These minutes are Approved and Final. Full Board review and decision took place at the April 8, 2014 Regular Meeting of the Board.

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

MINUTES OF THE MEETING
February 25 & 26, 2014

BOARD MEMBERS PRESENT:

Mark Noennig, Chairman
Kathy Bessette
Gary Buchanan (via conference call)
Karl Englund
Jack Prothero
Marilyn Ryan
Jon Satre
Sheena Wilson

BOARD MEMBER ABSENT:

Quinton Nyman

LEGISLATIVE LIAISONS PRESENT:

Senator Dave Lewis
Representative Kelly McCarthy

STAFF PRESENT:

Polly Boutin, Associate Financial Manager
Jason Brent, CFA, Alternative Investments Analyst
Geri Burton, Deputy Director
Dana Chapman, Board Secretary
Richard Cooley, CFA, Portfolio Manager, Fixed Income/STIP
Frank Cornwell, CPA, Associate Financial Manager
Roberta Diaz, Investment Accountant
David Ewer, Executive Director
Julie Flynn, Bond Program Officer
Tim House, Equity Analyst/Investment Operations Chief
Ethan Hurley, CAIA, Portfolio Manager, Alternative Equities
Ed Kelly, Alternative Investments Analyst
Teri Kolnik, CFA, Alternative Investments Analyst
Eron Krpan, Investment Data Analyst
Herb Kulow, MCMB, Portfolio Manager, In-State Loan Program
Tammy Lindgren, Investment Accountant
Gayle Moon, CPA, Financial Manager
Rande Muffick, CFA, Portfolio Manager, Public Equities
Jon Putnam, CFA, FRM, Fixed Income Investment Analyst
John Romasko, CFA, 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:

Becky Gratsinger, CFA, R.V. Kuhns & Associates
Mark Higgins, CFA, R.V. Kuhns & Associates
Roxanne Minnehan, Public Employees' Retirement System
John Harrington, Legislative Audit Division
Ross Johnson, Legislative Audit Division
Pat Murdo, Legislative Services - EAIC
Kris Wilkinson, Legislative Fiscal Division
Sheri Scurr, Legislative Services Division

CALL TO ORDER

Board Chairman Mark Noennig called the regular meeting of the Board of Investments (Board) to order at 10:30 AM. As noted above, a quorum of Board Members was present. Board Member Gary Buchanan attended via conference call. Board Member Quinton Nyman was absent.

Board 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 November 19, 2013 Board meeting or the December 9, 2013 special teleconference Board meeting. There were no changes or revisions.

> Board Member Jack Prothero made a Motion to approve the November 19, 2013, Board Meeting Minutes. Member Jon Satre seconded the Motion. The Motion carried 8-0.

> Board Member Jack Prothero made a Motion to approve the December 9, 2013, special teleconference Board Meeting Minutes. Member Jon Satre seconded the Motion. The Motion carried 8-0

ADMINISTRATIVE BUSINESS

Audit Committee Report

Audit Committee Chairman Jon Satre reported on the Audit Committee Meeting held prior to the regular Board Meeting. Chairman Satre advised the FY 2014 Financial Compliance Audit Entrance Conference is not conducted at a public meeting. Legislative Audit staff will arrange a meeting with MBOI staff later in the week. The Committee reviewed revisions to the Internal Controls Risk Assessment Model for the year ending June 30, 2014 and reviewed the Internal Audit Schedule for FY 2014. The changes resulted from a meeting of staff with Ryan Lindsay of Galusha, Higgins and Galusha. Changes in the Governance Manual and Committee Charters were also addressed.

Committee Chairman Satre welcomed John Harrington and Ross Johnson from the Legislative Audit Division and thanked them for all their hard work on the FY13 Legislative Performance Audit (Performance Audit). The Performance Audit was presented to the Committee accompanied by staff responses to the six report recommendations. The Audit Committee voted to agree with staff responses to the six Performance Audit Recommendations. (Recommendation #1 will be discussed with the Board at the end of the Audit Committee report.)

Staff concurred with Recommendation #2 to require ongoing educational activities be provided to the Board. The Governance Manual has been revised accordingly.

> Board Member Jon Satre made a Motion to approve the staff response to Performance Audit Recommendation #2 and approve revisions in the Governance Manual on education, Section 2, Paragraph 10. Member Sheena Wilson seconded the Motion. The Motion carried 8-0.

Staff concurred with Recommendation #3 to recommend to the Board the amendment of the Governance Manual to emphasize the commitment to annual affirmation of asset allocation of the entire portfolio of investments.

> Board Member Jon Satre made a Motion to approve the staff response to Performance Audit Recommendation #3 to provide revisions in the Governance Manual regarding asset allocation. Member Sheena Wilson seconded the Motion. The Motion carried 8-0.

Staff concurred with Recommendation #4 which states regularly required votes, reports and affirmations be more strictly adhered to in accordance with established charters. Committee charter revisions for the three committee charters will reflect policies that are truly enforceable:

- Proposed revisions to the Audit Committee Charter strikes language;
- Proposed revisions to the Loan Committee Charter changes staff descriptions; and
- Proposed revisions to the Human Resource Committee Charter removes/adds language on committee reporting provisions.

  Board Member Jon Satre made a Motion to approve the staff revisions to the Audit Committee Charter. Member Sheena Wilson seconded the Motion. The Motion carried 8-0.

