These minutes are Approved and Final. Full Board review and decision took place at the November 19, 2013 Regular Meeting of the Board.

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

MINUTES OF THE MEETING
August 20 & 21, 2013

BOARD MEMBERS PRESENT:
Mark Noennig, Chairman
Quinton Nyman
Gary Buchanan
Sheena Wilson
Karl Englund
Jack Prothero
Marilyn Ryan
Jon Satre

BOARD MEMBER ABSENT:
Kathy Bessette

LEGISLATIVE LIAISONS PRESENT:
Senator Dave Lewis (August 21 only)
Representative Kelly McCarthy

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
Roberta Diaz, Accountant
David Ewer, Executive Director
Julie Flynn, Bond Program Officer
Tim House, Investment Operations Chief
Ethan Hurley, CAIA, Portfolio Manager,
Alternative Equities
Ed Kelly, Alternative Investments Analyst
Teri Kolnik, CFA, 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
Mary Noack, Network Administrator
Chris Phillips, CFA, Investment Staff
Jon Putnam, CFA, FRM, Fixed Income
Investment 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:
Mark Higgins, CFA, R.V. Kuhns & Associates
Becky Gratsinger, CFA, R.V. Kuhns & Associates
John Harrington, Legislative Audit Division
Ross Johnson, Legislative Audit Division
Mike Heale, CEM Benchmarking, Inc.
Jenny Chambers, Department of Environmental Quality
Kathleen Coleman, Department of Justice
Mark Barry, Montana State Fund
Robert Collins, Department of Justice

Ryan Evans, Office of Budget and Program Planning
Julie Feldman, Department of Administration
Carolyn Fox, Department of Justice
Shawn Graham, Office of Budget and Program Planning
Russell Hill, Department of Administration
Laura Humberger, MSU Financial Services
Bill Kirley, Department of Environmental Quality
Anna Miller, Department of Natural Resources and Conservation
Christopher Watson, Office of Budget and Program Planning
Dan Villa, Office of Budget and Program Planning
Matt Gouras, Associated Press
Sharon Grubbs

CALL TO ORDER

Board Chairman Mark Noennig called the regular meeting of the Board of Investments (Board) to order at 10:49 AM. As noted above, a quorum of Board Members was present. Board Member Kathy Bessette was absent. Legislative Liaison Senator Dave Lewis was absent August 20 and present August 21.

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

Chairman Noennig called for any corrections or revisions to the Board minutes from the May 29, 2013 meeting. Member Sheena Wilson noted a correction on page 3 of a missing zero in an INTERCAP loan amount.

> Board Member Karl Englund made a Motion to approve the Minutes of the Board meeting on May 29, 2013, as corrected. Member Wilson seconded the Motion. The Motion carried 8-0.

ADMINISTRATIVE BUSINESS

Human Resource Committee Report

Human Resource Committee Chairman Karl Englund stated the Committee had no business and did not meet.

Audit Committee Report

Audit Committee Chair Jon Satre reported on five items discussed at the Committee Meeting held prior to the regular Board Meeting.

The completed FY13 Internal Controls Review was presented by Galusha Higgins & Galusha, PC, to the Committee. The Review included 11 recommendations which were each addressed and incorporated by staff into the final Review report. The Committee approved the Internal Controls Review and staff responses.

Revisions to the Internal Control Policy were presented by staff and were approved by the Committee.

The FY13 Legislative Financial Audit is ongoing. The Audit team was on site for two weeks in June and tested 50 transaction items covering the prior 11 month period. The team will be on site again in October.

The Performance Audit status was reported to the Committee by Mr. Angus Maciver of the Legislative Audit Division. Mr. Maciver advised the next step is for Audit staff to meet next month with Executive Director Ewer and staff to discuss which issues are likely to come up during the audit process.

A recent adverse appellate court ruling has impacted the ongoing Pfizer lawsuit necessitating MBOI rejoining the larger class action going forward.

Loan Committee Report

The Loan Committee met prior to the Board meeting. Ms. Louise Welsh presented a loan request from the Department of Natural Resources and Conservation (DNRC) for an INTERCAP loan in the amount of $3 million. The loan will be in the form of a Bond Anticipation Note (BAN) and will be used either to refinance existing borrower debt in the Renewable Resource Grant & Loan (RRGL) Program or for rehabilitation of water and sewer facilities approved by the 2013 Legislature in House Bill 8. The loan will have a 2 year term.

Mr. Herb Kulow presented a participation (80%) loan request for $3,508,000 from Pheasant Run Apartments I, LLC for construction of a 58 unit apartment complex in Sidney.

Committee Chair Jack Prothero reported both loans were within the Loan Committee's approval limits and were approved.

Board Education Highlights – IFE Market Makers 2013 Conference

Board Members Marilyn Ryan, Sheena Wilson and Kathy Bessette attended the IFE Conference in June held at Dana Point, California. Member Wilson shared the high points of the conference. The most impressive speaker was the head of Global and International Equities at Schroders, Ms. Virginie Maisonneuve, CFA. Her overall message was that innovative ideas and addressing long term sustainability are the keys to improving the economy. Demographics, energy, water, climate and aging are all important considerations as we move forward. The participation of young, engaged presenters at the conference is a positive indicator when looking to future economic challenges.

Member Ryan agreed that Ms. Maisonneuve was the most dynamic speaker on the program. We are in an era where continued exploration of new options is necessary to open up investment opportunities and active management must consider the impact on resources. Looking ahead, innovation will lead the world out of the current slump; the U.S. leading the way, followed by Japan and Asia, with Europe lagging behind.

Legislative Liaisons Comments

Representative Kelly McCarthy reported nothing new on the legislative front; however, he added the infrastructure challenges in eastern Montana did not see much progress in the last session which was a disappointment. He responded to possible concerns regarding higher risks associated with loans under the Veterans' Home Loan Program by reporting the VA loans at First Interstate Bank have the highest performance level, so he is not concerned that there may be increased risk.

Member Gary Buchanan asked Representative McCarthy how the legislature would be fixing the problems with the pension legislation which was passed.

Representative McCarthy stated the legislature was aware that changes in the Guaranteed Annual Benefit Adjustment (GABA) would be problematic; however, the pension fix bill would not have passed without the GABA triggers. The issue is headed to the courts.

EXECUTIVE DIRECTOR'S REPORT

Overall Comments

Executive Director David Ewer presented his executive director's memo. Per member requests from the last meeting, R.V. Kuhns will show the fiscal year to date figures for private equity (MPEP) as well as for the other asset classes.

The quarterly cost report is included in the Board packet. Total fiscal year costs and a budget update will be presented later in the agenda.

Following the recommendation of legal counsel, MBOI is rejoining the larger general class action in the Pfizer lawsuit due to an unexpected federal appellate ruling regarding changes in the statute of limitations.

The custodial bank contract for State Street Bank of Boston expires at the end of October, 2014. The Department of Administration, Board staff and R.V. Kuhns and Associates will soon begin working on the required Request for Proposal (RFP). Review and selection are expected to be completed by summer 2014.

Member Jon Satre inquired how many banks qualify as competition to State Street Bank, given the unique and complex services required by MBOI.

