funds. Valuation went up by 3.8%, or $300 million over the quarter. The increase reflected positive returns across the various asset classes. Public stocks had a strong quarter after weakness during the prior quarter. Domestic stocks were up 6.3% and International up 7.3%; fixed income had a strong quarter with an increase of 2.7%; real estate was up 2.4% and private equity was weakest at 0.3% due in part to the one quarter lag typical of underlying valuations. As a result of primarily market changes, the allocation to public equities increased slightly, as did the total equity exposure. Transactions included a net reduction in fixed income and an addition to real estate, with the allocations decreasing and increasing, respectively.

Member Bugni asked if there was any concern considering the RFBP is close to the bottom of the 22-32% range and if more flexibility of the range was needed. Mr. Sheets stated it's not a constraint at this time and the pool has not dipped below the bottom of the range as of yet. If stocks surge there is the possibility market dilution could cause the pool to dip below the allotted range; however, if that were to occur it would prompt a reallocation to reduce public stocks and add to fixed income per the discipline of staying within the policy ranges. He added that any discussion of lowering the fixed income allocations should not be considered in isolation, but rather in the context of the broader asset allocation policy. Mr. Jim Voytko noted RV Kuhns and Associates are now working on their 2013 return forecast for the various asset classes which may include a further reduction in fixed income return expectations. Mr. Sheets stated there will be a fixed income presentation and discussion later in the agenda, and that expected return is only one objective of this asset class.

Mr. Sheets concluded by noting there were high cash balances in the Police and Firefighters funds at the end of the quarter due to the annual lump sum contributions from insurance premium taxes that typically occur in September.

Comparison to State Street Public Fund Universe

Mr. Sheets presented the State Street Bank allocation and universe comparison charts. A slight overweight in public equities relative to peers has helped performance, as well as a higher allocation in domestic stocks over international during the past year. Equities and fixed income are more accurately reflected in the data than real estate and private equities where we are most likely in the 2nd quartile vs. peers.

Member Bugni congratulated staff on the top quartile performance for three year returns and inquired of Mr. Sheets what he thought were the most likely contributing factors.

Mr. Sheets attributed the strong returns to a combination of strong private equity returns and the turn in real estate after stabilizing in late 2009, and our overweight position in domestic stocks vs. international stocks compared to peers. While the total equities allocation is comparable to our peers, this overweight position in domestic holdings certainly helped.

There was a general discussion about the pension returns over the last 10 years, and the improvement in the absolute return as well as an improvement in relative performance compared to the 10 year rolling period in prior years. Mr. Voytko noted that the 2001-2002 tech bubble rolled off the 10-year returns as well, which made a substantial difference. Mr. Sheets added March 2003 goes back to the bottom of the prior bear market and the S&P has recovered, so it is just a function of time frames.

Chairman Buchanan asked what factors in the first fiscal quarter may have an effect on the longer period returns. Mr. Sheets advised international stocks improved while private equity is more subdued this quarter. Stocks are off 3.5% to 4% so far in the current quarter, but the calendar year to date is tracking positive.

Chairman Buchanan asked about the difference in the 3 year numbers for TRS and PERS. Mr. Sheets stated the 2 basis points higher return for TRS is due to holding less cash. TRS has been more cash negative as contributions and income are below outgoing benefits. Mr. Voytko added that over time the liability differences will increase between PERS and TRS creating challenges which will continue to be a complicated issue.

Fixed Income

Mr. Nathan Sax presented the Fixed Income overview. The third quarter bond market had lots of movement but ended where it started. Corporate bonds were up and Europe is still a factor. The Federal Reserve Board announced QE3+, its third major quantitative easing program, on September 13, allowing the program to remain open ended.

Core internal was up 209 basis points versus the benchmark index over 3 years. Reams and Artio outperformed their benchmarks over this time frame as well. High yield continues to outperform investment grade bonds for the calendar year-to-date, and our two managers here have beaten their benchmark, though Post's relative return remains weak for the one and three year periods.

Member Prothero asked what the forecast on inflation was. Mr. Sax replied there is a lot of money sloshing around, but inflation has not been an issue so far; however, deflation is a possibility. Institutions are paying down their debt and not taking on new debt, which is the same scenario with consumers who currently have an aversion to debt.

Chairman Buchanan thanked Mr. Sax, Mr. Romasko and Mr. Putnam.

Fixed Income External Manager Watch List

Mr. Sax presented the manager watch list. Post Advisors remain on the list. Ranked at the 83rd percentile for 2011, they are now ranked 12th for the calendar year. The visit with them last month was impressive and the pattern of recovery seems to be holding.

Manager	**Strategy**	**Reason**	**Amount Invested ($ millions)**	**Inclusion Date**
Post Advisors	Public High Yield	Performance	$58 RFBP $104 TFIP	February, 2012

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

Mr. Richard Cooley reported market conditions remain the same as last quarter. LIBOR rates are down 10 basis points which reflects a better feel for credit quality and Europe. STIP remains well diversified. This quarter $23 million in corporates and $70 million in Yankee CDs were purchased. Agencies have been reduced from 25% to 18% due to maturities; the two year spread on agencies is very low at about 20 basis points.

Member Prothero asked if there was an increased risk of default. Mr. Cooley stated while you would think there would be an increase in risk, direct risk has not risen. The Fed buying securities has helped.

Mr. Cooley reported the Treasurer's Fund totaled $924 million at September 30th with current securities holdings of $34 million. There were no securities transactions this quarter.

State Fund Insurance value at quarter end is $1.3 billion. The portfolio is overweight in agencies, asset backed securities (ABS), commercial mortgage backed securities (CMBS) and remains underweight in Treasuries versus its index benchmark. Asset backed securities have been increased over the last quarter. The total fixed income portion outperformed the benchmark by 69 basis points, and has outperformed by 210 basis points over the last year and 143 basis points over three years. The range for equities is set by the client at 8-12% and is currently 11.36% of the total and by policy is restricted to investment in index funds. By statute the equity limit is set at 25%.

Mr. Cooley advised staff will be meeting with State Fund on Friday and hope to have recommendations at the February Board Meeting. Mr. Sheets added the account has grown as premiums have outpaced losses paid out and those premiums have to be discounted. The high book yield has allowed premiums to decrease a little, but the buffer will decline. Mr. Cooley noted the current 4% book yield will decline by 25 basis points per year for 2013 and 2014, sinking to 3.5% in two years.

Mr. Voytko offered that this workers compensation issue is common. The key is the asset liability stance; writing more policies or taking on riskier clients all have to be taken into consideration.

Executive Director Ewer noted at $1.3 Billion, State Fund makes up 10% of the Board's fiduciary assets. Over the years, staff has discussed alternatives for asset allocation but ultimately rely on the client. Mr. Sheets added efforts to increase investment income on the margins are needed without taking on undue risk in order to mitigate the decline in the book yield of the bond holdings. Risk and policy restrictions need to be reviewed and credit risk for the fund is already high given the exposure to corporate bonds and some downgrades over time. A review of asset allocation will be presented to the Board at the February meeting.

Mr. Voytko offered there is a risk if liabilities and assets are not well matched. He added RV Kuhns could provide an educational presentation as they have done for other work comp plans.

<u>Montana Domestic Equity Pool (MDEP)</u>

Mr. Rande Muffick presented the Montana Domestic Equity Pool for the quarter ending September 30, 2012. The U.S. equity market had a great quarter. The pool restructuring transition to increase large cap passive stocks went well. All current weightings are within the new ranges approved at the May Board Meeting. Further diversification into small and mid caps is expected. The next step of the transition is underway and the research team has done preliminary due diligence and has met with RV Kuhns. In the next step, staff and RV Kuhns will discuss 15 small and mid-cap managers. The strategy is to continue to look for managers with a growth and value emphasis for small and mid-cap, and less emphasis on core options. The team expects to choose one to two managers each for small and mid-cap, one each for growth and value. Several aspects will be looked at for potential managers, such as fees compared to current managers, whether or not they are open, and a focus on finding managers that complement existing managers. The recent restructuring has had a positive effect on the quarter. While a bit overweight in small and mid-caps, there are grey areas as some mid-caps carry small caps, and some small caps include mid-caps.

<u>Montana International Equity Pool (MTIP)</u>

Mr. Muffick reported on the Montana International Pool for the quarter ending September 30, 2012. The objective to reduce active management within large caps was performed in the third week in October. The transition amounted to $216 million and included the termination of Batterymarch International Large Cap Core and BlackRock International Alpha Tilts to complete the first stage in the restructuring process. As the transition was performed in October, the quarter end report does not reflect the changes. BlackRock handled the transition. As always, there are transition costs when moving to a target portfolio as well as commissions and taxes. The overall cost total amounted to 25 basis points, or $524,838. The transition manager estimates the expected costs pre-transition. Actual costs varied 3 basis points from the estimate. Costs are kept in mind when considering termination of managers. The international markets had a great quarter in general, due in part to the central bank, news on Greece has subsided and China. The third quarter didn't struggle as much as past quarters. The transition of the portfolio should translate into tracking closer to the benchmark in the current quarter and going forward.

Member Satre thanked Mr. Muffick and Mr. Sheets and the rest of the transition team. Chairman Buchanan echoed that sentiment and noted it's been a very busy year for staff.

Public Equity External Manager Watch List
Mr. Muffick stated there were no changes to the public equity watch list in the third quarter. Martin Currie has improved but they still lag behind the benchmark longer term. They have a new lead person managing the portfolio in the last year that has been out to visit, but it's too early to remove them from the list. Alliance Bernstein is still a concern as they continue to struggle. Their investments assume risks in troubled companies which have potential and are not in danger of going out of business. However the strategy has yet to pay off.

PUBLIC EQUITIES MANAGER WATCH LIST
November 2012

Manager	Style Bucket	Reason	$ Invested (mil)	Inclusion Date
Martin Currie	International – LC Growth	Performance, Risk Controls	$100	February 2009
Alliance Bernstein	International – LC Value	Performance	$93	August 2012

PENSION BOARD REPORTS

Public Employees Retirement System Annual Report
Chairman Buchanan introduced Roxanne Minnehan of the Public Employees' Retirement System. Ms. Minnehan gave an overview of PERS. Eight retirement plans are included. PERS is required to have an actuarial report every year, the cost of which is funded by employee and employer contributions. Of the eight funds, four are actuarially sound, Judges, Firefighters, Police and Volunteer Firefighters. Liabilities increased for all plans and funded rates decreased for all except Game Wardens.

The PERS Board is proposing six bills for the 2013 legislature: 1. Housekeeping revisions; 2. IRS Federal regulation changes; 3. Adjustments to retirement age; 4. Funding bill requesting employer contributions increase going forward; 5. Third try on submitting a bill addressing retirees hired back as working retirees at state employment not contributing into the defined benefit plan.

Member Bugni added there are several separate funding bills expected to be introduced. The governor's bill increases by 1% employer contributions for employees and a 1% employee contribution increase. Use of excess Coal Tax Revenue is also proposed, but only for PERS. Separation of state and local governments is proposed so each would be treated as separate systems with Coal Tax only going towards state, not local governments. Excess Coal Tax currently goes into the General Fund.

Member Satre asked if passage of all bills would solve pension fund issues.

Ms. Minnehan responded, no, however the governor's plan makes the most progress.

Teachers' Retirement System Annual Report
Mr. David Senn presented the Teachers' Retirement System report. Mr. Senn reviewed the two types of plans, the Defined Benefit (DB) Plan which is based on years of service and average final contribution where the state takes on the burden of any investment risk decisions; and the Defined Contribution (DC) Plan which is a savings plan that pays benefits based on account balance where the participants take on the burden of risk for investment decisions. The

unfunded liability would require a 4.89% increase in contributions to reach policy parameters, although there have been improvements. If the legislature does not take action, TRS would require a yearly return of 9% to erase the unfunded liability. Assuming a 7.75% rate of return, assets will be depleted by 2054.

Proposed changes are in the works and most new hires will have changes to benefits and/or deductions. Current members would see a 1% contribution increase at July 1, 2013, employers will make a onetime contribution of $14.7 million from fund reserves, and state of Montana will make an annual $25 million payment to TRS from land trust revenues. New members as of July 1, 2013 would see the most changes including a contribution rate of 8.15% including triggers to increase or decrease depending on fund health, and an increase of retirement age both for full and early retirement options.

Additional issues to be addressed in the upcoming legislative session include breaks in service of 180 days for retirees before they are eligible to return, proposed adjustments needed to comply with IRS guidelines and issues with the university system who aren't part of the normal system.

ADJOURNED
Chairman Buchanan adjourned the Meeting for the day at 4:45 PM.

CALL TO ORDER – Day 2
November 14, 2012

Board Chairman Gary Buchanan reconvened the meeting Wednesday, November 14, 2012 at 8:03 AM with seven members of the Board present; Member Quinton Nyman arrived at 9:27 AM. Member Jim Turcotte and Legislative Liaisons Representative Franke Wilmer and Senator Ed Buttrey were absent.

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

Private Asset Pool Reviews

Montana Private Equity Pool (MPEP)
Mr. Ethan Hurley presented the private equity report for the quarter ended September 30, 2012. Mr. Hurley reported distributions have dropped off but there are still sufficient distributions that net cash flow remained positive for the quarter. The bulk of exposure is to buyouts at 54.9%. There is no active attempt to underweight or overweight by industry or geography, although the majority of holdings are U.S. and Canada. Vehicle exposure is at 64% direct exposure, which is the preferred option, where possible, to minimize fees. In response to a question from Chairman Buchanan as to any investments made in Montana, regional fund Highway 12 has made an investment in Missoula and has now wrapped up the investment phase of their fund. The pool returns generated since inception are 1.42 times investment and a 12.35 IRR.

Mr. Hurley summarized the four new commitments made since the August Board meeting. These are outlined in the table below.

Fund Name	Vintage	Subclass	Sector	Amount	Date
Sterling Partners IV, LP	2012	Buyout	Diverse	$20M	8/16/12
Audax Private Equity Fund IV, LP	2012	Buyout	Diverse	$25M	9/13/12
NB Strategic Co-Investment Partners II, LP	2012	Buyout	Diverse	$20M	9/13/12
Dover Street VIII, LP	2012	Secondaries	Diverse	Add'l $10M	10/11/12

Responding to a question from Chairman Buchanan, Mr. Hurley noted we do not generally have the leverage to negotiate on fees; however, it is possible at a future date that could change.

Mr. Sheets added the allocation decision is the primary consideration in selecting funds, and the higher cost structure of private equity funds is, the price of admission with this asset class. However, if there are two comparable options available for investment with different fee levels, the lower fee option is chosen. From a portfolio standpoint, returns over the long run are considered, so fees are not the only consideration. For secondary funds where underlying investments are further along in the life cycle and the J curve can be mitigated, those would also be considerations. Debt funds have a shallower J curve, but can translate into lower overall returns. As the retirement funds mature, adjustments in the types of strategies used will be made.

Member England asked for clarification on what qualifies as a secondary fund.

Mr. Hurley explained on a direct commitment we are initial investors, while with a secondary fund, the funding cycle for the underlying funds is already underway and we take on the funding obligation. Fund of funds investments can involve both direct investments and secondary investments.

Mr. Sheets added that in the life cycle of a fund the GP must consider the value of company investments already held if they are to acquire a secondary interest in a fund. In 2008 and 2009 some existing interests in immature funds were being given away as a way to avoid future capital call obligations due to deficient liquidity on the part of some investors. It is common for secondary managers to invest in funds which are already into years 2 to 5 of the life of the fund.

Mr. Hurley noted relative to the J curve, the pool has experienced relatively more net capital calls compared to similar investor peers. Mr. Sheets added there is no attempt at aligning the portfolio strategically vs. peers and overall portfolio performance has been good.

Montana Real Estate Pool (MTRP)

Mr. Hurley presented an overview of the real estate reports for the quarter ending September 30, 2012. The real estate pool continues to experience negative cash flows as heavy cash calls are ongoing.

Member Prothero asked for clarification regarding the Montana owned buildings.

Ms. Geri Burton explained the three Helena properties and the Bozeman property are managed by Executive Properties, Billings. Ms. Burton works with them and with tenants regarding leases, vacancies and building projects.

Mr. Hurley continued the pool is well diversified geographically and in regards to market value exposure. Real estate continues to deliver positive returns. Responding to a question from Member Bugni, Mr. Hurley advised cap rates have seen some compression on core properties, while value added properties have been less predictable.

Mr. Sheets added real estate is still seeing a tail wind which can be seen in the purchase queues of $1 to $2 billion in size for the largest core funds. Investors follow returns and we have seen positive returns the past two years with a growing tendency now for investors to consider higher risk investments. The last new core investment added to the pool was in 2010, but staff continues to invest in value added funds.

Mr. Hurley reported $40 million in new commitments since August: $20 million in The Realty Associates Fund X, LP and $20 million in CBRE Strategic Partners US Value 6, LP. The relationship with CBRE is new. A blue chip, value added manager, they had 30% already invested prior to our commitment. They focus on value enhancements, rehabs and then sell to a core funds.

Fund Name	Vintage	Subclass	Property Type	Amount	Date
The Realty Associate Fund X, LP	2012	Value – Add	Diverse	$20M	8/15/12
CBRE Strategic Partners US Value 6 LP	2011	Value – Add	Diverse	$20M	10/31/12

Partnership Focus List

There were no changes to the MPEP or MTRP Focus lists since the August 2012 Board Meeting.

CONSULTANT REPORT

RV Kuhns & Associates

Mr. Mark Higgins and Mr. Jim Voytko presented an overview of capital markets and Investment Performance for the quarter ending September 30, 2012. Mr. Higgins began the report by discussing recent economic and capital market developments. Overall, most asset classes produced strong returns during the third quarter. Asset values were bolstered by positive economic developments, such as solid job growth in the U.S., moderately positive GDP growth, strengthening of the U.S. housing market, and continued support from ongoing quantitative easing by the Federal Reserve. Mr. Higgins noted that while returns across most asset classes were strongly positive for the year, several significant economic headwinds and risks remain on a forward-looking basis.

Mr. Voytko followed Mr. Higgins with a review of investment performance for the MTBOI pension funds. Mr. Voytko framed the report by explaining four dimensions with which the Board should gauge fund performance. The four dimensions are:

1. Performance relative to the increase in expected benefit payments;
2. Performance relative to internal benchmarks and internal expectations;
3. Performance relative to peers; and
4. Performance relative to the amount of risk taken.

The relative performance of the pension funds along each of these dimensions was summarized as follows:

1. **Return Relative to Benefit Payments –** The 10 year return for the various pension plans was approximately 7.25% over the past 10 years. This return is reasonably close to the actuarially assumed return despite the significant drag of the financial crisis of 2008 and 2009. Over a 1-year and 3-year period, the total fund returns comfortably exceeded the actuarial required return; however, over a five year period, the return of just 1.58% significantly underperformed. The five year return was highly impacted by the 2008/2009 financial crisis.
2. **Relative to Internal Benchmarks and Expectations –** Compared to the internal benchmark, the portfolio outperformed by 10 basis points over 10 years, but trailed slightly over a 3-, 5-, and 7-year horizon. The underperformance of the domestic and international equity portfolios contributed heavily to the short term underperformance of the total fund, but Mr. Voytko expressed his belief that the recent restructuring of these portfolios could have a positive impact in the future.
3. **Relative to Peers –** Comparing to peers is difficult as there are no perfect peer groups. Compared with funds over $3 billion, which is considered a reasonable proxy for the MTBOI pension funds, the fund ranked in the 70th percentile over 10 years, 51st percentile over 5 years, and 21st percentile over three years. In summary, performance is satisfactory over the medium term and has improved dramatically over the prior 10 years.
4. **Relative to Risk Taken –** Overall, the MTBOI pension funds have produced attractive risk-adjusted returns. The Sharp ratio, which is a measure of risk-adjusted returns, is in the 29th percentile over three years and 46th percentile over seven years. Structural improvement of the portfolio is reflected in the 3 and 5 year data.

Mr. Voytko proceeded to discuss the performance of the specific asset class pools. Mr. Voytko reported that despite trailing the domestic equity benchmark over the trailing three years, The Montana Domestic Equity Pool ranks in the 37th percentile relative to domestic equity pools at other public plans. The Montana International Pool has not fared as well as domestic equity relative to both the benchmark and peers. Both the Retirement Funds Bond Pool and Trust

Funds Investment Pool have provided attractive returns over all trailing periods relative to both the benchmark and peers.

In response to several questions from Board members, Mr. Voytko discussed the Montana Private Equity Pool in the greatest depth. Several Board members questioned whether the 400 basis point expected premium over public markets is too high. Mr. Voytko suggested looking at the private equity benchmark next year. Mr. Ewer added benchmark review is an item on the Work Plan.

Fixed Income Management Review

Fixed Income Review
Mr. Cliff Sheets and Mr. Nathan Sax presented the Fixed Income Review. Mr. Jon Putnam and Mr. John Romasko were thanked for their help in compiling the presentation. Mr. Sheets advised later in the agenda the Board would be asked to approve proposed changes in the STIP investment policy statement. Fixed income management is a core competency of MBOI. A mixed variety of accounts use the fixed income pools; the Retirement Funds Bond Pool (RFBP) is utilized by the pension funds, and the Trust Funds Investment Pool (TFIP) is used by the Coal Tax Trust Fund and other trust accounts, and STIP is the cash account. Of the $7.7 billion in fixed income funds, the bulk, $6.8 billion, is managed internally. The small amount managed externally is mostly for funds requiring specific expertise.

Mr. Sax stated fixed income goals are total return, the change in price plus income; diversification vs. equity; and liquidity, which is key. The correlation of returns is low with equities, but positive. And while bonds can be volatile, they are much less so than stocks. The benchmark used is Barclays U.S. Aggregate Index, created in 1986, which most pension funds use. There have been changes to the index sector weightings over the past four years. Securitized was 43.7% and is now 32.7%; and the Treasury weighting is up from 25% to 36%; and agencies such as Fannie Mae and Freddie Mac are down. Credit quality is also down.

The overweight in non-core holdings of high yield and below investment grade holdings to seek out increased returns has been a strategic risk and is not intended as a permanent strategy, but rather as a function of current market conditions.

With the internally managed portfolio held by the Retirement Funds Bond Pool, the investment philosophy is risk constrained and deviations from the benchmark are kept within the constraints of policy. This limits volatility but also reduces the chance of outperforming or underperforming the benchmark by significant amounts. Tracking error has decreased since 2008.

Liquidity is important to enable flexibility in rebalancing and meeting benefit needs when the capital markets, particularly the stock markets, are stressed. Historically dealers would carry bonds in inventory and present an ongoing bid in the market but that is no longer an option for most dealers given capital and risk constraints.

Responding to a question from Member Prothero, Mr. Sax listed some of the fixed income brokers currently being used: JP Morgan Securities, Inc., Cantor Fitzgerald, Raymond James Financial, Inc., D.A. Davidson & Co., KeyBanc Capital Markets and CRT Capital Group, LLC. Competitive and accurate pricing are considered when choosing new brokers and all new brokers must be approved by staff. The list includes a mixture of primary and regional dealers and the complete list can be found in Resolution 217, Appendix A.

Mr. Sax noted the fixed income team meets weekly to gauge the market and the credit analysts have an increased role. Member Prothero asked for suggestions in reading material which may be beneficial to the Board. Mr. Sax replied there are a lot of market research newsletters out there and Mr. Higgins added Pioneering Portfolio Management is a good one. Other good resources are the PIMCO.com newsletter, Wilshire Axiom and the external managers are also helpful and Gimme Credit, which is independent.

Chairman Buchanan remarked the educational resources being provided the Board are good and have been helpful and added Pensions & Investments is a good resource.

Mr. Sax reported that costs are low at 2.4 basis points for the $1.4 billion core internal bond portfolio. Costs are low compared to other asset classes and are being controlled well. There are economies of scale that apply given the total amount of fixed income assets managed internally which helps keep costs low for the pension assets alone.

The bond pool policies will be reviewed and any recommended changes will be presented to the Board in 2013.

<u>STIP Management Review</u>
Mr. Rich Cooley presented the STIP Management Review. The three objectives of STIP are:

1. Preserve Principal
2. Liquidity
3. Provide return

The STIP Investment Policy was last revised in 2007. Liquidity requirements, approved credit lists and risk constraints were implemented. The STIP reserve cushion for realized losses was initiated and staff is recommending the cushion become permanent to STIP. The current balance in the STIP reserve is $12.6 million.

Member Satre asked how funds are added to the reserve.

Mr. Cooley stated additions come from withholding some income, realized gains on sales and income from former SIV-related issues.

Executive Director Ewer added the reserve fund gives portfolio managers needed flexibility. Mr. Voytko added from the customer's point of view it is good for them, as the market value is backed by the reserve.

Mr. Cooley stated STIP is well diversified with 70% of holdings top tier rated at AA or better. The Weighted Average Maturity (WAM) is currently 41.5 days; and is set by policy at a maximum of 60 days. STIP performance has consistently produced competitive returns, due in part to low management fees. Since the financial crisis the supply of money market securities has decreased. Corporations are moving away from reliance on commercial paper, Fannie Mae and Freddie Mac have reduced their debt levels and bank ratings have dropped. STIP strategy has shifted to account for market changes such as increasing longer term securities, restricting European bank holdings and the addition of Canadian and Australian banks. Longer term maturities help raise the return, while money markets still provide needed liquidity.

Mr. Sheets stated the unique return profile and diversification needs, as well as liquidity needs of fixed income pools have been managed well and efficiently by internal staff with very low costs which helps returns.

<u>STIP Investment Policy – Proposed Revisions</u>
Mr. Sheets summarized the proposed changes to the STIP Investment Policy Statement:

- Acknowledge the reserve which is maintained to offset any potential realized losses in the portfolio.

- Reduce the minimum rating requirement for certain credit related obligations which is a reflection of recent ratings downgrades to the banking sector.
- Remove the reference to SIV's as the product no longer exists and BOI holdings of former SIV's have either been restructured or the underlying securities have been distributed to us.
- Clarify the maximum maturity on floating rate securities is two years rather than implying it in the context of the "2a 7 like" reference.

Staff recommends the Board approve the revised STIP Investment Policy Statement.

> Member Prothero moved the Board approve the revised STIP Investment Policy Statement as presented. Member Bugni seconded. The motion passed 7-0. Chairman Buchanan abstained citing his role in serving clients who invest in STIP. Member Turcotte was absent.

<u>East Helena Compensation Fund – Investment Policy Statement (New)</u>
Mr. Sheets presented the new policy of the East Helena Compensation Fund. The fund is set up to serve the client, Department of Justice – Natural Resource Damage Program (NRD), to implement the restoration and oversight of environmental cleanup on and around the former site of the ASARCO smelter in East Helena

> Member Prothero moved the Board approve the East Helena Compensation Fund Investment Policy Statement as presented. Member Nyman seconded. The motion passed 8-0. Member Turcotte was absent.

Member Bugni raised for discussion the issue of the Montana Constitution not allowing equity type investments in non-retirement accounts. Senator Cocchiarella tried during the last legislative session to bring this issue forward. When considering the long term trust funds, does the Board have a fiduciary duty to bring this issue forward again, as yields continue to go lower and lower? If so, what steps, if any, should be taken by the Board? State Fund sought equity exposure to improve returns and eventually received it when policy was revised to allow up to 25% of the fund be invested in equities. Other states are looking at making similar changes.

Member Karl Englund suggested the timing is too late if looking at this issue for potential action during the 2013 legislature as the session will be starting soon. Perhaps at a later time the issue can be addressed, and it may take a session or two.

Member Noennig noted it is not a function of the Board to change the Montana Constitution.

Chairman Buchanan added that while the issue is a valid concern, discussions relating to the Coal Tax Trust can become political issues. And although it has been an ongoing issue, 3 or 4 years ago during the financial crisis the idea would have been a hard sell.

Member Bugni agreed this has been an ongoing issue for years and suggested he approach Senator Lewis as he may be in agreement with making changes.

Member Englund stated that as an issue which has been discussed previously, at length, extensive ground preparation work would be required to line up support long before the session begins. Member Noennig concurred that any major legislation must have support lined up far ahead of the legislature convening.

Executive Director Ewer suggested that while the Board functioning as an expert witness on this issue is appropriate, advocating for legislation is quite different. The Board must be cognizant of its role as opposed to the legislature and their role as policy makers.

ADJOURNMENT

Chairman Buchanan expressed thanks to staff for all their hard work. There being no further business, the meeting was adjourned at 11:25 AM.

Next Meeting
The next regular meeting of the Board will be Tuesday and Wednesday, February 26-27, 2013 in Helena, Montana.

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

BOARD OF INVESTMENTS

APPROVE: ______________________________
Mark Noennig, Chairman

ATTEST: ________________________________
David Ewer, Executive Director

DATE: __________________________________

MBOI:drc
1/7/13

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

SPECIAL BOARD MEETING
MINUTES OF THE MEETING
February 12, 2013
10:30 AM

BOARD MEMBERS PRESENT:
Mark Noennig, Chairman
Bob Bugni, CFA
Karl Englund (arrived 10:43 AM)
Quinton Nyman
Jack Prothero
Jon Satre
Kathy Bessette
Marilyn Ryan

BOARD MEMBERS ABSENT:
Gary Buchanan
Senator Ed Buttrey, Legislative Liaison
Representative Franke Wilmer, Legislative Liaison

STAFF PRESENT:
Polly Boutin, Accountant
Geri Burton, Deputy Director
Dana Chapman, Board Secretary
Frank Cornwell, CPA, Assistant Financial Manager
David Ewer, Executive Director
Julie Flynn, Bond Program Officer
Herb Kulow, Portfolio Manager
Tammy Lindgren, Accountant
April Madden, Accountant
Gayle Moon, Financial Manager
Louise Welsh, Senior Bond Program Officer

GUESTS:
Greg Gould, Luxan & Murfitt

CALL TO ORDER

Chairman Mark Noennig called the Special Conference Call Meeting of the Board of Investments (Board) to order at 10:34 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.

ADMINISTRATIVE BUSINESS

Chairman Noennig welcomed and introduced new Board Member appointees Marilyn Ryan of Missoula and Kathy Bessette of Havre.

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

INTERCAP SERIES 2013 BONDS – FINAL BOND RESOLUTION No. 231

Final Bond Resolution No. 231 – Louise Welsh, Senior Bond Program Officer

Senior Bond Program Officer Louise Welsh reviewed that at the November 13, 2013 Board meeting the Board approved the preliminary resolution authorizing staff to issue up to $12 million in additional INTERCAP bonds and to borrow up to $10 million from the Board in the form of a bond anticipation note (BAN), if required, to meet the needs of issuing the new bond. Ms. Welsh added the BAN will not be issued as there are sufficient funds to meet the needs of the program.

Ms. Welsh advised the purpose of Resolution No. 231 is:

- To serve as the Board's authorization to bond holders that the INTERCAP Series 2013 Bonds have been approved and are on parity with all other outstanding INTERCAP bonds.
- To approve the Series 2013 Supplemental Indenture.
- To pledge the INTERCAP bond's reserve account enhanced with a promise for the Board to loan monies to restore any deficiency in the reserve account and to purchase tendered INTERCAP bonds that have not been redeemed by the trustee or remarketed by the remarketing agent.
- To authorize staff to approve and execute the necessary documents to accomplish the sale.

Ms. Welsh presented staff's recommendation to the Board:

1. To authorize staff to take steps as deemed necessary to issue $12 million in INTERCAP bonds for a term of 25 years.
2. To adopt the final bond resolution.

Ms. Welsh reported that the new $12 million in bonds will be in addition to the $95 million currently outstanding. The bond ratings for the new bond have been reaffirmed by Fitch and Moody's. Fitch rated the bond at AA/F1+ and Moody's at Aa3/VMIG1.

> Board Member Bob Bugni made a Motion to authorize the Bond and adopt Resolution No. 231. Board Member Jon Satre seconded. The motion passed unanimously.

Executive Director Ewer noted that the INTERCAP program is authorized through the Legislature and asked if Board members had any questions.

Board Member Kathy Bessette stated that as a former county commissioner she was aware of the INTERCAP program and the valuable service it provides.

Board Member Bob Bugni inquired about the determination by staff not to issue the Series 2013 BAN as had been anticipated.

Ms. Welsh explained that delays of large projects and the related lack of expected draws, in addition to prepayments have alleviated the need for the BAN.

Board Member Prothero asked what rate could be expected on the new Bond.

Ms. Welsh noted that if sold today, the rate would be no less than 18 basis points, since that is the minimum rate set by the underwriter. The competitive market makes it difficult to predict the bonds' final rate. The underwriter will notify us what the adjusted interest rate for the bonds will be on the 22nd.

ADJOURNMENT

There being no further business, Chairman Noennig adjourned the meeting at 10:50 AM.

Next Meeting

The next regular meeting of the Board will be February 26 & 27, 2013 in Helena, Montana.

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

BOARD OF INVESTMENTS

APPROVE:______________________________
Mark Noennig, Chairman

ATTEST:_______________________________
David Ewer, Executive Director

DATE: ________________________________

MBOI:drc
2/14/13

Return to Agenda

Executive Director Reports

MEMORANDUM

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

To: Members of the Board

From: David Ewer, Executive Director

Date: February 26, 2013

Subject: Executive Director Reports

FY12 Annual Report and Financial Statements

The Board's Fiscal Year 2012 annual report and financial statements were delivered to the Governor's office as required by law by calendar year end. The report and statement are available on the Board's website.

Quarterly Cost Report

The Total Fiscal Year 2013 Management Fee worksheet is the report that shows the most recent quarter's cost and the previous quarter's. The report explains the largest variances in its footnotes.

Proposed Work Plan 2013

There are two primary goals of the plan. First, to cover all significant issues Board members are likely to face over a 24-month systematic cycle. Second, to provide notice to the public when these issues will be reviewed and in some cases, receive Board action. The 2013 plan picks up from where the 2012 plan left off with items not having been reviewed in 2012 and those that merit annual review.

Client Outreach

Staff is planning to invite key state program officers who are responsible for overseeing programs that have significant trust funds or other monies invested through the Board. While regular contact with the retirement boards and their staffs has been a long-standing practice, staff hopes to expand the outreach and have an opportunity for the Board to hear from these additional stake-holders first hand.

Code of Ethics

The following language is directly taken from the Board's ethics policy, which is mandated through its governance policy, which says, in part:

The Board adopts the following Code of Ethics (Code) for its members and staff to: ensure that the conduct of members and staff conform to state law, that potential conflicts of interest are reduced or eliminated and; that the Board's fiduciary reputation is not damaged in perception or in fact. All Board members and staff shall sign the Code annually and all new members and staff shall sign when appointed or hired. By signing the Code, each Board member and staff pledges to the best of his/her ability to comply with all provisions of the Code.

The February 2013 Board meeting presents this required annual agenda item to the Board.

2013 Legislative Session

The Board's budget is the most significant matter currently pending and there are no issues with it so far. There are a few bills that otherwise involve the Board and staff will provide a verbal update. The select committee on state pensions is meeting regularly. Board staff has made a brief presentation and there have been additional informational requests from legislative staff.

Total Fiscal Year 2013 Management Fees (Unaudited)

BOARD FEES

Pool	Q1 9/30/2012	Q2 12/31/2012	Change[1]	FY 2013 to Date
Retirement Funds Bond Pool (RFBP)	$ 111,690	$ 167,535	$ 55,845	$ 279,225
Trust Funds Investment Pool (TFIP)	73,472	110,208	36,736	183,680
Montana Domestic Equity Pool (MDEP)	97,880	146,820	48,940	244,700
Montana International Equity Pool (MTIP)	87,758	131,637	43,879	219,395
Montana Private Equity Pool (MPEP)	133,022	199,533	66,511	332,555
Montana Real Estate Pool (MTRP)	81,580	122,370	40,790	203,950
Short Term Investment Pool (STIP)	92,286	138,429	46,143	230,715
All Other Funds (AOF) Investments Managed	135,612	203,418	67,806	339,030
Total	**$ 813,300**	**$ 1,219,950**	**$ 406,650**	**$ 2,033,250**

[1] Board Fees: To reduce working capital, no Board fees were charged in July. This action resulted in the Q2 fee increase.

CUSTODIAL BANK FEES

Pool	Q1 9/30/2012	Q2 12/31/2012	Change[2]	FY 2013 to Date
Retirement Funds Bond Pool (RFBP)	$ 56,703	$ 56,703	$ -	$ 113,406
Trust Funds Investment Pool (TFIP)	39,519	39,519	-	79,038
Montana Domestic Equity Pool (MDEP)	133,731	133,731	-	267,462
Montana International Equity Pool (MTIP)	31,317	31,487	170	62,804
Montana Private Equity Pool (MPEP)	31,116	32,016	900	63,132
Montana Real Estate Pool (MTRP)	19,305	19,755	450	39,060
Short Term Investment Pool (STIP)	52,776	52,776	-	105,552
All Other Funds (AOF) Investments Managed	37,983	37,983	-	75,966
Total	**$ 402,450**	**$ 403,970**	**$ 1,520**	**$ 806,420**

[2] Custodial Fees: No significant changes.

Total Fiscal Year 2013 Management Fees (Unaudited)

EXTERNAL MANAGER FEES

Pool	Q1 9/30/2012	Q2 12/31/2012	Change[3]	FY 2013 to Date
Retirement Funds Bond Pool (RFBP)	$ 375,350	$ 381,932	$ 6,582	$ 757,282
Trust Funds Investment Pool (TFIP)	391,247	265,445	(125,802)	656,692
Montana Domestic Equity Pool (MDEP)	1,462,249	1,667,522	205,273	3,129,771
Montana International Equity Pool (MTIP)	771,879	580,222	(191,657)	1,352,101
Montana Private Equity Pool (MPEP)	3,160,997	4,105,611	944,614	7,266,608
Montana Real Estate Pool (MTRP)	931,273	1,117,195	185,922	2,048,468
Short Term Investment Pool (STIP)	-	-	-	-
All Other Funds (AOF) Investments Managed	6,188	6,160	(28)	12,348
Total	**$ 7,099,183**	**$ 8,124,087**	**$ 1,024,904**	**$ 15,223,270**

[3] RFBP: No significant changes.

TFIP: The fee decrease is attributed to non-recognition of September 30, 2012 quarterly fee for the American Realty Core position. September 30 and December 31, 2012 quarterly fees will be reported in Q3 ending March 31, 2013.

MDEP: Because of positive market returns of 6.3% in Q1, fee accruals increased due to a higher asset base.

MTIP: Manager fee declines resulted from the October termination of two active fee managers and a move to a lower cost index fund. The decrease is partially offset by Q2 fee increase accruals. Fee accruals are higher due to the positive return of 7.3% creating a higher asset base.

MPEP: Q2 fees increased due to growth in fund commitments which remain in their investment periods. Experience indicates fees are higher in the Q3 and Q4 as semi-annual or yearly fees are reported and recorded after calendar year end. Because reported fees are subject to a one quarter lag, quarterly fee comparisons are not meaningful.

MTRP: Q2 fees increased due to growth in fund commitments which remain in their investment periods. Experience indicates fees are higher in the Q3 and Q4 as semi-annual or yearly fees are reported and recorded after calendar year end. Because reported fees are subject to a one quarter lag, quarterly fee comparisons are not meaningful. Fees also increased due to a higher asset base on core funds due to positive returns.

