

**NORTH DAKOTA
BOARD OF UNIVERSITY AND SCHOOL LANDS**

INVESTMENT PERFORMANCE REPORT

For periods ended September 30, 2011



PERMANENT EDUCATIONAL TRUST ASSETS

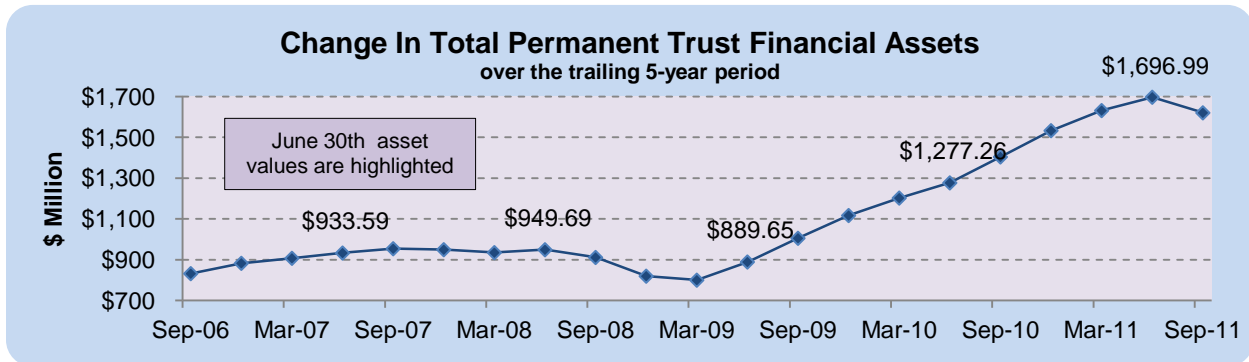
TOTAL TRUST ASSETS

The first section of this report shows combined data for the 13 permanent educational trust funds managed by the Board. Most assets of the trusts are invested in a pool. Each trust owns a share of the investments in the pool and each trust shares proportionately in the profits, losses and income generated by those investments.

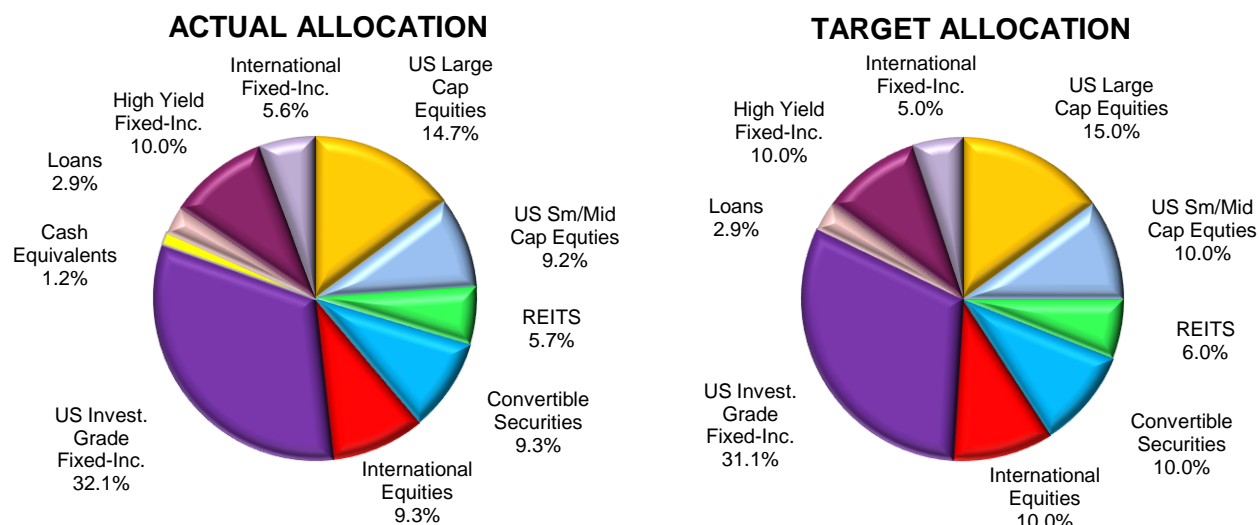
For the schedule below and for all other schedules, tables and charts that follow in this report, all loans, warrants, loan portfolios and certificate of deposits are valued at cost. All other investments in marketable securities, such as stocks, bonds, mutual funds and cash equivalents are valued at market value.

