Your VESTED INTEREST

North Dakota State Investment Board April 2009

FROM THE DIRECTOR'S CHAIR

Steve Cochrane, CFA
Executive Director/CIO

Do you wake up bright eyed and cheerful each day, wondering what amazement the day's experiences will bring? I know my dogs do. They offer plenty of encouragement that today will be even better than yesterday, which is hardly possible. They don't even mind when I dutifully down my morning coffee and turn to my despicable habit: watching the morning financial news. Bloomberg…CNBC… take your pick, they enjoy both shows. As for me, it's an early start on what has become an increasingly sad global economic and financial situation.

If you haven't already, you may want to consider picking up this addiction. Choose Bloomberg if you want more straight forward nuts and bolts information on global markets and corporate earnings. If it seems too droll, switch to CNBC, where Joe "The Kahuna" Kernen and the gang lead a lively discussion format with leading economists, financial wizards, corporate executives and politicians. They pick apart the news of the day, while depressing information scrolls across the bottom of the screen and generally negative market quotes alternately reveal themselves at the top. Yes, welcome to the morning news in early 2009.

Of course, you could choose one of the lighter morning shows, which only occasionally touch on economic and financial information. That would be nice. Only problem there is, when your brokerage statement arrives, you might actually be surprised to see how horrible it now looks. "How did that happen?" you may think.

I'm not sure which is better…the Chinese water torture approach, knowing each day how much darker the world is becoming, or happily moving through time, the living embodiment of the old phrase, "ignorance is bliss."

Most of our readers are well aware of today's current conditions. But, I thought it might be of some value just to print a few fairly recent quotes from print media which help illustrate the point. Italics have been added for emphasis. Keep in mind that this is being written weeks in advance of your reading it, so things may be better or worse. (You can put this down now if you want!)

- The Bank of England cut the benchmark interest rate to the lowest *since the central bank was founded in 1694* as policy makers tried to prevent the credit squeeze from deepening Britain's recession.
- Last month's losses mark the first time since records began in 1939 that job cuts exceeded half a million in three consecutive months.
- Consumer credit fell by $6.6 billion, or 3.1 percent at an annual rate, to $2.56 trillion, according to a Federal Reserve report released today in Washington. In November, credit decreased by $11 billion, more than previously estimated and the biggest drop since records began in 1943.
- Retail sales have tumbled every month since July, *the longest series of declines in Commerce Department data going back to 1992.*

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THE COMPANY WE KEEP (OR OUR THREE AMIGOS)

"Tell me what company you keep and I'll tell you what you are."

Miguel de Cervantes
(Spanish writer, author of 'Don Quixote,' 1547-1616)

The 2009 rankings of the world's richest people, just released by Forbes magazine, put Microsoft founder Bill Gates in the top position with an estimated wealth of $40 billion. That's a drop of $18 billion from last year's $58 billion, when Gates was number three. (2008 change in value = -31%)

Buffett is number two, with $37 billion, a decline of $25 billion from last year's $62 billion, or just over 40 percent. Forbes notes that Berkshire Hathaway's stock is down 45 percent over the twelve months. (2008 change in value = -40%)

Mexico's Carlos Slim stays in the top three with $35 billion. He also lost $25 billion on paper compared to last year's list. (2008 change in value = -42%)

And then there is the North Dakota State Investment Board (SIB) Pension Trust, which saw a loss, most of it on paper, during 2008, of approximately 28.5%. It would seem that, according to Cervantes, we are in fine company.

It's no secret that 2008 was a treacherous year for investors. As the global economy continues to worsen and the markets reflect the fear and panic, fiscal year 2009, which began on July 1, 2008, also presents a challenging investment environment. In fact, as of this writing in early March, the Pension Trust has seen a decline in market value of close to 35% for the period. *(Note: There is a 6 month overlap with the aforementioned calendar year 2008.)*

There is something about considering changes in asset values in percentage terms that seems just a little more relaxed than looking at the raw numbers. So, with a wistful eye to past valuations, let's take a look.

