These minutes are Approved and Final. Full Board review and decision took place at the August 20 - 21, 2013 Regular Meeting of the Board.

MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE
The Northern Hotel
19 North Broadway, 2nd Floor
Billings, Montana

MINUTES OF THE MEETING
May 29, 2013

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

BOARD MEMBERS ABSENT:
Quinton Nyman

LEGISLATIVE LIAISONS PRESENT:
Senator Dave Lewis
Representative Kelly McCarthy

STAFF PRESENT:
Geri Burton, Deputy Director
Dana Chapman, Board Secretary
Richard Cooley, CFA, Portfolio Manager, Fixed Income/STIP
David Ewer, Executive Director
Ethan Hurley, CAIA, Portfolio Manager, Alternative Equities
Herb Kulow, MCMB, Portfolio Manager, In-State Loan Program
Rande Muffick, CFA, Portfolio Manager, Public Equities
Nathan Sax, CFA, Portfolio Manager, Fixed Income
Clifford A. Sheets, CFA, Chief Investment Officer
Louise Welsh, Senior Bond Program Officer
Dan Zarling, CFA, Director of Research

GUESTS:
Jim Voytko, R.V. Kuhns and Associates
Mark Higgins, R.V. Kuhns and Associates
John Harrington, Legislative Audit Division
Ross Johnson, Legislative Audit Division
Scott Turner, Finance Director, Yellowstone County
Wayne Dykstra, Board Member, Montana State Fund
Terry Moore, CFO, First Interstate Bank, Billings
Matt Brown, Associated Press
Jim Gransberry, Citizen

CALL TO ORDER
Board Chairman Mark Noennig called the regular meeting of the Board of Investments (Board) to order at 11:47 AM in the Hart Albin Room on the second floor of the Northern Hotel at 19 North Broadway, Billings, Montana. As noted above, a quorum of Board Members was present. Board Member Quinton Nyman was absent.

Chairman Noennig introduced newly appointed Legislative Liaisons Senator Dave Lewis and Representative Kelly McCarthy. The Chairman then asked Board and staff members to introduce themselves.

Chairman Noennig called for any corrections or revisions to the Board minutes from the April 2, 2013 meeting. Member Sheena Wilson noted the omission of her name in the Board Member listing on page one. Board Secretary Dana Chapman advised the correction has been made.

> Board Member Gary Buchanan made a Motion to approve the Minutes of the Board meeting on April 2, 2013, as corrected. Member Wilson seconded the Motion. The Motion was carried 8-0.

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

ADMINISTRATIVE BUSINESS

Human Resource Committee Report

The Human Resource Committee met prior to the Board meeting. Committee Chair Karl Englund reported the Committee discussed two items and approved two motions. The first item discussed was the proposed pay increases, effective July 1, 2013, for exempt staff.

> Committee Chair England made a motion to approve the Committee's recommendation to provide pay increases to exempt staff as follows:

Executive Director	8.50%
Chief Investment Officer	9.75%
Portfolio Manager Domestic and International Equities	8.50%
Portfolio Manager Fixed Income/STIP	8.50%
Portfolio Manager Fixed Income	5.50%
Portfolio Manager Alternative Investments	5.50%
Portfolio Manager In-State Loan Program	5.50%
Director of Research	5.50%

> Member Jon Satre seconded the motion.
>
> After a brief discussion, Member Gary Buchanan made a substitute motion to provide a blanket 5.50% raise for exempt staff with further Board discussion to be held regarding performance and benchmarks upon receiving the final June 30, 2013 performance data. Member Jack Prothero seconded the substitute motion. The motion failed by a vote of 7-1. Member Buchanan voted aye.
>
> The Board voted on the original motion to approve the Human Resource Committee's recommended raises for exempt staff. The motion passed 7-1, Member Buchanan voted nay.

Committee Chair Englund presented the second item discussed by the Human Resource Committee. The Committee voted to approve staff recommendations to revise the wording of the Governance Manual to reflect in more detail the specific duties being performed by the Chief Investment Officer position. In addition, minor changes are proposed to the Executive Director position clarifying the delegation of authority.

Committee Chair England made a motion to approve the proposed changes to the Governance Manual. Member Kathy Bessette seconded the motion. The motion passed 8-0.

Audit Committee Report

Audit Committee Chair Jon Satre reported on the three items discussed at the Committee Meeting held prior to the regular Board Meeting. The Securities and Exchange Commission (SEC) inquiry of State Street Bank seeking information from MBOI on foreign exchange transactions has been complied with. No further action is required at this time.

