



ND STATE INVESTMENT BOARD MEETING

Friday, April 24, 2015, 8:30 a.m.
Workforce Safety & Insurance
1600 E Century Avenue, Bismarck, ND

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

II. ACCEPTANCE OF MINUTES (March 27, 2015)

III. INVESTMENTS

- A. Annual Board Planning Cycle and Strategic Investment Plan - Mr. Hunter (enclosed) (20 min) **Board Action**
- B. City of Grand Forks Pension Fund - Mr. Hunter (enclosed) (10 min) *Informational*
- C. Executive Session - Springbank - Mr. Hunter (20 min) **Board Action**
N.D.C.C. §44-04-19.1(9) and N.D.C.C. §44-04-19.2

IV. GOVERNANCE

- A. Legislative Update - Mr. Hunter (enclosed) (10 min) *Informational*
- B. Governance Policy Review - Mr. Hunter (enclosed) (20 min)
 - 1. Board Staff Relations (Second Reading) *Informational*
 - 2. Ends (First Reading) *Informational*

V. QUARTERLY MONITORING (enclosed) (10 min) **Board Acceptance**

- A. Budget and Financial Conditions - Ms. Flanagan
- B. Executive Limitations / Staff Relations - Mr. Hunter
- C. Investment Program - Mr. Hunter
- D. Retirement Program - Ms. Kopp
- E. Watch List - Mr. Schmidt

===== Break 10:00 to 10:15 =====

VI. BOARD EDUCATION (enclosed) (45 min) *Informational*

- A. North Dakota Bankers Association - Mr. Hunter (enclosed)
- B. Board Offsite Preview - Mr. Hunter (to follow)

VII. OTHER

Next Meetings:

SIB Audit Committee meeting - May 21, 2015, 3:00 pm - State Capitol, Peace Garden Room

SIB meeting - May 22, 2015, 8:30 a.m. - State Capitol, Peace Garden Room

ADJOURNMENT

**NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
March 27, 2015, BOARD MEETING**

MEMBERS PRESENT: Drew Wrigley, Lt. Governor, Chair
Mike Sandal, Vice Chair
Lance Gaebe, Land Commissioner
Mike Gessner, TFFR Board
Rob Lech, TFFR Board
Mel Olson, TFFR Board
Kelly Schmidt, State Treasurer
Yvonne Smith, PERS Board
Cindy Ternes, WSI designee (TLCF)
Tom Trenbeath, PERS Board

MEMBERS ABSENT: Adam Hamm, Insurance Commissioner

STAFF PRESENT: Eric Chin, Investment Analyst
Connie Flanagan, Fiscal & Invt Op Mgr
Bonnie Heit, Assist to the SIB
David Hunter, ED/CIO
Fay Kopp, Deputy ED/CRO
Terra Miller-Bowley, Supvr Audit Services
Cody Schmidt, Compliance Officer
Darren Schulz, Deputy CIO
Susan Walcker, Invt Acct

OTHERS PRESENT: Sarah Angus, Callan Associates Inc.
Jeff Engleson, Dept. Trust Lands
Levi Erdmann, Dept. Trust Lands
Paul Erlendson, Callan Associates Inc.
Jan Murtha, Attorney General's Office
Bryan Reinhardt, PERS

CALL TO ORDER:

Mr. Sandal called the State Investment Board (SIB) meeting to order at 8:30 a.m. on Friday, March 27, 2015, at Workforce Safety & Insurance, 1600 E Century Ave., Bismarck, ND.

Commissioner Hamm was absent attending a National Association of Insurance Commissioners meeting.

AGENDA:

IT WAS MOVED BY MR. TRENBEATH AND SECONDED BY MR. GESSNER AND CARRIED ON A VOICE VOTE TO ACCEPT THE AGENDA FOR THE MARCH 27, 2015, MEETING AS DISTRIBUTED.

AYES: COMMISSIONER GAEBE, TREASURER SCHMIDT, MR. OLSON, MS. TERNES, MR. GESSNER, MR. TRENBEATH, MR. LECH, AND MR. SANDAL

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER HAMM, MS. SMITH, LT. GOVERNOR WRIGLEY

MINUTES:

IT WAS MOVED BY MR. LECH AND SECONDED BY MR. OLSON AND CARRIED ON A VOICE VOTE TO APPROVE THE FEBRUARY 27, 2015, MINUTES AS DISTRIBUTED.

AYES: MR. GESSNER, MR. GAEBE, MS. TERNES, TREASURER SCHMIDT, MR. LECH, MR. OLSON, MR. TRENBEATH, AND MR. SANDAL

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER HAMM, MS. SMITH, LT. GOVERNOR WRIGLEY

INVESTMENTS

Strategic Mission - Mr. Hunter highlighted strategic initiatives as of March 31, 2015.

Mr. Hunter also requested the SIB confirm the Retirement and Investment Office's (RIO) mission statement as defined in SIB Governance Policy, Ends/Mission, D-1.

The SIB reaffirmed the existing mission of RIO.

Callan Timber Consulting Capabilities - Ms. Sarah Angus, Callan Associates, reviewed Callan's timber consulting capabilities.

Timber Survey & Staff Recommendation - Staff surveyed 72 state public funds in an effort to solicit feedback concerning best in class consultants in the timberland asset class. Of the responses received, Callan Associates was the most often cited general consultant. Pension & Investments February 9, 2015 edition cited Callan as being the most often cited general investment consultant and the second most often cited overall consultant. Aon Hewitt was cited as the second most often general consultant and the most often cited overall consultant in this survey.

Staff recommended the SIB contract with Callan to assess the Springbank properties whose existing management agreement expires on June 30, 2015. The negotiated price for this search will range between \$34,000 to \$50,000 which is reasonable based on peer discussion and potential future fee savings. Callan will report their findings to the SIB at their May 22, 2015, meeting.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MR. TRENBEATH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION AND ENGAGE CALLAN TO CONDUCT A SEARCH FOR AN ALTERNATIVE TIMBER MANAGER WHICH COULD POTENTIALLY REPLACE TIMBERLAND INVESTMENT RESOURCES IN THE EVENT CONTRACT NEGOTIATIONS DO NOT MEET EXPECTATIONS.

AYES: MR. OLSON, MR. TRENBEATH, COMMISSIONER GAEBE, MR. GESSNER, MS. SMITH, TREASURER SCHMIDT, MS. TERNES, MR. LECH, AND MR. SANDAL

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER HAMM, LT. GOVERNOR WRIGLEY

Tobacco Prevention/Control Trust Fund - At the SIB meeting on January 23, 2015, RIO staff presented the request of the Tobacco Prevention and Control Trust Fund (TPC) to have the SIB provide investment management services as allowed under NDCC 21-10-06 and as recommended in a recent audit. During this presentation it

was noted that TPC has a non-tobacco investment requirement and that this requirement does not fit within the existing Insurance Trust structure. As a result, board members expressed a concern regarding the SIB's ability to provide investment management services to TPC because of this restriction. Ms. Murtha provided comments and also referenced statute whereby the SIB may not decline to provide investment management services to the TPC.

Staff will work with the TPC representatives to develop a formal investment policy statement and asset allocation recommendation for final approval by the SIB and TPC Board. The SIB would manage the assets in a separate trust and the TPC would absorb all costs associated with a separately managed entity.

IT WAS MOVED BY MR. GESSNER AND SECONDED BY MR. LECH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT STAFF RECOMMENDATION AND MOVE FORWARD WITH SECURING A CONTRACT WITH THE TOBACCO CONTROL AND PREVENTION TRUST FUND FOR INVESTMENT SERVICES.

AYES: TREASURER SCHMIDT, MR. GESSNER, MS. TERNES, COMMISSIONER GAEBE, MS. SMITH, MR. LECH, MR. OLSON, AND MR. SANDAL

NAYS: MR. TRENBEATH

MOTION CARRIED

ABSENT: COMMISSIONER HAMM, LT. GOVERNOR WRIGLEY

Private Equity Update - Mr. Schulz reviewed a summary of the performance of the private equity portfolios in the Pension Trust. The Adams Street Partnerships have performed in line with expectations with a net internal rate of return of 16.6 percent in the last five years and 11.1 percent since inception.

The other SIB partnerships have generally performed below expectations with a net internal rate of return of 3.8 percent in the last five years and 1.2 percent since inception with a few positive exceptions noted. Staff will be researching the development of strategic partnerships to leverage a best ideas approach while increasing pricing leverage.

GOVERNANCE:

Legislative Update

Mr. Hunter provided an update on legislative bills staff is tracking that could possibly affect the SIB and RIO.

Lt. Governor Wrigley presided over the remainder of the meeting.

Discussion was held on HB 1033 which relates to definitions for the Legacy Fund, the Legacy Fund principal balance, and a transfer of Legacy Fund earnings. The bill has been amended which would require at least 10 percent of the Legacy Fund to be placed with one or more financial institutions chartered in and located in North Dakota and which are experienced in and hold considerable knowledge in the field of investments. A Senate Appropriations Committee hearing was held on March 17, 2015, and Lt. Governor Wrigley, Treasurer Schmidt, and Mr. Hunter provided testimony on the legal conflicts raised with the amendment which states the 10 percent investment should be made notwithstanding the prudent investor rule.

Staff has held discussions with sponsors of the bill and intend to meet with a group of North Dakota related investment firms along with Callan Associates. The entities are hoping to better understand the investment capabilities of the North Dakota firms and to also share the screening criteria utilized by Callan to

identify eligible investment managers. Staff will report back to the SIB at their April 24, 2015, meeting.

Governance Process Review - The Board received the second reading of the Executive Limitations policies. There were no modifications made to the policies. No action was taken.

The Board received the first reading of Board Staff Relationship policies. The policies will be presented for a second reading and possible acceptance at the next meeting.

The Board recessed at 10:02 a.m. and reconvened at 10:18 a.m.

ADMINISTRATION:

Executive Review - Mr. Lech reviewed the annual evaluation process of Mr. Hunter. The SIB was provided a formal summative evaluation of Mr. Hunter. The evaluation results were reviewed with Mr. Hunter on March 26, 2015.

IT WAS MOVED BY MR. LECH AND SECONDED BY MR. SANDAL AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE FORMAL SUMMATIVE EVALUATION OF MR. HUNTER.

AYES: MS. SMITH, MR. SANDAL, MR. OLSON, MR. GESSNER, MR. LECH, MR. TRENBEATH, MS. TERNES, MR. ENGLESON, TREASURER SCHMIDT, AND LT. GOVERNOR WRIGLEY

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER HAMM

The Executive Review Committee recommended a salary increase of 5-7 percent be considered for Mr. Hunter. A formal recommendation will be made at the May or June 2015 meetings once the legislative session has concluded.

IT WAS MOVED BY MR. LECH AND SECONDED BY MS. TERNES AND CARRIED BY A ROLL CALL VOTE TO APPROVE THE SALARY RANGE OF 5-7 PERCENT WITH A FINAL RECOMMENDATION TO BE MADE UPON CONCLUSION OF THE LEGISLATIVE SESSION.

AYES: MR. TRENBEATH, TREASURER SCHMIDT, MR. OLSON, MR. ENGLESON, MR. LECH, MR. SANDAL, MR. GESSNER, MS. SMITH, MS. TERNES, AND LT. GOVERNOR WRIGLEY

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER HAMM

Mr. Hunter thanked the Executive Review Committee and the SIB for going through the process and noted it has been very helpful. Included in the board's meeting materials was a strategic investment plan developed by Mr. Hunter. Mr. Hunter reviewed the plan with the Executive Review Committee on March 26, 2015, and will review the plan at the April 24, 2015, with the full board.

The Board thanked the Executive Review Committee: Mr. Lech, Chair, Ms. Ternes, and Mr. Sandal for all of their work on the annual evaluation of Mr. Hunter. Special recognition was given to Mr. Lech for his outstanding job of spearheading the survey and compiling the results.

Government Finance Officers Association (GFOA) Certificate - The Retirement and Investment Office (RIO) received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association for its Comprehensive Annual Financial Report for the year ended June 30, 2014. This marks the 17th consecutive year that RIO has been awarded this honor. RIO's report was judged by an impartial panel to meet the high standards of the program including demonstrating a constructive "spirit of full disclosure" to clearly communicate its financial story. The Certificate of Achievement is the highest form of recognition in the area of governmental accounting and financial reporting, and its attainment represents a significant accomplishment by a government and its management. The SIB directed staff to issue a press release on the certification.

Callan Manager Search Process - Mr. Erlendson reviewed Callan's manager search process. Mr. Erlendson and colleagues will be meeting with sponsors of HB 1033 to increase their awareness and understanding of the SIB's investment manager search process. The meeting will be scheduled sometime in April.

OTHER:

Next scheduled meetings:

SIB Meeting - April 24, 2015, 8:30 a.m. - Workforce Safety & Insurance
 SIB Audit Committee Meeting - May 21, 2015, 3:00 p.m. - State Capitol, Peace Garden Room

ADJOURNMENT:

With no further business to come before the SIB, Lt. Governor Wrigley adjourned the meeting at 11:15 a.m.

Lt. Governor Wrigley, Chair
 State Investment Board

Bonnie Heit
 Assistant to the Board

BOARD ACTION REQUESTED

TO: State Investment Board
FROM: Dave Hunter
DATE: April 24, 2015
SUBJECT: Annual Board Planning Cycle – Cover Memo

Pursuant to Section B.7 of the SIB Governance Manual, “the Board will strive to follow a biennial agenda which (a) completes a re-exploration of “Ends” policies annually and (b) continually improves its performance through attention to board education and enriched input and deliberation.”

In order to accomplish this objective for the upcoming biennium, RIO has provided the SIB with a strategic investment plan (“Plan”) which is aligned with RIO’s Mission Statement (as reaffirmed by the SIB at our last meeting on March 27, 2015). It is important to note that the Plan incorporates several major themes shared by the SIB in its annual review of the Executive Director/CIO. This collaborative approach should ensure the alignment of our common goals and key objectives for the upcoming biennium.

In connection with the annual review of our “Ends”, RIO supplied the SIB with documentation which supports management’s belief that the SIB and RIO are achieving their stated goals and objectives **pursuant to Section D. of the SIB Governance Manual on “Ends”**. This information was reviewed with the SIB at our last Board meeting, but has also been included at the end of this section for reference purposes.

Recommendation:

After Board review of the following materials which outlines our (strategic investment) Plan, **RIO recommends the SIB approve the proposed “Biennial Agenda for 2015 to 2017”**. RIO notes that our Plan and Biennial Agenda is dynamic in nature and can be reviewed and/or modified as conditions and priorities change in the future.

Annual Board Planning Cycle & Strategic Investment Plan

April 24, 2015

Dave Hunter, Executive Director / CIO
ND Retirement & Investment Office (RIO)
State Investment Board (SIB)

NDRIO 2015-17 Strategic Investment Plan

Fundamental Investment Beliefs

Asset allocation decisions are the primary driver of investment returns, but the prudent use of active investment management is an important contributor towards ensuring our clients attain their stated investment objectives. SIB clients generated \$200 million of incremental income via the prudent use of active investment management over the past five years including over \$55 million of excess return in 2014.

Strategic Investment Plan

1. Reaffirm the organizational commitment to our current governance structure including a persistent awareness to the importance of continuing board education.
2. Enhance transparency and understanding of our core goals and beliefs.
 - a. Remain steadfast in our commitment to the prudent use of active investment management.
 - b. Expand awareness to downside risk management which is essential to achieving our long term investment goals.
 - c. Given actual and projected growth of SIB client assets and the heightened public awareness of the Legacy Fund, align our investment platforms to promote greater clarity and efficiency in reporting and implementing client investment policies.
3. Expand RIO's influence and ability to create positive and sustainable change by developing relationships with existing clients, organizations and legislative leaders.
 - a. Enhance community outreach to build upon public awareness and confidence.
 - b. Develop concise presentations which highlight our overall risk, return and cost control framework including our progress towards attaining our long-term goals.
4. Heighten employee engagement by promoting an open and collaborative work environment while encouraging employee participation in staff meetings, offer more opportunities to impact RIO's change initiatives and improve overall compensation levels.
 - a. RIO's ability to continue to deliver strong results is dependent on the combined efforts of our highly valuable team members.
5. Enhance our existing risk management tools and processes by developing a more robust risk management framework utilizing proven risk management solutions with a focus on portfolio construction and downside risk management (or "stress test" scenarios).
 - a. A robust risk management framework provides a foundation to understand downside risks and our ability to withstand market corrections in varying stress test scenarios.
6. Evaluate and expand the efficient use of technology in our investment program activities including risk management, compliance monitoring, client satisfaction surveys, website design and communications in order to increase overall efficiency and effectiveness.

Fundamental Investment Beliefs

- ❑ **Asset allocation is the # 1 driver of investment returns.**

- ❑ **The prudent use of active investment management is an important contributor towards ensuring our clients attain their stated investment objectives.**
 - **SIB clients generated \$200 million of incremental income via the prudent use of active investment management since 2010.**

 - **SIB clients generated over \$55 million of excess return via the prudent use of active investment management in 2014.**

Reaffirm Commitment to Governance & Board Education

- ❑ **Reaffirm organizational commitment to our current governance structure.**
 - Annual board review of SIB governance manual including a governance day offsite in mid-2015.

- ❑ **Maintain a persistent awareness to the importance of continuing board education.**
 - Emphasize continuing board education at SIB meetings and promote the attendance of educationally focused industry conferences.

Enhance Understanding of Core Goals and Beliefs

- **Enhance transparency and understanding of our core goals and beliefs.**
 - **Remain steadfast in our commitment to the prudent use of active investment management.**
 - **Expand awareness to downside risk management which is essential to achieving our long term investment goals.**
 - **Given actual and projected growth of SIB client assets and the heightened public awareness of the Legacy Fund, align our investment platforms to promote greater clarity and efficiency in reporting and implementing client investment policies.**



Expand Influence and Ability to Create Positive Change

- **Expand RIO's influence and ability to create positive and sustainable change by developing relationships with existing clients, organizations and legislative leaders.**
 - Enhance community outreach to build upon public awareness and confidence.
 - Develop concise presentations which highlight our overall risk, return and cost control framework including our progress towards attaining our long-term goals.

Heighten Employee Engagement and Impact

- **Heighten employee engagement by promoting an open and collaborative work environment while encouraging employee participation in staff meetings, offer more opportunities to impact RIO's change initiatives and improve overall compensation levels.**
 - **RIO's ability to continue to deliver strong results is dependent on the combined efforts of our highly valuable team members.**

Enhance Existing Risk Management Framework

- ❑ **Enhance our existing risk management tools and processes by developing a more robust risk management framework utilizing proven risk management solutions with a focus on portfolio construction and downside risk management (or “stress test” scenarios).**
 - **A robust risk management framework provides a foundation to understand downside risks and our ability to withstand market corrections in varying stress test scenarios.**

Evaluate and Expand the Efficient Use of Technology

- Evaluate and expand the efficient use of technology in our investment program activities including risk management, compliance monitoring, client satisfaction surveys, website design and communications in order to increase overall efficiency and effectiveness.



Annual Board Planning Cycle – Biennial Agenda

Annual Board Planning Cycle Biennial Agenda

Fiscal 2015-16	July 2015	August	September	October	November	December	January 2016	February	March	April	May	June
	Gov. Offsite	Annual	Annual	Annual	Investment	No Meeting		Investment	Review		Investment	No Meeting
	- Election of Officers,	Investment Performance	Review of Gov. Manual	Evaluation of RIO vs. Ends policies	Director Report on Investment Work Plan	Scheduled		Director Report on Investment Work Plan	Budget Guidelines for next Biennium		Director Report on Investment Work Plan	Scheduled
	- Appoint Audit Comm.	Review	<i>(Done)</i>	Ends policies				Work Plan			Work Plan	
	- Plan Annual Agenda	- Establish Investment Work Plan	- New Board Member Orientation	- Annual Board Evaluation								
	- Plan Board Education	- Add Invest. Education	Complete						- Exec. Limit. & CIO Review		- Investment Guidelines	

Fiscal 2016-17	July 2016	August	September	October	November	December	January 2017	February	March	April	May	June
<i>The SIB Meeting Agenda has not been established for Fiscal 2016-17</i>	Gov. Offsite	Annual	Annual	Annual	Investment	No Meeting		Investment	Confirm		Investment	No Meeting
	- Election of Officers,	Investment Performance	Review of Gov. Manual	Evaluation of RIO vs. Ends policies	Director Report on Investment Work Plan	Planned		Director Report on Investment Work Plan	Budget Guidelines		Director Report on Investment Work Plan	Planned
	- Appoint Audit Comm.	Review	- New Board Member Orientation	- Annual Board Evaluation			- Legislative Update	Work Plan	- Legislative Update	- Legislative Update	Work Plan	
	- Plan Annual Agenda	- Establish Investment Work Plan	Complete									
	- Plan Board Education	- Add Invest. Education						- Exec. Limit. & CIO Review				

- 1.) SIB Governance Policy B-7 on Governance Process states that "the Board will follow a biennial agenda which (a) completes a re-exploration of Ends policies annually (April) and (b) continually improves its performance through attention to board education and to enriched input and deliberation."
- 2.) "In the first three months of the new cycle, the Board will develop its agenda for the ensuing year. Scheduled monitoring will be used to evaluate and adjust the annual agenda as needed."
- 3.) "The Board will identify areas of education and input needed to increase the level of wisdom forethought it can give to subsequent choices. A board education plan will be developed during July and August of each year."

RIO's Mission Statement

Preface: The remaining slides in this section were presented to the SIB at our March 27, 2015 meeting. These pages are provided for reference purposes only and support management's belief that the SIB and RIO are achieving their "Ends".

Background: RIO's "Mission" is defined in SIB Governance Policy D-1 on "Ends".

"The Retirement and Investment Office serves the SIB and exists in order that:

- 1) SIB clients receive investment returns, consistent with their written investment policies and market variables, in a cost effective investment manner and under the Prudent Investor Rule.
- 2) Potential SIB clients have access to information regarding the investment services provided by the SIB.
- 3) TFFR benefit recipients receive their retirement benefits in a cost effective and timely manner.
- 4) TFFR members have access to information which will allow them to become knowledgeable about the issues and process of retirement.
- 5) SIB clients and TFFR benefit recipients receive satisfactory services from the boards and staff of the office."

Summary: Based on SIB and TFFR client survey results and noting that every SIB client with a 3-year or 5-year track is generating positive excess return for the 3- and 5-year periods ended 12/31/2014 while adhering to prescribed risk metrics, the SIB and RIO are achieving its' stated goals and mission.



State Investment Board – Client Assets Under Management

Fund Name	Market Values as of 12/31/14 ⁽¹⁾	Market Values as of 6/30/14 ⁽²⁾	Market Values as of 12/31/13 ⁽¹⁾
Pension Trust Fund			
Public Employees Retirement System (PERS)	2,345,979,927	2,332,744,037	2,204,819,633
Teachers' Fund for Retirement (TFFR)	2,046,439,456	2,061,684,912	1,970,377,031
Job Service of North Dakota Pension	96,920,165	97,825,769	95,276,201
City of Bismarck Employees Pension	79,421,743	78,804,326	74,832,971
City of Grand Forks Employees Pension	56,347,332	57,896,611	53,459,799
City of Bismarck Police Pension	34,834,996	34,643,204	32,887,889
Grand Forks Park District	5,893,072	5,938,993	5,653,023
City of Fargo Employees Pension	9,656	9,702	4,742,525
Subtotal Pension Trust Fund	4,665,846,347	4,669,547,555	4,442,049,072
Insurance Trust Fund			
Legacy Fund	2,900,880,837	2,215,941,142	1,695,950,111
Workforce Safety & Insurance (WSI)	1,710,647,794	1,703,987,980	1,627,545,930
Budget Stabilization Fund	589,598,047	586,199,881	588,744,084
PERS Group Insurance Account	42,705,101	37,425,567	39,626,348
City of Fargo FargoDome Permanent Fund	40,651,973	41,775,992	38,668,924
State Fire and Tornado Fund	25,065,765	29,223,707	28,625,262
Petroleum Tank Release Compensation Fund	7,152,822	7,092,998	6,899,622
State Risk Management Fund	6,771,080	6,948,162	6,593,046
State Risk Management Workers Comp Fund	6,141,008	5,965,322	5,654,121
ND Association of Counties (NDACo) Fund	3,481,321	3,445,373	2,894,408
State Bonding Fund	3,299,303	3,268,991	3,171,622
ND Board of Medical Examiners	2,131,999	1,889,897	
Bismarck Deferred Sick Leave Account	859,648	849,818	807,624
Insurance Regulatory Trust Fund	646,335	1,146,038	1,107,837
Cultural Endowment Fund	373,276	364,979	359,577
Subtotal Insurance Trust Fund	5,340,406,309	4,645,525,847	4,046,648,516
PERS Retiree Insurance Credit Fund	93,282,939	90,360,366	83,492,581
Total Assets Under SIB Management	10,099,535,595	9,405,433,768	8,572,190,169

⁽¹⁾ 12/31/14 and 12/31/13 market values are unaudited and subject to change.

⁽²⁾ 6/30/14 market values as stated in the Comprehensive Annual Financial Report.

- ▶ SIB Client Assets Under Management grew by approximately 18.5% or \$1.53 billion in the last year.
- ▶ The Pension Trust posted a net return of over 5.9%, while the Insurance Trust generated a 5.1% net return in 2014. Investments were responsible for gains of \$265 million for the Pension Trust and \$204 million for the Insurance Trust.
- ▶ Legacy assets increased by 71% (or \$1.2 billion) primarily due to tax collections, while net returns were 4.2% for the year ended December 31, 2014.
- ▶ SIB client assets approximated \$10.1 billion based on preliminary valuations as of December 31, 2014.

Pension Trust – December 2014 Performance Update

	1 Yr Ended 12/31/2014	3 Yrs Ended 12/31/2014	5 Yrs Ended 12/31/2014	Risk 5 Yrs Ended 12/31/2014
PUBLIC EMPLOYEES RETIREMENT SYSTEM (PERS)				
Total Fund Return - Net	5.95%	11.89%	9.35%	8.7%
Policy Benchmark Return	5.15%	10.90%	9.18%	8.3%
Excess Return	0.80%	0.99%	0.17%	104.0%
TEACHERS' FUND FOR RETIREMENT (TFFR)				
Total Fund Return - Net	5.92%	11.96%	9.55%	9.6%
Policy Benchmark Return	5.13%	10.94%	8.91%	9.2%
Excess Return	0.79%	1.02%	0.65%	103.9%
CITY OF BISMARCK EMPLOYEES PENSION				
Total Fund Return - Net	6.16%	11.03%	9.36%	7.4%
Policy Benchmark Return	5.22%	9.65%	8.76%	7.1%
Excess Return	0.94%	1.38%	0.60%	102.9%
CITY OF BISMARCK POLICE PENSION				
Total Fund Return - Net	5.94%	11.49%	9.55%	8.0%
Policy Benchmark Return	5.09%	10.22%	9.06%	7.9%
Excess Return	0.85%	1.27%	0.48%	101.9%
JOB SERVICE PENSION PLAN				
Total Fund Return - Net	6.69%	10.94%	8.77%	6.4%
Policy Benchmark Return	5.55%	8.70%	8.11%	6.0%
Excess Return	1.14%	2.24%	0.66%	106.0%
CITY OF GRAND FORKS PENSION PLAN				
Total Fund Return - Net	6.28%	12.48%	9.98%	8.7%
Policy Benchmark Return	5.64%	11.32%	9.61%	8.5%
Excess Return	0.64%	1.16%	0.37%	102.9%
GRAND FORKS PARK DISTRICT PENSION PLAN				
Total Fund Return - Net	6.90%	12.94%	10.06%	9.1%
Policy Benchmark Return	6.56%	11.78%	9.75%	8.4%
Excess Return	0.34%	1.16%	0.31%	107.9%

Pension Trust:

- Every SIB client within the Pension Trust generated positive “Excess Return” for the 1-, 3- and 5-year periods ended December 31, 2014.
- “Excess Return” is defined as the actual investment return (after deducting investment fees) over the expected return of the underlying investment policy or benchmark (i.e. a passive index).
- SIB’s use of active management generated over **\$30 million of net incremental income** (after fees) in the last year for PERS & TFFR in total. This is based on \$4 billion of managed assets and Excess Return of 0.79% (\$4 billion x 0.79% = \$31.6 million/year).
- These strong returns have been achieved while reducing overall investment risk, as measured by standard deviation, during the past 10 years. Standard deviation measures the amount of variation or dispersion from the average.