On July 1, 2008, the State Investment Board held about $3.8 billion in the Pension Trust which invests on behalf of the TFFR and PERS plans, as well as several smaller funds. Based on actual values and estimated returns in the markets in which the plan is invested, it is likely that the 35% decline in market value through early March is in excess of $1.3 billion. Split between the two large participants in the trust, at current market value, TFFR and PERS have each declined by about $600 million in this devastating investment environment so far this fiscal year.

Now, Bill and Warren and Slim are all long term investors, and are not defined benefit plans. They know that they will recover eventually, as will the Pension Trust. However, liabilities continue to mount on a daily basis, or in other words, more and more future retirement benefits measured in dollars are being continuously earned by our plans' participants. (Our Three Amigos don't have this worry.) And according to responsible actuarial procedures, action must be taken to assure that the liabilities will be covered in the years to come. We know we will once again earn money in investments, but how much and how quickly cannot be determined. It is then necessary to consider that *contributions will need to increase to keep the funds healthy.* The timing and pattern of increased contributions can be designed in many ways, over various time spans, but the inescapable message to all readers is simply this: There is a large and growing unfunded liability in these plans and those involved in oversight of these plans – from legislators, to employers, to participants, to plan trustees, to citizens of the state – must all be aware of the need to address this looming issue.

PERSPECTIVES ON THE MARKET

By Paul Erlendson, Investment Consultant
Callan Associates Inc.

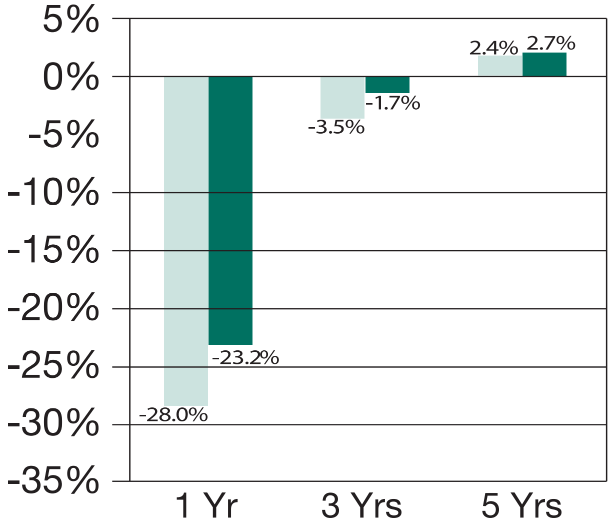
The world's financial markets have declined at a dizzying rate over the last 18 months. Both aggressive and conservative investors have been hurt by the decline in asset values. These near-term events carry over into the longer multi-year performance comparisons. With short-term fears overwhelming investors, even the most rational, disciplined investment processes suffer as excesses are wrung from the market. In short, fear and risk-aversion now drive investment return.

While it is tempting to let fear drive investment behavior, we reject that theory as imprudent and short-term oriented. History shows repeatedly that long-term success requires discipline. While current conditions are extreme, we also know that contractions are a normal part of the economic cycle. Rational investment strategies, like those employed by the SIB, will be rewarded as market conditions recover.

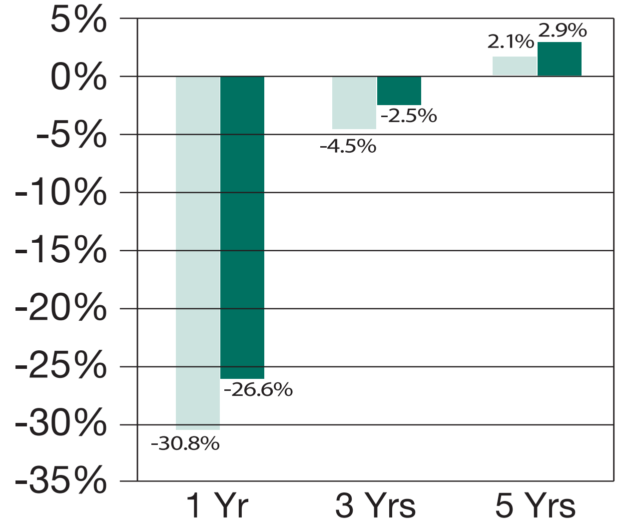
NET INVESTMENT PERFORMANCE

Periods ended December 31, 2008

PERS



TFFR



Note: Since the summer of 2007, the world economy has been deteriorating rapidly and financial markets have reflected this. It has been observed that rational, disciplined investment processes that have successfully added value over benchmarks have failed during this time period, as the normal long term factors that drive return have been brushed aside in favor of fear driven and risk averting tactics. This has affected N.D. Pension Funds' relative return in the last 18 months, which carries over in to the longer multi-year comparisons. We would expect this condition to reverse as the economy and financial markets recover.

