

# YOUR VESTED INTEREST

North Dakota State Investment Board

October 2009

## FROM THE DIRECTOR'S CHAIR

### Financial Armageddon? Well almost.

The national and global economic and financial system climate experienced during fiscal year 2009 can be characterized as nothing short of disastrous. As the year began, the credit crisis, which had begun with a rapidly deteriorating housing market in the prior year, had taken a firm hold on global markets and financial institutions. Unlike previous cycles of market volatility, there was virtually only one safe haven for investors: US



*Steve Cochrane, CFA  
Executive Director/CIO*

Treasury securities. Across all other asset classes and regions of the world, markets had begun collapsing and continued to do so until early 2009, when somewhat of a rebound began to occur in selected portions of our portfolio.

As history begins to reveal itself, we are learning how truly close our global financial and credit system came to the edge of "financial Armageddon." It is now being demonstrated that at certain points during the fall of 2008, the financial crisis had become so severe that we were literally within hours of a total freeze in credit, including access to individual's holdings in depository institutions. If you can, imagine a world in which you may hold thousands of dollars in your savings account and the ATM machine refuses to accept your card access. Checks written on accounts with solid positive balances would not have been honored. And

at the same time that global access to capital was locked, creditors would be demanding repayment of outstanding balances, leaving the individual or institution completely financially devastated. While this may read like something from Charles Dickens' wild and vivid imagination, it is not a stretch of reality. Only through massive coordinated global intervention by central banks and regulatory agencies were we able to divert such economic annihilation.

These conditions were, of course, reflected in the market prices of nearly all asset types. Many, such as commercial real estate, continue to find new low levels in value as this is being written.

In the United States, Gross Domestic Product (GDP), the measure of our collective output of goods and services, plunged for the year. All four quarters showed negative economic growth and capped out in the first calendar quarter of 2009 at a horrific -6.4%!

The United States stock market, not knowing what to anticipate, fluctuated within a fairly controlled bound from the beginning of July when "bear market status" of a cumulative return of -20% had been reached. This relative calm began to explode in September, 2008. In the first week of the month, the U.S. government took control of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), agencies which had widely supported the mortgage market. A week later, after a weekend of no sleep and a diet of Subway sandwiches,

#### State Investment Board

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#### RIO Administrative Office

Steve Cochrane, *Executive Director/CIO*  
Fay Kopp, *Deputy Executive Director/  
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Shelly Schumacher, *Editor*

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*Articles are for general information only and are not intended to provide specific advice or recommendation. Other forms of this newsletter are available upon request.*

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# Too Close to Home

Most of us in North Dakota are among the vast minority of Americans who have not universally felt the impact of the severe global recession either directly or peripherally. It would be nice if it were true for all of our citizens, but we now have hundreds of families in this state who have been directly and negatively impacted; some may be your friends, relatives, or neighbors.

While we have certainly been aware of economic stress and various cutbacks around the state, store closings for example, the virtual closure of the Bismarck Bobcat facility really hits home in the capital city.

The other morning, I listened to the press conference given by company president Rich Goldsbury. He cited pressures from the global recession as he explained the reasons for the painful decision to phase out 475 positions at the Bismarck plant. Bobcat indicated that about 390 of those positions will be switched to the Gwinner plant by Dec. 31, for a net loss of 85 jobs. Mr. Goldsbury said many of those jobs will most likely be filled by former employees from the Gwinner plant.

The fallout in a relatively small city is truly felt. About 300 students in Bismarck have parents who work at the Bobcat plant, affecting about 200 families, school district officials said. The knock-on effects to the local community are easy to imagine. The immediate effect on families who rely on a Bobcat paycheck could be harsh; many have been employed there for years and could have a tough time finding similar work.

“That payroll’s got to be in the millions,” said Dave Kemnitz, the Bismarck-based state president of the AFL-CIO. “It’s horrendous for the community.”