Galusha, Higgins & Galusha personnel have completed the on-site portion of the FY13 internal controls review. The written report is expected in August.

Mr. John Harrington and Mr. Ross Johnson from the Legislative Audit Division presented an update on the upcoming performance audit. The planning phase has been completed and both Mr. Harrington and Mr. Johnson expect to be on-site next week. They will meet with staff and Board members during the on-site phase.

Loan Committee Report

The Loan Committee met prior to the Board meeting. Committee Chair Jack Prothero reported that Mr. Herb Kulow presented staff recommended changes to four In-State Loan Program policies:

- Commercial Loan Policy
- Value Added Loan Policy
- Infrastructure Loan Policy
- Veterans' Home Loan Mortgage Policy

Committee Chairman Jack Prothero made a motion to approve the proposed changes to the four In-State Loan Program policies as presented. Member Marilyn Ryan seconded the motion. The motion passed 8-0.

The Loan Committee also reviewed staff recommended changes to the INTERCAP Loan Program Policy and the University System INTERCAP Loan Policy. Changes proposed for the INTERCAP Loan Program Policy incorporate revisions previously approved by the Board as well as a few minor technical changes. The changes to the University System INTERCAP Loan Policy cap the outstanding loan balance for both the University of Montana and Montana State University to 19% of the total INTERCAP loans outstanding. The changes help to avoid a concentration in the portfolio of university system loans which could affect marketability of the Program's bonds and addresses regulatory reporting requirements which would be required for an outstanding balance by a single borrower of 20% or more. The additional reporting requirements would burden both Board and University staff by requiring the collection and dissemination of extensive financial and operating data information.

Committee Chairman Prothero made a motion to approve the proposed changes to the INTERCAP Loan Program Policy and the University System INTERCAP Loan Policy as presented. Member Marilyn Ryan seconded the motion. The motion passed 8-0.

The Loan Committee approved three INTERCAP loans:

- $1,768,000 interim financing loan to the City of Libby for water distribution lines in anticipation of USDA Rural Development long term financing;
- $3,100,000 interim financing loan to DNRC for Water Pollution Control State Revolving Fund (SRF) Program in anticipation of GO bond issue; and
- $1,750,000 interim financing loan to DNRC for Drinking Water State Revolving Fund (SRF) Program in anticipation of GO bond issue.

The Loan Committee also reviewed staff recommended changes to the Treasurer's Fund Investment Policy Statement. The changes made to the policy specifically authorize a Treasurer's Fund investment in an MBOI-Montana Comprehensive Health Association (MCHA) loan.

Committee Chair Prothero made a motion to approve the proposed changes to the Treasurer's Fund Investment Policy Statement as presented. Member Marilyn Ryan seconded the motion. The motion passed 8-0.

The Loan Committee also approved a loan presented by Mr. Herb Kulow for a $2 million single advance loan to Montana Comprehensive Health Association, a program which serves Montanans not eligible for coverage under traditional insurance. The loan term is 90 days at an effective annualized rate of 2%.

Committee Chair Prothero made a motion to approve the loan to Montana Comprehensive Health Association as presented. Member Gary Buchanan seconded the motion. The motion passed 8-0.

Member Karl Englund introduced and welcomed former Board Chairman Terry Moore to the meeting.

EXECUTIVE DIRECTOR'S REPORT

Overall Comments

Executive Director Ewer presented his executive director's memo. One item regarding member requests from prior meetings was reviewed. Staff will continue to inform the Board of upcoming conferences and educational opportunities as soon as possible to allow for adequate time to plan and attend any beneficial events.

Asset Allocation will come before the Board at the November Board meeting.

Member Buchanan asked if the upcoming pension fund discussions regarding the 7.75% actuarial rate will involve the Board.

Executive Director Ewer advised Montana Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) are the main drivers in the actuarial rate discussion. TRS will likely determine and recommend what they think the assumed return will be, but they will confer with MBOI before the determination is made.

Mr. Jim Voytko commented the assumed rate of return is very important and the assumed rate in Montana drives the unfunded liability. If the assumed rate had a material effect on contributions it would be a different picture.

Executive Director Ewer reviewed the Quarterly Cost Report showing the Board fees, custodial fees and manager fees. They fluctuate throughout the year so it is difficult to make quarter-to-quarter comparisons. Responding to a question from Senator Lewis, Mr. Ewer stated the FY 2013 fees so far total $30 million and the projected total for the fiscal year is expected to be between $45-50 million. He stated private equity fees lag and additionally, when stocks increase in value, fees increase, as they are based on a percent of market value of the invested funds.