Note: Data as of 12/31/2014 is unaudited and subject to change.

Insurance Trust – December 2014 Performance Update

1 Yr Ended 3 Yrs Ended 5 Yrs Ended
12/31/2014 12/31/2014 12/31/2014

WORKFORCE SAFETY & INSURANCE (WSI)

\$ 1,710,647,794

	1 Yr Ended 12/31/2014	3 Yrs Ended 12/31/2014	5 Yrs Ended 12/31/2014
Total Fund Return - Net	7.26%	8.86%	8.39%
Policy Benchmark Return	6.28%	6.20%	6.58%
Excess Return	0.98%	2.66%	1.82%

LEGACY FUND

\$ 2,900,880,837

	1 Yr Ended 12/31/2014	3 Yrs Ended 12/31/2014	5 Yrs Ended 12/31/2014
Total Fund Return - Net	4.23%	3.01%	N/A
Policy Benchmark Return	3.62%	2.01%	N/A
Excess Return	0.61%	1.00%	

BUDGET STABILIZATION FUND

\$ 589,598,047

	1 Yr Ended 12/31/2014	3 Yrs Ended 12/31/2014	5 Yrs Ended 12/31/2014
Total Fund Return - Net	1.56%	1.96%	2.47%
Policy Benchmark Return	0.53%	0.41%	0.32%
Excess Return	1.04%	1.55%	2.14%

Note: The 3 largest clients in the **Insurance Trust** are:

- 1.) **WSI - \$1.7 billion;**
- 2.) **Legacy Fund - \$2.9 billion; and**
- 3.) **Budget Stabilization Fund - \$590 million.**

Insurance Trust:

- **Every SIB client within the Insurance Trust generated positive “Excess Return” for the 3- and 5-year periods ended December 31, 2014, while 13 out of our 15 Insurance Trust clients generated positive “Excess Return” for the 1-year ended 12/31/2014.**
- **“Excess return” is defined as the actual investment return (after deducting management fees) over the expected investment return of the underlying investment policy benchmark (or passive index).**
- **Based on WSI plan assets of \$1.7 billion and “Excess Return” of 0.98% in 2014, SIB’s use of active management generated over \$16 million of incremental income (after fees) for WSI (\$1.7 billion x 0.98% = \$16.66 million) in the last year.**
- **These returns were achieved in a risk controlled framework as each Insurance Trust client (with a 5-year track record) generated positive “Risk Adjusted Excess Return” for the 5-years ended 12/31/2014.**

Risk Adjusted Excess Return measures a portfolio’s excess return adjusted by its risk relative to a benchmark portfolio. This metric is positive if returns are due to smart investment decisions or negative if driven by excess risk.

Investment Policy, Governance, Service and Staffing Update

- **Investment Policy Statement Review** – RIO reviewed the investment policy statements of all SIB clients with assets in excess of \$10 million in 2014 and intends to review the statements of clients with assets less than \$10 million in 2015.
- **Fee and Custody Review** - Callan completed a fee review of our investment managers and custodians in 2014 so as to confirm the reasonableness of overall performance standards and fee levels.
- **Governance and Board Education** – The SIB Governance manual was reviewed in 2014. During the past year, the SIB engaged in over 10 hours of board education. This trend continues in 2015 and will include a governance day offsite in late-July.
- **Satisfaction Survey** – SIB clients assigned an “Excellent” or “Above Average” satisfaction rating based on 2014 survey results.

SUMMARY of SIB Client Satisfaction Survey Ratings:

	Excellent	Above Average	Average	Poor	N/A
Totals	63	25	0	0	8
Grade	4	3	2	1	0
Percent	66%	26%	0%	0%	8%
Average	3.7				

- **Government Finance Officers Association (“GFOA”) Award** – The North Dakota Retirement and Investment Office received a Certificate of Achievement for Excellence in Financial Reporting from the GFOA for its Comprehensive Annual Financial Report (“CAFR”) for the year ended June 30, 2014. This marks the 17th consecutive year that RIO has been awarded this honor. RIO’s CAFR was judged by an impartial panel to meet the high standards of the program including demonstrating a constructive “spirit of full disclosure” to clearly communicate its financial story. “The Certificate of Achievement is the highest form of recognition in the area of governmental accounting and financial reporting, and its attainment represents a significant accomplishment by a government and its management.”
- **RIO Staffing** – In order to be properly staffed based on expected asset levels, RIO filled legislatively approved positions during the past 16 months including *an audit supervisor, compliance officer, information technology specialist, retirement benefits specialist and two investment professionals*. This staffing level will help to ensure that SIB and TFFR clients receive investment returns or retirement benefits, consistent with their written policies and market variables, in a cost effective manner.

Strategic Initiatives – April 20, 2015 Update

- **Enhanced Risk Management Platform** – In order to enhance our existing risk management framework, RIO staff is investigating industry leading third-party provided risk management platforms. RIO investment staff will present its findings to the SIB at a future meeting. The primary goal of this operational initiative is to develop more robust risk analytic tools particularly relating to downside risk management and various economic stress testing scenarios.
- **PERS and TFFR Return Expectations** – RIO staff is working with PERS and TFFR personnel, board, actuaries and consultants to confirm the reasonableness of long-term expected return assumptions.
- **Governance Manual Review and Board Education** – SIB members will engage in 8 hours of board education relating to overall program governance and various investment related topics during the first eight months of 2015.
- **Budget Stabilization Fund Investment Policy Statement** – RIO has met with Bank of North Dakota management to review the contractual terms and liquidity provisions of the existing Match Loan Certificate of Deposit Program.
- **Watch List (Ongoing)** – PIMCO, Timber Investment Resources and UBS remain on the Watch List until performance improves and/or recent firm developments are satisfactorily resolved.
- **Novarca Contract and Pricing Review** – RIO has prioritized the Epoch, LSV and Private Equity investment strategies for an in-depth pricing review with Novarca during the first half of 2015.
- **Fee Saving Update** – Investment staff of RIO and the North Dakota Department of Trust Lands have been working together to explore additional fee savings with our joint manager relationships. During the past few months, this combined effort has identified \$100,000 of incremental savings for SIB clients (PIMCO and State Street) plus up to \$75,000 in potential savings for Land Board clients (Northern Trust and State Street). RIO also intends to commence the SIB approved securities lending program in April which Northern Trust previously estimated would generate \$900,000 in annual income for SIB clients.

INFORMATIONAL – NO BOARD ACTION REQUESTED

TO: State Investment Board

FROM: Dave Hunter

DATE: April 19, 2015

SUBJECT: Annual Investment Review of City of Grand Forks Pension Plan – Cover Memo

In accordance with **North Dakota Century Code 21-10-02.1**, “The asset allocation for each fund, to be effective, must be approved by the governing body of the fund and the SIB each year.” RIO previously reviewed the Investment Policy Statement of the City of Grand Forks Pension Plan in December of 2014 and intends to review it again with the City of Grand Forks Pension and Insurance Committee (“Committee”) in mid-2015.

On April 22, 2015, RIO intends to conduct the annual investment review of the Grand Forks Pension Plan for the year ended December 31, 2014. This review will coincide with a presentation by the plan’s actuary, Eric Roling from Deloitte, who intends to present the actuarial valuation report to the Committee. After these presentations, RIO intends to work with the Committee to review the plan’s Investment Policy Statement. Upon receiving the governing body’s approval, RIO will present the refreshed Investment Policy Statement to the SIB for final review and acceptance.

The attached presentation contains excerpts from the most recent annual investment review of the Grand Forks Pension Plan.

City of Grand Forks Pension Plan Annual Investment Review

April 22, 2015

Dave Hunter, Executive Director/CIO
Darren Schulz, CFA, Deputy Chief Investment Officer
ND Retirement & Investment Office (RIO)
State Investment Board (SIB)

Annual Investment Review Agenda

- ▷ **Capital Markets Update**
- ▷ **Annual Investment Review**
 - ▷ Pension Plan Activity
 - ▷ Investment Returns and Risk
 - ▷ Asset Allocation
 - ▷ Fees
- ▷ **Pension Trust – Risk and Return Trends**



Capital Markets Update

As of December 31, 2014

U.S Economy – GDP Growth Rates



- ▶ Quarterly GDP Growth Rates have been volatile as evidenced by the **-2.1%** rate in Q1/14 being preceded by **+3.5%** in Q4/13 and followed by **+4.6%** in Q2/14.

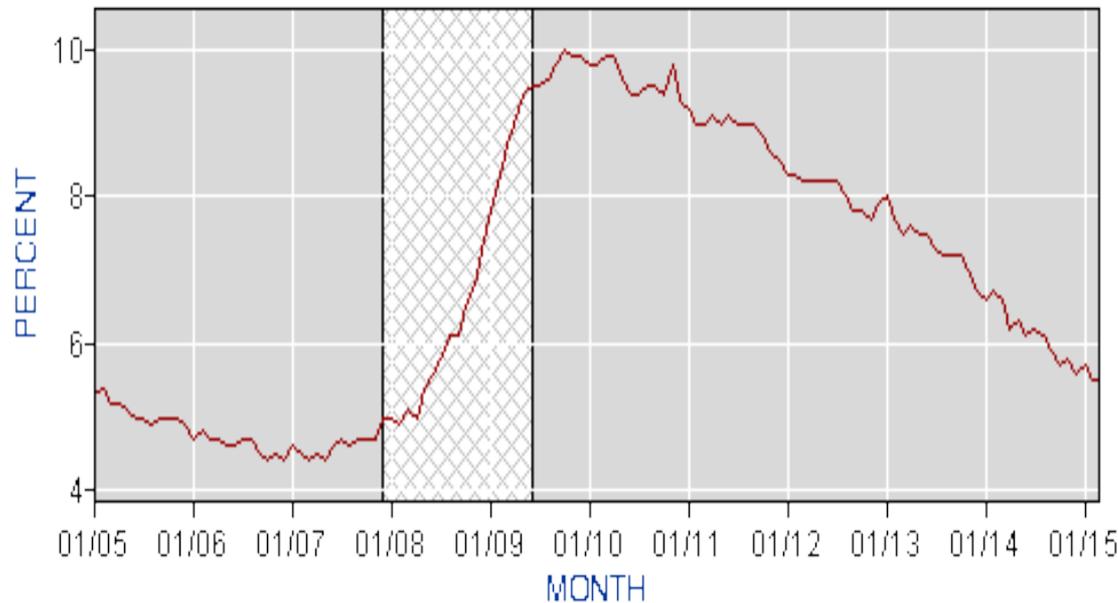


- ▶ In contrast, annual GDP Growth Rates have displayed slow to moderate growth of 1.6% to 3.1% since 2012 versus 2.4% at 4Q/14.

SOURCE: WWW.TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

U.S Labor Market Conditions

Unemployment rate (seasonally adjusted)



Note: Cross-hatched area represents recession.

The U.S. Unemployment Rate has declined to 5.5% in March of 2015 after peaking at 10% in October of 2009.

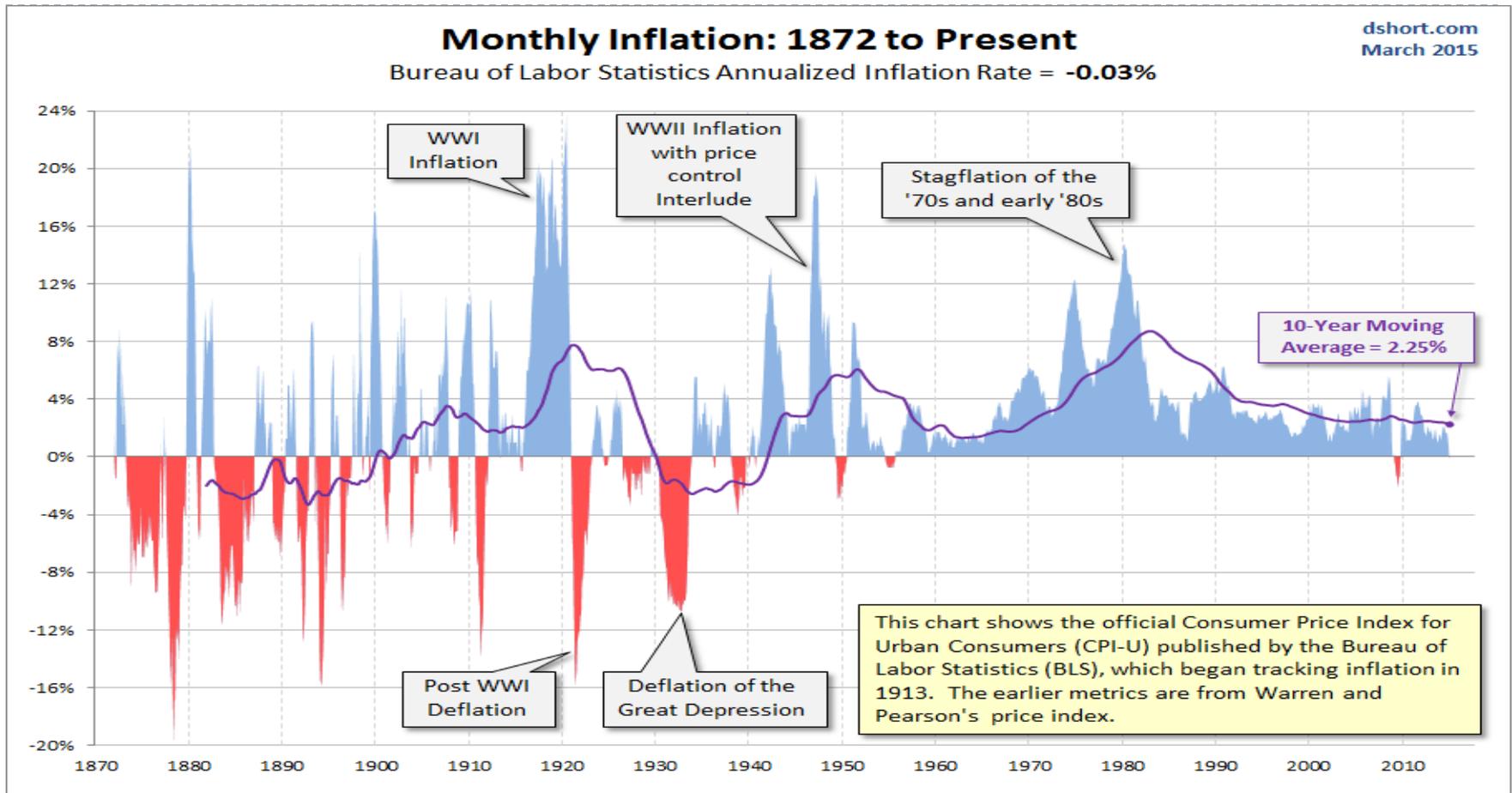
U.S. Unemployment at year-end since 2009:

Dec. / 2009	9.9%
Dec. / 2010	9.3%
Dec. / 2011	8.5%
Dec. / 2012	7.9%
Dec. / 2013	6.7%
Dec. / 2014	5.6%

Jan. / 2015	5.7%
Feb. / 2015	5.5%
Mar. / 2015	5.5%

Source: U.S. Department of Labor: Bureau of Labor Statistics

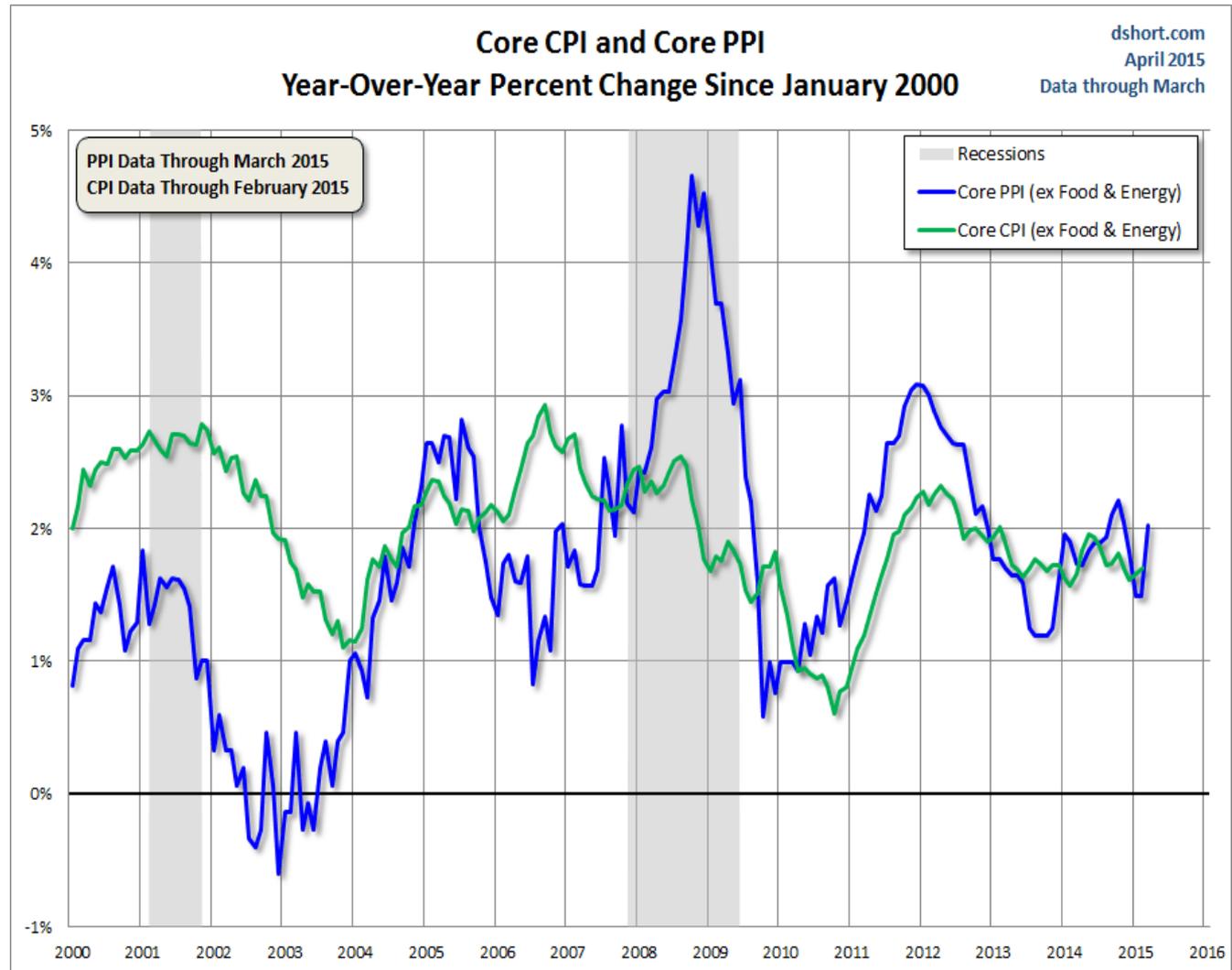
A Long-Term Look at Inflation



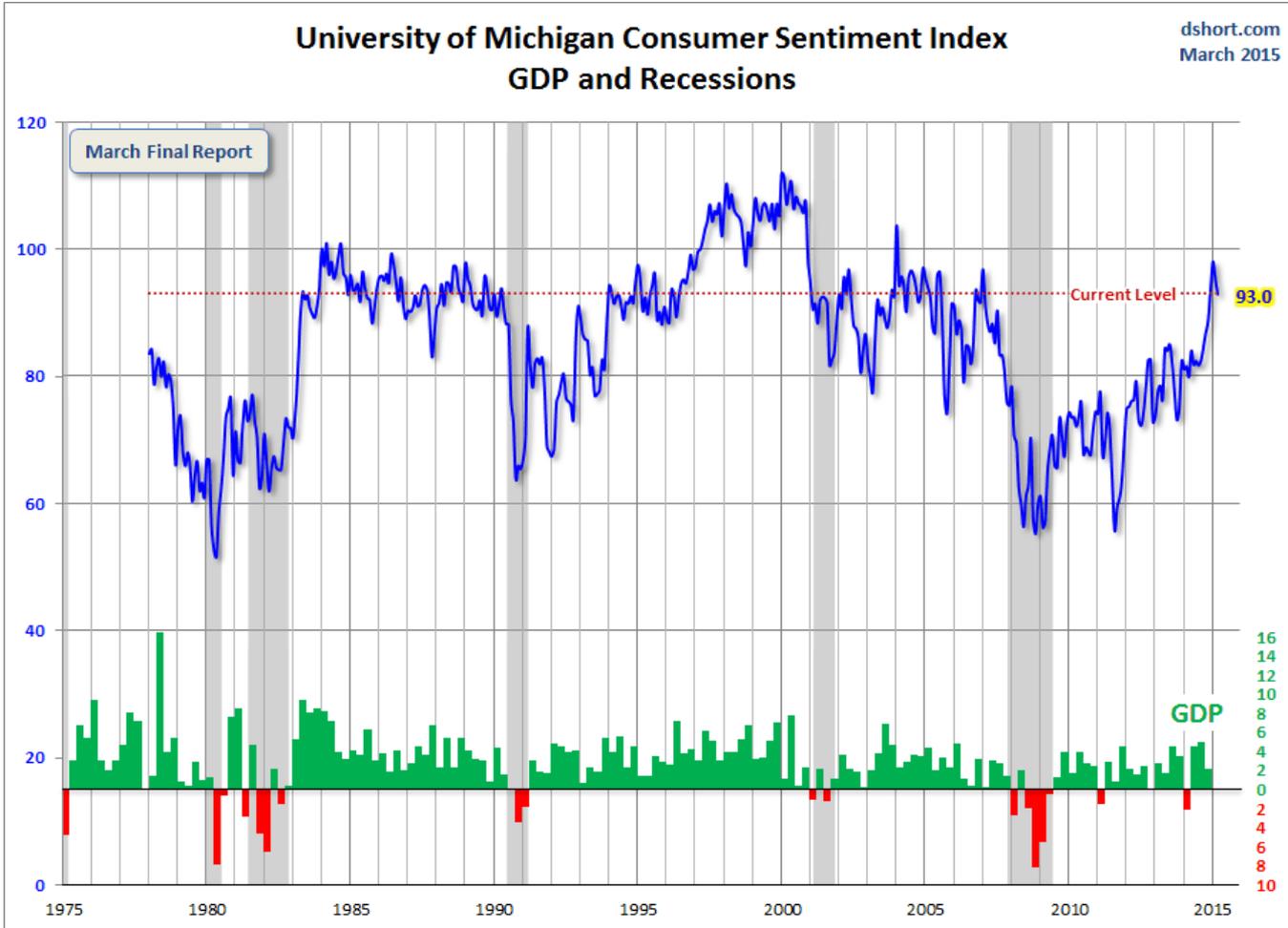
The Consumer Price Index for Urban Consumers (CPI-U) is substantially below the 3.85% average since the end of the Second World War and its 10-year moving average is now at 2.25%.

Recent Inflation Trends (Core CPI 1% to 3%)

The Core Producer Price Index is far more volatile than the Core Consumer Price Index. For example, during the last recession producers were unable to pass cost increases to the consumer. Likewise in 2010 the Core PPI generally rose while Core CPI generally fell. Since 2012, Core PPI steadily trended downward to its interim low in August of 2013. It rose in the final months of 2013 and has remained in a relatively narrow range since then.



U.S Consumer Sentiment



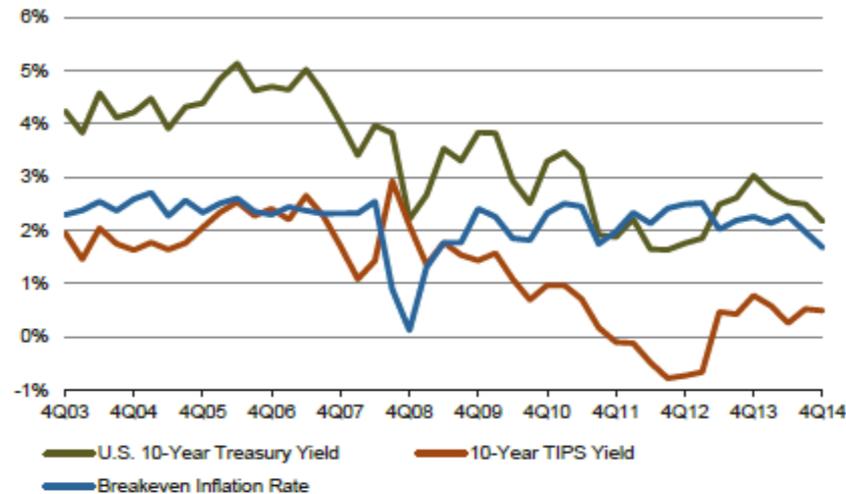
Summary: The University of Michigan preliminary Consumer Sentiment for March came in at 93.0, down 2.6 points from the final reading of 95.4 in February. **The average since its inception is 85.2.** During non-recessionary years the average is 87.4 versus 69.3 during the five recessions. **The latest sentiment number of 93.0 puts us 5.5 points above the non-recession average and 23.7 points above the average recession mindset.**

The **University of Michigan Consumer Sentiment Index** is a consumer confidence index published monthly by the University of Michigan and Thomson Reuters. The index is normalized to have a value of 100 in December 1964. Each month at least 500 telephone interviews involving fifty core questions are conducted within the U.S. These interviews are used to develop an index of consumer expectations, a subset of which are included in the Leading Indicator Composite Index published by the US Dept. of Commerce and Bureau of Economic Analysis.

Yield Curve Changes

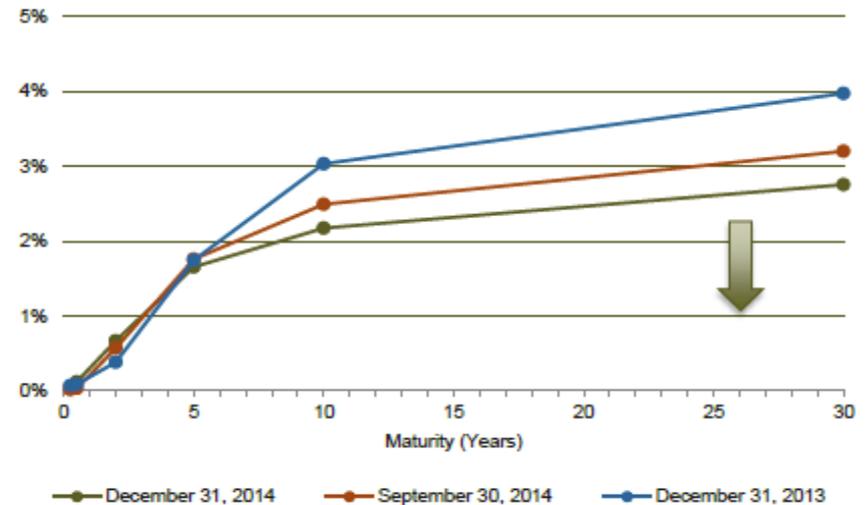
Periods Ending December 31, 2014

Historical 10-Year Yields



Source: Bloomberg

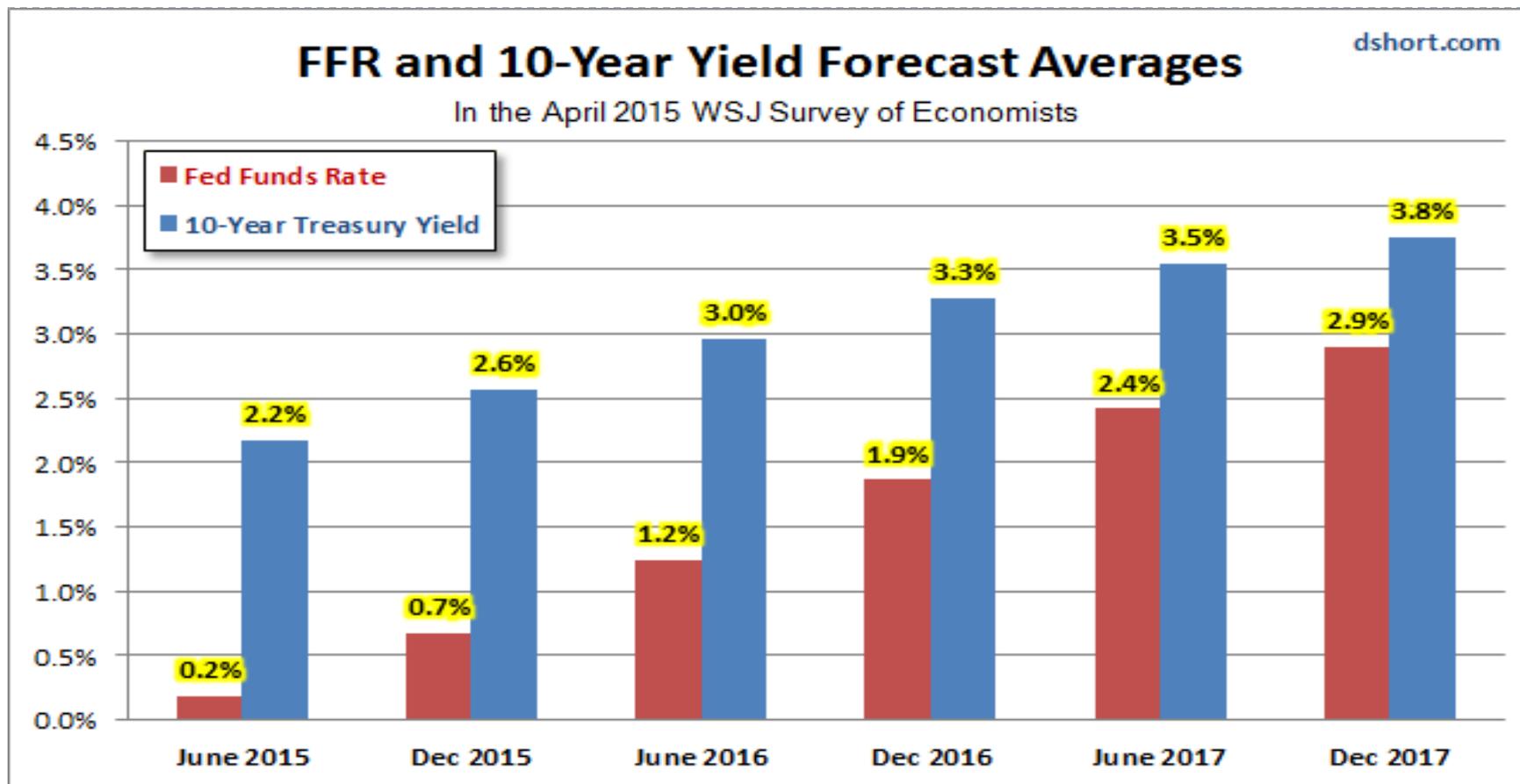
U.S. Treasury Yield Curves



Source: Bloomberg

- A flattening of the yield curve helped long-term Treasury returns
- The 10-year Treasury yield fell to 2.17%, a decline of 35 basis points from the end of 3rd quarter.
- Real yield on 10-year Treasury was only 0.46% at year end
- The breakeven inflation rate fell ending at 1.68% on a decline in nominal rates

Forecasts for 10-Year Yields and Fed Funds Rate (FFR)



- ▶ The Fed minutes of its March 17-18 policy meeting released last week were generally viewed by the popular financial press as showing a split in the FOMC on the timing of a rate hike. The Wall Street Journal has now made available its April survey of economists on key economic indicators. At this point only 19 percent of the 60+ economists see a June rate hike, with a 65-percent majority identifying September as the liftoff date.