  Board Member Jon Satre made a Motion to approve the staff revisions to the Loan Committee Charter. Member Sheena Wilson seconded the Motion. The Motion carried 8-0.

  Board Member Jon Satre made a Motion to approve the staff revisions to the Human Resource Committee Charter. Member Sheena Wilson seconded the Motion. The Motion carried 8-0.

Staff concurred with Recommendation #5 to adopt a proxy voting policy and periodically present to Board members a review of proxy vote results. Proxy voting is now incorporated into the 24-month Systematic Work and Education Plan and will be reviewed at the May 2014 Board meeting.

> After brief discussion, Board Member Jon Satre made a Motion to approve the staff response to Performance Audit Recommendation #5 to provide for regular timely review of proxy voting of public equities. Member Sheena Wilson seconded the Motion. The Motion carried 8-0.

Staff did not concur with Recommendation #6 to seek revisions to the Montana Procurement Act to provide an exemption to the Board for the procurement of external investment management services. The Board is already fully empowered and is charged under the Unified Investment Program as the sole decider on investment types. Staff reasserts the Board's authority. Board Chairman Mark Noennig added that the legal opinion issued in 2012 by the Department of Administration legal counsel agreed that the Board is exempt from the Procurement Act according to current Montana statute.

> After further discussion, Member Jon Satre made a motion to approve the staff response to Performance Audit Recommendation #6 affirming the Board's authority on selecting external investment management services. Member Sheena Wilson seconded the Motion. The motion carried 7-1. Member Gary Buchanan voted nay.

Recommendation #1 is directed at the Montana Legislature and requests action be taken by the legislature to revise Board composition. By statute, Board composition is directed by the legislature and the governor. Staff did not respond as concur or non-concur with Recommendation #1, but rather commented as an interested and knowledgeable party stating that the current Board composition, constructed as a "citizen board" with a diverse make up, is appropriate in fulfilling the functions and responsibilities of the Board.

> Board Member Jon Satre made a Motion to approve the staff response to Performance Audit Recommendation #1 to neither concur or non-concur. Member Sheena Wilson seconded the Motion.
>
> After a brief discussion, Member Gary Buchanan called for a substitute motion moving that the Board concur with the Legislative Auditors on Recommendation #1. There was no second.

The Board discussed in detail the industry organization comparison information on Board composition included by the Legislative Auditors regarding Recommendation #1.
Member Karl Englund reviewed several sources cited in the Performance Audit including the Stanford Institutional Investors' Forum (the "Stanford")(reports issued in 2007 and 2013) as well as the information included on board compositions of comparable state public fund pensions based on states with unified investment boards, states managing similar assets and states managing assets of similar size.

The Stanford desirable attributes of a Board cited in the Performance Audit were:
- A board composed of a group with a portfolio of skills
- Sufficient number of trustees with financial skills

Member Englund noted the Stanford reports also advise individuals serving as board members should possess or acquire the attributes and core competencies which embody traits such as:
- Loyalty
- Objectivity
- A willingness to serve
- Competent
- An inquisitive nature
- Ability to consider and debate
- Interpersonal skills
- A base of knowledge

Member Englund explained the Stanford report recommended that a wide range of attributes be considered and that a board should not "require" as a precondition to serve that members are financial professionals, as board competency requires a different skill set. All boards benefit from a diversity of members.

Member Englund reviewed the states offered as comparisons in the Performance Audit and found:
- South Carolina reported returns of 10% for fiscal year 2013; MBOI had 13% over the same period.
- In 2013 South Carolina's commission hired a new director. The inspector general produced a 39 page report on improper conduct.
- Nebraska for calendar year 2012 returned 12.9% vs. 13.4% for MBOI; Over the last 3-years, Nebraska had an 8.7% return vs. 9.6% for MBOI.

Member Englund concluded while it may be beneficial to consider the question of Board composition, all things considered, MBOI looks good.

Senator Lewis noted the Performance Audit recommends the legislature look at the issue of Board composition; therefore it is up to the legislature to take up the issue. He added Senator Jeff Essmann is requesting a committee bill on the topic to be presented in the 2015 Legislature. If the committee decides not to consider the bill, he stated that Senator Essmann will likely go forward and introduce a bill.

Member Buchanan asked Mr. John Harrington to comment on the discussion.

Mr. Harrington again thanked the Board and staff. He stated the recommendation is not an indictment of the Board. The Board should bring experience and be educated in context with other states. To adhere to the Montana Constitution mandate of "informed and experienced" the Legislative Auditor's interpretation views the higher threshold as relating to the field of investments.

Chairman Noennig added that when looking at other states, they varied widely in board composition.

Mr. Harrington agreed all states are different, and while they looked for comparable peers among the other states, there were none that matched exactly.

> Chairman Noennig called for a vote on the original motion to approve the staff response to Performance Audit Recommendation #1. The motion carried 7-1. Member Buchanan voted nay.

Human Resource Committee Report

Human Resource Committee Chairman Karl Englund reported on the Committee meeting held prior to the Board meeting. The Committee reviewed Continuity Resolution 234, a new resolution providing for continuity in the absence of the Chief Investment Officer. The Committee amended the resolution as presented striking redundant language.

> Member Englund moved to approve Resolution 234, Continuity Resolution for Chief Investment Officer Position, as amended. Member Jack Prothero seconded. The motion carried 8-0.

