

Your VESTED



INTEREST

North Dakota State Investment Board

September 2006

SIB FOCUS ON INVESTMENT EDUCATION

Imagine for a moment that you are seated on the eleven-member North Dakota State Investment Board (SIB). As you settle in for the next three hours or so, you quickly review the items on today's agenda. Hmmmm... today we are going to discuss transitioning one of our smaller investment management clients from an index-based single manager module to an architecture that introduces a healthy dose of quantitatively risk-controlled enhanced indexation across the asset class spectrum, improving return potential while keeping a lid on return volatility. That will make a nice warm up as the coffee awakens the brain cells. You anticipate the next gear shift to a proposed portable alpha strategy that will gain beta exposure to the large cap domestic equity world through the use of S&P 500 futures contracts and will use the collateral in a long-short market neutral quantitative process with an objective of adding excess return to that made available through the inherent index exposure. "Ah, the search

for alpha...that will be interesting," you think to yourself as you eye down to the final investment management issue, the opportunity to participate in a complementary pair of limited partnerships that invest in companies active in the acquisition of oil and gas producing properties in North America, including some potential to participate in North Dakota exploitation of the natural energy resources. It will become clear as the meeting unfolds that not only is this a natural resource discussion, but it also involves the strategic use of derivative securities to protect the ultimate sales prices the investor expects to receive over the life of the venture. "Well, just another day on the SIB," you figure. By the way, had this been you, then you would have been present at the August 2006 meeting of the Board.

Sound like fun? It should! Your SIB participates in a large sampling of diversified strategies that require in-depth study, due diligence, monitoring and an overlay of strategic structure to achieve the long term goals of its clients such as the Public Employees' Retirement System and the Teachers' Fund for Retirement. But how do these eleven individuals from diverse backgrounds come prepared to meetings that are so technically focused? In a word, education. In two words, continuous education. For more than a decade, every SIB meeting has featured at least one educational/informational segment which, over time, has the effect of creating a powerful basis for collective decision making. Month in and month out, SIB members learn about the finer points of institutional investment in an interactive and provocative setting. And it

has paid off, not only in terms of excellence in investment management, but in terms of recognition from the professional body of institutional investors in general. Time and again, the North Dakota SIB has been complimented, by those in the know, for exhibiting such an elevated level of investment knowledge and for its ability to engage in interactive discussion with technical experts from around the world regarding complex and sometimes cutting-edge investment strategies. In the long run, this experience contributes to the Board's ability to oversee a sophisticated and successful investment program.

Below are just a few of the issues handled by the SIB this past year. If you find your excitement level rising, then you know that the SIB may just be the best show in town!

- SIB studied the quantification of risk.
- SIB moved to retain a firm to manage an enhanced fixed income portfolio for the Insurance Trust.
- SIB determined that its interests would be best served by consolidating management of its timber investments under one manager and transferred control.
- SIB adjusted the mandate of a manager to allow a 130/30 long/short approach in managing their enhanced index assignment to further diversify and improve the risk/return profile of the Pension Trust Large Cap Domestic Equity allocation.
- SIB retained a firm to manage a portion of the assets in a Mezzanine Debt fund to further diversify and improve the risk/return profile of the Pension Trust High Yield allocation.
- SIB moved to further diversify holding in the Pension Trust Real Estate portfolio by committing assets to an Alternative Real Estate Fund.

State Investment Board

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Clarence Corneil Gary Preszler
Mike Gessner Howard Sage
Rosey Sand Mark Sanford
Ron Leingang Kelly Schmidt

RIO Administrative Office

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

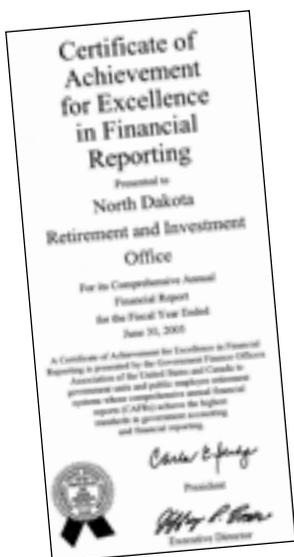
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Articles are for general information only and are not intended to provide specific advice or recommendation. Other forms of this newsletter are available upon request.



Steve Cochran, CFA
Executive Director/CIO



ACHIEVEMENT AWARD RECEIVED

The ND Retirement and Investment Office (RIO) is pleased to announce that its Comprehensive Annual Financial Report (CAFR) for June 30, 2005 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.

