

# YOUR VESTED INTEREST

North Dakota State Investment Board

October 2015

## FROM THE DIRECTOR'S CHAIR

David Hunter  
Executive Director/CIO



The Retirement and Investment Office is pleased to report that PERS and TFFR have exceeded their historical long-term return assumption of 8% during the last 3, 5, and 30 year periods ended June 30, 2015. During the past year, both retirement plans generated a net investment return of over 3.5% which exceeded their respective investment policy benchmarks by 1.3%.

## Is the glass half full or half empty?

I am generally a positive person and always like to emphasize the big picture over the long term. Given the heightened volatility in the capital markets in recent months (including Greece potentially leaving the European Union in June and weakening economic conditions in China), I want to emphasize that both retirement plans are beating their performance benchmarks over the past 1, 3, and 5 year periods, while meeting or exceeding their long-term expected return assumptions of 7.75% for TFFR and 8.00% for PERS. The following table shows that TFFR and PERS generated net investment returns of over 8% for the 3, 5, and 30 year periods ended June 30, 2015, despite negative returns in 2012 and fiscal 2015 returns of approximately 3.5%. I have to admit that I am always disappointed whenever we don't exceed our short-term (e.g. one-year) absolute return expectations. However, I understand that investment returns vary significantly from year to year and can accept these short-term disappointments when realizing we are achieving our long-term goals while outperforming most other U.S. public pension plans.

### State Investment Board (SIB)

Lt. Governor Drew Wrigley, *Chair*  
Mike Sandal, *PERS Trustee, Vice Chair*  
Lance Gaebe, *Land Commissioner*  
Mike Gessner, *TFFR Trustee*  
Adam Hamm, *State Insurance Commissioner*  
Rob Lech, *TFFR Trustee*  
Mel Olson, *TFFR Trustee*  
Kelly Schmidt, *State Treasurer*  
Yvonne Smith, *PERS Trustee*  
Cindy Ternes, CPA, *Designee WSI*  
Tom Trenbeath, *PERS Trustee*

### RIO Administrative Office

David Hunter, Executive Director/CIO  
Fay Kopp, Deputy Executive Director/  
Chief Retirement Officer  
Darren Schulz, Deputy CIO  
Shelly Schumacher, Editor

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## Investment Performance (net of fees)

	Fiscal Years ended June 30						Periods ended 6/30/15 (annualized)				
	2015	2014	2013	2012	2011	2010	3 Years	5 Years	10 Years	20 Years	30 Years
<b>TFFR</b>	3.52%	16.53%	13.57%	-1.12%	24.05%	13.87%	11.06%	10.94%	5.87%	7.23%	8.37%
<b>PERS</b>	3.53%	16.38%	13.44%	-0.12%	21.27%	13.67%	10.98%	10.61%	5.98%	7.65%	8.68%

Based on Callan's U.S. Public Pension Fund Database (for plans with at least \$1 billion in assets), TFFR and PERS fiscal 2015 returns were ranked in the 28th percentile (See chart on page 3). More importantly, I want to emphasize that we achieved returns in the 28th percentile while using less risk (as measured by standard deviation) than over 70% of other U.S. public pension plans. The ability to generate returns in the top 30% of Callan's public pension plan database while using less risk than 70% of our peers is encouraging particularly in light of the heightened level of investment volatility which has persisted in the capital markets post June 30, 2015.

## Asset Allocation



Asset allocation represents an investors' decision to choose between stocks, bonds, and real assets (such as real estate). Asset allocation has historically been responsible for over 90% of a portfolio's return over the long term. During the past five years, asset allocation was responsible for 91% or \$890 million of TFFR's net investment income while active management enhanced returns by 9% or \$85 million. PERS experienced similar results with asset allocation representing 94% or \$985 million of plan returns, while active management enhanced

results by \$60 million over the last five years. The TFFR and PERS plans have both benefited from successful active management during the last five years. Successful active management results when actual net returns outperform their respective investment benchmarks. As example, TFFR's net investment return in U.S. Large Cap Equity was 9.3% in fiscal year 2015 versus the 7.4% for the underlying Russell 1000 Index.

### PERS & TFFR Target Asset Allocations

#### Global Equity **57%**

- U.S.	31 %
- International*	21 %
- Private	5 %

#### Global Fixed Income **22%**

- U.S.	17 %
- International	5 %

#### Global Real Assets **20%**

- Global Real Estate	10 %
- Timber	5 %
- Infrastructure	5 %

#### Cash **1%**

*\* PERS & TFFR asset allocations have been aligned at the major asset class level. However PERS has a 1% higher allocation to emerging markets within international equity.*



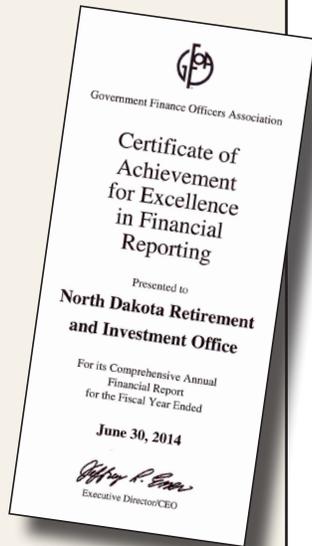
The Retirement and Investment Office regularly meets with our investment advisors to ensure we obtain competent and prudent investment services at a competitive price. During the past two years, investment management fees and expenses as a percentage of average assets under management declined by over 0.17% from 0.65% for the year ended June 30, 2013 to 0.47% for the fiscal year ended June 30, 2015. Based on average assets under management of over \$10 billion in the past fiscal year, this translates into \$17 million of reduced fees for the year ended June 30, 2015 (e.g. \$10 billion times 0.17% = \$17 million).

