YOUR VESTED INTEREST

North Dakota State Investment Board — December 2010

SIB Hires Executive Director/CIO

After a nation-wide search utilizing a third-party recruitment firm (EFL Associates) and subsequent rounds of interviews and a formal presentation, the State Investment Board (SIB) has hired John Geissinger as Executive Director and Chief Investment Officer (CIO) for the Retirement and Investment Office (RIO). With over 25 years of investment and risk management experience with major financial services firms, John is well qualified to serve the state, the SIB, and its constituents.

John is a native of Dover, DE, and received his Bachelor of Science degree in mathematics and economics from Wake Forest University, and his MBA in statistics from New York University. He also holds the designation of Chartered Financial Analyst (CFA). John has broad expertise in fixed income and equity markets, due diligence, portfolio construction, asset allocation, manager selection, and client relations.

John will make the move to North Dakota with his wife Anne. They have three grown children. Please join the SIB and RIO staff in giving them a warm North Dakota welcome. John will begin employment on December 6, 2010.

John Geissinger
Executive Director/CIO

Results of Independent Audits

RIO had two independent external audits conducted this summer – a financial audit and a performance audit.

The State Auditor's Office contracted with Eide Bailly LLP to perform the annual financial audit of RIO. Fiscal year 2010 is the second year of the three year contract. The annual financial audit is an independent external audit which provides an opinion on the financial statements for the year ending June 30, 2010 and also reviews internal controls over financial reporting. RIO received an unqualified opinion on this audit.

In addition, the SIB, through its Audit Committee, also had a performance audit conducted by an independent external auditor. With input from the State Auditor's Office and the SIB Audit Committee, the State Procurement Office issued an RFP in May. The objective of the performance audit was to determine whether the former Executive Director/Chief Investment Officer (ED/CIO) complied with the policies of the SIB, state law and common industry practice, and whether there was any irregular financial activity or discrepancies related to that position. The performance audit also included a review of the process of selecting, retaining, and compensating money managers, reasonableness of negotiated fees, and verification of investments into designated asset classes.

The SIB selected Clifton Gunderson LLP to conduct the performance audit. Clifton Gunderson is one of the nation's largest certified public accounting and consulting firms and provides a wide range of assurance, tax, and consulting services. Their methodology included reviews of applicable laws, regulations, and documentation provided by RIO; analysis of data provided by RIO; substantive tests using samples of data; and interviews and observations of RIO personnel, external investment managers, and other consultants.

Based on the evidence in support of the audit objectives, Clifton Gunderson's final report found no wrong-doing by the former ED/CIO but did include some findings and recommendations to enhance the overall operations and internal controls of RIO. The SIB and RIO staff have already begun addressing those findings and recommendations. The full performance audit report can be found on the RIO website at http://www.nd.gov/rio/News/RIOPerfAuditFinal8-26-10.pdf.

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From the Director's Chair

The Pendulum of Fear and Greed

People should be more concerned with the return of their principal than the return on their principal.

-- Will Rogers

Will Rogers coined this phrase during the 1930's. Certainly, it was a time of fear in the world of investing. I started my investing career in the early 80's, which was a time of fear of a different sort. We were faced with stubborn stagflation leading to increasing interest rates, the prime rate peaked at approximately 21%. When investing, a healthy dose of fear is a good thing. And so, the stage was set in 1979 when Paul Volcker became Chairman of the Federal Reserve for a golden era of investing I believe will not be repeated for a long time. Equity or fixed income investments achieved a 15% return during the 80's. Mutual fund companies experienced meteoric growth as individual investors began to participate directly in this "modern miracle." We had bumps in the road-the stock market crash of 1987, the real estate collapse and banking contraction in the early 90's-but a strange thing happened along the way. The Federal Reserve began to employ a new tactic to pursue their dual goal of stable inflation and economic growth. Whenever we experienced a shock to the financial system, the Fed intervened to supply liquidity to the markets and the shock was cured. Fear was quickly being replaced by Greed, and why not, the Fed was acting to reduce any risk to investing!