TOTAL FEES

Pool	Q1 9/30/2012	Q2 12/31/2012	Change	FY 2013 to Date
Retirement Funds Bond Pool (RFBP)	$ 543,744	$ 606,170	$ 62,426	$ 1,149,913
Trust Funds Investment Pool (TFIP)	504,238	415,172	(89,066)	919,410
Montana Domestic Equity Pool (MDEP)	1,693,860	1,948,073	254,213	3,641,933
Montana International Equity Pool (MTIP)	890,954	743,346	(147,608)	1,634,300
Montana Private Equity Pool (MPEP)	3,325,135	4,337,160	1,012,025	7,662,295
Montana Real Estate Pool (MTRP)	1,032,158	1,259,320	227,162	2,291,478
Short Term Investment Pool (STIP)	145,062	191,205	46,143	336,267
All Other Funds (AOF) Investments Managed	179,783	247,561	67,778	427,344
Total	**$ 8,314,934**	**$ 9,748,007**	**$ 1,433,073**	**$ 18,062,940**

Montana Board of Investments Meetings

All meetings

- Are public and duly noticed in advance
- Require that substantive decision items be scheduled, identified and publicized
- Will invite the public for comments at every meeting
- Have minutes taken and previous ones approved

Quarterly meetings - February, May, August, and November

- Standard business
  - Performance of prior period or year end
  - Activity of prior period
  - Investment consultant
  - Quarterly cost sheet
  - Board member education and training opportunities
- Actuarial Status & Asset Allocation implications
- Loan, Audit and Human Resource and any ad-hoc committees meet
- Rotation of topics to provide 24 month systematic review

Semi-Annual meetings - April and October

- In depth coverage on certain (to be determined) topics
- April - Asset Allocation at a strategic level
- Additional systematic review of topics to complete 24-month rotation
- Subcommittees meet only as needed

Additional Board Topics for 24-month Systematic Review, either (A) annually or at least (B) biennially

- Investment Policy Statements (A)
- Board's budget (A)
- Cost reporting including CEM, Inc. analysis (A)
- Accounting and internal data systems (A)
- Annual report and financial statements (A)
- Staffing levels and compensation (A)
- Securities Lending (A)
- Securities Litigation (A)
- Accounting, GAAP, audits and internal control standards, compliance and execution (A)
- PERS and TRS relationship (A)
- Ethics policy – affirmations (A)
- Resolution 217 update (typically November) (A)
- Board member training and staying current efforts (A)
- General operations (e.g. day to day, landlord, disaster recovery, vendor review) (A/B)
- BOI website (B)
- Custodial bank relationship, performance, continuity (B)
- Customer relationships especially large customers such as State Fund (B)
- Legislative session and interim matters (B)
- Outreach, especially commercial and municipal missions (B)
- The Board as a rated investment credit, a bond issuer and a credit enhancer (B)

Proposed Work Plan 2013

Feb. 26-27	(Pre-Board meeting new member orientation) **Quarterly Meeting's standard business and subcommittee meetings** Securities Lending Benchmark presentation (from RVK) State Fund-Investment Policy change and State Fund presentation - Decision Annual Report and Financial Statements Ethics Customer outreach INTERCAP Additional Bonds - Decision Legislative Update
April 2	**Semi-Annual (non-quarterly) Meeting** Asset allocation, (set stage for asset/liability study, be mindful of Board composition) Emergency/Disaster preparedness Web site Legislative update All-policy review (mostly process and general content)-Review OR Decision??
May 29-30	**Quarterly Meeting (Billings) standard business and subcommittee meetings** Economic development and other BOI loan programs Montana Facility Finance Authority - Decision Legislative update INTERCAP finance team follow-up
August 20-21	**Quarterly Meeting standard business and subcommittee meetings** Costs (including reviewing CEM Benchmarking Inc. results) MBOI Budget Accounting and internal control systems Fiscal Year performance through June 30th Non-pension investment funds and agency user presence/presentations Custodial bank RFP and selection timetable for Oct. 2014
October 8	**Semi-Annual (non-quarterly) Meeting** RVK – topic to be determined Board's real estate holdings in Montana
Nov. 19-20	**Quarterly Meeting standard business and subcommittee meetings** Actuarial Status & Asset Allocation Implications Resolution 217 PERS/TRS annual update Securities litigation status Exempt Staff Annual Performance

I. PURPOSE

State law regarding the standards of conduct for public officers and employees defines both Montana Board of Investments (Board) members and staff as public employees and includes them within the state's Code of Ethics (Ethics Code). The Board finds that the state Ethics Code is subject to differing interpretations and may not adequately address the fiduciary responsibilities of Board members and staff. Therefore, the Board adopts this Code of Ethics tailored specifically for its members and staff who have the fiduciary responsibility of managing billions of dollars in state and local government funds. The Board's Code of Ethics, while derived from and conforming to state law, establishes standards for Board members and staff conduct that specifically relate to the Board's responsibilities, mission, and potential for conflicts of interest. The state Ethics Code contains four major provisions that are applicable to the Board's investment and operations activities.

- Monetary Provisions
- Relationship Provisions
- Time and Facilities Provisions
- Dual Salary Provisions

II. STATE CODE OF ETHIC PROVISIONS

1. **Monetary Provisions** - The state's Ethics Code is found in Title 2, chapter 2, part 1, Montana Code Annotated. Legislative intent for the law is described in the statement of purpose:

> **Section 2-2-101. Statement of purpose. The purpose of this part is to set forth a code of ethics prohibiting conflict between public duty and private interest as required by the constitution of Montana. This code recognizes distinctions between legislators, other officers and employees of state government, and officers and employees of local government and prescribes some standards of conduct common to all categories and some standards of conduct adapted to each category. <u>The provisions of this part recognize that some actions are conflicts per se between public duty and private interest while other actions may or may not pose such conflicts depending upon the surrounding circumstances.</u>**

The underlined language (emphasis added) reflects the remainder of the state Ethics Code in that it is rather ambiguous and subject to interpretation. The underlined language seems to imply that it is the circumstances surrounding the action that may be more important in determining conflict rather than the action itself. Generally, the state's Ethics Code attempts to describe circumstances under which a public employee responsible for making material decisions impacting others may have a conflict of interest. The conflict could involve a personal or financial relationship with an existing or potential vendor/contractor/borrower or the receipt of a gift with monetary value from these entities if such a gift could influence an action favorable to the entity.

> **Section 2-2-104. A public officer, legislator, or public employee may not accept a <u>gift of substantial value</u> or a substantial economic benefit tantamount to a gift <u>that would tend improperly to influence</u> a reasonable person in the person's position to depart from the faithful and impartial discharge of the person's public duties or that the person knows or that a reasonable person in that position should know under the circumstances is primarily for the purpose of rewarding the person for official action taken.**

The underlined language (emphasis added) prohibits a public employee from receiving a "gift of substantial value" if such a gift would influence the recipients official action (assumed to be an action relating to the gift giver). This section apparently does not prevent public employees not serving in a "decision making" role from accepting gifts. Lending more ambiguity to this section is how a "gift of substantial value" is defined. Section 2-2-102(3) (a) describes a gift of substantial value as a gift with a value of $50.00 or more per individual unless the gift is not used and within 30 days of receipt is returned to the donor or donated to charity. The problem with this definition is there are no frequency limitations that might cap the cumulative effect of gifts over time, i.e. could one receive a $49.00 gift each day of the week and still not receive a "gift of substantial value?" In an extreme example, a person receiving a $49.00 gift every day of the year would have received gifts totaling $17,885 but would have never crossed the $50.00 substantial value threshold. Another potential problem is how the recipient would know the value of the gift without a pricing source. A pen for example, could be nothing more than an advertising prop or could be worth well over $50.00 dollars.

While the preceding discussion highlights the ambiguities and "subject to interpretation" provisions in the state Ethics Code, another section of state law is more on target as it relates to public employees who serve in material decision-making capacities. These provisions are found in Title 45 "Crimes" with a short title of "Criminal Code of 1973."

> **Section 45-7-104 (2) "No public servant having any discretionary function to perform in connection with contracts, purchases, payments, claims, or other pecuniary transactions of the government shall solicit, accept, or agree to accept any pecuniary benefit from any person known to be interested in or likely to become interested in any such contract, purchase, payment, claim, or transaction."**

This provision is very blunt and to the point but is tempered somewhat later in subsection (5) (b):

> **"This section shall not apply to trivial benefits incidental to personal, professional, or business contacts and involving no substantial risk of undermining official impartiality."**

Discretionary function is not defined here but a definition in the state Ethics Code likely describes the type of discretion referred to here. Section 2-2-102(5) states:

> **"Official act" or "official action" means a vote, decision, recommendation, approval, disapproval, or other action, including inaction, that involves the use of discretionary authority.**

The above provisions would seem to prevent any Board member or staff who has any responsibility for scoring/selecting investment vendors and contractors, or recommending/approving loans from receiving any type of monetary benefit from current or potential vendors, contractors, or borrowers unless the benefit is "trivial" which is subject to interpretation. While "pecuniary" is not defined here, the dictionary describes it as "consisting of or measured in money" and in Section 45-2-101(56) is defined as "benefit in the form of money, property, commercial interest, or anything else the primary significance of which is economic gain."

2. <u>**Relationship Provisions**</u> – The state Ethics Code prohibits certain types of relationships that may improperly interfere with a public employee's partiality.

> **Section 2-2-105, MCA (1) The requirements in this section are intended as rules of conduct, and violations constitute a breach of the public trust and public duty of office or employment in state or local government.**
> **(2) Except as provided in subsection (4), a public officer or public employee may not acquire an interest in any business or undertaking that the officer or employee has reason to believe may be directly and substantially affected to its economic benefit by official action to be taken by the officer's or employee's agency. ***

(4) When a public employee who is a member of a quasi-judicial board or commission or of a board, commission, or committee with rulemaking authority is required to take official action on a matter as to which the public employee has a conflict created by a personal or private interest that would directly give rise to an appearance of impropriety as to the public employee's influence, benefit, or detriment in regard to the matter, the public employee shall disclose the interest creating the conflict prior to participating in the official action.
(5) A public officer or public employee may not perform an official act directly and substantially affecting a business or other undertaking to its economic detriment when the officer or employee has a substantial personal interest in a competing firm or undertaking.
***(3) Has been excluded because it is not immediately relevant.**

This provision relates directly to the official duties of Board members and staff who are involved in the decision making process. Subsection (2) prevents a public employee from acquiring a personal or financial interest in an entity that they believe could benefit from future action the public employee may take. Examples would be a Board member or staff taking a financial interest in a business that had a loan request pending upon which the Board member or staff would ultimately act. Subsection (5) is the reverse situation in which a public employee has a financial or personal interest in a business that is a direct competitor of a business with a pending loan request before the Board. The competing interest of the Board member or staff could color the ultimate decision. Subsection (4) is specifically aimed at quasi-judicial Board members, such as the Board. It recognizes that lay board members have day-to-day business interests some of which may come before them in their official capacity as board members. Specific examples of this would be board members who are bank officials or employees when loan requests submitted by their bank are considered by the Board.

3. **Time and Facilities Provisions –** The state Ethics Code prohibits public employees from conducting private business on state time or facilities.

Section 2-2-121 (2) A public officer or a public employee may not: (a) subject to subsection (7), use public time, facilities, equipment, supplies, personnel, or funds for the officer's or employee's private business purposes

This provision prohibits public employees from using state time, facilities, etc. to conduct private business. Private business is not defined here but would likely mean conducting some type of business generating revenue rather than sending an occasional personal e-mail or making a personal phone call. This interpretation of private business is further reinforced by the reference to subsection (7) which states:

A listing by a public officer or a public employee in the electronic directory provided for in 30-17-101 of any product created outside of work in a public agency is not in violation of subsection (2)(a) of this section. The public officer or public employee may not make arrangements for the listing in the electronic directory during work hours.

This language implies that the reference to private business is in fact a bona fide business that produces a product for sale that may be listed in the "Made in Montana" electronic directory provided by the Department of Commerce.

4. **Dual Salaries Provisions –** The Ethics Code prohibits public employees from drawing two salaries from public agencies for the same period of time.

> **Section 2-2-104(3)(a) Except as provided in subsection (3)(b), a public officer, legislator, or public employee may not receive salaries from two separate public employment positions that overlap for the hours being compensated, unless: the public officer, legislator, or public employee reimburses the public entity from which the employee is absent for the salary paid for performing the function from which the officer, legislator, or employee is absent; or the public officer's, legislator's, or public employee's salary from one employer is reduced by the amount of salary received from the other public employer in order to avoid duplicate compensation for the overlapping hours.**

This provision prohibits a Board member who is also a public employee from receiving compensation from both sources for the same period of time. For example, if a Board member spent two days away from a public employee job to attend Board meetings and was a salaried employee who remained on a public payroll during the period, he/she could not receive per diem for attending the Board meeting. However, as clarified later in the state Ethics Code if the Board member was an hourly employee who took accrued leave or compensation time to attend the meeting he/she would be eligible for per diem for Board attendance.

This provision is reinforced in the law that governs quasi-judicial Boards:

> **2-15-124 (7) Unless otherwise provided by law, each member is entitled to be paid $50 for each day in which he is actually and necessarily engaged in the performance of board duties, and he is also entitled to be reimbursed for travel expenses, as provided for in 2-18-501 through 2-18-503, incurred while in the performance of board duties. Members who are full-time salaried officers or employees of this state or of a political subdivision of this state are not entitled to be compensated for their service as members except when they perform their board duties outside their regular working hours or during time charged against their annual leave, but such members are entitled to be reimbursed for travel expenses as provided for in 2-18-501 through 2-18-503. Ex officio board members may not receive compensation but shall receive travel expenses.**

III. RATIONALE FOR A BOARD OF INVESTMENTS CODE OF ETHICS

The Board's composition does not lend itself to the "pay to play" problems that have been discovered in other investment Boards. There are no elected officials on the Board as voting members nor do any elected officials exert any influence on the Board's decision making process. Therefore campaign contributions to any Montana elected official will have no impact on the Board's decision to hire or fire an investment vendor, make or deny make a loan, or to conduct business with a political contributor.

Perhaps the greatest potential for conflicts of interest of Board members and staff is with private investment vendor relationships. The Board's mission requires it to have numerous relationships with these vendors; including investment managers, investment brokers, investment consultants, investment and custodian banks, and commercial banks. Vendors selected by the Board to provide these services will receive millions in fees during the contract period. Therefore, the process for establishing and terminating these relationships must be based on well established protocol. When existing and potential vendors provide any type of financial benefits to persons who are ultimately responsible for selecting and maintaining these relationships a potential conflict could exist.

The type of "financial benefit" does not have to be direct to create a potential conflict of interest. There are firms in the investment business who sponsor conferences couched as educational in nature but are in fact a not so subtle attempt to get "buyers" and "sellers" of services (vendors) in the same place at the same time. Generally, the service "buyers", such as the Board are provided a host of "free" amenities to attend and mix with potential vendors. Basically, it is the vendors paying for the amenities provided free to the buyers.

While it is difficult to put a dollar value on these amenities, the cost to the vendors of providing free services to potential buyers is a "gift equivalent."

This restriction does not apply to meals/beverages provided at investor conferences held by General Partners in which the Board is a Limited Partner. This is the only opportunity Board Members/staff have to meet and interact with other Limited Partners and hear the General Partner discuss the strategy and progress of the fund. Because of the significant number of Limited Partners in the larger General Partnerships, the General Partners do not usually visit the Limited Partners individually but rather host periodic investor meetings.

The second greatest potential for conflict of interest involves the Board's economic development role. The Board manages several loan programs that lend Coal Tax Trust funds to hundreds of Montana borrowers. If Board members or staff in the "decision making loop" have personal or financial relationships with local lenders or borrowers whose loans are pending, serious conflicts could occur.

Also, Board employees are unique in state government because many of them have state-provided access to financial research tools and information that could benefit them when investing a personal portfolio. While research information obtained by staff in the course of normal job duties may provide incidental knowledge and benefit to the management of a personal portfolio, state time and facilities must not be used for personal enrichment. Personal security trading must not be conducted on state time/facilities nor should staff conduct any type of business enterprise on state time and facilities.

The Board adopts the following Code of Ethics (Code) for its members and staff to: ensure that the conduct of members and staff conform to state law, that potential conflicts of interest are reduced or eliminated and; that the Board's fiduciary reputation is not damaged in perception or in fact. All Board members and staff shall sign the Code annually and all new members and staff shall sign when appointed or hired. By signing the Code, each Board member and staff pledges to the best of his/her ability to comply with all provisions of the Code.

IV. BOARD OF INVESTMENTS CODE OF ETHICS PROVISIONS

1. Monetary Provisions

A) Board members/staff shall not attend conferences if any of the actual costs to the Board of attending such conferences are subsidized by current or potential investment vendors. However, Board members/staff may attend if the Board pays the actual cost for such attendance. If the conference is truly educational and otherwise worthwhile Board funds should be used to cover costs for member/staff attendance. These costs would include transportation, lodging, meals, and reasonable registration fees.

This restriction does not apply to meals/beverages provided at investor conferences held by General Partners in which the Board is a Limited Partner as this is usually the only opportunity Board Members/staff have to meet and interact with other Limited Partners and hear the General Partner discuss the strategy and progress of the fund.

B) A gift from current or potential vendors sent to a Board member/staff at the member's or staff's home or at the Board's office shall be donated to charity if the perceived value of the gift exceeds $50.00**.** The Board member/staff should immediately notify the Executive Director of such gift, the disposition of such gift, and the Executive Director shall maintain a log of such gifts and their disposition. Such gifts received by the Executive Director shall be immediately reported to the Board Chairperson.

C) A perishable gift from current or potential vendors to a Board member/staff at the Board's office with a perceived value of less than $50.00 shall be shared with all Board staff. The Executive Director shall maintain a log of such gifts and their disposition.

D) A non-perishable gift from current or potential vendors to a Board member/staff at the Board's office with a perceived value of less than $50.00 shall be auctioned and the auction proceeds deposited in the "employee fund." The Executive Director shall maintain a log of such gifts and their disposition.

E) All restaurant dinners attended by Board members\staff and current or potential investment vendors, or lenders shall be "no host."

F) The above meal restriction does not apply to Board members\staff attending meetings held by the General Partner of private equity funds, private real estate funds, or other private funds in which the Board is a Limited Partner.

2. Relationship Provisions

A) Board staff who have a material personal or financial relationship with a current or potential vendor shall recuse themselves from participating in any part of the decision to select, negotiate a contract with, or terminate the services of the vendor and shall not attempt to influence in any way Board members/staff who are part of the decision making process.

B) Board members who have a material personal or financial relationship with a current or potential vendor shall recuse themselves from participating in any part of the decision to select or terminate the services of the vendor and shall not attempt to influence in any way Board members/staff who are part of the decision making process. If the Board, as an entity, has the final authority to make the decision the Board member with the relationship shall, at the Board's public meeting, divulge in general terms the relationship and abstain from voting. Such abstention and the reason for the abstention shall be recorded in the meeting minutes.

C) Board staff who have a material personal or financial relationship with a current or potential lender or borrower shall recuse themselves from participating in any part of the decision to participate or not participate in the loan with the current or potential lender or borrower and shall not attempt to influence in any way Board members/staff who are part of the decision making process.

D) Board members who have a material personal or financial relationship with a current or potential lender or borrower shall recuse themselves from participating in any part of the decision to participate or not participate in the loan with the current or potential lender or borrower and shall not attempt to influence in any way Board members/staff who are part of the decision making process. If the Board, as an entity, has the final authority to make the decision the Board member with the relationship shall, at the Board's public meeting, divulge in general terms the relationship and abstain from voting. Such abstention and the reason for the abstention shall be recorded in the meeting minutes.

E) Board members may vote on INTERCAP loans made to local governments in the jurisdiction in which a Board member resides. Board members represent the entire state on the Board regardless of where they may reside.

3. Time and Facilities Provision

A) Board staff shall not use state time and facilities to conduct private business; which includes the researching of securities for personal portfolios, the trading of securities; or conduct any activities for a revenue generating business.

4. Dual Salaries Provision

A) Board members who are also public employees shall inform the Executive Director if they are in a public employee salaried position that continues to pay their salaries while they are carrying out Board activity for which they are entitled to per diem. Board members in this status shall not receive per diem for the same hours for which their salaries are paid but shall receive travel, meal, and lodging entitlement, and reimbursement for out of pocket expenses as do other Board members. This provision does not apply if the public employee takes accrued leave or compensatory time from the public employee position in order to carry out Board activities.

I have read and understand the Montana Board of Investments Code of Ethic and agree to the best of my ability to comply with all its provisions.

____

Board member/staff Date

Return to Agenda

Montana Loan Program

MEMORANDUM

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

To: Board of Directors

From: Herb Kulow, CMB

Date: February 26, 2013

Subject: Commercial Portfolio, Residential Portfolio and VA Residential Portfolio

The following is a summary of the commercial loan portfolio as of January 31, 2013.

Loans	Balance	Comments
129	125,824,646	Portfolio balance - 5.05% yield
10	17,202,858	Reservations
4	2,339,825	Commitments
1	101,341	SBA loan past due 61 days - 0.08%

According to the Mortgage Bankers Association, 2.93% of all real estate secured commercial loans were past due as of the end of the third quarter of 2012.

The following is a summary of the residential loan portfolio as of January 31, 2013.

Loans	Balance	Comments
395	17,243,667	Portfolio balance - approximate yield of 6.66%
0	0	Reservations
11	618,822	Total past due - 3.59%
8	520,910	Past due over 90 days - 3.02%
4	426,155	Gtd past due over 90 days - 2.47%
2	94,755	Non-gtd past due over 90 days - 0.5%

There has been no activity other than monthly payments and payoffs of residential loans. According to the Mortgage Bankers Association, 7.40% of the one-to-four family residential loans were past due as of the end of the third quarter of 2012.

The following is a summary of the Veterans Administration (VA) loans as of January 31, 2013.

Loans	Balance	Comments
43	7,421,189	Portfolio balance - approximate yield of 1.55%
19	3,308,552	Reservations

A total of $15,000,000 of coal tax trust money has been allocated to this program. There have been no delinquencies to date on the VA loan portfolio.

Return to Agenda

Bond Program

INTERCAP Loan Program

Activity Summary

As of December 31, 2012

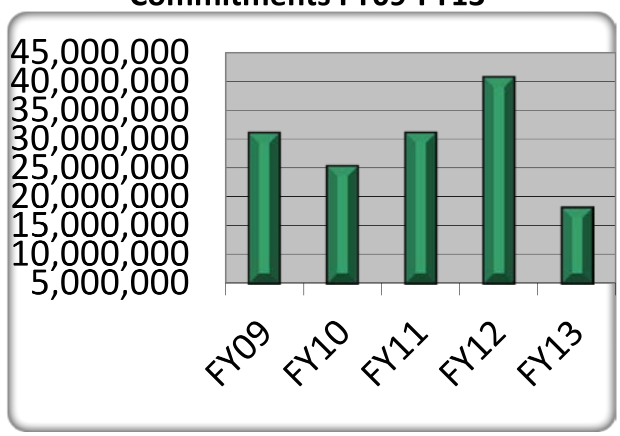
Since Inception 1987 - December 2012

Total Bonds Issued	**136,000,000**
Total Loan Commitments	**424,034,932**
Total Loans Funded	**387,222,033**
Total Bonds Outstanding	**95,030,000**
Total Loans Outstanding	**85,795,310**
Loan Commitments Pending	**36,812,899**

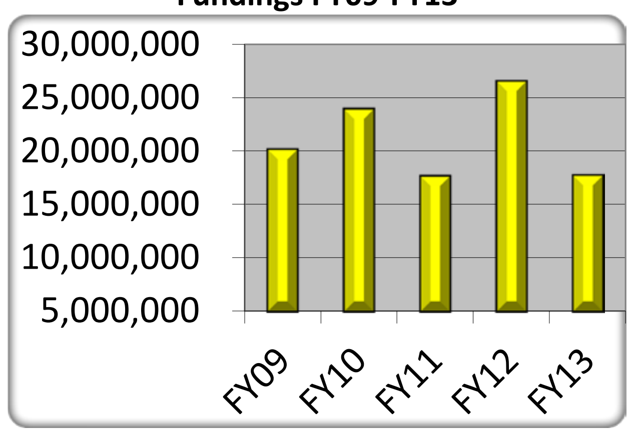
FY2013 To Date

Month	Commitments	Fundings
July-12	$ 6,016,000	$ 2,043,033
August	1,140,965	2,046,837
September	380,000	1,772,729
October	837,800	1,651,253
November	7,627,811	8,721,165
December	2,191,776	1,551,232
January		
February		
March		
April		
May		
June-13		
To Date	$ 18,194,352	$ 17,786,248

Commitments FY09-FY13



Fundings FY09-FY13



Note: Commitments include withdrawn and expired loans.

Variable Loan Rate History February 16, 2004 - February 15, 2013

February 16, 2005 - February 15, 2006	3.80%	February 16, 2009 - February 15, 2010	3.25%
February 16, 2006 - February 15, 2007	4.75%	February 16, 2010 - February 15, 2011	1.95%
February 16, 2007 - February 15, 2008	4.85%	February 16, 2011 - February 15, 2012	1.95%
February 16, 2008 - February 15, 2009	4.25%	February 16, 2012 - February 15, 2013	1.25%

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MEMORANDUM

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

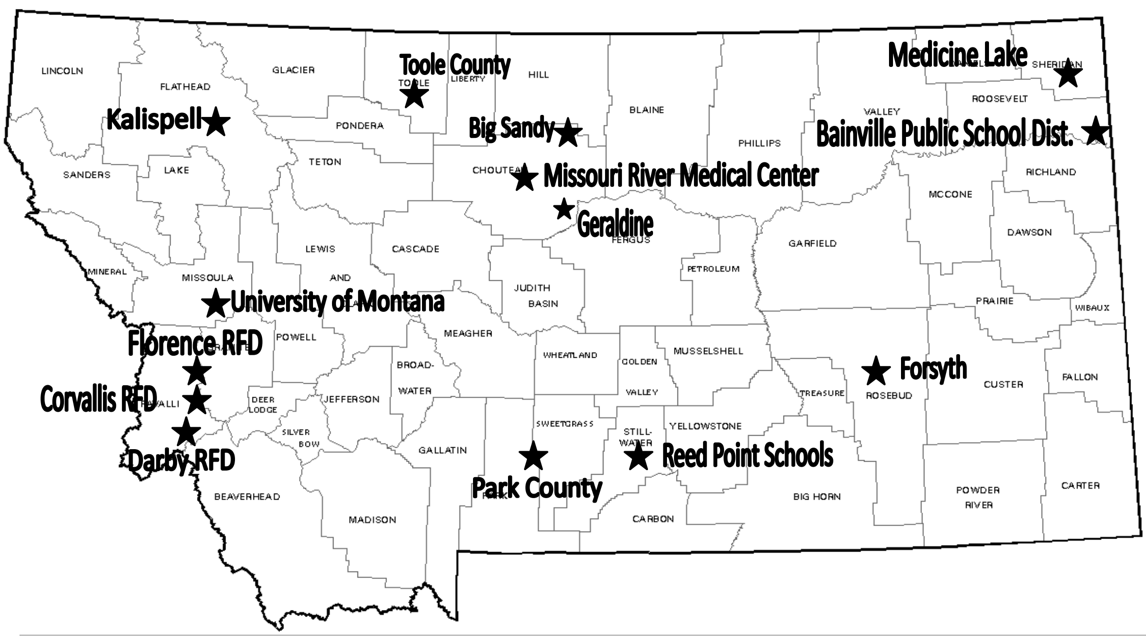
To: Members of the Board

From: Louise Welsh, Senior Bond Program Officer

Date: February 22, 2013

Subject: INTERCAP Staff Approved Loans Committed

Staff approved the following loans between October 1, 2012 and December 31, 2012.



Borrower:	Park County
Purpose:	Construct a Search and Rescue Operations Building
Staff Approval Date:	October 3, 2012
Board Loan Amount:	$700,000
Other Funding Sources:	$0
Total Project Cost:	$700,000
Term:	15 Years

Borrower:	City of Forsyth
Purpose:	Municipal pool improvements
Staff Approval Date:	October 5, 2012
Board Loan Amount:	$137,800
Other Funding Sources:	$0
Total Project Cost:	$137,800
Term:	10 Years

Borrower:	Corvallis Rural Fire District
Purpose:	Refinance a fire engine
Staff Approval Date	November 7, 2012
Board Loan Amount:	$120,360
Other Funding Sources:	$0
Total Project Cost:	$120,360
Term:	4 years

Borrower:	Corvallis Rural Fire District
Purpose:	Refinance two fire stations
Staff Approval Date	November 7, 2012
Board Loan Amount:	$627,648
Other Funding Sources:	$0
Total Project Cost:	$627,648
Term:	10 years

Borrower:	Florence Rural Fire District
Purpose:	Construct a satellite fire station
Staff Approval Date	November 8, 2012
Board Loan Amount:	$300,000
Other Funding Sources:	$0
Total Project Cost:	$300,000
Term:	15 years

Borrower:	Town of Geraldine
Purpose:	Street and sidewalk project
Staff Approval Date	November 14, 2012
Board Loan Amount:	$30,000
Other Funding Sources:	$39,812
Total Project Cost:	$69,812
Term:	10 years

Borrower:	Town of Big Sandy
Purpose:	Wastewater sludge removal
Staff Approval Date	November 19, 2012
Board Loan Amount:	$71,000
Other Funding Sources:	$0
Total Project Cost:	$71,000
Term:	6 years

Borrower:	Reed Point School District
Purpose:	Maintenance vehicle and equipment
Staff Approval Date	November 26, 2012
Board Loan Amount:	$20,000
Other Funding Sources:	$0
Total Project Cost:	$20,000
Term:	3 years

Borrower:	Choteau County Hospital District dba Missouri River Medical Center (Fort Benton)
Purpose:	Replace roof and purchase equipment/software
Staff Approval Date	November 29, 2012
Board Loan Amount:	$ 107,178
Other Funding Sources:	$ 22,500
Total Project Cost:	$ 129,678
Term:	4 years

Borrower:	Bainville Public School District #64D
Purpose:	Remodel school building
Staff Approval Date	December 11, 2012
Board Loan Amount:	$ 800,000
Other Funding Sources:	$ 100,000
Total Project Cost:	$ 900,000
Term:	5 years

Borrower:	Darby Rural Fire District
Purpose:	Purchase a new fire engine
Staff Approval Date	December 13, 2012
Board Loan Amount:	$ 88,481
Other Funding Sources:	$ 78,099
Total Project Cost:	$ 166,580
Term:	10 years

Borrower:	City of Kalispell
Purpose:	Purchase several pieces of equipment and vehicles
Staff Approval Date	December 14, 2012
Board Loan Amount:	$375,000
Other Funding Sources:	$0
Total Project Cost:	$375,000
Term:	5 years

Borrower:	Town of Medicine Lake
Purpose:	Preliminary engineering report – wastewater
Staff Approval Date	December 20, 2012
Board Loan Amount:	$40,000
Other Funding Sources:	$0
Total Project Cost:	$40,000
Term:	3 years

Borrower:	Toole County
Purpose:	Digitize County Records
Staff Approval Date	December 26, 2012
Board Loan Amount:	$277,347
Other Funding Sources:	$0
Total Project Cost:	$277,347
Term:	5 years

Borrower:	Toole County
Purpose:	Purchase truck/trailer and two motor graders
Staff Approval Date	December 26, 2012
Board Loan Amount:	$447,156
Other Funding Sources:	$271,000
Total Project Cost:	$718,156
Term:	7 years

Borrower:	Toole County
Purpose:	Repave airport taxiway and construct hangar
Staff Approval Date	December 26, 2012
Board Loan Amount:	$ 145,394
Other Funding Sources:	$ 1,868,543
Total Project Cost:	$ 2,013,937
Term:	10 years

Borrower:	Toole County
Purpose:	Purchase maintenance truck
Staff Approval Date	December 26, 2012
Board Loan Amount:	$18,038
Other Funding Sources:	$0
Total Project Cost:	$18,038
Term:	6 years

MONTANA UNIVERSITY SYSTEM

Borrower:	University of Montana – Missoula
Purpose:	Purchase and install IT equipment
Staff Approval Date	November 20, 2012
Board Loan Amount:	$401,625
Other Funding Sources:	$364,160
Total Project Cost:	$765,785
Term:	3 years

Montana Board of Investments
INTERCAP Loan Summary and Approval

Borrower: Flathead Valley Community College (FVCC) - Kalispell

Date: February 5, 2013
Approval Date: ___________

The FVCC requests a $2.4 million loan to finance costs associated with constructing its new Nursing and Health Sciences Building over a period of 10 years. The loan will be in the form of a general promise to pay of the FVCC based on allowable non-state revenues (see "Revenue Pledge"). The FVCC will contribute $3.3 million ($2.1 million in donations and $1.2 million from its Student Building & Grounds Fee Fund) towards the $5.7 million total project cost.

Authorization

20-15-301 Montana Code Annotated (MCA). (1) The board of trustees of any community college district may: (a) purchase, lease, build, enlarge, alter, or repair school buildings and dormitories; (2) The board of trustees of a community college district may borrow money for the purposes of this section and repay the obligations from the various revenues of the college. [Per the Office of the Commissioner of Higher Education and INTERCAP's bond counsel, since the FVCC project falls under statute 20-15-301 MCA, statute 18-2-102 MCA requiring the Governor's consent on the project does not apply.]

20-15-103 MCA. Community college districts shall be under the supervision and coordination of the board of regents. The regents shall: (1) supervise community college districts in accordance with the provisions of this section and 20-15-105;

20-15-105 MCA. (1) The board of trustees of a community college district may, in their discretion and upon approval of the board of regents, prescribe: (c) incidental fees, including building fees, for students in the community college.

May 24-25, 2012 - BOR Item 155-304-R0512 authorizing the Project, financing through the INTERCAP Program, and the donations pledged to repay the loan passed 7-0.

January 7-8, 2013 - BOR Item 158-301-R0113 authorization amendment to Item 154-304-R0512 clarifying the student building and grounds fees are the primary revenues pledged to repay the INTERCAP loan passed 7-0.

September 6, 2012 - Office of the Commissioner of Higher Education (OCHE) approved the INTERCAP application and repayment source.

- Note: OCHE approval certifies that it performed sufficient due diligence as to the appropriateness of the project in the context of the overall plans and policies of BOR, and that the proposed loan complies with existing contracts, statutes, and all legislative directives, mandates, and limitations.

INTERCAP Debt

Using rounded figures, the FVCC borrowed ~$3.3 million for a campus expansion project in 2007. The loan is current and fully funded with ~$1.8 million principal outstanding maturing February 2017.

Revenue Pledge (non-state)

NOTE: Montana statute places the supervision and coordination of the community colleges under the Board of Regents (BOR); however, the management and control of the community college remains with the FVCC's board of trustees. Neither the BOR nor OCHE assumes liability for repayment of community college debt.

There will be ~$304,000 annual debt service on the loan. The FVCC is pledging the surplus net revenue pledge of its student building & grounds fee revenues as the repayment source for the proposed loan. The FVCC's existing 2007 loan has ~$330,947 annual debt service and shares the same revenue pledge as the proposed loan. The FVCC has no other debt outstanding that has this revenue pledge.

In addition, the FVCC received a $4 million binding pledge from a private charitable foundation to construct and equip a new building for the FVCC's School of Nursing. The pledge was for the FVCC to receive $1 million by December 2011 and $600,000 in each of the subsequent five (5) years. The FVCC has received $1.6 million to date that is part of the $2.1 million in donations already applied to the project. The remaining $2.4 million of the pledged amount is to be fully distributed to the FVCC by or before December 2016. Though the proposed loan term is for 10 years, the FVCC intends to pay the loan off over the next four (4) years as these donated funds are received.

To the extent the Revenue Pledge is insufficient, the FVCC will reduce other expenditures, if necessary, and as authorized by and according to applicable provisions and limitations of law, budget and appropriate any allowable non-state revenues sufficient to pay the principal of and interest on the loan when due. The following Financial Report shows the FVCC can adequately support both debt services in the event the foundation monies are delayed.

Financial Report

FVCC overall	FY12	FY11 (audited)
Net Assets, beginning of year	$20,345,159	$17,719,957
Revenues	38,009,531	37,962,776
Expenditures	35,730,097	35,337,574
Net Assets, end of year	$22,624,593	$20,345,159

Net Change in Fund Balance	$ 2,279,434	$ 2,625,202
Fund Balance Cash	$12,515,226	$ 9,804,724
Fund Balance *Unrestricted*	$ 9,537,031	$ 8,491,516

Student Building & Grounds Fee Fund (Pledged Fund)

	FY12	FY11
Beginning Fund Balance	$2,468,621	$2,094,962
Revenues	953,429	1 036,760
Expenditures	636,430	663,101
Ending Fund Balance	$2,785,620	$2,468,621

Net Change in Fund Balance	$ 316,999	$ 373,659
Fund (Cash) Balance Unrestricted	$ 2,749,205	$2,468,621

COMMENTS:

FVCC Overall

Higher operations & maintenance costs offset by additional state/local funding primarily attribute to the increase in revenue and expenditures in FY12 compared to FY11.

FY11: Without ($1,538,763) depreciation expense and the onetime $15,720,010 revenues and ($13,325,996) expenses, the net change in fund balance would have been $1,769,951.

FY12: Without ($1,691,128) depreciation expense and the onetime $14,872,172 revenues and ($13,071,465) expenses, the net change in fund balance would have been $2,169,855.

Student Building & Grounds Fee Fund (Pledged Fund)

FY11: Without the onetime $79,687 revenues and ($192,250) expenses, the net change in fund balance would have been $486,222.

FY12: Without the onetime ($169,754) expenses, the net change in fund balance would have been $486,753.

Recommendation:

Approval recommended with the following condition:

1. The FVCC may not incur additional debt pledging the student building & grounds fee revenues without the Board's written permission.

Staff Loan Committee

David Ewer, Executive Director ___________________________ Approval Date: _____________

Geri Burton, Deputy Director ___________________________ Approval Date: _____________

Louise Welsh, Sr. Bond Program Officer ___________________________ Recommended: _____________

Board Loan Committee

Jack Prothero, Chairperson – Loan Committee ☐ Yes ☐ No ☐ Abstain
Dave Aageson, Member ☐ Yes ☐ No ☐ Abstain
____________, Member ☐ Yes ☐ No ☐ Abstain

Approval Date: ________

Return to Agenda

Investment Activity

MEMORANDUM

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

To: Members of the Board

From: Clifford A. Sheets, CFA, Chief Investment Officer
Rich Cooley, CFA, Portfolio Manager

Date: February 26, 2013

Subject: State Fund Policy Statement Changes

During the past year we have been in discussions with State Fund staff regarding the erosion of the book yield in their bond portfolio due to low interest rates. One of the options we discussed with them was using core real estate funds to help offset the decline in book yield as well as add diversification to the overall portfolio.

State fund staff agreed that the addition of core real estate would be beneficial and we presented this proposal to their Board on February 1, 2013. Our recommendation is to add this asset class with a target of 5% of the total portfolio and a range of +/- 2% or 3%-7%.

Staff recommends the Board approve the revised State Fund Investment Policy Statement, dated February 2013. The policy statement marked for these changes follows this memo.