COMPARATIVE ASSET ALLOCATION SCHEDULE							
Date	Total Assets	Large Cap Equities	Sm/Mid Cap Equities	REITS	Convertible Securities	International Equities	Fixed Income
6/30/11 Rebalanced	\$1,696,986,000	\$254,548,000 15.0%	\$169,699,000 10.0%	\$101,819,000 6.0%	\$169,699,000 10.0%	\$169,699,000 10.0%	\$831,522,000 49.0%
9/30/11 Actual	\$1,620,587,000	\$238,740,000 14.7%	\$149,268,000 9.2%	\$92,194,000 5.7%	\$150,565,000 9.3%	\$150,411,000 9.3%	\$839,409,000 51.8%
9/30/11 Target	\$1,620,587,000	\$243,088,000 15.0%	\$162,059,000 10.0%	\$97,235,000 6.0%	\$162,059,000 10.0%	\$162,059,000 10.0%	\$794,087,000 49.0%

- ◆ Total permanent trust financial assets declined by \$76.40 million during the quarter ended September 30, 2011. This is the first quarterly decline in trust assets since the quarter ended March 31, 2009.
- ◆ The combined investment portfolio posted a total return loss of -7.86% during the quarter ended September 30, 2011; resulting in a reduction in the value of trust assets of almost \$136 million. This loss more than offset the \$29.8 million of oil and gas royalties, \$8.9 million of mineral lease bonuses and \$16.7 million of oil extraction taxes collected during the quarter.
- ◆ During the quarter, \$8.8 million was distributed from the Common Schools Trust Fund to North Dakota public schools. A total of \$46.3 million will be distributed from this trust during fiscal year 2012, an increase of almost 20% over the annual distributions made during the 2009-11 biennium.
- ◆ Although total permanent trust assets declined during the quarter, they still stood at almost \$820 million more than they did two and one-half years earlier, on March 31, 2009, when the portfolio reached its most recent low point.



ACTUAL ALLOCATION VS. TARGET ALLOCATION AS OF SEPTEMBER 30, 2011



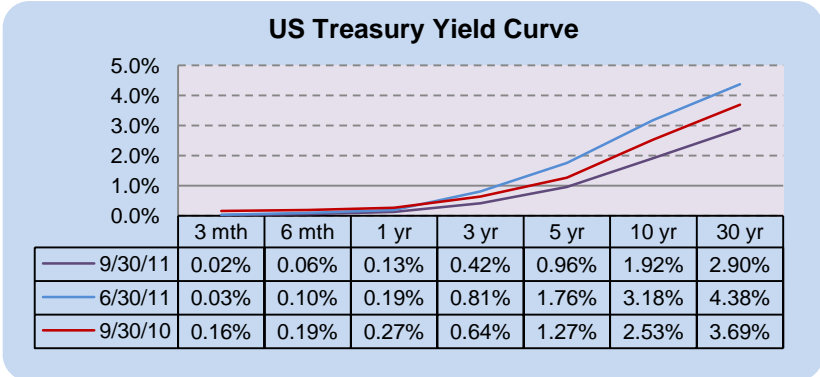
Asset Class	Actual \$ million	Actual %	Target \$ million	Target %	Difference \$ million	% Diff.
US Large Cap Equities	\$ 238.74	14.7%	\$ 243.09	15.0%	(\$ 4.35)	(0.3%)
US Sm/Mid Cap Equities	149.27	9.2%	162.06	10.0%	(12.79)	(0.8%)
REITS	92.20	5.7%	97.23	6.0%	(5.03)	(0.3%)
Convertible Securities	150.56	9.3%	162.06	10.0%	(11.50)	(0.7%)
International Equities	150.41	9.3%	162.06	10.0%	(11.65)	(0.7%)
Total Equities	\$ 781.18	48.2%	\$ 826.50	51.0%	(\$ 45.32)	(2.8%)
US Invest. Grade Fixed-Income	520.61	32.1%	504.42	31.1%	16.19	1.0%
Cash Equivalents	19.79	1.2%	0.00	0.0%	19.79	1.2%
Loans	46.58	2.9%	46.58	2.9%	0.0	0.0%
High Yield Fixed-Income	161.39	10.0%	162.06	10.0%	(0.67)	(0.0%)
International Fixed-Income	91.04	5.6%	81.03	5.0%	10.01	0.6%
Total Fixed-Income	\$ 839.41	51.8%	\$ 794.09	49.0%	\$ 45.32	2.8%
Total Portfolio	\$ 1,620.59	100.0%	\$ 1,620.59	100.0%		