Historical Asset Class Market Returns and Key Economic Indicators

Asset Class	Benchmark	Period Ended December 31, 2014			
		1-Year	3-Years	5-Years	10-Years
Large Cap US Stocks	Russell 1000	13.24%	20.62%	15.64%	7.96%
Small Cap US Stocks	Russell 2000	4.89%	19.21%	15.55%	7.77%
Non-US Stocks (Developed)	MSCI EAFE	-4.90%	11.06%	5.33%	4.43%
Non-US Stocks (Emerging)	MSCI Emerging Markets	-1.82%	4.41%	2.11%	8.78%
US Bonds	Barclays Aggregate	5.97%	2.66%	4.45%	4.71%
High Yield Bonds	Barclays Corporate High Yield	2.45%	8.43%	9.03%	7.74%
Non-US Debt	Citi Non-US World Govt	-2.68%	-1.94%	0.85%	2.64%
Inflation Protected	Barclays Global Inflation Linked	3.41%	2.63%	4.19%	4.29%
Real Estate	NCREIF	11.82%	11.11%	12.13%	8.38%

Recent Quarterly Indicators	4Q14	3Q14	2Q14	1Q14	4Q13	3Q13	2Q13	1Q13
GDP Growth	2.2%	5.0%	4.6%	-2.1%	3.5%	4.5%	1.8%	2.7%
Unemployment Rate	5.7%	6.1%	6.2%	6.6%	7.0%	7.3%	7.5%	7.7%
CPI	0.8%	1.7%	2.1%	1.5%	1.5%	1.2%	1.8%	1.5%
Consumer Sentiment (Mar . 93.0)	93.6	84.6	82.5	80.0	82.5	77.5	84.1	78.6

Asset Class Performance

Periods Ending December 31, 2014

- Russell 2000 best for quarter, gaining 9.7%, up 4.9% in 2014
- S&P 500 gained 4.9% for quarter and 13.7% for the year
- BC Aggregate rose 1.8% for quarter and 6.0% for 2014
- International equities lagged domestic equities for the quarter and year

Periodic Table of Investment Returns
for Periods Ended December 31, 2014

Last Quarter	Last Year	Last 3 Years	Last 5 Years	Last 10 Years
Russell:2000 Index 9.7%	S&P:500 13.7%	S&P:500 20.4%	S&P:400 Mid Cap 16.5%	S&P:400 Mid Cap 9.7%
S&P:400 Mid Cap 6.3%	S&P:400 Mid Cap 9.8%	S&P:400 Mid Cap 20.0%	Russell:2000 Index 15.5%	MSCI:Emer Markets 8.8%
S&P:500 4.9%	Barclays:Aggregate Index 6.0%	Russell:2000 Index 19.2%	S&P:500 15.5%	Russell:2000 Index 7.8%
Barclays:Aggregate Index 1.8%	Russell:2000 Index 4.9%	MSCI:EAFE US\$ 11.1%	MSCI:EAFE US\$ 5.3%	S&P:500 7.7%
3 Month T-Bill 0.0%	3 Month T-Bill 0.0%	MSCI:Emer Markets 4.4%	Barclays:Aggregate Index 4.4%	Barclays:Aggregate Index 4.7%
MSCI:EAFE US\$ (3.6%)	MSCI:Emer Markets (1.8%)	Barclays:Aggregate Index 2.7%	MSCI:Emer Markets 2.1%	MSCI:EAFE US\$ 4.4%
MSCI:Emer Markets (4.4%)	MSCI:EAFE US\$ (4.9%)	3 Month T-Bill 0.1%	3 Month T-Bill 0.1%	3 Month T-Bill 1.5%

	January	YTD (2/9/15)
Russell 3000	-2.8%	-0.2%
MSCI EAFE	0.5%	1.8%
MSCI EM	0.6%	1.8%
BC Aggregate	2.1%	1.1%
BC TIPS	3.2%	1.6%



Annual Investment Review

City of Grand Forks Employees Pension Plan

City of Grand Forks Pension Plan Activity - June 30, 2014

	2014	2013	2012	2011	2010	2010 to 2014
City of Grand Forks Pension Plan						
Net position beginning of year	\$ 50,088,805	\$ 43,890,145	\$ 43,013,441	\$ 34,915,157	\$ 30,006,961	\$ 30,006,961
Net increase/(decrease)						
in fair value of investments	7,198,621	4,988,932	(429,165)	6,821,525	3,626,358	22,206,271
Interest, dividends and other income	947,544	1,104,377	1,003,146	818,617	674,685	4,548,369
Expenses	198,607	162,026	151,256	153,222	137,909	803,020
Net securities lending income	-	-	264	4,499	3,136	7,899
Net incr/(decr) in net position resulting from unit transactions	(230,836)	267,377	453,715	606,865	741,926	1,839,047
Net position end of year	\$ 57,805,527	\$ 50,088,805	\$ 43,890,145	\$ 43,013,441	\$ 34,915,157	\$ 57,805,527

Summary of City Grand Forks Pension Plan for the five year period ended June 30, 2014:

- **The Grand Forks Pension Plan has grown by 93% to \$57.8 million (from \$30 million) in the last five years.**
- **This \$28 million increase in the City of Grand Forks Pension Fund was generated by \$26 million of net investment income plus \$1.8 million of contributions for the five year period ended June 30, 2014.**
- **Contributions have generally been positive for each of the above periods and over the last 5 years.**

Summary of City Grand Forks Pension Plan – Preliminary Update as of February 28, 2015:

- **The Grand Forks Pension Plan approximated \$57.1 million as of February 28, 2015, noting that cash distributions of \$3.1 million have exceeded cash contributions and investment income of \$2.3 million during the past eight months (since June 30, 2014).**

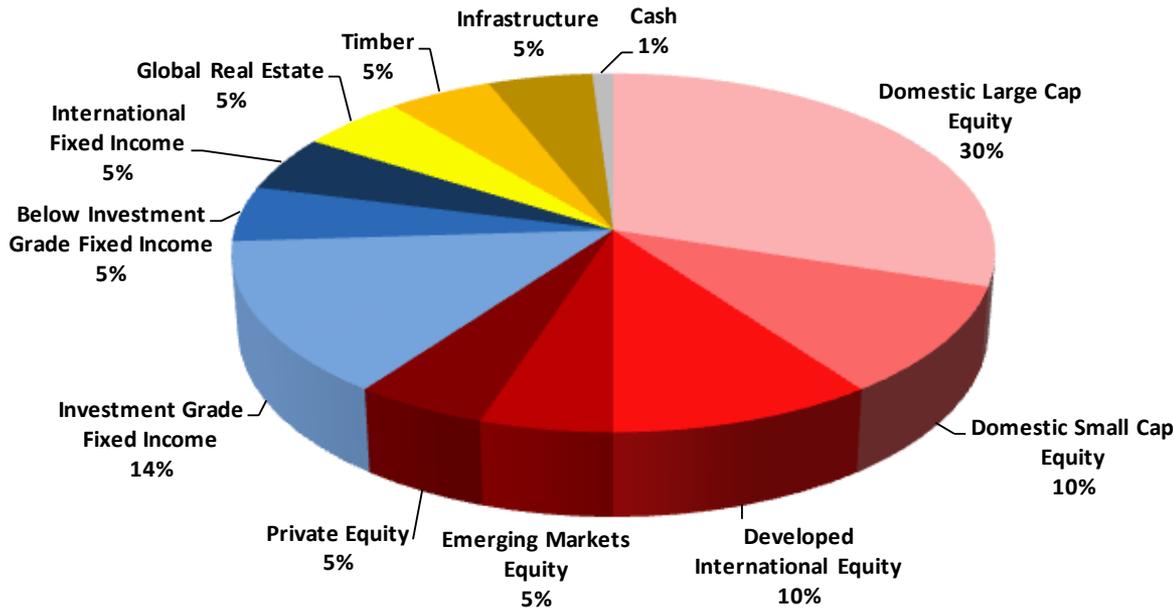
City of Grand Forks Pension Plan Performance – 12/31/2014

	1 Yr Ended 12/31/2014	3 Yrs Ended 12/31/2014	5 Yrs Ended 12/31/2014	Risk 5 Yrs Ended 12/31/2014	Risk Adj Excess Return 5 Yrs Ended 12/31/2014
CITY OF GRAND FORKS PENSION PLAN					
Total Fund Return - Net	6.3%	12.5%	10.0%	8.7%	0.10%
Policy Benchmark Return	5.6%	11.3%	9.6%	8.5%	
Excess Return	0.6%	1.2%	0.4%	103%	

- The **City of Grand Forks Pension Plan** has generated a **6.3%** net return (after fees) for the year ended 12/31/2014 and a **10.0%** net annualized return over the last five years.
- Asset allocation decisions are consistently the primary driver of returns and were responsible for “**Policy Benchmark Returns**” of **5.6%** and **9.6%** for the 1- and 5-year periods ended 12/31/2014, respectively.
- Although asset allocation is paramount, the selection of investment managers is important. Successful active management occurs when an investor selects managers which outperform the underlying benchmark index.
- The SIB has been successful in selecting active managers as evidenced by the **City of Grand Forks Pension Plan** generating **Excess Returns of 0.6% in the last year and 0.4% for the 5-years ended 12/31/2014**. This translates into \$1 million of incremental income for the plan over the last 5-years and \$350,000 in 2014.
- These returns were generated while adhering to prescribed investment guidelines noting that the actual risk (as measured by standard deviation) for the 5-years ended 12/31/2014 was within **3%** of investment policy.

City of Grand Forks Pension Plan Asset Allocation

Policy Allocation



NOTE: The above asset allocation pie chart is consistent with the investment policy statement which does not contain a dedicated Global Equity allocation.

➤ Asset allocation decisions are consistently the #1 driver of investment returns and are as follows:

Equity	60%
Fixed Income	24%
Real Assets	15%
Cash	1%

➤ During the past year, U.S. large cap equities were the top performer with a 13% return, while U.S. small cap and international equities earned 4% and -3%, respectively.

➤ Fixed income returns ranged from 8% for investment grade to 6% for non-investment grade and 1% for international debt.

➤ The Plan's real asset returns ranged from 14% for real estate, 7% for infrastructure and a sub-par 5% for timber.

City of Grand Forks Pension Plan

Actual versus Target Allocation

	Market Value	Allocation		Δ
		Actual	Policy	
TOTAL FUND	56,347,332	100.0%	100.0%	0.0%
GLOBAL EQUITIES	33,830,431	60.0%	60.0%	0.0%
GLOBAL FIXED INCOME	13,971,516	24.8%	24.0%	0.8%
GLOBAL REAL ASSETS	8,048,965	14.3%	15.0%	-0.7%
Total Cash Equivalents	496,420	0.9%	1.0%	-0.1%

NOTE: Monthly market values are preliminary and subject to change.

- ▶ Based on the broad asset allocation framework adopted in 2012, the City of Grand Forks Pension Plan was slightly **overweight to Global Fixed Income (0.8%), at policy for Global Equities** and **underweight to Global Real Assets (-0.7%)** as compared to its target asset allocation on December 31, 2014.

City of Grand Forks Pension Plan Fee Comparison

City of Grand Forks Pension		Basis
Asset Class	Target	Points
Global Equity	16.0%	61
Domestic Equity - Large Cap	21.3%	20
Domestic Equity - Small Cap	7.1%	64
International Equity	7.1%	40
Emerging Market Equity	3.5%	69
Private Equity	5.0%	190
Fixed Income (Investment Grade)	14.0%	130
Fixed Income (Below Inv. Grade)	5.0%	190
International Fixed Income	5.0%	36
Global Real Estate	5.0%	108
Infrastructure	5.0%	139
Timber	5.0%	39
Cash and Cash Equivalents	1.0%	15
	100.0%	77
Custody, Consultant & SIB Fees		1
FISCAL 2013 ANNUAL FEES (Estimated)		78

City of Grand Forks Pension		Basis
Asset Class	Target	Points
Global Equity	16.0%	80
Domestic Equity - Large Cap	21.3%	30
Domestic Equity - Small Cap	7.1%	53
International Equity	7.1%	34
Emerging Market Equity	3.5%	45
Private Equity	5.0%	255
Fixed Income (Investment Grade)	14.0%	66
Fixed Income (Below Inv. Grade)	5.0%	74
International Fixed Income	5.0%	35
Global Real Estate	5.0%	101
Infrastructure	5.0%	89
Timber	5.0%	38
Cash and Cash Equivalents	1.0%	14
	100.0%	66
Custody, Consultant & SIB Fees		1
FISCAL 2014 ANNUAL FEES (Estimated)		67

- The **Grand Forks Pension Plan** fees (expressed as a % of average managed assets) declined from **78 basis points** in fiscal 2013 to **67 basis points** in fiscal 2014.
- This was a direct result of a significant increase in SIB client assets under management, sharply lower performance fees and negotiated fee savings over the past 12-to-18 months.

Pension Trust – Risk and Return Trends

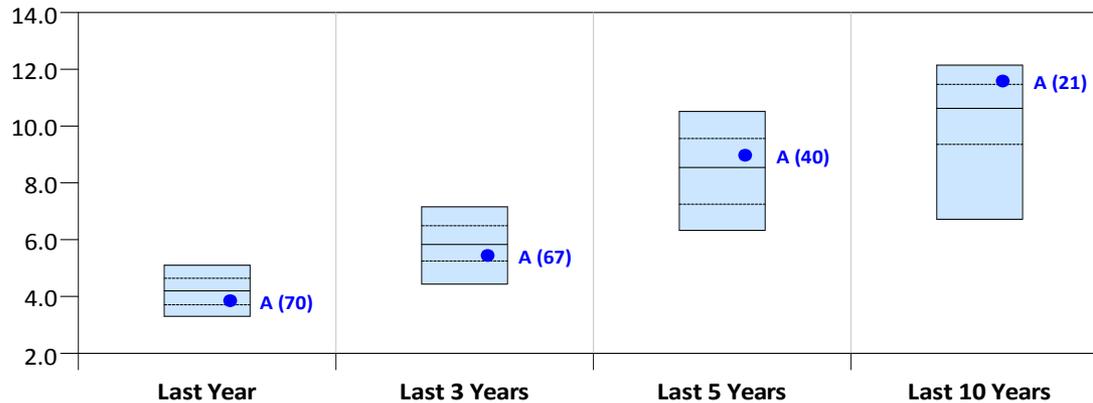
As of December 31, 2014

Pension “Risk” has declined as measured by Standard Deviation

Pension Trust

Standard deviation is used to measure investment volatility whereas a lower standard deviation is generally preferred over a higher standard deviation.

Standard Deviation
for Periods Ended December 31, 2014
Group: CAI Public Fund Sponsor Database



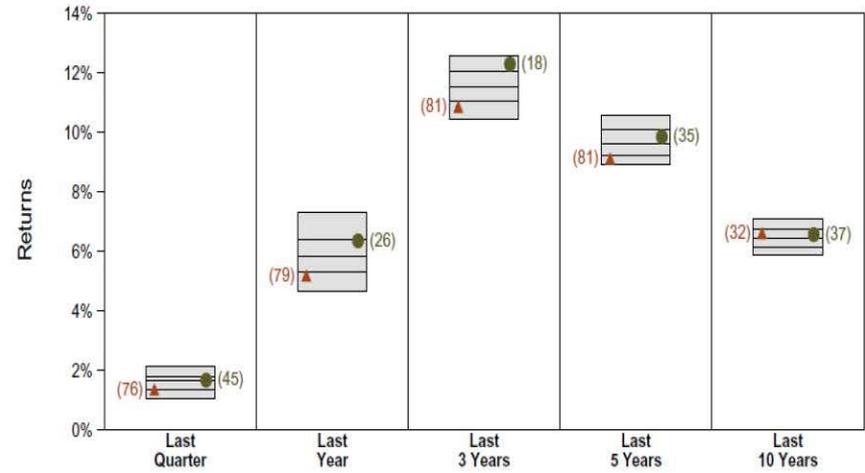
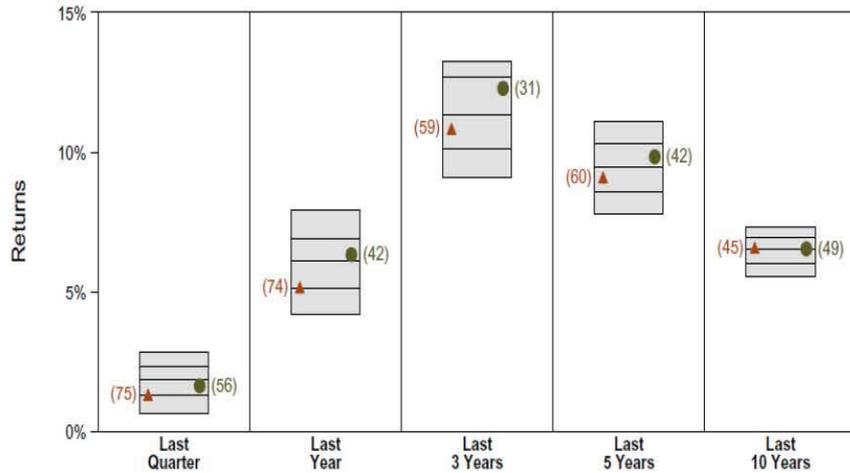
10th Percentile	5.1	7.2	10.5	12.1
25th Percentile	4.6	6.5	9.6	11.5
Median	4.2	5.8	8.5	10.6
75th Percentile	3.7	5.3	7.3	9.4
90th Percentile	3.3	4.4	6.3	6.7
Member Count	265	258	243	208
ND Pen-Total Fund ● A	3.9	5.4	9.0	11.6

Portfolio volatility, as measured by Standard Deviation, has declined significantly and currently resides in the 3rd quartile for 3-year period ended December 31, 2014 versus the upper two quartiles for the 5- and 10-year periods ended December 31, 2014.

Peer Performance - Pension Trust Total Fund Ranking

The charts display the ranking of the Total Pension Fund's performance relative to the Public Fund Sponsor Database for periods ended December 31, 2014. The left chart does not make any adjustment for the historical asset allocations of the Total Pension Fund, while the right chart adjusts for our asset allocation.

Callan Public Fund Sponsor Database



10th Percentile	2.86	7.91	13.27	11.10	7.34
25th Percentile	2.32	6.92	12.68	10.29	6.96
Median	1.86	6.09	11.31	9.49	6.52
75th Percentile	1.31	5.15	10.10	8.58	6.00
90th Percentile	0.65	4.20	9.09	7.81	5.56
Total Fund	1.65	6.33	12.28	9.83	6.54
Policy Target	1.33	5.16	10.84	9.10	6.59

10th Percentile	2.11	7.29	12.56	10.56	7.08
25th Percentile	1.77	6.37	12.05	10.06	6.71
Median	1.62	5.80	11.51	9.60	6.41
75th Percentile	1.33	5.30	11.05	9.19	6.13
90th Percentile	1.00	4.63	10.42	8.91	5.86
Total Fund	1.65	6.33	12.28	9.83	6.54
Policy Target	1.33	5.16	10.84	9.10	6.59

* Current Quarter Target = 16.5% Russell 1000 Index, 16.0% MSCI World Index, 13.0% Barclays Aggregate Index, 11.1% MSCI EAFE Index, 9.7% NCREIF Total Index, 5.0% Barclays HY Corp 2% Issue, 5.0% Global Agg ex USD, 4.9% CPI-W, 4.9% Russell 2000 Index, 4.9% NDSIB PEN - Private Equity, 4.9% NCREIF Timberland Index, 3.1% MSCI Emerging Mkts - Net and 1.0% 3-month Treasury Bill.

Gross Returns: The Pension Trust generated 2nd quartile returns for the 1-, 3-, 5-, and 10-year periods ended December 31, 2014 based on the Callan Associates Public Fund Sponsor Database (unadjusted basis). On an asset allocation adjusted basis (right chart), the Pension Trust performed at the 26th percentile during the last year, the 18th percentile over the last 3 years and the 35th percentile for the last 5 years.



City of Grand Forks

255 North Fourth Street • P.O. Box 5200 • Grand Forks, ND 58206-5200

(701) 746-2620
Fax# (701) 787-3740

May 8, 2012

RECEIVED

State Investment Board
ND Retirement and Investment Office
1930 Burnt Boat Drive
P.O. Box 7100
Bismarck, ND 58507-7100

MAY 10 2012

NDRIO

RE: Pension Fund Asset Allocation

Dear Ms. Flanagan:

At their April 18, 2012, meeting, the Grand Forks Pension and Insurance Committee approved a revised asset allocation for their pension fund investments with the ND State Investment Board. This action has been approved by the City Council at their meeting on May 7, 2012. Therefore, effective retroactively to April 1, 2012, please adjust the asset allocation to the following targets.

Global Equity	60%	
Domestic Equity	40%	
Large Cap		30%
Small Cap		10%
International Equity	15%	
Developed		10%
Emerging Markets		5%
Private Equity		5%
Global Fixed Income	24%	
Domestic Fixed Income	19%	
Investment Grade		14%
Below Investment Grade		5%
International Fixed Income	5%	
Global Real Assets	15%	
Real Estate		5%
Timber		5%
Infrastructure		5%
Cash Equivalents	1%	

Sincerely,


Maureen Storstad, CPA
Director of Finance/City Auditor

**STATEMENT OF
INVESTMENT GOALS, OBJECTIVES AND POLICIES
FOR THE CITY OF GRAND FORKS,
NORTH DAKOTA PENSION PLAN**

1. PLAN CHARACTERISTICS AND FUND CONSTRAINTS

The City of Grand Forks Pension Fund¹ (the "Fund") is operated by the Grand Forks City Council pursuant to the authority granted in the Grand Forks City Code Chapter 7.

Plan Description The City of Grand Forks, North Dakota Pension Plan (the "Plan") is a cost-sharing multiple employer public employee pension plan. All classified employees who earned at least one hour of service prior to January 1, 1996 are eligible to participate in the Plan. Some participants have elected to cease benefit accruals under the Plan as of June 30, 2008 and to participate in the North Dakota Public Employees Retirement System.

Membership in the Plan on January 1, 2009 (date of most recent actuarial study) is as follows:

Retirees and beneficiaries	200
Terminated vested and deferred beneficiaries	34
Active plan members	225
Active plan members (70 ½, drawing pension while working)	1

Number of participating employers: 2

Participants may be eligible for early retirement, special early retirement or normal retirement. The Plan permits early retirements at age 55 with at least 5 years of vesting service. Normal retirement age for full benefits is age 65 (unless the employee has elected a special early retirement age of either 55 or 62).

If a participant dies prior to starting retirement benefits, and is married, the participant's spouse will receive a survivor annuity. If the participant is not married, the participant's beneficiary will receive a single lump sum payment equal to the participant's accumulated employee contributions. If the participant dies after starting retirement benefits, payments will continue to the survivor if the participant elected an annuity with a survivor benefit. If the participant elected a single life annuity or received a lump sum payment, no benefits will be paid after the participant's death. If the amount of payments paid to the participant and the participant's joint annuitant, if any, do not equal the participant's accumulated employee contributions, the participant's beneficiary will receive an amount equal to the participant's accumulated employee contributions, minus any payments previously received by participant and the participant's joint annuitant.

Participants are fully vested in the Plan benefit after five years of vesting service. Non-vested participants are eligible for a full refund of their accumulated employee contributions. Upon termination of employment prior to retirement age, vested participants may elect a deferred vested benefit to begin no earlier than age 55. However, participants may elect to withdraw their accumulated employee contributions at any time after termination of employment. The

participant's accrued benefit will be reduced by the equivalent value of any withdrawn accumulated employee contributions.

If the present value of a participant's benefit is \$1,000 or less (including the participant's accumulated employee contributions), payment will be made in a lump sum.

Benefit provisions are established by the City Council.

Contributions Participating employees contribute to the Plan at a rate of 3.7% of salary (7.4% or 4.7%, respectively if the participant has elected a special early retirement age of 55 or 62). The employers contribute such amounts as necessary to provide the promised benefits. The contribution amounts are determined by the annual actuarial valuation report and approved by the City Council. Costs of administering the Plan are financed by the employer and employee contributions, and by the Plan's investment earnings.

Reserves The Plan's net assets as of December 31, 2008 are \$32,933,349 and the entire amount is reserved for employee pension benefits.

2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB)

Aggregate plan contributions plus earnings, minus allowable expenses constitute the Fund. The City Council is required to develop asset allocation plans pursuant to its responsibilities as outlined in the Grand Forks City Code Chapter 7. The State Investment Board (SIB) is charged with implementing the asset allocation as promptly and prudently as possible in accordance with the Board's policies by investing the assets of the Fund in the manner provided in the prudent investor rule, which provides:

The SIB shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income. The Fund must be invested exclusively for the benefit of Plan participants and in accordance with the Fund's investment goals and objectives.

The SIB may delegate investment responsibility of the Fund or any portion of the Fund to professional money managers. Where a money manager has been retained, the SIB's role in determining investment strategy is supervisory not advisory.

The SIB may at its discretion, pool the assets of the Fund with another fund or funds having similar investment objectives and time horizons in order to maximize returns and minimize costs. In pooling fund assets the SIB will establish asset class pools it deems necessary to achieve the specific quality, diversification, restrictions, and performance objectives subject to the prudent investor rule and the objectives of the funds participating in the pools.

The SIB is responsible for establishing the selection criteria, determining the performance measures, and retaining all fund money managers. SIB is also responsible for the selection and retention of any investment consultants that may be employed in the investment of the Fund assets.