Member Buchanan noted the cost in fees is approximately 57 basis points. Mr. Ewer agreed fees are between 50-60 basis points and added an analysis of our costs vs. other pension funds is now being conducted. During the past two years, MBOI fees have been slightly lower, while producing slightly better performance.

Executive Director Ewer reviewed the 2014 Work Plan briefly stating the lack of scheduled items for the October Board meeting may allow skipping the October meeting. After a brief discussion the Board agreed to review the need for the October meeting at the August meeting.

Mr. Ewer advised the Department of Commerce took the necessary steps to repeal Board rules which pertained to the now repealed Montana Capital Company Act. No Board action is needed.

Mr. Ewer reviewed staffing and budget items. The last two FTE's are in the process of being filled. There were initially six vacant FTE's when Mr. Ewer started as executive director, one position was passed on to Commerce. Accounting is now fully staffed and the two positions currently in the process of being filled are an alternative equity analyst and an investment performance analyst which is currently filled on a contract basis by Chris Phillips.

The Work Plan calls for the annual budget review in August. The 2013 Legislative House and Senate concurred with the MBOI budget. Staff will present the budget to the Board showing operation costs, overhead and research.

The major bills regarding pensions in the legislature were House Bill 454 and House Bill 377. The changes were substantial and complex. General fund cash and coal tax allocations in conjunction with a reduction in the Guaranteed Annual Benefit Adjustment (GABA) will be implemented on the pension funds. The changes represent a significant benefit to the funded status of the pension plans.

There was a brief discussion regarding a possible legal challenge to the reduction of GABA from 3% to 1.5% that was approved by the legislature. No suit has been filed to date. Chairman Noennig noted this issue may need further Board discussion if a suit is filed.

MONTANA LOAN PROGRAMS

In-State Loan Program

Mr. Herb Kulow presented an update of the commercial and residential loan program portfolios. As of April 30, 2013 the commercial loan program had 120 outstanding loans totaling $121,633,939; down $15,045,721 from a year ago and down approximately $85,000,000 since 2007. There are five past due loans, totaling $920,375, representing 0.75% of the portfolio.

The residential loan program has 369 loans totaling $16,034,337, a decrease of $5,202,233 since April 2012. There are eight loans past due totaling $498,389, or 3.11% of the portfolio. Seven loans totaling $433,646 or 2.70% of the portfolio were past due 90 days or greater, of which 5 loans were guaranteed representing $340,345 or 2.12% of the portfolio.

The Veterans' Home Loan Mortgage Program has grown to 57 loans totaling $9,924,094. The balance of coal tax money remaining for the program, after considering outstanding reservations of $3,424,007, is $1,651,899 prior to the additional $15,000,000 allocated in the most recent legislative session. The current portfolio yield is 1.45%. The BOH bond interest rate is 2.75%, established when BOH sold bonds totaling $25 million at market, which became effective May 3, 2013. The rate will not change until BOH sells additional bonds at market. The current interest rate for veterans using the program is 1.75% for a fixed rate 30 year loan and is determined by statute as 1% less than the lower of the Board of Housing (BOH) sold bond rate or market interest rate. Net yield to MBOI is 1.0% after deducting the BOH service and administration fees of .375 each. The potential for problem loans exists as the borrowers only have to put $2,500 down on an average loan size of $175,000; however, there is recourse for overdue loans past 30 days as the bank has to repurchase the loan.

BOND PROGRAM REPORTS

Activity Report

Ms. Louise Welsh reviewed the quarterly Activity Summary report and presented the staff approved loans. Ms. Welsh noted there were two bills in the legislative session which may be relevant to the Bond Program. The governor vetoed House Bill 301 which would have raised the bond debt limit for school districts on general obligation bonds from 50% to 100% of the taxable property value. The other bill, Senate Bill 175, which passed and was signed by the governor revises school finance laws reducing school district property taxes and redirecting oil and gas tax revenues from the state general fund to a new fund in support of school base budgets.