- ◆ The portfolio was out of balance on September 30, 2011, when the equity portion of the portfolio was 2.8% lower than the target allocation for equities.
- ◆ The significant underweighting to equities at quarter's end was a direct result of the double-digit negative returns posted by all of the portfolios in the combined equity portfolio during the quarter
- ◆ The overweight positions in cash equivalents and investment grade fixed income assets were remedied at the end of October, when \$27.5 million of cash and GNMA/Short Bond proceeds were transferred to various equity portfolios.
- ◆ Although rebalancing has generally been accomplished using only free cash flows the past couple of years, the Director used the downturn in equity markets as an opportunity to trim the size of the GNMA/Short Bond Fund, which has grown to be the one of the permanent trusts' largest portfolios.

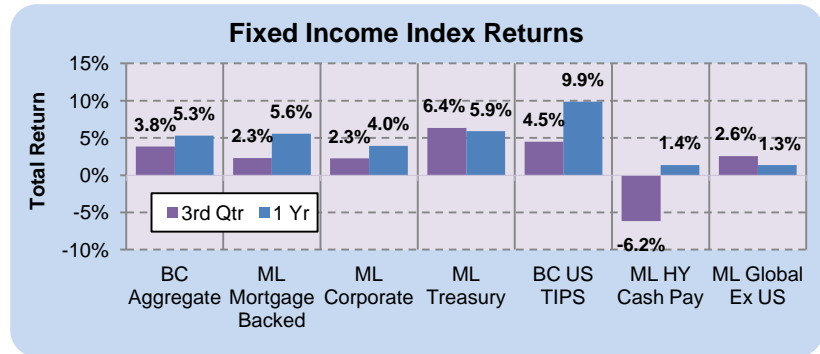
FINANACIAL MARKET OVERVIEW

FIXED INCOME MARKETS

- ◆ Rates fell along all maturities of the Treasury yield curve during the quarter ended September 30, 2011, despite the fact that S&P downgraded US debt during the quarter.
- ◆ The yield curve flattened substantially during the quarter as longer term rates fell by more than 100 basis points, while short-term rates, which were already near historic lows, fell only marginally.

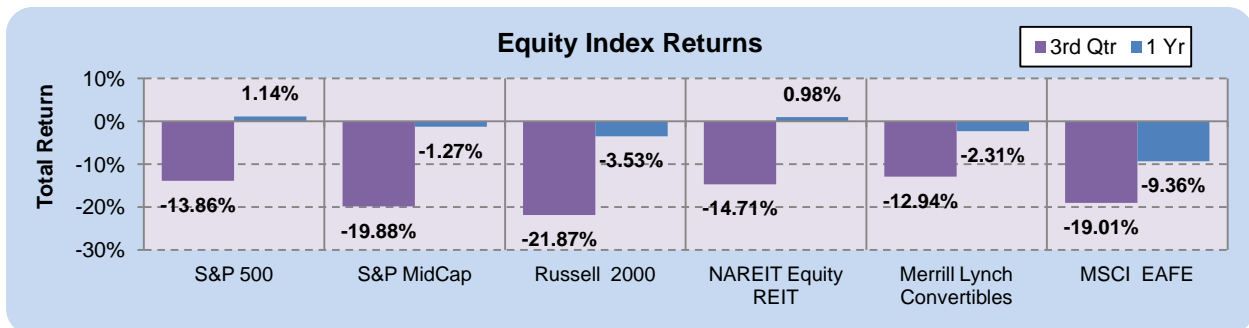


- ◆ The Fed kept the target fed funds rate in the 0% - 0.25% range during the quarter. The target rate has now been at this historic low rate for close to 3 years.
- ◆ US Treasuries outperformed all other fixed income asset classes during the quarter, as extremely volatile equity markets and the ongoing debt crises in Europe caused investors to flee to the relative safety of US government debt.
- ◆ The negative return posted by high yield bonds during the quarter was a direct result of high yield spreads widening by almost 300 basis points during the quarter.



EQUITY MARKETS

- ◆ Every equity asset class held in the portfolio posted double digit negative returns for the quarter ended September 30, 2011. Most also posted negative returns for the trailing year there ended.
- ◆ Foreign stocks and small/mid cap domestic stocks were hit hardest by the downturn in equity markets during the quarter.
- ◆ The downside protection provided by convertible securities was evident during the quarter, as converts outperformed all of the other equity asset classes held in the portfolio.