3. DELEGATION OF AUTHORITY

Management responsibility for Plan assets not assigned to the North Dakota State Investment Board (SIB) in Chapter 21-10 of the North Dakota Century Code (NDCC) is hereby delegated to the SIB, which must establish written policies and procedures for the operation of the Fund, consistent with this investment policy.

Such procedures must provide for:

1. The definition and assignment of duties and responsibilities to advisory services and persons employed by the SIB pursuant to NDCC 21-10-02.1(1) (a).
2. Investment diversification, investment quality, qualification of money managers, and amounts to be invested by money managers pursuant to NDCC 21-10-02.1(1)(e). In developing these policies it is understood:
 - a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
 - b. The use of derivatives will be monitored to ensure that undue risks are not taken by the money managers.
 - c. All assets must be held in custody by the SIB's master custodian or such other custodians as are selected by the SIB.
3. Guidelines for the selection and redemption of investments will be in accordance with NDCC 21-10-02.1(1) (d).
4. The criteria for making decisions with respect to hiring, retention, and termination of money managers will be clearly defined. This also includes selecting performance measurement standards, consultants, report formats, and frequency of meetings with money managers.

All participants in the investment process must seek to act responsibly as custodians of the public trust.

4. INVESTMENT GOALS

The investment goals of the Fund have been established by the City Council based upon their strategic objectives and a comprehensive review of the current and projected financial requirements. These goals are to be viewed over the long term.

Goal #1 Accumulate sufficient wealth through a diversified portfolio of investments which will enable the Fund to pay all current and future retirement benefits and expense obligations of the Fund.

5. INVESTMENT PERFORMANCE OBJECTIVE

The City Council will seek to make investments that generate sufficient return to meet the goals outlined in this policy. The objectives established in this section are in accordance with the fiduciary requirement in federal and state law and City Ordinances.

Adopted by the City Council on February 2, 2009

It is in the best interest of the Plan and its beneficiaries that performance objectives be established for the total Fund. It is clearly understood these objectives are to be viewed over the long term and have been established after full consideration of all factors set forth in this Statement of Investment Goals, Objectives and Policies.

- a. The Fund's rate of return, over the long term should equal, that of the policy portfolio which is comprised of policy weights of appropriate asset class benchmarks as set by the SIB.
- b. The annual standard deviation of total returns for the Fund should not exceed that of the policy portfolio.
- c. Over 10-year and longer periods the Fund should match or exceed the expected rate of return projected in the most recent actuarial study without exceeding the expected risk for the period as measured by standard deviation.

6. ASSET ALLOCATION

In recognition of the Plan's performance objectives, benefit projections, and capital market expectations, the City Council has established the following asset allocation:

Domestic Equities - Large Cap	30%
Domestic Equities — Small Cap	10%
International Equities	10%
Emerging Markets Equities	5%
Domestic Fixed Income	24%
High Yield Fixed Income	5%
International Fixed Income	5%
Real Estate	5%
Private Equity	5%
Cash	1%

Rebalancing of the Fund to this target will be done in accordance with the SIB's rebalancing policy, but not less than annually.

7. RESTRICTIONS

- A. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
- B. Use of derivatives will be monitored to ensure that undue risks are not taken by the money managers.
- C. No transaction may be made which threatens the tax exempt status of the Fund.
- D. No unhedged short sales or speculative margin purchases may be made.

Social Investing is defined as "The investment or commitment of public pension fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."

- E. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

Economically targeted investing is defined as an investment designed to produce a competitive rate of return commensurate with risk involved, as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

- F. Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule.

The Exclusive Benefit Rule is met if the following four conditions are satisfied:

- (1) The cost does not exceed the fair market value at the time of investment.
- (2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- (3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the Plan.
- (4) The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity are equivalent, the City Council's policy favors investments which will have a positive impact on the economy of North Dakota.

8. INTERNAL CONTROLS

The SIB must have a system of internal controls to prevent losses of public funds arising from fraud or employee error. The controls deemed most important are the separation of responsibilities for investment purchases from the recording of investment activity, custodial safekeeping, written confirmation of investment transactions, and established criteria for broker relationships. The annual financial audit must include a comprehensive review of the portfolio, accounting procedures for security transactions and compliance with the investment policy.

9. EVALUATION

Investment management of the Fund will be evaluated against the Fund's investment objectives and investment performance standards.

The annual performance report must include asset returns and allocation data as well as information regarding all significant or material matters and changes pertaining to the investment of the Fund, including:

- Changes in asset class portfolio structures, tactical approaches and market values.
- All pertinent legal or legislative proceedings affecting the SIB.
- Compliance with these investment goals, objectives and policies.
- A general market overview and market expectations.
- A review of Fund progress and its asset allocation strategy.

In addition, the State Investment Officer shall review with the Council the procedures and policies established by the SIB relating to this statement of investment goals, objectives, and policies.

Trustee for the City of Grand Forks,
North Dakota Pension Plan

By: Michael P. Brown

Date: 3-14-09



Steve Cochrane, CFA
Executive Director
North Dakota Retirement and Investment

Office Date: 4-15-09

By: Saroy Terath

Date: 4/7/09

INFORMATIONAL – NO BOARD ACTION REQUESTED

TO: State Investment Board
FROM: Dave Hunter
DATE: April 19, 2015
SUBJECT: Legislative Update – Cover Memo

RIO is closely monitoring two remaining bills:

1. **SB 2022 – RIO Budget Bill** – The Government Operations Subcommittee of the House Appropriations Committee adopted multiple amendments to this bill. Most applied to PERS but one amendment removed RIO's \$50,000 request for additional salary adjustment funds. No official action has been taken on the amendments or the bill by the full House Appropriations Committee as of April 19, 2015. *RIO notes that one of the PERS related amendments includes a provision to add legislators to the PERS board. Given that three PERS board members serve on the SIB, the proposal to add legislators to the PERS Board could result in one legislator being added to the SIB.*

RIO's Next Steps: RIO will monitor this bill and seek to provide testimony to support the reinstatement of our \$50,000 budget request for additional staff compensation.

2. **HB 1033 – Relating to definitions for the legacy fund principal balance, and a transfer of legacy fund earnings.** – Lt. Governor Wrigley, Treasurer Schmidt and Dave Hunter provided testimony about the legal conflict raised with the language of the proposed bill amendment which would require that at least 10% of the legacy fund to be placed “with one or more financial institutions chartered in and located in this state...” and made without regard to the prudent investor rule. This conflicted language was removed from the proposed bill amendment prior to it being vetoed by the Governor.

RIO's Actions and Next Steps: RIO's CIO and Deputy CIO along with Paul Erendson from Callan Associates met with 10 North Dakota based investment professionals on April 13, 2015. The meeting was arranged by Rick Clayburgh, President and CEO of the North Dakota Bankers Association, in order to improve our mutual understanding of the investment services offered by our local investment firms, while reviewing the investment manager search process and screening criteria utilized by the SIB, RIO and Callan. RIO will continue to explore opportunities to improve our understanding of investment services offered by local investment firms going forward.

SIB Legislative Bill Tracking Status Report As of April 17, 2015

1. SB2022 – RIO Budget Bill (Support)

1/06/2015 – Introduced, first reading, referred to Appropriations Committee

1/14/2015 8:30 am – Committee Hearing - Senate Appropriations

Dave presented testimony (Fay and Connie also attended); there were general investment related questions but no specific budget related questions.

1/29/2015 2:00 pm – Subcommittee Hearing with Senators Krebsbach, Sorvaag and Heckaman on PERS and RIO budget – Connie and Dave answered RIO budget questions without issue.

2/20/2015 9:30 am – Second Subcommittee meeting

Dave attended but no changes were requested for RIO

2/24/2015 – Reported back amended, do pass, 12-1 (removed Governor's market equity and retirement contribution increases and reduced performance based increase by 1% per year)

2/24/2015 – Amendment adopted, placed on calendar

2/24/2015 – Second reading, passed, 46-0

3/04/2015 – Introduced, first reading, referred to House Appropriations Committee

3/11/2015 2:15 pm – Committee Hearing – House Appropriations-Government Operations

Dave, Fay and Connie attended; Dave provided testimony; there were no substantive questions or concerns; an additional meeting will be scheduled in the next few weeks

3/27/2015 8:30 am – Committee Hearing

Connie attended; there were no questions regarding the RIO budget request

4/13/2015 – The Government Operations Subcommittee of the House Appropriations Committee adopted multiple amendments to this bill. Most applied to PERS but one removed RIO's \$50,000 request for additional salary adjustment funds. No official action has been taken on the amendments or the bill by the full House Appropriations committee.

2. HB1063 – Relating to modifications to investment policies for and funds under management of the State Investment Board (“administrative changes”) (Support)

This is the administrative changes bill submitted by the SIB. It clarifies existing language in Chapter 21-10, corrects an incorrect paragraph reference and updates the list of statutory funds under SIB management

1/06/2015 – Introduced, first reading, referred to House Government and Veterans Affairs Committee.

1/08/2015 9:30 am – Committee Hearing - House Government and Veterans Affairs

Dave provided testimony in support of the bill.

1/09/2015 – Reported back, do pass, 14-0-0

1/12/2015 – Second reading, passed, 92-0

2/19/2015 – Received from House, introduced, first reading, referred to Senate Gov't and Vets Affairs

3/13/2015 10:15 am – Committee Hearing – Senate Government and Veterans Affairs

Dave attended and provided testimony in support

3/13/2015 - Reported back, do pass, 7-0-0

3/16/2015 – Second reading, passed, 47-0

3/25/2015 – Sent to Governor

3/30/2015 – Filed with Secretary of State

3. SB2039 – ...relating to a public employee retirement stabilization fund and funds managed by the state investment board. (Monitor)

This bill would create the public employee retirement stabilization fund for the purpose of addressing any unfunded retirement obligations of the main state employee retirement plan and put the supervision of the investment of the fund under the SIB.

1/06/2015 – Introduced, first reading, referred to Senate Education Committee.

1/12/2015 – Committee Hearing – 10:15 am

Dave attended but did not provide testimony

2/06/2015 – Reported back amended, do pass, amendment placed on calendar 6-0-0

Amendment changes “public employee retirement stabilization” to “scholarship” and removes from SIB list of statutory clients

2/09/2015 – Amendment adopted, placed on calendar

2/11/2015 – Second reading, passed, 46-0

Note: As amended and passed, this bill no longer applies to the SIB but staff will continue to monitor for additional amendments.

4. HB1066 – Relating to the balance of and transfers to the budget stabilization fund. (Monitor)

This bill would clarify the timeframe in which the balance is reviewed and would allow the biennial transfers between this fund and the general fund to be netted to avoid liquidating assets and subsequently reinvesting them.

1/06/2015 – Introduced, first reading, (emergency) referred to House Appropriations.

1/20/2015 – Committee Hearing – 9:00 am

Dave attended and answered questions of the committee

1/20/2015 – Reported back, do pass, 23-0-0

1/22/2015 – Second reading, passed, 90-0, Emergency clause carried

2/23/2015 – Received from House, Introduced, first reading, referred to Senate Appropriations

3/13/2015 9:00 am – Committee Hearing – Senate Appropriations

Dave attended but did not provide testimony.

3/13/2015 – Reported back, do pass, 13-0-0

3/16/2015 – Second reading, passed, 47-0 (Emergency clause carried)

3/25/2015 – Sent to Governor

3/30/2015 – Filed with Secretary of State

5. HB1033 – Relating to definitions for the legacy fund, the legacy fund principal balance, and a transfer of legacy fund earnings. (Monitor)

This bill defines key terms related to the Legacy Fund, including “earnings” and “principal”; requires OMB to calculate the 15% of the principal balance that may be spent each biennium after 6/30/2017; requires earnings of the fund after 6/30/17 become part of principal until certain thresholds are met.

1/06/2015 – Introduced, first reading, referred to House Appropriations Committee

1/20/2015 – Committee Hearing – 3:15 pm

Dave attended but did not provide testimony.

1/30/2015 – Reported back, do pass, 21-0-2

2/02/2015 – Second reading, passed, 82-9

2/19/2015 – Received from House, introduced, first reading, referred to Senate Appropriations

3/13/2015 8:30 am – Committee Hearing – Senate Appropriations

Dave attended but did not provide testimony; an amendment was submitted by Rep. Keiser that would require at least 10% of the legacy fund to be placed “with one or more financial institutions chartered in and located in this state and which are experienced in and hold considerable knowledge of the field of investments.” A second hearing was scheduled due to this amendment for 3/17/2015.

3/17/2015 10:00 am – Committee Hearing – Senate Appropriations

Lt. Gov. Wrigley, Treasurer Schmidt and Dave provided testimony about the legal conflict raised with the language of the proposed bill amendment which states that this “10%” investment should be made “notwithstanding the prudent investor rule”.

4/08/2015 – Reported back, do pass, 13-0-0

Amendment was not approved.

4/08/2015 – Second reading, passed, 47-0

4/16/2015 – Vetoed by Governor

6. SB2038 – Relating to a defined contribution retirement plan for state employees... (Monitor)

Among other things specific to PERS administration, this bill would close the existing PERS defined benefit plan to new entrants effective January 1, 2016.

1/06/2015 – Introduced, first reading, referred to Senate Government and Veterans Affairs Committee

1/22/2015 – Committee Hearing – 9:00 am

Two current legislators and one former legislator testified in support while opposition included OMB, HRMS, ND United, AARP and other retiree groups.

2/09/2015 – Reported back, do not pass, 4-3-0

2/11/2015 – Laid over one legislative day

2/16/2015 – Second reading, failed to pass, 8-39

7. HB1329 – Relating to the membership of the state investment board. (Monitor)

This bill adds two additional members to the State Investment Board; “one member appointed by the majority leader of the senate, one member appointed by the majority leader of the house ...”.

1/13/2015 - Introduced, first reading, referred to House Political Subdivisions Committee

1/30/2015 – Committee Hearing – 9:00 am

Rep. Gary Kreidt testified in support; the Lt. Governor opposed; discussion revolved around constitutional authority. Dave attended and addressed a RIO staffing question, but did not provide written testimony.

1/30/2015 – Reported back, do not pass, 8-5-1

2/02/2015 – Second reading, failed, 46-45

8. HB1250 – Relating to the publishing of minutes of boards and commissions. (Monitor)

This bill would require each governing body to which the governor appoints any member to publish on the governor's office website the minutes of each meeting within sixty days after the meeting.

- 1/13/2015 – Introduced, first reading, referred to House Political Subdivisions Committee
- 1/23/2015 – Committee Hearing – 9:00 am
Connie attended and provided testimony.
- 2/09/2015 – Reported back amended, do not pass, 9-4-1
Amendment adds language to allow link to agency website and adds language that would require information to remain on the governor's website for one year after publication.
- 2/10/2015 – Amendment adopted, placed on calendar
- 2/12/2015 – Second reading, failed to pass, 32-59

9. HB1053 – Relating to centralized desktop support services through ITD (Monitor)

This bill would require certain state agencies not specifically exempted (RIO is not exempted) to obtain centralized desktop support services from the state Information Technology Department (ITD).

- 1/06/2015 – Introduced, first reading, referred to House Government and Veterans Affairs Committee
- 1/15/2015 – Committee Hearing – 8:30 am
- 1/19/2015 – Referred to Appropriations
- 2/09/2015 – Committee Hearing – 8:30 am
Subsequent to the hearing, information was requested by ITD/OMB from agencies that would be affected by this bill; RIO provided information regarding IT desktop hardware, software and budget
- 2/19/2015 – Reported back, do pass, 22-1
- 2/23/2015 – Second reading, passed, 72-21
- 2/25/2015 – Introduced, first reading, referred to Senate Government and Veterans Affairs Committee
- 3/12/2015 9:45 am – Committee Hearing – Senate Government and Veterans Affairs Committee
Dave and Rich attended; Dave provided testimony in opposition
- 3/30/2015 – Second reading, failed to pass, 4-43**

10. HB1374 – Relating to oil and gas tax revenue put options and swaps (Monitor)

This bill would allow the SIB to purchase oil swaps at the request of the OMB Director and Industrial Commission approval to offset lower state general fund oil and gas tax revenues.

- 1/19/2015 – Introduced, first reading, referred to House Industry, Business and Labor Committee
 - 1/26/2015 – Committee Hearing – 2:00 pm
The meeting was postponed until further notice.
 - 2/11/2015 – Reported back amended, do pass, 13-0-2
Amendment changes the bill to a study bill for the interim.
 - 2/12/2015 – Amendment adopted, placed on calendar
 - 2/16/2015 – Second reading, passed, 85-8
 - 2/23/2015 – Received from House, Introduced, first reading, referred to Senate Industry, Business and Labor Committee
 - 3/09/2015 11:00 am – Committee Hearing – Senate Industry, Business and Labor Committee
Dave provided testimony regarding the use of put options and swaps
 - 3/10/2015 – Reported back, do pass, place on calendar, 6-1-0
 - 3/11/2015 – Second reading, passed, 34-13
 - 3/17/2015 – Signed by Governor
 - 3/23/2015 – Filed with Secretary of State
-

11. SB2344 – Creating of a Legacy Foundation Committee (Monitor)

This bill would create a new 9-member committee appointed by the Governor and is privately funded. This committee would provide recommendations on use of the Legacy Fund earnings.

1/26/2015 – Introduced, first reading, referred to House Government and Veterans Affairs Committee

2/05/2015 – Committee Hearing – 8:30 am

Dave attended but did not provide testimony.

2/09/2015 – Reported back, do not pass, 5-2-0

2/24/2015 – Second reading, failed to pass, 16-29

12. HCR3041 – Concurrent resolution to provide for a Legislative Management study consisting of a comprehensive review and analysis of the investment practices by the state and the State Investment Board. (Monitor)

2/20/2015 – Introduced, first reading, referred to House Industry, Business and Labor Committee

2/23/2015 – Reported back, do pass, 13-0-2, placed on consent calendar

2/25/2015 – Second reading, adopted

2/26/2015 – Received from House, introduced, first reading, referred to Senate Industry, Business and Labor Committee

3/18/2015 11:00 am – Committee hearing, Senate Industry, Business and Labor Committee

Dave provided informational testimony regarding the SIB program

3/19/2015 – Reported back, do not pass, 4-2-1

3/20/2015 – Second reading, failed to adopt

13. HCR3042 – A concurrent resolution to amend and reenact section 26 of article X of the State Constitution. This measure would require the state treasurer to transfer four percent of the funds in the legacy fund to the state general fund at the end of each state fiscal year, beginning in 2018. (Monitor)

2/20/2015 – Introduced, first reading, referred to House Appropriations Committee

3/04/2015 – Committee hearing – 2:45 pm

3/06/2015 – Reported back, do not pass, 15-4-4 placed on calendar

3/09/2015 – Second reading, failed to pass, 23-68

AGENDA ITEM IV. B.

TO: State Investment Board

FROM: Dave Hunter, Executive Director/CIO

DATE: April 19, 2015

SUBJECT: SIB Governance Manual Review - **BOARD ACTION**

As directed by SIB Governance Manual Policy B-7 Section 4.C, the SIB conducted an annual review of the governance manual on September 26, 2014. Based on Board member discussion during this annual review, the Executive Director proposed a section by section review of the governance manual over the next six months which will culminate in a "Governance Day Offsite" scheduled for July 24, 2015. The Governance Day Offsite is intended to take the place of a regularly scheduled SIB meeting, but is expected to be expanded in length to allow for a deeper and more holistic discussion of overall Board governance policies.

January 2015	Governance Process – Accepted 2-27-15
February	Executive Limitations – Accepted 3-27-15
March	Board Staff Relationship – Board Acceptance
April	Ends – "First Reading" (Informational)
May	Investments and Guidelines
June	By-Laws and Century Code
July	Governance Day Offsite

RIO will conduct a "second reading" of the "Board Staff Relations" section of the Governance Manual at this meeting and then request SIB approval. RIO will then seek to review the "Ends" section of the Governance ("first reading") with the SIB.

NOTE: If the "**Ends**" section can be read in advance of our meeting, we may be able to reduce our combined review time.

Sections C. and D. of the SIB Governance Manual on "Board Staff Relationship" and "Ends" follow.

POLICY TYPE: GOVERNANCE PROCESS

POLICY TITLE: POLICY INTRODUCTION/AMENDMENT/PASSAGE

New policies or policy amendments may be proposed by the Executive Director or a Board member. All new policies or amendments may be submitted to the Board's Legal Counsel for drafting in the approved style.

Upon request of the Executive Director or a Board member a new policy or amendment shall be placed on the Board's agenda for action as follows:

1. Introduction and first reading. A brief explanation or summary of the new policy or amendment shall be presented to the Board. Upon approval of introduction and first reading, the measure shall be placed on the agenda of the next scheduled meeting of the Board for second reading and adoption. When appropriate, the measure shall be distributed to interested parties.
2. *Second reading and adoption. Interested parties and the public shall be allowed an opportunity to comment on the policy or amendment before final action by the Board. The measure shall take effect immediately following second reading and adoption by the Board, unless a different effective date is stated.*
3. Amendments. Amendments may be proposed at any time before final adoption of the measure. Upon determination by the Board that adoption of an amendment constitutes a substantive change that significantly changes the meaning or effect of the measure, the Board shall continue consideration of second reading and adoption to the next meeting to permit further review and comment.

Emergency measures. The Board may, upon determination that an emergency or other circumstances calling for expeditious action exists, waive the requirement of a second meeting and immediately approve second reading and adoption following introduction and first reading.

Policy Implemented: February 27, 2009

C. BOARD-STAFF RELATIONSHIP

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Chief Executive Role	C-1
Delegation to the Executive Director	C-2
Executive Director Job Description.....	C-3
Monitoring Executive Performance.....	C-4

POLICY TYPE: BOARD-STAFF RELATIONSHIP

POLICY TITLE: CHIEF EXECUTIVE ROLE

The executive director, as chief executive officer, is accountable to the board acting as a body. The board will instruct the executive director through these written policies, delegating to the executive director the implementation and administration of these policies.

Policy Implemented: June 23, 1995.

POLICY TYPE: BOARD-STAFF RELATIONSHIP

POLICY TITLE: DELEGATION TO THE EXECUTIVE DIRECTOR

All board authority delegated to staff is delegated through the executive director.

1. The board authority will direct the executive director to achieve specified results, for specified recipients, at a specified cost through the establishment of *Ends* policies. The board will limit the latitude the Executive Director may exercise in practices, methods, conduct, and other “means” to the *Ends* through establishment of *Executive Limitations* policies.
2. The Executive Director must use reasonable judgment in the implementation or administration of the board’s *Ends* and *Executive Limitations* policies; the executive director is authorized to establish practices, and develop activities.
3. The board may change its *Ends* and *Executive Limitations* policies. By so doing, the board changes the latitude of choice given to the Executive Director. If any particular delegation is in place, the board and its members will respect and support the Executive Director’s choices, provided that the Executive Director’s choice is consistent with the board’s fiduciary responsibility.
4. Only decisions of the board acting as the body are binding upon the Executive Director.
 - a. Decisions or instructions of individual board members, officers, or committees are not binding on the Executive Director except in rare instances when the board has specifically authorized such exercise of authority.
 - b. In the case of board members or committees requesting information, other than a public record, or assistance without board authorization, the Executive Director may refuse such requests that require a material amount of staff time or funds or is disruptive.
5. The Executive Director will be responsible for the hiring, termination, and annual evaluation of all employees of the Retirement and Investment Office.

Policy Implemented: June 23, 1995.

Amended: November 22, 1996; November 19, 1999.

POLICY TYPE: BOARD-STAFF RELATIONSHIP

POLICY TITLE: EXECUTIVE DIRECTOR JOB DESCRIPTION

As the board's single official link to the operating organization, the executive director's performance will be considered to be synonymous with the RIO's total performance.

Consequently, the executive director's job contributions can be stated as performance in the following areas:

1. Organizational accomplishment of the provisions of board policies on *Ends*.
2. Organizational operation within the boundaries of prudence and ethics established in board policies on *Executive Limitations*.
3. Maintain accurate records of the proceedings of the SIB and TFFR Board.

Policy Implemented: June 23, 1995.

POLICY TYPE: BOARD-STAFF RELATIONSHIP

POLICY TITLE: MONITORING EXECUTIVE PERFORMANCE

Monitoring executive performance is synonymous with monitoring organizational performance against board policies on *Ends* and on *Executive Limitations*. Any evaluation of the executive director's performance, formal or informal, may be derived only from these monitoring data.

1. The purpose of monitoring is simply to determine the degree to which board policies are being fulfilled. Information which does not do this will not be considered to be monitoring. Only a minimum amount of board time as necessary will be devoted toward monitoring so that meetings can best be used to create the future rather than to review the past.
2. A given policy may be monitored in one or more of three ways:
 - A. Internal report: Disclosure of compliance information to the board from the executive director.
 - B. External report: Discovery of compliance information by a disinterested, external auditor, inspector or judge who is selected by and reports directly to the board. Such reports must assess executive performance only against policies of the board, not those of the external party unless the board has previously indicated that party's opinion to be the standard.
 - C. Direct board inspection: Discovery of compliance information by a board member, a committee, or the board as a whole. This is a board inspection of documents, activities, or circumstances directed by the board which allows a "prudent person" test of policy compliance.
3. The board will monitor each *Ends* and *Executive Limitations* policy according to the following frequency and method:

Quarterly internal reports for policies:

- A-2 Staff Relations
- A-4 Budgeting
- A-5 Financial Condition
- D-3 Investment Services
- D-4 Investment Performance

Annual external reports for policies:

- A-2 Staff Relations
- A-4 Budgeting
- A-7 Asset Protection
- D-3 Investment Services
- D-4 Investment Performance

D. ENDS

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Organizational Beneficiaries.....	D-2
Investment Services	D-3
Information on Available Services	D-4
Retirement Services	D-5
Information on Retirement Services	D-6
Customer Satisfaction	D-7

EXHIBITS

<i>Organizational Beneficiaries.....</i>	<i>D-I</i>
<i>Monitoring Summary</i>	<i>D-II</i>

The Retirement and Investment Office exists in order that:

- SIB clients receive investment returns, consistent with their written investment policies and market variables, in a cost effective manner and under the Prudent Investor Rule.
- Potential SIB clients have access to information regarding the investment services provided by the SIB .
- TFFR benefit recipients receive their retirement benefits in a cost effective and timely manner.
- TFFR members have access to information which will allow them to become knowledgeable about the issues and process of retirement.
- SIB clients and TFFR benefit recipients receive satisfactory services from the boards and staff of the office.

Policy Implemented: October 27, 1995.

Amended: January 27, 2012.

POLICY TYPE: ENDS

POLICY TITLE: ORGANIZATIONAL BENEFICIARIES

RIO beneficiaries (clients) are those which are statutorily defined and those which have contracted for services under statutory authority. Exhibit D-I lists the organizational beneficiaries.

Policy Implemented: October 27, 1995.

The Retirement and Investment Office exists in order that:

1. SIB clients receive investment returns, consistent with their written investment policies and market variables, in a cost-effective manner and under the Prudent Investor Rule.
 - A. This “End” will be evaluated based on the following:
 1. Comparison of client fund’s rate of return NET of fees and expenses, to that of the client’s policy benchmark over a minimum evaluation period of 5 years.
 2. Comparison of the client fund’s risk, measured by standard deviation of NET returns, to that of the client’s policy benchmark over a minimum evaluation period of 5 years.
 3. Comparison of the risk adjusted performance of the client fund, NET of fees and expenses, to that of the client’s policy benchmark over a minimum evaluation period of 5 years.

Policy Implemented: October 27, 1995.

Amended: November 22, 1996, January 27, 2012.

POLICY TYPE: ENDS

POLICY TITLE: INFORMATION ON AVAILABLE SERVICES

The Retirement and Investment Office exists in order that:

1. Potential SIB clients have access to information regarding the investment services provided by the SIB.

Policy Implemented: October 27, 1995.

POLICY TYPE: ENDS

POLICY TITLE: RETIREMENT SERVICES

The Retirement and Investment Office exists in order that:

1. TFFR benefit recipients receive their retirement benefits in a cost-effective and timely manner.
 - A. Retirement program performance quality will be measured against the *Ends* and retirement policies and administrative rules adopted by the Teachers' Fund for Retirement Board.

Policy Implemented: October 27, 1995.

POLICY TYPE: ENDS

POLICY TITLE: INFORMATION ON RETIREMENT SERVICES

The Retirement and Investment Office exists in order that:

1. TFFR members have access to information which will allow them to become knowledgeable about the issues and process of retirement.

Policy Implemented: October 27, 1995.