Staff approved loans are listed below:

Borrower:	Sweet Grass County
Purpose:	Purchase two new patrol cars
Staff Approval Date	January 11, 2013
Board Loan Amount:	$68,000
Other Funding Sources:	$22,456
Total Project Cost:	$90,456
Term:	5 years
Borrower:	Toole County
Purpose:	Purchase hospital equipment/software for Marias Medical Center
Staff Approval Date	January 11, 2013
Board Loan Amount:	$579,394
Other Funding Sources:	$476,616
Total Project Cost:	$1,056,010
Term:	5 years
Borrower:	City of Libby
Purpose:	Finance preliminary engineering services
Staff Approval Date	January 17, 2013
Board Loan Amount:	$462,623
Other Funding Sources:	$1,148,377
Total Project Cost:	$1,611,000
Term:	6 years
Borrower:	McCone County
Purpose:	Purchase a pickup for the Road Department
Staff Approval Date	January 18, 2013
Board Loan Amount:	$29,230
Other Funding Sources:	$0
Total Project Cost:	$29,230
Term:	5 years
Borrower:	Town of Culbertson
Purpose:	Purchase a refuse vehicle
Staff Approval Date	January 28, 2013
Board Loan Amount:	$42,000
Other Funding Sources:	$0
Total Project Cost:	$42,000
Term:	7 years
Borrower:	City of Red Lodge
Purpose:	Replace 16 blocks of water mains, fire hydrants and valves
Staff Approval Date	February 7, 2013
Board Loan Amount:	$616,243
Other Funding Sources:	$2,057,715
Total Project Cost:	$2,673,958
Term:	15 years

Borrower:	Opportunity Rural Fire District
Purpose:	Purchase a new Fire Tender (Truck)
Staff Approval Date	February 13, 2013
Board Loan Amount:	$180,000
Other Funding Sources:	$100,000
Total Project Cost:	$280,000
Term:	10 years

Borrower:	Lewis and Clark County
Purpose:	Improve Big Sky Subdivision Rural Improvement District (RID) roads
Staff Approval Date	February 28, 2013
Board Loan Amount:	$194,737
Other Funding Sources:	$0
Total Project Cost:	$194,737
Term:	15 years

Borrower:	Town of Superior
Purpose:	Construct Town offices
Staff Approval Date	March 5, 2013
Board Loan Amount:	$105,000
Other Funding Sources:	$93,000
Total Project Cost:	$198,000
Term:	10 years

Borrower:	White Sulphur Springs High School District
Purpose:	Replace boiler system
Staff Approval Date	March 11, 2013
Board Loan Amount:	$450,000
Other Funding Sources:	$365,000
Total Project Cost:	$815,000
Term:	2 years

Borrower:	Town of Whitehall
Purpose:	Update a preliminary engineering report
Staff Approval Date	March 12, 2013
Board Loan Amount:	$15,000
Other Funding Sources:	$0
Total Project Cost:	$15,000
Term:	3 years

Borrower:	Missoula County
Purpose:	Purchase telemetry system for Lolo Water & Sewer District (RSID)
Staff Approval Date	March 15, 2013
Board Loan Amount:	$130,000
Other Funding Sources:	$20,000
Total Project Cost:	$150,000
Term:	5 years

Borrower:	Three Forks School District
Purpose:	Replace boiler system
Staff Approval Date	March 25, 2013
Board Loan Amount:	$132,500
Other Funding Sources:	$50,505
Total Project Cost:	$183,005
Term:	3-4 years

Borrower:	North Valley Public Library District (Stevensville)
Purpose:	Refinance building mortgage
Staff Approval Date	March 28, 2013
Board Loan Amount:	$68,000
Other Funding Sources:	$0
Total Project Cost:	$68,000
Term:	15 years

MONTANA UNIVERSITY SYSTEM

Borrower:	Montana State University-Bozeman
Purpose:	Purchase truck for KUSM, public television station
Staff Approval Date	February 15, 2013
Board Loan Amount:	$30,000
Other Funding Sources:	$0
Total Project Cost:	$30,000
Term:	5 years

BOARD'S REAL ESTATE HOLDINGS IN MONTANA

Deputy Director Geri Burton presented a report on the real estate holdings in Montana. MBOI owns four buildings and one parcel of land and administers them as investments in the retirement system portfolio. The holdings originally were held jointly by the Teachers' and Public Employees' Retirement Systems, but in 2011 the holdings were moved to the Montana Real Estate Pool to benefit all nine pension funds.

The first property was acquired in 1995 when the Board authorized the purchase of the Park Avenue building in Helena. It is well maintained and some major improvements have been made. The second building was the Colonial building in Helena when in 1997 the Board authorized the purchase of land to construct a new office building which would house the MBOI offices as well as additional tenants. The building was completed and the MBOI offices moved to the new location in the fall of 1999. State agency and private tenants moved into the remaining space. The building recently had new carpet installed and wainscoting added. A keyless entry system will be installed in the late summer or fall. The land owned by the Board is on California Street directly behind the Red Lion Colonial Hotel next to the Colonial building and was purchased in December 1998. The Bozeman building located at 2273 Boot Hill Court involved the construction of a one story office building on school trust land and houses four state agencies. The building at 1712 9th Avenue was purchased by and for PERS in 1968. The ownership deed was changed in 2000 to reflect Montana Board of Investments as the owner. The building houses two state agencies.