Montana State Fund

Real Estate Allocation Recommendation

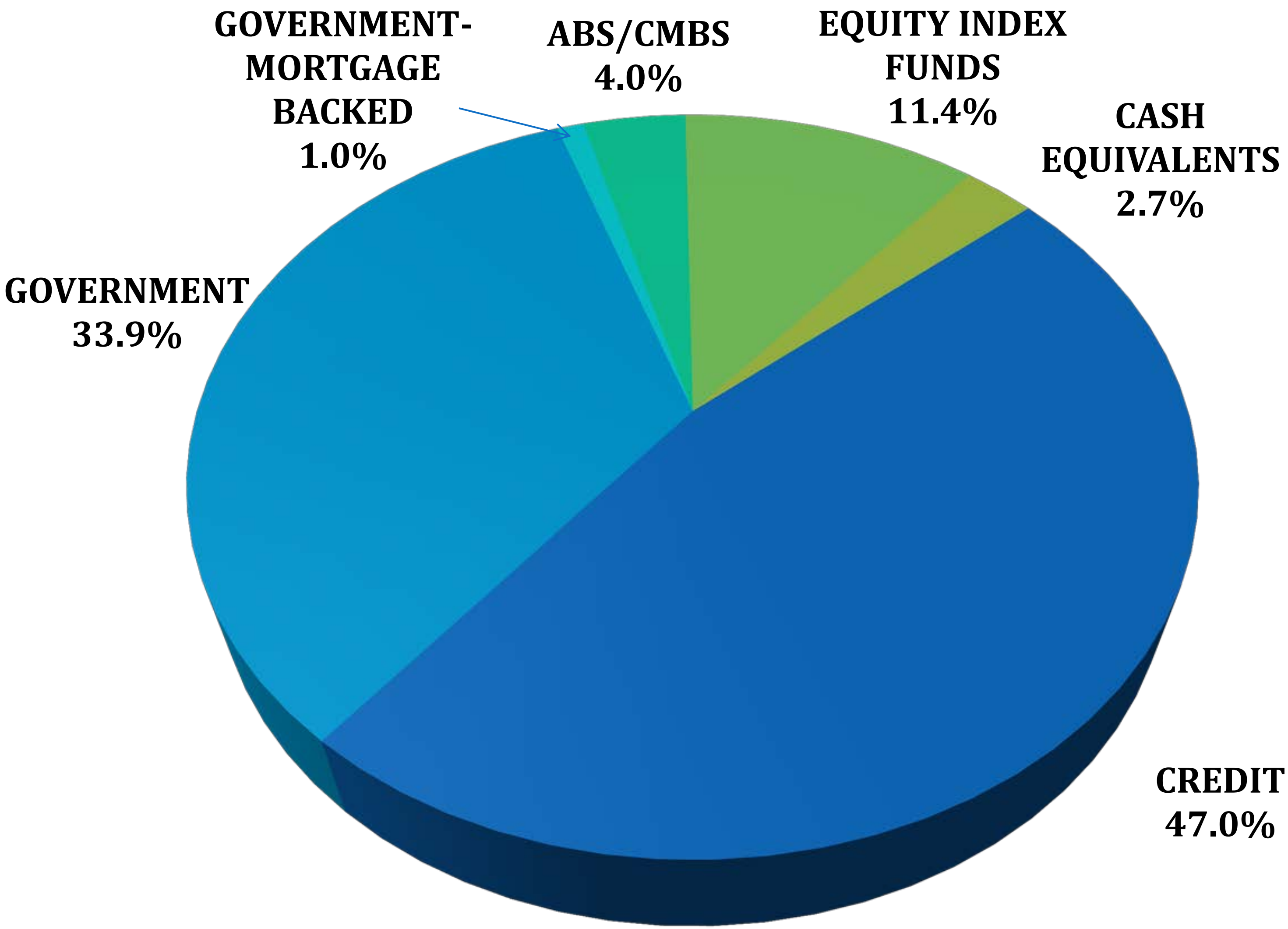
Montana Board of Investments

Cliff Sheets, Chief Investment Officer

Rich Cooley, Portfolio Manager

State Fund by Sector

As of 12/31/12



State Fund by Sector

As of 12/31/12

	Market Value	%
CREDIT	621,233,246	47.0%
GOVERNMENT	448,116,338	33.9%
GOVERNMENT-MORTGAGE BACKED	13,630,200	1.0%
ABS/CMBS	52,636,849	4.0%
TOTAL FIXED INCOME	1,135,616,633	85.9%
EQUITY INDEX FUNDS	151,393,651	11.4%
CASH EQUIVALENTS	36,117,889	2.7%
GRAND TOTAL	1,323,128,172	100.0%

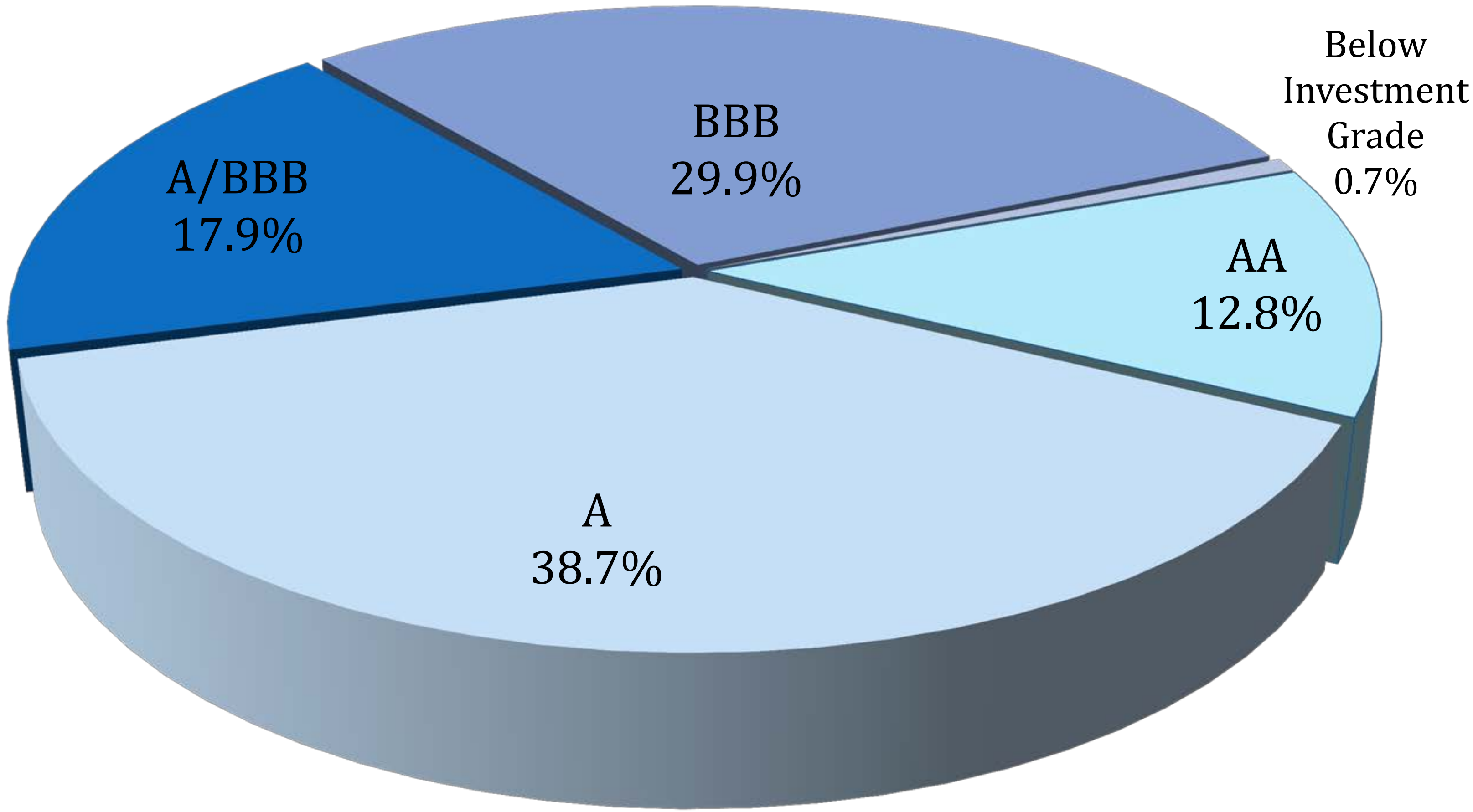
State Fund Investment Policy Summary

As of 12/31/12

- STIP (cash) balance range: 1-5%, Current: 2.7%
- Maximum holdings rated less than A3/A: 25%, Current: 24.2%
- Maximum corporate bonds: 55%, Current: 47.0%
- Maximum U.S. Pay international (Yankee) bonds: 5%, Current: 5%
- Total fixed income duration range : 2-5 years, Current: 3.85 years
- Common stock holdings range: 8-12%, Current: 11.4%

State Fund Corporate Credit Ratings

As of 12/31/12



An Alternative: Core Real Estate Commingled Funds What Are They?

- Ownership in a broad portfolio consisting of commercial real estate properties
- Diversification by property type
  - Retail
  - Commercial Office
  - Residential Multi-Family
  - Industrial
- Diversification by location
  - Large metro areas with a diverse economic base
- Limited leverage – typically 15-25%
- Quarterly dividend distribution to fund investors (3.5% to 5% range)
- Open-ended funds
  - Purchases and redemptions quarterly, subject to fund activity

Core Real Estate Commingled Funds

- Portfolio alternative to existing “risk” asset exposures
  - Corporate bonds (credit)
  - Stocks

- Income from a diversifying asset
  - Alternative high income sources compound existing risk exposures
    - High yield bonds – more credit risk
    - Long term bonds – more interest rate risk
    - High dividend yielding stocks – more equity risk

- Some inflation protection from rising rents over time

- Potential value appreciation via property prices

Core Real Estate Investment Risks

- Operating risk: Ability to generate net operating income and pay distributions
- Not totally liquid: Ability to sell a function of market and fund activity
  - Market disruptions (in 2008 and 2009 when real estate values were suffering, most commingled funds froze the right to redeem shares)
  - Specific fund and its liquidity (from property sales or new capital from other investors)
- Not immune to business cycles
  - Economic or recession risk
  - Availability of credit

Diversification Benefit of Real Estate

Correlation of Returns*

Core Real Estate (ODCE) versus	
Stocks (S&P 500)	-0.03
Bonds (Intermediate Gov/Credit)	-0.01

Long Term Returns*

	Core RE (ODCE Net, Qrt Lag)	Stocks (S&P 500)	Bonds (Int Gov/Cr)
Annualized Return	7.54%	8.51%	6.12%
Volatility of Annual Returns**	6.81%	17.65%	3.38%

*For 18 years ending 12/31/12 **Volatility: one standard deviation

NCREIF ODCE –National Council of Real Estate Investment Fiduciaries - Open End Diversified Core Equity index (30 open end commingled funds pursuing a core investment strategy, capitalization weighted, net of fees); lagged one quarter

Summary - Core Real Estate Allocation

- Diversification benefit
  - Versus existing risks that dominate the portfolio
- Attractive current income vs. alternatives
  - Existing portfolio book yield will continue trending down
- Proposed range of 3-7% with 5% target
  - Prudent investment
  - Timing: sooner the better
  - 5% ~ $65 million

MONTANA BOARD OF INVESTMENTS
STATE FUND INSURANCE – NEW FUND (MU26) (FUND 06035)
INVESTMENT POLICY STATEMENT

INTRODUCTION

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

The Montana Constitution, Article VIII, Section 13 (4) requires that "Investment of state compensation insurance fund assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of a private insurance organization. State compensation insurance fund assets may be invested in private corporate capital stock. However, the stock investments shall not exceed 25 percent of the book value of the state compensation insurance fund's total invested assets.

OBJECTIVES

To maximize investment income consistent with safety of principal through a broadly diversified portfolio of fixed income securities. In addition the portfolio will contain an allocation to public stocks in order to provide dividend income and long-term price appreciation potential.

Performance: The primary objective of the fixed income portfolio is to obtain a relatively high level of book (purchase) yield versus the benchmark. A secondary objective is to provide a total return in excess of the benchmark. Success in attaining the return objective will be measured against the return on the Barclays Capital Government /Credit Intermediate Term Index, the return on the S&P 500 index and the return on the MSCI ACWI Ex U.S. Index (international equity index), and the return of the NCREIF ODCE index (real estate), each weighted proportionately to the portfolio's holdings, over a five-year moving average.

PERMITTED FIXED INCOME INVESTMENTS

- Debt obligations of the U.S. Government, including its agencies and instrumentalities. These include Treasuries, Treasury Inflation Protected Securities (TIPS) and fixed and floating rate agency obligations.
- Dollar denominated debt obligations of developed country foreign governments.
- Dollar denominated debt obligations of index-eligible supranational agencies (e.g., EIB, IFC, IADB).
- Dollar denominated debt obligations of domestic and foreign corporations (Yankee bonds) up to 2% of portfolio assets per issuer. These may include trust preferred securities and be fixed or floating rate coupon structures.
- Securitized assets, including U.S. Agency mortgage pass through securities (MBS), non-agency MBS (limited to 3% of portfolio market value in total), collateralized mortgage obligations (CMOs), commercial mortgage backed securities (CMBS), hybrid ARMS and asset backed securities.
- When-issued securities.
- Rule 144a securities.
- Medium term notes.

MONTANA BOARD OF INVESTMENTS
STATE FUND INSURANCE – NEW FUND (MU26) (FUND 06035)
INVESTMENT POLICY STATEMENT

PROHIBITED FIXED INCOME INVESTMENTS

- Over the counter derivatives, including interest rate swaps and credit default swaps.
- Short sales and securities margin loans.
- Bank loans.
- Interest only (IO) and principal only (PO) mortgage strips.
- Companion/residual/equity tranches of CMOs or other structured securitizations.
- Capital securities (convertible from fixed to floating)
- Inverse floaters.
- Convertible bonds.

CONSTRAINTS

Liquidity: Liquidity is needed to pay claims on a daily basis. A STIP balance of 1 percent to 5 percent will be held for liquidity purposes.

Term: This fund is considered an intermediate-term insurance account. The maximum maturity will be approximately ten years for fixed income securities and the average duration of the fixed income segment of the portfolio will be maintained in a range of 2 to 5 years, except in extraordinary circumstances where a shorter duration may be advisable in order to preserve principal.

Fixed Income Quality:

- Fixed income securities purchased must be investment grade and be rated by either Moody's or S & P and the maximum fixed income credit risk will be limited to 2 percent of the total securities portfolio in any one name. There will be no limitation on US Government/Agency Securities.
- Fixed income holdings rated lower than "A3" or "A-" are limited to a maximum of 25 percent of the fixed income portfolio at the time of purchase. In the case of split rated securities, the lowest rating will apply.
- On a quarterly basis, the BOI will notify the State Fund of any issues out of compliance or issues that have fallen below investment grade.

OTHER PERMITTED ASSET ALLOCATIONS

Public Equities ~~Equity Allocation~~: An investment in publicly-traded stocks of domestic and international companies via the use of passive index funds. The allocation to public equities is targeted at 10 percent of total portfolio market value. The allocation range is set at +/-2% or 8% to 12%.

Core Real Estate: An investment in the ownership of operating and substantially-leased institutional quality real estate in the traditional property types (multi-family, office, retail, and industrial) via commingled funds. The objective for the allocation to core real estate is to achieve a diversification benefit versus the other asset classes held in the portfolio (stocks and bonds) while also receiving an attractive level of current income. The allocation to core real estate is targeted at 5 percent of total portfolio market value with an allocation range set at +/-2% or 3% to 7%.

MONTANA BOARD OF INVESTMENTS
STATE FUND INSURANCE – NEW FUND (MU26) (FUND 06035)
INVESTMENT POLICY STATEMENT

Sector Allocation:			
Fixed Income – Government/Agency Bonds	**20%**	**-**	**70%**
▪ U.S. Treasury/Agency	20%	-	45%
▪ U.S. Mortgage Backed Securities	0%	-	20%
▪ Non-U.S. Developed Country (U.S. Pay)	0%	-	5%
Fixed Income - Corporate Bonds	**30%**	**-**	**55%**
▪ Domestic	30%	-	50%
▪ International (U.S. Pay)	0%	-	5%
Cash - Short- Term Investment Pool (STIP)	**1%**	**-**	**5%**
Real Estate - Core Equity Real Estate	**3%**	**-**	**7%**
Equity – Common Stock	**8%**	**-**	**12%**
▪ S & P 500 Index Fund	6%	-	12%
▪ MSCI ACWI Ex U.S. Index Fund	0%	-	4%
Total Portfolio	**100%**		

ADMINISTRATIVE

Securities Lending: Section 17-1-113, MCA, authorizes the Board to lend securities held by the state. The Board may lend its publicly traded securities held in the investment pools, through an agent, to other market participants in return for compensation. Currently, through an explicit contract, State Street Bank and Trust, the state's custodial bank, manages the state's securities lending program. The Board seeks to assess the risks, such as counterparty and reinvestment risk, associated with each aspect of its securities lending program. The Board requires borrowers to maintain collateral at 102 percent for domestic securities and 105 percent for international securities. To ensure that the collateral ratio is maintained, securities on loan are marked to market daily and the borrower must provide additional collateral if the value of the securities on loan increases. In addition to the strict collateral requirements imposed by the Board, the credit quality of approved borrowers is monitored continuously by the contractor. From time to time, Staff or the investment manager may restrict a security from the loan program upon notification to State Street Bank. Staff will monitor the securities lending program, and the CIO will periodically report to the Board on the status of the program.

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MONTANA BOARD OF INVESTMENTS
STATE FUND INSURANCE – NEW FUND (MU26) (FUND 06035)
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ALLOCATION REPORT

Retirement Systems Asset Allocations as of 9/30/12								
				Total				
Pension Fund	**MDEP**	**MTIP**	**MPEP**	**Equity**	**RFBP**	**MTRP**	**STIP**	**Total Assets**
PUBLIC EMPLOYEES	37.9%	16.3%	12.7%	66.9%	24.0%	8.2%	0.9%	$ 4,054,774,541
TEACHERS	38.1%	16.4%	12.8%	67.3%	24.1%	8.2%	0.5%	$ 2,997,912,477
POLICE	36.1%	15.6%	12.1%	63.8%	22.9%	7.8%	5.5%	$ 245,439,758
SHERIFFS	37.7%	16.3%	12.7%	66.7%	23.9%	8.1%	1.3%	$ 225,390,238
FIREFIGHTERS	36.1%	15.6%	12.1%	63.8%	22.9%	7.8%	5.6%	$ 245,026,630
HIGHWAY PATROL	37.8%	16.3%	12.7%	66.9%	23.9%	8.1%	1.0%	$ 102,891,593
GAME WARDENS	37.6%	16.2%	12.7%	66.5%	23.8%	8.1%	1.7%	$ 104,496,866
JUDGES	37.6%	16.3%	12.7%	66.6%	23.9%	8.1%	1.5%	$ 67,419,050
VOL FIREFIGHTERS	38.1%	16.4%	12.8%	67.3%	24.2%	8.3%	0.2%	$ 27,607,246
TOTAL	**37.8%**	**16.3%**	**12.7%**	**66.9%**	**23.9%**	**8.2%**	**1.0%**	**$ 8,070,958,400**
Approved Range	30 - 50%	15 - 30%	9 - 15%	60 - 70%	22 - 32%	4-10%	1 - 5%	

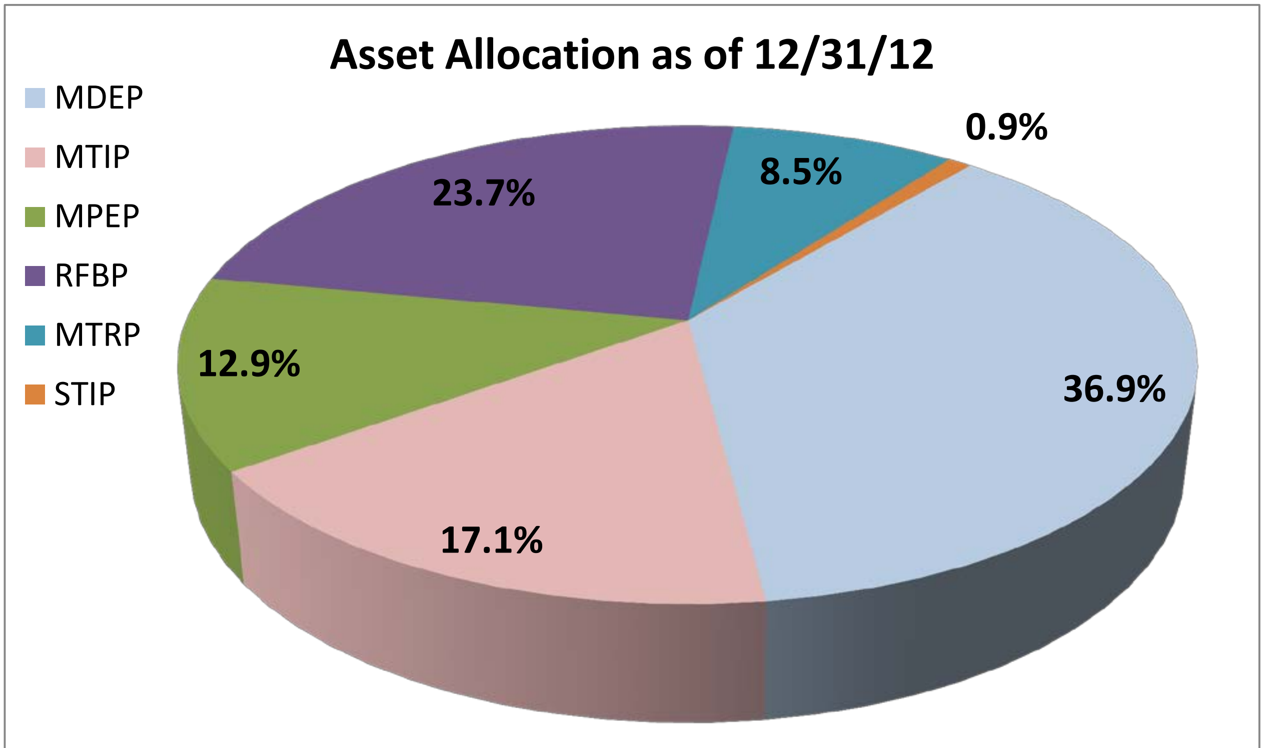
Retirement Systems Asset Allocations as of 12/31/12								
				Total				
Pension Fund	**MDEP**	**MTIP**	**MPEP**	**Equity**	**RFBP**	**MTRP**	**STIP**	**Total Assets**
PUBLIC EMPLOYEES	36.8%	17.1%	12.9%	66.8%	23.7%	8.5%	0.9%	$ 4,098,931,110
TEACHERS	36.9%	17.1%	13.0%	67.0%	23.7%	8.5%	0.8%	$ 3,022,697,689
POLICE	36.9%	17.1%	13.0%	67.0%	23.8%	8.5%	0.7%	$ 247,482,023
SHERIFFS	36.7%	17.0%	12.9%	66.6%	23.6%	8.4%	1.4%	$ 229,648,558
FIREFIGHTERS	36.8%	17.1%	13.0%	66.9%	23.7%	8.5%	0.9%	$ 247,596,191
HIGHWAY PATROL	36.9%	17.1%	13.0%	66.9%	23.7%	8.5%	0.8%	$ 104,060,320
GAME WARDENS	36.7%	17.0%	12.9%	66.6%	23.6%	8.5%	1.3%	$ 107,150,868
JUDGES	36.7%	17.0%	12.9%	66.6%	23.7%	8.5%	1.3%	$ 68,572,517
VOL FIREFIGHTERS	36.9%	17.0%	13.0%	67.0%	23.8%	8.5%	0.8%	$ 27,420,124
TOTAL	**36.9%**	**17.1%**	**12.9%**	**66.9%**	**23.7%**	**8.5%**	**0.9%**	**$ 8,153,559,401**
Approved Range	30 - 50%	15 - 30%	9 - 15%	60 - 70%	22 - 32%	4-10%	1 - 5%	

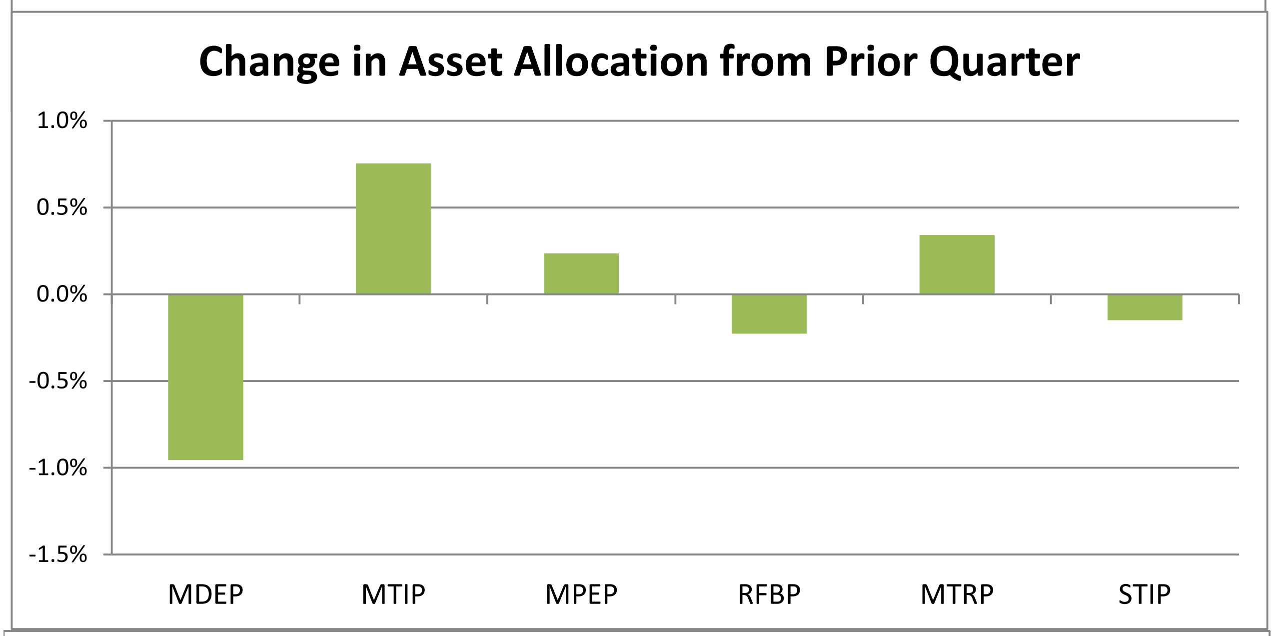
Change From Last Quarter								
				Total				
Pension Fund	**MDEP**	**MTIP**	**MPEP**	**Equity**	**RFBP**	**MTRP**	**STIP**	**Total Assets**
PUBLIC EMPLOYEES	-1.0%	0.7%	0.2%	-0.1%	-0.3%	0.3%	0.1%	44,156,569
TEACHERS	-1.2%	0.7%	0.2%	-0.3%	-0.3%	0.3%	0.3%	24,785,212
POLICE	0.8%	1.5%	0.8%	3.2%	0.9%	0.7%	-4.8%	2,042,265
SHERIFFS	-1.1%	0.7%	0.2%	-0.2%	-0.2%	0.3%	0.1%	4,258,320
FIREFIGHTERS	0.7%	1.5%	0.9%	3.1%	0.8%	0.7%	-4.7%	2,569,561
HIGHWAY PATROL	-1.0%	0.7%	0.3%	0.0%	-0.2%	0.4%	-0.2%	1,168,727
GAME WARDENS	-0.8%	0.7%	0.3%	0.1%	-0.2%	0.4%	-0.4%	2,654,002
JUDGES	-1.0%	0.7%	0.3%	0.0%	-0.2%	0.4%	-0.2%	1,153,467
VOL FIREFIGHTERS	-1.2%	0.6%	0.2%	-0.3%	-0.5%	0.2%	0.6%	(187,122)
TOTAL	**-1.0%**	**0.8%**	**0.2%**	**0.0%**	**-0.2%**	**0.3%**	**-0.1%**	**82,601,001**

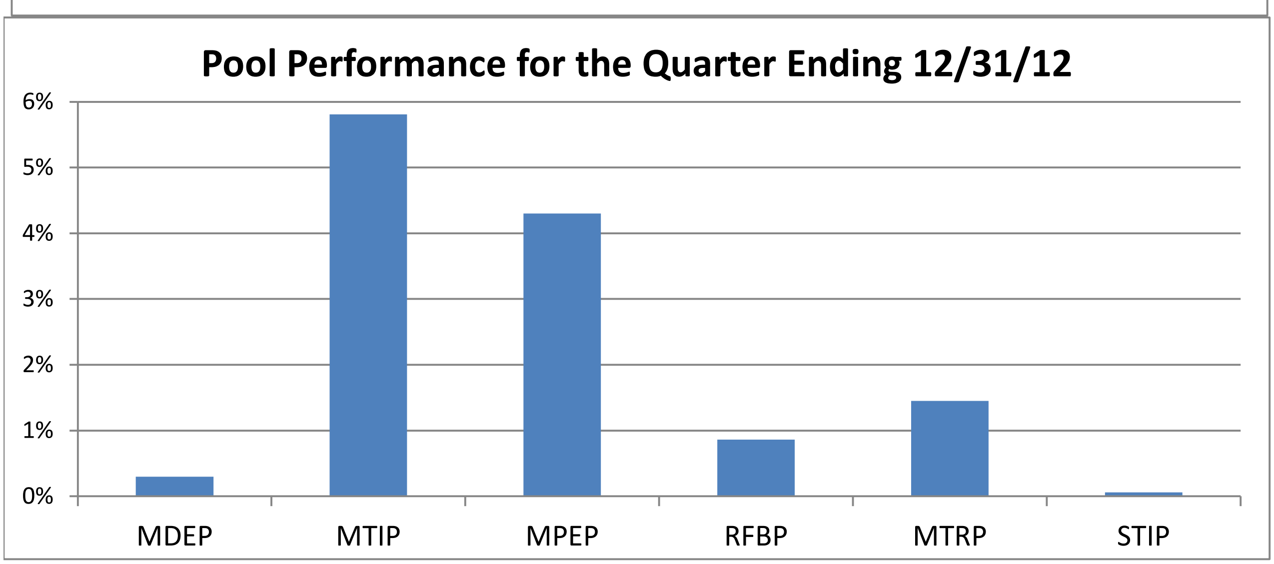
Allocations During Quarter

MDEP	**MTIP**	**MPEP**	**Total Equity**	**RFBP**	**MTRP**
($56,700,000)	($4,550,000)	($12,200,000)	($73,450,000)	$2,200,000	$28,700,000

Net New Investments for Quarter → **($42,550,000)**


Asset Allocation as of 12/31/12
MDEP
MTIP
MPEP
RFBP
MTRP
STIP
0.9%
8.5%
23.7%
12.9%
36.9%
17.1%


Change in Asset Allocation from Prior Quarter
1.0%
0.5%
0.0%
-0.5%
-1.0%
-1.5%
MDEP
MTIP
MPEP
RFBP
MTRP
STIP


Pool Performance for the Quarter Ending 12/31/12
6%
5%
4%
3%
2%
1%
0%
MDEP
MTIP
MPEP
RFBP
MTRP
STIP

Montana Board of Investments, Allocation Comparisons by Asset Class
PERIOD ENDING December 31, 2012
Public Funds > $5 Billion

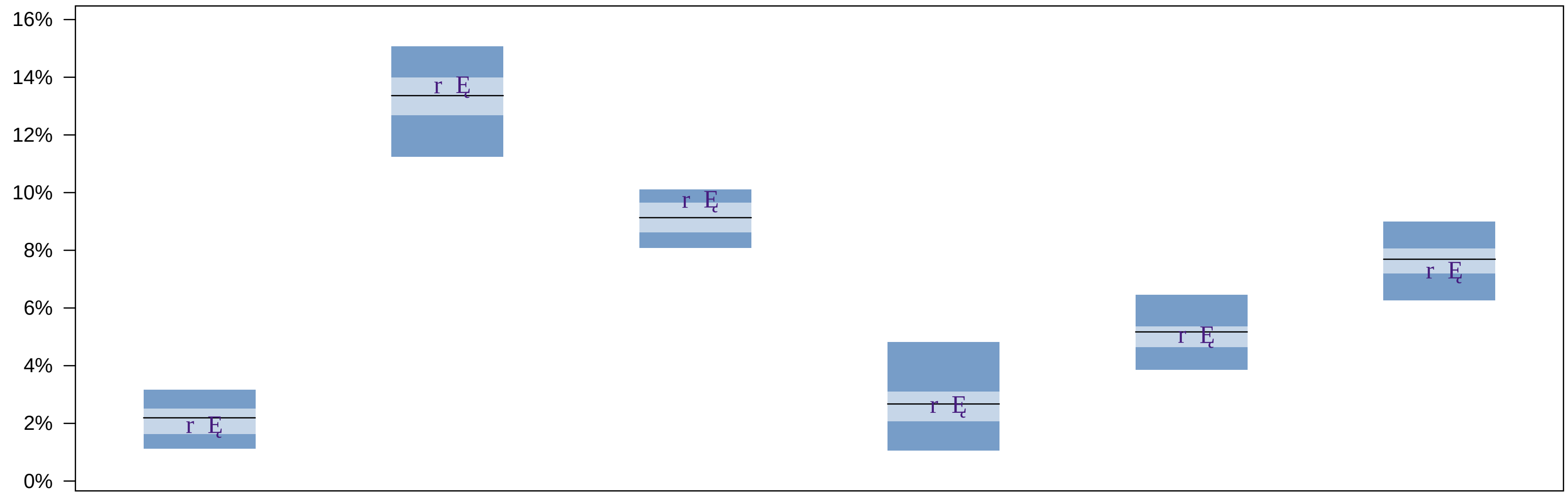
	Cash Equiv %	Equities %	Fixed Income %	Real Estate %	Private Equity %	Hedge Funds %
high %	52.17	79.91	54.81	14.14	27.16	9.56
median %	7.47	52.14	24.21	3.72	11.55	3.64
low %	0.90	10.03	4.82	0.01	0.64	0.22
# of observations	26	44	45	38	41	11
PERS %	0.94	53.84	23.74	8.50	12.97	0.00
TRS %	0.80	53.94	23.76	8.49	13.00	0.00

Montana Board of Investments

Public Funds (DB) > $1 Billion (SSE) - MBOI PERS - TRS UNIVERSE

PERIOD ENDING December 31, 2012

STATE STREET.



		Total Fund Return 1 Qtr		Total Fund Return 1 Yr		Total Fund Return 3 Yrs		Total Fund Return 5 Yrs		Total Fund Return 7 Yrs		Total Fund Return 10 Yrs	
	No. of Obs	65		63		61		55		54		48	
	5th Percentile	3.17		15.07		10.11		4.82		6.46		8.99	
	25th Percentile	2.52		13.99		9.65		3.11		5.36		8.06	
	50th Percentile	2.19		13.36		9.13		2.67		5.17		7.69	
	75th Percentile	1.63		12.67		8.61		2.06		4.64		7.19	
	95th Percentile	1.13		11.24		8.08		1.06		3.87		6.27	
r	PUBLIC EMPLOYEES RET	2.05	59	13.83	33	9.86	13	2.75	43	5.18	48	7.41	64
Ę	TEACHERS RETIREMENT	2.05	58	13.84	33	9.87	13	2.75	43	5.17	48	7.41	64

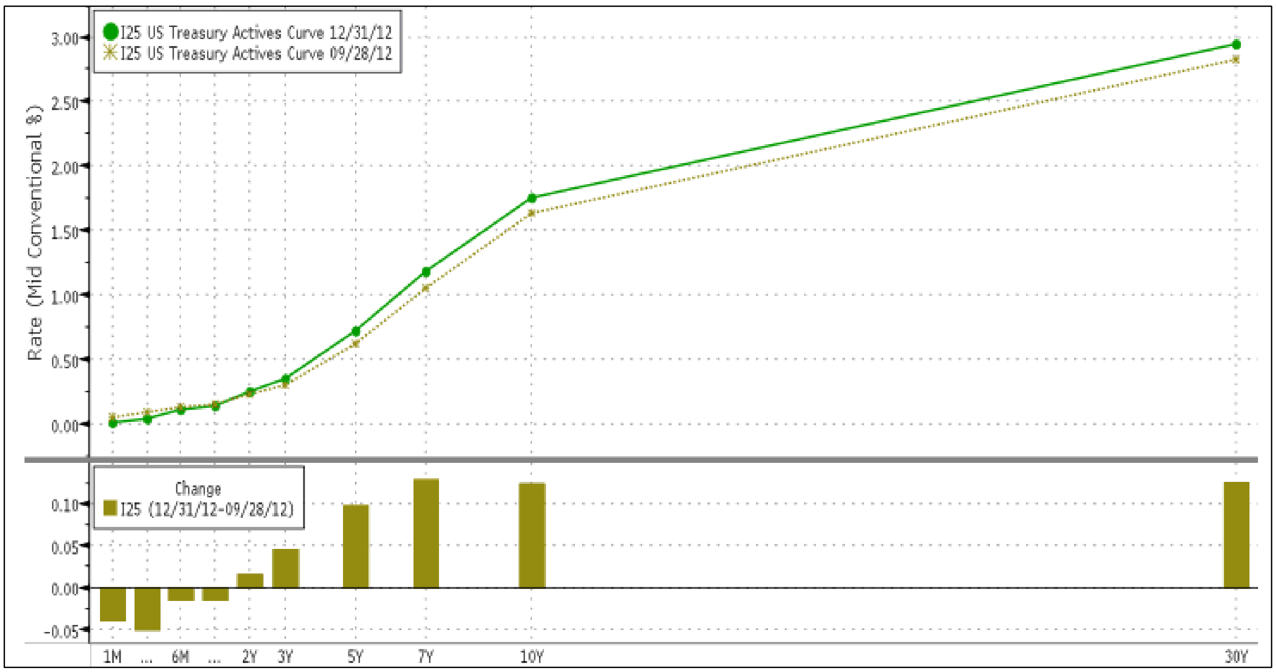
Provided by State Street Investment Analytics

FIXED INCOME OVERVIEW & STRATEGY
Nathan Sax, CFA, Portfolio Manager
February 26, 2013

RETIREMENT & TRUST FUND BOND POOLS

Interest rates rose modestly in the fourth quarter. The yield on the Treasury 10-year benchmark note ended the third quarter yielding 1.63% and ended the calendar year 2012 at 1.76%. The graph below shows the upward drift in rates. The intermediate portion of the yield curve steepened slightly. Corporate bonds beat Treasuries in the fourth quarter as they did all year. Treasuries posted a total return of -0.09% in the fourth quarter and +1.99% for the year. Corporate bonds were +1.06% and +9.82%, respectively. Securitized assets were -0.12% for the quarter and +3.01% in 2012. The Barclays Aggregate Index was +0.22% and +4.22% for all of 2012.

Historical Yield Curve 09/28/12 – 12/31/12



Real GDP in the fourth quarter was reported at an annual rate of -0.1%, partly because of a 5.3% decline in defense spending. Many economists consider the weak GDP print for the quarter an aberration, with underlying growth assumed to be closer to an annual rate of approximately 2.0%. The "fiscal cliff" was averted with a deal on New Year's Day to increase taxes on the wealthiest Americans. Discussions on the raising of the $16.7 trillion debt ceiling have been pushed off temporarily, until May. Automatic spending cuts, or in budget speak sequestration, were deferred to March 1st.

The following table shows the sector weightings of our external bond managers and the internally managed funds. It also shows holdings relative to policy constraints:

RFBP/TFBP vs. Barclays Aggregate – 12/31/12

		Retirement Fund Bond Pool							
		External Management				Internal Management			
	RFBP Combined	Reams	Artio	Post	Neuberg Berman	CIBP	TFBP	CIBP/TFIP Policy Range	Barclays Aggregate
Treasuries	16.69	23.19	19.00	0.00	0.00	17.39	17.27	10-35	36.42
Agencies & Govt Related	5.55	0.00	10.23	0.00	0.00	6.85	5.54	5-25	10.26
Total Government	**22.24**	**23.19**	**29.23**	**0.00**	**0.00**	**24.24**	**22.81**	**15-60**	**46.68**
Mortgage Backed	22.41	13.95	21.59	0.00	0.00	26.83	28.99	20-50	29.63
Asset Backed	4.58	5.96	4.87	0.00	0.00	4.87	4.67	0-5	0.35
CMBS	8.54	7.67	7.72	0.00	0.00	9.84	9.70	0-10	1.83
Total Securitized	**35.53**	**27.58**	**34.18**	**0.00**	**0.00**	**41.54**	**43.36**	**20-65**	**31.81**
Financial	13.00	25.46	10.65	7.61	7.79	11.60	12.01		6.99
Industrial	21.40	13.91	16.20	77.58	84.81	15.59	14.57		12.16
Utility	3.69	0.02	1.12	0.00	3.02	4.80	4.76		2.36
Total Corporate	**38.09**	**39.39**	**27.97**	**85.19**	**95.62**	**31.99**	**31.34**	**10-35**	**21.51**
Other	0.74	0.00	4.09	11.37	2.30	0.00	0.00		0.00
Cash	3.40	9.84	4.53	3.44	2.08	2.23	2.49	0-10	0.00
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

RFBP Fixed Income Sector	**Policy Range**	**RFBP on 12/31/12**
U.S. High Yield	0-15%	12.96%
Non-US (incl. EM)	0-10%	3.20%
Total "Plus" sectors	0-20%	16.16%
Core (U.S. Investment Grade)	80-100%	83.84%

TFIP Fixed Income Sector	**Policy Range**	**TFIP on 12/31/12**
High Yield	0-10%	6.91%
Core Real Estate	0-8%	5.32%
Core (U.S. Investment Grade)	0-100%	87.77%

High Yield spreads tightened by 41 basis points in the fourth quarter (see graph shown below). As of December 31st, the average spread on below investment grade bonds stood at 510 basis points as compared to 551 on September 28th. Investment grade corporate bonds narrowed as well, tightening by 15 basis points. Investment grade corporates showed an average spread of 141 basis points at quarter-end over comparable maturity Treasuries versus 156 basis points at the close of the third quarter.

The following table is a summary of relative total return performance for the fourth quarter and for the year:

Fixed Income Gross Returns 4Q & 2012

	4Q12	2012	4Q12 Benchmark	2012 Benchmark	4Q12 Difference	2012 Difference	Barclays Benchmark
External Portfolios							
Reams Asset Mgmt	0.87%	8.83%	0.58%	5.53%	0.29%	3.30%	Universal
Artio Global	1.02%	8.26%	0.34%	4.74%	0.68%	3.52%	Aggregate +50
Post Advisory	3.35%	17.67%	3.29%	15.78%	0.06%	1.89%	US High Yield
Neuberger Berman	3.34%	16.42%	3.29%	15.78%	0.05%	0.64%	US High Yield
Internal Portfolios							
Core Internal Bond Pool	0.59%	6.07%	0.21%	4.21%	0.38%	1.86%	Aggregate
Trust Fund Bond Pool	0.60%	6.15%	0.21%	4.21%	0.39%	1.94%	Aggregate
Combined Portfolios							
Retirement Fund Bond Pool	0.89%	7.44%	0.21%	4.21%	0.68%	3.23%	Aggregate
Trust Fund Investment Pool	0.88%	7.11%	0.21%	4.21%	0.67%	2.90%	Aggregate

Barclays U.S. High Yield 2% Issuer Cap, Average OAS – 01/03/12 to 02/08/13

The bond portfolios as compared to the benchmark are shown below. The Merrill index shown here is used as a proxy for the actual benchmark, the Barclays Capital Aggregate Bond Index.