> Member Englund moved to approve the necessary changes in the Governance Manual to reflect the approval of Resolution 234: the table of contents, Section III. 3. Regarding the Chief Investment Officer position and the addition of Resolution 234 as Appendix L. Member Prothero seconded the motion. The motion carried 8-0.

The Committee also considered the revised staff organizational chart. Staff recommends the restructure of the accounting staff by flattening the chain of command. The proposed structure allows for two Associate Financial Managers under the supervision of the Financial Manager, instead of a single Deputy Financial Officer. Each Associate Financial Manager will supervise two accountants, renamed Investment Accountants, to more closely reflect the duties of the positions.

> Member England moved to approve the revised staff organization chart as presented. Member Prothero seconded. The motion carried 8-0.

The Committee also considered a proposal by staff to revise the Portfolio Manager, In-State Loan Program position from an exempt position to a classified status. The Committee is not bringing the proposal in front of the full Board for consideration.

Loan Committee Report

The Loan Committee met prior to the Board meeting. Committee Chairman Jack Prothero reported the Committee approved one INTERCAP loan to the Department of Natural Resources and Conservation (DNRC) in the amount of $2.5 million for interim financing for its Drinking Water State Revolving Fund (DWSRF) Loan Program. The three (3) year term loan will be in the form of a general obligation bond anticipation note (BAN). No Board action is required.

Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) Updates

Member Sheena Wilson reported PERS will be issuing a Request for Proposal (RFP) for an investment consultant. PERS Board Member Bob Bugni will be leaving the PERS Board at the end of his current term, April 1, 2014. The PERS legislative committee is quite busy and will be addressing the two pension systems requiring additional attention: Game Wardens' Retirement and Sheriffs' Retirement. The PERS personnel committee will be meeting to review filling the executive director position.

Member Marilyn Ryan reported TRS has been approved by the IRS as a qualified plan. The injunction for the Guaranteed Annual Benefit Adjustment (GABA) came at the end of December. Retirees will receive the old rate of 1.5% pending the final court ruling. There is no schedule yet on when the case will be heard. The sweep from the county retirement systems in the amount of $2.2

million has been collected and deposited. Legislation to increase funding from the University System to fund retirement benefits failed to pass.

Legislative Liaisons Comments
Representative Kelly McCarthy reported he wrote up a synopsis of the MBOI Fiscal Year 2013 Annual Report and distributed it.

EXECUTIVE DIRECTOR'S REPORT

Overall Comments
Executive Director David Ewer presented his executive director's memo. He presented the quarterly cost report and update on staff outreach over the past year. The Request for Proposal (RFP) for custodial bank will be finalized for the upcoming April Board Meeting. By late July or early August staff expects to have a recommendation on a new custodial bank. The longest possible transition time is essential should the winning bid be a new bank. The universe of qualified banks is very limited; staff expects three or four proposals will be submitted.

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 December 31, 2013. Approved ranges now reflect the changes made in November. Following a strong third quarter, it was a very strong quarter with a total plan return of 5.6%. The pension funds realized an increase in value of $450 million for the quarter. Domestic and international stocks were the primary driver of market returns. The allocation to total equities increased by 0.9% to 68.3% for the quarter. Domestic equities increased 1% despite $76 million in sales. International equity stock allocation was down -0.1% to 17.6%, posting returns of 4.9% for the quarter. The private equity allocation declined by-0.2% to 11.8%, due to relative returns. The fixed income allocation decreased by -0.2% to 21.5%, a slight underweight vs. the range, due to weak relative returns and the denominator effect despite $89 million in purchases over the quarter. Additional purchases were made on January 2nd to move to the minimum of the range. The real estate allocation decreased -0.2% for the quarter to 9% with returns of 2.7% for the quarter.

Mr. Sheets stated Firefighters' and Police plans both received an infusion of cash due to insurance premiums and taxes in mid-September which required rebalancing in early October.

Member England inquired if lump sum cash infusions cause an effect on returns.

Mr. Sheets stated yes, there can be a cash drag effect depending on the returns for other asset classes in the month when the cash is received. In summary, the pension funds in total had net purchases of nearly $19 million for the quarter. Rebalancing is performed each month. PERS and TRS continue to experience negative cash flows, as expected. Mr. Sheets added he is projecting a monthly cash outflow of $51.7 million to provide the liquidity needed to pay benefits for all nine plans in total.

Custom peer group pension plan allocation comparisons provided by State Street Bank for the period ending December 31, 2013 show MBOI is very similar in total public equities, close to the median, while heavier for domestic and lighter for international, which has helped relative performance over the last five years. Fixed income is near the median; while cash is being kept below median, just high enough to provide for liquidity needs. Peer comparisons of real estate show the median has crept up; however, MBOI is still above the median at 9.0%.

Looking at relative performance, PERS and TRS rank in the top one-third vs. the State Street custom peer universe for the one, three and four year periods, while in the middle of the pack for 5-year and 7-year returns and lagging for the 10-year period. Performance over the 3-year period is especially strong, in the top decile. Longer term performance is respectable and the 10-year numbers are gradually improving.