Executive Properties in Billings manages all the properties, including all incoming and outgoing payments. The properties are well maintained, in good locations with long standing tenants. Upcoming improvements include electrical work at the Park Avenue building and the keyless entry at the Colonial building.

Member Jon Satre asked if a cost benefit analysis had been completed on the properties.

Ms. Burton stated the leases were put in place to acquire an actuarial rate of return for the retirement systems. Executive Director Ewer added sale of the properties has not been considered and as they are state buildings housing mostly state agencies, there is no plan at this time to cash out.

Member Gary Buchanan asked if the actuarial rate had been met on the real estate holdings.

Ms. Burton advised the properties were added to the real estate pool in April 2011 which has a line item specific to the properties. There is no long term return information due to the recent inclusion into the pool; however, there is a 6.5% to 8% cap rate for the various buildings.

Chairman Noennig asked if sale of the raw land parcel had been considered.

Ms. Burton stated there are no current plans to sell the parcel and no appraisal has been done recently.

Chairman Noennig suggested with no income being produced on the land parcel, this may be an item for future consideration.

Executive Director David Ewer advised MBOI does not plan to acquire any more properties or land at this time. The properties are occupied with good tenants and provide a good rate of return. No changes are recommended at this time.

CONSULTANT REPORT

RV Kuhns & Associates – Mr. Jim Voytko and Mr. Mark Higgins

In response to a request from the Board several months ago for more educational presentations, Mr. Jim Voytko presented four potential topics:

- Global Tactical Asset Allocation (GTAA) Investments – These are investments that tactically allocate capital across multiple asset classes based on relative valuation.
- RVK Public Fund Survey Results
- Economic growth globally and how it affects expectations of return and risk
- Inflation and asset class valuations

Mr. Voytko presented the capital market review and noted 10-year trailing performance has greatly improved due to the recent rally across several asset classes (most notably U.S. equity). Over the trailing 10-year period, six asset classes have exceeded the actuarial rate for the period ending March 31, 2013. Mr. Mark Higgins added equity markets have performed well since the end of the quarter due to better than expected economic indicators. However, he cautioned that valuations for fixed income and equities are strained right now. There is also heightened sensitivity to any hint that the Federal Reserve may accelerate the timeline for ending quantitative easing.

Mr. Voytko reviewed comparative performance for the retirement plans and noted there are three lenses through which to view performance. First, is the fund earning enough to serve the pension expectations? The answer is yes. The YTD, 1, 3 and 5 year returns are all positive and the 10 year return is climbing as additional years of higher return are incorporated. Secondly, are returns appropriate when you consider benchmarks and fees? This is mixed as the fund is slightly less than the benchmark, although positive over 10 years. And lastly, how is the plan doing when compared to peers? Peer ranking is the least vital factor as peers are not always invested in the same ways or have varying liabilities. Peer ranking has improved steadily overall; the fund ranked 72nd 10 years ago, but has improved to the top quartile for the 3 year period.

Mr. Voytko then discussed a comparison of the Public Employees' Retirement Plan vs. peer groups with assets >$3 billion. He stated that the hope of investors is to achieve higher returns with decreased levels of risk, and that the ideal scenario is to achieve the most return with the least risk. He then noted that over a five-year period, the Public Employees' Retirement Plan has achieved returns that are comparable to other plans; however, these returns have been achieved with a lower level of risk. Over a 10 year period, the fund has realized slightly less than average return, but shows less risk than peers.

Mr. Mark Higgins followed Mr. Voytko and presented comparative performance for the investment pools. Domestic equity for FYTD, 1 year and 3 years easily exceeded the 7.75 actuarial rate, and even the 5 year numbers were reasonably strong. Mr. Higgins noted that domestic equity was the key driver for the recent recovery at the total fund level. Mr. Higgins also noted that the reduced tracking error in the domestic and international equity portfolios was largely attributable to the recent restructuring of the two investment pools (namely the move to more passive strategies).

Member Buchanan asked if the significant changes made of reducing managers and moving to passive are responsible for the positive returns. Mr. Higgins responded it's too early to make a conclusive judgment; however, the tracking error shows good progress.