Benchmark Comparison Analysis CIBP vs. Merrill US Broad Market Index on 12/31/12						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	107.59	3.69	3.49	2.28	5.38	1.01
Benchmark	111.19	3.66	3.33	1.69	5.10	0.55
Difference	-3.60	0.04	0.16	0.58	0.28	0.47

Benchmark Comparison Analysis RFBP vs. Merrill US Broad Market Index on 12/31/12						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	106.84	2.90	3.63	2.48	5.23	1.28
Benchmark	111.19	3.66	3.33	1.69	5.10	0.55
Difference	-4.35	0.76	0.30	0.79	0.13	0.73

Benchmark Comparison Analysis TFBP vs. Merrill US Broad Market Index on 12/31/12						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	108.61	4.07	3.84	2.30	5.33	1.10
Benchmark	111.19	3.66	3.33	1.69	5.10	0.55
Difference	-2.58	0.41	0.51	0.61	0.23	0.56

The graph shown below illustrates the decline in risk premiums for investment grade corporate bonds in 2012 and since the onset of the Great Recession:

<u>Corporate OAS Spread 01/01/2007 – 02/08/13</u>

<u>Concluding Comments</u>

Fixed income has been under fire as an asset class because of low expected returns. The absolute level of yields is quite low and investors' appetite for more income may wane if bond yields continue to rise, causing prices to decline. Other asset classes may offer higher expected returns but more risk. Nevertheless, we are maintaining our overall risk and liquidity levels within the RFBP given a relatively slow but positive economic outlook.

MEMORANDUM

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

To: Members of the Board

From: Nathan Sax, CFA
Portfolio Manager – Fixed Income

Date: February 26, 2013

Subject: Fixed Income External Managers Watch List

Post Advisors, a High Yield manager that advises funds within both the Retirement Funds Bond Pool and the Trust Funds Investment Pool was originally put on the Fixed Income Watch List as reported to the Board during the February 2012 meeting.

Relative performance rebounded strongly in 2012. Senior investment staff are in place and operating at full capacity. At this time, we are recommending that Post Advisors be removed from the Watch List. There are no other fixed income managers on the Watch List.

Short Term Investment Pool (STIP)

Richard Cooley, CFA, Portfolio Manager
February 26, 2013

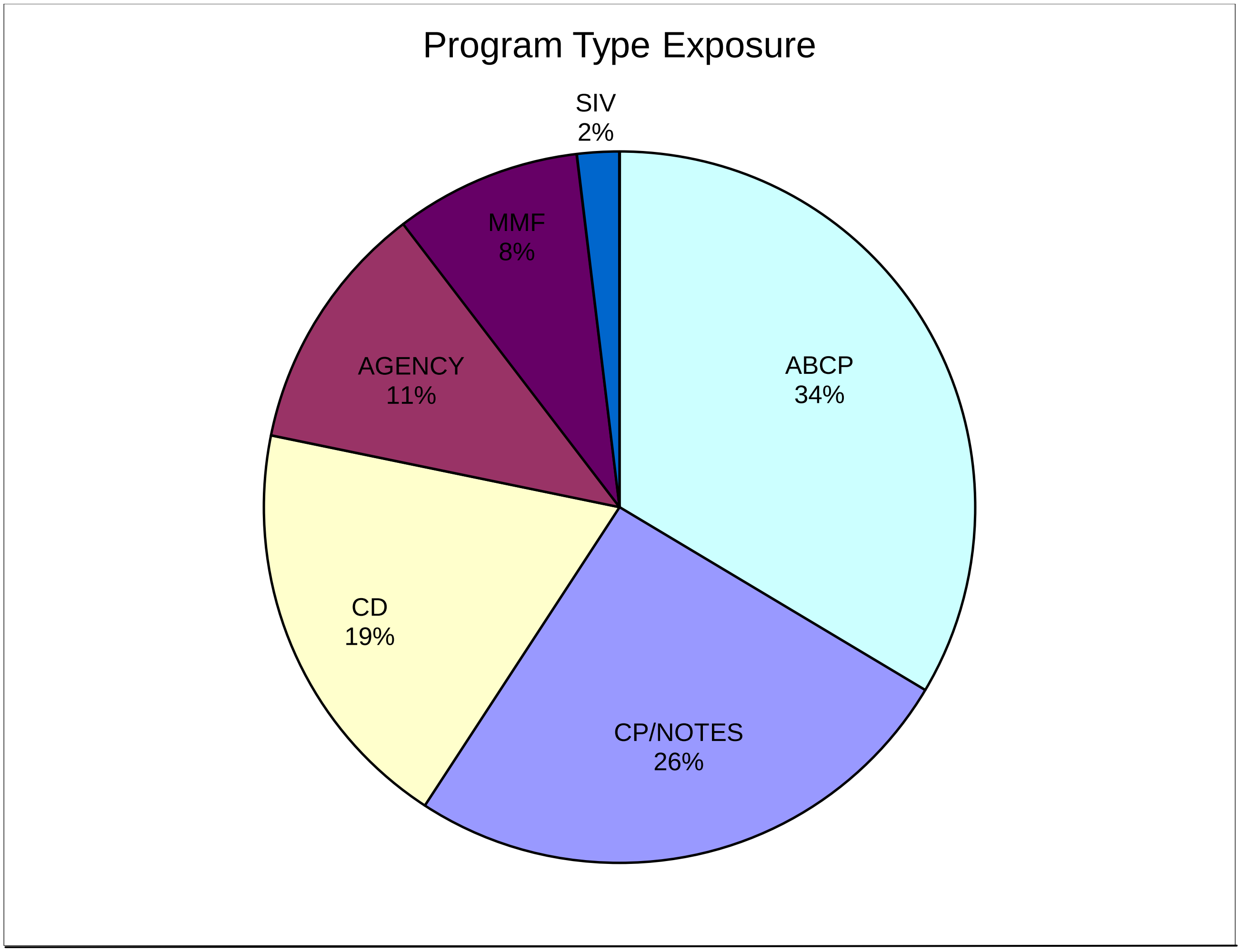
During the fourth quarter money market yields were lower as the Federal Reserve continued its four year-old policy of low fed funds rates. Three month Libor rates decreased by 5 basis points and one month Libor rates decreased by 1 basis point during the quarter. The improvement in Libor rates reflects the continuation of better market tone and funding conditions for the large international banks. Credit spreads were unchanged during the quarter, as depicted by the spread between three month Treasury bills and three month Libor rates (TED spread). This spread ended the fourth quarter at about 26 basis points, unchanged for the quarter.

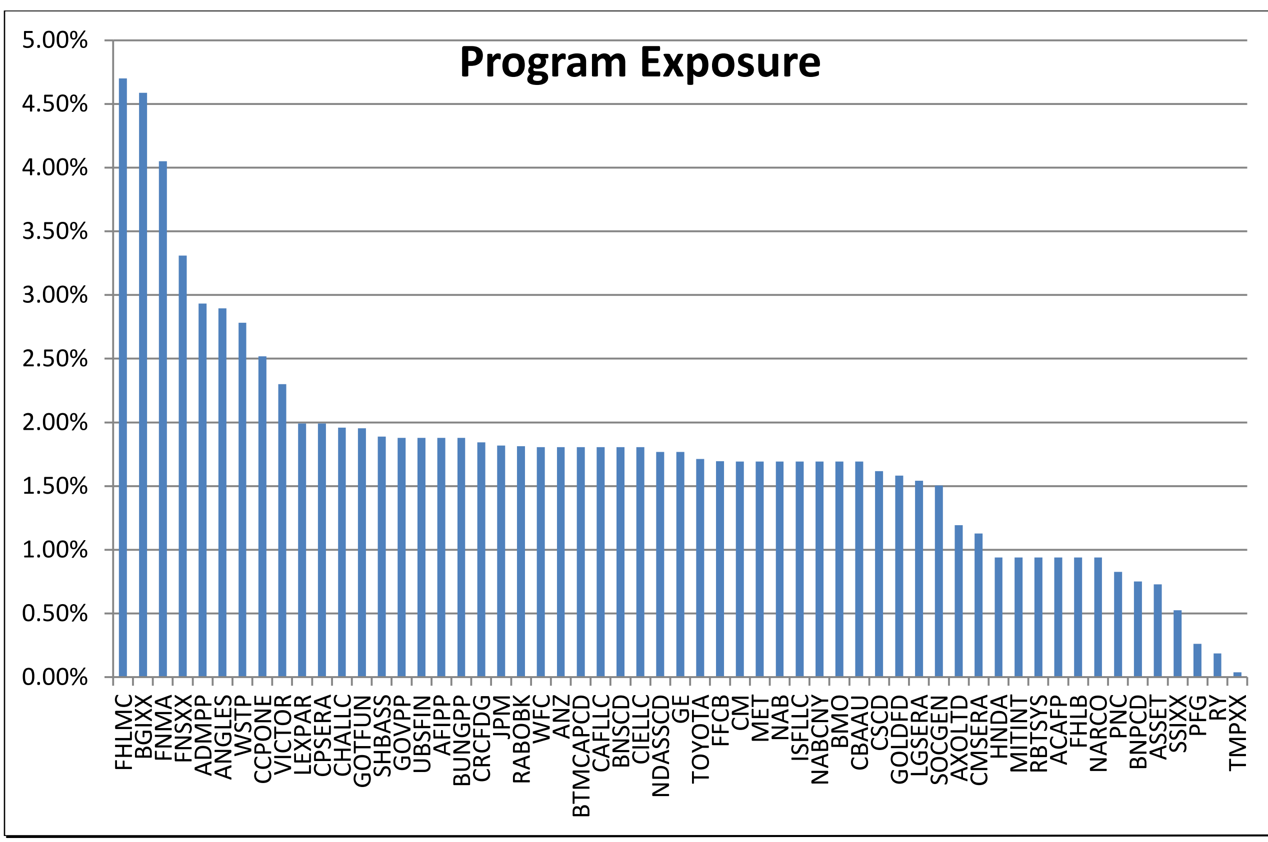
TED Spread (12/31/11 – 12/31/12)

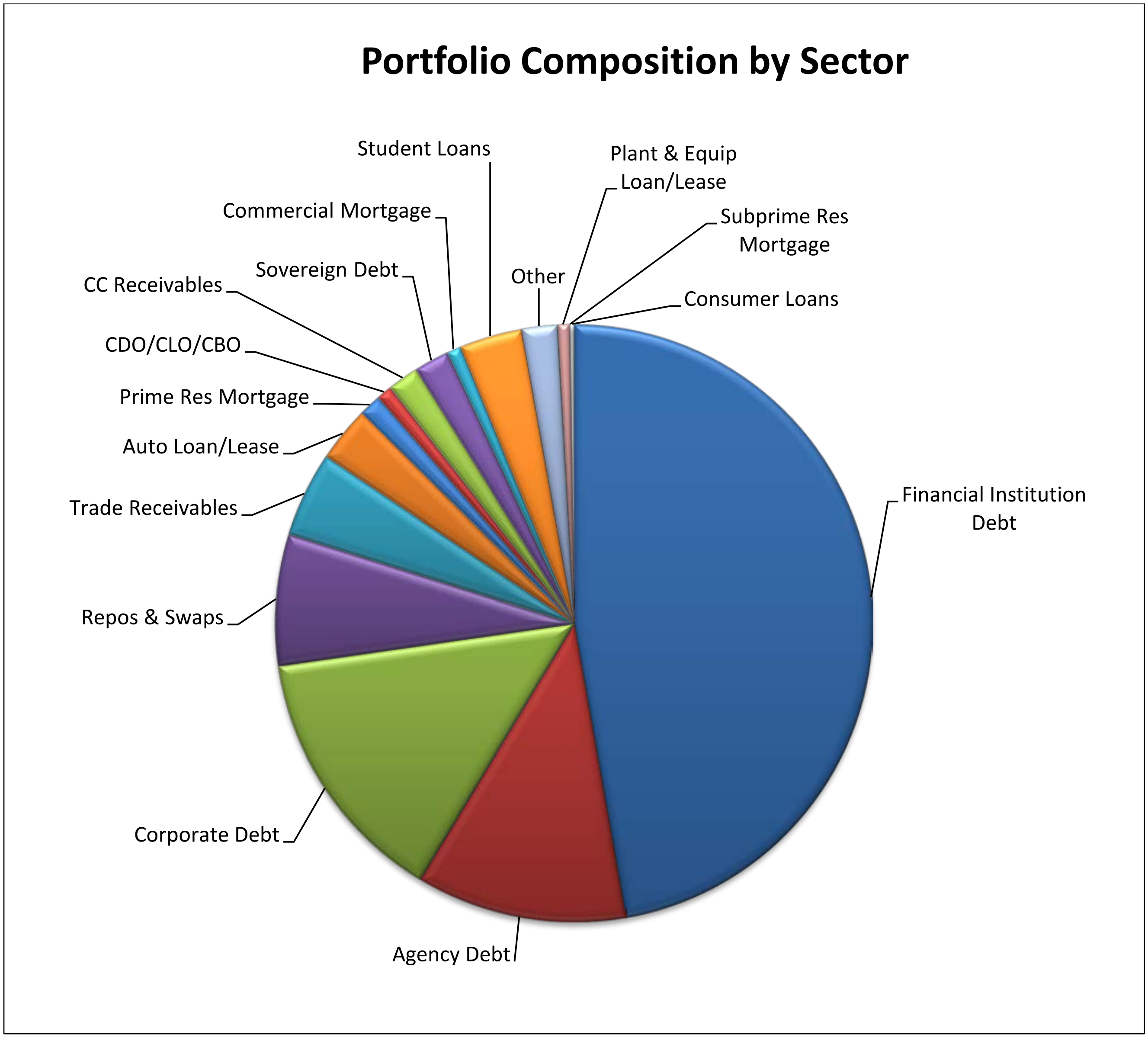
The STIP portfolio is currently well diversified and is operating within all the guidelines adopted by the Board at the November 2012 meeting. Daily liquidity is at a minimum of $150 million and weekly liquidity is at a minimum of $250 million. The average days to maturity are 42 days as compared to a policy maximum of 60 days. Asset-backed commercial paper is 34% of holdings (40% max) and corporate exposure is 26% (40% max). We currently have approximately 11% in agency paper, 19% in Yankee CD's (30% max) and 8% in four institutional money funds.

During the fourth quarter we purchased $55 million of floating rate corporate notes. We also purchased $70 million of Yankee CD's. Agency holdings fell from 18% to 11% as securities matured and were not replaced because of relatively low yields. Lower three month Libor rates detracted from the portfolio yield during the quarter.

The net daily yield on STIP is currently 0.23% as compared with the current one-month LIBOR rate of 0.20% and current fed funds target rate of 0.0%-0.25%. The portfolio asset size is currently $2.65 billion, up 15% from three months ago. All charts below are as of February 6, 2013.


Program Type Exposure
SIV 2%
MMF 8%
AGENCY 11%
ABCP 34%
CD 19%
CP/NOTES 26%


Program Exposure
5.00%
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
FHLMC
BGIXX
FNMA
FNSXX
ADMPP
ANGLES
WSTP
CCPONE
VICTOR
LEXPAR
CPSERA
CHALLC
GOTFUN
SHBASS
GOVPP
UBSFIN
AFIPP
BUNGPP
CRCFDG
JPM
RABOBK
WFC
ANZ
BTMCAPCD
CAFLLC
BNSCD
CIELLC
NDASSCD
GE
TOYOTA
FFCB
CM
MET
NAB
ISFLLC
NABCNY
BMO
CBAAU
CSCD
GOLDFD
LGSERA
SOCGEN
AXOLTD
CMSERA
HNDA
MITINT
RBTSYS
ACAFP
FHLB
NARCO
PNC
BNPCD
ASSET
SSIXX
PFG
RY
TMPXX



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

Treasurer's Fund

Richard Cooley, CFA, Portfolio Manager

February 26, 2013

The fund totaled $909 million as of December 31, 2012, consisting of approximately one half general fund monies and the balance in various other state operating accounts. There were no securities transactions in the fourth quarter. Current securities holdings total $20 million. The investment policy for the fund limits security holdings to 50% of the projected General Fund FYE balance of the current period. The January projected General Fund FYE balance was $461 million.

State Fund Insurance

Richard Cooley, CFA, Portfolio Manager
February 26, 2013

The table below lays out the basic characteristics of the State Fund fixed income portfolio in comparison to a Merrill Lynch index. The Merrill Lynch index serves as a proxy for the account's actual benchmark, the Barclays Capital Government/Credit Intermediate Index.

Benchmark Comparison Analysis State Fund vs. Merrill US Corp and Govt, 1-10 Yrs on 12/31/2012						
Summary Characteristics						
	Price	Coupon	Current Yield	Yield to Maturity	Effective Duration	Effective Spread
Portfolio	109.16	3.87	3.58	1.44	3.85	0.76
Benchmark	108.57	2.98	2.77	1.11	4.04	0.43
Difference	0.59	0.89	0.81	0.33	-0.19	0.33

The portfolio has an overweight in agencies, asset backed securities (ABS), mortgage backed securities (MBS), corporate bonds and commercial mortgage backed securities (CMBS) and is underweighted in Treasuries. The sector table on the following page provides more detail on the differences between the portfolio and the benchmark. The portfolio has a slightly shorter duration than the benchmark.

Spread product ended the fourth quarter mixed as compared to the end of the previous quarter. MBS spreads widened by 26 basis points to 50 basis points, agencies tightened by 3 basis points to 13 basis points and corporate spreads tightened by 25 basis points to 131 basis points. During the quarter, the ten year Treasury yield increased by 12 basis points from 1.63% to 1.75%.

The total fixed income (including STIP) portion of the account outperformed the benchmark by 34 basis points during the December quarter and outperformed by 226 basis points over the past year. Longer term performance is +135 basis points for the past three years, +92 basis points for the past five years and +46 basis points for the past ten years (ended December 31).

As a reminder, the primary investment objective is to maximize investment income consistent with safety of principal.

During the December quarter, there were purchases of $10 million of corporate bonds in the 5 year part of the curve. We also purchased $10 million of 5 year agencies. There were no equity fund transactions during the quarter.

The portfolio has a 33 basis point yield advantage over the benchmark. Client preferences include keeping the STIP balance in a 1-5 percent range (currently 2.73%) and limiting holdings rated lower than A3 or A- to 25 percent of fixed income, at the time of purchase, (currently 24.2%). As noted elsewhere in the board materials, staff is recommending the addition of an exposure to core real estate to provide a diversification benefit and as a means of enhancing the current yield of the portfolio.

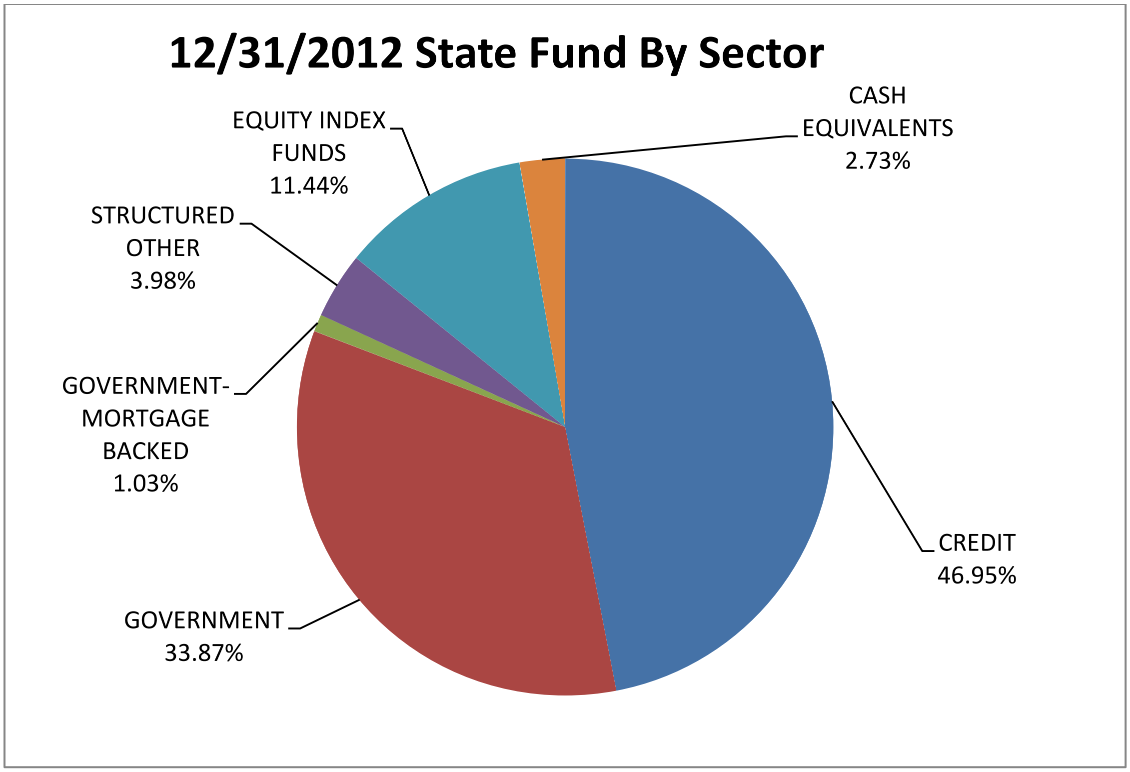
State Fund vs. Merrill US Corp and Govt, 1-10 Yrs on 12/31/2012

	SFBP Portfolio (%)	Benchmark (%)	Difference
Treasuries	15.92	57.72	-41.80
Agencies & Govt Related	22.21	13.80	8.41
Total Government	**38.13**	**71.52**	**-33.39**
Mortgage Backed	1.16	0.00	1.16
Asset Backed	3.98	0.00	3.98
CMBS	0.48	0.00	0.48
Securitized	**5.62**	**0.00**	**5.62**
Financial	25.38	10.22	15.16
Industrial	22.44	16.68	5.76
Utility	5.38	1.59	3.79
Total Corporates	**53.20**	**28.48**	**24.71**
Other	0.00	0.00	0.00
Cash	3.05	0.00	3.05
Total	**100.00**	**100.00**	

The following sector breakout is a look at the entire State Fund account including the S&P 500 and ACWI ex-U.S. equity holdings. The policy range for equities is currently 8%-12%. This is a client preference as the maximum allowed by statute is 25% of book value.

The last page is the monthly performance report from State Street. The custom composite index is an asset-weighted index that holds the same weights as the portfolio in each of the underlying benchmarks. The fixed income returns have been over the benchmark due to an overweight in spread product versus the benchmark.

12/31/2012 State Fund By Sector			
_	Sector	Market Value	%
	BANKS	109,067,812	8.24%
	COMMUNICATIONS	22,142,117	1.67%
	ENERGY	33,890,106	2.56%
	GAS/PIPELINES	6,360,372	0.48%
	INSURANCE	73,440,658	5.55%
	OTHER FINANCE	130,312,664	9.85%
	RETAIL	18,674,450	1.41%
	TRANSPORTATION	50,684,777	3.83%
	UTILITIES	67,088,536	5.07%
	ENERGY	5,609,180	0.42%
	INDUSTRIAL	103,962,574	7.86%
CREDIT		**621,233,246**	**46.95%**
	TITLE XI	1,071,867	0.08%
	TREASURY NOTES/BONDS	186,921,650	14.13%
	AGENCY	260,122,821	19.66%
GOVERNMENT		**448,116,338**	**33.87%**
	FHLMC	7,430,282	0.56%
	FNMA	6,199,919	0.47%
GOVERNMENT-MORTGAGE BACKED		**13,630,200**	**1.03%**
	OTHER STRUCTURED	46,946,067	3.55%
	CMBS	5,690,783	0.43%
STRUCTURED OTHER		**52,636,849**	**3.98%**
TOTAL FIXED INCOME		**1,135,616,633**	**85.83%**
EQUITY INDEX FUNDS		**151,393,651**	**11.44%**
CASH EQUIVALENTS		**36,117,889**	**2.73%**
GRAND TOTAL		**1,323,128,172**	**100.00%**


12/31/2012 State Fund By Sector
CASH
EQUIVALENTS
2.73%
EQUITY INDEX
FUNDS
11.44%
STRUCTURED
OTHER
3.98%
GOVERNMENT-
MORTGAGE
BACKED
1.03%
CREDIT
46.95%
GOVERNMENT
33.87%

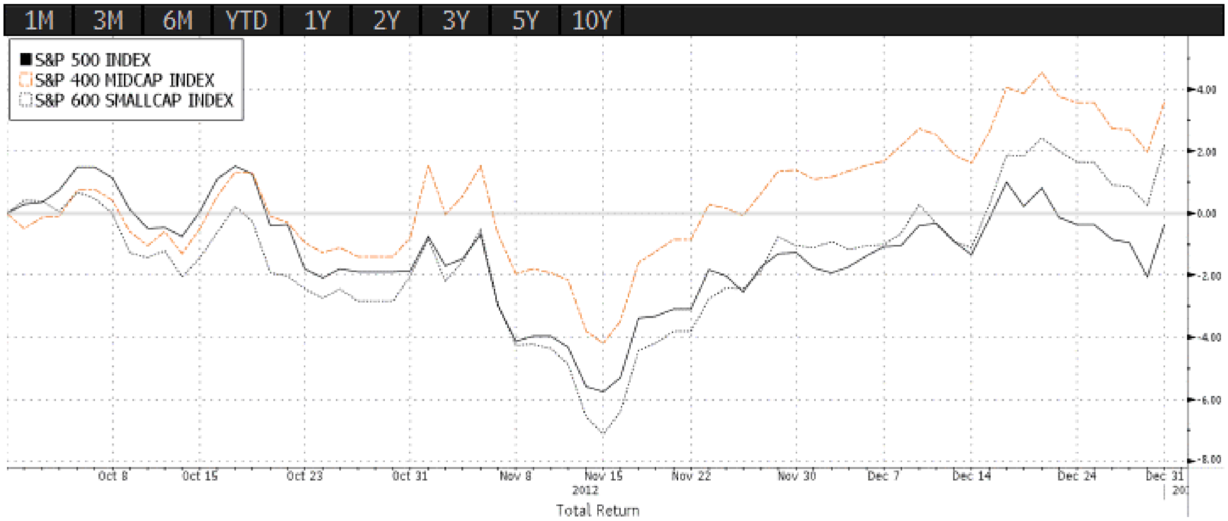
MONTANA DOMESTIC EQUITY POOL
Rande R. Muffick, CFA, Portfolio Manager
February 26, 2013

12/31/2012 Domestic Stock Pool By Manager			
			Approved
Manager Name	**Market Value**	**%**	**Range**
BLACKROCK EQUITY INDEX FUND	1,763,921,319	58.67%	
STATE STREET SPIF ALT INV	10,929,028	0.36%	
LARGE CAP PASSIVE Total	**1,774,850,347**	**59.04%**	**45-70%**
ENHANCED INVEST TECHNOLOGIES	87,221,782	2.90%	
T ROWE PRICE ASSOCIATES INC	260,548,500	8.67%	
WESTERN ASSET US INDX PLUS LLC	1,605,735	0.05%	
LARGE CAP ENHANCED Total	**349,376,016**	**11.62%**	**8-12%**
ANALYTIC INVESTORS MU3B	85,774,451	2.85%	
JP MORGAN ASSET MGMT MU3E	266,473,968	8.86%	
130-30 Total	**352,248,418**	**11.72%**	**8-12%**
COMBINED LARGE CAP Total	**2,476,474,782**	**82.37%**	**72-91%**
ARTISAN MID CAP VALUE	115,898,402	3.86%	
BLACKROCK MIDCAP EQUITY IND FD	101,384,828	3.37%	
TIMESSQUARE CAPITAL MGMT	117,814,345	3.92%	
MID CAP Total	**335,097,576**	**11.15%**	**6-17%**
ALLIANCE BERNSTEIN SMALL CAP3R	24,498,323	0.81%	
DIMENSIONAL FUND ADVISORS INC	77,523,595	2.58%	
ISHARES CORE S+P SMALL CAP ETF	17,386,083	0.58%	
VAUGHAN NELSON INV	75,448,136	2.51%	
SMALL CAP Total	**194,856,137**	**6.48%**	**3-11%**
MDEP Total	**3,006,428,495**	**100.00%**	

The table above displays the Montana Domestic Equity Pool (MDEP) allocation at quarter end across market cap segments and manager styles. At this time, all weightings are within the approved ranges. The ranges reflect the restructure of the pool as approved by the Board last May.

The U.S. equity market turned in modest returns in the quarter as concerns over the U.S. fiscal cliff weighed against positive economic data, the resolution of U.S. elections, and commitment by the Fed to keep interest rates low and to continue quantitative easing.

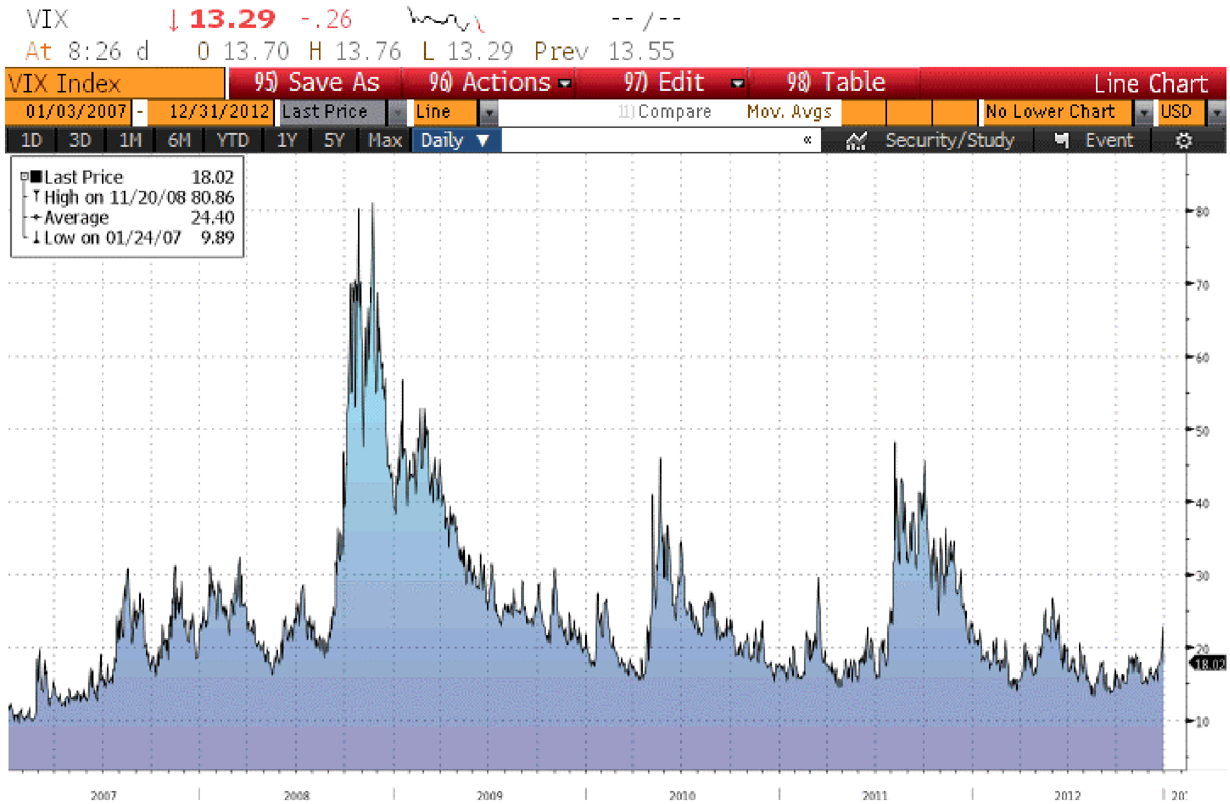
1) Settings	2) Actions			Page 1/6	Comparative Return
Range 09/28/2012 - 12/31/2012		Period Daily		No. of Period	94 Day(s)
Security	Currency	Price Appreciation	Total Return	Difference	Annual Eq
1. SPX Index	USD	-1.01%	-.38%	-3.99%	-1.46%
2. MID Index	USD	3.18%	3.61%		14.76%
3. SML Index	USD	1.83%	2.22%	-1.39%	8.89%



Mid cap stocks and small cap stocks posted positive returns while large cap stocks were basically flat for the quarter. Mid caps returned 3.6% to lead the way, followed by small caps with a return of 2.2% and large caps with a return of 0.4%. MDEP was overweight mid caps and small caps in the quarter, so the market cap allocation added to overall performance of the pool.

4Q 2012					2012			
	Value	Blend	Growth			Value	Blend	Growth
Large	1.5%	-0.4%	-1.3%		Large	17.5%	16.0%	15.3%
Mid	3.9%	2.9%	1.7%		Mid	18.5%	17.3%	15.8%
Small	3.2%	1.9%	0.4%		Small	18.1%	16.3%	14.6%

Value stocks bested growth stocks within all market cap categories for the second quarter in a row. The most pronounced difference was within the large caps. Large value returned 1.5% while large cap growth lost -1.3%. Mid cap value returned 3.9% to 1.7% for mid cap growth. And small cap value posted a 3.2% gain compared to 0.4% for growth. MDEP is slightly tilted toward value stocks with most of the tilt within the small caps, so this tilt added to pool performance.



The volatility index was relatively subdued for most of the quarter and tested new lows in October, yet spiked at the end of the quarter. This move reflected investor concerns of the approaching fiscal cliff and the lack of response from Congress at that time. Since a short term solution was arrived at, the VIX has set new lows in the current quarter, approaching a reading of 12. Part of this move seems to reflect “crisis fatigue” where investors are beginning to look past fiscal concerns and concentrate on what appears to be an improving economic backdrop.

Active management for the quarter was again encouraging as the active managers in combination generated added performance to the pool. Within large caps, the partial long/short style bucket outperformed the benchmarks. JP Morgan 130/30 led the way with 139 basis points of outperformance. Large cap enhanced underperformed slightly.

Within mid caps, active management performance was basically flat to the S&P 400 Index but outperformed the Russell Mid Cap Index. Both value and growth active managers outperformed when comparing to the Russell.

Within small caps, active management outperformed as core and value outperformance more than offset the lagging growth portfolio.

MDEP performance for the quarter generated 27 basis points of outperformance, reflecting less tracking error following the initial stage of the restructure and improved active manager performance for the second consecutive quarter. The overweight in mid caps and small caps helped as well. The pool also outperformed by 27 basis points for the calendar year.

Going forward further diversification of the actively managed portfolios within the mid cap and small cap allocations is likely over the next year. The overweight in mid caps and small caps will continue and could be increased should the markets provide an opportunity.

DOMESTIC EXPOSURE-MARKET CAP %

December 31, 2012

MANAGERS	MEGA $200B+	GIANT $100-$200B	LARGE $50-$100B	LARGE $20-$50B	LARGE $10-$20B	MID $2.5-$10B	SMALL $500MM-$2.5B	MICRO < $500MM	WTD AVG MARKET CAP ($B)
Alliance Bernstein	0.0	0.0	0.0	0.0	0.0	40.7	55.7	3.6	2,459.3
Analytic Investors, Inc	24.5	13.6	13.4	9.1	27.2	11.1	-1.2	-0.2	108,611.7
Artisan Partners	0.0	0.0	0.0	0.0	37.3	58.8	3.8	0.0	8,273.8
Dimensional Fund Advisors	0.0	0.0	0.0	0.0	0.0	6.2	74.3	19.4	1,237.6
INTECH Investment Management	15.0	14.1	10.9	20.8	23.2	15.8	0.2	0.0	92,392.5
J.P. Morgan	7.0	27.1	11.2	33.2	13.0	5.9	0.1	0.0	97,053.2
T. Rowe Associates	14.7	22.2	15.2	21.5	15.7	10.5	0.0	0.0	106,722.6
TimesSquare Cap Mgmt	0.0	0.0	0.0	4.3	20.1	70.4	5.2	0.0	8,171.6
Vaughan Nelson Mgmt	0.0	0.0	0.0	--	0.0	44.4	55.0	0.6	2,401.6
BlackRock S&P 500 Index Fund	14.5	21.9	15.9	22.6	15.9	9.0	0.1	0.0	105,939.4
BlackRock Midcap Equity Index Fund	0.0	0.0	0.0	0.0	2.6	74.4	22.9	0.1	4,189.0
ALL DOMESTIC EQUITY PORTFOLIOS	**11.6**	**18.1**	**12.4**	**19.2**	**15.7**	**16.7**	**5.4**	**0.6**	**87.2**
Benchmark: S&P Composite 1500	**12.8**	**19.3**	**14.1**	**19.9**	**14.3**	**14.4**	**4.9**	**0.3**	**93.8**
Over/underweight(-)	**-1.2**	**-1.2**	**-1.6**	**-0.7**	**1.4**	**2.3**	**0.5**	**0.3**	

DOMESTIC EXPOSURE-SECTOR %

December 31, 2012

MANAGERS	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Technology	Materials	Telecom Services	Utilities
Alliance Bernstein	21.1	1.4	6.0	4.9	19.5	23.5	22.2	1.5	--	--
Analytic Investors, Inc	12.1	12.7	9.6	16.2	11.2	4.3	21.2	1.8	3.9	4.4
Artisan Partners	9.5	3.7	12.1	23.0	5.0	17.9	27.1	--	--	1.6
Dimensional Fund Advisors	17.0	4.7	4.6	17.2	9.7	19.2	17.5	5.9	0.6	3.6
INTECH Investment Management	18.3	8.6	9.7	14.3	9.6	8.7	16.5	4.7	4.7	4.9
J.P. Morgan	17.6	6.3	11.9	15.1	13.8	8.5	19.7	2.5	1.2	1.0
T. Rowe Associates	12.0	10.4	11.1	15.7	12.1	10.3	18.2	4.4	2.8	2.9
TimesSquare Cap Mgmt	19.5	3.3	5.9	13.2	9.8	17.9	22.8	3.6	3.9	--
Vaughan Nelson Mgmt	11.2	2.8	5.1	27.4	5.6	23.2	14.5	8.2	--	2.1
BlackRock S&P 500 Index Fund	11.4	10.6	11.0	15.7	12.0	10.1	19.0	3.6	3.1	3.4
BlackRock Midcap Equity Index Fund	13.3	3.8	6.1	21.8	9.4	17.3	15.5	7.2	0.5	4.9
All Domestic Equity Portfolios	**12.8**	**9.0**	**10.3**	**16.3**	**11.5**	**11.3**	**19.2**	**3.7**	**2.6**	**3.0**
Benchmark: S&P Composite 1500	**11.7**	**9.8**	**10.3**	**16.5**	**11.7**	**10.9**	**18.7**	**4.0**	**2.8**	**3.6**
Over/underweight(-)	**1.1**	**-0.8**	**-0.1**	**-0.2**	**-0.3**	**0.4**	**0.5**	**-0.3**	**-0.2**	**-0.5**

DOMESTIC PORTFOLIO CHARACTERISTICS

December 31, 2012

MANAGERS	Market Value	Number of Securities	3Yr Historical EPS Growth	Price/ Earnings	Price/ Book	Dividend Yield
Alliance Bernstein	24,491,359	101	35.0	24.4	3.0	0.2
Analytic Investors, Inc	87,861,809	176	23.3	10.0	1.9	2.3
Artisan Partners	116,165,106	59	11.6	12.5	1.5	1.8
Dimensional Fund Advisors	77,521,316	2,311	20.2	15.7	1.6	1.3
INTECH Investment Management	87,616,227	332	15.0	15.9	2.4	2.2
J.P. Morgan	273,130,130	259	13.2	16.7	1.9	1.9
T. Rowe Associates	260,868,754	264	15.0	15.8	2.2	2.0
TimesSquare Cap Mgmt	118,085,784	78	24.6	14.1	2.6	0.7
BlackRock S&P 500 Index Fund	1,763,562,644	501	14.6	14.9	2.1	2.2
BlackRock Midcap Equity Index Fund	101,383,034	401	16.9	17.9	2.0	1.5
All Domestic Equity Portfolios	**3,016,375,333**	**3,214**	**15.4**	**15.0**	**2.0**	**2.0**
BENCHMARKS						
S&P Composite 1500		**1,500**	**14.9**	**15.2**	**2.1**	**2.1**
S&P/Citigroup 1500 Pure Growth		341	39.7	18.5	2.5	0.8
S&P/Citigroup 1500 Pure Value		364	6.2	11.4	0.9	2.1
S&P 500		500	14.6	14.9	2.1	2.2
Russell 1000		991	15.1	15.3	2.1	2.1
Russell 1000 Growth		571	21.3	17.8	4.0	1.7
Russell 1000 Value		696	8.5	13.4	1.5	2.5
Russell Midcap		798	16.2	17.5	2.0	1.8
Russell Midcap Growth		457	20.9	20.3	4.1	1.2
Russell Midcap Value		564	11.3	15.5	1.4	2.2
Russell 2000		1,978	18.9	16.1	1.7	1.6
Russell 2000 Growth		1,120	22.2	19.5	3.1	0.9
Russell 2000 Value		1,422	15.4	13.8	1.2	2.3

MONTANA INTERNATIONAL EQUITY POOL
Rande R. Muffick, CFA, Portfolio Manager
February 26, 2013

12/31/2012 International Stock Pool By Manager			
			Approved
Manager Name	**Market Value**	**%**	Range
MONEY MARKET FD FOR EBT	155	0.00%	
BLACKROCK CASH	1	0.00%	
BATTERYMARCH INTL EQUITY	116,336	0.01%	
BLACKROCK ACWI EX US SUPERFUND	861,634,270	61.84%	
BLACKROCK MSCI EM MKT FR FD B	27,941,303	2.01%	
EAFE STOCK PERFORMANCE INDEX	15,963,721	1.15%	0-10%
CORE Total	**905,655,785**	**64.99%**	**50-70%**
ACADIAN ACWI EX US VALUE	92,370,180	6.63%	
BERNSTEIN ACWI EX	99,461,009	7.14%	
VALUE Total	**191,831,189**	**13.77%**	**10-20%**
HANSBERGER INTL EQUITY GROWTH	101,980,721	7.32%	
MARTIN CURRIE ACWI X	105,383,347	7.56%	
GROWTH Total	**207,364,068**	**14.88%**	**10-20%**
BLACKROCK ACWI EX US SMALL CAP	23,023,550	1.65%	
DFA INTL SMALL CO PORTFOLIO	65,555,839	4.70%	
SMALL CAP Total	**88,579,389**	**6.36%**	**5-15%**
MTIP Total	**1,393,430,431**	**100.00%**	

The table above displays the Montana International Equity Pool (MTIP) allocation at quarter end across market cap segments and manager styles. At this time, all weightings are within the approved ranges. The ranges reflect the restructure of the pool as approved by the Board last August.