Executive Director Ewer advised there are a few. Northern Trust, BNY Mellon and JPMorgan Chase are all contenders. Ms. Becky Gratsinger added it is a very small universe of banks that are able to handle the task. Mr. Ewer stated State Street Bank has been renewed the maximum time periods allowed by contract, requiring the issuance of a new RFP at the expiration of the current contract extension. Ms. Gratsinger added the selection process can vary, although often a staff recommendation is brought before a Board, with or without a finalist presentation. R.V. Kuhns will be assisting in the process and all four qualified banks are expected to respond to the RFP.

Executive Director Ewer presented the newly compiled glossary of terms commonly used at the Board.

Staff recommends cancelling the scheduled one day October Board Meeting. The items assigned on the Work Plan for the October meeting have been completed at other meetings. Chairman Noennig concurred, since Board agenda items and educational presentations are up to date and on schedule. The next Board meeting will be November 19 and 20, in Helena.

MONTANA LOAN PROGRAMS

In-State Loan Program

Mr. Herb Kulow presented an update of the commercial and residential loan program portfolios. As of June 30, 2013 the commercial loan program had 122 outstanding loans totaling $110,397,710; down $24,706,743 from a year ago and down approximately $82,500,000 since 2007. There were 10 reservations as of June 30, 2013 totaling $25,063,704 and three committed loans totaling $2,414,217. There is one past due loan, with a $634,111 balance. No other loans are past due as of June 30, 2013.

The residential loan program has 347 loans totaling $14,849,085, as of June 30, 2013, a decrease of $5,269,216 since June 2012. There are 12 loans past due totaling $664,438 or 4.47% of the total portfolio. Seven loans or 2.70% of the portfolio, were past due 90 days or greater, of which five loans were guaranteed, representing $337,743 or 2.27% of the portfolio and two loans are conventional financing totaling $92,729 or 0.62%.

The Veterans' Home Loan Mortgage Program has grown to 68 loans totaling $11,782,153 as of June 30, 2013 and 21 outstanding reservations totaling $4,017,701. The current portfolio yield is 1.41%. The current interest rate for new reservations is 2.50%. Net yield to MBOI is 1.75% after deducting the Board of Housing (BOH) service and administration fees of .375 each. The Board of Housing is receptive to lowering fees charged to MBOI. The Program requires a down payment in the amount of $2,500, therefore the potential for future problem loans exists; however, any loan overdue past 30 days requires the bank to repurchase the loan.

BOND PROGRAM REPORTS

Activity Report

Ms. Louise Welsh reviewed the quarterly Activity Summary Report and presented the staff approved loans and the Annual INTERCAP Loan Detail Report.

Member Satre observed on the detail report that state agencies now account for 12.56% of the outstanding loan total compared to 23.49% for the fiscal year ending June 30, 2012.

Ms. Welsh advised the state agency reductions in total were due to Governor Schweitzer placing a freeze on the purchasing of state replacement vehicles for the Montana Department of Transportation and a large loan prepayment made by the Department of Justice.

Staff approved loans are listed below:

Borrower:	Choteau County District Hospital dba Missouri River Medical Center (Fort Benton)
Purpose:	Purchase imaging, lab and patient equipment
Staff Approval Date:	April 10, 2013
Board Loan Amount:	$ 31,491
Other Funding Sources:	$ 0
Total Project Cost:	$ 31,491
Term:	5 years

Borrower:	Eureka Fire Service Area
Purpose:	Purchase a new water tender
Staff Approval Date:	April 10, 2013
Board Loan Amount:	$ 100,000
Other Funding Sources:	$ 110,000
Total Project Cost:	$ 210,000
Term:	4 years

Borrower:	Ravalli County
Purpose:	Refinance County Parks land/building loan
Staff Approval Date:	April 16, 2013
Board Loan Amount:	$ 267,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 267,000
Term:	15 years

Borrower:	City and County of Butte-Silver Bow
Purpose:	Purchase an asphalt crusher
Staff Approval Date:	April 17, 2013
Board Loan Amount:	$ 700,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 710,000
Term:	10 years

Borrower:	City and County of Butte-Silver Bow
Purpose:	Purchase a fire rescue unit
Staff Approval Date:	April 17, 2013
Board Loan Amount:	$ 175,613
Other Funding Sources:	$ 0
Total Project Cost:	$ 175,613
Term:	4 years

Borrower:	Lockwood Rural Fire District #8 (Billings)
Purpose:	Purchase an ambulance
Staff Approval Date:	April 24, 2013
Board Loan Amount:	$ 170,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 170,000
Term:	7 years

Borrower:	Valley County
Purpose:	Construct county airport hangar
Staff Approval Date:	April 24, 2013
Board Loan Amount:	$ 400,000
Other Funding Sources:	$ 100,000
Total Project Cost:	$ 500,000
Term:	15 years

Borrower:	Columbus Rural Fire District #3
Purpose:	Purchase a new wild land fire engine
Staff Approval Date:	April 25, 2013
Board Loan Amount:	$ 140,000
Other Funding Sources:	$ 20,000
Total Project Cost:	$ 160,000
Term:	10 years

Borrower:	Lone Rock School District #13 (Stevensville)
Purpose:	Purchase a new phone system
Staff Approval Date:	May 3, 2013
Board Loan Amount:	$ 30,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 30,000
Term:	10 years

Borrower:	Stillwater County/Stillwater County Solid Waste District
Purpose:	Purchase a roll-off truck
Staff Approval Date:	May 2, 2013
Board Loan Amount:	$ 165,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 165,000
Term:	15 years

Borrower:	Choteau County Hospital District dba Missouri River Medical Center (Fort Benton)
Purpose:	Purchase Medical Management Software
Staff Approval Date:	May 7, 2013
Board Loan Amount:	$ 203,900
Other Funding Sources:	$ 0
Total Project Cost:	$ 203,900
Term:	2 years

Borrower:	Fisher River Valley Fire Service Area (Libby)
Purpose:	Purchase a new fire engine
Staff Approval Date	May 9, 2013
Board Loan Amount:	$ 70,000
Other Funding Sources:	$ 20,000
Total Project Cost:	$ 90,000
Term:	10 years

Borrower:	Powder River County
Purpose:	Purchase a gravel crusher
Staff Approval Date	May 15, 2013
Board Loan Amount:	$ 800,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 800,000
Term:	10 years

Borrower:	Custer County School District #1 (Miles City)
Purpose:	Repair/expand Lincoln Elementary School
Staff Approval Date	May 16,2013
Board Loan Amount:	$ 1,000,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 1,000,000
Term:	5 years

Borrower:	Shields Valley School Districts #J12-5 (Wilsall and Clyde Park)
Purpose:	Replace boiler
Staff Approval Date	May 21, 2013
Board Loan Amount:	$ 197,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 197,000
Term:	5 years

Borrower:	Frenchtown Rural Fire District
Purpose:	Purchase a new fire truck
Staff Approval Date	May 23, 2013
Board Loan Amount:	$ 34,000
Other Funding Sources:	$ 16,000
Total Project Cost:	$ 50,000
Term:	3 years

Borrower:	Hamilton School District #3
Purpose:	Replace boiler/remodel at Daly Elementary School
Staff Approval Date	June 6, 2013
Board Loan Amount:	$ 350,000
Other Funding Sources:	$ 0
Total Project Cost:	$ 350,000
Term:	15 years

CONSULTANT PRESENTATION – ASSET ALLOCATION INTRODUCTION

R.V. Kuhns & Associates – Ms. Becky Gratsinger, CFA and Mr. Mark Higgins, CFA
Mr. Mark Higgins and Ms. Becky Gratsinger presented the Asset Allocation Introduction. The 10-year annualized total fund returns compared to the public fund universe of 77 funds at December 31, 2012, shows that on a gross of fees basis, the MBOI returned 7.41%, which is just shy of the 7.75% actuarial assumed rate of return and slightly below the fund median of 7.69%. Ms. Becky Gratsinger added the MBOI 5-year return of 2.75% reflects the impact of the financial crisis, but there has been a lot of improvement over the last five years.