In keeping with the theme of the Director’s Chair article, it is important to point out that this is not the result of poor management at Bobcat, or the effects of manufacturing anything other than a superb product. The impetus for this condition is global in nature, and many observations were made which are simply explanations of reality, not excuses. Included in this article are a few, as reported by the *Bismarck Tribune* and *Fargo Forum*:

- Company’s sales are off 70 % from the peak in 2005.
- Goldsbury called the decision “painful, yet necessary,” especially as the down economy chills the construction industry that purchases the company’s signature skid steer loader. “We live in difficult and unprecedented times,” Goldsbury added. “Our customers are hurting as the construction industry in North America is at a standstill.”
- Again citing global economic and financial realities, Goldsbury said the company is not expecting a rebound in the “foreseeable future.”
- Kelvin Hullet, the president of the Bismarck-Mandan Chamber of Commerce, said the plant’s closure will impact the entire community, especially the manufacturer’s

suppliers in Bismarck.

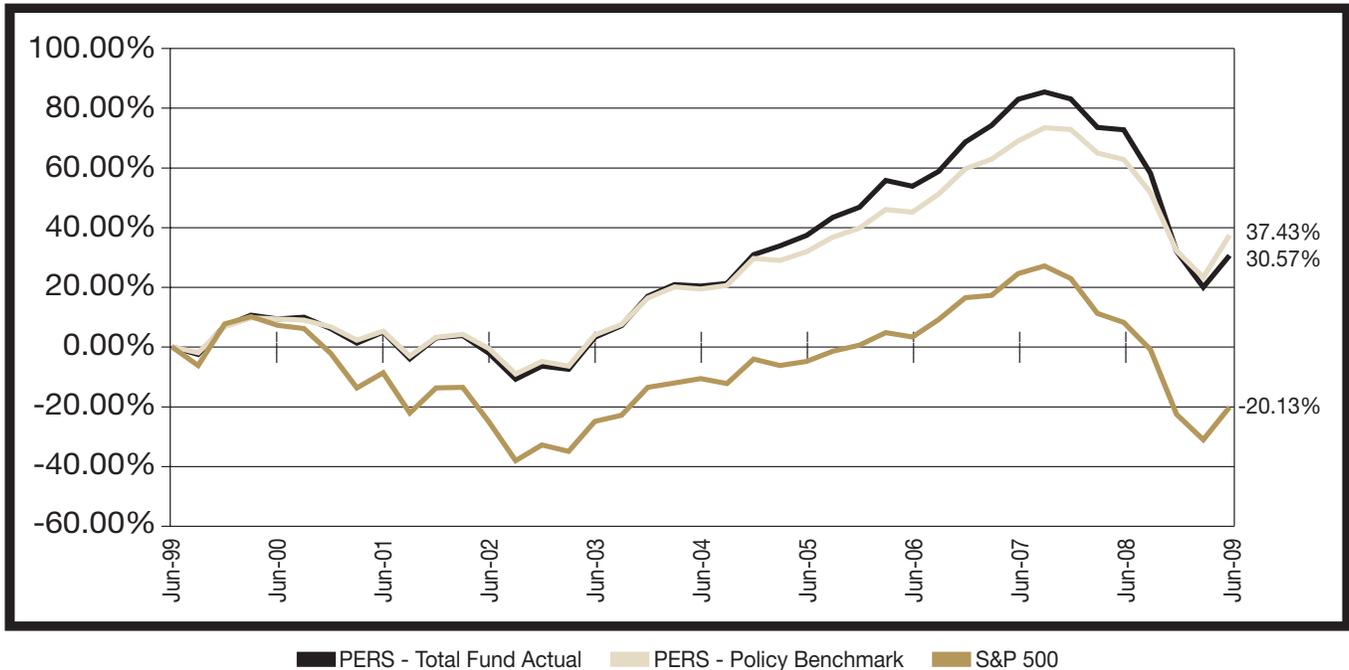
- “Certainly, the golden bubble that we’ve been operating under has been burst,” Bismarck-Mandan Development Association President Russ Staiger told The Associated Press. “We’ve been very sheltered, if you will, because we’ve had a lot of diversified growth in our community. I think it brings us to the realities that the rest of the country has been experiencing.”
- While Bismarck-Mandan held up well during the ongoing recession when compared to the rest of the nation, the earlier departure of Home Depot, and now Bobcat, are reminders of the connection between the local and national economies.