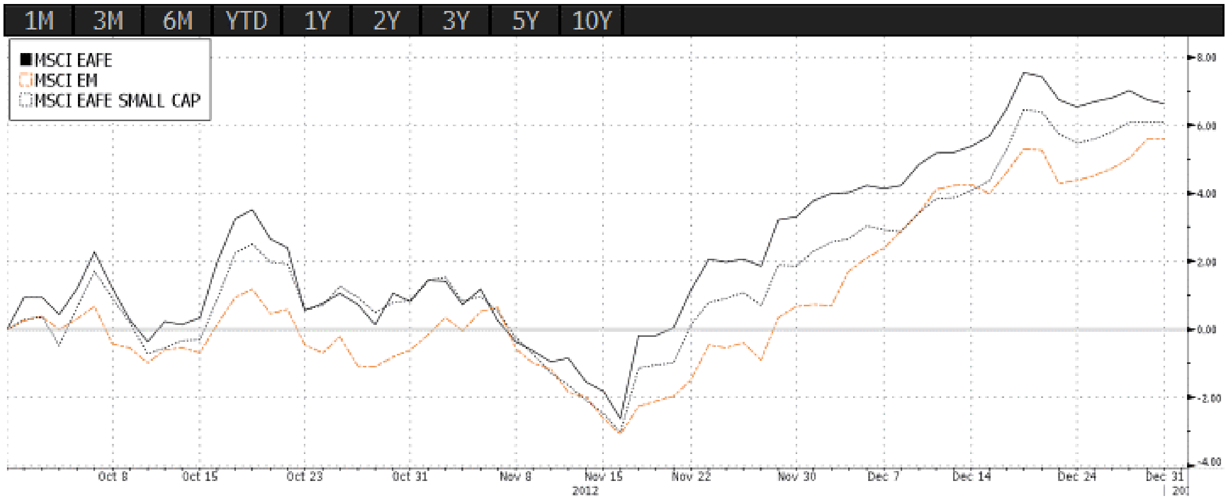
International equity market performance for the quarter was positive with returns outdistancing domestic markets. The ACWI ex US Index returned 5.85% as investors gained confidence that the European Central Bank’s bond purchasing plan would ease the sovereign situation. Additionally, a new prime minister ignited speculation of further easing in Japan, and concerns about China’s growth seemed to be overdone.

Country market performance was led by Greece with a 16.5% return, followed by China at 13.6% and the Philippines at 12.3%. The biggest laggard country market was Egypt with a -7.2% return as political turmoil continued to pressure the equity market there.

1) Settings 2) Actions Page 1/6 Comparative Return

Range 09/28/2012 - 12/31/2012 Period Daily No. of Period 94 Day(s)

	Security	Currency	Price Appreciation	Total Return	Difference	Annual Eq
1.	MXEA Index	USD	6.17%	6.63%	1.03%	28.29%
2.	MXEF Index	USD	5.24%	5.60%		23.57%
3.	MXEASC Index	USD	5.68%	6.09%	.49%	25.80%



Large cap developed market stocks posted the best gains with a 6.6% return while small stocks were close behind with a 6.1% return. Emerging market stocks, although posting somewhat lower comparative returns still generated a 5.6% gain. MTIP is overweight emerging market stocks which detracted slightly from overall pool performance for the quarter. Likewise, MTIP is overweight small cap stocks compared to the current custom benchmark which added slightly to overall pool performance.

Similar to domestic stocks, international value stocks performed better than international growth stocks for the second consecutive quarter. Value returned 6.5% compared to 5.3% for growth stocks. MTIP is overweight growth compared to value which detracted from overall performance.

The value of the U.S. dollar finished the quarter flat compared to a basket of major currencies and thus had virtually no effect on international equity returns for U.S. investors. The dollar actually rose by about four percent midway through the quarter following the conclusion of U.S. elections. However, it gave back those gains as the fiscal cliff concerns escalated near the end of the quarter.

Active management performance was mixed as three of the five active portfolios outperformed for the quarter. Martin Currie, Alliance Bernstein, and DFA bested their respective benchmarks. Overall, MTIP performance for the quarter was above the benchmark by 3 basis points for the quarter and by 15 basis points for the calendar year.

Going forward the passive weight within the large cap allocation has been increased in the initial phase of the pool restructure. Further diversification of the active portion of the small cap allocation and the addition of dedicated active management within the emerging markets allocation is expected.

INTERNATIONAL EXPOSURE-MARKET CAP %

December 31, 2012

Managers	MEGA $200B+	GIANT $100-$200B	LARGE $50-$100B	$20-$50B	$10-$20B	MID $2.5-$10B	SMALL $500MM-$2.5B	MICRO < $500MM	WTD AVG MARKET CAP ($B)
Acadian Asset Management	2.9	8.4	17.7	22.6	16.3	14.3	10.8	7.0	27.3
Bernstein Inv Mgt & Research with look throughs	2.0	10.7	13.7	14.8	15.5	17.2	4.1	0.1	38.1
DFA International Small Cap	0.0	0.0	0.0	0.1	--	21.6	58.9	19.5	1.4
Hansberger Global Investors	4.2	8.1	13.6	31.9	16.0	16.5	9.7	--	32.6
BlackRock ACWI Ex US Superfund A	2.7	10.8	19.4	26.2	17.8	20.9	2.1	--	40.1
BlackRock Intl Small Cap Index look through	--	--	--	--	--	17.8	66.0	15.2	1.2
BlackRock Emerging Market Fund look through	5.9	3.2	12.2	21.9	23.1	27.7	6.0	--	22.4
ALL INTERNATIONAL EQUITY PORTFOLIOS	**3.0**	**9.7**	**16.7**	**24.7**	**16.6**	**20.2**	**7.4**	**1.6**	**36.1**
International Custom Benchmark	**2.7**	**10.7**	**19.2**	**25.9**	**17.6**	**20.9**	**2.8**	**0.2**	**39.6**
Over/underweight(-)	**0.3**	**-1.0**	**-2.5**	**-1.3**	**-1.0**	**-0.7**	**4.6**	**1.5**	

INTERNATIONAL EXPOSURE-SECTOR %

December 31, 2012

MANAGERS	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Technology	Materials	Telecom. Services	Utilities
Acadian Asset Management	8.7	1.5	16.4	33.3	5.8	8.9	8.8	6.5	7.2	2.6
Bernstein Inv Mgt & Research with look throughs	15.0	6.8	12.7	23.5	7.9	8.0	6.8	10.0	5.0	3.1
DFA International Small Cap	19.0	6.3	6.0	14.2	5.4	24.5	8.8	11.9	1.5	2.2
Hansberger Global Investors	17.1	14.0	3.8	14.1	7.7	11.0	10.1	13.9	6.4	1.9
Martin Currie with look throughs	18.8	16.4	7.5	14.7	8.3	9.8	5.1	14.5	2.7	2.4
BlackRock ACWI Ex US Superfund A	9.5	10.2	10.3	25.9	7.1	10.6	6.4	11.0	5.4	3.5
BlackRock Intl Small Cap Index look through	17.2	6.2	6.5	19.6	5.1	18.8	9.2	13.0	1.1	2.3
BlackRock Emerging Market Fund look through	7.9	8.7	12.5	26.4	1.3	6.5	13.8	11.7	7.7	3.4
All International Equity Portfolios	**11.2**	**9.9**	**9.9**	**23.9**	**7.0**	**11.0**	**7.5**	**11.2**	**5.2**	**3.1**
International Custom Benchmark	**9.6**	**10.2**	**10.2**	**25.9**	**7.1**	**10.7**	**6.4**	**11.0**	**5.4**	**3.5**
Over/underweight(-)	**1.6**	**-0.3**	**-0.3**	**-2.0**	**-0.1**	**0.3**	**1.1**	**0.2**	**-0.2**	**-0.4**

*Note: Artio & Bernstein figures have been manually input.

INTERNATIONAL PORTFOLIO CHARACTERISTICS

December 31, 2012

	Market Value	Number of Securities	3Yr Hist EPS Growth	Price/ Earnings	Price/ Book	Dividend Yield
International Accounts with look throughs	**1,393,664,313**	**8,632**	**20.1**	**12.8**	**1.5**	**3.07**
International Equity Managers						
Acadian Asset Management	92,370,022.9	377	20.9	9.1	1.1	3.31
Bernstein Inv Mgt & Research with look throughs	99,539,564	207	24.0	10.4	1.2	3.45
DFA International Small Cap	65,095,027	4,559	17.3	13.0	1.1	2.86
Hansberger Global Investors	102,099,200	63	27.7	16.4	2.3	2.04
Martin Currie with look throughs	105,638,678	61	16.5	16.5	2.3	2.33
BlackRock ACWI Ex US Superfund A	862,011,645	1,877	19.1	13.0	1.5	3.22
BlackRock Intl Small Cap Index look through	23,004,618	4,266	21.2	12.8	1.2	2.84
BlackRock Emerging Market Fund look through	27,941,559	841	27.2	12.0	1.6	2.70
Benchmarks						
MSCI All Country World Ex-United States		1,827	19.1	13.0	1.5	3.22
MSCI All Country World Ex-United States Growth		1,024	20.7	16.3	2.3	2.28
MSCI All Country World Ex-United States Value		1,014	17.4	10.7	1.1	4.16
MSCI EAFE Small Cap		2,177	18.4	13.4	1.2	2.91
MSCI World Ex-United States Small Cap		2,419	18.3	13.5	1.2	2.93
MSCI All Country Pacific		927	25.6	13.5	1.4	2.75
MSCI Europe		436	13.7	12.6	1.5	3.69

MEMORANDUM

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

To: Members of the Board

From: Rande R. Muffick, CFA
Portfolio Manager – Public Equities

Date: February 26, 2013

Subject: Public Equity External Managers Watch List - Quarterly Update

There was one change to the Watch List this quarter. Martin Currie was removed from the list given increased confidence in the new portfolio manager and the improved relative performance of the portfolio during her tenure.

PUBLIC EQUITIES
MANAGER WATCH LIST
February 2013

Manager	Style Bucket	Reason	$ Invested (mil)	Inclusion Date
Alliance Bernstein	**International – LC Value**	**Performance**	**$99.5**	**August 2012**

Return to Agenda

Private Equity & Real Estate

MEMORANDUM

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

To: Members of the Board

From: Ethan Hurley, Portfolio Manager – Alternative Investments

Date: February 26, 2013

Subject: Montana Private Equity Pool (MPEP)

Following this memo are the items listed below:

(i) **Montana Private Equity Pool Review:**
Comprehensive overview of the private equity portfolio for the quarter ended September 30th.

(ii) **New Commitments:**
The table below summarizes the investment decisions made by Staff since the last Board Meeting. A commitment of $30M was made to White Deer Energy II, LP. The MBOI was ultimately allocated $20M. The investment brief summarizing the fund and the general partner follow.

Fund Name	Vintage	Subclass	Sector	Amount	Date
White Deer Energy II, LP	2013	Buyout	Energy	$20M	1/25/13

(iii) **Portfolio Index Comparison:**
Table comparing the performance of the private equity portfolio to the State Street Private Equity IndexTM.

Montana Board of Investments

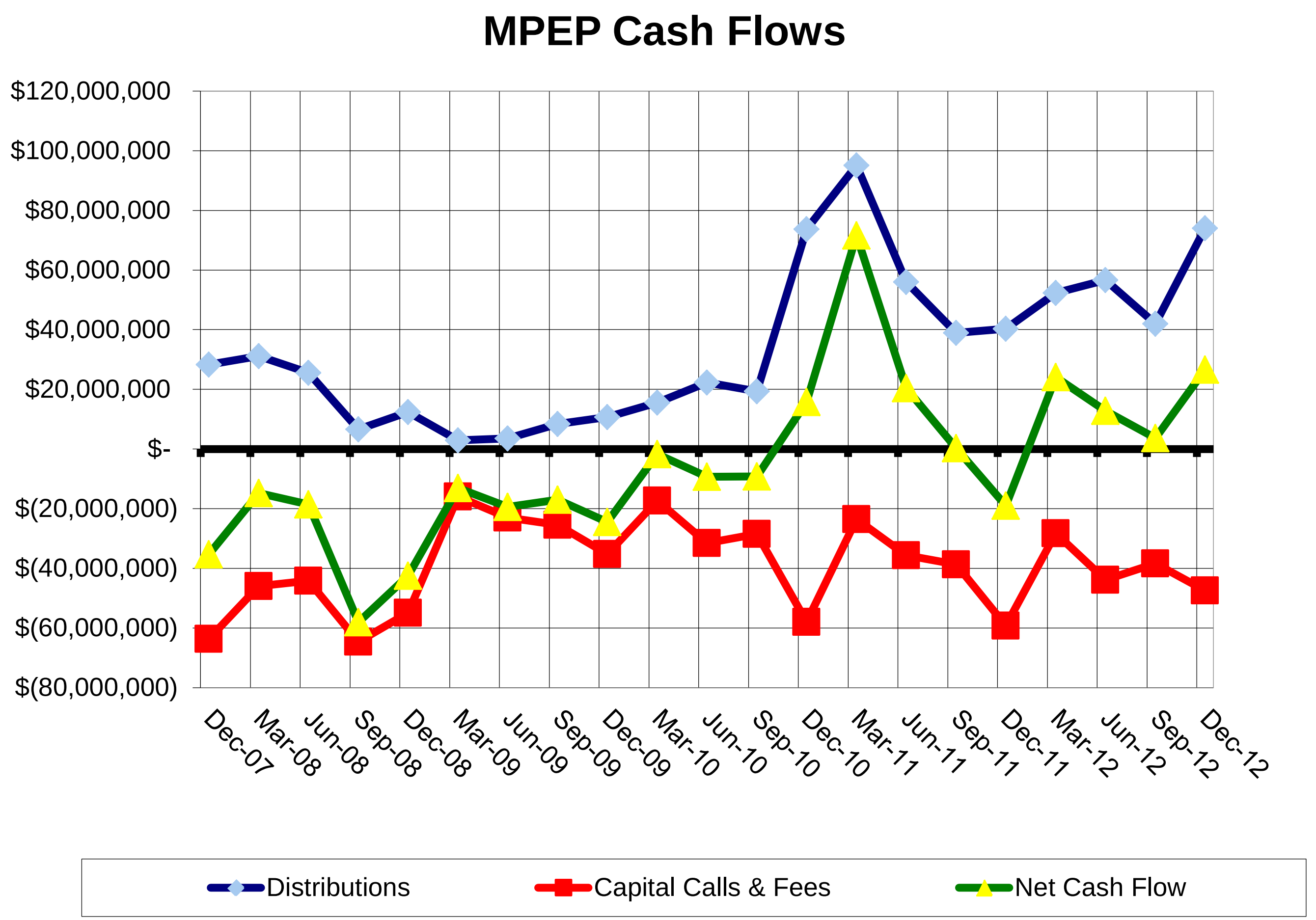
Private Equity Board Report

Q3 2012

Due to, among other things, the lack of a valuation standard in the private equity industry, differences in the pace of investment across funds and the understatement of returns in the early years of a fund's life, the internal rate of return information may not accurately reflect current or expected future returns, and the internal rates of return and all other disclosures with respect to the Partnerships have not been prepared, reviewed or approved by the Partnerships, the General Partners, or any other affiliates.

Contents

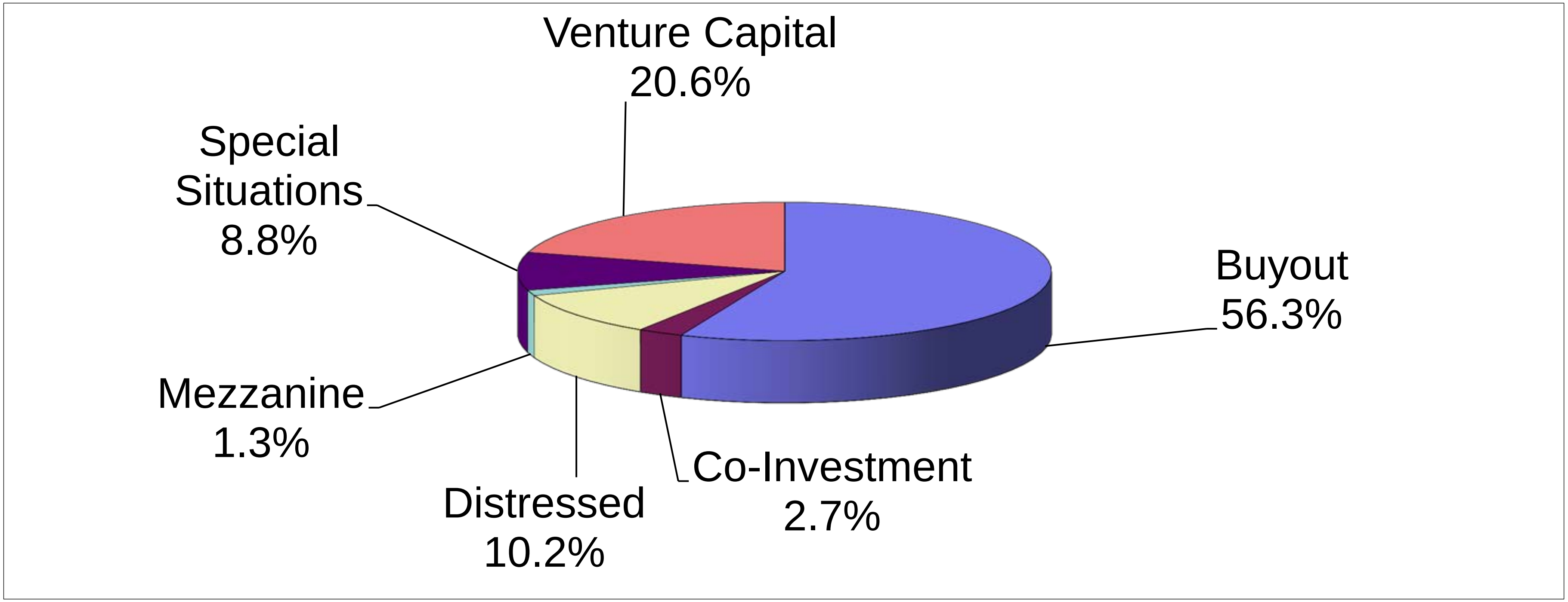
MPEP Quarterly Cash Flows
December 31, 2007 through December 31, 2012



Distributions picked up significantly during the quarter ending 12/31/12 resulting in another quarter of positive net cash flow to the pool. Broadly speaking, M&A was up relative to 3Q12. The 4Q12 global IPO markets saw the total number of deals increase relative to 3Q12 and the prior year period 4Q11. Proceeds raised were down slightly in 4Q12 at $6.3B relative to $6.6B raised in 3Q12 and $6.4B in 4Q11.

Q3 2012 Strategy – Total Exposure

(Since inception through September 30, 2012)

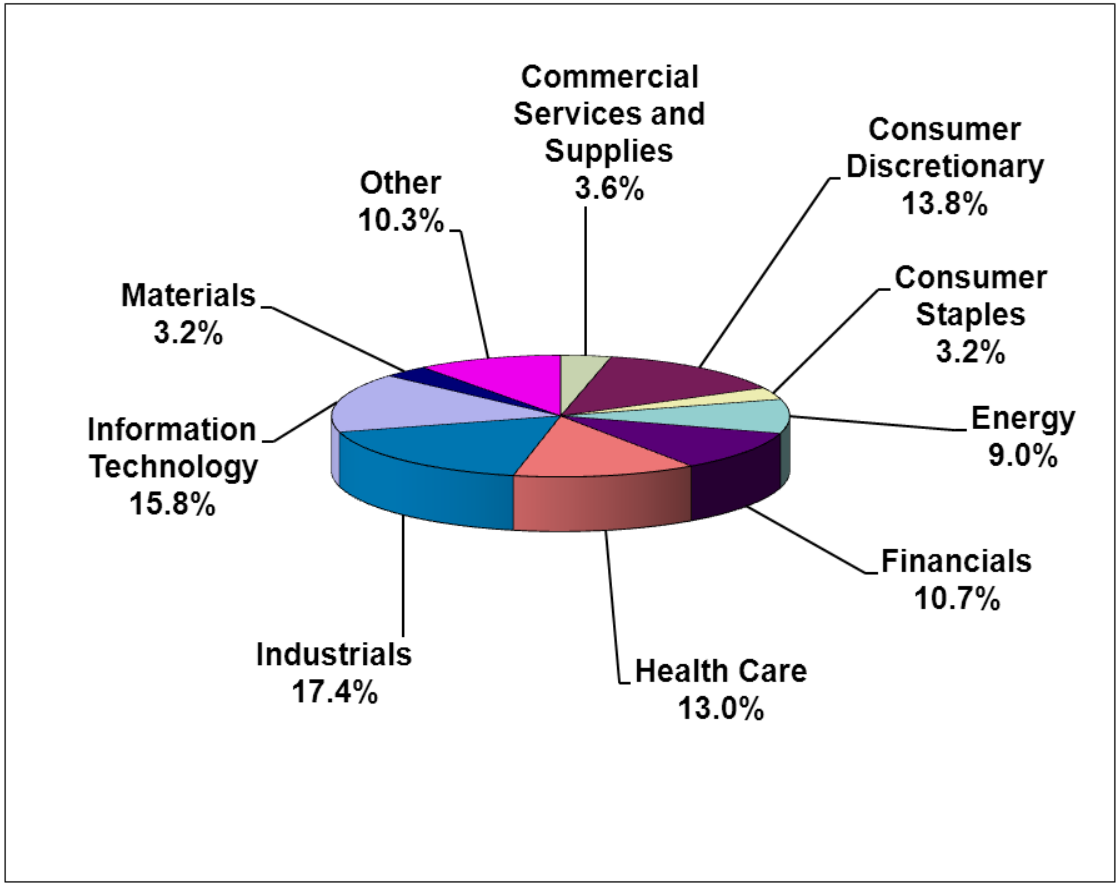


Strategy	Remaining Commitments	Percentage	Market Value	Percentage	Total Exposure	Percentage
Buyout	$356,238,814	59.2%	$567,404,965	54.7%	$923,643,779	56.3%
Co-Investment	$5,297,389	0.9%	$39,648,543	3.8%	$44,945,932	2.7%
Distressed	$63,765,046	10.6%	$103,653,733	10.0%	$167,418,779	10.2%
Mezzanine	$4,137,953	0.7%	$17,079,293	1.6%	$21,217,246	1.3%
Special Situations	$51,859,571	8.6%	$92,946,199	9.0%	$144,805,770	8.8%
Venture Capital	$120,828,681	20.1%	$217,002,543	20.9%	$337,831,225	20.6%
Total	$602,127,454	100.0%	$1,037,735,277	100.0%	$1,639,862,730	100.0%

The portfolio is well diversified by strategy, with the most significant strategy weight consisting of Buyout at 54.7% of total exposure. When combined with Co-Investment and Special Situations, the overall exposure to Buyout strategies is approximately 68%. Strategic allocations are expected to remain relatively stable going forward. That said, the Distressed allocation, though up slightly relative to last quarter, should continue to decline in the near-term given the ongoing liquidation of mature funds in this category.

Q3 2012 Industry – Market Value Exposure

(Since inception through September 30, 2012)

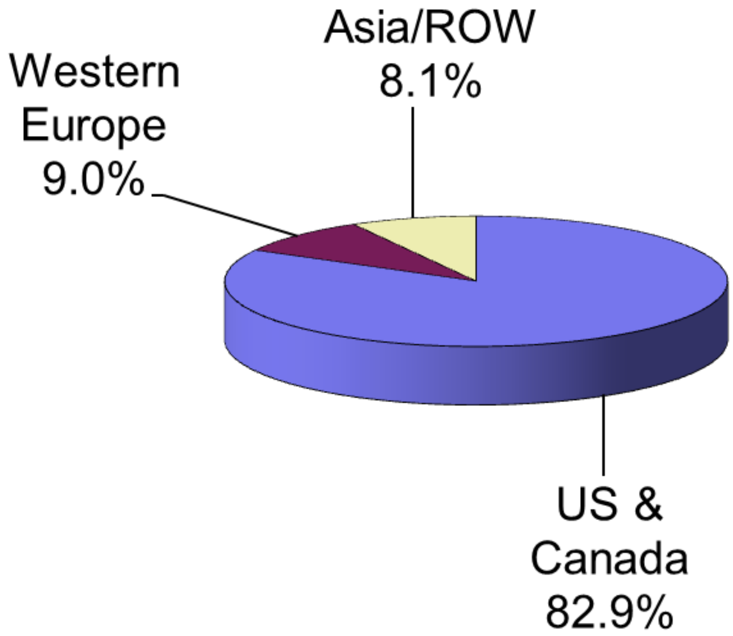


Industry	Investments, At Market Value	Percentage
Commercial Services and Supplies	$36,066,861	3.6%
Consumer Discretionary	$139,757,949	13.8%
Consumer Staples	$32,883,133	3.2%
Energy	$91,737,793	9.0%
Financials	$108,660,574	10.7%
Health Care	$131,356,343	13.0%
Industrials	$176,440,299	17.4%
Information Technology	$160,097,463	15.8%
Materials	$32,754,245	3.2%
Other	$104,081,219	10.3%
Total	$1,013,835,878	100%

The portfolio is broadly diversified by industry with the consumer discretionary, healthcare, industrials and information technology sectors being the highest industry concentrations representing 60% of total assets. With the exception of energy and the information technology-related industries, the portfolio's underlying managers tend to be multi-sector investors. Therefore, composition of the portfolio by industry is and will continue to primarily be a function of a manager's industry expertise and success in sourcing deals rather than a function of staff's desire to over or underweight a specific industry.

Q3 2012 Geography – Total Exposure

(Since inception through September 30, 2012)



The portfolio's predominate geographic exposure is to developed North America, representing 82.9% of the market value and uncalled capital domiciled in or targeted for the US and Canada. No significant divergence from this is expected in the near-term. Targeted international investments will continue to be made largely through fund-of-funds given existing constraints on internal resources.

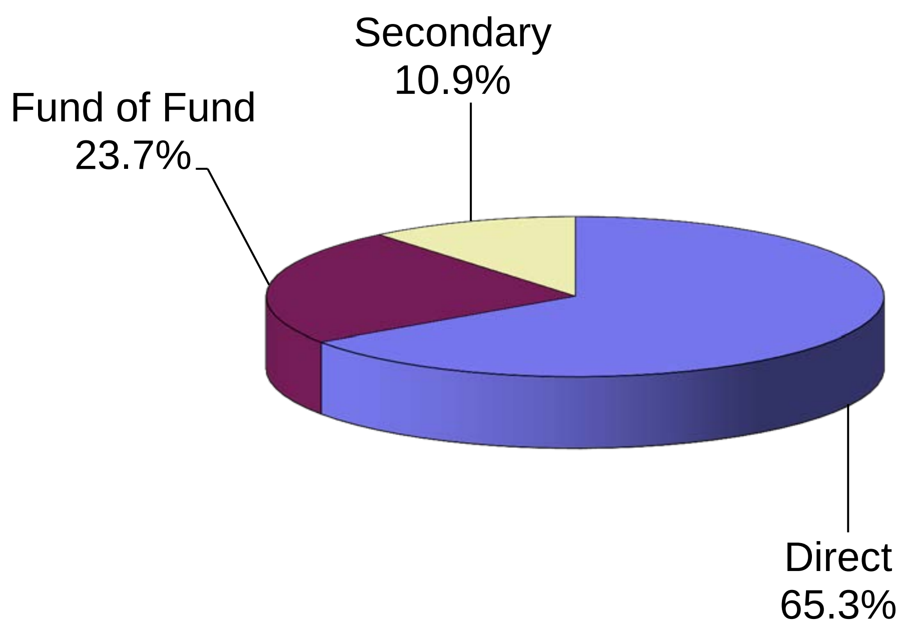
Geography	Remaining Commitments (1)	Percentage	Market Value (2)	Percentage	Total Exposure	Percentage
US & Canada	$ 536,796,257	89.1%	$ 802,819,188	79.2%	$ 1,339,615,445	82.9%
Western Europe	$ 23,849,767	4.0%	$ 121,460,137	12.0%	$ 145,309,904	9.0%
Asia/ROW	$ 41,481,429	6.9%	$ 89,556,553	8.8%	$ 131,037,982	8.1%
Total	$ 602,127,454	100.0%	$ 1,013,835,878	100.0%	$ 1,615,963,332	100.0%

(1) Remaining commitments are based upon the investment location of the partnerships.

(2) Market Value represents the agrregate market values of the underlying investment companies of the partnerships.

Q3 2012 Investment Vehicle – Total Exposure

(Since inception through September 30, 2012)



The portfolio is invested primarily through direct private equity commitments. To the extent the quality of managers invested with directly is comparable to the quality of managers available through a fund-of-funds, a direct strategy should outperform fund-of-funds due to a reduced fee burden. In the medium-term, the portfolio is likely to continue to depend upon fund-of-funds managers for targeted international investments as well as for maintaining its core allocation to domestic venture capital. Longer term it is the intention of staff to leverage the fund-of-funds relationships to slowly, but not entirely move away from this model in order to access more of these specialized managers directly and to reduce overall costs. Non-venture domestic exposure will be accessed directly.

Investment Vehicle	Remaining Commitments	Percentage	Market Value	Percentage	Total Exposure	Percentage
Direct	$ 393,746,017	65.4%	$ 677,487,421	65.3%	$ 1,071,233,437	65.3%
Fund of Fund	$ 154,703,051	25.7%	$ 234,390,456	22.6%	$ 389,093,508	23.7%
Secondary	$ 53,678,385	8.9%	$ 125,857,400	12.1%	$ 179,535,785	10.9%
Total	$ 602,127,453	100.0%	$ 1,037,735,277	100.0%	$ 1,639,862,730	100.0%

Q3 2012 1 – 3 – 5 Year Periodic Return Comparison

	Current					1 Year Return	3 Year Return	5 Year Return
Description	**Count**	**Ending Market Value**	**Inv Multiple**	**IRR[1]**	**Contribution to IRR**	**IRR[1]**	**IRR[1]**	**IRR[1]**
Total	**139**	**1,037,735,277.09**	**1.43**	**12.39**	**12.39**	**13.37**	**14.46**	**5.32**
Adams Street Funds	34	154,394,431.00	1.51	12.18	2.77	11.20	13.01	3.65
ASP - Direct VC Funds	4	23,718,932.00	1.60	15.68	0.66	24.10	20.37	6.15
ASP - Secondary Funds	7	12,916,996.00	1.66	42.33	0.39	7.95	12.15	6.22
ASP - U.S. Partnership Funds	14	103,412,435.00	1.45	9.67	1.50	9.31	11.82	3.09
ASP Non-US Partnership Funds	9	14,346,068.00	1.52	10.65	0.22	6.16	8.92	(0.03)
Buyout	36	371,781,769.00	1.56	12.19	5.42	16.03	17.95	6.50
Co-Investment	2	39,648,543.00	1.24	7.09	0.20	9.35	15.78	5.09
Distressed	11	104,616,485.00	1.44	24.82	1.66	31.44	14.87	11.31
Mezzanine	3	15,784,085.00	1.27	6.70	0.11	2.52	(0.47)	2.10
Non-US Private Equity	8	61,294,118.57	1.10	3.85	0.19	7.79	10.18	(5.89)
Secondary	8	112,940,404.00	1.38	13.40	1.04	9.64	15.83	6.47
Special Situations	7	79,008,472.00	1.22	6.65	0.43	5.34	10.08	5.62
Venture Capital	30	98,266,969.52	1.30	16.11	0.57	8.58	12.94	6.63

1.) Due to, among other things, the lack of a valuation standard in the private equity industry, investment across funds and the understatement of returns in the early years of a fund's life, differences in the pace of the internal rate of return information does not accurately reflect current or expected future returns, and the internal rates of return and all other disclosures with respect to the Partnerships have not been prepared, reviewed or approved by the Partnerships, the General Partners, or any other affiliates.

As of 9/30/12, the portfolio's since inception net investment multiple and net IRR results were up slightly relative to last quarter to 1.43x and 12.39%, respectively, from 1.42x and 12.35%. As of quarter end, all strategy categories performed in-line relative to last quarter's performance.

Q3 2012 LPs by Family of Funds

		Since Inception									
Description	Vintage Year	Commitment	Capital Contributed for Investment	Management Fees	Remaining Commitment	% Capital Contributed/Committed	Capital Distributed	Ending Market Value	IRR[1]	Investment Multiple	Total Exposure
Total		**2,262,363,174**	**1,567,748,159.61**	**117,844,129**	**602,127,454**	**74.51**	**1,377,169,602**	**1,037,735,277**	**12.39**	**1.43**	**1,639,862,731**
Active											
Total		**2,248,470,174**	**1,554,484,709.65**	**116,215,541**	**602,127,454**	**74.30**	**1,337,669,216**	**1,037,735,277**	**11.77**	**1.42**	**1,639,862,731**
Adams Street Partners		327,129,264	289,111,294.72	30,596,989	19,537,432	97.73	328,390,824	154,394,431	12.18	1.51	173,931,863
Adams Street Partners Fund - U.		94,000,000	79,037,374.00	6,422,271	8,540,355	90.91	49,117,629	66,393,058	7.12	1.35	74,933,413
Adams Street - 2002 U.S. Fund, L.P.	2002	34,000,000	29,660,810.00	2,531,335	1,807,855	94.68	24,560,811	22,353,920	8.46	1.46	24,161,775
Adams Street - 2003 U.S. Fund, L.P.	2003	20,000,000	16,933,750.00	1,346,250	1,720,000	91.40	10,857,834	14,201,071	7.36	1.37	15,921,071
Adams Street - 2004 U.S. Fund, L.P.	2004	15,000,000	12,503,908.00	996,092	1,500,000	90.00	6,697,721	10,933,427	6.29	1.31	12,433,427
Adams Street - 2005 U.S. Fund, L.P.	2005	25,000,000	19,938,906.00	1,548,594	3,512,500	85.95	7,001,263	18,904,640	4.73	1.21	22,417,140
Adams Street Partners Fund - Nc		16,000,000	13,684,901.00	1,074,099	1,241,000	92.24	10,084,276	10,862,830	9.05	1.42	12,103,830
Adams Street - 2002 Non-U.S. Fund,	2002	6,000,000	5,333,537.00	432,463	234,000	96.10	6,304,540	3,226,445	12.82	1.65	3,460,445
Adams Street - 2004 Non-U.S. Fund,	2004	5,000,000	4,205,145.00	335,355	459,500	90.81	2,395,823	3,579,585	6.83	1.32	4,039,085
Adams Street - 2005 Non-U.S. Fund,	2005	5,000,000	4,146,219.00	306,281	547,500	89.05	1,383,913	4,056,800	5.02	1.22	4,604,300
Brinson Partnership Trust - Non-		9,809,483	9,598,173.00	1,122,284	286,300	109.29	14,689,282	3,587,382	13.08	1.70	3,873,682
Brinson Non-U.S. Trust-1999 Primary	1999	1,524,853	1,503,681.00	174,456	96,162	110.05	2,590,285	184,931	10.93	1.65	281,093
Brinson Non-U.S. Trust-2000 Primary	2000	1,815,207	1,815,207.00	207,675	0	111.44	2,998,720	517,175	12.32	1.74	517,175
Brinson Non-U.S. Trust-2001 Primary	2001	1,341,612	1,341,612.00	153,492	0	111.44	2,031,734	344,501	11.47	1.59	344,501
Brinson Non-U.S. Trust-2002 Primary	2002	1,696,452	1,696,452.00	194,087	0	111.44	1,828,711	1,142,986	9.46	1.57	1,142,986
Brinson Non-U.S. Trust-2002 Second	2002	637,308	601,542.00	72,913	35,766	105.83	1,424,583	104,144	26.33	2.27	139,910
Brinson Non-U.S. Trust-2003 Primary	2003	1,896,438	1,783,977.00	216,968	112,461	105.51	3,077,508	761,273	20.66	1.92	873,734
Brinson Non-U.S. Trust-2004 Primary	2004	897,613	855,702.00	102,694	41,911	106.77	737,741	532,372	7.32	1.33	574,283
Brinson Partnership Trust - U.S.		103,319,781	99,168,866.82	10,877,599	4,154,032	106.51	129,025,973	38,414,672	10.14	1.52	42,568,704
Brinson Partners - 1996 Fund	1996	3,950,740	3,832,645.82	460,991	121,212	108.68	7,159,236	0	14.80	1.67	121,212
Brinson Partners - 1997 Primary Fun	1997	3,554,935	3,554,935.00	417,170	0	111.73	14,521,984	0	71.46	3.66	0
Brinson Partners - 1998 Primary Fun	1998	7,161,019	7,122,251.00	840,141	38,768	111.19	10,819,769	170,165	6.47	1.38	208,933
Brinson Partners - 1998 Secondary F	1998	266,625	266,625.00	31,316	0	111.75	192,993	0	(7.35)	0.65	0
Brinson Partners - 1999 Primary Fun	1999	8,346,761	7,998,817.00	978,376	347,944	107.55	9,277,486	1,035,688	2.46	1.15	1,383,632
Brinson Partners - 2000 Primary Fun	2000	20,064,960	19,079,570.00	2,250,050	985,390	106.30	24,698,810	4,790,165	5.96	1.38	5,775,555
Brinson Partners - 2001 Primary Fun	2001	15,496,322	14,830,208.00	1,551,484	666,114	105.71	14,817,719	7,804,446	5.83	1.38	8,470,560
Brinson Partners - 2002 Primary Fun	2002	16,297,079	15,783,921.00	1,623,974	513,158	106.82	19,801,649	8,606,686	11.89	1.63	9,119,844
Brinson Partners - 2002 Secondary F	2002	2,608,820	2,498,592.00	301,176	110,228	107.32	3,790,137	886,764	12.70	1.67	996,992
Brinson Partners - 2003 Primary Fun	2003	15,589,100	14,784,432.00	1,523,813	804,668	104.61	15,705,536	7,391,937	8.90	1.42	8,196,605
Brinson Partners - 2003 Secondary F	2003	1,151,151	1,077,749.00	103,673	73,402	102.63	2,171,607	508,531	23.51	2.27	581,933
Brinson Partners - 2004 Primary Fun	2004	8,832,269	8,339,121.00	795,436	493,148	103.42	6,069,047	7,220,290	8.26	1.45	7,713,438
Remaining ASP Funds		104,000,000	87,621,979.90	11,100,735	5,315,745	94.93	125,473,664	35,136,489	21.10	1.63	40,452,234
Adams Street Global Oppty Secondar	2004	25,000,000	19,475,700.00	1,249,300	4,275,000	82.90	19,188,241	11,350,586	11.89	1.47	15,625,586
Adams Street V, L.P.	2003	40,000,000	34,806,956.00	5,193,044	0	100.00	26,556,729	21,380,424	3.37	1.20	21,380,424
Adams Street VPAF Fund II	1990	4,000,000	3,621,830.11	378,170	0	100.00	7,885,046	0	25.25	1.97	0
Brinson Venture Capital Fund III, L.P.	1993	5,000,000	4,045,655.64	954,344	0	100.00	15,634,528	0	40.47	3.13	0
Brinson VPF III	1993	5,000,000	4,488,559.09	530,671	0	100.38	15,024,708	66,563	29.47	3.01	66,563
Brinson VPF III - Secondary Interest	1999	5,000,000	4,820,288.22	198,942	0	100.38	8,307,583	66,971	41.46	1.67	66,971
BVCF III - Secondary Interest	1999	5,000,000	3,602,734.65	356,520	1,040,745	79.19	9,646,385	0	97.02	2.44	1,040,745
BVCF IV, L.P.	1999	15,000,000	12,760,256.19	2,239,744	0	100.00	23,230,444	2,271,945	6.99	1.70	2,271,945