FROM THE DIRECTOR'S CHAIR

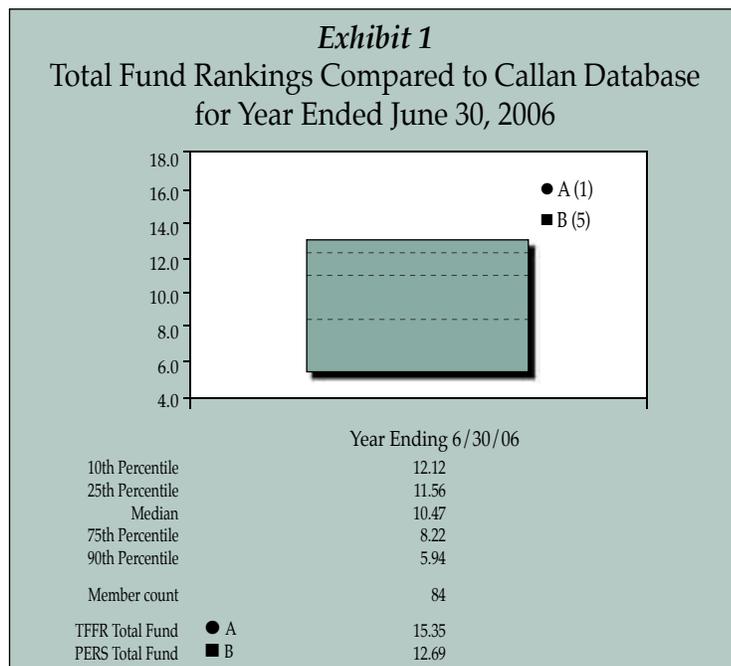
If you were to visit my office, you might notice something that has hung on the wall over my door since my first day on the job. Yep, a horseshoe, properly positioned to hold the good luck in its cup! It's there for decoration more than anything, but as far as helping with the success of our investment program, it hasn't hurt! The \$3.5 billion Pension Trust has continued to perform quite nicely throughout the fiscal year that ended in June. As the investment platform for the PERS and TFFR funds, it has enabled our defined benefit plans to diversify broadly and participate in generally robust returns across the investment spectrum.

As the following charts and tables indicate, the PERS and TFFR plans had very good years in the investment markets in both relative and absolute terms. In absolute terms, the gross return for PERS was 12.69%, while the TFFR enjoyed a gross increase of 15.35%. Net of fees and expenses, the PERS and TFFR funds returned 12.00% and 14.80%, respectively.

For relative comparison purposes, we calculate how the investment pools would have performed if they were simply a weighted average of the indexes or benchmarks that represent their asset class opportunity set. We call these the "policy target benchmarks" and they returned 10.04% for PERS and 13.13% for TFFR. You can tell by comparing these numbers that PERS and TFFR have different asset allocations. During this past

year, the TFFR's relative overweight to International Stocks and Real Estate and underweight to Domestic Fixed Income largely explain the return differential with PERS. While the multi-year return patterns vary between these two funds, the long-term returns exhibit relatively small levels of dispersion.

To compare ourselves with a universe of similar funds from around the country, we turn to the database maintained by the SIB's performance measurement consultant, Callan Associates. The universe we use represents almost 100 funds totaling over \$700 billion in pension assets and is a good representation of what similar public pension plans experienced last fiscal year in the investment markets. Exhibit 1 is a floating bar chart and it plots our PERS and TFFR plans against the entire measured universe on a gross return basis (gross is used because plans have different levels of fees and expenses). As you can see, the North Dakota PERS and TFFR performed very well, ranking in the top 1% and 5% of all funds in the annual study, respectively. For periods ended June 30, 2006, the Pension Trust itself ranked in the top 2% for the



year, top 3% for three years, top 8% for five years and top 19% for 10 years.

I also find Exhibit 2 comforting in that it shows our relative performance advantage did not just come from one or two areas of investment. In fact, as measured by our investment consultant, all asset types performed very well over the same period, contributing to an overall outstanding year. Note that in each case, performance was in the top quartile of the universe. Similarly, our broad asset classes performed well over the entire five-year period ended June 30, 2006, landing our funds in the top quartile of the

Exhibit 2

Broad Asset Class	Performed in the top:
Domestic Equity (US Stocks)	24%
Domestic Fixed Income (US Bonds)	1%
International Equity (Non-US Stocks)	18%
International Fixed Income (Non-US Bonds)	7%
Real Estate	16%
Cash Equivalents	13%