Actuarial Assumed Rate of Return

The median actuarial assumption rate, which is based on 68 survey respondents, was 7.75% as of December 31, 2012. In addition, 74% of survey respondents used an assumption rate of 7.75% or below. Finally, 97.5% of respondents reported being significantly underfunded.

Asset Allocation

MBOI has more U.S. equities and less global investments in comparison to other funds in the universe with assets of $1-5 billion. Alternative and real estate holdings are higher than the universe by about 1%. Responding to a question from Member Karl Englund, Ms. Gratsinger stated historical trends over time are evaluated. For instance international, emerging global and fixed income assets have all grown over time.

Ms. Gratsinger reviewed the objectives of different asset classes. Of the broad spectrum of assets to choose from, cash is yielding very low returns but provides liquidity, fixed income provides the anchor of a portfolio with moderate risk and return, and domestic equity comes with a fair amount of risk and volatility but is expected to produce higher returns. Alternatives and international equities provide diversification with a bit more volatility. Private equity and real estate are limited by liquidity constraints, but provide diversification from traditional assets. Ms. Gratsinger noted that asset allocation drives returns, and has a much greater impact than manager selection on long term fund performance.

Ms. Gratsinger explained that analysis using Mean Variance Optimization (MVO) which helps determine maximum returns while minimizing risk, are usually done every 2-3 years, although it is becoming more common to conduct them annually. She stated that asset allocation structure should be revisited annually to see if adjustments are needed. She also noted that while models, such as MVO, are valuable tools, there are no perfect models and all must be informed with qualitative judgment. The last formal asset liability study was completed two years ago.

Mr. Cliff Sheets reminded the Board members that the work plan has a review of the asset allocation policy ranges scheduled for the November Board meeting. The MVO will be run based on R.V. Kuhn's data and presented to the Board. Executive Director Ewer noted asset allocation is on the schedule twice a year, once as an educational presentation, and again as a formal review which will

be at the November Board meeting. Staff will present recommended changes, if any, for Board consideration at that time.

Responding to a question from Member Buchanan, Ms. Gratsinger stated that data for June 30, 2013 were not used in the survey as they were not available yet, but it is important to note while data from all periods is looked at, the longest time period is the most useful. The unproductive decade impacts all of the data. She also noted all data is gross of fees, as net of fees data are not available for the universe and fees vary widely from fund to fund.

Mr. Cliff Sheets added time perspective is critical. The rally was robust and the unproductive years have been left behind; three to four years ago, figures were zero to negative, but looking at the longest time frame, returns over the past 19 years are at 7.46%. As of July 31, 2013, that number jumps to 7.59% due to the market rally. Even 19 years is a short time period from an actuarial standpoint and short term figures tend to be volatile.

NON-PENSION LONG TERM INVESTMENT CLIENTS ACTIVITIES/REPORTS

General Session – Executive Director David Ewer

Executive Director David Ewer introduced staff's presentation on Separate Account Fixed Income Investing, detailing how MBOI manages money for the state's many trusts and various funds. Invited guests from the various state agencies were in attendance.

Mr. Ewer introduced Dan Villa, Budget Director for Governor Steve Bullock. Mr. Villa stated the Budget Office manages a collective $2 billion general fund and a roughly $12 million operating budget, along with overseeing about 12,000 state employees who are covered in one way or another under the state pension systems, the state's health care funds or self-insured funds, and also under the state Worker's Compensation system. Mr. Villa introduced Mr. Ryan Evans, Finance Manager at the Budget Office, who is responsible for the balance sheet; Mr. Shawn Graham, Operations Manager and Mr. Chris Watson, a new analyst overseeing the natural resource budget. Mr. Villa stated he is very pleased with the Board and all the hard work on the PERS and TRS pension fixes, which could not have been accomplished without the Board's hard work.

Member Buchanan asked Mr. Villa about the pension bills passed at the end of the legislative session.

Mr. Villa responded there are a couple of different issues, the 1% employee/employer contribution and the reduction in the Guaranteed Annual Benefit Adjustment (GABA) which is expected to be challenged in court. Mr. Villa believes the GABA language will be struck down as it is guaranteed by contract, but that the 1% Employee/Employer metric will remain in place.

Member Englund asked Mr. Villa if there were things the Board could be doing better to improve the relationship with the Budget Office.

Mr. Villa responded given the recent major pension overhaul, a little time for the dust to settle is in order. Given some time, a review of any adjustment to the assumption rate can be addressed.

Mr. Ewer next introduced Ms. Carol Fox, Restoration Chief and Mr. Rob Collins, Supervising Attorney General, with the Department of Justice. Ms. Fox commended MBOI for the great returns and particularly thanked Mr. John Romasko who assisted with decisions regarding recent separations into subaccounts. Mr. Collins added they started out with just $5 million in the 1990's to file litigation against ASARCO, and received settlements in 1999 and again in 2008, all funds which had to be managed. There are many different accounts covering different sites such as the Clark Fork River and Butte. Working with initial settlement grants, programs were set up to serve the different entities

and have been working off of the interest most of the time since. Mr. Collins added Arco has settled, and the Exxon Oil spill is still a pending suit.

Ms. Jenny Chambers, Remediation Division Administrator and Mr. Bill Kirley, Attorney Specialist with the Montana Department of Environmental Quality were introduced. Ms. Chambers stated litigation was undertaken to facilitate restoration needs. Funds for remediation restoration have been well invested, and with more money available, progress can move forward on more projects such as Streamside Tailings, Montana Pole, Upper Blackfoot and Abandoned Mines.

Mr. Ewer introduced Ms. Anna Miller, Bureau Chief of the Department of Natural Resources and Conservation (DNRC). Ms. Miller stated as the conservator of the state's natural resources and a touchstone with local governments, the Department manages $40-70 million worth of water and wastewater projects each year. Ms. Miller commended staff members Ms. Louise Welsh, Deputy Director Geri Burton and Ms. Julie Flynn, all of whom have been very helpful implementing funds for the various projects. Current projects include eastern Montana wastewater treatment, projects with the cities of Glendive and Laurel and a drinking water project in Great Falls. Projects are funded by Coal Severance Tax Fund bonds which generate interest. There have been no defaults.