Q3 2012 LPs by Family of Funds - Continued

			Since Inception								
Description	Vintage Year	Commitment	Capital Contributed for Investment	Management Fees	Remaining Commitment	% Capital Contributed/Committed	Capital Distributed	Ending Market Value	IRR[1]	Investment Multiple	Total Exposure
Affinity Asia Capital		15,000,000	10,699,477.01	1,809,692	2,492,498	83.39	3,664,452	14,621,855	15.70	1.46	17,114,353
Affinity Asia Pacific Fund III, L.P.	2006	15,000,000	10,699,477.01	1,809,692	2,492,498	83.39	3,664,452	14,621,855	15.70	1.46	17,114,353
American Securities LLC		35,000,000	5,172,011.96	541,967	29,286,021	16.33	19,733	5,268,619	(7.46)	0.93	34,554,640
American Securities Partners VI, L.P.	2011	35,000,000	5,172,011.96	541,967	29,286,021	16.33	19,733	5,268,619	(7.46)	0.93	34,554,640
Arclight Energy Partners		70,000,000	45,231,833.50	3,404,815	21,363,352	69.48	47,927,568	21,172,397	11.35	1.42	42,535,749
ArcLight Energy Partners Fund II, L.P.	2004	25,000,000	20,484,419.86	1,210,142	3,305,438	86.78	33,705,858	2,815,340	18.19	1.68	6,120,778
ArcLight Energy Partners Fund III, L.P.	2006	25,000,000	19,965,151.52	1,696,125	3,338,724	86.65	14,110,347	13,401,426	5.49	1.27	16,740,150
ArcLight Energy Partners Fund V, L.P.	2011	20,000,000	4,782,262.12	498,548	14,719,190	26.40	111,363	4,955,631	(10.89)	0.96	19,674,821
Avenue Investments		35,000,000	33,123,011.00	2,086,886	0	100.60	44,266,071	1,840,585	10.90	1.31	1,840,585
Avenue Special Situations Fund V, LP	2007	35,000,000	33,123,011.00	2,086,886	0	100.60	44,266,071	1,840,585	10.90	1.31	1,840,585
Axiom Asia Private Capital		50,000,000	10,126,437.00	923,116	38,988,931	22.10	559,187	10,412,385	(0.52)	0.99	49,401,316
Axiom Asia Private Capital II, LP	2009	25,000,000	10,126,437.00	923,116	13,988,931	44.20	559,187	10,412,385	(0.52)	0.99	24,401,316
Axiom Asia Private Capital III, LP	2012	25,000,000	0.00	0	25,000,000	0.00	0	0	N/A	0.00	25,000,000
Black Diamond Capital Management		25,000,000	8,496,349.20	642,767	15,860,884	36.56	274,661	9,167,345	4.38	1.03	25,028,229
BDCM Opportunity Fund III, L.P.	2011	25,000,000	8,496,349.20	642,767	15,860,884	36.56	274,661	9,167,345	4.38	1.03	25,028,229
Carlyle Partners		60,000,000	50,863,317.00	4,592,500	4,643,185	92.43	44,585,781	43,459,722	10.88	1.59	48,102,907
Carlyle Partners IV, L.P.	2005	35,000,000	31,664,089.00	1,529,334	1,905,579	94.84	31,660,908	27,730,113	12.37	1.79	29,635,692
Carlyle U.S. Growth Fund III, L.P.	2006	25,000,000	19,199,228.00	3,063,166	2,737,606	89.05	12,924,873	15,729,609	7.09	1.29	18,467,215
Cartesian Capital Group, LLC		20,000,000	2,788,735.00	247,158	16,964,107	15.18	0	3,289,531	10.50	1.08	20,253,638
Pangaea Two, L.P.	2012	20,000,000	2,788,735.00	247,158	16,964,107	15.18	0	3,289,531	10.50	1.08	20,253,638
CCMP Associates		30,000,000	24,939,015.00	2,307,316	2,753,669	90.82	8,504,600	29,008,956	12.14	1.38	31,762,625
CCMP Capital Investors II, L.P.	2006	30,000,000	24,939,015.00	2,307,316	2,753,669	90.82	8,504,600	29,008,956	12.14	1.38	31,762,625
Centerbridge		57,500,000	23,149,865.00	985,901	33,364,234	41.98	466,375	30,305,231	15.09	1.27	63,669,465
Centerbridge Capital Partners II, L.P.	2011	25,000,000	8,671,010.00	589,756	15,739,234	37.04	2,176	10,097,932	10.98	1.09	25,837,166
Centerbridge Special Credit Partners	2009	12,500,000	11,594,120.00	280,880	625,000	95.00	464,199	17,209,907	16.41	1.49	17,834,907
Centerbridge Special Credit Partners II	2012	20,000,000	2,884,735.00	115,265	17,000,000	15.00	0	2,997,392	(0.11)	1.00	19,997,392
CIVC Partners		25,000,000	8,412,991.79	1,339,832	15,341,847	39.01	246,875	12,166,929	26.44	1.27	27,508,776
CIVC Partners Fund IV, L.P.	2010	25,000,000	8,412,991.79	1,339,832	15,341,847	39.01	246,875	12,166,929	26.44	1.27	27,508,776
Energy Investors Funds		25,000,000	4,315,408.00	907,984	19,776,608	20.89	370,349	4,248,422	(12.02)	0.88	24,025,030
EIF US Power Fund IV, L.P.	2011	25,000,000	4,315,408.00	907,984	19,776,608	20.89	370,349	4,248,422	(12.02)	0.88	24,025,030
First Reserve		55,485,789	46,506,978.64	1,996,616	7,252,777	87.42	9,444,680	42,172,407	2.12	1.06	49,425,184
First Reserve Fund XI, L.P.	2006	30,000,000	28,472,300.09	1,005,047	793,235	98.26	7,868,036	24,398,947	2.74	1.09	25,192,182
First Reserve Fund XII, L.P.	2008	25,485,789	18,034,678.55	991,568	6,459,543	74.65	1,576,644	17,773,460	0.71	1.02	24,233,003
Gridiron Capital		15,000,000	2,928,866.00	397,051	11,733,705	22.17	141,564	2,817,230	(7.47)	0.89	14,550,935
Gridiron Capital Fund II, LP	2011	15,000,000	2,928,866.00	397,051	11,733,705	22.17	141,564	2,817,230	(7.47)	0.89	14,550,935
GTCR LLC		25,000,000	11,311,923.00	362,728	13,325,349	46.70	0	11,249,764	(5.68)	0.96	24,575,113
GTCR X, L.P.	2011	25,000,000	11,311,923.00	362,728	13,325,349	46.70	0	11,249,764	(5.68)	0.96	24,575,113
HarbourVest		71,823,772	38,755,357.18	1,402,167	31,679,774	55.91	8,970,149	39,568,577	9.23	1.21	71,248,350
Dover Street VII L.P.	2008	20,000,000	16,305,650.00	657,875	3,050,000	84.82	3,249,931	19,440,539	15.10	1.34	22,490,539
Dover Street VIII LP	2012	10,000,000	0.00	0	10,000,000	0.00	0	172,931	N/A	0.00	10,172,931
HarbourVest Direct 2007 Fund	2007	20,000,000	17,848,427.00	451,573	1,700,000	91.50	4,005,449	16,673,936	5.09	1.13	18,373,936
HarbourVest Intl Private Equity Fund VI	2008	21,823,772	4,601,280.18	292,719	16,929,774	22.43	1,714,769	3,281,171	1.94	1.02	20,210,944

Q3 2012 LPs by Family of Funds - Continued

			Since Inception								
Description	Vintage Year	Commitment	Capital Contributed for Investment	Management Fees	Remaining Commitment	% Capital Contributed/Committed	Capital Distributed	Ending Market Value	IRR[1]	Investment Multiple	Total Exposure
Hellman & Friedman		40,000,000	26,526,977.00	1,632,212	11,840,811	70.40	8,377,826	25,564,898	6.27	1.21	37,405,709
Hellman & Friedman Capital Partners VI	2006	25,000,000	22,346,249.00	1,350,732	1,303,019	94.79	8,377,826	21,409,909	6.78	1.26	22,712,928
Hellman & Friedman Capital Partners VII	2011	15,000,000	4,180,728.00	281,480	10,537,792	29.75	0	4,154,989	(9.26)	0.93	14,692,781
Highway 12 Ventures		10,000,000	7,811,101.97	1,464,215	724,683	92.75	671,745	10,085,278	5.04	1.16	10,809,961
Highway 12 Venture Fund II, L.P.	2006	10,000,000	7,811,101.97	1,464,215	724,683	92.75	671,745	10,085,278	5.04	1.16	10,809,961
Industry Ventures		10,000,000	9,067,566.44	741,213	595,358	98.09	6,153,018	6,141,791	6.13	1.25	6,737,149
Industry Ventures Fund IV, L.P.	2005	10,000,000	9,067,566.44	741,213	595,358	98.09	6,153,018	6,141,791	6.13	1.25	6,737,149
JCF		25,000,000	23,744,233.00	997,022	311,204	98.97	1,690,714	5,628,935	(23.97)	0.30	5,940,139
J.C. Flowers II, L.P.	2006	25,000,000	23,744,233.00	997,022	311,204	98.97	1,690,714	5,628,935	(23.97)	0.30	5,940,139
Joseph Littlejohn & Levy		25,000,000	21,560,342.00	1,313,050	2,126,608	91.49	11,725,868	22,160,776	10.80	1.48	24,287,384
JLL Partners Fund V, L.P.	2005	25,000,000	21,560,342.00	1,313,050	2,126,608	91.49	11,725,868	22,160,776	10.80	1.48	24,287,384
KKR		175,000,000	175,000,000.00	9,450,416	1,672	105.40	352,902,567	4,295,087	12.37	1.94	4,296,759
KKR 1987 Fund	1987	25,000,000	25,000,000.00	2,101,164	0	108.40	56,620,964	0	8.92	2.09	0
KKR 1993 Fund	1993	25,000,000	25,000,000.00	1,002,236	0	104.01	48,971,319	0	17.79	1.88	0
KKR 1996 Fund	1997	100,000,000	100,000,000.00	4,582,023	0	104.58	188,549,072	1,154,108	13.51	1.81	1,154,108
KKR European Fund, L. P.	1999	25,000,000	25,000,000.00	1,764,993	1,672	107.06	58,761,212	3,140,979	19.86	2.31	3,142,651
Lexington Capital Partners		155,000,000	116,966,354.64	6,436,033	31,672,158	79.61	98,149,546	74,106,077	13.68	1.40	105,778,235
Lexington Capital Partners V, L.P.	2001	50,000,000	47,119,341.02	2,637,277	243,382	99.51	69,314,064	12,514,700	18.73	1.64	12,758,082
Lexington Capital Partners VI-B, L.P.	2005	50,000,000	45,754,124.46	2,383,366	1,862,510	96.27	23,338,037	33,909,363	5.27	1.19	35,771,873
Lexington Capital Partners VII, L.P.	2009	45,000,000	18,551,698.16	1,169,881	25,352,967	43.83	4,293,475	21,884,141	22.85	1.33	47,237,108
Lexington Middle Market Investors II, LP	2008	10,000,000	5,541,191.00	245,509	4,213,300	57.87	1,203,970	5,797,873	13.76	1.21	10,011,173
Madison Dearborn Capital Partners		75,000,000	54,764,663.81	2,832,965	17,458,184	76.80	48,736,317	37,282,350	10.67	1.49	54,740,534
Madison Dearborn Capital Partners IV, LF	2001	25,000,000	23,699,359.97	594,527	761,926	97.18	34,484,322	10,026,115	14.41	1.83	10,788,041
Madison Dearborn Capital Partners V, LP.	2006	25,000,000	22,220,103.12	1,001,069	1,778,828	92.88	6,509,768	22,388,931	4.92	1.24	24,167,759
Madison Dearborn Capital Partners VI, LF	2008	25,000,000	8,845,200.72	1,237,369	14,917,430	40.33	7,742,227	4,867,304	10.91	1.25	19,784,734
Matlin Patterson		30,000,000	23,355,368.96	2,197,290	4,447,341	85.18	11,571,993	19,314,396	5.80	1.21	23,761,737
MatlinPatterson Global Opps. Ptnrs. III	2007	30,000,000	23,355,368.96	2,197,290	4,447,341	85.18	11,571,993	19,314,396	5.80	1.21	23,761,737
MHR Institutional Partners		25,000,000	14,295,823.00	2,195,478	8,508,699	65.97	2,173,258	19,834,230	6.37	1.33	28,342,929
MHR Institutional Partners III, L.P.	2006	25,000,000	14,295,823.00	2,195,478	8,508,699	65.97	2,173,258	19,834,230	6.37	1.33	28,342,929
Montlake Capital		15,000,000	11,406,801.39	2,018,199	1,575,000	89.50	3,927,432	10,594,035	2.89	1.08	12,169,035
Montlake Capital II, L.P.	2007	15,000,000	11,406,801.39	2,018,199	1,575,000	89.50	3,927,432	10,594,035	2.89	1.08	12,169,035
Neuberger Berman Group, LLC		35,000,000	30,013,899.23	1,787,869	3,597,389	90.86	18,333,199	22,974,607	7.81	1.30	26,571,996
NB Co-Investment Partners, L.P.	2006	35,000,000	30,013,899.23	1,787,869	3,597,389	90.86	18,333,199	22,974,607	7.81	1.30	26,571,996
Northgate Capital Partners		45,000,000	9,690,000.00	60,000	35,250,000	21.67	0	9,329,053	(4.43)	0.96	44,579,053
Northgate V, L.P.	2010	30,000,000	9,240,000.00	60,000	20,700,000	31.00	0	8,967,473	(3.51)	0.96	29,667,473
Northgate Venture Partners VI, L.P.	2012	15,000,000	450,000.00	0	14,550,000	3.00	0	361,580	(19.65)	0.80	14,911,580
Oak Hill Capital Partners		45,000,000	36,723,178.60	3,668,097	4,690,078	89.76	18,842,089	36,935,510	8.38	1.38	41,625,588
Oak Hill Capital Partners II, L.P.	2005	25,000,000	22,460,873.50	2,052,667	486,459	98.05	18,797,973	19,485,922	9.78	1.56	19,972,381
Oak Hill Capital Partners III, L.P.	2008	20,000,000	14,262,305.10	1,615,430	4,203,619	79.39	44,115	17,449,588	3.58	1.10	21,653,207
Oaktree Capital Partners		120,000,000	112,033,211.00	4,472,616	3,500,000	97.09	153,143,746	32,752,630	42.02	1.60	36,252,630
Oaktree Opportunities Fund VIII, L.P.	2009	10,000,000	9,586,811.00	413,189	0	100.00	89,318	11,563,625	8.73	1.17	11,563,625
OCM Opportunities Fund IVb, L.P.	2002	75,000,000	73,086,225.00	1,913,775	0	100.00	121,554,428	136,438	44.89	1.62	136,438
OCM Opportunities Fund VIIb, L.P.	2008	35,000,000	29,360,175.00	2,145,652	3,500,000	90.02	31,500,000	21,052,567	17.99	1.67	24,552,567
Odyssey Partners Fund III		45,000,000	34,325,399.02	3,046,857	7,627,764	83.05	33,706,154	33,671,776	25.55	1.80	41,299,540
Odyssey Investment Partners III, L.P.	2004	25,000,000	21,937,897.88	1,714,708	1,347,394	94.61	33,680,728	15,418,915	26.39	2.08	16,766,309
Odyssey Investment Partners IV, L.P.	2008	20,000,000	12,387,501.14	1,332,150	6,280,370	68.60	25,426	18,252,861	19.26	1.33	24,533,231
Opus Capital Venture Partners		10,000,000	1,736,221.85	312,500	7,951,278	20.49	0	1,605,038	(29.53)	0.78	9,556,316
Opus Capital Venture Partners VI, LP	2011	10,000,000	1,736,221.85	312,500	7,951,278	20.49	0	1,605,038	(29.53)	0.78	9,556,316

Q3 2012 LPs by Family of Funds - Continued

Description	Vintage Year	Commitment	Since Inception Capital Contributed for Investment	Management Fees	Remaining Commitment	% Capital Contributed/Committed	Capital Distributed	Ending Market Value	IRR[1]	Investment Multiple	Total Exposure
Performance Venture Capital		25,000,000	11,044,342.42	1,063,596	12,892,062	48.43	187,147	12,612,384	3.36	1.06	25,504,446
Performance Venture Capital II	2008	25,000,000	11,044,342.42	1,063,596	12,892,062	48.43	187,147	12,612,384	3.36	1.06	25,504,446
Portfolio Advisors		70,000,000	51,659,365.00	2,615,845	15,971,641	77.54	5,949,509	61,508,986	7.05	1.24	77,480,627
Port. Advisors Fund IV (B), L.P.	2006	30,000,000	21,903,895.00	1,220,313	6,875,792	77.08	1,754,911	29,227,833	7.20	1.34	36,103,625
Port. Advisors Fund IV (E), L.P.	2006	15,000,000	11,041,889.00	751,700	3,206,411	78.62	388,285	11,208,662	(0.51)	0.98	14,415,073
Port. Advisors Fund V (B), L.P.	2008	10,000,000	6,703,037.00	350,000	3,063,710	70.53	755,504	7,993,425	9.05	1.24	11,057,135
Portfolio Advisors Secondary Fund, L.P.	2008	15,000,000	12,010,544.00	293,832	2,825,728	82.03	3,050,809	13,079,066	20.90	1.31	15,904,794
Quintana Energy Partners		15,000,000	11,947,914.81	1,562,599	1,509,857	90.07	4,478,520	11,415,246	3.83	1.18	12,925,103
Quintana Energy Partners Fund I, L.P.	2006	15,000,000	11,947,914.81	1,562,599	1,509,857	90.07	4,478,520	11,415,246	3.83	1.18	12,925,103
Siguler Guff & Company		50,000,000	25,471,883.16	1,166,323	23,494,081	53.28	3,812,081	32,567,040	12.16	1.37	56,061,121
Siguler Guff Small Buyout Opportunities	2007	25,000,000	19,298,080.08	1,090,126	4,744,081	81.55	3,812,081	24,891,669	11.35	1.41	29,635,750
Siguler Guff Small Buyout Opps Fund II	2011	25,000,000	6,173,803.08	76,197	18,750,000	25.00	0	7,675,371	24.58	1.23	26,425,371
Sterling Capital Partners		20,000,000	0.00	0	20,000,000	0.00	0	250,915	N/A	0.00	20,250,915
Sterling Capital Partners IV	2012	20,000,000	0.00	0	20,000,000	0.00	0	250,915	N/A	0.00	20,250,915
Summit Ventures		20,000,000	900,000.00	0	19,100,000	4.50	0	851,545	(5.38)	0.95	19,951,545
Summit Partners Growth Equity Fund VIII	2011	20,000,000	900,000.00	0	19,100,000	4.50	0	851,545	(5.38)	0.95	19,951,545
TA Associates, Inc.		10,000,000	4,060,254.00	264,746	5,675,000	43.25	250,000	4,459,701	7.30	1.09	10,134,701
TA XI, L.P.	2010	10,000,000	4,060,254.00	264,746	5,675,000	43.25	250,000	4,459,701	7.30	1.09	10,134,701
Tenaya Capital		20,000,000	1,210,385.61	5,333	18,784,282	6.08	0	1,090,314	(15.25)	0.90	19,874,596
Tenaya Capital VI, L.P.	2012	20,000,000	1,210,385.61	5,333	18,784,282	6.08	0	1,090,314	(15.25)	0.90	19,874,596
Tenex Capital Management		20,000,000	3,932,191.35	81,806	15,986,003	20.07	0	3,317,159	(18.10)	0.83	19,303,162
Tenex Capital Partners SG, L.P.	2012	20,000,000	3,932,191.35	81,806	15,986,003	20.07	0	3,317,159	(18.10)	0.83	19,303,162
Terra Firma Capital Partners		25,432,997	20,908,261.75	2,668,381	1,873,406	92.70	-1,345,585	13,000,131	(19.34)	0.49	14,873,538
Terra Firma Capital Partners III, L.P.	2007	25,432,997	20,908,261.75	2,668,381	1,873,406	92.70	-1,345,585	13,000,131	(19.34)	0.49	14,873,538
Thayer Hidden Creek Management, L.I		20,000,000	8,021,235.00	1,487,073	10,818,390	47.54	432,370	15,100,366	33.82	1.63	25,918,756
HCI Equity Partners III, LP	2008	20,000,000	8,021,235.00	1,487,073	10,818,390	47.54	432,370	15,100,366	33.82	1.63	25,918,756
The Catalyst Capital Group		15,000,000	1,500,000.00	0	13,500,000	10.00	0	1,500,000	0.00	1.00	15,000,000
Catalyst Fund LP IV	2012	15,000,000	1,500,000.00	0	13,500,000	10.00	0	1,500,000	0.00	1.00	15,000,000
Trilantic Capital Partners		11,098,351	9,051,080.81	981,966	1,067,931	90.40	3,505,849	11,306,385	17.68	1.48	12,374,316
Trilantic Capital Partners IV L.P.	2007	11,098,351	9,051,080.81	981,966	1,067,931	90.40	3,505,849	11,306,385	17.68	1.48	12,374,316
Veritas Capital		25,000,000	13,360,205.00	177,595	11,462,200	54.15	0	14,457,505	5.40	1.07	25,919,705
The Veritas Capital Fund IV, L.P.	2010	25,000,000	13,360,205.00	177,595	11,462,200	54.15	0	14,457,505	5.40	1.07	25,919,705
Welsh, Carson, Anderson & Stowe		75,000,000	66,463,577.82	4,968,761	3,750,000	95.24	52,460,984	46,856,746	8.11	1.39	50,606,746
Welsh, Carson, Anderson & Stowe IV, LP	2004	25,000,000	21,039,895.82	1,460,104	2,500,000	90.00	11,631,311	15,784,085	4.84	1.22	18,284,085
Welsh, Carson, Anderson & Stowe IX, L.F	2000	25,000,000	22,454,505.00	2,045,495	500,000	98.00	33,693,062	7,587,455	12.28	1.68	8,087,455
Welsh, Carson, Anderson & Stowe X, L.P	2005	25,000,000	22,969,177.00	1,463,162	750,000	97.73	7,136,611	23,485,206	4.89	1.25	24,235,206

1.) Due to, among other things, the lack of a valuation standard in the private equity industry, differences in the pace of investment across funds and the understatement of returns in the early years of a fund's life, the internal rate of return information does not accurately reflect current or expected future returns, and the internal rates of return and all other disclosures with respect to the Partnerships have not been prepared, reviewed or approved by the Partnerships, the General Partners, or any other affiliates.

Matlin Patterson and MHR continue their upward performance trajectory from earlier fears of capital impairment. Pangaea Two, while still very early is reporting positive performance after its second full quarter. CIVC experienced a significantly positive uptick from a 13.79% IRR and 1.13x MOIC to a 26.44% IRR and 1.27x MOIC. Additionally both JLL and Siguler Guff II experienced nice upticks from an 8.8% IRR and 1.36x MOIC and 14.9% IRR and 1.11x MOIC to a 10.8% IRR and 1.48x MOIC and 24.5% IRR and 1.23x MOIC, respectively.

IRR Benchmark Comparison (Since 1980)
As of September 30, 2012

By Investment Focus

Description	PIC	Client	DPI	Client	RVPI	Client	TVPI	Client	IRR	Client
Buyout	0.80	0.74	0.78	0.81	0.65	0.63	1.43	1.44	12.45	11.38
Venture Capital	0.81	0.66	0.74	0.72	0.59	0.69	1.33	1.41	10.04	15.93
Mezz & Distressed	0.81	0.82	0.73	0.94	0.66	0.49	1.39	1.43	11.40	21.85
Pooled IRR	**0.80**	**0.76**	**0.77**	**0.82**	**0.64**	**0.62**	**1.41**	**1.43**	**11.94**	**12.39**

By Origin

Description	PIC	Client	DPI	Client	RVPI	Client	TVPI	Client	IRR	Client
US	0.80	0.77	0.80	0.83	0.64	0.62	1.44	1.46	12.22	12.73
Non-US	0.79	0.69	0.66	0.64	0.66	0.54	1.32	1.18	10.69	6.05
Pooled IRR	**0.80**	**0.76**	**0.77**	**0.82**	**0.64**	**0.62**	**1.41**	**1.43**	**11.94**	**12.39**

By Vintage Year

Description	PIC	Client	DPI	Client	RVPI	Client	TVPI	Client	IRR	Client
1990	1.01	1.04	2.46	2.41	0.00	0.00	2.46	2.41	18.53	27.63
1991	1.03	1.07	2.83	2.29	0.00	0.00	2.83	2.29	27.07	24.24
1992	0.99	N/A	2.28	N/A	0.00	N/A	2.28	N/A	23.49	N/A
1993	0.98	1.03	2.29	2.22	0.01	0.00	2.30	2.23	25.07	23.25
1994	0.96	N/A	2.50	N/A	0.00	N/A	2.50	N/A	26.10	N/A
1995	0.92	N/A	1.96	N/A	0.01	N/A	1.97	N/A	21.47	N/A
1996	0.98	1.09	1.70	1.67	0.02	0.00	1.71	1.67	13.18	14.80
1997	0.99	1.05	1.57	1.87	0.02	0.01	1.60	1.88	10.72	15.19
1998	0.97	1.11	1.36	1.33	0.04	0.02	1.40	1.35	7.06	6.03
1999	0.97	1.03	1.17	1.82	0.12	0.11	1.29	1.93	5.48	14.78
2000	0.96	1.02	1.38	1.28	0.18	0.27	1.57	1.55	10.19	9.18
2001	0.98	1.00	1.45	1.31	0.28	0.33	1.73	1.65	15.89	13.98
2002	0.98	1.00	1.42	1.32	0.29	0.27	1.71	1.59	19.48	25.78
2003	0.97	0.99	1.37	0.75	0.54	0.57	1.91	1.32	20.19	5.96
2004	0.97	0.90	1.05	0.98	0.58	0.58	1.63	1.56	13.90	13.11
2005	0.96	0.94	0.73	0.57	0.73	0.83	1.46	1.39	9.79	8.21
2006	0.91	0.88	0.36	0.31	0.81	0.86	1.17	1.18	4.28	4.48
2007	0.85	0.91	0.32	0.48	0.91	0.67	1.23	1.14	6.93	4.73
2008	0.68	0.64	0.29	0.32	0.97	0.99	1.26	1.31	9.83	12.85
2009	0.67	0.57	0.20	0.10	1.05	1.16	1.25	1.26	13.52	14.19
2010	0.53	0.41	0.10	0.01	1.00	1.08	1.10	1.10	7.35	8.68
2011	0.30	0.26	0.05	0.01	0.99	0.98	1.04	1.00	5.72	-0.56
3Q 12	0.18	0.08	0.04	0.00	0.96	0.98	0.99	0.98	2.22	-3.84
Pooled IRR	**0.80**	**0.76**	**0.77**	**0.82**	**0.64**	**0.62**	**1.41**	**1.43**	**11.94**	**12.39**

Based on data compiled from 2,122 Private Equity funds, including fully liquidated partnerships, formed between 1980 to 2012.
IRR: Pooled Average IRR is net of fees, expenses and carried interest.

MEMORANDUM

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

To: Members of the Board

From: Ethan Hurley, Portfolio Manager – Alternative Investments

Date: February 26, 2013

Subject: Montana Real Estate Pool (MTRP)

Following this memo are the following reports:

(i) **Montana Real Estate Pool Review:**
Comprehensive overview of the real estate portfolio for the quarter ended September 30th.

(ii) **New Commitments:**
There have been no new investment decisions made by Staff since the last Board Meeting.

Montana Board of Investments

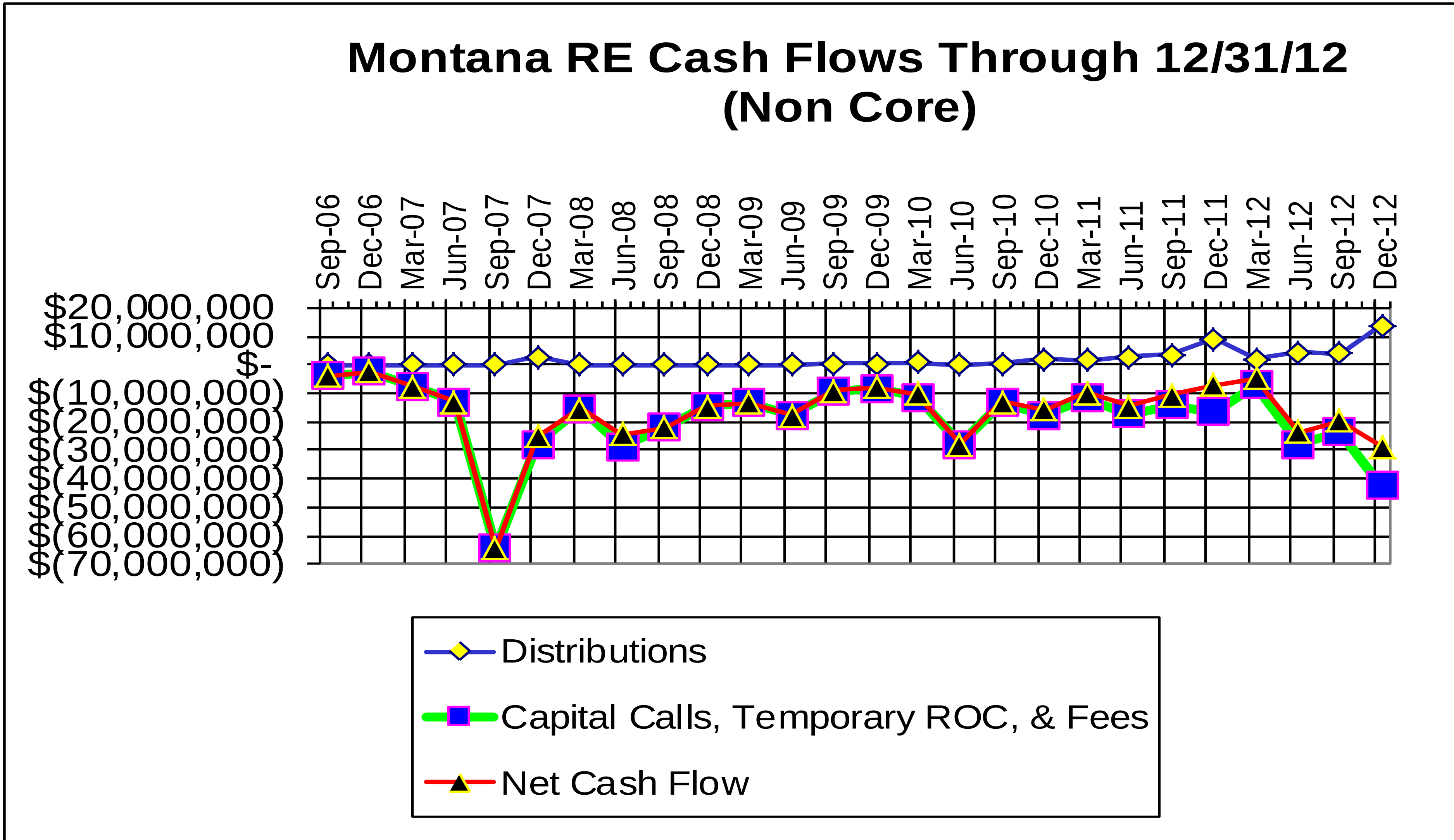
Real Estate Board Report

Q3 2012

Due to, among other things, the lack of a valuation standard in the real estate private equity industry, differences in the pace of investment across funds and the understatement of returns in the early years of a fund's life, the internal rate of return information may not accurately reflect current or expected future returns, and the internal rates of return and all other disclosures with respect to the Partnerships have not been prepared, reviewed or approved by the Partnerships, the General Partners, or any other affiliates.

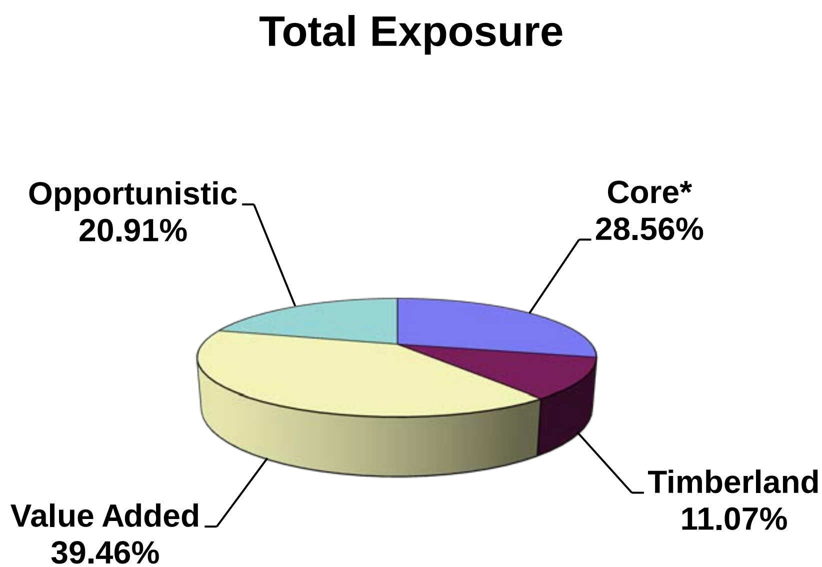
Contents

Quarterly Cash Flows through December 31, 2012



Both capital calls and distributions accelerated in the 4th quarter relative to the 3rd quarter. Though market conditions seem to be improving slightly, net cash flow remains negative which is to be expected until sale activity of the underlying properties held in our closed end fund holdings pick up.

Q3 2012 Strategy – Total Exposure

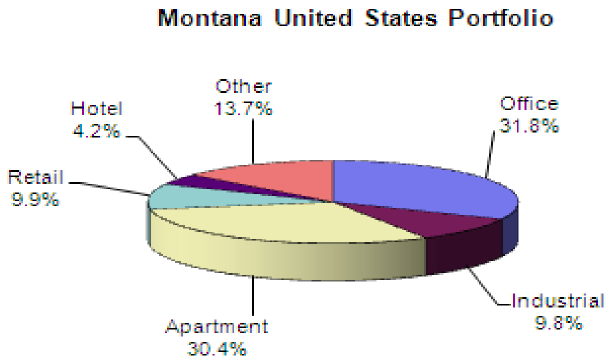


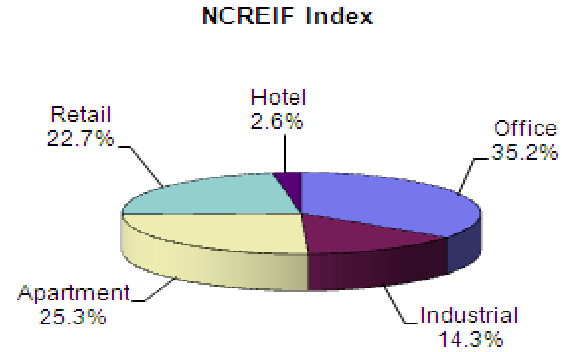
Strategy	Remaining Commitments	Percentage	Net Asset Value	Percentage	Total Exposure	Percentage
Core*	$0	0.00%	$263,389,584	40.22%	$263,389,584	28.56%
Timberland	$53,728,089	20.10%	$48,370,685	7.39%	$102,098,774	11.07%
Value Added	$157,357,645	58.86%	$206,514,665	31.54%	$363,872,309	39.46%
Opportunistic	$56,260,191	21.04%	$136,581,196	20.86%	$192,841,387	20.91%
Total	$267,345,924	100.00%	$654,856,129	100.00%	$922,202,054	100.00%

* Includes MT Office Portfolio

Timberland is the most recent addition to the real estate portfolio and represents approximately 7.4% of the total portfolio's NAV and approximately 11% of the aggregate exposure which includes unfunded commitments. Core real estate dominates assets in the ground at approximately 40% and now includes the directly owned Montana office buildings. Value Added and Opportunistic account for approximately 32% and 21% respectively.

Q3 2012 Property Type – Market Value Exposure





	Office	Industrial	Apartment	Retail	Hotel	Other[2]	Total
Montana US Value[3]	$311.9	$96.4	$298.1	$97.5	$41.5	$134.3	$979.7
Montana US Total	31.8%	9.8%	30.4%	9.9%	4.2%	13.7%	100.0%
NCREIF Value[3,4]	110,772	44,758	79,506	72,025	8,223		$315,285
NCREIF[1]	35.1%	14.2%	25.2%	22.8%	2.6%		100.0%
Difference	-3.3%	-4.4%	5.2%	-12.9%	1.6%	13.7%	
Montana Non-US Value[3]	$38.2	$0.0	$5.7	$8.5	$13.6	$76.6	$142.6
Montana Non-US Total	26.8%	0.0%	4.0%	5.9%	9.5%	53.7%	100.0%
Montana Total Value[3]	$350.1	$96.4	$303.8	$105.9	$55.1	$211.0	$1,122.4
Montana Total[1]	31.2%	8.6%	27.1%	9.4%	4.9%	18.8%	100.0%

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

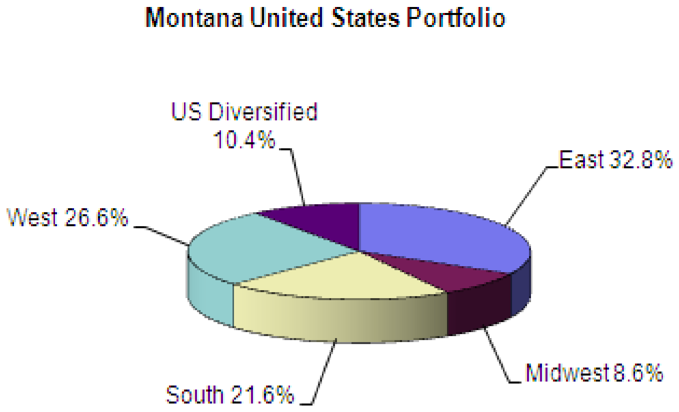
2) Total Other includes $16,657,926 in mixed-use assets, $1,418,942 in healthcare/senior living, $11,516,321 in land, $645,990 in storage, $2,605,822 in debt assets, $179,432 in parking, $9,575,371 in manufactured assets, $44,647,336 in timber and $47,089,784 in other assets.

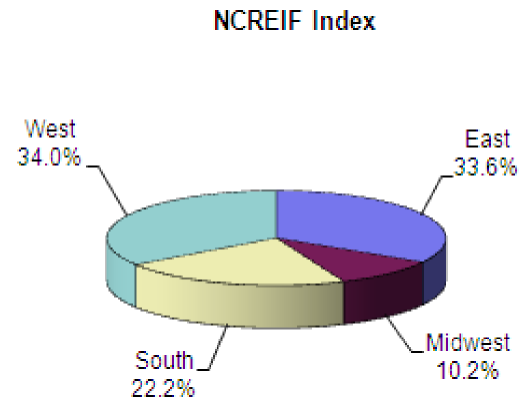
3) Values shown are in Millions.

4) The NCREIF gross market values represent the total gross asset values of the participating funds exclusive of any underlying debt. This amount differs from the index total due to rounding in the NCREIF report.

The real estate portfolio is well diversified across the major property types and is underweight relative to NCREIF in Office, Retail and Industrial and overweight in Apartments and Hotels. At 13.7%, Other represents the portfolio's exposure to Timberland, Mixed-Use properties, Land, Manufactured Housing, Storage, Parking, Senior Living and Healthcare related properties. As has been noted in the past, composition of the portfolio by property type is and will continue to be primarily a function of a manager's expertise and success in sourcing deals rather than a function of staff's desire to over or underweight a specific property type.

Q3 2012 Geography – Total Exposure





	East	Midwest	South	West	US Diverse	Non-US	Total
Montana US Value[2]	$321.2	$84.1	$212.0	$260.9	$101.5		$979.7
Montana US Total[1]	32.8%	8.6%	21.6%	26.6%	10.4%		100.0%
NCREIF Value[2, 3]	105,724	31,452	69,246	108,862			315,285
NCREIF[1]	33.5%	10.0%	22.0%	34.5%			100.0%
Difference	-0.7%	-1.4%	-0.4%	-7.9%	10.4%		
Montana Total Value[2]	$321.2	$84.1	$212.0	$260.9	$101.5	$142.6	$1,122.4
Montana Total[1]	28.6%	7.5%	18.9%	23.2%	9.0%	12.7%	100.0%

1) Diversification percentages are based on the Gross Market Value, which represents the MBOI share of the partnerships' interests in properties exclusive of any underlying debt used to acquire each property.
2) Values shown are in Millions.
3) The NCREIF gross market values represent the total gross asset values of the participating funds exclusive of any underlying debt.

The geographical mix of the real estate portfolio is fairly aligned with NCREIF, although exposure in the West at 26.6% is 7.4% less than the index. 10.4% of the portfolio is broadly diversified across the remainder of the US and the portfolio's international exposure represents 12.7% of the mix.