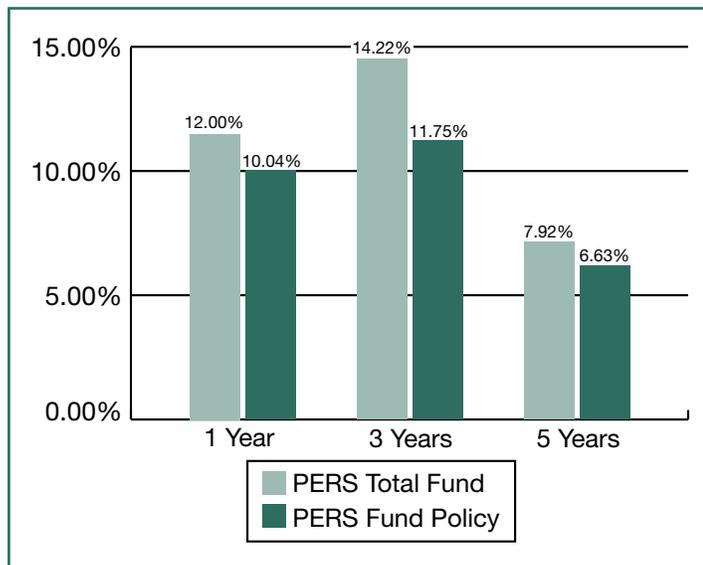
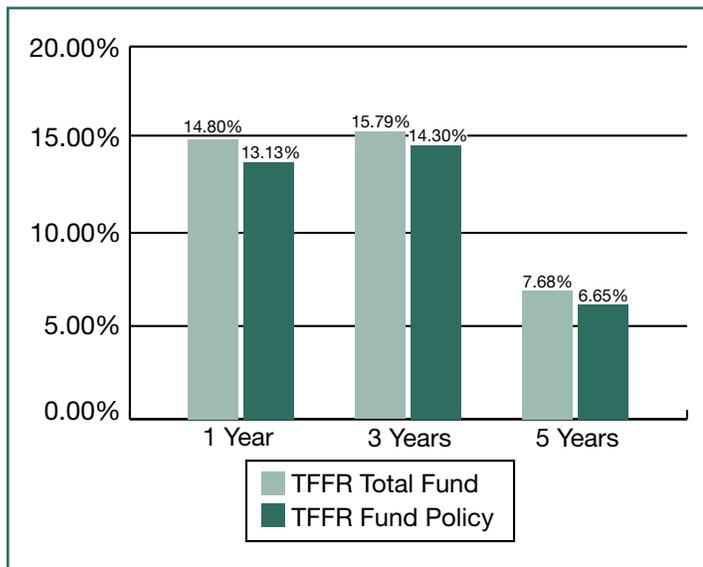
universe using this measurement for the multi-year period which includes much of the tumultuous investment market experience of the early 2000's.

As I have mentioned before, it's fun

to look back and enjoy the results of a successful investment time period. History tells us that this will not always be the case, so let's enjoy it while we can!

NET INVESTMENT PERFORMANCE

Periods Ended June 30, 2006

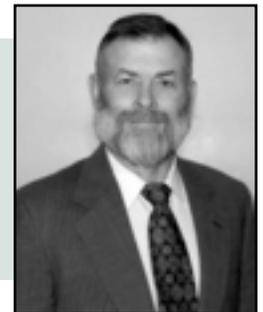


THANK YOU, BARB

Special thanks to Barb Evanson for her years of dedicated service on the State Investment Board. We congratulate you on your retirement from Bismarck Public Schools and wish you many happy and fulfilling retirement years.

NEW SIB MEMBER

The SIB would like to welcome Mike Gessner to the board. Mr. Gessner is a teacher in Minot and represents TFFR on the SIB.



ASSET ALLOCATION

June 30, 2006

	PERS	TFFR
Large Cap Domestic Equity	30.0%	28.0%
Small Cap Domestic Equity	10.0%	10.0%
International Equity	10.0%	18.0%
Emerging Markets Equity	5.0%	5.0%
Domestic Fixed Income	24.0%	12.0%
High Yield Fixed Income	5.0%	7.0%
International Fixed Income	5.0%	5.0%
Real Estate	5.0%	9.0%
Private Equity	5.0%	5.0%
Cash Equivalents	1.0%	1.0%

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 2006-2007 fiscal year:



Lt. Governor
Jack Dalrymple
Chairman



Howard Sage
Vice Chairman



Clarence Corneil
Parliamentarian

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 partici-

pants. Current members include Mike Gessner, representing the Teachers' Fund for Retirement; Ron Leingang, representing the Public Employees Retirement System; and Dave Sandy, designee of Sandy Blunt of Workforce Safety & Insurance, representing elected and appointed officials. Lonny Mertz, CPA, CIA, CFE of Job Service North Dakota and Rebecca Dorwart, CPA, CIA with MDU Resources Group, Inc. serve as independent participants on the Committee.



Mike Gessner, Lonny Mertz, Rebecca Dorwart, Dave Sandy, Ron Leingang

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