This story could go on with many more points, but I think the reader gets the picture. Like Bobcat, the portfolios of the State Investment Board’s clients have been severely impacted. It would be nice if we all had that crystal ball to allow us to avoid such circumstances. However, we live in a world that has always been cyclical, experienced times of boom and bust, and ultimately, we count on long term economic growth to provide the platform for business and investment success.

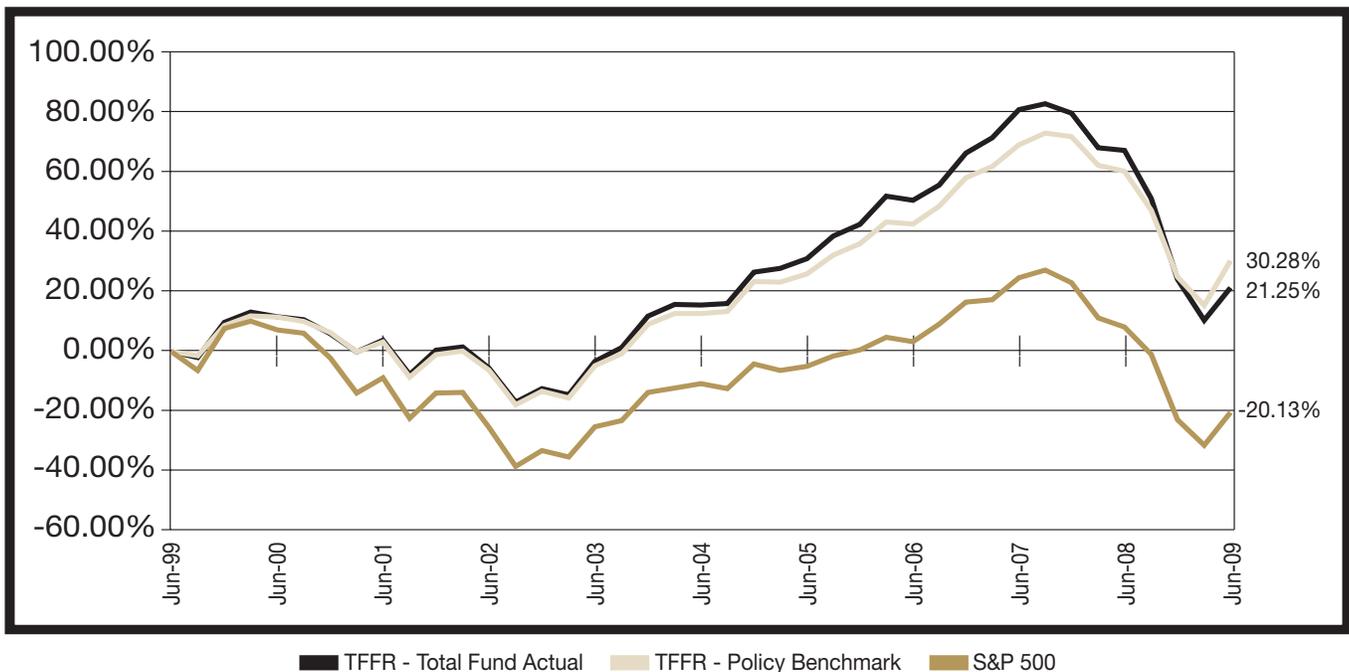
## Comments from Investment Officer:

The cumulative line charts of fund performance vs. benchmarks shown below and the associated bar chart on page 4, illustrate the devastating effect of this "Great Recession" on our portfolios. My one comment relative to benchmark comparisons is that such measurements have become very misleading over the past two years. Why? Well, benchmarks have not been forced to liquidate their best and most easily sold securities to meet capital requirements, deleveraging and other distortions which only occur in such an extreme environment. They are simply unmanaged collections of stocks, bonds, etc., which pay no fees and do not have to deal with the realities faced by institutions relative to liquidity for the last two years. So, as a person who has taken more than my share of statistics classes, my note of caution is to be aware that never in my 28 years in the institutional investment management business have I seen indices be less reflective of the true underlying realities of the markets. I could write an entire newsletter on this subject, so I will stop here, you lucky reader!