Mr. Ewer introduced Ms. Julie Feldman, Accounting Acting Administrator, and Mr. Russ Hill, Health Care and Benefits Division Administrator, from the Department of Administration. He also introduced Mr. Mark Barry, Corporate Support Vice President of Montana State Fund, noting that State Fund comprises approximately 10% of MBOI's invested funds.

Ms. Feldman stated the comprehensive financial report for all agencies is made up of a considerable amount of information provided by MBOI. The Treasury Unit has daily contact with MBOI through the warrant writer units, as well as ACH cash management of the General Fund.

Mr. Mark Barry, who has been Chief Financial Officer of State Fund since 1994, stated they insure 26,000 businesses across the state and have $1.3 billion under investment with MBOI. Staff meets on a quarterly basis with Mr. Sheets and Mr. Cooley to review portfolio activity and any other issues.

Mr. Russ Hill explained the self-funded health care pool has $150 million per year in expenditures. The underwriting process depends on how well costs are calculated and how well the funds are invested. Division personnel meet quarterly with Mr. Cooley, and Mr. Cooley serves on the advisory board.

Ms. Laura Humberger, Associate Vice President of MSU Financial Services, commended Ms. Louise Welsh, Deputy Director Geri Burton, Ms. Gayle Moon and Ms. April Madden for all of their assistance. MSU has $15 million in the Trust Fund Investment Pool (TFIP) and $120 million in the Short Term Investment Pool (STIP). They are looking into more medium term investments.

<u>Separate Accounts Fixed Income Presentation – Mr. Cliff Sheets, CFA, CIO, Mr. Richard Cooley, CFA and Mr. John Romasko, CFA, CPA</u>

Mr. John Romasko detailed the four different categories of separate accounts:

- Permanent funds are constitutionally or legislatively mandated funds where only interest is dispersed, the principal is retained. The Coal Tax Trust Fund is the main permanent fund.
- Insurance funds are perpetual, but balances fluctuate; Montana State Fund is the main insurance fund.
- Expendable funds are created for a special project with a finite end of when the fund will be depleted and can vary in duration from very short to very long. Expendable funds require a reasonable estimate of cash flow needs, but cash flow needs are also subject to revision. Most expendable funds are pollution mitigation funds such as the Upper Clark Fork Fund. The most recently created fund is the East Helena Restoration Fund.

- Operating funds provide liquidity needs for operation expenses, such as the Treasurer's Fund.

Liquidity balances fluctuate significantly; the type of fund determines how the funds are allocated.

Mr. Romasko added insurance funds function to match client needs; expendable funds allocate to the fund needs. All funds have STIP for liquidity and operating funds contain almost entirely STIP.

Executive Director Ewer added the individual fund investment policy statements set the guidelines followed by staff for the investments of each fund.

Mr. Rich Cooley reviewed the different types of fixed income investments. STIP is the default fund for investments not otherwise allocated, securities are invested by client preferences and increase yield, the Trust Fund Investment Pool (TFIP) is broadly diversified and offers more yield. Client cash flow requirements, risk tolerance and client preferences or constraints are all considered to best meet the needs of clients when investing.

Fixed Income Management Review – Mr. Cliff Sheets, CFA, CIO, Mr. Nathan Sax, CFA, Mr. Richard Cooley, CFA,

Mr. Cliff Sheets introduced the topic and the fixed income team, and noted Mr. John Romasko and Mr. Jon Putnam also work with Mr. Sax and Mr. Cooley in managing all the fixed income assets, and each has responsibility for some separate accounts. Mr. Sheets began by describing the fixed income asset class in general. Fixed income encompasses a broad array of security types which can be thought of as representing a set of future cash flows. This cash flow is more certain and typically less volatile than those offered by equity assets.

As of fiscal year end, MBOI had $7.64 billion in fixed income assets, roughly half of the total assets. Fixed income is held primarily in two large internal bond pools, Montana State Fund, externally managed specialty funds and STIP. Fixed income management is a core competency and MBOI has the expertise to manage the assets and choose outside managers. Internally managed assets account for 90% of the $7.64 billion total.

Mr. Nathan Sax detailed the objectives of fixed income as generating income and total return, providing diversification with less volatility than stocks and providing liquidity with ease of sale to raise cash when needed. Mr. Sax noted the fixed income benchmark, the Barclays Aggregate, has changed considerably since 2008. Treasuries are up from 25.1% to 36.5%; corporates have increased from 17.7% to 21.47% and securitized mortgage backed securities decreased from 43.7% to 31.5%.

Responding to a question from Member Englund, Mr. Sax noted all non-core assets are externally managed except in cases where an asset has been downgraded since purchase. Core fixed income is managed internally with a risk constrained process to manage risk and volatility. The internal management philosophy is to diversify and limit risk; the Core Internal Bond Portfolio (CIBP) has been less volatile in recent years. MBOI holdings comprise a different mix than the index, and only investment grade assets are purchased for the internally-managed portfolios. The investment grade index is used as a benchmark for the internal portfolios, rather than a hybrid index. In response to regulation and capital constraints, broker dealers no longer provide very much liquidity. Having liquidity within our fixed income holdings provides flexibility in pension rebalancing or shifts in strategy and provides necessary cash for benefit needs when the other markets are stressed.

The fixed income team meets weekly and monthly strategy sessions are held with the team which Mr. Dan Zarling and Mr. Sheets attend. A consensus approach is used to make decisions and the analysts are engaged in the strategy and portfolio management.

Fixed income resources include Wilshire Axiom, a portfolio analytics system; the external managers also offer their insights; and several credit research sources are utilized. Internally, accounting clears trades and fixes any trade errors. The internally managed costs are low when compared to other asset classes.

Short Term Investment Pool Review (STIP), Mr. Richard Cooley, CFA

Mr. Rich Cooley gave an overview of the Short Term Investment Pool (STIP). The three objectives of STIP are preservation of principal, liquidity and return. The total value of STIP has been consistent at approximately $2.6 billion and performance is competitive compared to money market funds. Trades for STIP settle the same day. Mr. Putnam and Mr. Romasko act as back up when Mr. Cooley is out of the office. The STIP reserve account was implemented to provide an offset to prevent any realized losses. Currently $17,000 is added per day to the reserve out of a portion of income, and realized gains on sales are also added to the reserve. Mr. Sheets added fixed income provides relative stability and diversification for the pensions, and is managed efficiently.

Mr. Cooley explained the reserve fund was started due to a realized loss. Previously there was no reserve fund and credit issues do come up occasionally, so having a reserve fund is a good idea. Mr. Sheets further explained a reserve fund acts as a safety valve. There is no size limit on the reserve and one has not been established in policy as the reserve is not yet viewed as too large. Placing a size limit in the STIP investment policy statement will be revisited at a later date as the fund grows larger. If yield becomes less competitive, contributions to the fund can also be scaled back.

Executive Director Ewer added the Board discussed the reserve fund at the April Board meeting and it was decided to continue growing the fund for the near term. The fund was created only after a loss, and it provides more flexibility going forward in dealing with any future problems.

