

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

INVESTMENT PERFORMANCE REPORT

For periods ended June 30, 2014



PERMANENT EDUCATIONAL TRUST ASSETS

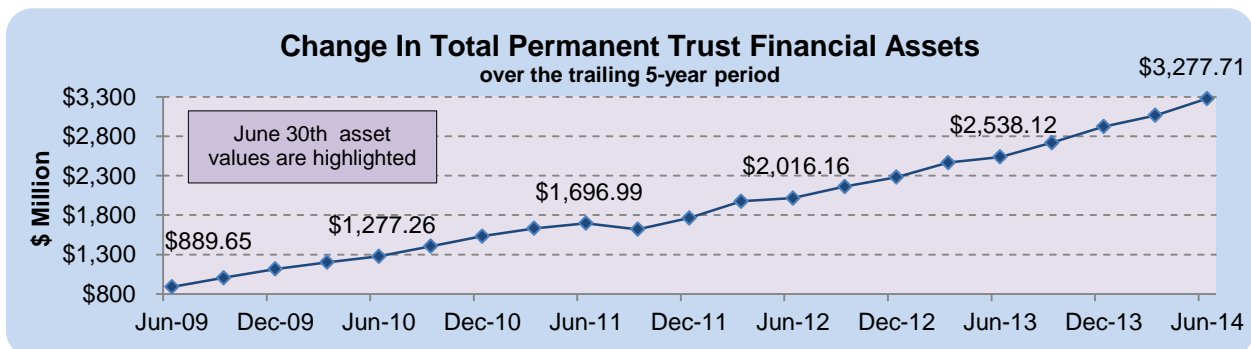
TOTAL TRUST ASSETS

The first section of this report shows combined data for the 13 permanent educational trust funds and the Indian Cultural Education Trust 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.

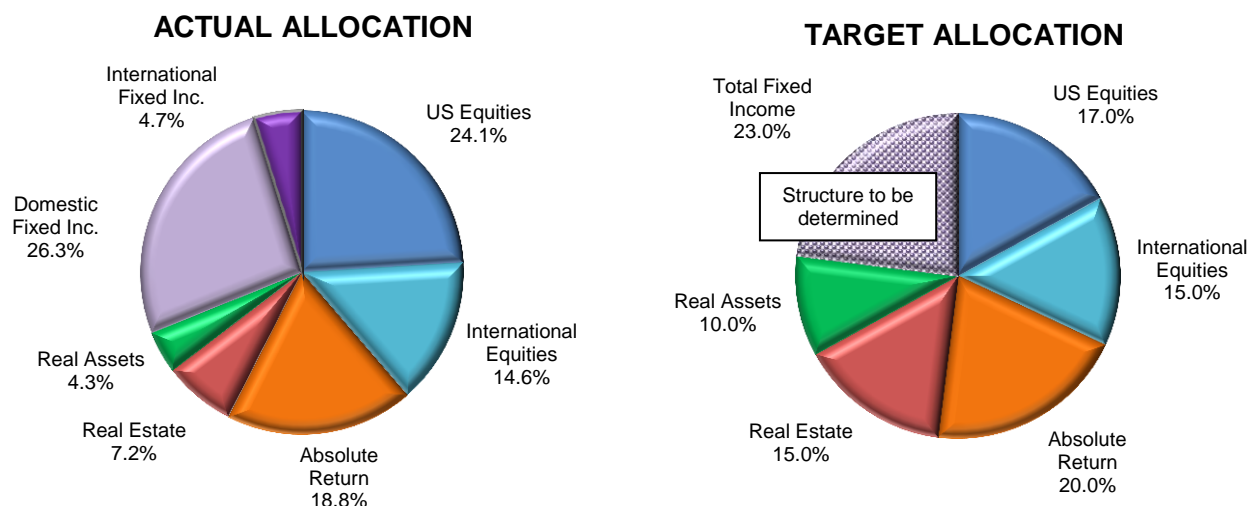
For the schedule below and for all other schedules, tables and charts that follow in this report, all loans, warrants, loan portfolios and certificates of deposit are valued at cost. All other investments in marketable securities, such as stocks, bonds, mutual funds and cash equivalents are valued at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