### Ten Year Cumulative Return vs. Benchmarks - PERS



### Ten Year Cumulative Return vs. Benchmarks - TFFR

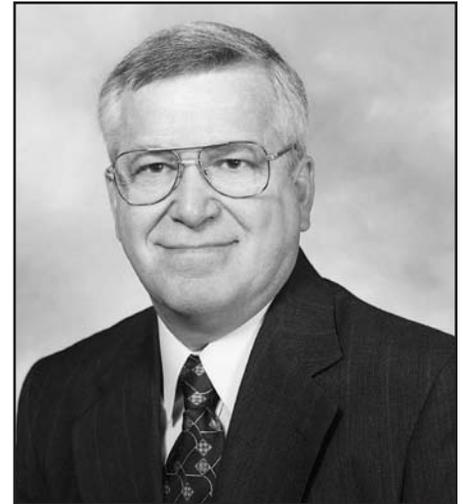


# SIB AUDIT COMMITTEE

The Audit Committee is the only standing committee of the SIB. This committee is authorized to develop and direct the internal audit program for the Retirement and Investment Office (RIO), as well as, oversee the annual external audit function. RIO employs a Supervisor of Internal Audit and one internal auditor.

The Audit Committee meets regularly to conduct essential business and contributes to the overall sense of fiscal security that RIO strives to maintain in its role as administrator of the State Investment Board and Teachers' Fund for Retirement programs.

The SIB Audit Committee consists of five members – three from the SIB and two independent participants. Current members include Mike Gessner, representing the Teachers' Fund for Retirement; Mike Sandal, representing the Public Employees Retirement System; and Cindy Ternes, designee of the Executive Director of Workforce Safety & Insurance, representing elected and appointed officials. Lonny Mertz, CPA, CIA, CFE employed by the ND Department of Health and Rebecca Dorwart, CPA, CIA with MDU Resources Group, Inc. serve as independent participants on the Committee.

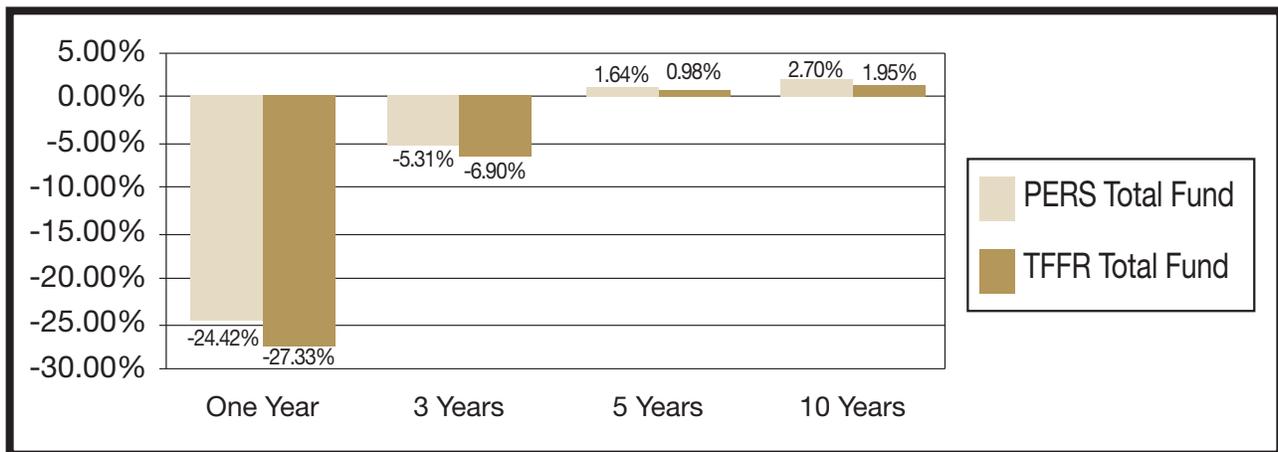


## IN APPRECIATION

Special thanks to Ron Leingang for his dedicated service on the State Investment Board and SIB Audit Committee. Good luck, Ron.