The daily STIP statement and yield is posted on the web site daily. Ms. Gayle Moon added the participants also receive electronic statements.

CEM BENCHMARKING ANALYSIS

CEM Benchmarking Presentation – Mr. Mike Heale

Mr. Mike Heale presented the CEM Benchmarking Results report for the 3-year period ending December 31, 2012. He first thanked staff for providing all the needed MBOI data to compile the report. CEM data collected covers $2.7 trillion in invested assets. The U.S. Public Fund Universe utilized for the MBOI report is compiled of 58 public funds representing $1.8 trillion in assets. Cost analysis is based on a custom peer group with funds sized from $3.4 to $14 billion. The report compares cost and return performance relative to peers by measuring policy return, value added, costs and whether the costs paid are adding net value. The MBOI 3-year return of 10.0% was above the U.S. median of 9.3% and above the peer median of 9.1%.

MBOI policy return, or investing in the index according to policy mix, was 9.3%, compared with U.S. public median at 8.8% and the peer median at 8.6%. The net value added of zero, after adjusting for fees, outperformed the median which had a net value added of -0.2% for the U.S. public universe and -0.1% for peers.

Policy returns for the 3-year period reflect a favorable return for private equity at 11.0% and a relatively poor return of 3.3% for hedge funds. MBOI's overweight position in private equity and no assets invested in hedge funds proved beneficial over the period. Mr. Heale noted policy returns are based on policy mix, not the actual portfolio holdings. Mr. Mark Higgins added, however, that the policy mix of MBOI reflects closely the actual asset allocation of the portfolio. Mr. Heale stated the net gain of zero was positive compared to peers who were -(0.10) percentage points. He added over a 22 year time frame, active management does generate net added value, although modest at 0.18 percentage points for all US funds.

Asset management costs for 2012 were 61.5 basis points, or $48.0 million, down from 68.7 basis points in 2010. The benchmark cost, or the cost using the median costs incurred by peers for similar services, based on actual asset mix was 65.3 basis points, compared to actual costs of 61.5 basis points, resulting in a cost savings of 3.8 basis points. Utilizing less external active management than peers, 55% versus peers at 69%, accounts for some of the cost reduction as external management costs more. MBOI paid slightly more than peers for external manager costs for some services; however, differences in implementation style saved 4.3 basis points relative to peers. In addition to the comparison of asset management costs, the analysis of costs for oversight, custodial, and consulting showed a net cost savings of 0.9 basis points, or $713,000 vs. peers.

MBOI benefits by having fewer investments in fund-of-funds which will continue to decrease over time. Peers generally are paying less in fees for U.S. large cap stocks, and higher fees on private equity investments. Mr. Rande Muffick added holdings for large cap active stocks include 130/30 managers which are higher cost. Mr. Ewer clarified the CEM data is calculated on calendar years while MBOI reporting is on a fiscal year basis ending June 30. Mr. Heale added the implementation style changes have had an impact on overall costs but next year should show a larger impact. Mr. Sheets stated the restructuring of domestic stocks which increased passive management occurred in May, and in October for international holdings, so the complete effect is not reflected in one year's timeframe. The expectation is that net savings will be realized once the full restructuring is complete.

Mr. Heale summarized some of the key market trends. Total U.S. fund costs have increased from 39 to 60 basis points over the last 10 years due to changes in asset mix such as an increase in more expensive asset classes, including hedge funds and private equity and changes in style. The style trend towards external active management, which is the most expensive by far, has increased from 66% to 73% over time. Asset mix is the most important decision for fund management and value added net of costs is possible, but is modest with no large margin of error. U.S. funds over a period of 22 years averaged net added value of 18 basis points. Large funds generally fare better than small funds and realize substantial savings when more assets are managed internally due to lower costs. For instance a $20 billion fund will do better than a $1 billion fund. Investments in emerging market equities, small cap equities, and private equity have been rewarded given the high absolute returns for these asset classes over this 22 year timeframe.

Responding to a question from Member Buchanan regarding pension fund management costs for 2012 of $48.0 million, Executive Director David Ewer clarified that amount is the total for the pension fund management costs only, and the CEM report is for the calendar year. The MBOI annual report details custodial, management and operational fees for each fiscal year ending June 30 for all funds managed by MBOI. Ms. Gayle Moon explained generally accepted accounting principles (GAAP) dictate how financial statements are presented in the annual report.

Member Buchanan inquired about the possibility of including CEM cost data into the annual report. Executive Director Ewer noted that the narrative section of the annual report offers more flexibility of format for such inclusion than the financial section and he will discuss with staff the possibility of including the CEM results in some manner in the narrative section.

Responding to a question from Member Karl Englund whether MBOI is meeting the benchmarks over this time period when calculating actual returns minus actual costs, Mr. Heale stated yes, we are.

Mr. Mark Higgins added that while private equity is an expensive asset to invest in, the consensus is it has been a valuable investment for MBOI.

The meeting adjourned for the day at 4:34 PM.

Chairman Mark Noennig called the meeting to order at 8:30 AM and called for public comment. There was no public comment.

Public Employees' Retirement System and Teachers' Retirement System Update

Member Marilyn Ryan reported the Teachers' Retirement Board has narrowed down the search for the new executive director to two applicants to replace Mr. Dave Senn who is retiring. The two remaining applicants are Ms. Denise Pizzini and Mr. Shawn Graham. The TRS Board meets this coming Friday to make a final decision. Two applicants were interviewed. Two new Board members have been appointed to the TRS Board, Ms. Janice Muller and Ms. Lisa Cordingley. Mr. Scott Dubbs was reappointed. The computer system which runs all benefits payments is being replaced. The process will take two years to complete.

Member Sheena Wilson reported on the Public Employees' Retirement Board. The legislature enacted a new post-tax Roth IRA program in deferred comp. PERS is also replacing its computer system. The long process of digitizing the system will take years to complete. The system must be capable of accurately determining any estimates or buy backs for members. The process of implementing the pension bill, HB454, is underway.

FY 2013 Budget Review - Executive Director David Ewer and Deputy Director Geri Burton

Mr. Ewer presented a summary of the budget. The way we account for and manage costs includes several line items. For the "investment program" costs, the legislature sets a maximum charge within the internal service fund to the investment pools to cover operational costs and working capital within permissible levels. The Bond Program Office is a little different and is funded by the Board's enterprise fund through lending rates.

Secondly the legislature allows the MBOI, the Department of Administration (DOA) and the Treasurer as designated users of the custodial banking services. The state's depository bank is U.S. Bank in downtown Helena; when the state writes warrants, or checks, they are drawn on U.S. Bank. The custodial bank, State Street Bank of Boston (SSB), handles the cash flow through MBOI staff and staff at the DOA. Custodial banking is not paid under HB2 but is determined by statutory authority set by the legislature. Custodial fees are paid through a perpetual expenditure granted by statute, which can be repealed by statute as well. Custodial fees are paid by charges against the Board's investment pools and All Other Funds.