Montana Domestic Equity Pool (MDEP)
Mr. Rande Muffick reported on the Montana Domestic Equity Pool (MDEP) for the quarter ending December 31, 2013. MDEP and MTIP have both benefited from strong equity returns; MDEP grew to $3.6 billion at quarter end. Both large cap enhanced and 130/30 are at the top of the 8-12% range, therefore any trimming will likely come from those. General domestic stocks are strong, although the market is not as cheap as it was. Earnings growth for 2014 will determine the stock market growth near term. A volatile year is expected. Both domestic and international markets had a 6% correction in late January, but the market came back. The odds favor another positive year with the strong momentum last year and fourth quarter earnings reports were good. If earnings growth reaches 6-8% again this year it will be a positive year, but still not likely as good as 2013. Small cap growth did an exceptional 49.9% for the calendar year. Of the 13 active portfolios, ten outperformed their benchmarks for the quarter and active managers look good so far this quarter. Small and midcaps remain overweight and are currently 4% over the benchmark weighting. Overweight positions have helped returns measurably over the long term.

Montana International Equity Pool (MTIP)
Mr. Muffick reported the Montana International Equity Pool (MTIP) has also performed strongly for the year ending December 31, 2013; however, emerging markets caused some drag, due in part to growth concerns in China which shows in the overall numbers. Looking ahead for the year, international markets will continue to fluctuate and emerging markets will continue to have an effect. There is a large discrepancy between large cap value vs. growth, growth has done very well, value has not. Three out of the five international managers outperformed their benchmarks. Markets are less macro driven with investors looking for more solid fundamentals.

Further diversification of the small cap allocation is planned and contracts for the two new managers are nearly complete. Both are expected to begin on March 3, 2014. When the new managers start, the benchmark will also be changed to the IMI (Investible Market Index) benchmark. The new IMI benchmark has an approximate 12% small cap allocation; we will be slightly underweight vs. the benchmark.

Responding to a question from Member Jack Prothero, Mr. Muffick stated funding for the two new managers will be $40 million for small cap value manager Templeton Investment Counsel, LLC, and $30 million for small cap growth manager, American Century Investment Management. We will maintain a value bias in small caps, as value, over time, is expected perform better than growth.

A search for emerging market managers was conducted. Most of the desirable managers with separate account options required a minimum investment of $100 million, or were full. Co-mingled funds as well as limited partnerships were explored. Staff narrowed the search down to two potential managers; however, after discussions with attorneys, staff decided to not go forward with contracts, due in part to the loss of control and high fees and the emerging market exposure, which is already available through current managers.

Public Equity External Manager Watch List
Mr. Muffick stated the watch list remained the same this quarter aided by the good performance being seen by most of our active managers. Hansberger and Alliance Bernstein remain on the list; however, have both continued to show improvement. Hansberger continues to have a large bet on China, and Alliance Bernstein was expected to perform better; they own a lot of deep value distressed stocks.

PUBLIC EQUITIES MANAGER WATCH LIST
February 2014

Manager	Style Bucket	Reason	$ Invested (mil)	Inclusion Date
Alliance Bernstein	International – LC Value	Performance	$114.2	August 2012
Hansberger	International – LC Growth	Performance	$121.4	May 2013

Mr. Cliff Sheets noted the international asset class review will be presented at the April 8, 2014 Board Meeting.

Fixed Income
Mr. Nathan Sax presented the Fixed Income overview and strategy. Short term interest rates are still near zero continuing the trend of the last five years. Interest rates rose on comments by Federal Reserve Chairman Bernanke that the Fed will discontinue the purchase of treasury and mortgage backed securities. The quantitative easing is expected to be discontinued by year end. The U.S. 10-year Treasury yielded 1.76% at the start of last year and ended at 3.03%. Housing and employment are still showing weakness and real GDP for the calendar year was at 1.9%.

The Barclays Capital Aggregate Bond Index posted a calendar year return of -2.0. Compared to the Index, fixed income assets have outperformed the benchmark over the one, three and five year periods. All bond portfolio assets are within policy and sector ranges, although are underweight in government bonds, neutral on duration and overweight in high yield bonds which has helped return.

Reviewing the comparative performance for fixed income managers, Post Advisory and Neuberger Berman have both done quite well. Responding to a question from Member Englund regarding the poor performance by Artio, Mr. Sax noted they may be added to the watch list if the five year relative returns remain low. Mr. Sheets added that returns for high yield could have skewed total returns in the peer group used for comparison here. Artio's style includes investing in non-hedged emerging markets, but they have stayed true to their style. R.V. Kuhns does include Artio on their watch list; however, if compared to other non-dollar managers, they would not look as bad.

Mr. Sax stated in 26 years, this past year is only the third year bonds have realized negative returns. The Fed Funds rate is expected to remain at zero for another year, but as Fed purchases of mortgages and bonds taper each month, rates should rise. Inflation is still lower than the Fed would like and opinions vary on the current health of the economy.

Short Term Investment Pool, State Fund Insurance & Treasurer's Fund Report
Mr. Rich Cooley gave a brief overview of the Treasurer's Fund stating short term rates rose briefly but have eased back down. There were no security purchases for the fund in the fourth quarter.

Mr. Cooley gave an overview of the Short Term Investment Pool (STIP) for the quarter ending December 31, 2013. The current Fed Funds target rate is 0 – 25 basis points. The STIP portfolio is within all guidelines for liquidity, diversification and average days to maturity, currently 53 days, compared to the policy maximum of 60 days. The STIP daily net yield is at 12 basis points compared to the current one-month LIBOR rate at 16 basis points. Total fund return over 10-years is 2%. The STIP portfolio has increased to $2.7 billion, up $250 million from three months ago.

The monthly addition to the reserve account has been reduced from $17,000 per day to $12,500 per day to help preserve the return as some high yielding paper rolls off, adding 6 basis points of annualized yield.