FROM THE DIRECTOR'S CHAIR

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- Consumer confidence fell last month *to the lowest ever recorded,* according to the New York-based Conference Board's index *that began in 1967.*

- *A record* 19 million U.S. houses stood empty at the end of 2008, the U.S. Census Bureau said in a report today.

- (We are experiencing) *the first simultaneous recessions* in the U.S., Europe and Japan since World War II.

- The recession in U.S. manufacturing persisted for a 13th month in February as sales dropped worldwide and *factories cut jobs at the fastest pace on record.*

- Senate Banking Committee Chairman Christopher Dodd said banks may have to be *nationalized* for "a short time" to help lenders including Citigroup Inc. and Bank of America Corp. *survive the worst economic slump in 75 years.*

- U.S. stocks tumbled, sending the Dow Jones Industrial Average *below its lowest close since 1996*. (That means *0% return* in U.S. stocks in my 12 year career at the state!)

- Europe's benchmark index sank *to a six-year low*, while Japan's Topix plunged *to the lowest since 1984.*

- The (current) period is poised to be the sixth straight quarter of decreasing profits, *the longest streak on record.*

- Shares of General Motors (GM) tumbled to their *lowest level in more than 70 years.*

- Detroit-based General Motors Corp. last week reported the *second- biggest quarterly loss in its 100-year history.*

- The value of global financial assets including stocks, bonds and currencies probably *fell by more than $50 trillion in 2008.*

- Warren Buffett's Berkshire Hathaway Inc. fell to its *lowest price in five years.* The stock of the Omaha, Nebraska-based firm (effectively, Buffett's investment portfolio) has plunged 48 percent in the past 12 months.

- Billionaire Warren Buffett said the economy will be "in shambles" this year, and perhaps longer, before recovering from the reckless lending that caused *the worst "freefall" he ever saw in the financial system.*

- American International Group Inc. (AIG) posted the *largest corporate loss in U.S. history.*

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FROM THE DIRECTOR'S CHAIR

From page 3

- *A record 5.4 million American homeowners* with a mortgage of any kind, about one in eight, ended 2008 behind on their loan payments or in the foreclosure process.

- "We're in the middle of a kind of *massive economic crisis*," Volcker, a former Federal Reserve chairman who heads President Barack Obama's Economic Recovery Advisory Board, said today at a Columbia University conference in New York. "It's *not like a typical recession* in the U.S. or elsewhere."

Well, if you are still hanging in there, you may agree that these are grave times, indeed. Retirement plans of all types, individual savings, corporate earnings, and government budgets are being severely damaged. While some point to typical charts which illustrate how quickly the world has recovered from a number of past recessions, I view these bits of hopeful evidence with caution.

As Volcker mentioned above, this time is different. On top on the usual recessionary cycle which is economically normal and generally controllable through monetary policy adjustments, much more looms in the background today. Massive declines in asset values, a freeze in the global credit markets, record low interest rates which limit government action (can't take rates below 0%, or can you?), lack of liquidity and enormous deleveraging (the action of reducing borrowings) are typical of depressionary periods. Keep in mind that depressions are not really just bad recessions. Beware of signs as they continue to develop. But know this, these are already times which you will tell your children and grandchildren about, much as our ancestors may have shared stories from many years ago.

2008 ANNUAL FINANCIAL REPORT AVAILABLE

The North Dakota Retirement and Investment Office Comprehensive Annual Financial Report (CAFR) may be viewed from our website, www.nd.gov/rio or a copy may be requested by contacting the administrative office. This report is a complete review of the financial, investment, and actuarial conditions of the State Investment Board and the Teachers' Fund for Retirement.