External management fee costs are a very important function and closely monitored by the Board. They are within the purview of the Board, and currently run about $40 million per year. Operational costs are budgeted at about $5 million per year, custodial services are budgeted at about $1.6 million per year. Custodial service costs are somewhat offset by our share of security lending income through State Street Bank. The Bond Program Office is not in HB2 but is paid through the enterprise fund granted by statutory authority. Participation in the Bond Program is voluntary and income depends on the gains, or the difference between revenues and costs, the spread between the users of INTERCAP and our costs. We are allowed statutorily to pay for bond interest under law.

The main driver of the budget is the director of the Department of Commerce (Commerce) who submits it to the governor's budget director. MBOI's final budget was very close to the budget estimate. The budget is on a two year cycle; however, the budget status is reported to the Board annually at the August Board meeting.

Member Jack Prothero asked if there were any items which stood out on the budget.

Deputy Director Geri Burton explained the personal services line item included non-budgeted compensated absences; the new executive director came on board and all his accumulated leave balance was attributed to the enterprise fund, rather than split between the internal service fund and the enterprise. Other contracted services in the FY14 budget are attributed to hiring Jackson & Walker, with the approval of the budget office, to handle private equity and certain real estate investment legal services. Jackson & Walker is a Houston firm and the bulk of their clients are investors such as MBOI, working specifically in private asset transactions, which are very complex.

Luxan & Murfitt, LLP, continues to handle some of the Board's private asset legal services; however, Jackson & Walker offer more specialized experience in this area when needed.

Research services are a large budget item and fluctuate from year to year. Increases are due to the timing of invoices and increases in the cost of services. Credit Sights is up due to service add-ons we have implemented. Other increases are due to the regular yearly increases.

The Department of Commerce charges its divisions, including MBOI, a fee for human resource and legal services and increased this fee from 12.95% to 14.65% for FY14 and FY15.

Member Buchanan asked if the reduction in total fees from $46 million in FY12 to $43.4 million in FY13 is due in part to the transition from active to passively managed stocks. Executive Director Ewer stated yes, going to more passive management has saved costs.

Representative Kelly McCarthy advised he was on the legislative committee that granted the Department of Commerce the service fee increase. Ms. Burton added in the past when the Department of Commerce collected fees in excess of expenses, they would eliminate the fee for a month, or more if needed, but the decrease was not based on use.

CONSULTANT REPORT

R.V. Kuhns & Associates – Mr. Mark Higgins, CFA

Mr. Mark Higgins presented a market overview for the quarter ending June 30, 2013. Returns for the second quarter were mixed. Real gross domestic product (GDP) grew at 1.5% accompanied by moderate employment growth. Strong housing and shrinking deficits as a result of sequestration and added tax revenues helped, but the Fed is hinting at cutting back on quantitative easing which may continue to put upward pressure on interest rates. Fixed income has seen losses for the quarter but the S&P 500 was up 3%. MBOI's overweight in U.S. equities was beneficial; emerging markets were down almost 8% and China remains a concern. MBOI's slight overweight in emerging markets, while good over the long term, has hurt in the short term. Private equity has continued to perform well on a relative basis, but has trailed (as expected) behind public equities in a strong bull market.

Overall Fund Performance

Over the previous 5 and 7 year period, the retirement plan has trailed the index, but is improving in more recent periods. In addition, relative to peers, the fund has performed well, ranking in the 35th percentile over 7 years and 43rd percentile over 5 years. Mr. Higgins also noted that performance relative to benchmarks has trailed due to the lagging nature of private equity. Compared to the peer median in terms of risk versus relative return, taking less risk with higher return is the ideal outcome. Over 5 years, MBOI accomplished this and achieved a higher return with less risk. Over the 10 year time frame, MBOI had less risk but also less return; however, the intent is to continue to improve this over time as underperforming years extend beyond 10 years.

Asset Class-Level Performance

Looking at the asset class pools, domestic and international equity one year returns look good relative to the benchmark. Three year returns are slightly above for international equities and slightly below for domestic equities versus the benchmark. The move to passive management is expected to continue to be beneficial over the long term, and while the one year period is too soon to offer a definitive verdict on these efforts, the trend is positive. Mr. Higgins noted that small and mid-cap managers have recently been added to the portfolio, and the process is underway for international managers.

Member Buchanan asked that if passive management has been a positive move, would it be beneficial to increase the passive management even more. Mr. Higgins responded international assets are less efficient so hiring managers can be beneficial. He also noted that passive management is not an option for real estate and private equity. Outside managers have been utilized well for fixed income in the Retirement Fund Bond Pool (RFBP) and Trust Funds Investment Pool (TFIB) and both ranked favorably to peers in the top quartile.

Mr. Higgins noted that a conference call was conducted with Post Advisory due to concerns with the main partner retiring from the company. Mr. Nathan Sax has also followed up and both teams are comfortable with the changes.

The Montana Real Estate Pool (MTRP) is trailing the benchmark by 359 basis points over 7 years which raises concern. Timing is an issue, and the inclusion of timber is a consideration. Market entry in 2007 was not the best starting point and the effects are still being felt. That said, Mr. Higgins noted that focusing in on real estate for a potential Board member educational session could be helpful.

Private equity is benchmarked against the S&P 1500 plus 4% and is underperforming the benchmark for the first time for the 7 and 10 year periods. Mr. Higgins reminded the Board members that private equity tends to lag the benchmark, and the strong bull market has had a substantial impact on relative returns. Responding to a question from Member Buchanan, Mr. Higgins clarified, with such a strong bull market over the short term, even short term returns have a material impact on the long term returns. Mr. Cliff Sheets added the strong returns of the past quarter had an impact on the 10 year numbers. He also noted that private equity is tracked against the public equity returns and we now have 19 year returns; private equity has returned 16% versus 8% for domestic equity so the asset class is earning its way. Mr. Higgins noted that while fees are high and returns may not have reached the 4% premium of the benchmark, private equity has earned millions relative to public equity over the 19 year asset history.

Member Karl Englund noted at each Board meeting there is discussion regarding the private equity benchmark of S&P 1500 plus 4%. Mr. Sheets stated there is no appropriate private equity benchmark, so it must be approximated using Private Edge and the public equity benchmark. The asset class has a lot of unique characteristics. CEM uses our benchmark as it was a better fit. The need for a timely benchmark to measure quarterly returns when using peer comparisons is not a viable option due to the lag in returns.

Executive Director Ewer added discussion explaining the justification for how the benchmarks are used and determined is beneficial for the Board. For instance why has STIP never underperformed? The fund has a longer duration than the corresponding benchmark to increase yield, and in bonds we have consistently over-weighted corporates, so we always realize a difference from the benchmark. Each benchmark carries nuanced aspects and it is important to understand the characteristics of each and how they compare to our holdings.

Senator Dave Lewis inquired if when reporting to the legislative caucus leadership if it is fair to say MBOI is middle of the road when analyzing returns. Mr. Higgins noted MBOI has slightly better performance than peers, net of fees and the CEM report showed slightly lower costs with slightly better returns. Mr. Higgins concluded by offering some thoughts on the market outlook going forward. Global markets are hitting some uncertainty and markets tend to get more volatile with the threat of higher interest rates which could impact markets adversely.