Responding to a question from Senator Dave Lewis, Mr. Sheets clarified the reserve account is a proactive approach by staff in case the portfolio suffers a realized loss or as an option to sell a problem asset to avoid a projected greater loss later. The reserve account does take current income for future use, but acts as a contingency and allows the freedom to be more flexible. Although there may be a slight variation of exposure to different participants over time, all participants have a stake in STIP and most account holders remain static over time. As the reserve fund grows, the need to place a ceiling on the amount will be revisited.

Mr. Cooley presented an overview of the State Fund Insurance portfolio for the quarter ending December 31, 2013. The Fund totaled $1.3 billion at quarter end and performance continues to be good, aided by investment grade securities and the added allocation in April and July 2013 of $70 million to real estate. Purchases for the quarter included $39 million in corporate bonds and $10 million in agencies. For the quarter, the fixed income portion of the Fund outperformed the benchmark by 18 basis points and by 51 basis points for the year. Long term returns compared to the fixed income benchmark were +92 basis points for three years, +184 basis points over five years, and +48 basis points for the past ten years ending December 30, 2013.

Private Asset Pool Reviews

Montana Private Equity Pool (MPEP)
Mr. Cliff Sheets presented the private equity report for the quarter ending September 30, 2013. (Mr. Ethan Hurley is traveling.) Cash flow remained positive for the pool for the eighth quarter in a row. The last 12 months were high in both number and value of initial public offerings (IPO's). Geographic exposure changed very little and is mostly within North America at about 82%, although we continue to look at Asia and the broader markets, usually using fund of funds which continue to decrease. Direct investment is preferred when available. Pool level returns at September 30, 2013 returned 12.57 IRR since inception, net of all expenses. Looking at the 5-year period of September 30, 2008 to September 30, 2013 returns jumped from 6.96% to 9.63% just by removing one bad quarter. There were three new fund commitments since the last Board meeting. New commitments made in January 2014 were: $20 million to Eureka Growth Capital III, LP, a small cap buyout manager; $20 million to buyout manager HKW Capital Partners IV, LP; and $25 million to buyout manager Odyssey Investment Partners Fund V, LP, an existing manager that has performed very well for us.

Fund Name	Vintage	Subclass	Sector	Amount	Date
Eureka Growth Capital III, LP	2013	Growth Equity	Diversified	$20M	1/23/2014
HKW Capital Partners IV, LP	2013	Buyout	Diversified	$20M	1/23/2014
Odyssey Investment Partners Fund V, LP	2014	Buyout	Diversified	$25M	1/24/2014

As Mr. Hurley noted at the last Board meeting, staff is researching the possibility of a secondary market offering of some of the MBOI fund interests. A number of the funds are being marketed, but currently there are no sales pending. Staff is still considering the sale as the process continues and will report to the Board when any decisions are made.

Montana Real Equity Pool (MTRP)
Mr. Cliff Sheets presented the real estate report for the quarter ending September 30, 2013. There was one new commitment since the last Board meeting for $25 million to an existing value added manager, Stockbridge Value Fund II, LP. The portfolio is well diversified by strategy and geographic exposure and is balanced and diversified by property type. The pool includes 10% timberland exposure which is not always included in the real estate category by our peers, but provides a broader diversification. Net cash flows for real estate remain negative as capital calls still outpace distributions; however, market activities are picking up and we are seeing positive returns. Real estate is a good diversifier and there is a high demand currently in the market for core real estate.

Fund Name	Vintage	Subclass	Sector	Amount	Date
Stockbridge Value Fund II, LP	2014	Value Add	Diverse	$25M	1/6/2014

Member Buchanan asked if the goal of staff is to sell underperforming private equity funds during the potential upcoming sale of select holdings on the secondary market.

Mr. Sheets stated while that would be ideal, it is not practical to include any funds on the watch list as bids would be weak for those funds, at a significant discount to current NAV's. Market conditions are optimal for private equity sales and staff has chosen funds to offer which should bring in more favorable bids, and represent relationships we are willing to part with given they are inconsistent with current pool strategy . The specific funds offered are listed with a broker through an engagement letter. Marketing of the funds is labor intensive, but has gone smoothly. Pricing has been on the rise and market confidence is strong, so in a cyclical sense the timing is good. More details will be provided at the next Board meeting.

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

MONTANA DOMESTIC EQUITY POOL ASSET CLASS REVIEW

Mr. Cliff Sheets, CFA, CIO and Mr. Rande Muffick, CFA, Portfolio Manager - Public Equities
Mr. Sheets and Mr. Muffick presented an asset class review of the Montana Domestic Equity Pool. Domestic equities are expected to provide high returns over the long term and are the main driver of plan returns. MDEP is by far the largest asset class and has a 2:1 ratio vs. international stocks. Domestic equities have a higher risk with a standard deviation of 18% and the asset class is highly liquid. Large caps dominate the S&P 1500, but small and midcaps are represented. The recent restructuring of MDEP broadened the ranges for small and midcaps and the pool is significantly over weight vs. the benchmark as shown below:

	Benchmark	MDEP
Large Caps	88%	80.1%
Midcaps	8.4%	12.5%
Small caps	3.6%	7.4%

Most active manager fees go to cover small and midcap mandates and the pool invests in a variety of types for diversification. Types include commingled and separate accounts, indexed funds which mirror the index benchmark, enhanced index which takes on slightly more risk to enhance return; traditional long only which has a 400-600 basis point tracking error vs. the benchmark and 130/30 which is active with a 300-500 basis point tracking error vs. the benchmark.