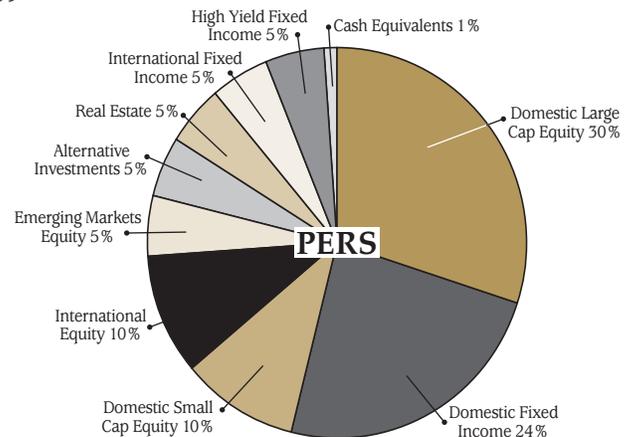
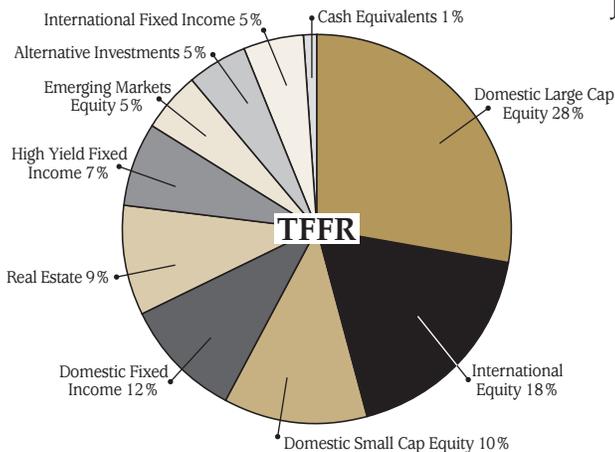
## Net Investment Performance

*Periods ended June 30, 2009*



## Target Asset Allocation

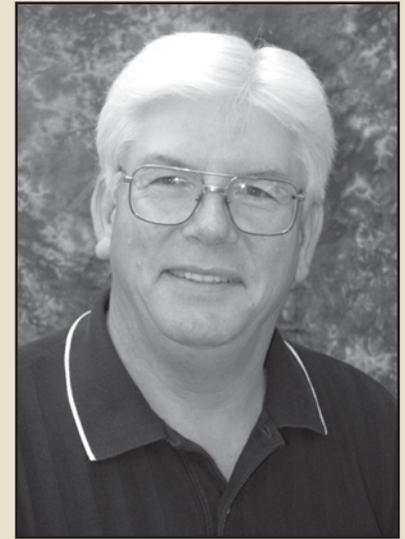
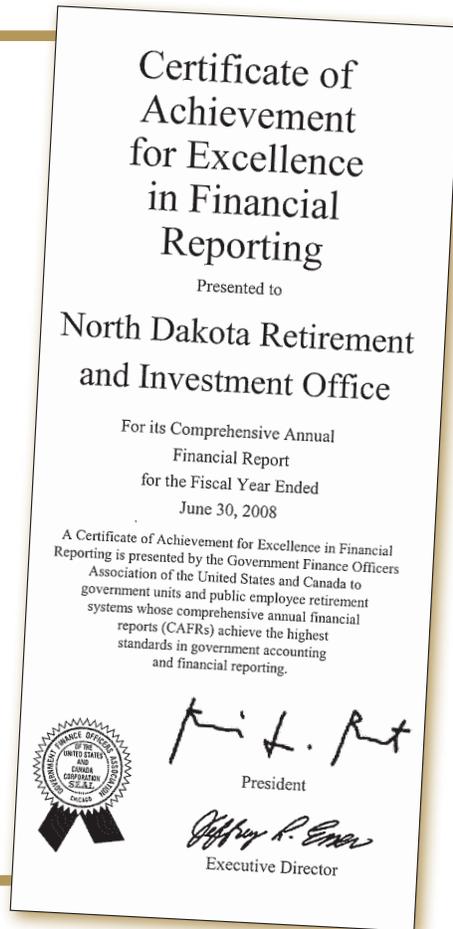
June 30, 2009



## ACHIEVEMENT AWARD RECEIVED

The ND Retirement and Investment Office (RIO) is pleased to announce that its Comprehensive Annual Financial Report (CAFR) for June 30, 2008 has qualified for a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA).