INVESTMENT ACTIVITIES/REPORTS

Retirement System Asset Allocation Report, Mr. Cliff Sheets, CFA

Mr. Sheets presented the asset allocation report detailing changes in allocation and performance for the fiscal year and quarter ending June 30, 2013. For the calendar quarter, pension funds returned

just 1%. Returns on private equity, real estate, and domestic equities were positive, while fixed income and international returns were negative. The allocation to total equity was unchanged; domestic allocation increased by 0.2% due to strong returns, international equity shrank by (0.3)%, and the allocation to private equity went up by 0.1% Sales of $40 million were made from private equity during the quarter to remove excess liquidity due to net positive distributions received from the underlying funds. The allocation to fixed income has since slipped below the 22.1% allocation on June 30 due to strong public equity returns diluting fixed income. Cash flow for pensions remains negative on balance overall, however the new pension laws in place should help mitigate the imbalance.

Member Jon Satre asked if a $15-20 million negative cash flow is normal. Mr. Sheets advised that cash outflow for all nine pension plans for fiscal year 2012 averaged $6.6 million monthly, while fiscal year 2013 averaged $10.5 million per month, so a substantial increase. Sales from pools must be made to cover cash needs for the payment of benefits, rather than holding excess cash given its low return; new contributions coming in should help.

Fiscal year 2013 was a period of strong returns in all asset classes except fixed income. Public equity returns were dramatic and total equity allocation was up to 67.4% compared to 66.1% a year ago. The allocations to international and domestic equities are up over last fiscal year; the private equity allocation was reduced due to the dilution effect of strong public equity performance and private equity pool sales. The private equity pool had weaker relative returns compared to public stocks, but still a strong 12.55% for the fiscal year. The real estate allocation was up a meaningful amount, 1.1%, over a year ago and had a return of 8.55% for the fiscal year. Fixed income allocation dipped from 24.9% a year ago to 22.1% at fiscal yearend, nearing the low end of the approved range; returns were weak but still positive at 1.6%. Allocation to the Retirement Fund Bond Pool (RFBP) will be increased if it remains below the range, as occurred subsequent to quarter-end. Overall, all asset class returns paled in comparison to domestic stocks.

Allocation comparisons versus public fund peers having assets in the $3-20 billion range with at least 30% equity are comparable for overall public equity exposure. We are at a 38.3% domestic equity allocation which is very similar to the peer median, though our allocation is lower than peers in international equity by 2.5% which has helped our relative performance. Fixed income holdings are comparable to the peer median. Only 26 peer plans have real estate exposure and here we are above the median, likely in the 2nd quartile. We are also above the median for private equity.

Mr. Sheets stated it is important to take comfort in how our plan is doing in both comparisons to peers and benchmarks. Looking at the 5-year returns, while we underperformed the custom benchmark by 42 basis points, it is important to remember the custom benchmark used for private equity is rolled up into the custom benchmark. This effect alone had a notable impact and accounts for more than the 42 basis points shortfall. Overall, benchmark comparisons are good and getting better. Costs do matter and we are efficient and improving; costs are driven by asset allocation. The returns corroborate that the changes we've made have been beneficial. We have made institutional improvements over the last seven years and it is showing in a revealing way. More diversification has helped us during a time when the market volatility has been severe; on a risk adjusted basis we are doing well. Pension returns were in a big hole, yet now the actuarial effect of smoothing is positive. Staff and the Board should be commended.

Chairman Mark Noennig added the agencies presenting today showed appreciation for MBOI and were very complimentary to staff. Thank you to staff.

Private Asset Pool Reviews

Montana Private Equity Pool (MPEP)

Mr. Ethan Hurley presented the private equity report for the quarter ended March 31, 2013. New commitments totaled $190 million in the past year. Cash flow was positive through fiscal year end; the 4th quarter of 2011 was the only negative cash flow quarter in recent history. Total exposure by industry is broadly diversified; we leave individual underlying investment decisions up to manager discretion. Geographic exposure is mostly within North America. We continue to focus on direct investments and generally avoid fund of funds investments, which will continue to decrease over time. Responding to a question from Member Buchanan, Mr. Hurley confirmed fees for fund of funds have decreased over last year from 110 basis points to 98 basis points.

Executive Director Ewer explained when the Board started investing in private equity many years ago, it hired fund of funds managers mostly, and there is still a place for them when direct investment is not feasible. Mr. Hurley added there is a need, mostly in venture capital and for investments in Asia; we did re-up with Axiom Asia, a fund of funds manager. So in niche markets, there is a place for them. The snapshot of returns for the overall portfolio looks good at a net multiple 1.46 times since inception in 1988, so for every dollar invested, $1.46 has been returned.

Responding to a request from Member Buchanan to add the 10 year return numbers, Mr. Hurley stated they will be included going forward.

Member Jack Prothero asked if there were any notable changes in the portfolio. Mr. Hurley said no, most returns were in line with last quarter.

Two new commitments were made since the last Board meeting; $20 million to Trilantic Capital Partners V (North America), LP, a top quartile manager for us in the last fund and $15 million to Southern Capital Fund III, LP a small SE Asian fund, a control oriented manager. Southern Capital is an attractive fund and the general partners made large contributions of their own.

Fund Name	Vintage	Subclass	Sector	Amount	Date
Trilantic Capital Partners V (North America), LP	2013	Buyout	Diversified	$20M	5/22/13
Southern Capital Fund III, LP	2013	Buyout	Diversified	$15M	6/7/13

Member Jon Satre asked Mr. Hurley how he became aware of the new fund.

Mr. Hurley stated he was aware of Southern Capital and had been tracking them for the past year or so. The fund was highly over-subscribed but we managed to secure an allocation.

Mr. Hurley clarified how we receive payment from private equity investments. Before general partners get any profits they must pay us all expenses and capital back, then typically a minimum percent to us called a preferred return, then they can take a share of any profits. Looking at the State Street Bank comparison for private equity, MBOI has outperformed, paying in less and receiving more back when compared to peers.

Montana Real Estate Pool (MTRP)

Mr. Ethan Hurley presented the real estate report for the quarter ended March 31, 2013. An additional commitment of $40 million was made in TIAA-CREF Asset Management Core Property Fund, LP, since the last Board meeting. They are already included in the Trust Fund Investment Pool and the Montana State Fund portfolio. They are a known entity among our core funds and they were able to put equity to work right away. For the fiscal year, we committed $130M to a total of 5 real

estate managers: two new managers and three existing managers. Real estate is recovering slowly; vintage funds are not distributing a lot of capital, so withdrawals are still outpacing contributions.

Fund Name	Vintage	Subclass	Sector	Amount	Date
TIAA-CREF Asset Management Core Property Fund, LP	N/A	Core	Diverse	$40M	5/1/13

Geographically the pool is diverse, and as with private equity we leave it up to the managers to make individual investment decisions. Property type is also well diversified; timber has been a nice addition. Core timber adds value and so far the numbers have been positive. Responding to a request from Member Buchanan, Mr. Hurley noted the 7 year numbers will be added to the report.

Partnership Focus List

There were no changes to the MPEP or MTRP Focus lists since the last Board Meeting, although some additions may be coming.