Representative Kelly McCarthy asked how proxies are voted for the active portfolios.

Mr. Muffick advised staff does not execute proxies. Each individual manager votes according to best management practices providing the most benefit to the client, the stock owner. Mr. Muffick added that proxies will be covered in depth at the May Board meeting.

Portfolio diversification is always a consideration. A balance of active managers is maintained and managers are chosen who will be complementary and fit well with the current stable of managers. The small and midcap overweight is being maintained with the consideration that over the long term they outperform large caps. The fees paid to active managers are cost effective and total fees for the pool have been reduced by 12 basis points since March 2012, from .36% to .24%.

The pool often provides cash for the monthly retirement plan benefit needs and going forward the overweight position for small and midcaps will be maintained. The current stable of managers is expected to be maintained in the near term and small and midcap weights may be leveled to provide assets to new managers.

Member Karl Englund asked if we are missing anything with the current structure of MDEP.

Ms. Betsy Gratsinger stated MDEP is in good shape and is performing well. The pool is efficient and rebalanced as needed.

ADJOURNMENT

The meeting was adjourned for the day at 5:02 PM.

CALL TO ORDER

Board Chairman Mark Noennig called the regular meeting of the Board of Investments (Board) to order at 9:02 AM. As noted above, a quorum of Board Members was present. Board Member Gary Buchanan attended via conference call. Board Member Quinton Nyman was absent. Chairman Noennig called for public comment. There was no public comment.

MONTANA LOAN PROGRAMS

In-State Loan Program

Mr. Herb Kulow presented an update of the commercial and residential loan program portfolios. Commercial loans totaled $102,914,935 with 117 loans as of February 4, 2014. The current yield of the portfolio is 4.84%. There were two loans committed totaling $4,268,000 and there are nine reservations totaling $36,328,897. There are two past due loans; an SBA guaranteed loan for $95,000 which is 31 days past due and the Vann's bankruptcy loan for $634,111.45 which has not been transferred to "real estate owned" yet. Total MBOI commercial loans past due equals 0.71% of the total portfolio, compared to state of Montana banks at 4.06% as of September 30, 2013.

Residential mortgage balance is $13,193,688 with 302 loans as of January 31, 2014. The current yield of the portfolio is 6.32%. Nine loans are past due over 30 days representing 3.71% of the portfolio.

The Veterans' Home Mortgage Loan Program (VHML) continues to grow. There are eight outstanding reservations totaling $1,364,534.

The internal loan committee approved one Intermediary Relending Program (IRP) loan for $250,000 to Gallatin Development Corporation d/b/a Prospera Business Network as matching funds for a USDA $500,000 IRP revolving fund loan.

ADF Group is building a paint facility in Great Falls which they are self-financing for approximately $6 million. With the addition of the paint facility, ADF will have invested nearly $30 million in Montana. MBOI financing, including the participation in the equipment loan and the infrastructure loan, will be from $8 – $8.5 million. If ADF's plan to expand goes as expected, they will add up to 500 jobs. A trip to visit the plant will be scheduled in the spring at the Board's pleasure.

BOND PROGRAM REPORTS

Activity Report

Ms. Louise Welsh reviewed the quarterly Activity Summary Report and presented the staff approved loans. The Loan Committee approved one loan prior to the Board meeting to the Department of Natural Resources and Conservation (DNRC) in the amount of $2.5 million for interim financing for its Drinking Water State Revolving Fund (DWSRF) Loan Program.

The annual remarketing of INTERCAP bonds will take place on Monday, March 3, 2014. Bond rates last year were at 22 basis points compared to 16 basis points this year; consequently, the loan interest rate to borrowers will remain at 1% this year. Of the ~$106 million in bonds outstanding, only $26 million was tendered (put back), while the remaining bond-holders held their bonds.

Member Englund asked about any outstanding INTERCAP loans to Ravalli County due to the recent news stories about issues at the Ravalli County Treasurers' Office.

Ms. Welsh noted all February payments from outstanding loans to entities within the County have been received and delinquencies are not expected as all revenue has been collected by the County. County reports are expected to be up to date; thus allowing them to process all funds prior to the next loan payment due date.

Staff approved loans are listed below:

Borrower:	Hamilton School District #3
Purpose:	Upgrade technology infrastructure
Staff Approval Date:	November 5, 2013
Board Loan Amount:	$750,000
Other Funding Sources:	$ 0
Total Project Cost:	$750,000
Term:	7 years

Borrower:	Elliston Rural Fire District
Purpose:	Finance a new fire truck
Staff Approval Date:	November 5, 2013
Board Loan Amount:	$60,000
Other Funding Sources:	$30,000
Total Project Cost:	$90,000
Term:	10 years

Borrower:	Montana City Rural Fire District
Purpose:	Purchase land and construct a satellite fire station
Staff Approval Date	November 5, 2013
Board Loan Amount:	$750,000
Other Funding Sources:	$ 0
Total Project Cost:	$750,000
Term:	15 years

Borrower:	McCone County
Purpose:	Refinance five road graders
Staff Approval Date	November 8, 2013
Board Loan Amount:	$350,000
Other Funding Sources:	$ 0
Total Project Cost:	$350,000
Term:	5 years