MANAGER AND PORTFOLIO RETURNS

RETURNS FOR PERIODS ENDED SEPTEMBER 30, 2011							
Asset Class MANAGER Benchmark/Index	9/30/11 Allocation (\$ mil.)	% of Total Portfolio	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Large Cap US Equity							
STATE STREET - S&P 500 Index	\$238.74	14.7%	(13.87)	1.15	1.25	-	-
S&P 500 Index			(13.86)	1.14	1.23	(1.18)	2.82
Small/Mid Cap US Equities	\$149.27	9.2%	(20.64)	(2.33)	-	-	-
NORTHERN TRUST	\$84.19	5.2%	(20.54)	(2.43)	1.69	(0.46)	5.56
STATE STREET - Small/Mid Index	\$65.08	4.0%	(20.75)	(2.11)	-	-	-
60% R2000/40% S&P Mid Cap + 200 bp Russell Completeness Index			(20.57) (10.81)	(0.62) (2.26)	3.41 2.94	2.30 0.57	8.71 6.73
Real Estate Investment Trusts (REITS)							
DELAWARE INVESTMENT ADVISORS	\$92.20	5.7%	(13.39)	2.43	(1.39)	(1.52)	-
NAREIT Equity REIT Index			(14.71)	0.98	(1.97)	(2.42)	9.18
Convertible Securities							
TRUST COMPANY OF THE WEST	\$150.56	9.3%	(12.09)	(2.23)	3.61	(0.51)	2.48
Merrill Lynch All US Convertibles Index Merrill Lynch All US Investment Grade Index			(12.94) (8.91)	(2.31) (1.67)	8.81 5.41	2.24 (0.76)	5.17 1.69
TOTAL DOMESTIC EQUITIES	\$630.77	38.9%	0.21	29.74	-	-	-
International Equities							
STATE STREET - International Alpha	\$150.41	9.3%	(22.27)	(12.82)	(3.37)	(5.55)	-
MSCI EAFE Index			(19.01)	(9.36)	(1.13)	(3.46)	5.03
TOTAL EQUITIES	\$781.18	48.2%	(16.54)	(2.86)	0.15	(2.68)	3.77
US Investment Grade Fixed Income							
BND - Project Notes	\$540.40	33.3%	2.27	5.44	-	-	-
PAYDEN & RYGEL - Long Term	\$3.71	0.2%	1.32	3.16	7.14	6.86	5.49
PAYDEN & RYGEL - GNMA/Short Bond	\$135.77	8.4%	1.72	4.07	8.94	6.48	6.09
NORTHERN TRUST - TIPS	\$238.57	14.7%	1.35	3.97	5.87	5.41	-
PAYDEN & RYGEL - Cash	\$142.56	8.8%	4.83	9.96	8.60	7.25	-
Barclay's Capital US Aggregate Index	\$19.79	1.2%	0.04	0.04	0.18	1.85	2.12
Barclay's Capital TIPS			3.83	5.29	7.99	6.53	5.67
6 Month T-Bill			4.51	9.86	8.12	7.10	-
			0.04	0.21	0.50	2.09	2.15
Loans							
BND - Farm Loan Pool	\$46.58	2.9%	1.52	6.20	-	-	-
BND - Energy Construction Loans	\$44.93	2.8%	1.57	6.29	6.66	7.03	7.39
LAND DEPARTMENT - DD Loans	\$1.65	0.1%	1.39	-	-	-	-
	\$0.0	0.0%	0.72	(return for July only, loans sold to BND)			
US High Yield Fixed Income							
LAZARD ASSET MANAGEMENT	\$161.39	10.0%	(3.55)	2.25	9.80	6.16	-
Merrill Lynch US High Yield Cash Pay Index			(6.17)	1.36	13.52	6.84	-
Merrill Lynch BB/B Index			(4.98)	2.00	12.01	6.31	-
TOTAL DOMESTIC FIXED INCOME	\$748.37	46.2%	0.96	4.89	-	-	-
International Invest. Grade Fixed Income							
FIRST INT'L ADVISORS (Evergreen)	\$91.04	5.6%	3.68	1.95	7.07	5.37	-
Merrill Lynch Broad Global (Ex-US) Index - Hedged			2.55	1.34	5.25	4.31	-
TOTAL FIXED INCOME	\$839.41	51.8%	1.24	4.59	8.03	6.32	5.88
TOTAL PORTFOLIO	\$1,620.59	100.0%	(7.86)	1.38	4.86	2.34	5.21

All return figures for periods of 1 year or greater have been annualized. All returns are net of fees.