POLICY TYPE: ENDS

POLICY TITLE: CUSTOMER SATISFACTION

The Retirement and Investment Office exists in order that:

1. SIB clients and TFFR benefit recipients receive satisfactory services from the boards and staff of the office.
 - A. The quality of services will be assured by direct board contact and by surveying clients and beneficiaries at least annually and promptly addressing identified client/beneficiary concerns.

Policy Implemented: December 1, 1995.

ORGANIZATIONAL BENEFICIARIES

INVESTMENT CLIENTS:

Statutory:

1. Budget Stabilization Fund
2. Cultural Endowment Fund
3. Insurance Regulatory Trust Fund
4. Petroleum Tank Release Compensation Fund
5. Public Employees Retirement System Fund
6. Risk Management Fund
7. State Bonding Fund
8. State Fire and Tornado Fund
9. Teachers' Fund for Retirement
10. The Legacy Fund
11. Workforce Safety & Insurance Fund

Contractual:

1. City of Bismarck Deferred Sick Leave Fund
2. City of Bismarck Employees Retirement Fund
3. City of Bismarck Police Retirement Fund
4. City of Fargo Dome Permanent Fund
5. City of Grand Forks Park District Pension Fund
6. City of Grand Forks Pension Fund
7. ND Association of Counties Fund
8. ND Job Service Retirement Fund
9. Public Employees Retirement System Group Health Insurance Fund
10. Public Employees Retirement System Retiree Health Insurance Fund
11. State Board of Medical Examiners

ADMINISTRATIVE CLIENTS:

Statutory:

1. Teachers' Fund for Retirement Beneficiaries

Amended: April 30, 2014

EXHIBIT D-II

GOVERNANCE POLICY MONITORING SUMMARY				
POLICY	METHOD	RESPONSIBILITY	FREQUENCY	BOARD ACTION
ENDS				
Investment Services	External	Investment Consultant	Annual - FYE	N/A
	Internal	Investment Officer	Quarterly	Accept or Follow-Up
Retirement Services	External	Actuary	Annual - FYE	N/A
	Internal	Retirement Officer	Quarterly	Accept or Follow-Up
EXECUTIVE DIRECTOR LIMITATIONS				
Executive Constraint	Internal	Executive Director	Annual - CYE	Accept or Follow-Up
	Internal	Audit Supervisor	Quarterly	Accept or Follow-Up
Staff Relations	Internal	Executive Director	Quarterly	Accept or Follow-Up
	Internal (External)	Audit Supervisor (SIB)	Annual - CYE	Accept or Follow-Up
Public Relations	Internal	Executive Director	Annual - CYE	Accept or Follow-Up
	Internal	Audit Supervisor	Annual - CYE	Accept or Follow-Up
Budgeting	Direct	Board Review	Biennial	Accept or Follow-Up
	External	Governor (State Auditor)	Annual - FYE	N/A
	Internal	Executive Director	Quarterly	Accept or Follow-Up
Financial Condition	External	External Auditor	Annual - FYE	Accept or Follow-Up
	Internal	Executive Director	Quarterly	Accept or Follow-Up
Board Communication	Direct Board Participation	State Investment Board	Annual - CYE	Accept or Follow-Up
Asset Protection	External	External Auditor	Annual - FYE	N/A
	Internal	Executive Director	Annual - CYE	Accept or Follow-Up
Compensation and Benefits	Internal	Executive Director	Annual - CYE	Accept or Follow-Up
	Internal	Audit Supervisor	Annual - CYE	Accept or Follow-Up
Conflict of Interest	Internal	Executive Director	Annual - CYE	Accept or Follow-Up
	Internal	Audit Supervisor	Annual - CYE	Accept or Follow-Up
Code of Conduct	Internal	Executive Director	Annual - CYE	Accept or Follow-Up
	Internal	Audit Supervisor	Annual - CYE	Accept or Follow-Up
Unrelated Business Interests	Internal	Executive Director	Annual - CYE	Accept or Follow-Up
	Internal	Audit Supervisor	Annual - CYE	Accept or Follow-Up

Audit Supervisor = Report to State Investment Board Audit Committee with a Summary Report to the SIB
 FYE = Fiscal Year End CYE = Calendar Year End N/A = Not Applicable *Amended September 26, 2014*

BUDGETING / FINANCIAL CONDITION

AS OF MARCH 31, 2015

	2013-2015 BUDGET	ADJUSTED APPROPRIATION	BIENNIUM TO DATE ACTUAL	EXPENDITURES		
				BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	\$ 3,772,504.00	\$ 3,772,504.00	\$ 2,883,886.75	\$ 888,617.25	23.56%	12.50%
ACCRUED LEAVE PAYMENTS	71,541.00	71,541.00	42,734.46	28,806.54	40.27%	12.50%
OPERATING EXPENDITURES	973,324.00	973,324.00	679,125.30	294,198.70	30.23%	12.50%
CONTINGENCY	82,000.00	82,000.00	61,987.33	20,012.67	24.41%	12.50%
TOTAL	<u>\$ 4,899,369.00</u>	<u>\$ 4,899,369.00</u>	<u>\$ 3,667,733.84</u>	<u>1,231,635.16</u>	<u>25.14%</u>	<u>12.50%</u>

EXPENDITURE REPORT
QUARTER ENDED MARCH 31, 2015

	<u>INVESTMENT</u>	<u>RETIREMENT</u>	<u>QUARTERLY TOTALS</u>	<u>FISCAL YEAR TO - DATE</u>	<u>BIENNIUM TO - DATE</u>
<u>CONTINUING APPROPRIATIONS</u>					
INVESTMENT EXPENDITURES (SEE ATTACHED DETAIL)	\$ 6,480,614.93	\$ 0.00	\$ 6,480,614.93	\$ 22,071,961.71	\$ 44,323,813.05
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0.00	41,892,951.11	41,892,951.11	125,753,810.09	283,349,773.62
2. REFUND PAYMENTS	0.00	1,061,398.14	1,061,398.14	2,971,277.97	7,700,662.26
TOTAL MEMBER CLAIMS	0.00	42,954,349.25	42,954,349.25	128,725,088.06	291,050,435.88
OTHER CONTINUING APPROPRIATIONS	27,628.06	27,465.89	55,093.95	263,002.51	556,456.61
TOTAL CONTINUING APPROPRIATIONS	6,508,242.99	42,981,815.14	49,490,058.13	151,060,052.28	335,930,705.54
<u>BUDGETED EXPENDITURES</u>					
1. SALARIES & BENEFITS					
SALARIES	179,706.85	181,729.33	361,436.18	1,031,137.37	2,136,156.77
OVERTIME/TEMPORARY	0.00	0.00	0.00	0.00	2,950.00
TERMINATION SALARY & BENEFITS	0.00	0.00	0.00	0.00	0.00
FRINGE BENEFITS	55,670.56	67,153.30	122,823.86	350,755.24	744,779.98
TOTAL SALARY & BENEFITS	235,377.41	248,882.63	484,260.04	1,381,892.61	2,883,886.75
2. ACCRUED LEAVE PAYMENTS	0.00	0.00	0.00	5,590.88	42,734.46
3. OPERATING EXPENDITURES					
DATA PROCESSING	2,962.03	15,725.43	18,687.46	51,390.38	129,029.67
TELECOMMUNICATIONS - ISD	1,078.22	1,543.96	2,622.18	6,995.40	18,068.96
TRAVEL	5,899.06	1,230.52	7,129.58	41,301.12	67,211.76
IT - SOFTWARE/SUPPLIES	50.55	30.79	81.34	6,824.51	9,112.39
POSTAGE SERVICES	489.05	17,196.87	17,685.92	37,544.61	77,328.68
IT - CONTRACTUAL SERVICES	294.83	1,547.34	1,842.17	15,571.77	117,291.77
BUILDING/LAND RENT & LEASES	7,536.06	12,421.23	19,957.29	60,471.87	140,139.53
DUES & PROF. DEVELOPMENT	1,376.32	2,037.58	3,413.90	20,203.90	32,453.61
OPERATING FEES & SERVICES	818.38	2,461.27	3,279.65	9,179.58	27,136.25
REPAIR SERVICE	0.00	0.00	0.00	0.00	144.25
PROFESSIONAL SERVICES	495.58	(1,239.58)	(744.00)	4,321.00	17,583.00
INSURANCE	0.00	0.00	0.00	481.84	1,095.37
OFFICE SUPPLIES	218.10	663.25	881.35	1,711.21	3,273.39
PRINTING	1,231.38	4,262.44	5,493.82	13,410.54	26,555.00
PROFESSIONAL SUPPLIES & MATERIAL	0.00	0.00	0.00	753.27	1,696.87
MISCELLANEOUS SUPPLIES	385.73	177.78	563.51	950.65	1,649.99
IT EQUIPMENT UNDER \$5000	0.00	0.00	0.00	3,967.66	4,527.81
OTHER EQUIPMENT UNDER \$5000	537.17	4,289.83	4,827.00	4,827.00	4,827.00
TOTAL OPERATING EXPENDITURES	23,372.46	62,348.71	85,721.17	279,906.31	679,125.30
3. CONTINGENCY	0.00	0.00	0.00	0.00	61,987.33
TOTAL BUDGETED EXPENDITURES	258,749.87	311,231.34	569,981.21	1,667,389.80	3,667,733.84
TOTAL EXPENDITURES	\$ 6,739,364.80	\$ 43,265,580.59	\$ 50,060,039.34	\$ 152,727,442.08	\$ 339,598,439.38

INVESTMENT EXPENDITURE DETAIL

FEES PAID DURING THE QUARTER ENDED MARCH 31, 2015

FOR QUARTER ENDED 9/30/14

PENSION DEVELOPED INTERNATIONAL EQUITY POOL

Northern Trust		21,997.15
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PENSION EMERGING MARKETS

JP Morgan	16,647.20	
Northern Trust	34,682.61	
TOTAL PENSION EMERGING MARKETS	<hr/>	51,329.81

PENSION LARGE CAP EQUITY POOL

Northern Trust		226,937.21
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PENSION REAL ESTATE

JP Morgan (Special & Strategic)		362,183.93
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INSURANCE SHORT TERM FIXED

JP Morgan		58,440.90
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LEGACY FUND SHORT TERM FIXED

JP Morgan		50,617.35
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CUSTODIAN

Northern Trust		227,833.22
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TOTAL FOR QUARTER ENDED 9/30/14

999,339.57

FOR QUARTER ENDED 12/31/14

PENSION DEVELOPED INTERNATIONAL EQUITY POOL

Capital Guardian	120,220.89	
Northern Trust	20,883.99	
Wellington	169,014.41	
TOTAL PENSION INTERNATIONAL EQUITY	<hr/>	310,119.29

PENSION GLOBAL EQUITY POOL

Epoch	496,909.86	
LSV	104,257.00	
TOTAL PENSION GLOBAL EQUITY	<hr/>	601,166.86

PENSION BELOW INVESTMENT GRADE FIXED

Loomis Sayles		276,428.60
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PENSION INVESTMENT GRADE FIXED INCOME POOL

JP Morgan	61,165.10	
PIMCO	77,780.36	
State Street	10,021.12	
TOTAL PENSION INVESTMENT GRADE FIXED INCOME	<hr/>	148,966.58

PENSION INFRASTRUCTURE POOL

JP Morgan		298,264.63
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PENSION LARGE CAP EQUITY POOL

Northern Trust	58,194.40	
LA Capital	238,234.83	
TOTAL PENSION LARGE CAP EQUITY	<hr/>	296,429.23

PENSION REAL ESTATE

JP Morgan (Special & Strategic)	371,524.71	
Invesco	149,683.66	
TOTAL PENSION REAL ESTATE	<hr/>	521,208.37

PENSION INTERNATIONAL FIXED INCOME

INVESTMENT EXPENDITURE DETAIL

FEES PAID DURING THE QUARTER ENDED MARCH 31, 2015

UBS		87,700.31
<u>PENSION PRIVATE EQUITY</u>		
Adams Street Partners		11,341.00
<u>PENSION CASH</u>		
Northern Trust		14,844.29
<u>INSURANCE FIXED INCOME POOL</u>		
Prudential	113,170.65	
State Street	22,501.85	
Wells	290,713.18	
Western Asset	212,725.96	
TOTAL INSURANCE FIXED INCOME	<hr/>	639,111.64
<u>INSURANCE LARGE CAP EQUITY POOL</u>		
LA Capital	188,654.13	
LSV	190,971.00	
TOTAL INSURANCE LARGE CAP	<hr/>	379,625.13
<u>INSURANCE SMALL CAP EQUITY POOL</u>		
Research Affiliates		72,627.46
<u>INSURANCE INT'L EQUITY</u>		
Capital Guardian	278,757.50	
LSV	314,012.00	
TOTAL INSURANCE INT'L EQUITY	<hr/>	592,769.50
<u>INSURANCE DIVERSIFIED REAL ASSETS</u>		
JP Morgan	204,078.23	
Western Asset	94,409.77	
TOTAL INSURANCE DIVERSIFIED REAL ASSETS	<hr/>	298,488.00
<u>INSURANCE REAL ESTATE</u>		
Invesco	103,925.76	
JP Morgan	437,714.00	
TOTAL INSURANCE REAL ESTATE	<hr/>	541,639.76
<u>INSURANCE SHORT TERM FIXED</u>		
Babson	99,363.88	
JP Morgan	65,158.05	
TOTAL INSURANCE SHORT TERM FIXED	<hr/>	164,521.93
<u>LEGACY FUND SHORT TERM FIXED</u>		
Babson	37,713.50	
JP Morgan	25,392.58	
TOTAL LEGACY FUND SHORT TERM FIXED	<hr/>	63,106.08
<u>PERS RETIREE HEALTH INSURANCE CREDIT FUND</u>		
SEI		65,235.81
<u>CONSULTANT</u>		
Callan		97,680.89
		<hr/>
TOTAL FOR QUARTER ENDED 12/31/14		5,481,275.36
		<hr/>
TOTAL FEES PAID DURING QUARTER ENDED 3/31/2015		6,480,614.93
		<hr/> <hr/>

NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE

QUARTERLY MONITORING REPORT

Quarter Ended March 31, 2015

EXECUTIVE LIMITATIONS / STAFF RELATIONS

The Executive Limitation “Staff Relations” deals with the treatment of staff at RIO. The executive director “shall not cause or allow any condition or any communication which is unfair, undignified, or disrespectful.” This Executive Limitation lists six specific limitations that range from personnel policies to exit interviews. All the limitations are intended to protect staff from unfair, undignified, or disrespectful treatment by management.

During the past quarter, there were no exceptions to this Executive Limitation.

Denise Osmond joined the RIO team as a Retirement Programs Specialist on March 3, 2015.

The Executive Limitations Audit for the period of January 1, 2014 through December 31, 2014 was completed by Terra Miller-Bowley, Supervisor of Audit Services, during the past quarter. The audit examined the Executive Director/CIO’s level of compliance with the SIB Governance Manual Executive Limitation policies A-1 through A-11. The RIO Audit Division and SIB Audit Committee is of the opinion that the Executive Director / CIO is in compliance with these policies. The SIB accepted the Executive Limitations Audit Report on February 27, 2015.

The Executive Director/CIO has conducted four office meetings with the full RIO team during 2015 in order to promote an open and collaborative work environment while enhancing team member communication, awareness and engagement.

RIO is fully staffed as of March 31, 2015.

**Quarterly Report on Ends
Q3:FY15**

Investment Program

Continuing due diligence conducted on following:

Western Asset	Vanguard
Northern Trust	TIR
Wells	LA Capital
PIMCO	UBS
LSV	Epoch
Prudential	Matlin Patterson
Babson	Axiom
Prudential	Adams Street
Capital Group	Declaration

Initial due diligence conducted on the following:

AQR	Carlyle
Hamilton Lane	Blackrock
Janus	DE Shaw
AllianceBernstein	KKR
Franklin Templeton	Portfolio Advisors
Longview	Pantheon
Arrowstreet	
Crestline	
CarVal	

At the January SIB meeting, the Board approved revised investment policy statements for the Legacy Fund and the Job Service Pension Plan.

Also at the January SIB meeting, the Board approved placing the UBS non-U.S. fixed income mandate within the pension trust on Watch due to performance.

Staff completed the implementation of the new strategic asset allocation for the Legacy Fund in January 2015.

At the March SIB meeting, the Board accepted the Staff recommendation to secure a contract for investment services with the North Dakota Tobacco Control and Prevention Trust Fund.

The Board approved a Staff recommendation to retain Callan Associates for the purpose of reviewing the Springbank timberland investment, which has an existing management agreement that expires on June 30, 2015.

Staff continues to work with the Bank of North Dakota to clarify and document in writing the short-term liquidity requirements of the BND Match Loan CD program within the Budget Stabilization Fund.

A legal review of the Novarca contract was completed and the firm commenced its analysis of relevant private equity and global equity cost elements as part of its examination process.

Staff attended meetings with the following entities: TFFR Board, NDPERS Investment Subcommittee, Workforce Safety and Insurance, House and Senate Government and Veterans Affairs Committee, Senate Appropriations Committee and the North Dakota Bankers Association.

Staff is conducting a review of third-party risk vendors with the goal of implementing an enhanced risk management system which utilizes holdings-based analysis across all investment programs overseen by the SIB.

Staff continues to conduct preliminary due diligence on possible managers/products for future consideration.

Staff continues to monitor each client's asset allocation monthly and makes rebalancing decisions based on rebalancing policy and cash flow requirements.

Quarterly Monitoring Report on TFFR Ends Quarter Ended March 31, 2015

Retirement Program

This report highlights exceptions to normal operating conditions.

- RIO's external auditors completed census data testing, and plan to issue an audit opinion on GASB 68 schedules in April. GASB information was presented to school administrators at annual meeting in January. Additional GASB materials continue to be added to TFFR website.
- TFFR technical corrections bill (HB 1064) was approved by ND Legislature and signed by Governor. Staff monitored and testified on other bills relating to TFFR plan during 2015 legislative session.

NDSIB Watch List

PIMCO data as of 12/31/2014

PIMCO Disco II (Ins.)		\$76,530,001	
	Returns	Index ¹	Excess
1 Year	6.88	5.97	0.92
2 Year	9.44	1.89	7.55
Inception*	18.47	2.81	15.67

*Funded 10/07/2011

PIMCO Disco II (Pen.)		\$85,127,586	
	Returns	Index ¹	Excess
1 Year	6.88	5.97	0.92
2 Year	9.43	1.89	7.54
Inception*	18.70	2.81	15.89

*Funded 10/07/2011

PIMCO Bravo II (Ins.)		\$23,439,357	
	Returns	Index ¹	Excess
1 Year	28.50	5.97	22.53
Inception*	20.58	4.63	15.95

*Funded 10/01/2013 (6th Close)

PIMCO Bravo II (Pen.)		\$23,439,357	
	Returns	Index ²	Excess
1 Year	28.50	2.46	26.04
Inception	20.58	4.87	15.71

*Funded 10/01/2013 (6th Close)

PIMCO MBS (Pen.)		\$178,584,265	
	Returns	Index ⁴	Excess
1 Year	5.41	6.08	(0.67)
2 Year	1.51	2.26	(0.76)
Inception*	2.15	2.38	(0.24)

*Funded 3/31/2012

PIMCO Unconstrained (Pen.)		\$94,009,218	
	Returns	Index ⁵	Excess
1 Year	2.32	0.23	2.09
2 Year	0.06	0.25	(0.19)
Inception*	2.58	0.30	2.28

*Funded 3/12/2012

TIR data as of 12/31/2014

TIR Teredo		\$79,882,211	
	Returns	Index ⁵	Excess
1 Year	11.44	10.48	0.96
3 Year	3.50	9.30	(5.80)
5 Year	5.65	5.78	(0.13)
Inception*	10.31	7.18	3.13

*Funded 06/12/2001

UBS data as of 12/31/2014

UBS		\$105,201,153	
	Returns	Index ⁷	Excess
1 Year	(3.88)	(3.09)	(0.79)
3 Year	(1.42)	(0.75)	(0.67)
5 Year	0.69	1.38	(0.69)
Inception*	6.37	6.17	0.30

*Funded 07/01/1989

TIR Eastern Timber		\$64,136,104	
	Returns	Index ⁶	Excess
1 Year	15.44	3.41	12.03
3 Year	6.30	2.63	3.67
5 Year	4.65	4.19	0.46
Inception*	4.26	4.39	(0.13)

*Funded 10/14/2008

TIR Springbank		\$117,133,499	
	Returns	Index ⁵	Excess
1 Year	0.56	10.48	(9.92)
3 Year	(2.34)	9.30	(11.64)
5 Year	(5.36)	5.78	(11.14)
Inception*	7.22	8.70	(1.48)

*Funded 09/20/2004

- ¹ Barclays Aggregate Index
- ² Barclays High Yield 2% Index
- ³ Libor 3-Month
- ⁴ Barclays Mortgage Index
- ⁵ NCREIF Timberland Index
- ⁶ Barclays Global Inflation Linked
- ⁷ Barclays Global Agg. Ex US

Note: All returns are net of fees.

INFORMATIONAL – NO BOARD ACTION REQUESTED

TO: State Investment Board
FROM: Dave Hunter
DATE: April 19, 2015
SUBJECT: North Dakota Bankers Association Meeting – Cover Memo

Background:

Rick Clayburgh, President and CEO of the North Dakota Bankers Association, arranged a meeting with RIO to improve our mutual understanding of the investment services offered by our North Dakota based firms and review the search process and selection criteria utilized by the SIB and RIO. RIO's CIO and Deputy CIO attended this meeting on April 13, 2015, along with Paul Erendson of Callan Associates and ten (10) North Dakota based investment professionals.

Overall Observations:

- 1) The vast majority of our North Dakota based investment firms specialize in providing multi-asset class solutions;
- 2) Bell State Bank has the ability to provide single and multi-asset class solutions;
- 3) SIB clients have historically utilized single asset class investment strategies over multi-asset class solutions;
- 4) All attendees expressed a strong desire to improve their ability to work together;
- 5) There was a general concern about the appropriateness of the Callan manager database due to a perceived or actual "poor fit";
- 6) There was a favorable response to the NDSIB Due Diligence Questionnaire (raised by our Deputy CIO);
- 7) RIO gained a better understanding of the concerns raised by the individuals attending this meeting;
- 8) RIO intends to share these observations with the SIB on April 24th.

Next Steps:

Based on the favorable response to # 6, RIO forwarded the NDSIB Due Diligence Questionnaire to Rick Clayburgh for further review and potential distribution to interested parties. RIO noted that this questionnaire is generally required to be completed by all of our new and existing investment managers at least once a year. The questionnaire is nine pages in length and it can take a moderate amount of time to complete. As a result, RIO extended an invitation for a follow-up meeting to review the questionnaire in greater detail. RIO also noted that each firm should provide a response for each investment strategy in which they would like consideration (i.e. multi-asset class solutions or institutional bond portfolio). RIO will continue to explore opportunities to improve our understanding of investment services offered by local investment firms going forward.

NORTH DAKOTA STATE INVESTMENT BOARD

DUE DILIGENCE QUESTIONNAIRE

FOR PERIOD ENDING 12/31/14

Please read the following instructions before completing this questionnaire:

1. All questions must be completed.
2. Type or select answers to each question.
3. If any questions are not applicable, please answer as "N/A".
4. If any answer is larger than the space available, please include it in an attachment that references the page and section number.

GENERAL INFORMATION

Firm Name: _____
Address: _____
City: _____ **State:** _____ **Zip:** _____
Contact Name: _____ **Phone:** _____
Title: _____ **Fax:** _____
E-mail: _____

FIRM INFORMATION

1. Describe the history of your firm including a timeline of key dates/events (i.e. new products, acquisitions, personnel lift-outs, etc).
2. Describe your firm's ownership structure. List all entities/individuals with 5% ownership or more. Note any recent (within the past five years) or pending changes in ownership structure.
3. Explain owners' relationship to firm.
4. List all related companies and explain related companies' relationship to firm.
5. Is the firm a Registered SEC Investment Advisor? If so, please provide SEC registration name and file number.
6. Is the organization involved in any other business other than investment management? If yes, please explain.
7. Please list your firm's lines of business and the approximate contributions of each business to your organization's total revenue. If you are an affiliate or subsidiary of an organization, what percentage of the parent firm's total revenue does your subsidiary or affiliate generate?
8. Please describe whether investment management capabilities were developed in-house or derived through acquisition of talent from another firm. If the latter, indicate when this occurred.
9. Which of your firm's offices service this account? Which specific services are provided by which offices?
10. List the locations where the firm has other offices.
11. How would you describe the culture of the firm? How would you illustrate this culture to someone outside the firm?
12. Provide information pertaining to any organizational changes that have occurred during the past five years that a prudent investment professional would consider material. Are there any changes anticipated in the coming year?
13. Has your firm been the subject of an audit, censure (fine), inquiry or administrative action by the SEC, IRS, or DOL in the past five years? If so, please explain findings and provide a copy, as well as evidence of any changes in procedures implemented as a result of such audit.
14. Please indicate your firm's fiduciary classification. Please check all that apply:

Registered Investment Advisor (registered under the Investment Advisors Act of 1940)

Bank (as defined in the Investment Advisors Act of 1940)

15. Indicate the name of your insurance carrier and the dollar amount of your coverage:

Errors & Omissions: Coverage: \$

Fiduciary Liability: Coverage: \$

Fidelity Bond: Coverage: \$

PERSONNEL

1. Please list the individuals involved in portfolio management and research for this strategy. For each individual, please provide the following information:
 - a. Tenure at company and with this strategy
 - b. Industry experience
 - c. Education and credentials
 - d. Office location
 - e. Area(s) of specialization
 - f. If applicable, other responsibilities beyond those associated with this strategy
2. Please indicate when and why any investment professionals involved with the subject product departed or joined the firm in the last five years. For personnel who have left, please indicate job titles and years with the firm. Please include all additions and departures, regardless of seniority.
3. Does your firm have a succession plan in place for key personnel on the subject product? Please describe.
4. Discuss your organization's compensation and incentive program for investment professionals. How are professionals evaluated and rewarded? What incentives are provided to attract and retain superior individuals? If equity ownership is possible, on what basis is it determined and distributed? How is the departure of a shareholder treated?
5. Provide information regarding the expiration date of current employment contracts with key personnel. Please include a discussion of long term incentives, options or performance clauses.
6. Provide an organizational chart diagramming the relationships between the professional staff as well as the parent-subsidiary, affiliate, or joint venture entities. You may attach this chart to the end of the DDQ.
7. Has any employee associated with this product been party to any investigations, litigation (including any settled out of court), or regulatory action during the past five years while at this or any other firm? If so, provide a detailed explanation and indicate the current status. Specify whether the employee is involved in any pending litigation or investigations.

ASSETS AND BREAKDOWN

1. Please provide assets managed and number of accounts as of 12/31/14.

	Firm		Product	
	Assets (\$mil)	# Accounts	Assets (\$mil)	# Accounts
Total Assets				
Total Institutional Assets				
US Tax Exempt				
US Taxable				
By Client Type				
Public Fund				
Corporate				
Union/Multi-Employer				
Endowment & Foundation				
Healthcare				
Insurance				
High Net Worth				
Wrap Accounts				
Sub-Advisor				
Other				

Describe "other":

2. Complete the following tables indicating accounts and market value of assets gained and lost for each of the last three calendar years.

Firmwide

	2014			2013			2012		
	Total	Gain	Loss	Total	Gain	Loss	Total	Gain	Loss
Total accounts									
Total assets									
Total public fund accounts									
Public fund assets									

Subject Product

	2014			2013			2012		
	Total	Gain	Loss	Total	Gain	Loss	Total	Gain	Loss

Total accounts									
Total assets									
Total public fund accounts									
Public fund assets									

3. Please provide an explanation of account departures and additions and for any meaningful changes in firm wide and/or product assets.
4. What is the minimum, average, and maximum account size for the subject strategy?
5. You may include additional detail or explanation of firm assets under management below to demonstrate firm capabilities.
6. Please list clients representing more than 10% of total firm assets under management or total firm revenue. It is adequate to describe the client without identifying them (e.g., public pension plan). Please comment on business risk related to client concentration.

