YOUR VESTED INTEREST

North Dakota State Investment Board

December 2012

FROM THE DIRECTOR'S CHAIR

"Happy families are all alike; every unhappy family is unhappy in its own way."

~ Leo Tolstoy, Anna Karenina

Darren Schulz
Interim Chief Investment Officer

Anna Karenina and the Markets

In his book, "Guns, Germs, and Steel," Jared Diamond popularized the "Anna Karenina principle" to describe how animals have been domesticated throughout history. He observed that domestication has relied on the absence of negative traits rather than the presence of positive ones – like all happy families are alike. A team of researchers from the University of Leicester has expanded upon the principle to explain that people, plants, and economic systems function similarly until crisis approaches, at which point they start to react differently to a change in circumstances. Whether studying humans in adverse living conditions, trees under the influence of air pollution, rats under poisoning, banks in financial crises, or enterprises in recession, systems experience stress in their own way.

Like Tolstoy's unhappy families, the nature of the Great Recession—a "balance sheet" crisis—set it apart in many ways from other post-war U.S. recessions, and so the recovery period has been vastly different. Following a multi-decade period of mounting debt, a phase of deleveraging by households and financial institutions was ushered in after the Great Crash. In response to a collapse in credit growth, incomes, and asset values, households began the process of repairing balance sheets. As the engine of the economy, consumers cut back on spending while the housing market, the driver of prior recoveries, suffered from a glut of inventory. In response, firms cut back on investment amid falling private sector demand, resulting in a painfully slow recovery of job losses. And while private deleveraging has been nearly offset by unprecedented central bank and government intervention to contain and slow the deleveraging process, the road to recovery has been choppy. Amid the ongoing deleveraging in the private sector that follows a balance-sheet recession, the U.S. has experienced a subpar, anemic recovery and below-trend growth. Going forward, the path of the economic recovery remains highly dependent upon how long the process of deleveraging continues.

Government intervention in markets across the developed world has served to distort financial markets, leading to heightened uncertainty, volatility, and "financial repression" through low interest rates, which penalizes savers. Market prices have been largely driven by expectations of government and political actions: if, when, and how much. As such, top-down global macro forces and themes have dominated asset class performance, which have created the "risk-on" and "risk-off" environments that have swept through financial markets with regularity.

Continued on page 2

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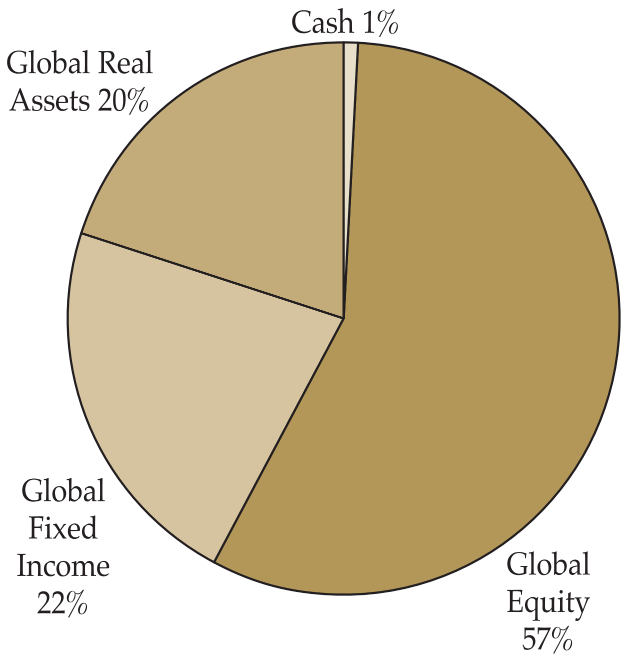
Target Asset Allocation