EQUITY PORTFOLIO REVIEW

- ◆ The combined equity and convertible securities portfolio posted a total return loss of -16.54% during the quarter ended September 30, 2011. Over the trailing year the equity portfolio returned -2.86%.
- ◆ All equity portfolios posted double-digit negative returns for the quarter. This was the worst quarterly performance earned by the permanent trusts' combined equity portfolio since the 4th quarter of 2008, when it posted a negative return of -27.69%
- ◆ Convertible securities, REITs and large cap US equities were the best performing portfolios during the quarter. REITs and large cap domestic equities were the only portfolios to post positive returns over the trailing year ended September 30, 2011.

Northern Trust – Small/Mid Cap

- ◆ Northern Trust essentially matched the return of the custom benchmark for this portfolio during the quarter. The portfolio has underperformed versus the benchmark for all other periods shown in the table on page 4.
- ◆ In September, the Commissioner and Investment Director met with Northern Trust in Chicago to discuss the portfolio. During that meeting Northern explained that benchmark has drifted away from the actual makeup of small and mid cap markets in recently years, and that is responsible for much of the underperformance. The benchmark for this portfolio is 200 basis points more than a custom index return that is calculated using 60% of the return of the S&P Mid Cap Index and 40% of the return of the Russell 2000 Index.
- ◆ The Commissioner and Investment Director are working with Northern Trust to possibly tweak both the benchmark and the allocation of managers in the investment portfolio so that both better reflect the actual characteristics of domestic small and mid cap equity markets

Delaware Investment Advisors

- ◆ THE REIT portfolio managed by Delaware continues to perform well. It outperformed the benchmark NAREIT Equity Index for the quarter ended September 30, 2011, and for all other periods shown in the table on page 4.
- ◆ Investments in 3 apartment focused REITs, Camden Property Trust, Essex Property Trust and Equity Residential were a big driver of portfolio returns over first 9 months of 2011.

Trust Company of the West (TCW)

- ◆ TCW outperformed the broad Merrill Lynch All US Convertibles Index for the second quarter in a row during the quarter ended September 30, 2011; TCW has underperformed the broad index for all other periods shown in the table on page 4.
- ◆ As one would expect, the higher than index quality of the portfolio helped it outperform the broad index during the quarter, as did the larger than index market cap of the portfolio. A tactical overweight to consumer staples also helped relative performance during the quarter.
- ◆ Although the portfolio's returns have lagged the investment grade portion of the convertible securities universe for shorter periods of time, portfolio returns are pretty much in line with the investment grade index over the trailing 5 and 10 year periods ended September 30, 2011.

State Street Global Advisors (SSGA) – International Alpha

- ◆ This portfolio underperformed its benchmark by over 300 basis points for the quarter ended September 30, 2011, although 100 basis points of the quarterly underperformance can be attributed to a timing difference that was reversed on October 1, 2011.
- ◆ When markets are driven by fear, quantitative model driven portfolios such as this one tend to underperform, as market metrics that usually drive returns, such as valuations and earnings, are ignored by investors. This portfolio has experienced two fear driven market downturns since it was established in 2006; if more normal markets prevail, this portfolio should perform more in line with expectations.

FIXED INCOME PORTFOLIO REVIEW

- ◆ The combined fixed income portfolio posted a total return of 1.24% during the quarter ended September 30, 2011. The portfolio also posted positive returns for all other periods shown in the table on page 4.
- ◆ Investment grade bonds, both foreign and domestic, were the best performing portion of the fixed income portfolio during the quarter ended September 30, 2011, while high yield bonds, which were down more than -3.5%, were a drag on performance.

Payden & Rygel – Long-Term

- ◆ This portfolio underperformed the Barclay's Capital Aggregate Index by over 200 basis points during the quarter ended September 30, 2011, as Treasury bonds outperformed all other fixed income asset classes. The portfolio has shown mixed results versus the index over longer periods of time, but has outperformed the index over the past 10 years and since inception in 1995.

Payden & Rygel – GNMA/Short Bond

- ◆ During the quarter this portfolio maintained the 60% allocation to the GNMA Fund Payden and Rygel recommended by Payden & Rygel earlier this year.
- ◆ Both funds have performed well over time; the GNMA Fund continues to be rated 5 stars by Morningstar

Northern Trust – TIPS

- ◆ This portfolio continues to track the returns of the Barclays Capital TIPS Index at an acceptable level. The added returns over the index are primarily the result of the securities lending income this portfolio receives.

