

YOUR VESTED INTEREST

North Dakota State Investment Board

October 2016

FROM THE DIRECTOR'S CHAIR

David Hunter
Executive Director/CIO



TFFR and PERS Generate Net Return of 0.3% for Year Ended June 30, 2016

The Teachers' Fund for Retirement (TFFR) and Public Employee's Retirement System (PERS) are long-term investors. Despite disappointing returns in the global equity markets during the past two years, the TFFR and PERS pension plans have generated net investment returns which are near their respective long-term assumptions of 7.75% and 8.00%, respectively.

Asset allocation decisions are the primary driver of investment returns,

noting that TFFR and PERS have similar asset allocations to equities (58%), fixed income (23%), and real assets (18% for TFFR and 19% for PERS). During the past year, PERS and TFFR equity allocations generated disappointing results as global equities declined by 3.7%, while U.S. equity returns were mixed with large cap stocks increasing nearly 3% and small cap stocks declining nearly 7%. Slowing global growth rates following China's devaluation of its currency in August 2015, combined with escalating economic uncertainty after the U.K. Brexit vote in June, contributed to disappointing returns in the global equity markets. On a positive note, fixed income and real assets performed well, largely due to this economic uncertainty which caused interest rates to decline. Fixed income investments, which rise in value when

interest rates decline, increased by 6% last year, as measured by the Barclays Aggregate index (a widely used fixed income benchmark). Real assets were the best performing sector posting a near 8% return (with real estate increasing 11%). Although last year's results were below our long-term expectations, current fiscal year to date results (through September), appear to be stronger and are estimated to be in line with our long term return assumptions.

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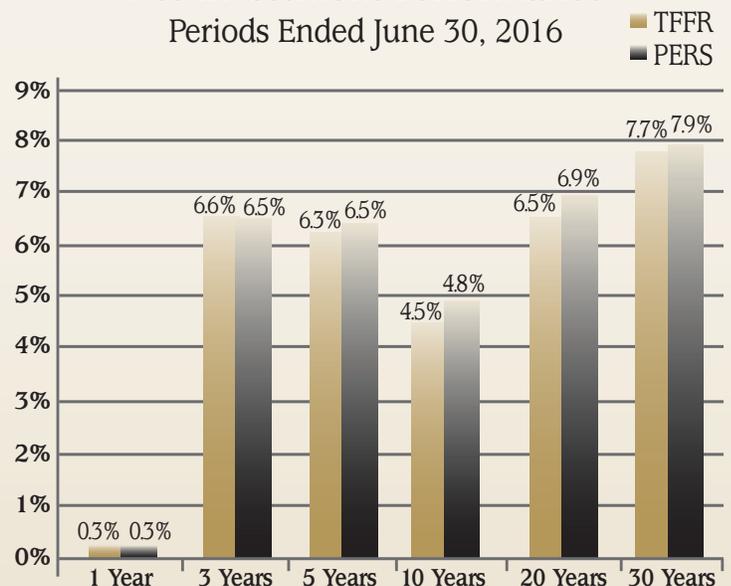
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Net Investment Performance

Periods Ended June 30, 2016



Peer Performance

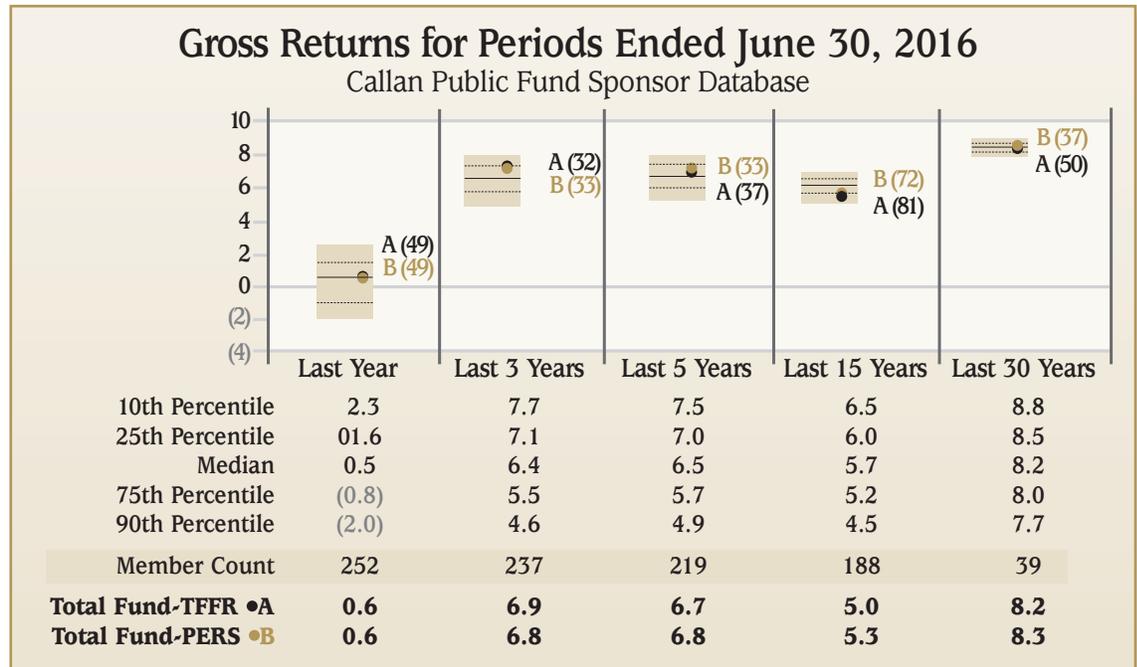
TFFR and PERS returns have outperformed most other U.S. public pension plans for the 3 and 5 year periods ended June 30, 2016. This peer group comparison is based on Callan’s U.S. Public Pension Database for plans which report gross investment returns.