Mr. Voytko added with reduced fees and the move to passive investments, there is less likelihood of dipping too far below the benchmark.

Mr. Higgins stated the Retirement Fund Bond Pool (RFPB) has continued to perform above the benchmark. Credit goes to staff management for the timely move to high yield and the quality of internal manager performance. However, Mr. Voytko cautioned that quarter-to-date returns fell below the actuarial rate and it will be very difficult to realize strong absolute returns in the current fixed income market.

Mr. Higgins reviewed real estate investments. While the real estate pool continues to lag behind the NCREIF Index, the obvious drag is timber which is a very long term investment. The asset class provides a strong diversifier, reducing return, but without added risk.

STIP serves as a cash vehicle and with low interest rates, low returns will continue; however, STIP has outperformed the benchmark over the long term.

The private equity pool always reflects a quarter lag behind the benchmark and is a long term asset class. The pool has added 155 basis points over 10 years vs. the benchmark, the S&P 1500 plus a premium of 4%, a strong contribution to the total fund as well as serving as a diversifier.

Responding to a question from Member Englund, Mr. Higgins clarified on the comparison chart of PERS vs. public funds >$3 billion, the data reflects gross of fee returns as the fees are unknown for the funds included. The CEM report reflected MBOI fees are slightly lower than the assumed rate.

Mr. Cliff Sheets stated with peer comparisons, asset allocation and fees of the public universe peers are unknown and also fluctuate from quarter to quarter. The CEM survey is valuable for data comparison; the results will be presented in depth at the August Board meeting. The last survey assumed a fee cost of 165 basis points for fund-of-funds private equity, which was not accurate as it was too high.

Member Prothero asked Mr. Higgins if there were any other noteworthy items to discuss. Mr. Higgins noted Alliance Bernstein and Hansberger continue to struggle and remain on the watch list. Martin Currie has resolved outstanding issues they faced and so concern is diminished. Post Advisors has recovered and has a good team in place now.

Mr. Voytko added that firing a manager for poor short term performance is not always the best strategy, unless they are a bad fit or have lost managers that have not been replaced, or perform poorly when they should be outperforming.

INVESTMENT ACTIVITIES/REPORTS

Retirement System Asset Allocation Report

Mr. Cliff Sheets presented the asset allocation report for the nine pension funds for the quarter ending March 31, 2013. Positive returns for the quarter were generated by equities. The pension funds saw an increase in value of $358 million and equities increased to 67.5% due to market growth. Domestic equities increased by 1.3% for the quarter. Strong absolute returns were realized despite sales of $89 million during the quarter.

All other asset class exposures did shrink slightly as a percent of the total with bonds showing the most dilution effect from strong equity returns. There were small private equity sales made to reduce liquidity in the pool given ongoing strong distributions. Fixed income allocation decreased, although there were no sales, due to weak relative returns compared to the other asset classes. Real estate decreased slightly for the quarter although returns were positive for the quarter and there were $14 million in real estate purchases. In total there was a net $94 million in sales out of long term asset pools, partly to fund benefits. Over all, changes in asset allocation were driven mostly by market returns this quarter.

Comparison to State Street Public Fund Universe

Mr. Sheets presented the asset allocation comparison to the State Street Bank pension plan universe. The public fund universe data compiled this quarter by State Street Bank is different from previous quarters. Previous comparisons included all public plans in State Street Bank's universe greater than $1 billion. This quarter the comparison was limited to public funds valued between $3 and $20 billion, reflecting a universe more closely aligned with our plan. This excludes the mega plans and includes about 40 comparable plans. A comparison of at least 30 funds is needed to get a reasonable comparison. Additionally, plans in the new group have at least 30% public stocks. Many public fund universes have no transparency regarding asset allocation making comparisons difficult; therefore, including those with at least 30% public equities provides a more accurate comparison. Using the new data, our public equity and fixed income allocations are still very close to the median; are near the low end on cash, and in the upper half for real estate and private equity. Hedge funds are not included in the comparison, and only 11 plans in the State Street Bank universe have any hedge fund exposure. This standard will be used going forward as it is a better fit, and is also consistent with the R.V. Kuhns universe as far as minimum size.

Member Karl England asked if the data is skewed due to the manner which different funds classify alternative equities and real estate.

Mr. Sheets noted while real estate is considered alternative in our holdings, some funds classify it as conventional. Additionally, some funds hold only core real estate, while we have a more diversified portfolio, including timberland which is classified as real estate. Plans that have virtually no holdings in real estate are included in figuring the median and this can skew the data.