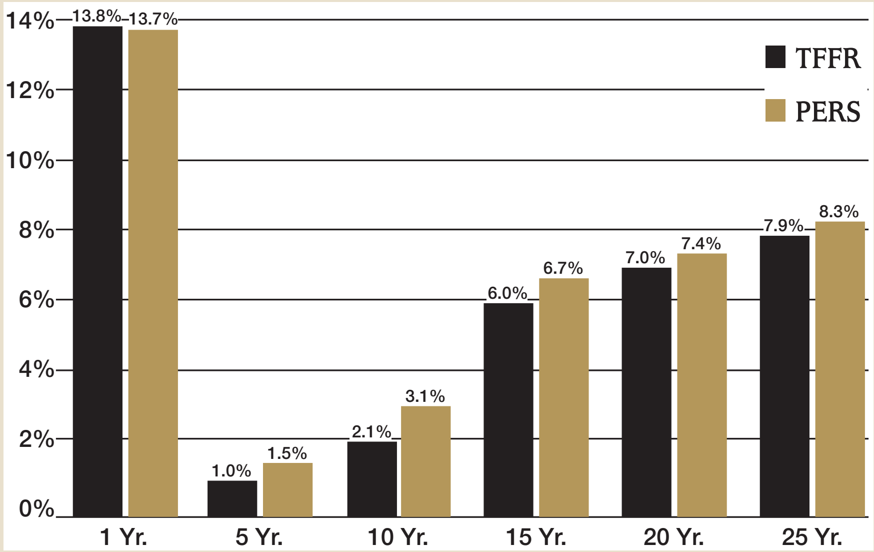
As Fear was replaced by Greed, another more insidious trend was developing. With the Fed acting as the "lender of last resort," other financial service firms were entering the unofficial banking business. And let's not forget the repeal of the Glass-Steagall Act in 1999, which allowed banks to enter the apparent lucrative business of security underwriting. (I will not digress at this point. That topic is worthy of a much longer discussion.) Securities firms, private equity firms, hedge funds and yes, pension funds were providing liquidity to lending activities which previously were the domain of regulated banking institutions. This shadow banking system was in its infancy during the 90's and did not get much scrutiny by the regulators. After all, why worry about this trend? Isn't it a good thing to have virtual access to liquidity?

Greed was also seeping into the country's government sponsored entities, specifically the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Company (FHLMC). There is no argument the original charter of these two organizations was appropriate at the time of their creation. However, by the 90's it is my opinion these organizations transformed from an entity created to stabilize the US mortgage market, to one of pure profit motive. Aided by their credit line to the US Treasury, and below market borrowing costs, both of these companies pursued strategies to generate in excess of 20% returns to their equity owners. Achieving their return on equity goal was predicated on growth; they had to increase the size of their investment portfolio by becoming an ever-larger player in the mortgage market. And they were succeeding. FNMA was a darling in most equity portfolios. I was derided by my colleagues as just a "fixed income guy" when I started to recommend the sale of FNMA shares in 1998 because they were nothing more than a government sponsored mortgage hedge fund!

At the same time, the US Government was pursuing policies to improve fair lending practices. In yet another

Net Investment Performance

Periods ending June 30, 2010



Performance Observations

1. Fiscal year 2010 was a very good year for TFFR and PERS. Both funds achieved returns in excess of 13.5%. However, this is only a one year return and cannot be expected to be achieved every year going forward.
2. TFFR and PERS have long term time horizons. Over the past 25 years, both funds have achieved approximately 8%. With careful and thoughtful investment management, it is expected the funds will achieve a minimum of 8% over the next 25 years.

chapter in the book "Unintended Consequences," the underwriting standards for residential mortgages slowly eroded. I will not delve into all of the details here, but I encourage you to read the article published in 2008 entitled, "The Anatomy of a Train Wreck" by Stan Liebowitz.

As we approached the new millennium, Fear had faded from the memories of most investors. I constantly heard the refrain of the "new world order," unending productivity gains, and investors making money in companies that had no revenue, much less earnings. Needless to say, my devotion to companies with real cash earnings, and investment strategies striving for a lowly 4.5% real return was met with disdain at weekend social gatherings. After a bit of reality set in during the NASDAQ crash in 2000, I thought Greed would be balanced by Fear, but Greed is a hard animal to tame. The trends I mentioned above: the Fed as lender of last resort, the shadow banking system, and FNMA and FHLMC with relaxed underwriting standards, set the stage for the financial collapse of 2008. Yes, a small dose of Fear entered the equity markets after the NASDAQ crash and there was concern of a deflationary spiral. No fear, the Fed and US Treasury came to the rescue. Where would the additional liquidity provided by the Fed and shadow banking system go if not into the equity markets? You know the answer - into one of the largest markets in the US - the residential housing market.

And as Paul Harvey would say, "And now you know the rest of the story."

As we sit here today, Fear is prevalent. The liquidity supplied by the shadow banking system has declined dramatically, and the Fed is struggling to replace this liquidity, much less add additional liquidity to the system. The availability of credit is scarce. I know of one real estate broker who commented on mortgage lending: "The mortgage underwriters are a deer in the headlights; they would rather do nothing than make a mistake through action."