Borrower:	Custer County
Purpose:	Interim loan in anticipation of issuing a General Obligation Bond to construct a detention center
Staff Approval Date	November 8, 2013
Board Loan Amount:	$400,000
Other Funding Sources:	$ 0
Total Project Cost:	$400,000
Term:	1 year

Borrower:	Lake County
Purpose:	Finance gravel pit reclamation settlement
Staff Approval Date	November 13, 2013
Board Loan Amount:	$365,022
Other Funding Sources:	$ 0
Total Project Cost:	$365,022
Term:	3 years

Borrower:	Hot Springs
Purpose:	Finance water system improvements
Staff Approval Date	November 14, 2013
Board Loan Amount:	$ 156,805
Other Funding Sources:	$1,042,550
Total Project Cost:	$1,199,355
Term:	15 years

Borrower:	City of Kalispell
Purpose:	Purchase garbage truck and two dump trucks
Staff Approval Date	December 5, 2013
Board Loan Amount:	$400,000
Other Funding Sources:	$ 0
Total Project Cost:	$400,000
Term:	5 years

Borrower:	Cascade County
Purpose:	Purchase 42 vehicles for County motor pool
Staff Approval Date	December 9, 2013
Board Loan Amount:	$1,000,000
Other Funding Sources:	$ 179,726
Total Project Cost:	$1,179,726
Term:	4 years

Borrower:	Bridger School District #2
Purpose:	Finance an Energy Retrofit Using Energy Performance Contracting
Staff Approval Date	December 30, 2013
Board Loan Amount:	$116,960
Other Funding Sources:	$184,600
Total Project Cost:	$301,560
Term:	15 years

CONSULTANT REPORT

Ms. Becky Gratsinger, CFA, and Mr. Mark Higgins, CFA, R.V. Kuhns & Associates
Ms. Becky Gratsinger presented an overview of the capital market review. Returns were strong for the quarter ending December 31, 2013. Domestic stocks returned 10.5%, international stocks 5.7% and small caps returned 8.7% for the quarter. Interest rates are up, but not back to 2010 levels. Equities remain a bit expensive and equity market returns going forward should moderate. Fixed income markets were down for quarter; the Barclays US Aggregate Bond Index returned -0.14 for the quarter, and -2.02% for the year. Unemployment rates have decreased; however the Fed is looking for 6.5% unemployment. The stimulus raised concerns about inflation; however we are not seeing indicators of inflation on the horizon at this time.

Historically since 1976, risk and equity markets did best in 2013, while bonds did the worst. Small cap stocks returned 39% percent compared to -9.5% for commodities. The Fed has kept policy steady with quantitative easing compared to 1994 when the Fed raised rates several times. Looking at various potential interest rate scenarios for the Barclay's U.S. Aggregate Bond Index over one, three and five year periods, the shorter the timeframe and the steeper the rate increases, the sharper and more detrimental the results. A 1% increase in rates over one year would result in a –(2.25)% return, while a 2% increase in interest rates over one year would show a negative return of –(7.0)%. When rates are increased by 1% or 2% over 5 years however, returns remain in positive territory.

Market value of the nine retirement plans at December 31, 2013 was nearly $9.4 billion. Asset breakdown for the plans is 56% equities, 21% fixed income, 12% private equity, 9% real estate and 1% cash equivalents. The retirement funds realized negative performance versus the benchmark due to the one quarter lag environment of private equity and the high return expectation reflected in the private equity benchmark. Low relative-to-benchmark returns for real estate also contributed to the negative benchmark comparison.

Responding to a question from Chairman Noennig, Ms. Gratsinger stated the total fund return could be run excluding private equity, and some pension funds do that; however, it would not be very informative.

While private equity and real estate have a slight lag, all traditional asset classes are beating their benchmarks and there are no other issues in the portfolio.

Overall, portfolio ranking versus the peer universe of funds greater than $3 billion is terrific. The overweight in domestic equities versus international equities has been very beneficial. Comparing risk vs. return, the portfolio has a slight outperformance over the benchmark and the peer group median, while taking less risk over the last five years. Allocations to private equity and real estate have helped lower risk, as well as fixed income holdings; peers tend to hold more fixed income with a higher equity like nature.

Member Jack Prothero asked if Ms. Gratsinger sees any negative tendencies in the portfolio.

Ms. Gratsinger noted the sources of risk must always be monitored. Considering the high price of domestic equity stocks, if we get a risk-off market and if international markets start to do well, it would have an impact. The asset mix is good. The biggest risk is if the domestic equity market declines and the rest of the world does well, or another price depreciation in real estate, which will cause non-core real estate to suffer. In general, progress is good.

Member Satre noted returns have been amazing and asked if there were any recommendations if domestic equities were to be sold.

Ms. Gratsinger noted domestic equities have good liquidity and some plans go with a higher international allocation. Exposure to U.S. equities means a dependence on the health of the U.S. economy, and some plans go with global managers, but there are very few global vendors available.

Chairman Noennig asked how much less in international equities the portfolio has compared to peers.

Ms. Gratsinger stated MBOI has roughly a 2:1 domestic to international ratio. Mr. Sheets added MBOI has 38% in domestic equities, compared to peers at 32.41%; and 18% in international equities, compared to peers at 20.44%. At 56%, total equities are at the peer median. Over the last five years, U.S. stocks have fared better given the economic troubles in other parts of the world. The growing U.S. economy helps corporate earnings and feeds into stock prices. At the current time there is no compelling reason to shift, and the global economy favors the U.S. Equity does have risk and the portfolio is equity centric, but we are well diversified and have realized the benefit of private equity, real estate and fixed income allocations.