The SIB and RIO have historically placed greater emphasis on 5-year performance metrics as shorter time periods may be overly impacted by one or two

quarters of abnormal returns which are not reflective of long-term return expectations. Please note that the “Member Count” of 39 for the “Last 30 Years” column makes it less meaningful than the other reporting periods in which the “Member Count” contained a greater number of plans for comparison purposes. The chart is based on unaudited valuations which are deemed to be materially accurate. RIO’s financial results are audited annually with a June 30 fiscal year end.

The floating bar chart highlights investment returns of over 200 peers noting that TFFR (A) was ranked in the 37th percentile, while PERS (B) was ranked in the 33rd percentile, for the “Last 5 Years.”

As a result, TFFR and PERS gross investment returns outperformed 63% and 67% of the other public pension plans, respectively, during this period.



Asset Allocation Targets

TFFR and PERS review their investment policy statements on a regular basis. Both TFFR and PERS recently completed this review process and the respective Boards approved and the SIB accepted the following investment policy statement modifications.

- TFFR’s investment return assumption was reduced from 8.0% to 7.75% effective July 1, 2015, while PERS maintained their investment return assumption at 8.0%. Both evaluations were based on recent Actuarial Experience Studies completed by Segal Consultants.
- Based on the results of an Asset Allocation Study completed by Callan Associates, TFFR’s asset allocation was revised to reflect a 1% increase to equity, 1% increase to fixed income and 2% decrease to real assets. PERS asset allocation was also revised to reflect a 1% increase to equity and 1% increase to fixed income. In order to support a slightly higher expected return, PERS approved a 1% decrease to real assets along with a 1% decrease to cash.

TFFR and PERS Asset Allocation Targets

	TFFR	PERS
Global Equity	58%	58%
Public	52%	51%
Private	6%	7%
Global Fixed Income	23%	23%
Investment Grade	19%	18%
Other	4%	5%
Global Real Assets	18%	19%
Real Estate	10%	11%
Infrastructure / Timber	8%	8%
Cash Equivalents	1%	0%
TOTAL	100%	100%

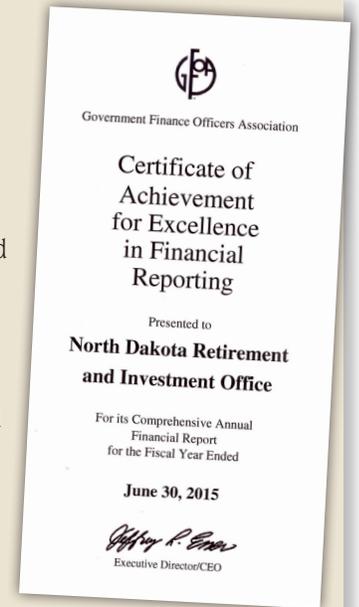
Achievement Award Received

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, 2015. 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 18th 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.



Active Management Adds Value

Successful active management results when the SIB selects a team of investment managers which outperform an underlying benchmark index.



For the three-year period ended June 30, 2016, active management improved TFFR and PERS net investment returns by 0.59%. Based on over \$4 billion of combined investments for TFFR and PERS, this translates into over \$70 million of incremental income for the two retirement plans in the last three fiscal years (e.g. \$4 billion times 0.59% x 3 years = \$70 million).

Focus on Fees

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 three years, investment management fees and expenses as a percentage of average assets under management declined by over 0.20%, from 0.65% for the fiscal year ended June 30, 2013 to less than 0.45% for the fiscal year ended June 30, 2016. Based on average assets under management of nearly \$10 billion, this translates into \$60 million of incremental income for our SIB clients during the last three fiscal years (e.g. \$10 billion times 0.20% = \$20 million per year times 3 years = \$60 million).

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 2016-17 fiscal year.



*Lt. Governor Drew Wrigley
Chairman*



*Mike Sandal
Vice Chairman*



*Rob Lech
Parliamentarian*



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

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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 Joshua Wiens, CPA, employed as CFO with McDonalds of Bismarck-Mandan and Shiloh Christian School serve as independent participants on the Committee. Ms. Dorwart serves as Chair of the Audit Committee. Mr. Wiens recently joined the Audit Committee replacing Karol Riedman.

In Appreciation

The members of the SIB Audit Committee, RIO staff, and the Board members of TFFR and SIB express their sincere gratitude to Karol Riedman for her contributions to the Audit Committee over the past two years.

*Thank
you*