Fiscal year to date market value has increased by $739 million, 76% of which is attributable to stocks, mostly domestic, resulting from the stock market rally. State Street Bank public fund universe return comparisons show median numbers that are very close to those from R.V. Kuhns. We are very close to the median for five and seven year periods. The trailing 10 year returns for the pension funds continue to improve and reflect stock prices have appreciated substantially during that time period.

Responding to a question from Member Englund, Mr. Voytko stated that while our alternative investments appear to be a larger allocation versus peer groups the data does not show peer exposures to alternatives such as hedge funds or opportunistic, so the median representation to alternatives here may understated relative to Montana's.

Member Buchanan asked if our risk is lower with our private equity rather than if those investments were in hedge funds instead. Mr. Voytko responded liquidity and equity risk are higher; however, headline and transparency risk are lower.

<u>Fixed Income</u>

Mr. Nathan Sax presented the Fixed Income overview and strategy. Investors are nervous about ending quantitative easing by the Fed and interest rates are likely to remain low through 2014. Economists predict 2% growth for calendar 2013 which is better than the rest of the world. Combined fixed income returns as reflected in the Barclays Aggregate Index for the last quarter was a negative 12 basis points. The portfolio is 72% internally managed.

External manager selection has been good; all managers are within the first or second quartile. Manager correlation is good with varying styles. Spreads since 2011 have been getting tighter and investors are still going after high yield investments, but taking on more risk.

There have been no changes to the below investment grade holdings held in internally-managed portfolios. Lehman Brothers has been providing some distributions, which should continue for the next two years; the current price is 26 cents on the dollar. Our expected recovery should be approximately $1.5 to $2 million above the current book value on these bonds.

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

Mr. Richard Cooley reported credit quality of money markets has improved slightly; rates have remained the same providing very little return. Three month Libor rates are down 2 basis points. The STIP portfolio remains well diversified. The net daily yield on STIP is 0.20% and the balance remains the same as last quarter at $2.65 billion. The recent purchase of some longer term securities will help increase yield slightly.

The Treasurer's Fund, made up of half general fund money and half other various state operating accounts not invested in STIP, had no securities transactions during the quarter.

State Fund Insurance fixed income holdings had a yield to maturity that was 15 basis points above the benchmark at the end of the quarter. The fund total return performed at 158 basis points over its benchmark for the last year and has outperformed for the 1, 3, 5 and 10 year periods. The STIP balance, limited to a range of 1-5% by policy, rose slightly above 5% in anticipation of funding for the two core real estate purchases approved as a new asset class at the February Board meeting. The two purchases, totaling $35.7 million, settled on April 1, 2013. One fund is fully funded and the other is partially funded. Equity holdings, limited to 8-12% by client preference, inched up near 12% due to the strong equity market, necessitating the sale of $6 million in the S & P Index fund.

In attendance at the meeting, State Fund Board Member Wayne Dykstra, was introduced by Member Buchanan.

Trust Funds Investment Pool Policy Statement

Mr. Cliff Sheets presented the proposed revisions to the Trust Funds Investment Pool Policy Statement. The policy statement, which was approved at the last Board meeting, has one housekeeping item which revises the policy asset class ranges to match those in the Core Internal Bond Portfolio Policy Statement.

> Member Sheena Wilson made a motion to approve the proposed policy statement changes as presented. Member Kathy Bessette seconded the motion. The motion passed 8-0.

Montana Domestic Equity Pool (MDEP)

Mr. Rande Muffick reported on the Montana Domestic Equity Pool (MDEP) for the quarter ending March 31, 2013. The great stock rally has continued bringing the MDEP market value to $3.2 billion at quarter end. Low yields in fixed income and cash drove investors to equities. The Fed is in better shape than the rest of the world, and dividend yields are good. The strong showing in the S & P 500 makes a correction this summer likely. MDEP outperformed the benchmark by 37 basis points over the quarter and has outperformed by 76 basis points through the first three quarters of the fiscal year. The positive effects of the recent restructuring are apparent. Active managers and overweight allocations in small and midcap have all added value. The search for additional small and midcap managers has been completed and four new managers were added at the end of April. Two mid cap managers received $40 million each and the two small cap managers received $20 and 25 million. May 1st was the start date for the new managers and is when their performance measurement will start. Managers were picked according to performance, stability of investment teams and strategy/philosophy as well as how they complement the current managers. The new pool structure includes more active small and midcap stocks and more passive/index holdings for large cap. The funding of the new managers completes the MDEP restructure.

Member Buchanan asked what impact the new strategy will have on overall manager fees and what the final costs of the transition were.