Q3 2012 Time Weighted & Internal Rates of Return

Time Weighted Returns

	Current Quarter			Year to Date		1 - Year		3 - Year		5 - Year		Inception	
	NAV	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross
Clarion Lion Properties Fund	35,050,308	2.09%	2.33%	7.74%	8.51%	10.79%	11.84%	12.55%	13.68%	1.61%	1.86%	-1.35%	-0.32%
INVESCO Core Real Estate-USA	37,438,311	2.57%	2.80%	5.67%	6.38%	8.70%	9.68%	10.71%	11.70%	1.76%	1.98%	-1.72%	-0.82%
JP Morgan Strategic Properties Fund	110,392,769	3.62%	3.87%	8.55%	9.36%	11.85%	12.97%	11.19%	12.30%	2.98%	3.24%	0.30%	1.32%
UBS-Trumbull Property Fund	62,130,855	2.25%	2.51%	7.17%	8.02%	9.35%	10.50%	-	-	-	-	13.41%	14.44%
Core Total	**245,012,242**	**2.89%**	**3.14%**	**7.63%**	**8.43%**	**10.56%**	**11.66%**	**10.83%**	**11.90%**	**2.23%**	**2.48%**	**0.44%**	**1.45%**
Montana Office Portfolio	**18,377,341**	**0.00%**	**0.00%**	**4.90%**	**4.90%**	**4.90%**	**4.90%**	-	-	-	-	**5.53%**	**5.53%**
Timberland Total	**48,370,685**	**1.69%**	**1.93%**	**0.30%**	**1.02%**	**0.49%**	**1.42%**	-	-	-	-	**3.81%**	**4.59%**
Value Added Total	**206,514,665**	**1.19%**	**1.88%**	**5.57%**	**7.47%**	**8.93%**	**11.33%**	**2.61%**	**4.87%**	**2.16%**	**2.95%**	**0.78%**	**4.06%**
Opportunistic Total	**136,581,196**	**2.05%**	**2.54%**	**8.55%**	**10.11%**	**9.81%**	**11.90%**	**13.59%**	**17.00%**	**-1.26%**	**1.23%**	**-16.35%**	**-12.71%**
Total Portfolio	**654,856,129**	**2.01%**	**2.44%**	**6.66%**	**7.93%**	**9.11%**	**10.77%**	**7.96%**	**9.87%**	**1.66%**	**2.39%**	**-1.29%**	**0.98%**
Benchmark (gross)													
NCREIF	**315,284,562,298**		**2.34%**		**7.81%**		**11.00%**		**10.90%**		**2.27%**		**9.08%**
NFI-ODCE	**86,208,600,000**		**2.77%**		**8.39%**		**11.61%**		**12.19%**		**-1.14%**		**8.31%**

Internal Rates of Return (Net of Fees)

	NAV	Current Quarter	Year to Date	1 - Year	3 - Year	5 - Year	Inception
Montana Office Portfolio	**18,377,341**	**0.00%**	**4.92%**	**4.90%**	-	-	**5.03%**
Molpus Woodlands Fund III, LP	41,568,562	1.63%	1.85%	1.11%	-	-	0.82%
ORM Timber Fund III, LLC	249,108	-16.96%	-	-	-	-	-16.96%
RMS Forest Growth III LP	6,553,015	2.05%	-1.18%	1.32%	-	-	5.13%
Timberland	**48,370,685**	**1.58%**	**0.85%**	**1.04%**	-	-	**2.67%**
ABR Chesapeake Fund III	17,294,305	-1.22%	0.19%	8.42%	1.68%	0.87%	1.40%
ABR Chesapeake Fund IV	9,200,190	-0.95%	1.90%	12.80%	-	-	8.62%
AG Core Plus Realty Fund II	13,082,955	3.11%	6.42%	16.74%	13.55%	7.10%	6.68%
AG Core Plus Realty Fund III	11,031,922	2.04%	4.47%	5.35%	-	-	2.89%
Apollo Real Estate Finance Corp.	5,854,063	1.11%	10.38%	4.49%	-2.73%	-2.79%	-2.89%
AREFIN Co-Invest	3,562,903	3.02%	37.30%	33.11%	8.16%	-	6.71%
CBRE Strategic Partners US Value Fund 6	0	-	-	-	-	-	-
DRA Growth & Income Fund VI	21,175,503	0.30%	2.23%	3.25%	11.26%	5.81%	5.73%
DRA Growth & Income Fund VII	10,895,133	3.17%	11.58%	-	-	-	13.46%
Five Arrows Securities V, L.P.	23,396,249	1.72%	5.32%	11.73%	9.24%	7.93%	7.78%
Hudson RE Fund IV Co-Invest	9,670,716	0.21%	1.00%	1.94%	-0.59%	-	0.52%
Hudson Realty Capital Fund IV	10,418,334	-0.49%	-0.65%	1.87%	-2.06%	-7.01%	-6.74%
Landmark Real Estate Partners VI	9,972,667	4.65%	13.20%	18.62%	-	-	44.78%
Realty Associates Fund IX	20,706,495	1.90%	6.65%	9.80%	-	-	10.39%
Realty Associates Fund VIII	13,478,326	-0.07%	-1.63%	-0.23%	-6.98%	-7.08%	-6.99%
Realty Associates Fund X	0	-	-	-	-	-	-
Stockbridge Value Fund, LP	9,225,324	-3.29%	-	-	-	-	3.30%
Strategic Partners Value Enhancement Fund	17,549,580	1.69%	11.99%	9.92%	-2.74%	-0.02%	-1.19%
Value Added	**206,514,665**	**0.98%**	**5.63%**	**8.91%**	**4.25%**	**1.92%**	**1.74%**
AG Realty Fund VII L.P.	12,928,364	2.35%	6.67%	13.39%	10.74%	-	8.63%
AG Realty Fund VIII L.P.	5,821,413	2.69%	4.36%	6.75%	-	-	1.00%
Beacon Capital Strategic Partners V	10,441,378	-0.68%	5.14%	2.90%	7.94%	-14.27%	-14.32%
Carlyle Europe Real Estate Partners III	21,801,875	3.72%	3.16%	4.11%	7.43%	-	-2.78%
CIM Fund III, L.P.	25,637,419	0.37%	19.48%	19.67%	15.82%	8.89%	7.21%
GEM Realty Fund IV	9,904,647	4.90%	18.64%	20.60%	-	-	14.21%
JER Real Estate Partners - Fund IV	2,660,446	-0.69%	4.58%	4.90%	32.52%	-6.18%	-6.30%
Liquid Realty IV	12,181,793	-0.39%	8.94%	8.68%	8.36%	-1.68%	-3.82%
MGP Asia Fund III, LP	19,525,686	2.42%	2.25%	3.88%	37.51%	-	1.43%
MSREF VI International	6,664,176	2.32%	6.84%	8.92%	14.28%	-29.66%	-29.89%
O'Connor North American Property Partners II	9,013,999	6.63%	11.17%	13.06%	4.91%	-	-13.99%
Opportunistic	**136,581,196**	**2.05%**	**8.46%**	**9.74%**	**14.28%**	**-5.90%**	**-6.32%**
Total	**409,843,887**	**1.36%**	**6.04%**	**8.16%**	**7.45%**	**-1.30%**	**-1.58%**

The portfolio turned in another positive quarter as general real estate market conditions continue to stabilize and show some signs of improvement. Core performance increased relative to Q2 and continues its positive momentum. Value-Added underperformed relative to Q2, but continues its upward trajectory outperforming relative to the prior period's 3yr and ITD periods. Opportunistic outperformed relative to Q2 and continues its upward trajectory outperforming the prior period's 1yr, 3yr and ITD periods. Value-Added and Opportunistic have now reached their 5yr reporting threshold.

Q3 2012 Commitment Summary

	Since Inception										
	Vintage Year	Commitment	Capital Contributed	Contributed %	Remaining Commitment	Capital Distributed	Net Asset Value	NAV %	Total Exposure	Total Exposure%	Investment Multiple
Core		**238,236,254**	**238,236,254**	**100%**	**-**	**21,880,764**	**245,012,242**	**37.41%**	**245,012,242**	**26.57%**	**1.09**
Clarion Lion Properties Fund	2006	48,236,254	48,236,254	100%	-	9,439,121	35,050,308	5.35%	35,050,308	3.80%	0.89
INVESCO Core Real Estate-USA	2007	45,000,000	45,000,000	100%	-	5,639,419	37,438,311	5.72%	37,438,311	4.06%	0.93
JP Morgan Strategic Property Fund	2007	95,000,000	95,000,000	100%	-	1,759,599	110,392,769	16.86%	110,392,769	11.97%	1.15
UBS-Trumbull Property Fund	2010	50,000,000	50,000,000	100%	-	5,042,625	62,130,855	9.49%	62,130,855	6.74%	1.31
Montana Office Portfolio	**2011**	**17,674,045**	**17,674,045**	**100%**	**-**	**621,854**	**18,377,341**	**2.81%**	**18,377,341**	**1.99%**	**1.07**
Timberland		**105,000,000**	**51,271,911**	**49%**	**53,728,089**	**4,191,422**	**48,370,685**	**7.39%**	**102,098,774**	**11.07%**	**1.03**
Molpus Woodlands Fund III, LP	2011	50,000,000	41,350,000	83%	8,650,000	-	41,568,562	6.35%	50,218,562	5.45%	1.01
ORM Timber Fund III, LLC	2012	30,000,000	300,000	1%	29,700,000	-	249,108	0	29,949,108	3.25%	0.83
RMS Forest Growth III LP	2011	25,000,000	9,621,911	38%	15,378,089	4,191,422	6,553,015	1.00%	21,931,104	2.38%	1.12
Value Added		**389,200,000**	**231,842,355**	**60%**	**157,357,645**	**40,422,076**	**206,514,665**	**31.54%**	**363,872,309**	**39.46%**	**1.05**
ABR Chesapeake Fund III	2006	20,000,000	20,000,000	100%	-	3,971,252	17,294,305	2.64%	17,294,305	1.88%	1.06
ABR Chesapeake Fund IV	2010	30,000,000	9,000,000	30%	21,000,000	551,603	9,200,190	1.40%	30,200,190	3.27%	1.06
AG Core Plus Realty Fund II	2007	20,000,000	16,742,334	84%	3,257,666	7,270,011	13,082,955	2.00%	16,340,621	1.77%	1.22
AG Core Plus Realty Fund III	2011	35,000,000	10,850,000	31%	24,150,000	59,984	11,031,922	1.68%	35,181,922	3.81%	1.02
Apollo Real Estate Finance Corp.	2007	10,000,000	10,000,000	100%	-	3,198,390	5,854,063	0.89%	5,854,063	0.63%	0.91
AREFIN Co-Invest	2008	10,000,000	10,000,000	100%	-	7,841,838	3,562,903	0.54%	3,562,903	0.39%	1.14
CBRE Strategic Partners US Value Fund 6	2012	20,000,000	-	-	20,000,000	-	-	-	-	-	-
DRA Growth & Income Fund VI	2007	35,000,000	21,140,000	60%	13,860,000	6,297,187	21,175,503	3.23%	35,035,503	3.80%	1.19
DRA Growth & Income Fund VII	2011	30,000,000	10,473,000	35%	19,527,000	294,222	10,895,133	1.66%	30,422,133	3.30%	1.05
Five Arrows Securities V, L.P.	2007	30,000,000	23,385,046	78%	6,614,954	4,254,971	23,396,249	3.57%	30,011,202	3.25%	1.16
Hudson RE Fund IV Co-Invest	2008	10,000,000	10,000,000	100%	-	553,261	9,670,716	1.48%	9,670,716	1.05%	1.02
Hudson Realty Capital Fund IV	2007	15,000,000	15,000,000	100%	-	244,542	10,418,334	1.59%	10,418,334	1.13%	0.71
Landmark Real Estate Partners VI	2011	20,000,000	8,207,186	41%	11,792,814	2,065,943	9,972,667	1.52%	21,765,481	2.36%	1.46
Realty Associates Fund IX	2008	20,000,000	19,200,000	96%	800,000	2,351,652	20,706,495	3.16%	21,506,495	2.33%	1.20
Realty Associates Fund VIII	2007	20,000,000	20,000,000	100%	-	852,819	13,478,326	2.06%	13,478,326	1.46%	0.72
Realty Associates Fund X	2012	20,000,000	-	-	20,000,000	-	-	-	20,000,000	2.17%	0.00
Stockbridge Value Fund, LP	2011	25,000,000	8,644,789	35%	16,355,211	-	9,225,324	-	25,580,535	2.77%	1.03
Strategic Partners Value Enhancement Fund	2007	19,200,000	19,200,000	100%	-	614,400	17,549,580	2.68%	17,549,580	1.90%	0.95
Opportunistic		**248,008,422**	**194,248,231**	**78%**	**56,260,191**	**27,569,529**	**136,581,196**	**20.86%**	**192,841,387**	**20.91%**	**0.82**
AG Realty Fund VII L.P.	2007	20,000,000	15,854,000	79%	4,146,000	6,559,231	12,928,364	1.97%	17,074,364	1.85%	1.23
AG Realty Fund VIII L.P.	2011	20,000,000	8,400,000	42%	11,600,000	2,648,282	5,821,413	0.89%	17,421,413	1.89%	1.01
Beacon Capital Strategic Partners V	2007	25,000,000	20,500,000	82%	4,500,000	464,109	10,441,378	1.59%	14,941,378	1.62%	0.53
Carlyle Europe Real Estate Partners III	2007	30,994,690	23,496,582	76%	7,498,108	167,861	21,801,875	3.33%	29,299,983	3.18%	0.92
CIM Fund III, L.P.	2007	25,000,000	20,475,842	82%	4,524,158	279,080	25,637,419	3.91%	30,161,577	3.27%	1.15
GEM Realty Fund IV	2009	15,000,000	9,000,000	60%	6,000,000	330,245	9,904,647	1.51%	15,904,647	1.72%	1.13
JER Real Estate Partners - Fund IV	2007	20,000,000	17,000,994	85%	2,999,006	10,555,791	2,660,446	0.41%	5,659,452	0.61%	0.78
Liquid Realty IV	2007	22,013,732	18,818,202	85%	3,195,530	5,829,013	12,181,793	1.86%	15,377,322	1.67%	0.87
MGP Asia Fund III, LP	2007	30,000,000	18,647,200	62%	11,352,800	35,146	19,525,686	2.98%	30,878,486	3.35%	1.05
MSREF VI International	2007	25,000,000	27,500,000	110%	-	17,313	6,664,176	1.02%	6,664,176	0.72%	0.24
O'Connor North American Property Partners II	2008	15,000,000	14,555,411	97%	444,589	683,457	9,013,999	1.38%	9,458,588	1.03%	0.65
Montana Real Estate		**998,118,721**	**733,272,797**	**73%**	**267,345,924**	**94,685,646**	**654,856,129**		**922,202,054**		**1.00**

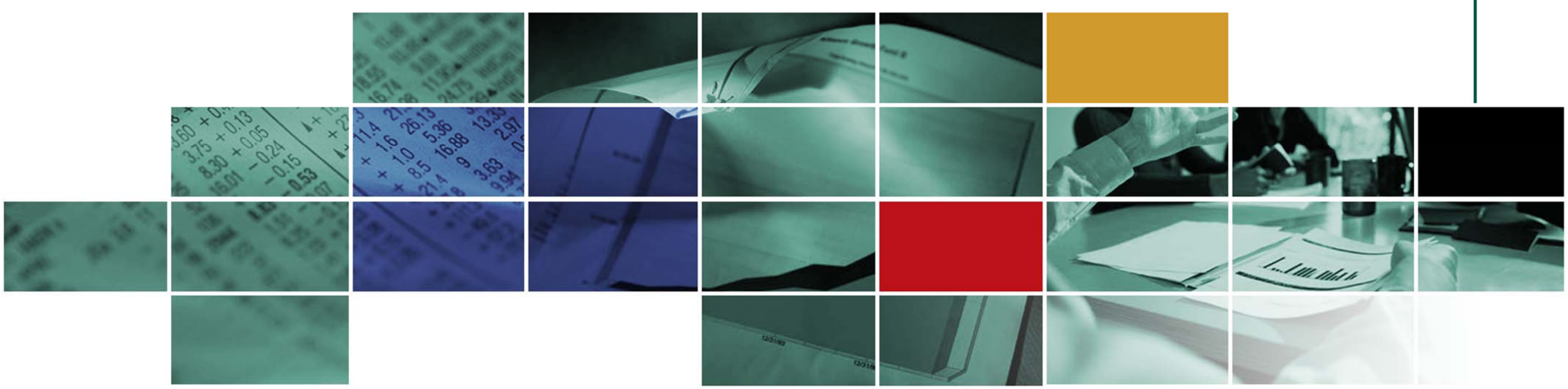
Additions to the Commitment Summary include a $20M commitment to CBRE Strategic Partners US Value Fund 6, LP.

RVKuhns & ASSOCIATES, INC.

Securities Lending Programs

Montana Board of Investment

February 26, 2013



Overview of Securities Lending

- Securities lending is a commonly-used investment strategy in which institutional investors make short-term loans of their otherwise idle securities to earn supplemental income.

- Loan results in a transfer of title to the borrower, who is obligated to return the same security at a later date.

- Incremental amounts of income can be generated but associated risk-factors must be monitored closely.

Benefits to Borrowers

Borrowers borrow securities primarily to facilitate settlement, create short positions, or obtain title and temporary ownership for market purposes. Common borrowers include:

- Market makers needing inventory of securities for settlement and to facilitate short sales or shortened settlement.

- Prime Brokers that need to provide inventory to arbitrageurs seeking to exploit differential tax treatment on dividends for non-US securities.

Benefits to Lenders

Securities lending is used by the lending party to increase the total return or yield of a portfolio.

- Although not required to be used for such payments, some programs use securities lending income to pay operational expenses such as custodial banking fees.

- Our client experience has been generally 3-5 basis points annually, depending on portfolio composition.

How Does it Work?

Securities Lending in Brief

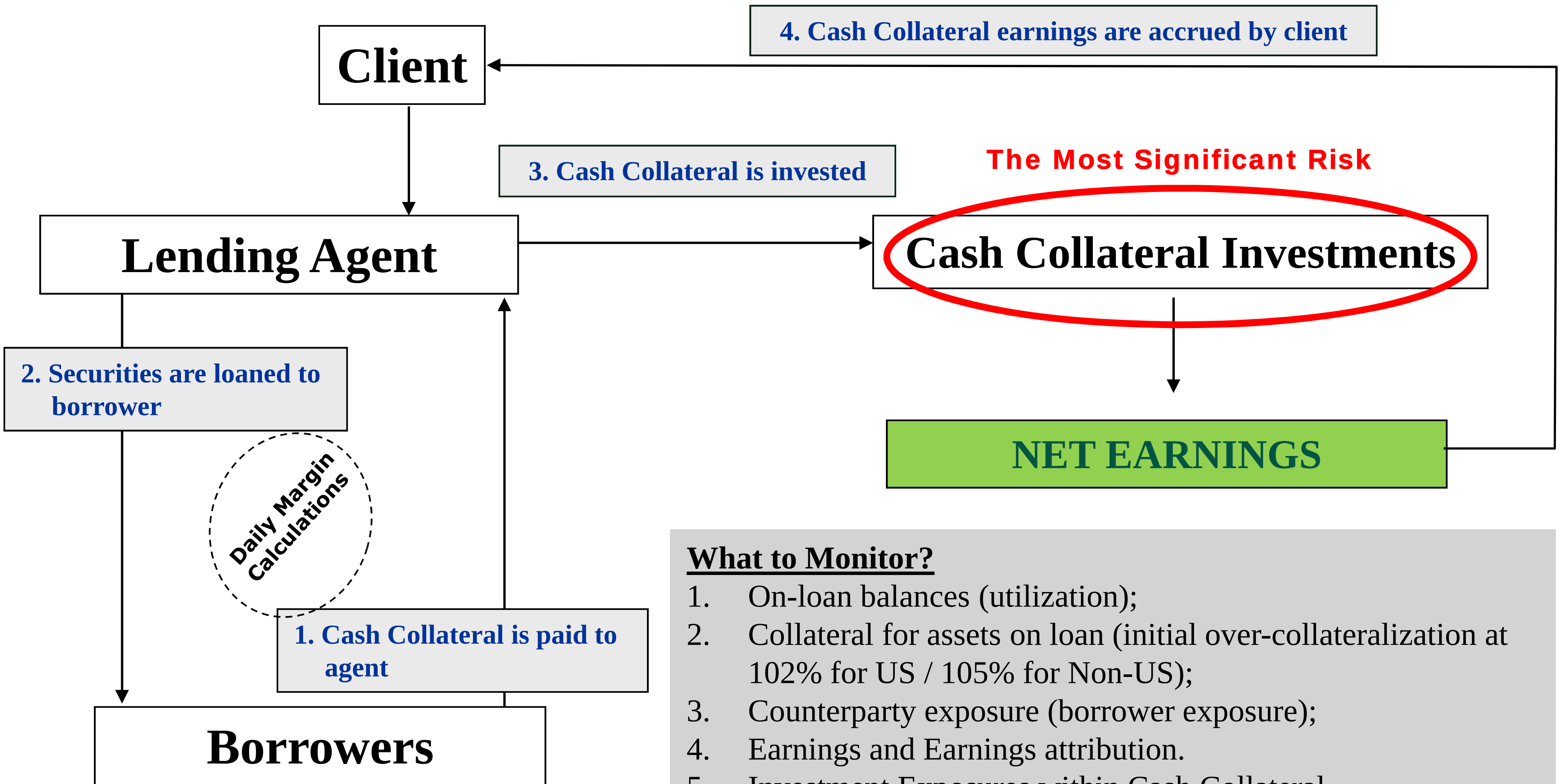
❶ Participants in securities lending programs temporarily lend their securities to borrowers such as market-makers, hedge funds, and other financial institutions through a lending agent.

❷ Borrowers deliver temporary collateral to lender (or agent) for securities borrowed in exchange for a negotiated rebate – generally a rate equal to a negative spread to a risk-free rate, such as Fed Funds. Positions are over-collateralized and marked to market daily (typically 102% for domestic & 105% for international).

❸ Lenders invest the cash proceeds according to investment guidelines to earn a yield that is expected to produce a profit.

❹ The total return to securities lending programs is based on achieving a positive spread on a daily basis between the rate earned on collateral investments and the required interest payment to the borrower.

Securities Lending Process Diagram



What to Monitor?

1. On-loan balances (utilization);
2. Collateral for assets on loan (initial over-collateralization at 102% for US / 105% for Non-US);
3. Counterparty exposure (borrower exposure);
4. Earnings and Earnings attribution.
5. Investment Exposures within Cash Collateral
   - Asset Class & Maturity Exposure
   - Liquidity & Fundamental Risk
   - Mark-to-Market NAV

* Non-cash loans are made as permitted by lending agents who take a non-cash security interest and a negotiated fee from the borrower of securities.

RVKuhns & ASSOCIATES, INC.

Securities Lending Example

Income Summary

Gross Revenue	$	7,650
Rebate (to Borrower)	$	(6,630)
Net Revenue	$	1,020
Revenue (to Agent)	$	(204)
Net Income	**$**	**816**
Net Income (bps)		**8.16 bps**

Assumptions

Avg Value of Securities	$1,000,000
Collateral Value	$1,020,000
Loan Term	365 days
Avg Rebate	0.65%
Avg Collateral Yield	0.75%
Revenue Split	80/20

Securities Lending Risks

- **Borrower Default**—Borrower fails to return securities due to bankruptcy/insolvency.
- **Operational Errors**—Interest/dividends are not posted accurately, delivery fails, failure to adequately mark to market occurs
- **Collateral Investment Losses**—Cash Investment yield underperforms current rebate yield or principal loss occurs. The client is generally NOT indemnified against losses on investments

Staff Monitoring

Monitoring should involved periodic review of the securities lending program with the lending agent. Evaluation items should include, but may not be limited to:

- ☑ Lending volumes
- ☑ Cash & non cash collateral usage
- ☑ Adherence to sufficient collateral levels
- ☑ Reinvestment pool guidelines – liquidity and weighted average maturity levels
- ☑ Counterparty (borrower) exposure (ideally agent indemnifies MBOI against borrower default)
- ☑ Earnings, earnings attribution, fees, and revenue split
- ☑ Any trade fails due to lending activity
- ☑ Market/program changes

Conclusion

- Securities lending program can deliver incremental revenue to plan participants.

- A securities lending program is not without risk; staff's ongoing review of lending program and associated characteristics with agent and consultants is prudent.

- CIO also considers the securities lending program when considering asset allocation changes.

MEMORANDUM

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

To: Board Members

From: Cliff Sheets, CFA, Chief Investment Officer

Date: February 27, 2013

Subject: Securities Lending Update

The following presentation from State Street Securities Finance provides a history of the securities lending activity and earnings for the MBOI.

The purpose of this memo is to explain more about the collateral used to secure loans and the background related to the State Street cash collateral pools. As explained in the RVK educational summary, when a security is loaned out, the borrower must provide collateral of at least 102% of the market value of the loan. This collateral can be in the form of cash or non-cash (i.e., securities that meet certain requirements). If cash collateral is received it is invested in a short-term investment portfolio until the security loan is terminated. One of the underlying risks of a securities lending program is the investment risk imbedded in the cash collateral investment portfolio. This discussion focuses on the cash collateral investment portfolios managed by State Street that are used to secure any MBOI "cash loans."

State Street provides commingled investment portfolios for the investment of cash collateral by their securities lending clients. The investment portfolio used for cash collateral on loans from the pension accounts is called Quality D, and the investment portfolio used for cash collateral on loans from the non-pension accounts is called SLQT. Within each of these portfolios are two subcomponents, the Liquidity component and the Duration component. Think of these as sub-portfolios which have different characteristics. The Liquidity component is invested in highly liquid, high quality money market assets, much like a money market fund, whereas the Duration component holds longer duration assets.

As background, it is important to understand the origin of the Liquidity and Duration components. Prior to the GFC, State Street, similar to many of its peers, invested cash collateral in assets that were perceived to be of high quality and short duration. These assets were thought to have naturally high liquidity by virtue of their short maturities or short expected average lives, in the case of amortizing structures, such as various asset-backed securities (ABS). However, in the wake of the housing crisis and general deterioration in consumer credit quality and the ability to refinance, many of the housing-related ABS suffered significant maturity extensions in their expected average lives. As a result, the prices of these securities declined and their natural liquidity by virtue of their pay down structure was compromised.

The effect on the ABS positions, along with the general illiquidity and quality concerns impacting other assets in the investment portfolios, caused these portfolios to be marked at less than par, or less than 100, beginning in late 2007 and continuing into 2010. Because of the obligation to return 100 cents on the dollar (plus any promised rebate) of cash collateral received upon the termination of a securities loan, the unrealized losses in the portfolios made it difficult to satisfy the objectives of these collateral pools. Some asset owners (lenders) wanted out of the program completely in an effort to avoid potential realized losses. Lenders leaving the program, creating a "run on the bank" scenario, would indirectly harm remaining lenders in these portfolios. At the time, in order to protect all lending clients, State Street restricted lenders' ability to leave the securities lending program without taking a pro rata slice of all the underlying assets held in the investment portfolios. State Street's intent was to maintain relative stability in the investment portfolios. The result, however, compromised the ability of lenders to make overall asset allocation changes which would directly impact the securities lending program.

As the credit markets gradually recovered in 2009-2010, with the exception of the ABS positions, so too did the underlying invested assets held in the cash collateral portfolios. State Street wanted to allow more liquidity options for lenders and eventually lifted the freeze on assets enrolled in the securities lending program that were tied up in the cash collateral pools. However, before doing so, in December 2010, they divided each portfolio into two components, the Liquidity and Duration components. Initially these components represented about an 80/20 split of the assets of each portfolio, Quality D and SLQT. Lenders had ready access to the Liquidity portion of the portfolio and could withdraw funds at 100 cents on the dollar, but were restricted from withdrawing their cash from the Duration component because the underlying assets were still trading at less than 100% of NAV.

Today the liquidity in the collateral pools has improved as the securities held in the Duration components continue to pay down. As these maturities occur the cash is transferred from the Duration component to the Liquidity component of the portfolios. As of year-end the SLQT portfolio held a Duration component that represented 5.8% of the total. For the Quality D portfolio, the Duration component represented 8.9%.

The market values on the underlying securities held in the Duration components have generally increased with time, as shown in the State Street presentation. The balances of these Duration components are expected to continue to decline as pay downs on the underlying assets continue. In both portfolios, the forecasted maturities in the Duration components are about 55% over the next three years. State Street continues to believe that the assets held in both Duration components will eventually be fully repaid. Until that happens, though, this portion of the collateral pools is expected to remain restricted to any redemptions, unless an owner (lender) wishes to take their pro rata slice of the underlying securities held and liquidate them on their own, suffering any potential losses outside of the funds.

In summary, the history of the cash collateral portfolios at State Street is complicated. To the credit of the investment managers of these portfolios, no defaults have been experienced, however they were not immune from the extension risk that impacted most housing related ABS. As a result there remains an illiquid component to our cash collateral investment exposure which continues to be marked at less than par. The degree of exposure is relatively minor and continues to diminish as the underlying assets held continue to mature.

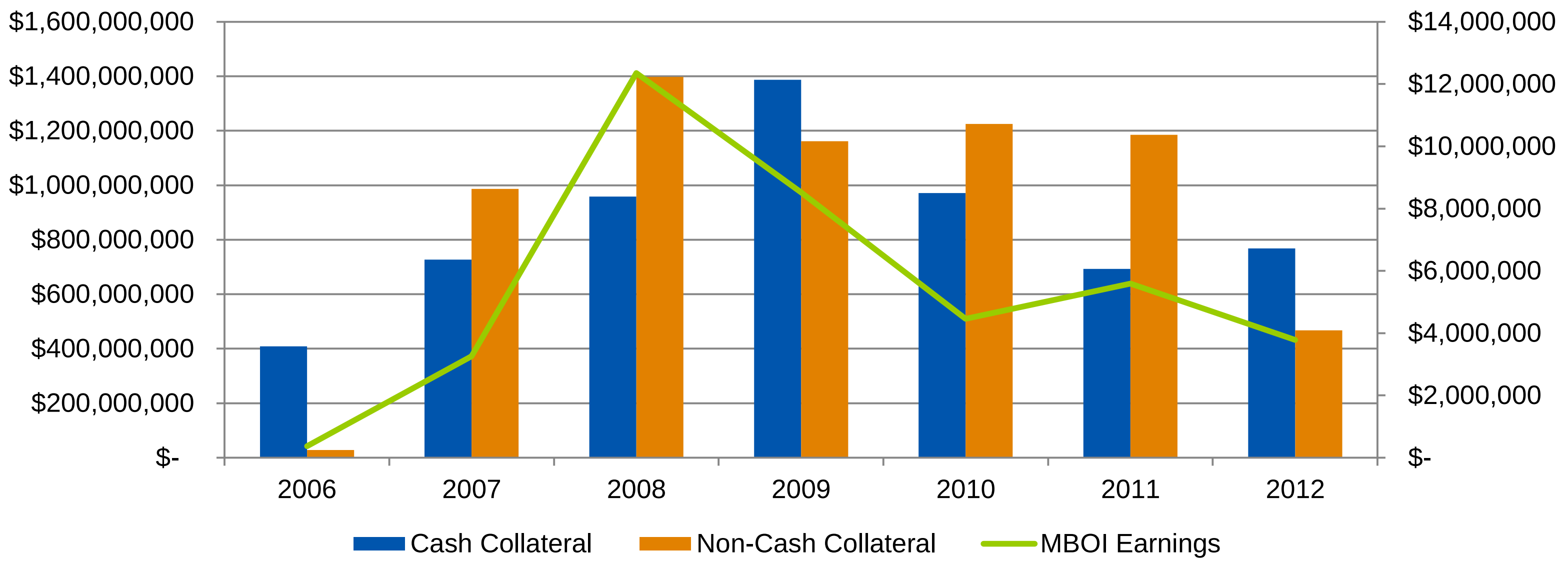
Montana Board of Investments

Securities Finance Overview

February 2013

Performance Summary

Cash vs. Non-Cash Collateral Balances



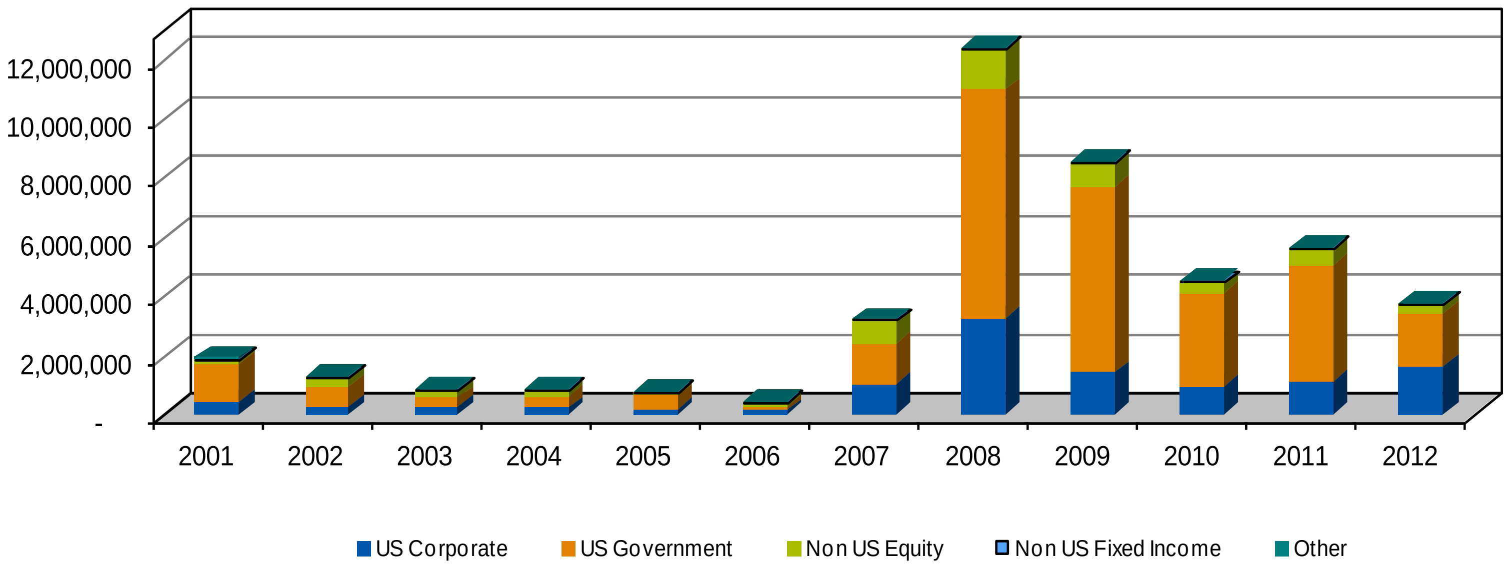
	2006	2007	2008	2009	2010	2011	2012
Cash Collateral	$408,102,669	$726,540,400	$958,575,049	$1,387,182,814	$971,505,399	$692,644,489	$767,583,567
Non-Cash Collateral	$28,090,282	$986,700,970	$1,397,278,471	$1,161,471,200	$1,224,623,500	$1,185,149,531	$467,107,138
MBOI Earnings	$374,357	$3,258,929	$12,357,161	$8,517,479	$4,461,041	$5,589,041	$3,776,825

Source: my.statestreet.com
Performance data shown represents past performance and is not a guarantee of future results

Currency reflected in U.S. dollars

Performance Summary

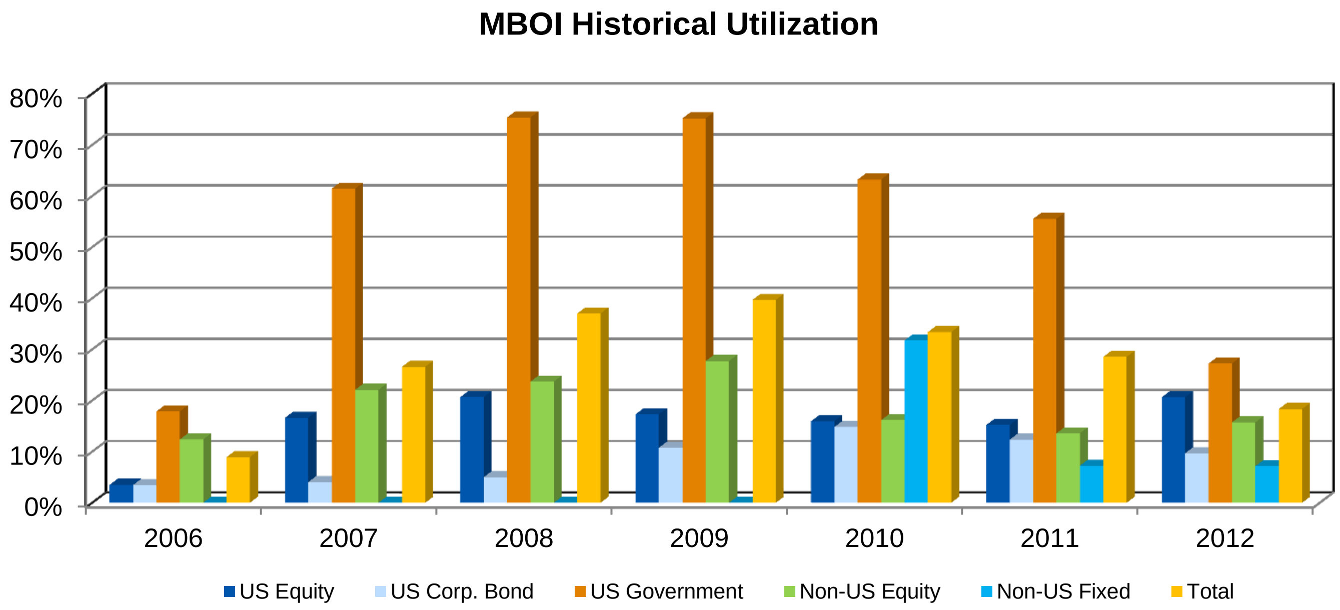
Historical Earnings



Source: my.statestreet.com
Performance data shown represents past performance and is not a guarantee of future results

Currency reflected in U.S. dollars

Performance Summary
Utilization By Asset Class



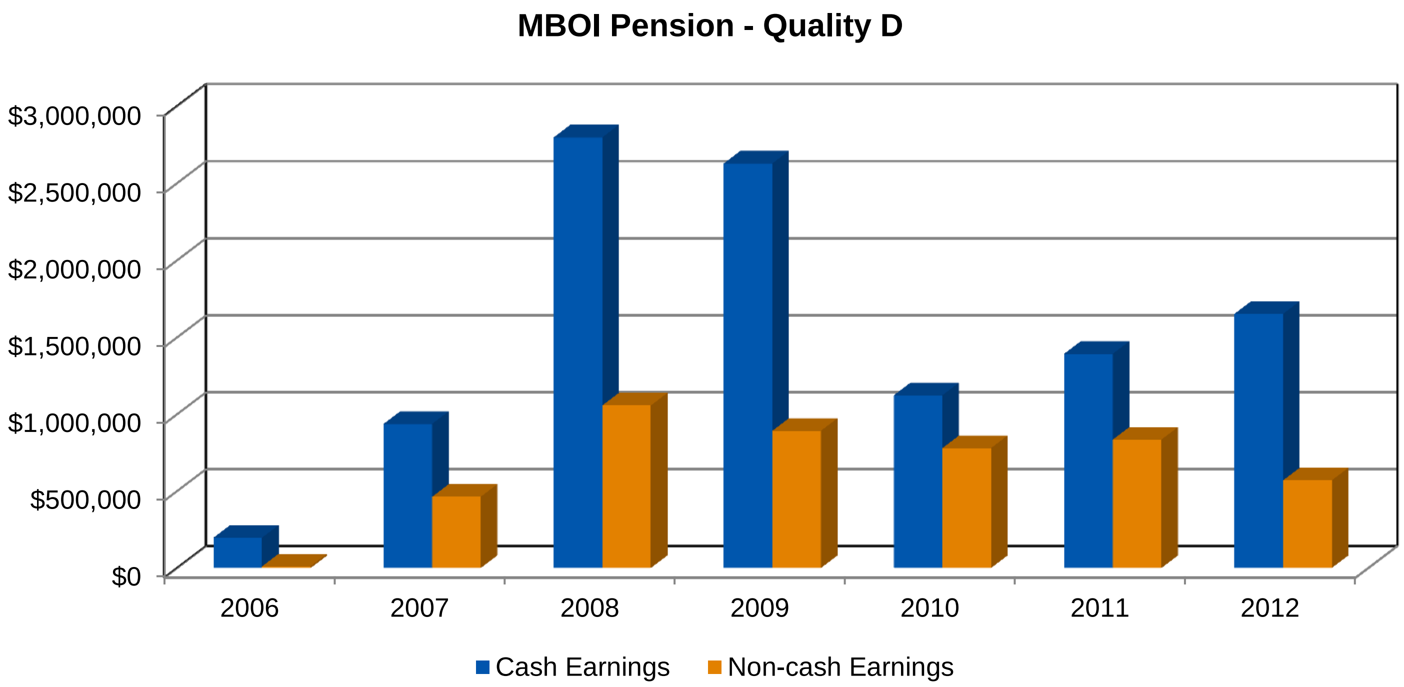
MBOI - All Assets	2006	2007	2008	2009	2010	2011	2012
US Equity	3.52%	16.62%	20.68%	17.32%	15.93%	15.21%	20.64%
US Corp. Bond	3.46%	4.05%	5.00%	10.78%	14.82%	12.34%	9.68%
US Government	17.87%	61.45%	75.37%	75.20%	63.23%	55.54%	27.24%
Non-US Equity	12.39%	22.10%	23.70%	27.73%	16.15%	13.59%	15.72%
Non-US Fixed	0.00%	0.00%	0.00%	0.00%	31.73%	7.25%	7.15%
Total	8.93%	26.59%	37.02%	39.69%	33.38%	28.54%	18.34%