Executive Director Ewer added the GDP outlook for the U.S. is better than the world outlook and so a bias to domestic equity is a safer bet.

Ms. Gratsinger continued that the overall plan beta of .6 is low due to diversification. Private equity and real estate both help with beta. The beneficial structural changes to the portfolio have shown results. Manager choices over the last three years have been good and the remaining managers as a group have done very well. No glaring problems exist with the current managers, and watch lists have shrunk. Performance net of fees is looked at, as well as the annual CEM report, and performance overall, net of fees is looking good. Additionally, manager fees have been reduced with the recent structural changes for domestic and international equities.

REAL ESTATE INVESTING

Ms. Becky Gratsinger, CFA, and Mr. Mark Higgins, CFA, R.V. Kuhns & Associates

Mr. Mark Higgins provided an overview of real estate investments. Real estate provides portfolio diversification with a low correlation to traditional assets. Real estate provides income generation through rental and lease income and capital appreciation through increased property values or sales of properties. Investors may develop raw land with construction, or invest in existing properties at a discount which are run down or distressed and then sell the improved property at a profit.

Various types of properties serve as investments; traditional, such as office, retail and apartment/residential properties, or non-traditional such as self-storage, and senior or student housing. Ms. Gratsinger added that core real estate, which is considered less risky, generates about 80% of its return from lease/rental income and the remainder from price fluctuations. External appraisals are performed at least annually to determine value, but can be conducted as often as quarterly. The use of rotating appraisers is sometimes employed. Non-core real estate generates returns through a combination of rental income and price appreciation, so you want to be sure the manager is adding value. The total return is lease income and price appreciation, which is reflected in the value of the property. The ultimate impact on returns is when the property is sold. MBOI also invests in timberland, a unique asset class. Many pension funds do not invest in timberland, or if they do, it is not classified as part of real estate holdings.

Mr. Higgins stated the financial crisis caused an aversion to value added and opportunistic strategies and a higher demand for core investments which remains in high demand with limited availability.

Drawbacks of real estate are low liquidity, although this is not a current concern for MBOI, and the commitment to a long term time horizon of five to ten years to fully realize the value of an investment.

Mr. Sheets stated core real estate is still seeing price appreciation; however, as our real estate allocation is near the top of the range, it may be time to take advantage of the strong demand and peel some off; and selling core is the only option for reducing our allocation. Mr. Sheets added at some point, the real estate market will stabilize and investors will be more willing to move to value added and opportunistic properties.

Mr. Higgins explained the J curve effect where funds are initially committed and drawn down with no returns, and then the upswing occurs close to the maturity of the fund, rendering short term returns almost meaningless. Timing positions so that all capital calls are not coming at once is a good strategy. There are also benchmarking challenges for real estate with a lack of an investible index. Even the available indexes are very different than exposures and are reported on infrequently, suffering from high tracking errors and stale performance.

Ms. Gratsinger added an internal rate of return is more helpful, which is measured as part of the total fund. Responding to a question from Member Englund, she responded there is not really a solution to the measurement problem for real estate.

There are global opportunities in real estate such as Asia, but all come with the higher risk of opportunistic investments and in a legal environment that can be challenging. Investments would need local management and there can be currency issues.

Mr. Sheets noted MBOI does have some global legacy exposure with some of the early real estate investments. Morgan Stanley runs one of our international funds which experienced very poor returns given it was overleveraged and they lost control of several properties during the global recession. Mr. Sheets added we're not currently seeking international exposure and U.S. real estate still provides desirable opportunities.

RECAP

Executive Director Ewer stated that INTERCAP underwriter services are scheduled for review at the April 2014 Board meeting.

Member Buchanan spoke to the structure of the current Board meetings regarding education and training opportunities and stated the decision to increase the number of Board meetings per year from four to six was originally intended to reserve the interim one day meetings primarily for education, training and higher order issues. In reviewing the April meeting items, Member Buchanan stated there is very little time dedicated to education or training.

Member Buchanan stated there is a greater need for education and training, as was noted in the FY13 Legislative Performance Audit, and while the issue has been addressed to some degree, in the form of regular presentations by R.V. Kuhns and formally including the Board Education Policy in the Governance Manual, much more remains to be done.

Chairman Noennig asked for Executive Director Ewer to respond.

Executive Director Ewer responded that when Board members attend Board meetings, it is in effect on-the-job training. By following the 24-month Systematic Work and Education Plan, Board members gain exposure to every mission of the Board on issues which members are likely to have to make decisions on. The April Board meeting is in concert with the 24-month Plan and the April meeting agenda covers important Board mission areas in place of the usual quarterly meetings where substantial time slots are dedicated to quarterly reports.

Chairman Noennig asked if there was further discussion on the topic.

Member Buchanan stated his view of the additional one day interim meetings differs from the Executive Director's view and he proposed further discussion between himself and Chairman Noennig on the subject.

Chairman Noennig stated he would be happy to discuss any suggestions Member Buchanan may have; ultimately it is the Board's decision.

There being no further business, the meeting was adjourned at 11:44 AM.

Next Meeting
The next regular meeting of the Board will be April 8, 2014 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: April 8, 2014

MBOI:drc
4/4/14