COMPARATIVE ASSET ALLOCATION SCHEDULE						
Date	Total Assets	Total Equities	Absolute Return	Real Estate	Real Assets	Fixed Income
6/30/13 Rebalanced	\$2,538,122,000	\$1,294,442,000 51.0%				\$1,243,680,000 49.0%
6/30/14 Actual	\$3,277,707,000	\$1,267,207,000 38.7%	\$617,285,000 18.8%	\$236,110,000 7.2%	\$139,434,000 4.3%	\$1,017,671,000 31.0%
6/30/14 Target	\$3,277,707,000	\$1,048,866,000 32.0%	\$655,541,000 20.0%	\$491,656,000 15.0%	\$327,771,000 10.0%	\$753,873,000 23.0%

- ◆ Total trust assets grew by \$212.24 million during the quarter ended June 30, 2014; total assets grew by just less than \$740.0 million during fiscal year 2014.
- ◆ The investment portfolio earned a return of 2.82% during the quarter ended June 30, 2014, resulting in approximately \$89.3 million of trust growth. Other large contributors to trust growth during the quarter were oil and gas royalties (\$72.31 million) and oil extraction tax collections (\$39.50 million).
- ◆ In April, \$9.96 million was distributed from the Common Schools Trust Fund to K-12 education; a total of \$65.16 million was distributed to K-12 education during the fiscal year. \$2.1 million was distributed to the beneficiaries of the other 12 permanent trust funds in June 2014, bringing that total to \$4.19 million for the fiscal year.
- ◆ In June, staff began implementing a number of the asset allocation changes approved by the Land Board over the past six months as a result of the RVK study. Approximately \$1.1 billion of securities were liquidated during June and the proceeds were used to fund new absolute return and emerging market equity portfolios, and adjust the exposures of the trusts' international and domestic equity portfolios.



ACTUAL ALLOCATION VS. TARGET ALLOCATION AS OF JUNE 30, 2014



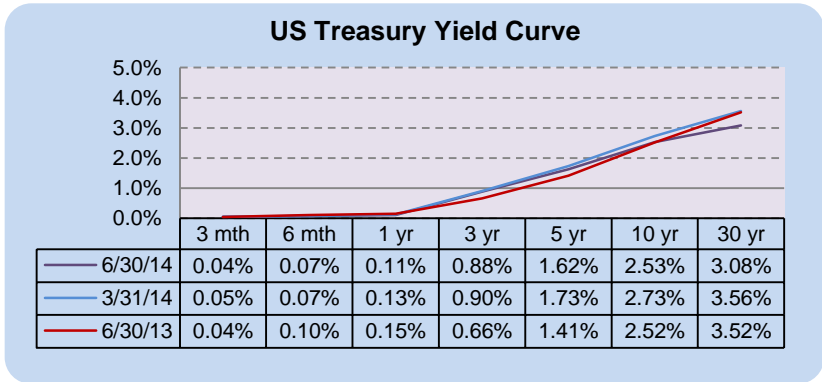
Asset Class	Actual \$ million	Actual %	Target \$ million	Target %	Difference \$ million	% Diff.
US Large Cap Equities	\$ 442.36	13.5%	\$ 442.49	13.5%	(\$ 0.13)	(0.0%)
US Small/Mid Cap Equities	345.93	10.6%	114.72	3.5%	231.21	7.1%
International. Dev. Mrkt. Equities	383.70	11.7%	393.32	12.0%	(9.62)	(0.3%)
Emerging Market Equities	95.22	2.9%	98.33	3.0%	(3.11)	(0.1%)
Total Equities	\$ 1,267.21	38.7%	\$ 1,048.86	32.0%	\$ 218.35	6.7%
Absolute Return	\$ 617.28	18.8%	\$ 655.54	20.0%	(\$ 38.26)	(1.2%)
Real Estate	\$ 236.11	7.2%	\$ 491.66	15.0%	(\$ 255.55)	(7.8%)
Real Assets	\$ 139.43	4.3%	\$ 327.77	10.0%	(\$ 188.34)	(5.7%)
US Invest. Grade Fixed Income	713.22	21.7%	To Be Determined			
Loans	21.71	0.7%				
High Yield Fixed Income	127.29	3.9%				
International Fixed Income	155.45	4.7%				
Total Fixed Income	\$ 1,017.67	31.0%	\$ 753.87	23.0%	\$ 263.80	8.0%
Total Portfolio	\$ 3,277.70	100.0%	\$ 3,277.70	100.0%		