Source: my.statestreet.com
Performance data shown represents past performance and is not a guarantee of future results

Currency reflected in U.S. dollars

Performance Summary

Cash vs. Non-Cash Earnings – Pension



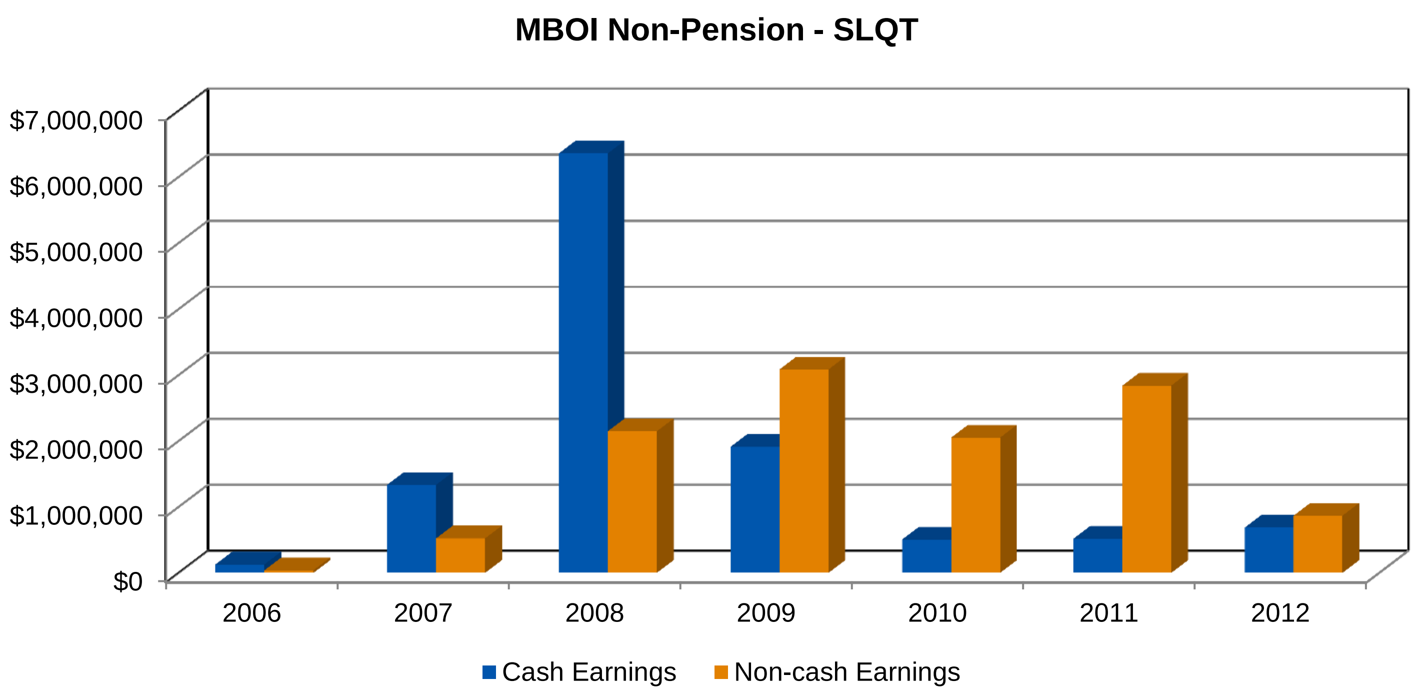
MBOI - Pension	2006	2007	2008	2009	2010	2011	2012
Cash Earnings	$197,005	$937,462	$2,797,003	$2,628,229	$1,124,163	$1,393,593	$1,653,368
Non-cash Earnings	$10,573	$463,371	$1,057,539	$892,920	$780,257	$835,344	$570,293
Total	$207,579	$1,400,833	$3,854,542	$3,521,149	$1,904,420	$2,228,937	$2,223,661

Source: my.statestreet.com
Performance data shown represents past performance and is not a guarantee of future results

Currency reflected in U.S. dollars

Performance Summary

Cash vs. Non-Cash Earnings – Non-Pension



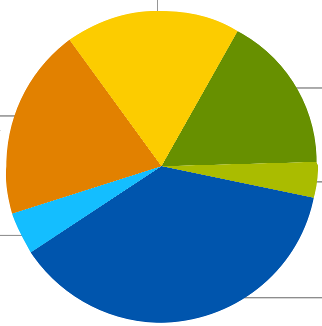
MBOI - Non-Pension	2006	2007	2008	2009	2010	2011	2012
Cash Earnings	$127,424	$1,334,596	$6,355,432	$1,910,513	$504,870	$519,069	$685,890
Non-cash Earnings	$39,355	$523,499	$2,147,187	$3,085,817	$2,051,751	$2,841,035	$867,274
Total	$166,779	$1,858,095	$8,502,619	$4,996,330	$2,556,621	$3,360,104	$1,553,164

Source: my.statestreet.com
Performance data shown represents past performance and is not a guarantee of future results

Currency reflected in U.S. dollars

FC14 — Quality D
Summary Characteristics

As of December 31, 2012	
1-Day Yield[1]	0.38%
Shares Outstanding (in millions)	10,548.98
Floating Rate	38.53
Foreign Issuers[2]	21.67
Weighted Average Maturity (WAM)[3]	33
Weighted Average Life (WAL)[4]	71
Fund Price as of 12/31/12	1.00
Number of Holdings	64



Liquidity Schedule	% of Fund
Next Business Day (2 Day)	9.97
3-7 Days Liquidity	1.67
8-14 Days Liquidity	2.14
15-21 Days Liquidity	7.38
22-28 Days Liquidity	14.80
29-35 Days Liquidity	15.41
36-60 Days Liquidity	14.99
61-90 Days Liquidity	7.17
Greater than 90 Days Liquidity	26.47
90 Day Liquidity	**73.53**

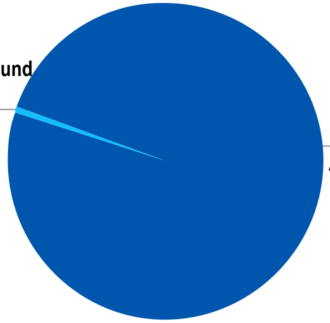
Long-term Ratings	% of Fund
AAA	—
AA	8.81
A	4.00
BBB+	—
BBB	—
BBB-	—
BB+	—
BB	—
BB-	—

Short-term Ratings	% of Fund
A-1+/P-1	19.50
A-1/P-1	64.50
SPLIT	—
Other	3.18

Source: SSgA, Bloomberg. Ratings are from Bloomberg and are S&P. Past performance is not a guarantee of future results.
1. 1 Day yield does not include Management Fees
2. All YCD's and Repo are being reported as Domestic and thus not included in the % Foreign Issuers
3. Weighted Average Maturity (WAM): aggregation of WAM of underlying securities in fund defined as (1) Floating rate securities: Next Reset Date - Current Date; (2) Fixed Rate: Maturity Date - Current Date defined in days
4. Weighted Average Life (WAL): aggregation of WAL of underlying securities in fund defined as (1) Floating rate securities: Expected Maturity Date - Current Date; (2) Fixed Rate: Expected Maturity Date - Current Date (defined in days)

FC4J — Quality D Duration
Summary Characteristics

As of December 31, 2012	
1-Day Yield[1]	0.47%
Shares Outstanding (in millions)	1,030.59
Floating Rate	99.44
Foreign Issuers[2]	75.64
Weighted Average Maturity (WAM)[3]	41
Weighted Average Life (WAL)[4]	1,924
Fund Price as of 12/31/12	0.95
Number of Holdings	38



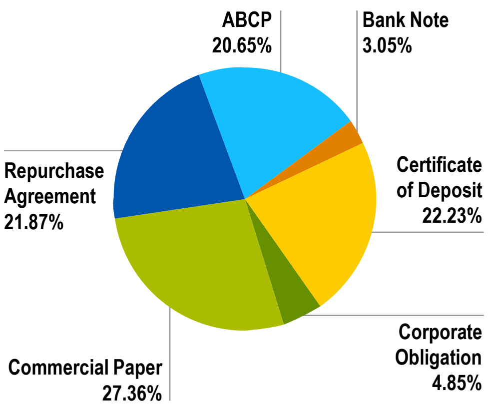
Liquidity Schedule	% of Fund
Next Business Day (3 Day)	0.56
4-7 Days Liquidity	0.00
8-14 Days Liquidity	0.00
15-21 Days Liquidity	0.00
22-28 Days Liquidity	0.00
29-35 Days Liquidity	0.00
36-60 Days Liquidity	0.00
61-90 Days Liquidity	0.00
Greater than 90 Days Liquidity	99.44
90 DAY LIQUIDITY	**0.56**

Long-term Ratings	% of Fund
AAA	19.06
AA	40.09
A	31.08
BBB+	—
BBB	7.24
BBB-	—
BB+	—
BB	—
BB-	—
Short-term Ratings	**% of Fund**
A-1+/P-1	—
A-1/P-1	—
SPLIT	—
Other	2.54

Source: SSgA, Bloomberg. Ratings are from Bloomberg and are S&P. Past performance is not a guarantee of future results.
1. 1 Day yield does not include Management Fees
2. All YCD's and Repo are being reported as Domestic and thus not included in the % Foreign Issuers
3. Weighted Average Maturity (WAM): aggregation of WAM of underlying securities in fund defined as (1) Floating rate securities: Next Reset Date - Current Date; (2) Fixed Rate: Maturity Date - Current Date defined in days
4. Weighted Average Life (WAL): aggregation of WAL of underlying securities in fund defined as (1) Floating rate securities: Expected Maturity Date - Current Date; (2) Fixed Rate: Expected Maturity Date - Current Date (defined in days)

FC12 — Securities Lending Quality Trust Fund
Summary Characteristics

As of December 31, 2012	
1-Day Yield[1]	0.30%
Shares Outstanding (in millions)	1,328.70
Floating Rate	46.44
Foreign Issuers[2]	22.71
Weighted Average Maturity (WAM)[3]	33
Weighted Average Life (WAL)[4]	56
Fund Price as of 12/31/12	1.00
Number of Holdings	46



Liquidity Schedule	% of Fund
Next Business Day (2 Day)	13.11
3-7 Days Liquidity	2.67
8-14 Days Liquidity	3.98
15-21 Days Liquidity	4.11
22-28 Days Liquidity	16.69
29-35 Days Liquidity	12.95
36-60 Days Liquidity	20.10
61-90 Days Liquidity	10.48
Greater than 90 Days Liquidity	15.92
90 DAY LIQUIDITY	**84.08**

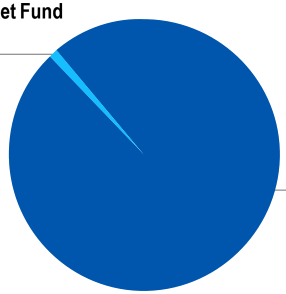
Long-term Ratings	% of Fund
AAA	—
AA	2.14
A	4.23
BBB+	—
BBB	—
BBB-	—
BB+	—
BB	—
BB-	—

Short-term Ratings	% OF FUND
A-1+/P-1	16.16
A-1/P-1	77.48
SPLIT	—
Other	—

Source: SSgA, Bloomberg. Ratings are from Bloomberg and are S&P. Past performance is not a guarantee of future results.
1. 1 Day yield does not include Management Fees
2. All YCD's and Repo are being reported as Domestic and thus not included in the % Foreign Issuers
3. Weighted Average Maturity (WAM): aggregation of WAM of underlying securities in fund defined as (1) Floating rate securities: Next Reset Date - Current Date; (2) Fixed Rate: Maturity Date - Current Date defined in days
4. Weighted Average Life (WAL): aggregation of WAL of underlying securities in fund defined as (1) Floating rate securities: Expected Maturity Date - Current Date; (2) Fixed Rate: Expected Maturity Date - Current Date (defined in days)

FC4A — SLQT Duration
Summary Characteristics

As of December 31, 2012	
1-Day Yield[1]	0.30%
Shares Outstanding (in millions)	80.72
Floating Rate	98.98
Foreign Issuers[2]	96.53
Weighted Average Maturity (WAM)[3]	34
Weighted Average Life (WAL)[4]	688
Fund Price as of 12/31/12	0.98
Number of Holdings	19

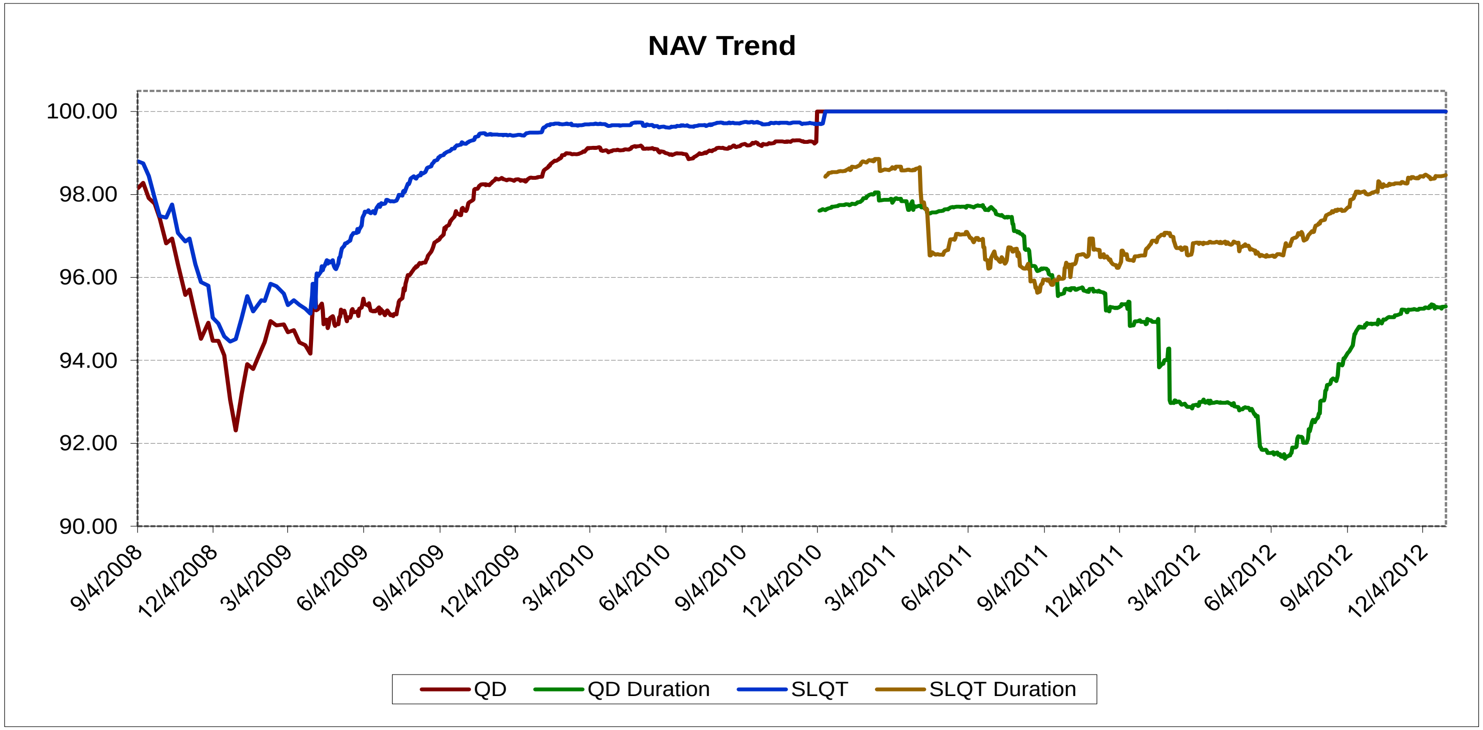


Liquidity Schedule	% of Fund
Next Business Day (2 Day)	1.02
3-7 Days Liquidity	0.00
8-14 Days Liquidity	0.00
15-21 Days Liquidity	0.00
22-28 Days Liquidity	0.00
29-35 Days Liquidity	0.00
36-60 Days Liquidity	0.00
61-90 Days Liquidity	0.00
Greater than 90 Days Liquidity	98.98
90 Day Liquidity	**1.02**

Long-term Ratings	% of Fund
AAA	41.19
AA	—
A	55.34
BBB+	—
BBB	—
BBB-	—
BB+	—
BB	—
BB-	—
Short-term Ratings	**% of Fund**
A-1+/P-1	—
A-1/P-1	—
SPLIT	—
Other	3.47

Source: SSgA, Bloomberg. Ratings are from Bloomberg and are S&P. Past performance is not a guarantee of future results.
1. 1 Day yield does not include Management Fees
2. All YCD's and Repo are being reported as Domestic and thus not included in the % Foreign Issuers
3. Weighted Average Maturity (WAM): aggregation of WAM of underlying securities in fund defined as (1) Floating rate securities: Next Reset Date - Current Date; (2) Fixed Rate: Maturity Date - Current Date defined in days
4. Weighted Average Life (WAL): aggregation of WAL of underlying securities in fund defined as (1) Floating rate securities: Expected Maturity Date - Current Date; (2) Fixed Rate: Expected Maturity Date - Current Date (defined in days)

Historical NAV Trend



- Quality D Portfolio bifurcation to Quality D Liquidity and Quality Duration on 12/6/2010
- SLQT Portfolio bifurcation to SLQT Liquidity and SLQT Duration on 12/13/2010

Source: my.statestreet.com
Performance data shown represents past performance and is not a guarantee of future results

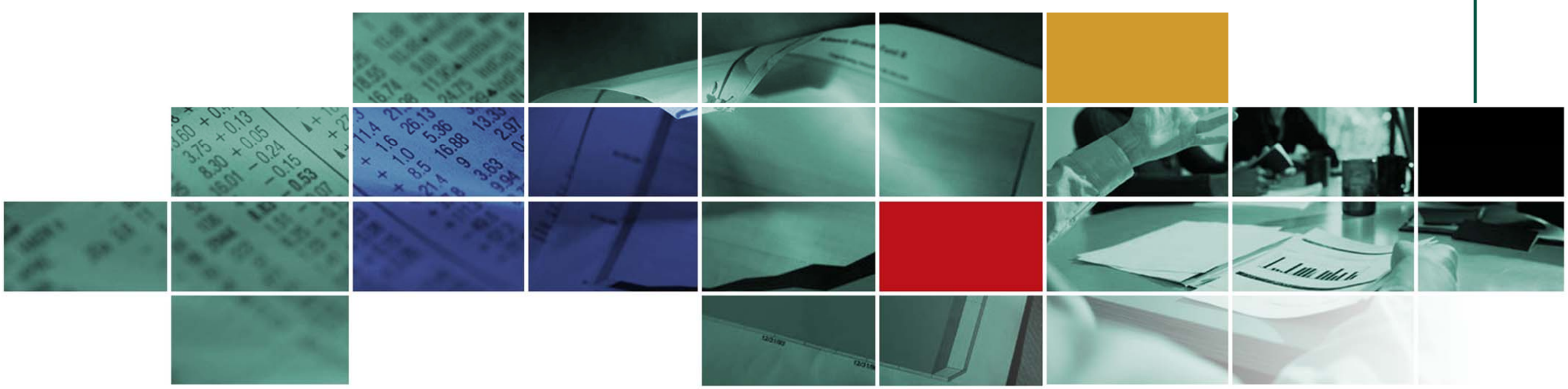
Currency reflected in U.S. dollars

RVKuhns & ASSOCIATES, INC.

Benchmarking Overview: Measuring Portfolio Management Effectiveness

Montana Board of Investments

February 26, 2013



What are performance benchmarks?

CFA Criteria for an Effective Benchmark

- Specified in advance
- Appropriate
- Measurable
- Unambiguous
- Reflective of current investment options
- Accountable
- Investable

Example of a Strong Benchmark

Benchmark:	S&P 500 Index
Type:	U.S. Large/Mid Cap Equity
Underlying Holdings:	Common stock in large and mid cap companies that covers approximately 75% of U.S. public equities.

Performance Against the CFA Criteria:

1. **Specified in advance**—The S&P 500 Index has existed since the mid 1900s, and it can easily be specified in advance of investing in a manager.
2. **Appropriate**—Appropriateness is determined by the strategy against which a manager (or group of managers) is measured. This would depend on how it is used by MBOI.
3. **Measurable**—Performance of the S&P 500 is reported continuously during equity market hours and clearly meets the measurability standard.
4. **Unambiguous**—The S&P 500 index includes a clearly defined universe of equity securities.
5. **Reflective of current investment options—**This would depend on the manager that is being benchmarked.
6. **Accountable—**Relevant managers would accept accountability for performance against the benchmark if it is appropriate for their strategy.
7. **Investable**—Investors can invest easily in an inexpensive S&P 500 index fund thereby gaining full exposure to the index.

Performance "Benchmarking" Involves More than Market Indexes

MBOI Performance Measurement Toolbox

1. Actuarially Required Rate of Return	Return rate that the actuary assumes must be met to maintain the required level of funded status.
2. Market Indices	Standardized benchmark against which performance of individual funds or asset class composites are measured. • **Example: S&P 1500 Index**
3. Peer Ranking	Percentile based measurement where funds or composites are ranked within a "universe" of managers or peer group possessing a similar investment style. • **Examples: (1) All Public Plans > $3 Billion** **(2) IM Large Cap Growth Median**
4. Target Allocation Index	A high level measurement where asset classes are assigned an appropriate index benchmark and weighted according to the Plan's target allocation
5. Actual Allocation Index	Similar to the Target Allocation Index but weightings are based on the actual allocation as opposed to the target allocation
6. Cost Comparisons	Measures a fund's management costs against a "universe" of funds possessing a similar investment style and structure • **Example: CEM Benchmarking Study**

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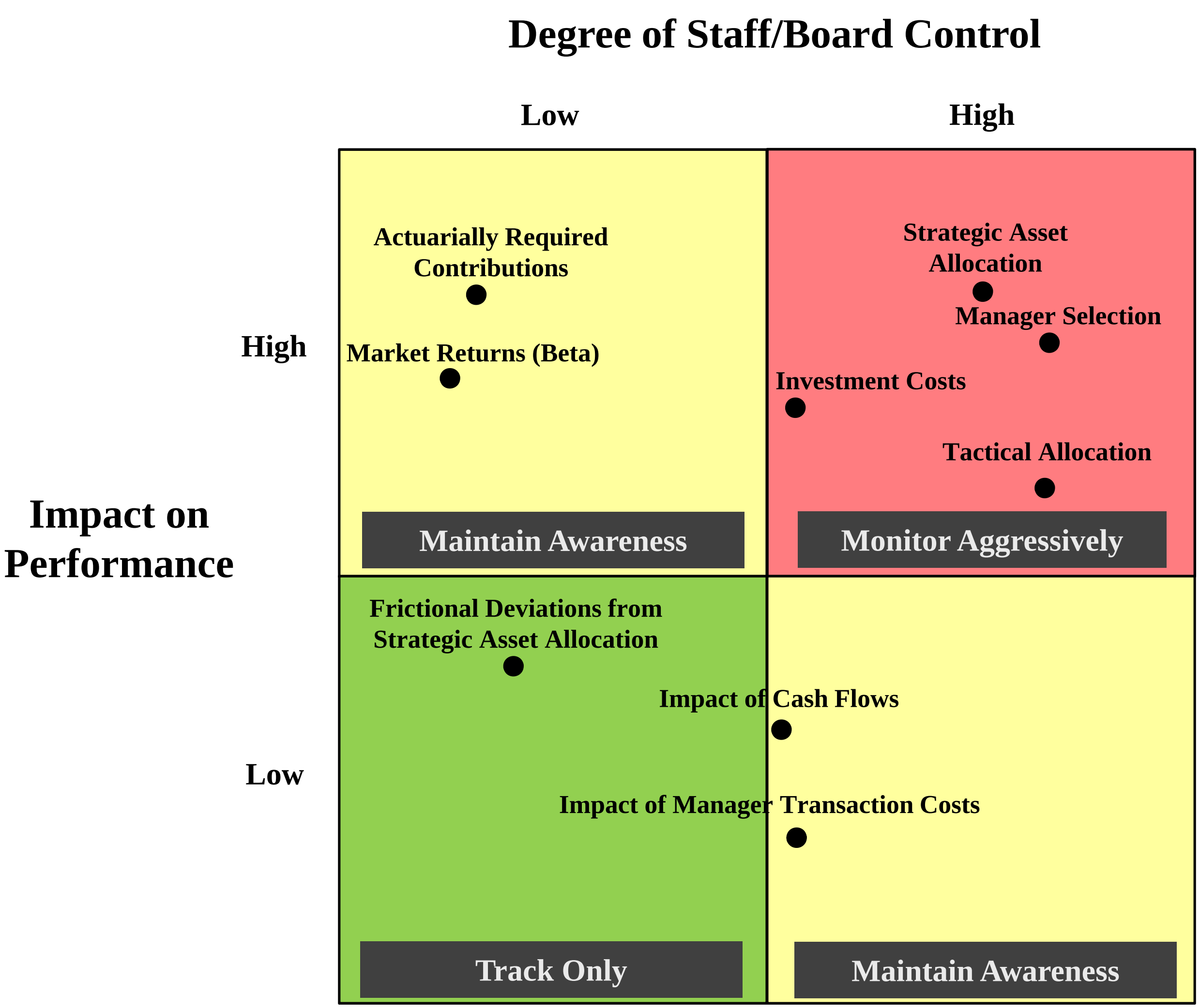
Framework for Approaching Performance Measurement

1. **Controllability—**What are the controllable and uncontrollable outcome drivers that staff and board members are able to affect?

2. **Degree of Impact—**To what degree do "controllable" events impact portfolio performance?

Performance Evaluation Prioritization Framework



Current MBOI Performance Measurement

Outcome	Current Method	Potential Adjustments
Strategic Asset Allocation	• **Peer Rankings**—Retirement plan performance is compared with a universe of public funds of similar size.	None Suggested
Tactical Asset Allocation	None	MBOI could establish a target allocation and compare the actual allocation index versus target allocation index to gauge whether deviations from target had a positive or negative impact.
Manager Selection (Asset Class Level)	• **Public Market Indices**—Asset class returns are compared with broad market indexes. • **Peer Rankings**—Asset class returns are compared with other plans employing similar investment strategies.	None Suggested
Manager Performance	• **Public Market Indices**—Manager returns are compared with relevant market indexes. • **Peer Rankings**—Manager returns are compared with manager peer groups employing similar investment strategies.	None Suggested
Costs	• **Peer Benchmarking**—Investment manager, operational, and administrative costs are periodically compared with plans of similar size and objectives.	None Suggested

Strategic Asset Allocation

MBOI Performance Summary

(Date Ended September 30, 2012)

	QTD	CYTD	1 Year	3 Year	5 Year	7 Year	10 Year	2011	2010	2009	2008	2007
Public Employees' Retirement - Gross	**4.48**	**11.55**	**17.11**	**10.47**	**2.14**	**5.18**	**7.64**	**2.68**	**13.44**	**16.08**	**-25.60**	**9.04**
All Public Plans > $3 Billion	4.64	10.55	16.32	9.54	2.18	5.30	8.17	0.82	12.82	18.20	-27.17	9.25
Ranking	**56**	**25**	**32**	**21**	**51**	**56**	**70**	**27**	**41**	**73**	**32**	**59**

- Comparisons to peers serve as a rough assessment of the effectiveness of the strategic asset allocation, as asset allocation is typically the primary contributor to relative return differences among different plans.
- RVK compares MBOI performance to a universe of other public plans provided by BNYMellon and Investment Metrics.
- Montana benchmarks against other public plans with greater than $3 billion, which is the peer group that most closely matches the plan.
- MBOI also has access to peer benchmarks provided by State Street.

Limitations

1. **Restricted Population**—The MBOI peer group is typically limited to roughly 50 peers, which is only a small subset of all public plans similar to MBOI.
2. **Shifting Population—**BNYMellon and Investment Metrics continually update their databases each quarter as data arrives. Depending upon when data is submitted, the actual participants in the peer group vary at any given point in time.
3. **Different Objectives & Constraints**—Differences in allocation typically represent differences in investment objectives and constraints (which are uncontrollable), as opposed to the effectiveness of strategic allocation decisions (which are controllable).*

* The CEM Benchmarking study provides adjusted performance that takes into account allocation differences.

Tactical Asset Allocation

- MBOI does not evaluate tactical asset allocation, as a large portion of "tactical" deviations result from uncontrollable circumstances, such as cash flows from private investments and market movements.
- A general limitation of tactical allocation measurement is that it is difficult to isolate controllable decisions.
- This measure is particularly limited at MBOI, as tactical allocation is not done on a large scale and is largely frictional as a result of capital calls, benefit payments and market movements.
- Should MBOI wish to evaluate tactical asset allocation, the establishment of a "fixed weight" benchmark would be required. The impact of tactical allocation would then be assessed by measuring the performance of the actual fund allocation vs. the desired target allocation.

Manager Selection – Traditional Asset Classes

MBOI Performance Summary

(Date Ended September 30, 2012)

	QTD	CYTD	1 Year	3 Year	5 Year	7 Year	10 Year	2011	2010	2009	2008	2007
Domestic Equity Composite	**6.28**	**16.09**	**29.46**	**12.98**	**0.85**	**4.04**	**N/A**	**0.44**	**16.37**	**29.05**	**-38.39**	**5.08**
S&P 1500 Composite Index	6.25	16.13	30.18	13.37	1.36	4.66	8.35	1.75	16.38	27.25	-36.72	5.47
Difference	*0.03*	*-0.04*	*-0.72*	*-0.39*	*-0.51*	*-0.62*	*N/A*	*-1.31*	*-0.01*	*1.80*	*-1.67*	*-0.39*
Retirement Funds Bond Pool	**2.72**	**6.40**	**8.25**	**8.60**	**7.47**	**6.75**	**6.54**	**7.69**	**10.32**	**12.11**	**-1.31**	**6.72**
Barclays US Aggregate Bond Index	1.58	3.99	5.16	6.19	6.53	5.92	5.32	7.84	6.54	5.93	5.24	6.97
Difference	*1.14*	*2.41*	*3.09*	*2.41*	*0.94*	*0.83*	*N/A*	*-0.15*	*3.78*	*6.18*	*-6.55*	*-0.25*

- **Investment Manager Selection**—Asset class composites are compared to broad market indices to gauge relative performance in terms of manager selection and style biases (e.g., overweight to small cap equities).
- **Internal Portfolio Management**—For portfolios that are managed internally, the comparison also reveals the relative effectiveness of internal staff in terms of security selection and style tilts.

Limitations

1. **Imperfect Measure of Manager Performance**—Deviations from indexes may be a combination of style tilts (e.g., large cap bias) in addition to manager performance. This methodology does not isolate the two factors.
2. **Short Time Horizons—**Every manager underperforms and outperforms over time, and it is important for MBOI not to overemphasize short term performance, which may not accurately reflect the long term prospects of the manager.

Manager Selection – Alternative Asset Classes

MBOI Private Equity Performance Summary

(Date Ended September 30, 2012)

	QTD	CYTD	1 Year	3 Year	5 Year	7 Year	10 Year	2011	2010	2009	2008	2007
Private Equity Pool	**0.26**	**9.57**	**7.39**	**15.53**	**4.55**	**9.13**	**11.90**	**16.11**	**14.21**	**-10.46**	**-4.71**	**24.15**
S&P 1500 + 4% (Qtr Lag)	-1.96	12.31	8.63	20.76	4.46	8.31	9.67	4.92	14.92	-2.76	-17.27	20.57
Difference	*2.22*	*-2.74*	*-1.24*	*-5.23*	*0.09*	*0.82*	*2.23*	*11.19*	*-0.71*	*-7.70*	*12.56*	*3.58*

- The performance of alternative asset classes, such as private equity, are measured to gauge the effectiveness of MBOI's selection of underlying asset managers.
- In addition to public indices provided by RVK, MBOI benchmarks the performance of the private equity portfolio against State Street's Private Edge benchmark, which consists of actual private equity fund returns.

Limitations

1. **Limited Meaning over Short Time Horizon—**For public indices, the underlying securities in which managers invest do not overlap with the securities in the. While the expectation is that returns should be similar over the long term, dramatic deviations can (and do) occur over the short term, making short term comparisons of limited value.
2. **Lagged Nature of Returns**—Due to delayed reporting of alternative asset managers, such as private equity, performance reporting must be lagged.
3. **Uncertainty of Excess Return Requirements**—In asset classes, such as private equity, there is an expectation of equity-like returns, but with a premium for illiquidity. Determining the appropriate threshold is the subject of debate, and there is no clear answer as to what is the most appropriate expectation. This further complicates performance monitoring for alternative asset classes.

Manager Performance

Vaughn Nelson Small Cap Value Management Performance Summary

(Date Ended September 30, 2012)

	QTD	CYTD	1 Year	3 Year	5 Year	7 Year	10 Year	2011	2010	2009	2008	2007
Vaughan Nelson Management - Net	**5.08**	**11.98**	**25.60**	**12.17**	**5.29**	**N/A**	**N/A**	**-3.61**	**24.21**	**28.91**	**-23.61**	**N/A**
Russell 2000 Value Index	5.67	14.37	32.63	11.72	1.35	3.74	9.68	-5.50	24.50	20.58	-28.92	-9.78
Difference	*-0.59*	*-2.39*	*-7.03*	*0.45*	*3.94*	*N/A*	*N/A*	*1.89*	*-0.29*	*8.33*	*5.31*	*N/A*
Vaughan Nelson Management - Gross	**5.29**	**12.67**	**26.67**	**13.12**	**6.21**	**N/A**	**N/A**	**-2.77**	**25.27**	**30.05**	**-22.88**	**N/A**
IM U.S. Small Cap Value Equity Median	5.56	13.16	31.63	13.32	3.49	6.05	11.71	-3.31	27.77	34.03	-32.92	-2.11
Ranking	**55**	**57**	**76**	**56**	**14**	**N/A**	**N/A**	**47**	**67**	**63**	**4**	**N/A**

- Individual manager returns are compared to public indices that are reflective of the underlying strategy, as well as groups of managers with similar investment strategies.
- Deviations from the benchmark and/or peer group median occur due to combination of the quality of the manager’s stock selection, as well as intentional style biases, such as industry concentration and capitalization weighting.

Limitations

1. **Attribution of Performance—**The drivers (and acceptability) of relative performance are not clearly apparent. More granular analysis is required to reveal why underperformance (or outperformance) occurred, and whether it is acceptable.

2. **Strategy Mismatch—**Managers do not always exclusively invest in securities contained within the index; therefore, benchmarks (even if appropriate at a high level) are not a perfect metric for measuring performance.

Roll Up Process

MBOI Performance Summary

(Date Ended September 30, 2012)

	QTD	CYTD	1 Year	3 Year	5 Year	7 Year	10 Year	2011	2010	2009	2008	2007
Public Employees' Retirement - Net	**4.38**	**11.09**	**16.47**	**9.86**	**1.58**	**4.70**	**7.25**	**2.13**	**12.77**	**15.42**	**-26.01**	**8.72**
Actual Allocation Index	3.84	12.61	16.32	10.57	1.75	4.83	7.15	2.15	12.54	15.52	-26.42	8.34
Difference	*0.54*	*-1.52*	*0.15*	*-0.71*	*-0.17*	*-0.13*	*0.10*	*-0.02*	*0.23*	*-0.10*	*0.41*	*0.38*

❷ Aggregate returns for each pension plan represents a weighted average of the underlying asset class returns and their corresponding indexes.

24% **Fixed Income Portfolio**

17% **Int'l Equity Portfolio**

8% **Real Estate Portfolio**

37% **Domestic Equity Portfolio**

1% **Cash Portfolio**

13% **Private Equity Portfolio**

37% **Domestic Equity Portfolio**

- Manager A
- Index A

2.5%

- Manager B
- Index B

1.2%

- Manager C
- Index C

0.5%

- Manager D
- Index D

0.9%

❶ Aggregate returns for the domestic equity portfolio and index represent a weighted average of the underlying managers and their corresponding indexes.

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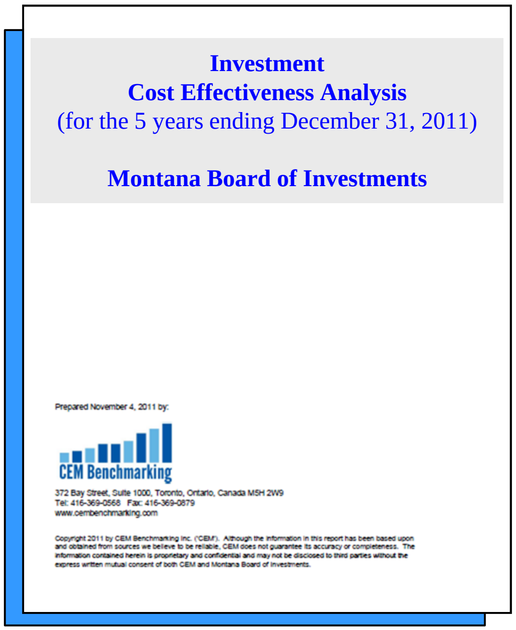
Cost Comparisons


Investment
Cost Effectiveness Analysis
(for the 5 years ending December 31, 2011)

Montana Board of Investments

Prepared November 4, 2011 by:

CEM Benchmarking

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- MBOI periodically hires a third party to evaluate the total cost of the investment program and benchmark the costs versus similar public funds
- 2011 study revealed that MBOI's costs (adjusted for its allocation) are slightly lower than peers.
- The CEM study also reveals detailed cost attribution, which enabled Montana to pinpoint relatively high and low cost areas that can be targeted for improvement.

Summary Observations

1. We encourage clients to focus performance measurement on outcome drivers that are controllable and have the potential for high impact.
2. That said, performance measurement is inherently imperfect and quantitative observations must be tempered with qualitative judgment.
3. We believe that MBOI has robust performance evaluation capabilities that are appropriately interpreted.

MONTANA BOARD OF INVESTMENTS
ACRONYM INDEX

ACH .... Automated Clearing House

ADR .... American Depository Receipts

AOF .... All Other Funds

BOI .... Board of Investments

CFA .... Chartered Financial Analyst

EM .... Emerging Market

FOIA .... Freedom of Information Act

FWP .... Fish Wildlife and Parks

IPS .... Investment Policy Statement

MBOH .... Montana Board of Housing

MBOI .... Montana Board of Investments

MDEP .... Montana Domestic Equity Pool

MFFA .... Montana Facility Finance Authority

MPEP .... Montana Private Equity Pool

MPT .... Modern Portfolio Theory

MSTA .... Montana Science and Technology Alliance

MTIP .... Montana International Pool

MTRP .... Montana Real Estate Pool

MTSBA .... Montana School Boards Association

MVO .... Mean-Variance Optimization

NAV .... Net Asset Value

PERS .... Public Employees' Retirement System

PFL .... Partnership Focus List

MONTANA BOARD OF INVESTMENTS
ACRONYM INDEX

QZAB .... Qualified Zone Academy Bonds

QSCB .... Qualified School Construction Bonds

RFBP .... Retirement Funds Bond Pool

RFP .... Request for Proposal

SABHRS .... Statewide Accounting Budgeting and Human Resource System

SSBCI .... State Small Business Credit Initiative

STIP .... Short Term Investment Pool

TFBP .... Trust Funds Bond Pool

TFIP .... Trust Funds Investment Pool

TIF .... Tax Increment Financing

TIFD .... Tax Increment Financing District

TRS .... Teachers' Retirement System

VIX .... Volatility Index

2013 CALENDAR

01 New Year's Day
21 M.L. King Day

JANUARY						
S	M	T	W	Th	F	S
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

18 Presidents Day

FEBRUARY						
S	M	T	W	Th	F	S
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28		

29 Good Friday
31 Easter Sunday

MARCH						
S	M	T	W	Th	F	S
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

APRIL						
S	M	T	W	Th	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30				

12 Mother's Day
27 Memorial Day

Billings Meeting

MAY						
S	M	T	W	Th	F	S
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

16 Father's Day

JUNE						
S	M	T	W	Th	F	S
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30						

JULY						
S	M	T	W	Th	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

04 Independence Day

AUGUST						
S	M	T	W	Th	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

SEPTEMBER						
S	M	T	W	Th	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30					

02 Labor Day

OCTOBER						
S	M	T	W	Th	F	S
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

14 Columbus Day
31 Halloween

NOVEMBER						
S	M	T	W	Th	F	S
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30

11 Veterans Day
28 Thanksgiving Day

DECEMBER						
S	M	T	W	Th	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

25 Christmas Day