However, I am beginning to see anecdotal signs the paralyzing Fear is being replaced by a more thoughtful and beneficial Fear. Planes are full, companies are beginning to hire, and consumers are purchasing if the price is right. However, the pendulum of Fear and Greed takes time to swing. Time will be required to absorb the excesses created in the residential housing market, to rebuild corporate and individual balance sheets, and restore the availability of credit. In the meantime, I am becoming more optimistic about the long-term prospects for financial assets given the more cautious Fear prevalent worldwide. But make no mistake, the market returns achieved in the 80's and 90's were predicated upon very unique circumstances.

The recent financial crisis has left the Pension Funds with some challenges ahead. I am confident through a renewed focus on downside risk management, prudent financial planning, and patience, the Funds will return to sound financial health. The RIO Staff and I will be working closely with the pension and investment boards to refine the asset allocations. Also, I will initiate an exhaustive review of the investment managers in conjunction with the State Investment Board and our consultant to ensure the Funds have the most efficient lineup of managers and strategies.

Stay tuned; I will have more to report after I have unpacked the boxes. I want to express my thanks to LeRoy Gilbertson for his advice and counsel during this transition, and everyone on the RIO staff for their dedication and patience as I settle in.

And remember, the tortoise won the race!

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 2010-2011 fiscal year:

Governor
Jack Dalrymple
Chairman

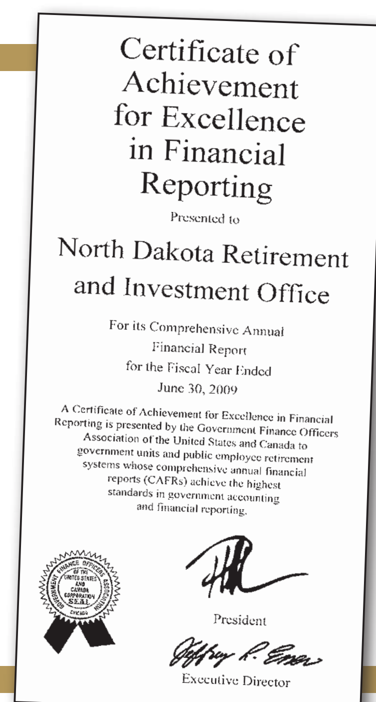
Mike Sandal
Vice Chairman

Clarence Corneil
Parliamentarian

Achievement Award

The ND Retirement and Investment Office (RIO) is pleased to announce that its Comprehensive Annual Financial Report (CAFR) for June 30, 2009 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.



Certificate of Achievement for Excellence in Financial Reporting

Presented to

North Dakota Retirement and Investment Office

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2009

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

President

Executive Director

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

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Results of Investment Fee Study

The SIB contracted with its investment consultant, Callan Associates, to conduct an analysis of the fees paid to its investment managers. The objectives of the study were to determine what the amount and rate of fees were for the one-year period ended March 31, 2010, and to compare the fees paid with those of other large institutional investors.

Callan analyzed each of the portfolios within the pension and insurance pools and assigned them to one of two categories. In "conventional strategies" managers bill for their services using what is known as asset-based fee models. In this type of structure, the investment manager is paid according to a fee schedule that is applied to the amount of assets invested by the client. The two factors that affect asset-based fees are the rates in the fee schedule and asset size. Investment performance, per se, is not a factor in the calculation of an asset-based fee.

The second category is "special strategies" that tend to use incentive fee arrangements, also known as performance fees. Incentive fees allow the manager to share in the profits if certain performance objectives are met. These types of fee arrangements generally include a base fee that provides a level of income to the manager until such time as incentive fees are earned and paid. The base fee is usually calculated on the entire capital commitment, which is the amount of investment capital the investor is contractually obligated to provide. In the early years of this type of investment, the basis point calculation of the fees on market value of the assets can be skewed as the market value is generally less than the commitment amount.

The incentive fee portion, also known as carried interest, is a percentage of realized earnings above an agreed upon hurdle rate. The more successful the strategy is in terms of performance, the higher the dollar amount of incentive fees paid.

The results of the fee analysis indicated that the fees paid to investment managers for "conventional strategies" tend to be near or below industry average for accounts of similar size. The fees paid to investment managers for "special strategies" increase the fees paid within the asset classes to which these strategies have been assigned. However, the fee structures of these special strategies were within the averages negotiated by similarly sized institutional investors.

Thank You Gil

Special thanks to LeRoy Gilbertson for all his guidance and many hours of service to the State Investment Board and RIO staff. His contributions as Interim Executive Director/CIO will not be forgotten.