- ◆ The charts and tables above all reflect the new asset allocation approved by the Board for the permanent trusts in September 2013, as well as action taken since that date related to implementation.
- ◆ Most of the revised equity portfolio is now place, the primary exception being the small/mid cap portfolio. During June, the passive domestic large cap portfolio was reduced, the active small/mid cap portfolio was transitioned to an active small cap portfolio, international equity exposure was broadened to a new ACWI Ex US passive mandate and two new emerging market equity managers were hired. The large overweight to small/mid cap stocks will be reduced in August when some funds will be reallocated to other asset classes.
- ◆ The absolute return portion of the portfolio was funded completely in June with the hiring of three new absolute return managers. Another name for these strategies is global tactical asset allocation (GTAA). The slight underweight to GTAA at quarter's end was corrected in late-July.
- ◆ Both real estate and real assets are substantially underweight on June 30, 2014. The real estate portfolio is currently 100% REITS, which were previously classified as equities. It will take up to 6 quarters to fully fund the two core real estate managers that were recently hired. The real assets bucket currently consists of the TIPS portfolio that was previously classified as fixed income. The Board will work on developing a structure and hiring managers in this area later this fall.
- ◆ The Board will be working on the fixed income portion of the portfolio this Fall, however, the fixed income portion of the portfolio will continue to be overweight until the real asset and real estate portfolios are funded

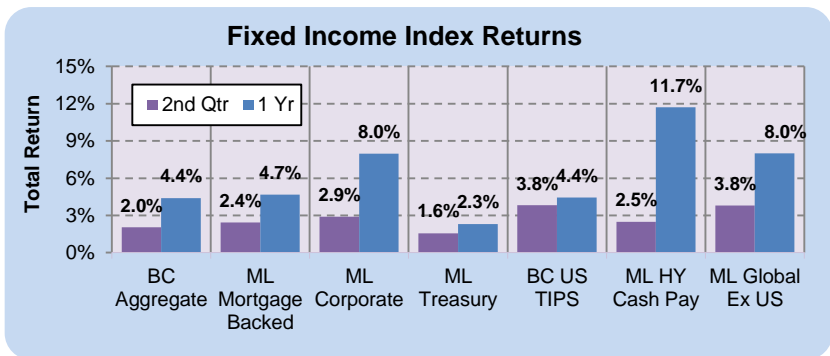
FINANCIAL MARKET OVERVIEW

FIXED INCOME MARKETS

- ◆ During the quarter, the Treasury yield curve flattened, as long-term rates fell, and shorter-term rates stayed near historic lows.
- ◆ Longer-term Treasury rates continued on their recent roller coaster ride. 10-year Treasury rates stood at 2.53% on March 31, 2014, 66 basis points higher than 15 months ago, but 51 basis points less than 6 months ago. 30-year Treasury rates are essentially the same as they were 15 months ago, however, they are still down 88 basis points over the past 6 months.

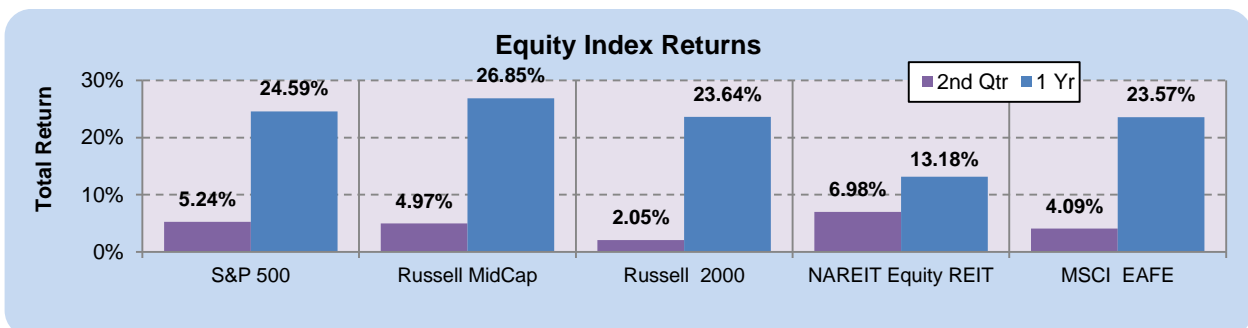


- ◆ Every fixed income asset class tracked in the table to the right posted positive returns for both the quarter and year ended June 30, 2014.
- ◆ A combination of lower Treasury rates and shrinking spreads helped drive the performance of both high yield bonds and investment quality corporate debt.