The Certificate of Achievement is the highest form of recognition in public employee retirement system accounting and financial reporting, and its attainment represents a significant accomplishment. This report must satisfy both generally accepted accounting principles and applicable legal requirements.



## NEW SIB MEMBER

The SIB would like to welcome back Howard Sage to the board. Mr. Sage represents PERS on the SIB. He was recently elected to the PERS Board to represent retired state employees.

## FROM THE DIRECTOR'S CHAIR

*From page 1*

federal regulators found no solution suitable to save an icon of the global financial world, Lehman Brothers. Merrill Lynch disappeared the same weekend, bought by Bank of America. When the markets opened on Monday, September 15, the Dow plunged 500 points. Within days, if not hours, the realization of how utterly disastrous this situation was began to set in. A sense of panic ensued and the scrambling began at every level of government and corporate America. Similar scenarios were playing out in other nations around the globe. In short order, three-month U.S. Treasury bills fell to near 0%, reflecting the most massive flight to safety in modern history. Once "safe" money market funds were in turmoil as investors rushed to liquidate. Federal regulators seized Washington Mutual at the same time the crisis was hitting European banks. The

month came to a close as the House of Representatives failed to understand the depth of the situation, voting down a rescue package, and the Dow fell 777 points.

Waking up to its own failings, Congress began to take positive action in early October with the passage of the Emergency Economic Stabilization Act of 2008 (TARP). However, details and implementation were foggy and bungled, and the markets continued to fall. Economic indicators of perceived risk hit historic highs while global central banks cut rates further. The Treasury worked to save a number of large banks and financial institutions in the U.S., now deemed as "too big to fail."

In the following months, some clarity began to emerge, but the markets

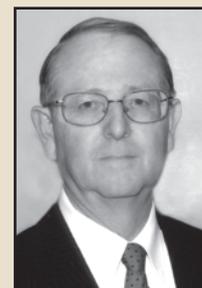
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## SIB OFFICERS ELECTED

The State Investment Board (SIB) recently held its annual election of officers. The SIB chose the following members to hold leadership positions for the 2009-2010 fiscal year:



Lt. Governor  
Jack Dalrymple  
*Chairman*



Clarence Corneil  
*Vice Chair & Parliamentarian*



**NORTH DAKOTA  
RETIREMENT AND  
INVESTMENT OFFICE**  
*Teachers' Fund for Retirement  
State Investment Board*

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## FROM THE DIRECTOR'S CHAIR

*From page 5*

remained skeptical and by the time the stock market reached its March 9, 2009 low, the S&P 500 had fallen close to 57% from its high point in September 2007.

During this time period, a number of investment scandals emerged, further putting fright into investors' souls. Credit had become so tight that many access points for short term borrowing, such as the commercial paper market which supports corporate activities, had come to a standstill.

As we moved towards the end of the fiscal year, conditions began to show signs of improvement and the markets took some comfort in that by regaining some of the lost ground. Meanwhile, the average consumer was receiving letters from their credit card companies, radically changing the terms of borrowing agreements, not in the consumers' favor. With the huge decline in GDP came massive layoffs and the fiscal year ended with a domestic unemployment rate of 9.5%. As this is being written in late September 2009, this rate has risen to 9.7% and the consensus view is for the rate to meet or exceed 10% by calendar year end.

This, in brief, describes the climate within which our funds were invested in accordance with their diversification policies. Within the SIB's investment program, the investment trust funds are invested within their policy guidelines, and seek to add investment return to their expected benchmark return objectives over multi-year periods. Our funds fell far short of actuarially projected goals this past year, and the coming years will most likely be challenging from an investment standpoint. Recessions brought on by banking and financial disasters are characterized historically to be followed by extended multi-year periods of slow global growth. The SIB will garner all the resources it can muster to face the many challenging years ahead.