INVESTMENT STRATEGY

1. Describe your investment philosophy for the subject strategy.
2. Describe the drivers of return. What has been your historical experience on return drivers?
3. Have you made or are you planning any modifications to your overall investment philosophy or process? If so, describe the process used to identify and effect the change.
4. Address the following as it relates to your investment strategy and the portfolio construction process you use to implement your philosophy:
 - a. Role of top-down, thematic and/or sector allocation decisions in your process, and how these decisions are made and implemented.
 - b. What is the firm’s research process as it relates to the subject strategy? How is the research process organized (i.e. regional, country and/or sector)?
 - c. Comment on security selection, including the initial universe, decision making factors, and analysis by market segment. Include use of model portfolios or recommended lists. Describe the process by which an investment idea is originated and implemented.

- d. Describe your portfolio construction process. What specific factors are integral to the portfolio construction process? Specify the portfolio guidelines and rules, such as maximum issue and sector weights. Describe any quantitative techniques or optimization tools used to construct portfolios.
 - e. How is portfolio risk measured, monitored and controlled? Describe any risk management models used and how this analysis is incorporated in the portfolio management process.
 - f. Describe your sell discipline. Under what conditions can the manager/investment committee deviate from your stated discipline?
 - g. If subject strategy is a passive mandate, does your strategy attempt full index replication or are sampling techniques utilized when constructing the portfolio? If sampling is utilized, please describe your sampling process.
5. Please list the relative importance of each of the following decisions:

	<u>Fixed Income</u>	<u>Equity</u>
Allocation		Allocation
Selection		Selection
Duration		Currency
Curve		Other (list and explain below)
Currency		Totals
Other (list and explain below)		100%
Totals	100%	

6. What unique attributes or competitive advantage does your firm or subject strategy have, which distinguishes it from its competitors? Why do you believe this advantage is sustainable?
7. Describe what circumstances or market conditions would favor the subject strategy? When can it be expected to be out of phase or be unrewarded?
8. If applicable, please describe your currency decision and hedging policy.
9. Does this strategy utilize leverage in any way? If so, please describe. What is the expected and maximum leverage employed in the strategy?
10. Describe the firm's use of derivatives in the management of the strategy. If applicable, please list any procedures that serve as guidelines for your firm's management of the collateral.

TRADING

1. Please describe your policies and procedures concerning trading and execution, including those relating to the following:

- a. How your firm seeks to achieve best execution;
 - b. How your firm measures trading costs;
 - c. How your traders interact with portfolio managers and analysts.
2. Describe your trading practices, including the trading systems and strategies you use, and indicate any enhancements your firm is contemplating.
 3. What guidelines and practices does your firm employ in managing its counterparty risk?
 4. Please list the broker/dealers your firm uses. How are they selected?
 5. Does your firm trade client accounts through any related or affiliated broker/dealer? If yes, describe the nature of the relationship and the percentage of trades directed through such affiliate(s).
 6. Does your firm use soft dollars? If so, for what purpose?

COMPLIANCE/INTERNAL CONTROLS

1. What compliance system does your firm employ? How is compliance implemented in your firm's operations?
2. Provide a detailed summary of your firm's internal control structure. Who serves as your firm's compliance officer? Who does he/she report to? Does the firm conduct periodic risk assessment?
3. What systems are in place for ensuring that portfolios are in compliance with client guidelines?
4. Has your firm ever violated a client guideline in the subject strategy? If so, please describe the violation and resolution. It is acceptable if this information is grouped by some method of categorization that allows for easier reporting.
5. Describe valuation policies and procedures by security type, list pricing sources and personnel responsible for valuation. Describe any special systems, valuation services, or other unique issues relating to the pricing of less liquid securities in the portfolio.
6. Is your firm registered with the CFA Institute as compliant with the CFA Institute's Asset Manager Code (AMC) of Professional Conduct? If not, would your firm consider registering as compliant in the future?
7. Please state your firm's ethics policy. How do you ensure that employees follow this ethics policy? How are violations of the firm's ethics policy handled?

FEES

1. Please provide a fee schedule for the subject strategy, including any breakpoints.
2. Under what circumstances are your fees negotiable?
3. Do all clients pay the same fee? Please explain any discrepancies.
4. Is there a minimum annual fee?
5. Do you offer a performance-based fee? If so, please provide a performance-based fee schedule. Over what period is performance evaluated and against what benchmark? What is the base fee? Is there a maximum fee (a cap)?
6. Do you offer a Most Favored Nations (MFN) clause? If not, please provide an explanation of why not.

CLIENT SERVICES

1. Describe your firm’s approach to client service.
2. What policies are in effect to control the workload as it relates to the number of clients serviced by each account manager? Is there a limit on the number of accounts that an account manager may handle?
3. Provide a breakdown for each key investment person’s time dedicated to each listed function (add more rows for additional key persons if necessary):

Key Persons	Portfolio Management	Research	Management / Supervision	Marketing / Client Service	Other
1.					
2.					
3.					
4.					

Describe other:

BUSINESS PLANS

1. Please discuss the overall business objectives of your firm with respect to future growth. Comment on any present or planned areas of emphasis over the near future. Be sure to include in your response the following:
 - a. Total assets or client relationships that will be accepted;
 - b. Maximum amount of clients or assets per portfolio manager;
 - c. Plans to develop and expand resources.
2. Indicate the details of any new investment services you plan to introduce.
3. Do you have any plans to cap or limit your growth in terms of total assets and total number of accounts? If so, please describe.

OTHER

1. Describe your emergency and disaster recovery plans. Do you have plans/arrangements in place for an alternative work site should your facilities become inoperative?

CALLAN MANAGER SEARCH AND SELECTION CRITERIA WORKSHOP

Monday, April 13, 2015, 2:30 p.m.
Bismarck Convention & Visitors Bureau
1600 Burnt Boat Drive, Bismarck, ND

AGENDA

- I. INTRODUCTION - Dave Hunter, NDRIO ED/CIO
- II. CALLAN MANAGER SEARCH PROCESS - Paul Erlendson, Callan SVP
 - A. Overview
 - B. Key Factors and Common Search Considerations
 - C. Selection Criteria in Manager Evaluation
 1. Quantitative Factors
 2. Qualitative Considerations
 - D. Emerging Managers
- III. CALLAN MANAGER DATABASE SURVEY - Paul Erlendson, Callan SVP
 - A. Databases for New Investment Managers
 - B. Setting Up New Manager Databases
 - C. Other Observations on Manager Search Databases
- IV. NDRIO MANAGER SELECTION CASE STUDY - Dave Hunter, NDRIO ED/CIO
 - A. Executive Summary
 - B. Investment Manager Recommendation & Rationale
 - C. Emerging Market Equity - Candidate Profile (Selection Criteria)
 - D. Manager Performance Criteria - Sample
 1. AQR - Finalist Overview
 2. Axiom - Finalist Overview
- V. NEXT STEPS - Dave Hunter, NDRIO ED/CIO and Darren Schulz, NDRIO Deputy CIO

Sponsor:

Rick Clayburgh, President & CEO, North Dakota Bankers Association

North Dakota Banker Attendees:

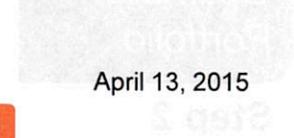
Ann McConn, Alerus Financial *CFA, JD*
Patrick Chaffee, Bell State Bank & Trust *CFA*
Joe Heringer, American Bank Center *JD*
Bob Willer, American Bank Center
Steve Stenehjem, First International Bank and Trust *Pres. Chmn IEBL*
John Stibbe, First International Bank and Trust *Wealth Mgr*
Chris Lamoureux, First Western Bank and Trust *Invest SVP*

April 13, 2015

North Dakota Retirement and Investment Office

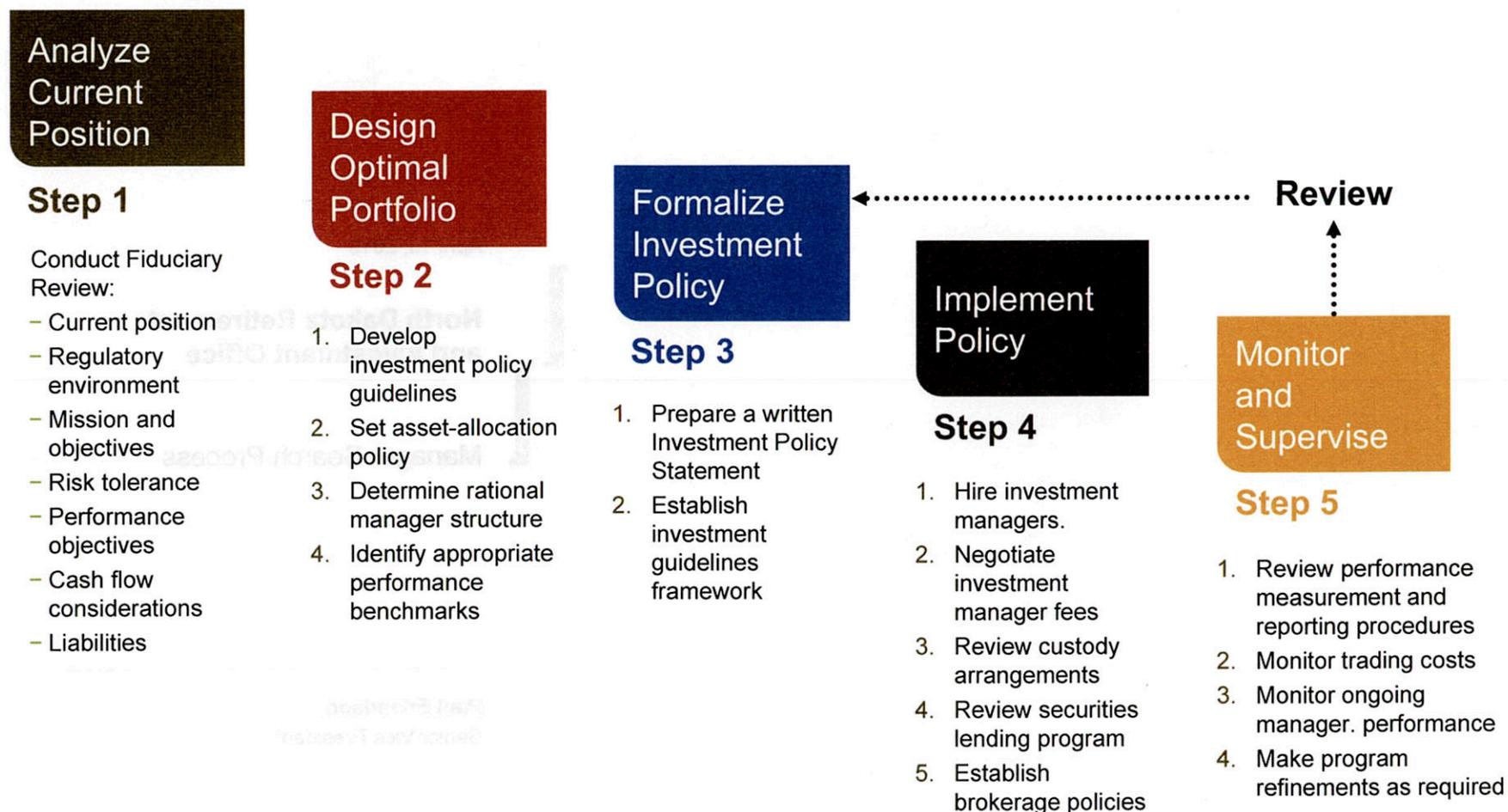
Manager Search Process

Paul Erlendson
Senior Vice President



Framing the Discussion

A Recommended Fiduciary Process for All Types of Funds



Manager Search Process Overview

As conducted by Callan Associates

- The Process:
 - Every search should start from scratch
 - Supported by extensive due diligence and accumulated knowledge of specialist and generalist consultants
 - Selection Process: Discipline and Consistency
 - Customization of criteria based on each client's investment needs and objectives
 - Peer review ensures quality control and mitigation of any individual biases
- The Outcome:
 - The identification of the managers and products that are the best fit for the investment program and the specific mandate.
- Client Cooperation:
 - All parts of this process are transparent and client involvement is encouraged. Any part of this process can be used to supplement a client's existing search process.

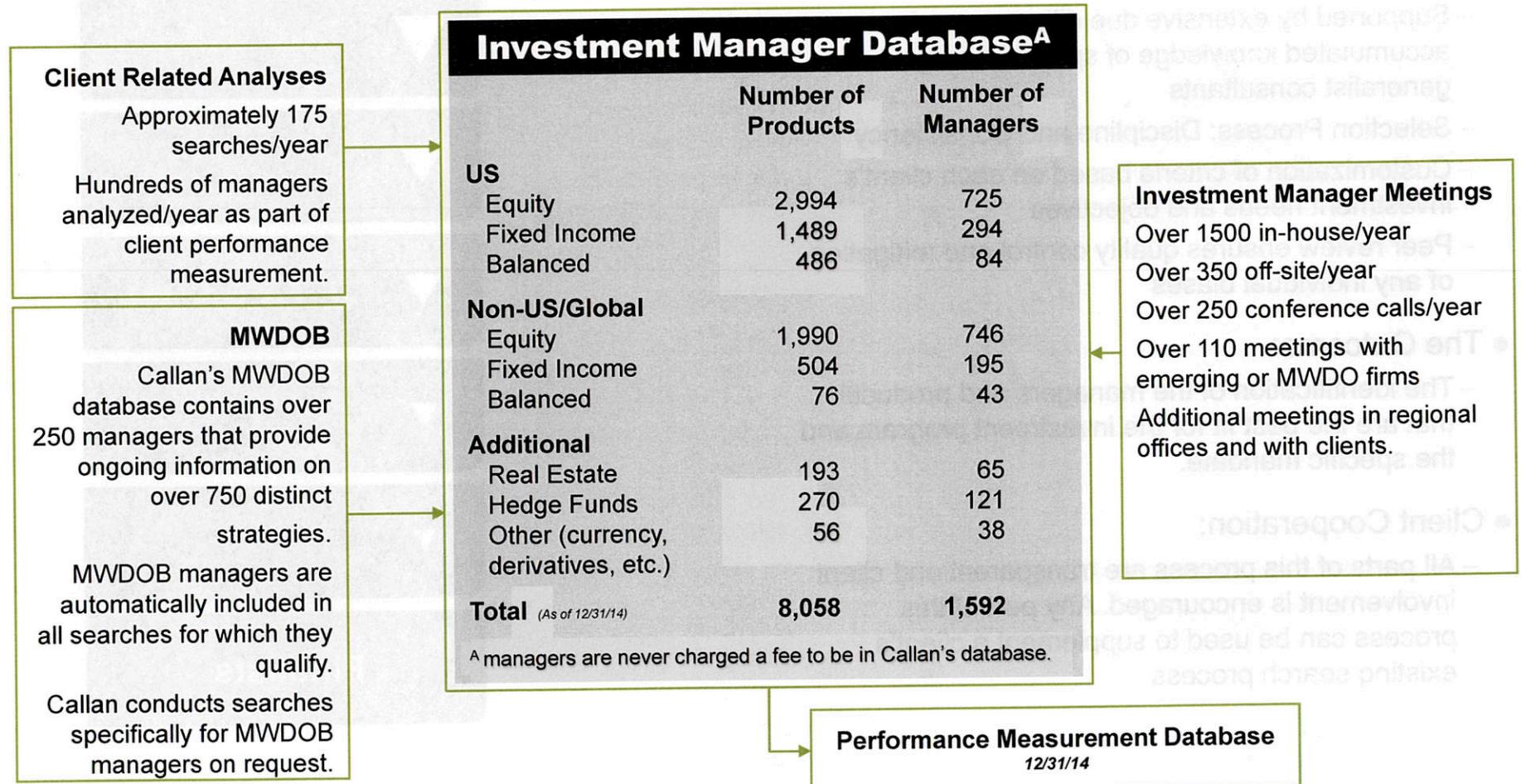
Manager Search Process



Manager Research Resources

Manager Search Database

You can use Callan data with confidence – We stand behind the data because we own and control it.



Manager Search

Why Use a Consultant in a Manager Search Project?

- Independent and objective third party.
- Adherence to a consistent search process that maintains clear, written guidelines to govern the search, which helps plan sponsor reduce fiduciary liability.
- Consistency will allow for a fair, repeatable process that will serve the organization as a whole, no matter the individuals involved at certain time periods.
- A resource that is committed to conducting manager due diligence.
 - Computer database availability.
 - Continuity over time.
 - Help ensure ERISA-based safe harbor protections (not required by public funds).

Factors in the Search Process

- Every search should be based on the needs of the investor / ultimate beneficiaries.
- Client defined search specifics will narrow candidate universe (plan type, size, continuing managers, risk preferences, 'emerging manager', or other relevant factors).
- Searches are conducted through a series of steps:
 - Client-Driven Considerations
 - Screening Criteria
 - Quantitative review
 - Qualitative Assessment
 - Search Review by Senior Policy Committee
 - Document semi-finalist candidates for Client
 - Identify Finalists
 - Interview Finalists
 - Select Firm

How do Consulting Firms Collect the Data?

General Information

- Organizational statistics
- Product specific information
- Annual questionnaire

Performance Database

- Quarterly rates of return
- Updated quarterly from money managers
- 1,049 organizations; 4,082 different funds; all mutual funds

Money Manager Visit Reports – On-site

- Qualitative impressions of money manager's philosophy, style, investment process
- Visits to money manager's offices by Global Manager Research staff and consultants
- Verification of Information
- Average of 500 visits per year

Money Manager Visit Reports – In-House

- Qualitative impressions of money manager's philosophy, style, investment process
- Visits by money managers to Callan's four offices
- Verification of Information
- Average of 1,000 visits per year

Mutual Client Relationships

- Qualitative impressions of money manager's philosophy, style, investment process
- Active evaluation of Callan's performance evaluation work with clients
- Verification of Information

Common Considerations in a Search

Search considerations are client-specific and depend on a variety of items:

- Purpose (i.e., search rationale)
- Active vs. Passive
- Choice of Benchmark
- Acceptance of Style Drift
- Size Spectrum
- Risk Tolerance
 - Benchmark Aware/Unaware
 - Concentration
 - Active Share
- Specialty Management
 - Small Cap
 - Emerging Markets
 - Currency
 - Distressed Debt
 - Thematic
 - ESG
 - “Emerging” Managers

Key Requirement: Appropriate Selection Criteria

- Manager Type
- Investment Style
- Investment Vehicle
- Managed Assets
- Size of Professional Staff
- Years of Experience
- Operational and Internal Controls
- Involvement With Other Businesses
- Flexibility of Individual Portfolio Managers
- Security Analysis Orientation
- Risk Levels
- Capitalization Levels
- In-House Research Emphasis
- Use of Cash Equivalents
- Use of ADRs, 144As, and futures and/or options
- Historical Performance Criteria
- Experience and Education of Professionals
- Financial Well Being of Firm
- Client-Servicing Capabilities
- Fees
- Organizational Ownership
- Informational Technology

Investment Manager Evaluation

A Combination of Qualitative and Quantitative Analysis

- Quantitative research:
 - Consistency of investment performance
 - Analyzing the portfolios
 - *Return-based style analysis*
 - *Traditional holdings based analysis*
 - *MSCI's "Z-score" methodology*
 - Portfolio characteristics (e.g. duration, quality, liquidity) relative to client's objective and risk tolerance
- Qualitative research: Kicking the tires
 - Requires ongoing interaction with managers to understand their philosophy, process and people
 - It is instructive to know how managers view themselves
 - Observe how the "key" people interact with one another
 - Confirm that the "marketing" pitch and confirms to "reality"

Quantitative Portfolio Characteristics

Frequently Used Quantitative Factors

Stocks

- Z-Scores
- P/E Ratio
- Price-to-Book Value Ratio
- Earnings Per Share Growth Rate (Short and Long)
- Dividend Yield
- Market Capitalization
- Internal Growth Rate
- Regional/Country Allocation
- Sector/Industry Allocation
- Diversification Ratio

Bonds

- Type
- Credit Quality
- Duration
- Maturity
- Yield to Worst
- Convexity

Qualitative Considerations

Frequently Used Qualitative Factors

PEOPLE!!!

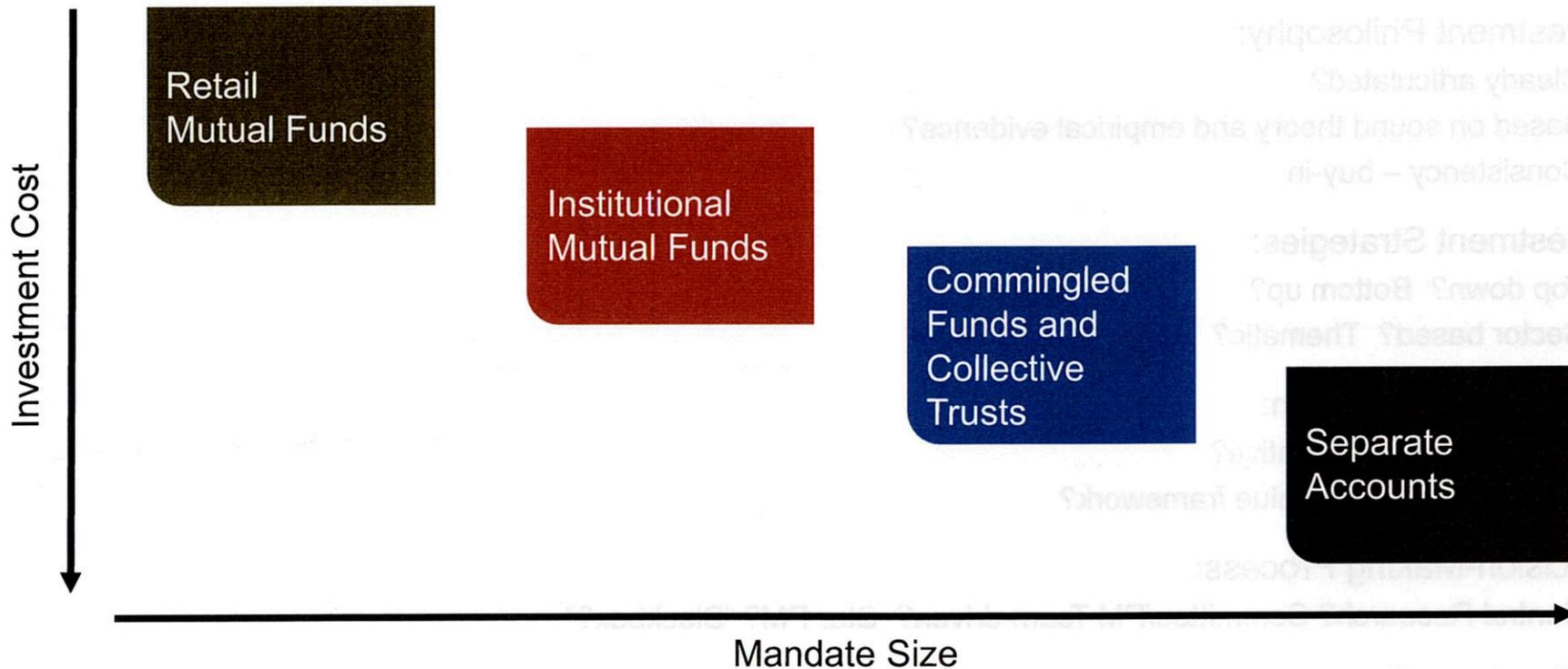
1. Who are the “idea generators?”
2. Intelligence, creativity, and innovation
3. Tenure working together
4. Depth of resources – “star” system or team effort
5. Succession planning
6. Communication infrastructure
7. Integrity
8. Stability
9. Organizational culture
10. Compensation, incentive, and retention – “skin in the game”

Other Important Qualitative Factors

- Investment Philosophy:
 - Clearly articulated?
 - Based on sound theory and empirical evidence?
 - Consistency – buy-in
- Investment Strategies:
 - Top down? Bottom up?
 - Sector based? Thematic?
- Research Orientation:
 - Quantitative? Qualitative?
 - Fundamental price/value framework?
- Decision-Making Process:
 - Central Research? Committee/PM Team-driven? Star PM? “Blackbox?”
- Cultural and Environmental Values
- Risk Controls:
 - What tools or strategies does the manager use to control risk?

Fees: A Function of the Investment Vehicle

Vehicle Decisions Can Have Important Cost Impacts to the Investor



After a Manager Selection Decision

- Negotiate an Investment Management Agreement, including guidelines, and fees.
- Development of written plan that assigns accountabilities during the transition.
 - *Date by which transition will be complete.*
 - *Identity of transition broker (if any).*
 - *Create documentation of process for files.*
- The amount of discretion given to the manager is the client's responsibility (with a possible assist from a consultant).
- Execute a contract and make sure manager receives a copy of the investment policy statement including a clear understanding of benchmarks and peer expectations.
- Establish reporting and client service protocol.

“Why was the manager hired?” is the best question to answer when monitoring a portfolio

Making the Case for Emerging Managers

- “Does Size Matter: Assets Under Management a Questionable Criterion”: White paper authored by Callan’s Greg Allen and published in The Journal of Portfolio Management, Spring 2007.
 - Defines large vs. small manager
 - Used clearly defined benchmarks
 - Adjusts for back-fill, or instant history, bias

Other studies include:

- Beckers, Stan and Vaughan, Greg. “Small Is Beautiful – An attempt to quantify the comparative disadvantage of large asset managers.” The Journal of Portfolio Management, Summer 2001.
- Krum, Ted. “Insight On: Potential Benefits of Investing with Emerging Managers: Can Elephants Dance?” Northern Trust Global Advisors, 1995.
- Williams, Tina Byles and Yang, Xiaofan. “Study on The Performance Drivers for Emerging Managers, Three Years Ending December 31, 2006.” Emerging Manager Monthly. Vol. II, Issue 9. Financial Investment News, July 30, 2007. 1-12.

Conclusions from the Callan Study¹

- 1) Studies that use self-reported manager databases are inherently subject to an upward bias.
- 2) In capacity-constrained asset classes, all things held equal, there is a statistically significant negative relation between assets under management and performance.
- 3) The results of core fixed-income, and to a lesser extent emerging markets equities, suggest that there are asset classes and strategies where advantages that come with additional resources can outweigh the negative impact of portfolio size.

¹ "Does Size Matter?" The Journal of Portfolio Management, Spring 2007

Defining Emerging Managers

- There is no standard definition for what defines an “emerging manager” – investors, consulting firms and even regulatory agencies all define the term differently.
- The most common definition relates to an investment manager with assets under management below a certain threshold (i.e. managers with < \$3bn in AUM, or the smallest X% of institutional managers).
- Less commonly, emerging managers are defined as those with a track record of less than 2 years. This is most prevalent in alternative asset categories such as private equity and real estate.
- Some include Minority, Women and Disabled-Owned (MWDO) firms in the emerging manager category.
- Callan defines emerging managers as those with between \$10 million and \$3 billion in AUM.
 - Those classified as majority MWDO are emerging with assets less than \$10 billion.

Use of Emerging Managers: Why, or Why not?

Factors to consider when using firms that are newer to the large institutional world

- Pros

- Strong incentives (both monetarily and professionally) to perform well.
- Ability to take concentrated positions.
- Ability to be more nimble and take positions that differ significantly from the benchmark (able to allocate more assets to alpha ideas rather than beta idea).
- Able to better capitalize on smaller opportunities than larger managers.
- Large body of research that suggests emerging managers outperform most notably in illiquid or capacity-constrained asset classes.

- Cons

- Higher failure rate than larger firms.
- More exposure to business and operational risks.
- Difficult to perform extensive due diligence.
- Difficult for large institutional investors to make a meaningful allocation without becoming a large percentage of the firm's assets.
- Is performance differential real or the product of backfill and survivorship bias?

Evaluating Emerging Managers

- Investment Philosophy, Process, Track Record

- Evolution of the product
- Key decision makers and functional responsibilities
- Differentiating features of the philosophy and approach
- Historical track record

Callan's History and Commitment to Emerging Managers

- Callan's founder, Edwin Callan, identified the need to research and evaluate emerging firms for Callan's clients.
- Based on our research, Mr. Callan co-founded Progress Investment Management in 1990, a minority-owned firm specializing in multi-manager solutions of emerging and MWDO (minority, women and disabled owned) managers for institutional investors. Callan is committed to the research and due diligence necessary to identify and bring value-added EM managers to our clients.
- Callan established an internal EM/MWDO Committee comprised of senior consultants at Callan and is chaired by our CEO. This Committee:
 - Plans, coordinates, and focuses our EM/MWDO search and outreach activities
 - Strategizes on how best to communicate our efforts internally and externally to provide maximum transparency on our initiatives
 - Functions to ensure that we hear and act on valuable feedback on the program from clients and our Associates

Callan's History and Commitment to Emerging Managers

- Callan is active with organizations that support and provide educational venues for emerging managers. Organizations include:
 - National Association for Securities Professionals
 - New America Alliance
 - Opal Financial Group
 - RG & Associates
 - The Robert Toigo Foundation
 - Real Estate Executive Council
 - Association of Asian American Investment Managers
- Annually, Callan hosts a best practices workshop on working with institutional investors for emerging managers.
- Callan launched “Callan Connects” in 2010 to expand our universe of emerging managers and MWDO firms.
 - Callan holds quarterly meetings in major U.S cities to minimize travel for managers.
 - Since inception, 204 firms (132 emerging and 72 MWDO) have participated in Callan Connects through November 2014.