Bank of North Dakota (BND) – Farm Loan Pool

- ◆ Approximately \$1.7 million of new farm real estate loans were funded during the quarter ended September 30, 2011.
- ◆ During the quarter the Department took over management of a farm loan property that was foreclosed on in 2010. The borrower did not redeem the property within a year of the original sheriff's sale as allowed by state law.

Bank of North Dakota – Energy Construction Loan Program

- ◆ During July, the Energy Construction Loan Program funded a new loan to help finance multi-family housing in Parshall. This loan was for \$625,000, at a gross yield to the Common Schools Trust of 5.25% (loan floor).
- ◆ After a slow start getting this program started, demand is picking up. BND currently has an additional \$14.6 million of loans for various projects in which they would like the Land Board to participate.

Land Department – Developmentally Disabled Loans

- ◆ A bill passed during the 2011 legislative session resulted in BND purchasing the Common Schools Trust Fund's share of these loans during July 2011. BND will now manage its own program to provide low interest rate loans to group homes and other such entities in the state.

Lazard

- ◆ Although the Lazard high yield bond portfolio outperformed the Merrill Lynch High Yield Cash Pay Index by more than 260 basis points during the quarter, it still posted a return on -3.55%. The portfolio has underperformed the benchmark by less than 100 basis points over the past 5 years, and since inception of the account almost 8 years ago.
- ◆ Spreads widened by 300 basis points during the quarter, as the European debt crisis and fear of a second double-dip recession worried investors.
- ◆ As expected, Lazard's high quality focus to investing paid off as lower quality securities saw larger price declines than the B and better rated securities that make up the majority of this portfolio.

OTHER TRUSTS MANAGED BY THE LAND BOARD

The Capitol Building Trust was created for the construction and maintenance of “public buildings at the capital”. The Lands and Minerals Trust (LMTF) was created to account for all income derived from the sale, lease and management of sovereign lands and minerals formerly managed by the State Treasurer and the Bank of North Dakota. The LMTF was renamed to the **Strategic Investment and Improvements Fund (SIIF)** effective July 1, 2011. It is the intent of the Legislative Assembly that this fund be used for one-time expenditures relating to improving state infrastructure. Because the entire balance of both of these trusts can be appropriated by the legislature each biennium, trust assets are invested in conservative, short-term fixed income securities, such as short-term investment funds, U.S. T-Bills and BND CDs, which tend to have maturities of 2 years or less.

	9/30/11 Asset Balances	Current Yield
Capitol Building Trust	\$3,335,000	0.46%
Strategic Investment and Improvements Fund	\$ 253,948,000	0.23%

- ◆ Historic low interest rates continued to pull the yield of both these portfolios down. The yield earned on our BND MMDA account was down to 0.15% at the end of September, while the STIF account at Northern Trust was earning 0.% Both trusts had a substantial amount of cash at quarter’s end. The large cash balances were reinvested into Treasury securities in October 2011.
- ◆ HB 1451 not only changed the name of the SIIF, it also changed the distribution formulas for gross production tax and oil extraction tax receipts so that a portion of those proceeds will now be deposited into the SIIF after total tax receipts reach certain preset levels.

The Coal Development Trust Fund is a permanent fund, from which the Land Board issues loans to energy impacted counties, cities and school districts as provided in NDCC Section 57-62-03, and loans to school districts pursuant to NDCC Chapter 15-60. The Land Board is responsible for investing all funds that have not been loaned to political subdivisions. Because these funds can be loaned at any time, they are invested in a conservative short-term fixed income portfolio managed by Payden & Rygel. The income earned by this fund is transferred to the General Fund each year.

	9/30/11 Asset Balances	Current Yield
Coal Development Trust Fund		
Coal Warrants	\$ 4,316,000	4.12%
School Construction Loans	\$ 26,421,000	2.23%
Marketable Securities	<u>\$ 32,670,000</u>	N/A - see returns below
Total	\$ 63,407,000	

Payden and Rygel – Coal

- ◆ This portfolio underperformed its benchmark by a small margin for the quarter ended September 30, 2011, and for the 1, 5 and 10-year periods there ended. It outperformed the benchmark over the past 3 years.
- ◆ The week economic environment during the quarter led to a flight to quality that sent Treasury prices lower. The defensive duration position of the portfolio prevented underperformance from being more than it was.

	9/30/11 Asset Balance	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Payden & Rygel Coal Dev.	\$32.67	0.21	0.98	2.90	3.37	3.19
ML 1-3 Year Treasury Index		0.49	1.21	2.39	3.83	3.31
All return figures for periods of 1 year or greater have been annualized. Returns are net of fees						