	TFFR	PERS
Global Equity	**57%**	**57%**
Domestic Equity	*31%*	*31%*
Large Cap Domestic Equity	24%	
Small Cap Domestic Equity	7%	
International Equity	*21%*	*21%*
Developed Int'l Equity	17%	16%
Emerging Markets Equity	4%	5%
Private Equity	*5%*	*5%*
Global Fixed Income (FI)	**22%**	**22%**
Domestic Fixed Income	*17%*	*17%*
Investment Grade FI	12%	12%
Below Investment Grade FI	5%	5%
Developed International FI	*5%*	*5%*
Global Real Assets	**20%**	**20%**
Global Real Estate	*10%*	*10%*
Other	*10%*	*10%*
Timber		5%
Infrastructure		5%
Cash Equivalents	**1%**	**1%**

PERS & TFFR Global Asset Allocation



Anna Karenina and the Markets

Continued from page 1

It has been a long and circuitous journey in the financial markets over the last five years. In general, the investment climate has been characterized by high volatility and low investment returns. Despite heightened volatility, U.S. equity markets were essentially unchanged and international equities declined four percent on an annualized basis over the five year period ending June 30, 2012. When adjusted for inflation, returns over this period were negative. One is supposed to get rewarded for accepting risk, so to withstand a negative real return is troublesome.

For a global economy and financial system so accustomed to an abundance of credit in recent decades, the adjustment to an unhappy family environment in the form of a debt-repaying world continues to have uncertain consequences. As developed market public-sector deleveraging takes hold and monetary policy becomes less effective in stimulating growth, deficit nations will need to undergo economic adjustments. As it stands, the outlook suggests more of the same for the foreseeable future.

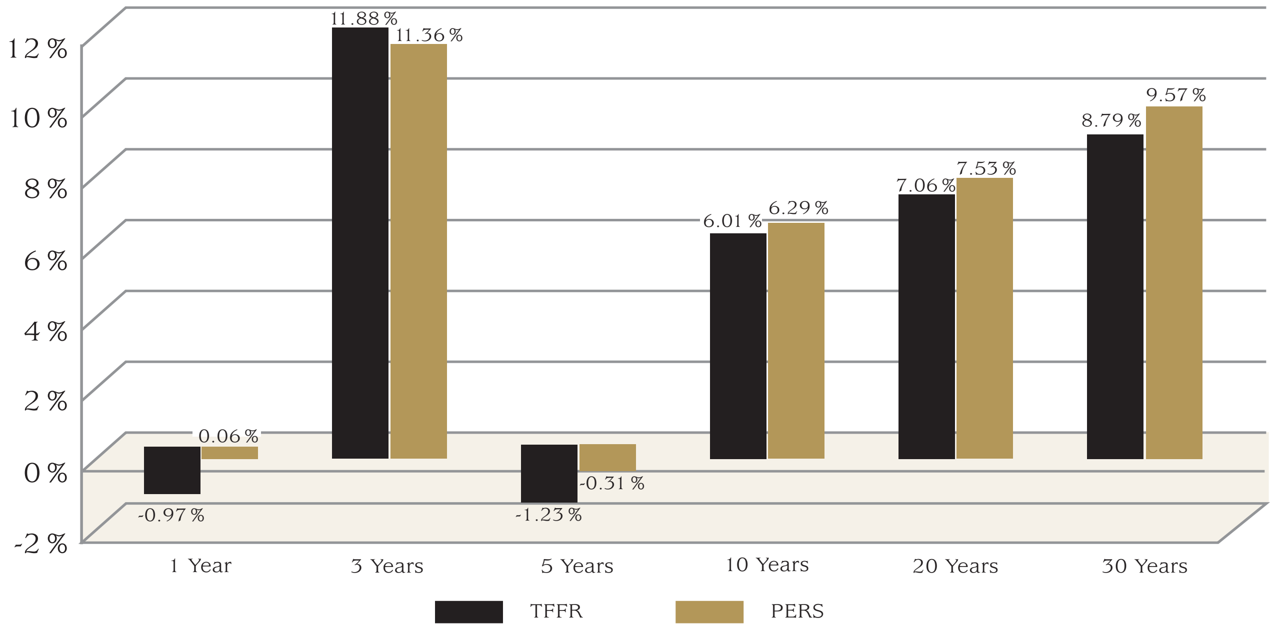
In such an environment, riding the rollercoaster of market indices is likely to be uncomfortable, so one must work diligently to shape a portfolio that can succeed in a challenging low return, high volatility environment. With this in mind, the State Investment Board has embarked on several recent initiatives to optimize the investment programs of its individual clients, and to protect and grow assets in the challenging investment climate:

- Adopt a broader asset allocation framework that emphasizes a more global perspective;
- Restructure our pension clients' fixed income allocation to reduce sensitivity to equity market movements and enhance risk-adjusted returns;
- Migrate to global equity mandates to more efficiently capture equity return drivers and risk factors;
- Increase commitments to real assets to provide further diversification and protection against unexpected inflation;
- Achieve more robust diversification through the identification of strategies with distinct return/ risk factor profiles as compared to the rest of the portfolio;
- Reduce investment management fees through negotiation, consolidation of manager mandates, and adjustments to the blend of active and passive management across all equity segments.

While some of these initiatives are on-going, we have already made some positive strides and we envision that they will be even more additive in the years ahead.

Net Investment Performance

For Periods Ending June 30, 2012



Performance Observations

1. Following two fiscal years of double-digit returns, fiscal year 2012 was a difficult one for TFFR and PERS, as both plans failed to achieve their actuarially projected return target: TFFR and PERS recorded returns of -0.97 % and 0.06 %, respectively.

2. In absolute terms, both Funds generated positive returns in real estate; private equity; U.S. investment grade, U.S. high yield and international fixed income; and large cap domestic equity. In contrast, international, emerging, and small cap domestic equity turned in negative results. Each sub-class was adversely impacted by "risk-off" periods that bracketed the fiscal year.

3. In relative terms, when compared to their respective benchmarks, both Funds generated outperformance for the year in emerging and small cap domestic equity, international fixed income, and real estate. Both Funds underperformed the respective benchmarks in large cap domestic and international equity, and U.S. investment grade and high yield fixed income.

Search for Executive Director/CIO Underway

John Geissinger, Executive Director and Chief Investment Officer of the North Dakota Retirement and Investment Office (RIO) announced his resignation earlier this year. Effective June 1, 2012, the State Investment Board (SIB) appointed Fay Kopp as Interim Executive Director and Darren Schulz as Interim Chief Investment Officer (CIO) until a permanent replacement is hired.

The SIB has established a Committee to lead the search for a new Executive Director/CIO . The Committee includes representation from the various SIB client groups and includes Lt. Governor Drew Wrigley, Chair; State Treasurer Kelly Schmidt; State Land Commissioner Lance Gaebe; TFFR trustee Bob Toso; and PERS trustee Mike Sandal.

The SIB also has taken the opportunity to review the organizational structure of RIO and has determined the existing business model should be continued.

Please be assured the funds entrusted to the SIB are well positioned and are in good hands with a very qualified and experienced staff, board, investment managers, and consultants working together to prudently invest trust fund assets.

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

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SIB Officers Elected

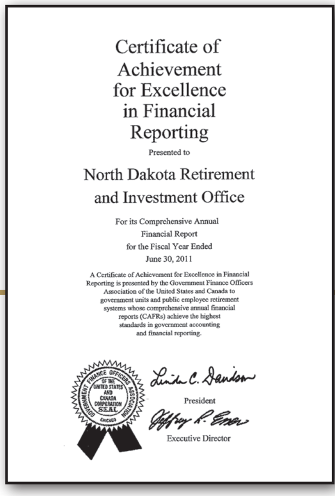
The State Investment Board (SIB) chose the following members to hold leadership positions for the 2012-2013 fiscal year:

Lt. Governor Drew Wrigley ~ Chairman

Clarence Corneil - Parliamentarian

Mike Sandal ~ Vice Chairman

Achievement Award Received


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, 2011

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

The ND Retirement and Investment Office (RIO) is pleased to announce that for the 14th consecutive year its Comprehensive Annual Financial Report (CAFR) was recognized for achieving the highest standards in state and local government accounting and financial reporting. The Government Finance Officers Association (GFOA) awarded its Certificate of Achievement for Excellence in Financial Reporting to NDRIO for its 2011 CAFR.