Memorandum

To: North Dakota Retirement and Investment Office
From: Paul Erlendson
Date: April 6, 2015
Subject: Manager databases

A survey was conducted to solicit descriptions of the types of manager databases respondent firms populate with organizational and investment product information. Additionally, we solicited these firms' opinions about procedures and considerations they deemed relevant to the challenges and opportunities of participating in manager databases. Callan contacted several well-known institutional investment managers for this survey, all of whom offer strategies across a variety of asset classes.

The remainder of this memorandum consists of three sections and groups manager responses according to the three questions posed to each respondent in the survey. Answers are stated essentially as provided by the managers with only minor editing to keep responses anonymous and to facilitate readability. All views expressed below are solely those of the respondents. Some responses may appear redundant or even in conflict with one another given that multiple firms were surveyed. The information contained herein is provided purely for educational purposes and may or may not agree with Callan's views on these same issues.

1. With which databases would you suggest a "new" manager make contact (e.g.—eVestment; Lipper; Mercer; Russell; Wilshire; Callan; others)?

- We focus our efforts on several databases, which include Callan, eVestment, Mercer, Russell and Wilshire. We believe that covering this group will get exposure to a majority of the larger consultants. The proprietary databases are, obviously, important due to the sheer size of the assets under advisement. The 2013 Greenwich report had Callan, Wilshire, Mercer and Russell ranked two, three, five and six respectively, with regard to assets under advisement. Other large consultants in that survey (e.g., Aon Hewitt (1), NEPC (10), Towers (9)) are all eVestment clients, so you get a majority of exposure by participating in these databases.
- There has been a steady migration to eVestment over time on the institutional side.

- I would consider the two lists below as the 'long list' of manager databases. However, a "new" manager will have to consider balancing resources and opportunity before pursuing them.
 - On the third-party/retail side:
 - eVestment
 - Lipper
 - Morningstar
 - PSN
 - Investorforce
 - On the proprietary side:
 - Callan
 - Mercer
 - Russell
 - Wilshire
 - Albourne Moat Space (only if the manager has alternative strategies)
 - LCG
 - RogersCasey EQuest
 - DeMarche
 - Cambridge
 - Pavilion-Brockhouse
- I would include global databases eVestment, Callan, Mercer and Cambridge along with Wilshire, Morningstar and Lipper. Others vary depending on business line/strategies offered and region.
- The way to gain exposure to the broadest client opportunity set is through the most widely adopted, third party databases as well as proprietary databases of influential investment consultants. eVestment is the most widely utilized source of data by consultants and clients so that is imperative. Other databases are more specific to individual consultants' (Mercer GIMD, Callan, Wilshire's Compass) or retail distribution (eg. Lipper).

In general, these databases are hungry for manager info, so getting set up on them is probably not difficult if you can prove you are an accredited asset manager. However, if a new manager chooses to start listing its products on every single database, they need to be aware of the potentially massive increase in work. There is some crossover between databases in regards to the questions they ask and the data they require, but it's not as extensive as one would hope.

You can count on having to build a new mapping/template methodology for each consultant and 3rd party database, as well as the different asset classes within them in some cases. The only "shortcut" to this right now is a 3rd party database like eVestment, because they have invested in improving their technology, and because through their one portal you can get your products in front of many consultants.

- eVestment is the largest and they offer the additional benefit of serving a multitude of consulting firms including Wilshire, RogersCasey, Mercer and Brockhouse Cooper. A manager pays a fee (based on number of strategies, products, etc.) to Evestment. Evestment massages and pushes the data to their subscribers; i.e., they organize it in a form desirable by a given consultant.
- Informa is important because it is the core of the PSN database and is used for Zephyr analytics (style, competition, etc.). We think Morningstar's push into separate accounts will be meaningful. They have great breadth and recognition due to their mutual fund franchise.

2. Whom and how does one contact at each database? How does one go about populating each of these databases initially and on an on-going basis?

- Each database has its own client support desk to answer any database related questions. We usually contact the desk by phone or email.
- When setting up a new product initially into a database, we would go into the database and populate all the fields (example: Product Group/Category, Strategy Name, Contacts, Managers, Vehicles/Fees, Product Assets Under Management ("AUM"), Historical Performance, Historical Product Characteristics, Product Guidelines) that are required for a new product. After this stage, on a quarterly basis, we provide the most current returns, AUMs, characteristics and employee turnover information for all products that we have in a database. We also confirm the Fees remain the same for each product and all the product questionnaires are fully addressed.
- The home page of each database provider has a login screen, but also contact details (~"if not a member, click here") for first-timers.
- Many of these databases have a dedicated, live "database administrator" with whom to interface.
- The initial population is more time-consuming, as you are entering data that won't necessarily need to be updated in future quarterly updates (firm-level information, strategy narratives, etc.) but you need to submit initially.

- The ongoing population requires quarterly updates of returns, characteristics, AUM, personnel, etc. and is less intensive.
- Most databases/consultants have a link on their website for whom to contact to get started as it varies by database. At start-up, you will need to initially set up each strategy you want included and provide historical data (ideally at least 3-5 years of data and full history of returns, if available, for analysis and screening), then maintain updates, typically on a quarterly basis going forward. To reduce manual entries/updates, eVestment offers a technology solution that helps to format and streamline submission of data to top databases called Optima.
- Contacting database providers is fairly straightforward and all employ web-based inputs for populating data. The initial population of data is a large undertaking and dependent on how many products you are listing. These databases are slowly improving their technological capabilities, with some of them much better than others. However, as a whole, the process is incredibly manual. There are hundreds of web pages and forms that need to be filled out. If the manager chooses to backfill historical data the task gets much bigger as well. On an on-going basis, it's a little better in that most of the data does not get updated each quarter – just performance, characteristics, AUM, and personnel if it has changed. The narratives and questionnaires are unlikely to have to be updated regularly.
- The "how" of engaging these firms is as simple as going on-line and following "New" instructions. Contact personnel etc. are identified and provided in the signing in process. As with any technology interface, some are more user-friendly than others. It is a learn-by-doing exercise. Patience is required.
- When a new business opportunity arises from these databases, the manager is typically notified via email. A simple message is sent out highlighting the strategy and any follow up requirements. It is typical (but not universally true) that an RFP is attached to the notice of search. That becomes the thread for the manager to pursue the inquiry.

3. Any other information or observations that you think worth mentioning relative to investment managers and third-party databases that might fuel the manager search process.

- About seven years ago we reviewed the names of our fixed and equity products. A concern we had at the time was whether the product names were easily interpreted. Back then we had a product called "Investment Grade Full Discretion".

We changed the name to “Core Plus Full Discretion” and search activity picked up immediately. We had another product called “Extended Small Cap Value”, which was changed to “SMID Core”. This resulted in any even more rapid increase in search activity. We realized that, in many cases, database screens at some consulting firms are done by relatively young people. Therefore, if there are any products that do not have good name recognition, they will likely be screened out.

- Another thing I will point out is that we have five people internally dedicated to database/consultant support. While we are now a larger firm, it is a relatively large effort to maintain data across all of these databases. If a manager’s resources are limited, it may be wise to pick a sub-group of the manager databases and focus on those where the firm may have some realistic traction.
- Given the resource strain, especially for a new manager, it is important to prioritize not only which databases you intend to populate but also which focus/featured products (for example, getting sellable strategies that are in demand) and which data/characteristics to populate.
- There are a number of automation tools/features that an investment manager can purchase that can help with population (e.g. Omni).
- In order to be included in searches, it is critical to maintain actively marketed strategies in industry databases and make sure all relevant fields are updated to be captured in screens. For proprietary consultant databases, it is also important to understand the consultant’s business focus, product ratings, if applicable (not all consulting firms “rate” or “rank” products), and the types of strategies relevant to their clients.
- One of the things eVestment touched on at a recent breakfast seminar was the tendency to put sub-optimal people in charge of populating all the data. Often it’s junior analysts or people that are not as familiar with the products. They feel that this often results in inaccurate and incomplete data. Unfortunately, it’s rarely possible to pin down which data needs to be fixed because of its esoteric nature. The massive upsurge in blind searches means that a manager may never know why they are not getting included in a search, because they have no idea that a search is even happening. eVestment also sent out a report in 2014 that detailed some of the main reasons that managers dropped out of searches – it could be something as benign as not filling out the number of holdings in a portfolio.

- Additionally, I'd add that if it's not cost-prohibitive, tools like eVestment's Omni offering or Compass iTech's ProFusion can be time-savers, populating numerous databases from one interface.
- In short, there is a clear view that as asset managers consolidate and data provision increases, the number of databases that are in the market place makes it difficult for any manager that has more than one product to focus the necessary resources to update all the various database requirements for all products – a general shift to eVestment by many consultants has helped, but not gone far enough as yet. This means that databases can be a useful starting point but doesn't by any means replace the work that manager research and consultants do in terms of engaging with managers.
- There are a multitude of "private" databases, including the likes of Lipper (i.e. Nelson's) and Cambridge. It is the same undertaking here more or less. However, these databases are likely to constrain product input based on firm orientation or how full their line-up in a given strategy might be; "More Large Cap Growth anyone? No thanks - I'm full."
- Engaging all of these databases can be a full time assignment. A manager needs to assess the trade-offs between effort and opportunity. Considerations include:
 - deadlines and timeliness (miss a filing date and you may be "locked out" until the next update period);
 - the need to ensure your firm's data is accurate at the site (even though you handled the input, they make no assurances);
 - checking / updating subscriber sites (e.g. did the info I put in eVestment get to the RogersCasey site correctly?); and,
 - annual or semi-annual firm update (typically coincides with filing the ADV at the SEC).
- There is a whole other class of databases that relate to platform providers like Wells Fargo, Schwab or Merrill-Lynch. These have unique needs. Our approach has been to walk before we run. We get comfortable with the large scale players, then follow up as our comfort levels grow.

#

RIO Recommendation:

RIO recommends the State Investment Board approve an approximate \$110 million Emerging Market Equity mandate with Axiom International Investors. This recommendation is based on extensive due diligence performed by RIO's CIO and Deputy CIO, as supported by Callan's investment consulting team, and included onsite interviews with the portfolio management team. The recommendation is subject to satisfactory negotiation of legal documentation including review and approval by designated counsel.

Background:

1. RIO developed a "Candidate Profile" by identifying the key characteristics which best suited our desired EME mandate. Specific qualities included an active manager with at least \$2 billion in assets under management including \$500 million in this strategy. We required at least five years of EME experience and strategies which avoided the use of short sales, extensive use of derivatives for non-hedging purposes, and candidates involved in significant litigation, merger or acquisitions or experiencing high turnover of investment professionals or management. These are minimum requirements.
2. Based on a quantitative review of approximately 400 EME strategies, RIO and Callan jointly identified 10 managers which best fit our "Candidate Profile". These 10 candidates were promoted for further consideration to the Callan manager search committee after detailed discussion with RIO.
3. Callan prepared a report for each of the top 10 managers while providing a quantitative comparison of historical return and risk metrics including excess return versus the MSCI EME benchmark over rolling 3-year (or more) periods; up and down market capture; and correlation with our existing EME strategy (with Dimensional Fund Advisors or "DFA").
4. After further discussion with Callan EME specialists to understand the qualitative strengths and weaknesses of each manager under consideration, RIO and Callan conducted interviews in person with two representatives from each of the top four ranked firms.
5. To complete the semi-finalist due diligence process, RIO met with the top three firms in their respective offices to gain a greater understanding of firm culture, investment style, risk management, compliance systems, size and client service capabilities.
6. The CIO and Deputy CIO ranked Axiom slightly ahead of AQR largely due to it being a better compliment to our existing DFA strategy (which was also highly ranked by RIO and Callan).

Summary:

Axiom has generated 4% of annualized excess return (versus benchmark) since inception, net of fees. Axiom is one of four firms assigned the highest ranking (along with AQR and DFA) by Callan based on consistency of excess returns and our "Candidate Profile". The return on estimated fees approximates a 4:1 ratio and deemed reasonable for this sector. Northern Trust is also the custodian for this commingled trust vehicle which should serve to minimize transition costs, while aiding operational efficiencies.

Investment Recommendation – Axiom International Investors

Executive Summary

Recommendation

Staff and Callan recently conducted a manager search to identify active emerging markets equity candidates to replace mandates formerly managed by UBS and PanAgora, which are currently being managed in a Northern Trust Asset Management MSCI Emerging Markets Index Collective Trust on an interim basis. The result of the search is a recommendation to replace the existing passive exposure with Axiom International Investors in the Pension Trust. Additionally, Staff recommends the termination of the existing JPMorgan Emerging Markets Focused mandate due to performance and the transition of the assets to Axiom International. As of April 30, 2014, Northern Trust and JPMorgan managed emerging market equity mandates totaled approximately \$87 million (1.9% of total assets) and \$24.6 million (0.5%), respectively, and the remaining emerging markets mandate resides with DFA Emerging Markets Small Cap at \$35 million (0.8%).

Background

As part of an initiative to reduce the number of equity manager mandates within the Pension Trust so as to realize economies of scale and administrative and oversight efficiencies, three active emerging market mandates were terminated over the course of the past two years and the manager mandates were transitioned to Northern Trust Asset Management to be managed in a passive emerging market mandate on an interim basis: Blackfriars (terminated June 2012), PanAgora and UBS (both December 2013). In an asset class like emerging markets, where the alpha opportunities are comparatively greater and the opportunity costs of retaining a lower conviction manager are more apparent, Staff felt it prudent to conduct a search for an active emerging market equity manager to replace Northern Trust and JPMorgan and to complement the existing DFA Emerging Market Small Cap mandate.

Process

Staff and Callan Associates screened the pool of candidates to create a “shortlist” of potential candidates based on a variety of qualitative and quantitative factors, including:

- Staff and Callan knowledge and opinions regarding the firm and product;
- Team attributes, including consistency and depth;
- Firm attributes, including employee ownership, assets under management, and organizational culture;
- Portfolio attributes, including benchmark-relative risk, portfolio holdings, style characteristics, and correlation of returns relative to other Pension Trust equity managers; and,
- The history of relative performance including consistency and upside/downside capture.

Four firms – Axiom, AQR, Harding Loevner, and William Blair – were invited to make formal presentations to Staff at Callan’s office in Denver. Staff reviewed all analysis and written materials and participated in a post-interview discussion with Callan to debate the relative merits of the firms. It is important to note

that emerging markets remains a capacity constrained asset class and capacity availability is an unavoidable impediment in any manager search. Onsite visits were conducted with AQR, Axiom and William Blair. While all three products were highly regarded, Axiom's product rose to the top.

Rationale

I. Organizational Overview

Axiom was founded in 1998 by CIO Andrew Jacobson. He and his team of research analysts left Columbus Circle where the group developed and managed the International Equity Strategy. With the exception of a US Small Cap product, the firm is dedicated to managing international assets. Axiom manages both long only and long/short portfolios. All portfolios are managed with the same investment process. Based in Greenwich, Connecticut, the firm is 100% employee owned with \$10.1 billion in assets under management.

The Emerging Markets Equity strategy is co-managed by Chris Lively and Don Elefson. Supported by one dedicated research analyst, the two portfolio managers draw on the research of a broader group of analysts for macro research applicable to their companies. All analysts employ the same research methodology which allows for the development of themes and the cross fertilization of ideas across the firm.

II. Strategy and Performance Overview

With assets of \$2.3 billion, the Axiom Emerging Markets Equity strategy can be described as having a fundamental and momentum driven philosophy. They seek to identify companies that are exceeding expectations by identifying key business drivers for each stock. A key component of their process is understanding the market's expectations for a given stock as it relates to the key drivers of that stock. Key business driver analysis begins with identifying the dozen or so key operational drivers for each of the companies being considered. They employ a combination of primary and secondary research in order to capture efficiently a comprehensive array of information on each company. Key drivers include company specific, industry, macroeconomic and political factors. For each of these drivers, they survey a wide variety of sources in order to determine investor expectations. They then continuously monitor the actual results being achieved to identify positive or negative developments. Ultimately, they seek to purchase companies where the key drivers are exceeding investor expectations and sell those companies where the drivers are falling short of expectations.

Axiom uses a proprietary rating/ranking system for stock selection and portfolio construction. Each stock under consideration is assigned a number and letter ranking. The letter ranking is a representation of how established or emerging an enterprise is, while the number ranking represents the degree to which a company's aggregate key business drivers are tracking ahead or behind consensus expectations. While they use this multi-factor screen to rank companies, most new ideas are identified as a consequence of specific positive fundamental developments

in a company's operations. Stocks are bought or sold when key business drivers are moving away from expectations. A proprietary database allows each new piece of information to be cataloged and monitored for trends in operational data.

Below is a summary of maximum common period returns and risk statistics of AQR, Axiom, and JPMorgan and DFA relative to the MSCI Emerging Markets Index (net of withholding taxes).

Common Period Returns and Risk Statistics

5 3/4 Years as of 3/31/14

	AQR	Axiom	JPMorgan	DFA EM SC
Returns	3.96%	5.31%	2.10%	7.84%
Excess Return	3.12%	4.47%	1.25%	7.00%
Standard Deviation	30.88%	29.87%	27.88%	28.83%
Tracking Error	2.71%	2.76%	3.01%	12.18%
Information Ratio	1.62%	1.67%	0.38%	0.60%
Batting Average	65.22%	86.96%	56.52%	65.22%
Alpha	3.37%	4.55%	1.08%	7.23%
Beta	1.06	1.03	0.96	0.91
Risk Adjusted Excess Return (ND)	2.89%	4.32%	1.33%	7.05%
Up Market Capture	128.86%	126.40%	91.53%	106.82%
Down Market Capture	100.50%	96.48%	93.78%	82.39%

As compared to AQR, the Axiom Emerging Market strategy has exhibited higher excess and risk-adjusted excess returns, greater consistency of outperformance as measured by batting average, and favorable up and down market capture ratios.

III. Manager Structure

Within the emerging markets sub-asset class, Axiom's growth and momentum orientation is complementary to DFA's value bias. Pairing the two mandates and observing rolling three year correlations of the active returns of the Axiom Emerging Markets strategy and DFA Emerging Markets, Staff has observed low correlation, thereby demonstrating diversification benefits.

Staff modeled global equity manager mixes comprised of all existing Pension Trust global equity manager mandates at their current target weights with the exception of the Northern Trust Emerging Markets and JPMorgan Global Emerging Markets Focused mandates. Separate allocations to AQR, Axiom and JPMorgan were modeled to assess the impact on the overall global equity manager. While the relatively small size of the allocation (4.6%) as compared to the total global equity allocation does dampen the effect at the aggregate portfolio level, favorable differences can be observed at the margin.

Common Period Returns and Risk Statistics

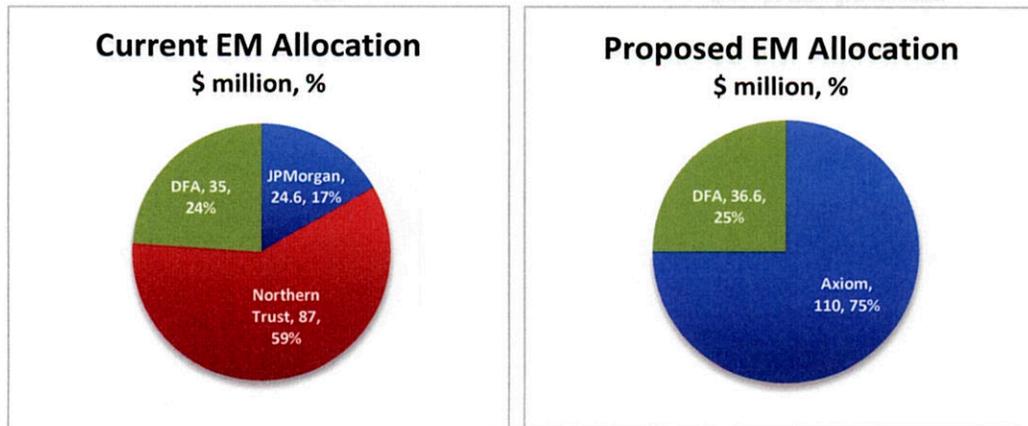
5 1/4 Years as of 3/31/14

	ND Pen GE AQR	ND Pen GE Axiom	ND Pen GE JPMorgan	ND Pen GE Policy
Returns	17.50%	17.52%	17.25%	15.63%
Excess Return	1.86%	1.89%	1.62%	0.00%
Standard Deviation	18.53%	18.52%	18.46%	19.10%
Tracking Error	1.10%	1.12%	1.13%	0.00%
Information Ratio	2.17%	2.18%	2.04%	0.00%
Batting Average	66.67%	71.43%	66.67%	100.00%
Alpha	2.07%	2.11%	1.90%	0.00%
Beta	0.97	0.97	0.97	1.00
Risk Adjusted Excess Return (ND)	2.39%	2.44%	2.21%	0.00%
Up Market Capture	106.44%	106.46%	104.98%	100.00%
Down Market Capture	93.74%	93.54%	93.89%	100.00%

IV. Current and Proposed Allocation

Within the emerging markets asset class, the Pension Trust has historically maintained a strategic overweight to small cap emerging market equities as compared to a market capitalization weighted index in order to capture the size premium that exists in emerging market equities. Additionally, the value effect is even more pronounced in emerging markets as compared to developed market equities, making DFA an ideal manager to capture long-term size and value effects. Currently, emerging markets small equities comprise 12.5% of the MSCI Emerging Markets Investable Market Index, which covers all investable large, mid and small cap securities in emerging markets. Staff recommends maintaining the current DFA Emerging Markets Small Cap target weighting at 25% of the total emerging markets allocation.

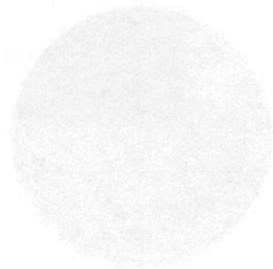
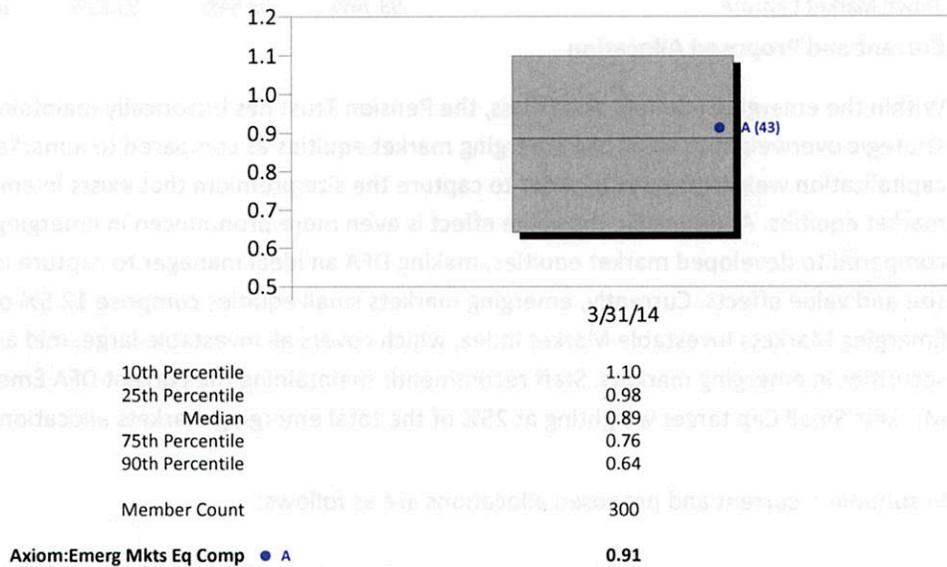
In summary, current and proposed allocations are as follows:



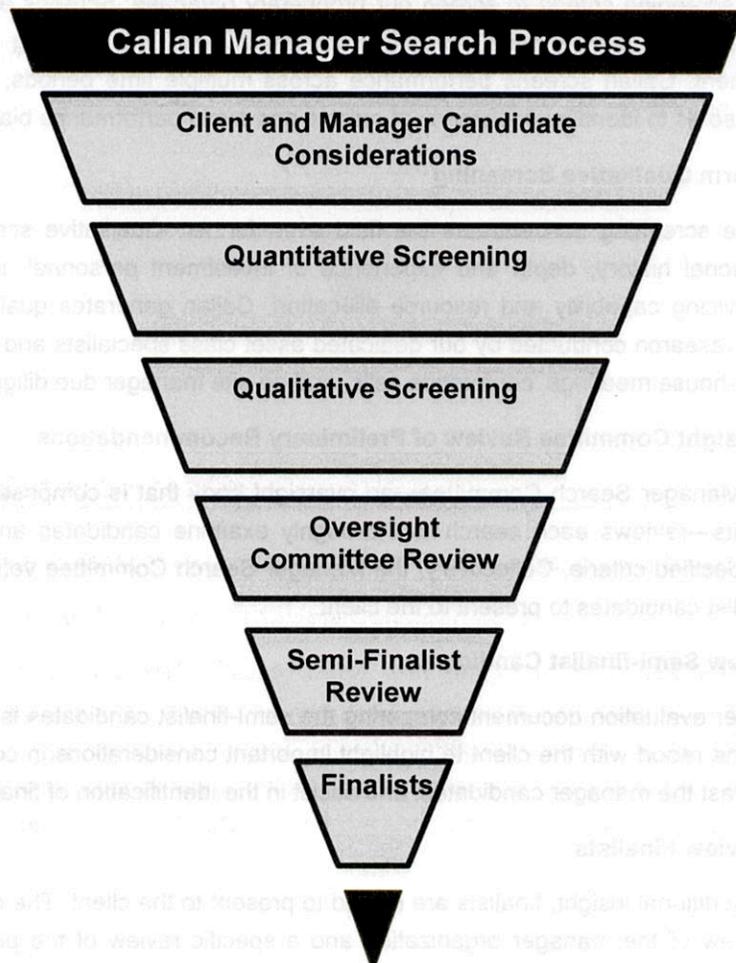
V. Fees and Capacity

Axiom currently manages \$2.3 billion in the Emerging Markets Equity strategy. Due to the nature of their investment process and their desire to focus on existing client assets, they have decided to close the product to new business once they reach approximately \$2.5 billion in assets. Axiom’s fees are generally in line with the median Emerging Markets equity manager. We do not expect them to negotiate fees because of the low level at which they plan to close the product.

Effective Annual Fee
for a \$110,000,000 Mandate
for Periods Ended March 31, 2014
Group: CAI Emerging Markets Equity DB



Manager Search Process



Manager Search Process Overview

Callan's investment manager searches are underpinned by a disciplined, six-step process:

I. Identify Client and Manager Candidate Considerations

At the onset of each search, Callan meets with the client to review and document any specific characteristics sought in an investment manager. This includes factors such as the manager's strategy and approach, organizational structure, minimum/maximum assets under management, performance criteria relative to an appropriate index and peer group, and risk tolerance. These factors serve as the basis for developing the appropriate quantitative and qualitative screening criteria.

II. Conduct Quantitative Screening

After beginning with the broadest possible universe of candidates, Callan narrows the field using client-specified screening criteria to screen our proprietary database. Screens examine numerous quantitative factors including performance, volatility, correlation with the existing structure, and assets under management. Callan screens performance across multiple time periods, market cycles, and statistical analyses so as to identify consistency of returns and avoid performance bias.

III. Perform Qualitative Screening

Qualitative screening concentrates the field even further. Qualitative screens examine manager type, organizational history, depth and experience of investment personnel, investment process and style, client servicing capability and resource allocation. Callan generates qualitative assessments based on manager research conducted by our dedicated asset class specialists and generalist consultants through regular in-house meetings, conference calls, and on-site manager due diligence.

IV. Oversight Committee Review of Preliminary Recommendations

Callan's Manager Search Committee—an oversight body that is comprised of approximately [18] senior consultants—reviews each search to thoroughly examine candidates and ensure Callan has met the client's specified criteria. Collectively, the Manager Search Committee vets the candidates and identifies semi-finalist candidates to present to the client.