Mr. Muffick stated the savings will be about $3 million annually in fees. Previous cost per year of 30 basis points should be reduced to about 20 basis points for all investments. The transition was handled by State Street Global Markets. They had a low cost option which they estimated at 21 basis points, or $270,000, and they kept costs very close to the estimate.

Responding to a question from Executive Director Ewer, Mr. Muffick advised Factset is the tool utilized by research staff each quarter to run data provided by State Street Bank which provides attribution and holdings reports. These reports track the added value provided by each manager.

Montana International Equity Pool (MTIP)

Mr. Muffick reported international markets also realized good but mixed returns this quarter. Japan was up 70% the last few months, but emerging markets were down in the first quarter and Europe was in the middle. The dollar had a strong quarter which took about 4% from international returns.

Interviews will begin next week for international small cap and emerging market managers, as the next phase of the international pool restructure begins. A lot of good managers are full and not taking new clients as investors are seeking out managers with the best returns.

Public Equity External Manager Watch List

Mr. Muffick stated there was one addition to the watch list this quarter. Hansberger was added this month due to lagging performance versus the benchmark. They were previously on the watch list due to performance. They were overweight in China and are now pulling back as the big bets have not paid off. We will continue to monitor them closely. Alliance Bernstein remains on the list since being added in August 2012. A deep value strategy has not worked well; however, performance is starting to pick up.

PUBLIC EQUITIES MANAGER WATCH LIST
May 2013

Manager	Style Bucket	Reason	$ Invested (mil)	Inclusion Date
Alliance Bernstein	International – LC Value	Performance	$101.1	August 2012
Hansberger	International – LC Growth	Performance	$105.5	May 2013

Private Asset Pool Reviews

Montana Private Equity Pool (MPEP)
Mr. Ethan Hurley presented the private equity report for the quarter ended March 31, 2013. Three commitments were made since the last Board meeting totaling $50 million. A commitment of $20 million was made to Affinity which has been a top performer. An additional $5 million was committed to Dover VIII in a secondary international buyout opportunity. And $25 million was committed to CCMP which focuses on U.S. consumer, industrial and health care industries. Private equity has had a net positive cash flow for the last several quarters. The total exposure by strategy is broadly diversified and within policy ranges. Exposure geographically is mainly focused on North America. Going forward, Asia may increase and Europe is expected to decrease. As more direct primary commitments are made and fund of funds investments decrease, corresponding fees will diminish. The portfolio has performed well; since 1988, for every dollar invested, $1.40 has been returned.

Fund Name	Vintage	Subclass	Sector	Amount	Date
Affinity Asia Pacific Fund IV, LP	2013	Buyout	Diversified	$20M	4/12/13
Dover Street VIII, LP	2012	Secondaries	Diversified	Add'l $5M	4/24/13
CCMP Capital Investors III, LP	2013	Buyout	Diversified	$25M	4/26/13

Montana Real Estate Pool (MTRP)
Mr. Ethan Hurley presented the real estate report for the quarter ended March 31. There have been no new commitments since the last Board meeting. There is a negative cash flow with capital calls exceeding payouts. Exposure is diversified and relatively well balanced. One timber manager is up for renewal this year. Geographically the fund is well diversified. Over the quarter, value added and opportunistic outperformed core investments.

Mr. Sheets added the positive trend experienced since calendar 2010 is expected to continue with more emphasis on non-core assets. Real estate provides an important diversifier. There should be improvement in the next two to three years, real estate lagged with the market on the way down and will lag on the way up and closed end funds always have a one quarter lag.

Partnership Focus List
There were no changes to the MPEP or MTRP Focus lists since the last Board Meeting.

Public Employees' Retirement System and Teachers' Retirement System Update
Member Sheena Wilson reported the Public Employees' Retirement Board will be very busy in the coming months. Emergency rules will need to be implemented in the interim to address actuarial assumptions. Ms. Wilson stated the PERB is pleased to have the opportunity to make improvements to the retirement system. Member Marilyn Ryan stated the TRS Board is relieved and grateful for the legislative action on the retirement systems. TRS Executive David Senn is retiring and a nationwide search will be conducted for his replacement.

Recap and To Do List
R.V. Kuhns will provide the requested fiscal year-to-date private equity return number.

ADJOURNMENT

There being no further business, the meeting was adjourned at 4:39 PM.

Next Meeting
The next regular meeting of the Board will be Tuesday and Wednesday, August 20 and 21, 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: 8/20/13

MBOI:drc 7/10/13