## U.S. Markets Versus International Markets

Improving U.S. labor markets and generally favorable economic policy were responsible for generating strong investment returns in the U.S, while economic uncertainty in the European Union (relating to the potential exit of Greece) and slowing growth prospects in the emerging markets (including China), created a major drag on investment earnings over the last year. For the fiscal year ended June 30, 2015, the PERS and TFFR pension plans generated net investment returns of over 3.5% which exceeded their investment policy benchmark of 2.2%. Strong returns in U.S. equities (up 8.5%) and U.S. fixed income (up 3.2%) were partially offset by disappointing results in international equities (down 2.7%) and international fixed income (down 10%). Impressive real asset returns including real estate (up 15%) were partially offset by disappointing results in our private equity portfolio (down 5%) and timber investments (up 4%).

# Achievement Award Received

The Certificate of Achievement for Excellence in Financial Reporting has been awarded to the North Dakota Retirement and Investment Office (RIO) by the Government Finance Officers Association of the United States and Canada (GFOA) for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2014. 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. This marks the 17th consecutive year that RIO has been awarded this honor.



An Award of Financial Reporting Achievement has been awarded to the individual designated by the government as primarily responsible for preparing the award-winning CAFR. This Award has been presented to Connie Flanagan, Fiscal and Investment Operations Manager of RIO.

The GFOA noted that RIO's CAFR has been 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 and motivate users to read the CAFR.

The GFOA is a nonprofit professional association serving approximately 17,500 government finance professionals with offices in Chicago and Washington, D.C.

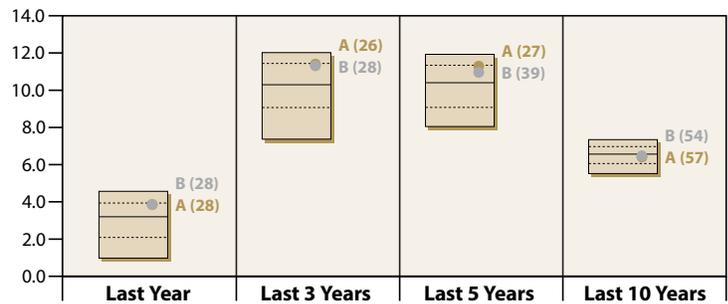
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# Peer Performance

TFFR (A) and PERS (B) "gross" investment returns have improved to the 28th percentile in the "Last Year" and to the 26th and 28th percentile in the "Last 3 Years" (first two columns in the floating bar chart) from the 57th and 54th percentile in the "Last 10 Years" (last column) based on the Callan Associates Public Fund Sponsor Database for the periods ended June 30, 2015. As noted previously, this improved peer performance was generated during a time in which both the TFFR and PERS funds exhibited lower standard deviation than most other U.S. public pension plans. Both retirement plans have made strategic decisions to lower their overall risk profile in the last decade.

## Gross Returns for Periods Ended June 30, 2015

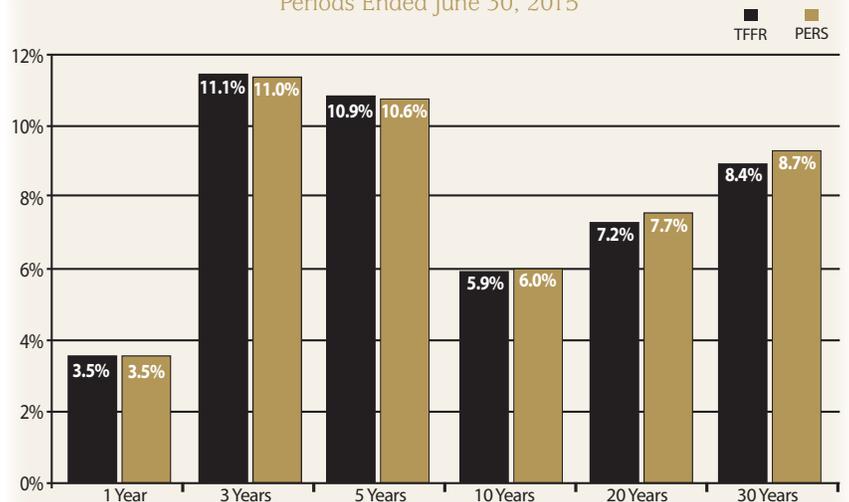
Callan Public Fund Sponsor Database



10th Percentile	4.6	12.0	11.9	7.3
25th Percentile	3.9	11.4	11.3	7.0
Median	3.2	10.3	10.4	6.6
75th Percentile	2.1	9.1	9.1	6.1
90th Percentile	1.0	7.4	8.0	5.5
Member Count	256	236	220	191
<b>Total Fund-TFFR ● A</b>	<b>3.9</b>	<b>11.4</b>	<b>11.3</b>	<b>6.4</b>
<b>Total Fund-PERS ● B</b>	<b>3.9</b>	<b>11.3</b>	<b>11.0</b>	<b>6.5</b>

## Net Investment Performance

Periods Ended June 30, 2015



Note: Over the last 30 years, the TFFR and PERS plans have been successful in generating net investment returns of over 8%.



**NORTH DAKOTA  
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*Teachers' Fund for Retirement  
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## SIB Audit Committee

The Audit Committee is the only standing committee of the State Investment Board (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. Rebecca Dorwart, CPA, CIA with MDU Resources Group, Inc. and Karol Riedman, CPA, CIA, CGMA employed by the ND Department of Health serve as independent participants on the Committee.

## 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 2015-16 fiscal year.



*Lt. Governor Drew Wrigley  
Chairman*



*Mike Sandal  
Vice Chairman*



*Rob Lech  
Parliamentarian*