V. Review Semi-finalist Candidates

A manager evaluation document comparing the semi-finalist candidates is prepared for the client. Callan reviews the report with the client to highlight important considerations in conducting the search, compare and contrast the manager candidates, and assist in the identification of finalist candidates.

VI. Interview Finalists

To gain additional insight, finalists are invited to present to the client. The presentations generally include an overview of the manager organization and a specific review of the product being considered. They also provide the opportunity for the client and/or consultant to address any outstanding issues. A winner is typically selected following these presentations.

**North Dakota State Investment Board
Emerging Markets Equity Manager Search
Candidate Profile (revised)
March 28, 2014**

The North Dakota State Investment Board ("SIB") is looking for emerging market equity candidates who can successfully manage tax exempt money for both qualified and non-qualified investment pools. Candidates should satisfy a majority of the following criteria:

1. Manager Orientation

Emerging markets equity.

2. Manager Type

Only qualified investment counselor organizations registered under the Investment Advisors Act of 1940 will be considered. This includes investment counselors and investment counseling subsidiaries of banks, brokerage houses and insurance companies.

3. Investment Style

The SIB is searching for an active emerging markets equity manager. The selected manager may make tactical use of frontier markets (not to exceed 10% of the account's value), although this allocation is not expected to be a major source of value added. Both quantitative and fundamental strategies are open to consideration. Successful candidates will have the ability to manage both tax-exempt and non-qualified pools of capital in the same strategy.

4. Investment Vehicle

An institutional collective fund is required as the SIB prefers not to establish local trust/custody accounts.

5. Securities Lending

SIB will consider collective vehicles that employ securities lending on a case-by-case basis.

6. Total Assets and Accounts Under Management

The SIB prefers to be less than 20% of the total strategy assets under management ("AUM") but will consider exceptions on a case-by-case basis for financially secure firms. SIB prefers that candidates' AUM in the relevant strategy be at least \$500mm. SIB prefers that total assets under management at the firm be at least \$2 billion. SIB may be willing to consider candidates on a case-by-case basis that do not meet the AUM standard.

7. Size of Professional Staff

Investment staff should be of sufficient depth and breadth to perform ongoing duties of the firm. Additionally, there should be a sufficient number of client service and investment personnel relative to the firm's account load to ensure that the SIB has reasonable access to the firm and that the investment portfolios are well attended.

8. Years of Experience in Managing Funds and Strategy Track Record

At least five years of experience by the investment team is preferred, with at least two key professionals having ten years or more of direct experience. Experience gained at another firm is permissible as long as the historical record is directly attributable to the investment team at the firm under consideration. Highly qualified teams not meeting this criterion may be considered on a case-by-case basis.

9. Geographic Location

None specifically required.

10. Flexibility of Individual Portfolio Manager

The dispersion of portfolio returns across accounts within the firm's product composite should be small. There should be a firm-wide investment process.

11. Portfolio Risk Level

Returns generated by the portfolio will be evaluated in light of the portfolio risk. Risk will be evaluated relative to the benchmark and peer group through quantitative measures such as Sharpe Ratio, Standard Deviation, Tracking Error, Correlation, and R-Squared. Candidates should demonstrate risk-adjusted performance that compares favorably to the product's benchmark and peer group.

12. Historical Performance Criteria

Performance screening will focus on consistency of returns relative to appropriate indexes and peer groups over time. Historical performance will be scored based on the following:

- Cumulative 4, 5 and 7 year data relative to the MSCI Emerging Markets Index and Callan's Emerging Markets Broad Style Group.
- Rolling 3-year periods based on quarterly data compared to the MSCI Emerging Markets Index and Callan's Emerging Markets Broad Style Group.

Performance will be evaluated relative to each criterion. There will be a maximum of 40 points possible (17 rolling 3-year periods and three other cumulative periods). Candidates will receive one point for each standard passed. The relative score will be considered for candidates with limited performance history. Performance at a prior employer may be utilized on a case-by-case basis.

13. Client Servicing

Qualified representatives will be expected to meet with the SIB's Board of Trustees at least annually and, as requested, with the SIB's investment staff within the Retirement and Investment Office staff. The selected manager's investment staff is expected to participate in quarterly telephonic reviews of investment results with SIB staff.

14. Qualities to be Avoided

- Strategies that use short sales;
- Extensive use of options/futures/swaps with the exception of unlevered currency adjustment, country management and other common and conventional uses;
- Long-term records that have been propelled by just a few block-buster years;
- Excessive recent growth in assets within the strategy;
- Allocations of greater than 10% to frontier markets; and
- Candidates currently involved in significant litigation, a merger or acquisition.

15. Qualities Specifically Sought

- Complement to the DFA Emerging Markets Small Cap strategy;
- Experienced investment professionals whose interests are aligned with those of their clients;
- Consistent and competitive risk-adjusted returns through time;
- Fully invested, well diversified portfolios;
- Well established organization with institutional focus;
- Disciplined investment process with risk controls;
- Depth of portfolio management and research;
- Effective communication skills and commitment to client service; and
- Low turnover of investment personnel.

16. Business Plan and Financial Well-Being

The SIB seeks emerging market equity managers who have been successful in the business of money management and are committed to continued delivery of above average product performance and client service. Candidates should be able to demonstrate their ongoing commitment to the investment management of comparable funds and possess the financial wherewithal to survive a poor business environment without significant changes to their investment process or organization.

17. Fees

Investment management fees should be competitive. SIB wants to be aware of any contribution and/or withdrawal transaction fees that will be associated with the emerging market equity investment vehicles.

18. Assets to be Allocated

The total target amount for this allocation is approximately \$100 million. It is expected that that amount will include assets from the Pension Trust. Future funding from the non-qualified Insurance Trust may be made in the future.

19. Client Requests

The SIB's incumbent managers should be evaluated if they have appropriate investment products. These firms are to be evaluated pari passu with all other potential candidates.

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Org. Name	Total Org Assets for 12/31/13	Total Org Assets for 12/31/12	Total Product Assets for 12/31/13	Total Product Assets for 12/31/12	Avg. of Number of Holdings for 12 Quarters Ended 12/31/13	Avg. of Wtd. Average Market Cap. for 12 Quarters Ended 12/31/13	Avg. of Wtd. Median Market Cap. for 12 Quarters Ended 12/31/13	Emerging Markets for 12 Quarters Ended 12/31/13	Avg. of Tracking Error vs. MSCI:Emer	Avg. of 12 Qtr MSCI:Emer	Avg. of Standard Deviation for 28 Quarters Ended 12/31/13	Relative CAI Matrix Score vs. CAI:Emer	Relative CAI Matrix Score vs. MSCI:Emer	Up Market	Up Market	Up Market	Down Market	Down Market	Down Market	Relative Returns vs. MSCI:Emer	Avg. of 12 Qtr Relative Returns vs. MSCI:Emer	Avg. of 12 Qtr Information Ratio vs. MSCI:Emer	Avg. of 12 Qtr Alpha vs. MSCI:Emer	Returns for 4 Quarters Ended 12/31/13	Returns for 16 Quarters Ended 12/31/13	Returns for 20 Quarters Ended 12/31/13	Effective Annual Fee for a 50,000.00 Mandate for 12/31/13	Effective Annual Fee for a 100,000.00 Mandate for 12/31/13	Effective Annual Fee for a 250,000.00 Mandate for 12/31/13
														Capture vs. MSCI:Emer															
Dimensional Fund Advis	337,781	261,794	3,995	3,463	2,851	1.3	1.0	99	7.67	29.15	100	100	121	124	90	98	88	90	1.74	3.02	0.44	2.84	(0.57)	6.29	20.75	0.82	0.82	0.82	
J.P. Morgan Asset Mana	1,598,074	1,426,401	21,025	19,730	63	40.1	24.3	91	3.60	24.39	85	85	90	89	87	94	91	87	(1.73)	1.20	0.45	1.33	(3.95)	4.02	14.69	1.30	1.30	1.30	
Callan Database Compos	100,090	71,776	3,627	3,681	97	34.4	14.5	93	3.49	26.15	50	53	97	97	97	98	95	94	2.57	(0.05)	0.06	0.13	0.25	3.59	15.33	0.95	0.95	0.85	
MSCI Inc.					819	34.5	16.0	100	-	25.86	50	100	100	100	100	100	100	100	-	-	-	-	(2.27)	3.12	15.15				
1 AQR Capital Managemer	98,770	79,711	5,068	2,225	231	34.7	13.0	100	2.40	26.08	100	100		127	125		98	96	4.92	3.24	1.73	3.10	2.54	6.55	19.69	0.85	0.85	0.81	
2 Axiom International Investors LLC		8,612	2,079	1,443	74	38.2	15.6	90	2.93	28.23	100	100		125	120		92	92	6.72	4.27	1.58	4.28	4.30	7.74	20.36	0.95	0.93	0.85	
3 Columbia Management Ir	321,500	297,826	2,919	1,969	103	28.9	14.9	88	2.91	25.23	86	86		105	103		89	87	2.26	1.47	0.56	1.59	(0.05)	5.66	17.80	0.80	0.73	0.65	
4 Franklin Templeton Inves	879,139	781,769	8,327	9,444	63	38.0	26.4	78	3.66	26.56	100	95	109	111	97	101	101	96	(0.30)	0.50	0.23	0.74	(2.56)	3.91	16.82	0.95	0.95	0.86	
5 Harding Loevner LP	36,302	24,711	6,182	3,859	77	33.0	13.5	92	3.63	25.60	75	65	98	99	112	94	81	79	8.08	1.00	0.28	0.94	5.63	7.80	17.87	0.97	0.97	0.80	
6 MFS Investment Manag	412,159	321,417	3,947	3,240	129	33.3	12.6	88	3.21	25.80	55	55	96	97	96	100	95	96	(1.59)	(0.28)	0.25	0.15	(3.82)	4.73	15.48	0.95	0.93	0.85	
7 Morgan Stanley Investme	311,551	281,494	12,649	11,755	155	31.1	13.8	92	3.62	26.14	65	55	90	84	79	96	76	73	3.32	0.48	0.13	0.28	0.97	5.07	16.08	0.80	0.80	0.76	
8 Quantitative Managemen	109,743	86,273	6,143	4,722	291	34.8	13.5	98	1.62	26.67	100	100	113	111	114	100	98	99	0.37	1.39	0.79	1.24	(1.90)	5.09	17.08	0.65	0.63	0.58	
9 Schroder Investment Management No	344,545	19,321	18,505	131	131	46.9	21.5	97	2.24	25.53	85	75	103	101	116	98	98	96	1.98	0.80	0.47	0.84	(0.33)	3.90	15.68	1.00	1.00	0.85	
10 William Blair & Company	61,979	49,613	757	296	59	38.8	22.3	98	5.18	24.87	86	86		97	90		77	82	3.78	1.65	0.41	2.01	1.42	6.03	18.21	0.78	0.69	0.57	

INFORMATIONAL – NO BOARD ACTION REQUESTED

TO: State Investment Board

FROM: Dave Hunter

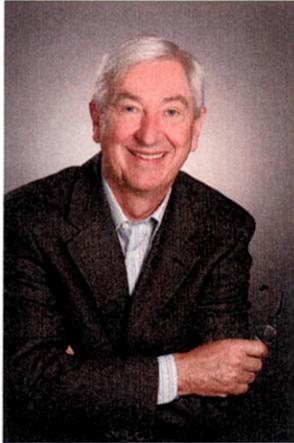
DATE: April 21, 2015

SUBJECT: Board Offsite Preview – Keith Ambachtsheer

RIO has arranged for Keith Ambachtsheer of *KPA Advisory Services* to present at the SIB pension governance offsite meeting on the morning of July 24, 2015. Keith has been a leader in pension fund governance for over 30 years and serves as the Academic Director of the Rotman-ICPM Board Effectiveness Program for Pension Funds and Other Long-Horizon Investment Institutions. Mr. Ambachtsheer also founded KPA Advisory Services in 1985 and co-founded CEM Benchmarking in 1991, the latter of which benchmarks the organizational performance of some 400 major pension funds around the world. Keith's biography is attached along with a recent article entitled "Rethinking Investment Beliefs for the 21st Century".

Mr. Ambachtsheer will be requested to present on the following three topics: 1) survey findings on pension fund governance and their implications; 2) preferred investment board dynamics and practices; and 3) investment beliefs and policies for the 21st Century.

The CIO and Deputy CIO selected Keith Ambachtsheer after a review and discussion of industry leaders in pension governance with Callan Associates and Novarca. Both firms deemed Keith Ambachtsheer to be a true leader in this area. The CIO also noted that each of the two other highly acclaimed governance experts considered for this role referenced Keith Ambachtsheer as the most widely renowned expert in the pension governance field.



KEITH AMBACHTSHEER
President
KPA Advisory Services

Keith has been a participant in the pensions and investments industry since 1969. He founded his own firm *KPA Advisory Services* in 1985. Through it, he provides strategic advice to a global clientele in person, and through the monthly *Ambachtsheer Letter*. He is the author of three best-selling books, and has been a regular contributor to industry publications since the 1970s. He was the Editor of the *Rotman International Journal of Pension Management* from 2008 to 2014.

In 1991, Keith co-founded *CEM Benchmarking* which benchmarks the organizational performance of some 400 major pension funds around the world. In 2005, he played a major role in founding the *Rotman International Centre for Pension Management (Rotman ICPM)*. He was appointed Director of *Rotman ICPM* and Adjunct Professor of Finance at the *Rotman School of Management, University of Toronto*. He was appointed Director Emeritus in 2014.

At the start of 2011, he was appointed Academic Director of the Rotman-ICPM Board Effectiveness Program for Pension Funds and Other Long-Horizon Investment Institutions. He has personal governance experience as a member of two corporate boards, and has served as Board Chair of a major medical foundation.

His research, writing and advice have influenced pension and endowment design, policy, and organizational structure in Canada and elsewhere. He has won major awards, including CFA Institute's Award for Professional Excellence in 2011 for "exemplary achievement, excellence of practice, and true leadership", and the EBRI Lillywhite Award in 2010, given in recognition of outstanding lifetime contributions to Americans' economic security. In July of 2009 Keith was awarded James Vertin Award from the *CFA Institute* for his contributions "of enduring value" to investment theory and practice. In 2007, he was honoured with the Outstanding Industry Contribution Award by *Investments and Pensions Europe*. In 2003, he was named 'One of the 30 Most Influential People in Pensions and Investments' by *Pensions and Investments* in the USA. In 2013, *aiCIO* named him one of the globe's "10 most influential academics in institutional investing", and the globe's #1 "knowledge broker" in institutional investing in 2014.



The AMBACHTSHEER Letter

Sustainable Pension Design • Effective Pension Management

March 2015

RETHINKING INVESTMENT BELIEFS FOR THE 21ST CENTURY

*"Piketty sees the 60-year WWI-1970s period as an anomaly....which is now well behind us....
Future annual returns on capital will likely fall below the 5% experience of the 18th and 19th
Centuries...."*

The Ambachtsheer Letter - April 2014

Rethinking MPT

When we entered the investment business 45 years ago, the big new thing was Modern Portfolio Theory, or MPT for short. It was elegant and radical at the same time: elegant because it embodied a simple, understandable set of investment beliefs....and radical because these beliefs were at odds with the conventional wisdom of the day.

Today, MPT is no longer new, and no longer seen by most as elegant or radical. Just as Thomas Piketty (of "Capital in the 21st Century" fame) saw the 60-year period from World War I to the 1970s as a socio-economic anomaly in the grander sweep of things, so is MPT increasingly seen as an interesting anomaly in an investment context. At its core lay the Efficient Markets Hypothesis (EMH). It posits that investors act rationally, have access to the same information sets, interpret that information the same way, and consequently, hold the same risky market portfolio. Investors expressed their different tolerances for risk-bearing through their different weightings of this risky market portfolio and a risk-free asset.

Today, we recognize that we cannot invoke MPT as a substitute for thinking about how investment markets really work, and for thinking about how the resulting investment beliefs should lead us to invest the financial wealth of other people. This *Letter* traces the evolution of our own investment beliefs over the course of the last four decades, and the investment policy conclusions they lead to today.

The Lo and Minsky Contributions

MIT's Andrew Lo offers a plausible alternative to the EMH: the Adaptive Markets Hypothesis, or AMH for short.ⁱ Lo explains it as taking a biological/evolutionary approach to understanding investment markets and the people in it, rather than a robotic 'physics' approach. It is fear and greed that drives these markets, more than sober, rational calculation. In a similar vein, Washington University's Hyman Minsky posited the Financial Instability Hypothesis (FIH), arguing that financial stability in developed economies would naturally become a source of future instability through speculative risk-taking. His work was largely ignored until people acknowledged that the Global Financial Crisis offered a text book example (a 'Minsky Moment') of the FIH in action.ⁱⁱ

In the tradition of Lo's AMH and Minsky's FIH, long-time readers of this publication will recognize Table 1 on the next page. It has played a central role in our prognostications about capital markets prospects for many years now, for three reasons:

1. The table reflects the FIH by reminding us that financial markets have mindsets that swing from extended periods of growing optimism to extended periods of growing pessimism.
2. It also reflects the AMH because these mindset swings impact pricing in the capital markets in predictable ways. Growing optimism leads to rising prices for risk assets, generous risk premium realizations, and hence falling

prospective risk premiums. Conversely, growing pessimism leads to falling prices for risk assets, negative risk premium realizations, and hence rising prospective risk premiums.

3. The table facilitates focused conversations about past investment eras, about the current one we are living through, and about periods during which one era transitions into another.

We stated the belief in our January 2014 *Letter* that the *Double Bubble Blues* era ended around 2010/2011, and that we have been transitioning into a new era which we called *Mature Capitalism*. Our challenge now is to visualize how a *Mature Capitalism* era might play out. A clue from Table 1 is that we should give it an optimistic spin, contrary to the prevailing mood of pessimism.

Conventional Narratives about the *Mature Capitalism* Era

As noted, most prognostications today about the unfolding future paint a rather dreary picture of it, with four defining elements:

- **Demographics:** as populations age and worker/retiree ratios fall from 4:1 to 2:1 in the developed world, consumption, capital formation, productivity will weaken, and hence economic growth will also weaken.
- **Fiscal Deficits:** both families and governments are borrowing to make ends meet. This cannot go on forever. Eventually, a day of reckoning will come. This too will dampen future economic demand, and hence growth prospects.

- **Geopolitical Risks:** seem to always be with us, with an assertive China, a belligerent Russia, and an unsettled Middle East making current headlines.
- **Environmental Risks:** are also in play in the form of global warming and changing weather patterns, which in turn cause wide-spread floods and droughts. The concomitant financial risk relates to assets becoming 'stranded' as the full costs of production are internalized (e.g., for carbon emission and water pollution).

If these four elements fully defined the now-unfolding *Mature Capitalism* era, one would think they would be reflected in how markets are pricing long-horizon financial assets such as equities. Yet, the earnings yield of the S&P500 is about 5% today, versus a long term average somewhere between 6% and 7%. In short, the pessimism embedded in the demographics, debt, geopolitical conflict, and climate change narratives don't seem to be embedded in the pricing of risky USA-based assets. European and Emerging Markets equities appear to be somewhat more conservatively priced at earnings yields of 6% and 7% respectively.ⁱⁱⁱ Why are equity prices not deep in the dumps? Our January 2014 *Letter* referenced an *FAJ* article by William Bernstein titled "The Paradox of Wealth" as an explanation.

The Paradox of Wealth

Bernstein offers four reasons for why *Mature Capitalism* might turn out better than most people expect:

Table 1: Entering the Eighth Capital Markets Era Since WWI

Investment Era	Investor Mindset	Approximate Time Span	Dividend Yield Change	Realized ERP*
<i>The WW I Decade</i>	Pessimistic	10 years	5% → 7%	- 5%
<i>Roaring Twenties</i>	Optimistic	10 years	7% → 4%	+ 12%
<i>Dirty Thirties/ Fateful Forties</i>	Pessimistic	20 years	4% → 7%	0%
<i>Pax Americana I</i>	Optimistic	20 years	7% → 3%	+ 8%
<i>Scary Seventies</i>	Pessimistic	10 years	3% → 6%	- 3%
<i>Pax Americana II</i>	Optimistic	20 years	6% → 1%	+ 9%
<i>Double-Bubble Blues</i>	Pessimistic	10 years	1% → 2%	- 6%
<i>Mature Capitalism?</i>	Optimistic?	20 years?	2% → ?%	?%

* Stock returns come from *Triumph of the Optimists* by Dimson, Marsh, Staunton. Bond returns are based on a hypothetical CPI-linked bond with a real yield of 2.5%. If the actual LT TIPS return had been used for the *Double-Bubble Blues* era, the realized ERP would have been -10%.

1. Scientific rationalism: it is unduly pessimistic to assert that all things worth discovering or inventing have already been discovered and invented. New discoveries and inventions will continue to accumulate and add to societal wealth in this century.
2. Property rights buttressed by the rule of law: the evidence in support of this prosperity factor is overwhelming. Wealthy developed economies already have this property rights/rule of law attribute. Poorer developing economies would benefit greatly from acquiring it.
3. Well-functioning capital markets: despite the realities of the AMH and FIH, well-functioning capital markets are essential to transforming savings into wealth-producing capital on a large scale. Institutional investors can and should play a critical role in making capital markets more functional.
4. Modern communication and transportation technologies: it is not sufficient to simply produce the goods and services consumers want. They also need to know about them and be able to easily access them. To this end, communication and transportation technologies continue their march towards greater effectiveness and lower costs.

Now for Bernstein's paradox: increasing societal wealth in a developed economy does not logically mean increasing returns on capital. In fact, quite the opposite: increasing wealth logically lead to lower returns on capital. Why? Because increasing capital productivity decreases demand for new capital. At the same time, the decreasing urgency of spending income on immediate consumption increases the supply of capital.

Piketty comes to the same 'lower future returns on capital' conclusion in his "Capital in the 21st Century" book. He calculates a steady 5% return on productive capital (including real estate) in 18th and 19th Century France and the UK. He then observes an extended period of capital destruction through WW1, the Great Depression, and WW2, followed by an extended, post-WW2 high-growth reconstruction/baby boom period accompanied by high returns on capital (i.e., the *Pax Americana I* and *II* eras in Table 1 above). That period is now behind us. With high-return opportunities declining, and a potentially increasing savings rate as

societal wealth and income continue to concentrate, he foresees a decline in the return on productive capital from 5% to 4% as a logical consequence.

The S&P500 Entrails: A Closer Look

A quick look back at Table 1 confirms Bernstein/Piketty 'lower returns on capital' assessment. Note the S&P500 dividend yield was 7% at the start of Pax Americana I (i.e., 1950ish). Fifty years later, by the end of Pax Americana II (i.e., 2000ish), it had dropped to 1%. Table 2 on the next page offers a closer look at the S&P500 entrails in the *Double Bubble Blues* era (approximately 2000-2010), and the first four years of the *Mature Capitalism* era.

To read the table, some definitions are required:

- Dividend Yield: dividends paid in the year divided by average index value.
- Net Buy-Back Yield: net share repurchases in the year divided by average index value. While gross repurchases data is generally available, new share issuance is not. Based on some rough calculations, we assumed a relatively low rate of new share issuance at 0.5% of share value per year.
- Payout Yield: sum of Dividend Yield and Net Buy-Back Yield.
- Plowback Yield: Difference between Earnings Yield and Payout Yield. These are the earnings retained by S&P500 companies after paying out dividends and net share repurchases divided by average index value.
- Earnings Yield: Net earnings for the year divided by average index value.
- LT TIPS Yield: year-end 30-year TIPS yield.
- Implied ERP: Difference between Earnings Yield and LT TIPS Yield. The calculation implicitly assumes zero real earnings growth, and hence is arguably a conservative long term estimate.
- Index Value: year-end index value.
- Trailing Earnings: Net earnings for the year.

Table 2 makes it clear why the *Double Bubble Blues* Decade era was as painful as we predicted it would be in 2000: the implied Equity Risk Premium at that time was negative. It took until 2010 for the Implied ERP to hit a comfortable 5.0%. Note that even now, with the S&P500 up 800 points since 2010, the ERP still stands at 4.6%.

Table 2: S&P500 Fundamentals in Transition from *Double Bubble Blues* to *Mature Capitalism*

Year	Dividend Yield	Net Buy-Back Yield	Payout Yield	Plow-Back Yield	Earnings Yield	LT TIPS Yield	Implied ERP	Index Value	Trailing Earnings
2000	1.20%	0.70%	1.90%	1.70%	3.60%	3.70%	-0.10%	1320	\$50
2001	1.30%	0.80%	2.10%	0.00%	2.10%	3.50%	-1.40%	1148	\$25
2002	1.60%	0.80%	2.40%	0.60%	3.00%	2.70%	0.30%	880	\$28
2003	1.80%	1.10%	2.90%	2.10%	5.00%	2.30%	2.70%	1112	\$49
2004	1.70%	1.50%	3.20%	1.80%	5.00%	1.90%	3.10%	1212	\$59
2005	1.80%	1.70%	3.50%	2.50%	6.00%	2.00%	4.00%	1248	\$70
2006	1.90%	2.20%	4.10%	2.00%	6.10%	2.80%	3.30%	1418	\$82
2007	1.90%	4.10%	6.00%	-1.50%	4.50%	2.50%	2.00%	1468	\$66
2008	2.60%	2.40%	5.00%	-3.60%	1.40%	2.40%	-1.00%	903	\$15
2009	2.50%	0.90%	3.40%	2.30%	5.70%	2.00%	3.70%	1115	\$51
2010	2.00%	2.10%	4.10%	2.70%	6.80%	1.80%	5.00%	1258	\$77
Mean	1.80%	1.70%	3.50%	1.00%	4.50%	2.50%	2.00%		
2011	2.10%	3.10%	5.20%	1.80%	7.00%	0.80%	6.20%	1258	\$87
2012	2.30%	2.60%	4.90%	1.40%	6.30%	0.40%	5.90%	1426	\$87
2013	2.10%	2.40%	4.50%	1.60%	6.10%	1.60%	4.50%	1848	\$100
2014	2.10%	2.60%	4.70%	0.70%	5.40%	0.80%	4.60%	2059	\$103
Mean	2.10%	2.70%	4.80%	1.40%	6.20%	0.90%	5.30%		

Sources: Bloomberg, Standard & Poor's, Garland, Lazonic

Should investors still be comfortable? Certainly 'yes' relative to the 2000 situation. And plausibly 'yes' if (a) US stocks in the index can maintain or grow their real earnings from here, and (b) if there is no permanent spike up in the LT TIPS yield from current levels. Further, recall our observation earlier that European and Emerging Markets equities are priced more cheaply than US equities.

Table 2 points to another unfolding trend: an apparent secular rise in Net Share Buybacks, from under 1% of the S&P500 index value in the early 2000s...to figures approaching 3% today, compared to a dividend yield of 2%. So corporations are now using more of their earnings to buy back stock than they are to pay dividends. Further, when you add the two yields together (i.e., the Payout Yield), the sum of the two almost approaches the Earnings Yield. The implication is that corporations are now returning most of their earnings to shareholders in the form of dividends and share buy-backs, and retaining little for capital re-investment. This is yet another indication of the arrival of *Mature Capitalism*.

So where does all this lead to? The most important

conclusion is that, despite the strong rise in the S&P500 in first four years of the *Mature Capitalism*, its valuation is not in 'bubble' territory. Pricing is consistent with a lower return-on-capital, lower growth, lower long-term interest rate environment. In such an environment, an equity risk premium in the 4% area does not seem out of line.

However, we advise readers to re-read last month's *Letter* on the excess return potential of what we called high-sustainability 'stakeholder value-creation' companies. There is a strong case that emphasizing this type of investment will continue to produce excess returns relative to the market portfolio in the *Mature Capitalism* era.



Endnotes:

- i. See, for example, Lo's 2011 book "A Non-Random Walk Down Wall Street".
- ii. Look for a new film titled "Boom Bust Boom" on Hyman Minsky and his Financial Instability Hypothesis. Contact Marja Koolschijn at Cardano for more information. (m.koolschijn@cardano.com)
- iii. See GMO's 4Q Quarterly Letter for more on this topic.
- iv. For more on the share buy-back phenomenon, see William Lazonic's article "Profits Without Prosperity" in HBR – September 2014.

The information herein has been obtained from sources which we believe to be reliable, but do not guarantee its accuracy or completeness.

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