Montana Domestic Equity Pool (MDEP)

Mr. Rande Muffick reported on the Montana Domestic Equity Pool (MDEP) for the fiscal year ending June 30, 2013. Public equity returns have been very good for the fiscal year and the market as a whole has done well. The Federal Reserve has been signaling possible easing. The market has done well on all style and cap sizes overall with mid and small cap leading the way. The Montana Domestic Equity Pool (MDEP) had a good year of relative performance; active managers performed well and the overweight of mid and small cap added value as they did better than large cap stocks. Our managers did well overall; six managers outperformed and three underperformed the benchmarks for the fiscal year. Of the four new managers added May 1, 2013, three, Iridian, Nicholas and Met West are outperforming so far, which would be expected in an up market. The fourth, ING, a downside manager characteristically, is slightly down, but actually did better than we expected. In the brief two month history since they were hired, all managers are performing as expected and added diversification. At some point in the future we will look at adding more funds with these new managers to further complement our old managers and add further diversification; for now we will let things settle in with the recently added managers.

Montana International Equity Pool (MTIP)

Mr. Rande Muffick reported international markets also performed well for the fiscal year, however not as well as the domestic markets due to struggles with the emerging markets and continued concern over China. Emerging markets, some with double digits negative returns for the second quarter, dragged markets down for the fiscal year, particularly value stocks. The Montana International Investment Pool (MTIP) outperformed the benchmark by 59 basis points for the fiscal year ending June 30, 2013. Active management did add value for the fiscal year.

All three style buckets did well and outperformed for the fiscal year. The manager search for emerging markets and international small cap is in the final stages. We are looking at three managers and legal is looking over the contracts. Emerging market manager interviews will be done after the final review of contracts is completed and is the final phase of the MTIP restructuring. Both emerging market and small cap manager decisions should be made by this fall. Emerging market exposure was added in the second quarter; the all country world index also has some exposure. Emerging markets do carry risk, but now is a good time to add on. The Board has approved the index change which will occur when the new small cap managers are funded. The MSCI ACWI IMI Index is better suited to the portfolio changes that will be made in the near future.

Member Karl England asked why invest in emerging markets if it adds volatility.
Mr. Muffick responded we will invest close to the benchmark and when looking at the 20 year history of emerging markets in the CEM report, emerging markets outperform. Additionally, emerging markets are less correlated to U.S. stocks.

Mr. Sheets noted the emerging market component can be volatile, but broad country diversification is desired and over time the higher relative growth of these economies will help their markets do well. Mr. Sheets added a cautionary note regarding the performance of public stocks; they are not expected to continue as they have with such magnificent returns. Over the long term, expect 8%. The S&P 1500 has been up 18% annually over the last three years which will not continue uninterrupted. As the Federal Reserve backs off, there could be market setbacks, especially in the latter part of the year. The economy continues to grow and is fundamentally positive. The question is can the market survive an interest rate increase? Policy uncertainty may also affect the market going forward, although at this point we are not expecting a major setback.

Public Equity External Manager Watch List

Mr. Muffick stated there were no changes to the watch list this quarter. Hansberger and Alliance Bernstein have both shown improvement but are still lagging a bit.

PUBLIC EQUITIES MANAGER WATCH LIST

August 2013

Manager	Style Bucket	Reason	$ Invested (mil)	Inclusion Date
Alliance Bernstein	International – LC Value	Performance	$99.3	August 2012
Hansberger	International – LC Growth	Performance	$103.0	May 2013

Fixed Income

Mr. Nathan Sax presented the Fixed Income overview and strategy. Interest rates rose dramatically during the last quarter due to comments by Federal Reserve Chairman Ben Bernanke that the Fed would start tapering back on monthly Treasury and mortgage backed securities purchases.

For the fiscal year ending June 30, 2013, Reams Asset Management outperformed the universal index and their performance over three years puts them in the 34th percentile vs. similar managers; Artio Global also outperformed their benchmark, by 120 basis points, and is in the 44th percentile over three years; Post Advisory outperformed over three years and is in the 15th percentile for this timeframe and Neuberger Berman outperformed as well and is in the 37th percentile over three years.

The Core Internal Bond Pool (CIBP) and Trust Fund Bond Pool (TFBP) had relative good performance for the fiscal year. The Retirement Fund Bond Pool (RFBP) has outperformed the benchmark 196 basis points per year over the past three years and the Trust Fund Investment Pool (TFIP) has outperformed the benchmark by 190 basis points over the past three years. Staff manages 72% of the fixed income assets internally. The investment grade fixed income benchmark returned -(69) basis points over the fiscal year but high yield had a strong return of over 9% which helped our overall fixed income performance. It's difficult to predict changes in interest rates in the next year. There were no changes in the below investment grade holdings.

Member Jack Prothero asked if problem bonds were generally sold off. Mr. Sax responded since we do not have a "must sell" policy on downgraded bonds, each is looked at on a case by case basis. Mr. Sheets stated if it's a hopeless case the bond is sold, but if there is a possibility for recovery, even downgrades are sometimes held. Mr. Sax noted that Post Advisory was added to the watch list due to the upcoming retirement of Larry Post as head of the company for over 45 years. They have lost three key personnel with the exit of Mr. Post and while performance remains good, we want to be sure staff will stabilize after his departure so are watching them closely.

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

Mr. Richard Cooley presented the STIP report for the quarter ending June 30, 2013. Money markets remain unchanged, while credit conditions have improved; spreads are more compressed and rates are lower in the 30-60 day range. The net daily yield on STIP is 18-19 basis points. The portfolio has

the built in advantage of buying longer duration securities. The STIP is well diversified and the fund balance remains at $2.6 billion, the same as last quarter.

The Treasurer's Fund was valued at $1.27 billion at fiscal yearend. There was a purchase of $10 million in securities in the last quarter. Rates are gradually creeping up in the 2-3 year maturity periods.

Montana State Fund was five basis points below benchmark for the quarter, but outperformed the benchmark by 119 basis points for the fiscal year ending June 30, 2013. The portfolio has performed above the benchmark by 110 basis points for the past five years. The purchase of real estate which was approved at the February 2013 Board meeting was completed on July 1, 2013, completing the $70 million allocation. S&P 500 Index fund units were sold to bring the equity holdings allocation down below the client preference of 12%. Due to strong equity markets and weak bond performance, equities allocation had increased to 11.65% at fiscal yearend.

Recap and To Do List
Staff will consider including the CEM report findings in the narrative of the Board's annual report;
R. V. Kuhns will have another educational presentation for an upcoming Board meeting;
Private equity reports will include the ten year performance data;
Member Satre asked if R.V. Kuhns would review past terminated managers; and
Member Buchanan asked for the Human Resource Committee to consider reviewing exempt staff performance in August when year-end performance is also reviewed.

ADJOURNMENT

There being no further business, the meeting was adjourned at 12:07 PM.

Next Meeting
The next regular meeting of the Board will be Tuesday November 19, 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 E. Noennig
Mark Noennig, Chairman

ATTEST: David Ewer
David Ewer, Executive Director

DATE: 12/2/2013

MBOI:drc
10/21/13