EQUITY MARKETS

- ◆ All equity asset classes in the portfolio posted strong positive returns for both the quarter and trailing-year ended June 30, 2014. Equity markets continued to push upwards, with a number of indexes reaching all-time highs during the quarter.
- ◆ REITs posted strong returns for the quarter ended June 30, 2014. REITs lagged other equity asset classes over the trailing year due to the impact of the expectation that the Fed will reduce stimulus efforts going forward, which result in higher interest rates.
- ◆ Developed market equities, as measured by the S&P 500 and EAFE Indexes, posted strong returns for both the quarter and trailing year ended June 30, 2014, with large cap domestic stocks generally outperforming small, and domestic stocks slightly outperforming international equities.



MANAGER AND PORTFOLIO RETURNS

RETURNS FOR PERIODS ENDED JUNE 30, 2014								
Asset Class MANAGER Benchmark/Index	6/30/14 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	\$442.36	13.5%	5.23	24.57	16.55	188.2	-	
S&P 500 Index			5.24	24.59	16.58	18.83	7.78	
Small/Mid Cap US Equities								
NORTHERN TRUST	\$345.93	10.6%	2.70	25.75	15.04	20.26	-	
STATE STREET - Small/Mid Index	\$112.19	3.4%	1.53	23.49	14.06	19.30	8.57	
STATE STREET - Small/Mid Index	\$233.74	7.2%	3.46	27.21	15.87	21.70	-	
60% Russell 2000/40% Russell Mid Cap			3.23	24.96	15.11	20.97	9.52	
Russell Completeness Index			3.47	27.36	15.83	21.63	10.09	
International Equities								
STATE STREET - International Alpha	\$383.70	11.7%	2.62	24.41	7.15	11.02	-	
NORTHERN TRUST - EAFE Index	\$383.70	11.7%	2.22	24.56	7.29	11.10	-	
NORTHERN TRUST - EAFE Index	residual	0.0%	3.64	22.89	-	-	-	
MSCI EAFE Index			4.09	23.57	8.10	11.77	6.93	
Emerging Market Equities								
DIMENSIONAL – EM Core	\$95.22	2.9%	1.30					
HARDING LOEVNER – EM	\$47.70	1.5%	1.50	funded	6/5/14	-	-	
HARDING LOEVNER – EM	\$47.52	1.4%	1.10	funded	6/5/14	-	-	
(do not have partial month index data)								
TOTAL EQUITIES	\$1,267.21	38.7%	3.63	22.70	12.63	17.04	6.82	
GMO – Benchmark-Free								
PIMCO – All Assets All Authority	\$205.65	6.3%	0.32	funded	6/5/14			
WESTWOOD- Income Opportunity	\$205.39	6.2%	0.19	funded	6/19/14			
WESTWOOD- Income Opportunity	\$206.24	6.3%	0.56	funded	6/5/14			
(do not have partial month index data)								
TOTAL ABSOLUTE RETURN-GTAA	\$617.28	18.8%	0.36	-	-	-	-	
DELAWARE INVESTMENT ADVISORS								
NAREIT Equity REIT Index	\$236.11	7.2%	6.73	13.57	11.89	22.78	9.49	
NAREIT Equity REIT Index			6.97	13.18	11.82	23.52	9.61	
TOTAL REAL ESTATE	\$236.11	7.2%	6.73	13.57	11.89	22.78	9.49	
NORTHERN TRUST - TIPS								
Barclay's Capital TIPS Index	\$139.43	4.3%	3.92	4.60	3.66	5.81	5.31	
Barclay's Capital TIPS Index			3.81	4.45	3.56	5.55	5.25	
TOTAL REAL ASSETS	\$139.43	4.3%	3.92	4.60	3.66	5.81	5.31	
US Investment Grade Fixed Income								
PAYDEN & RYSEL - Aggregate	\$713.22	21.7%	1.25	3.07	3.16	4.97	-	
JP MORGAN - Intermediate	\$215.44	6.6%	2.17	5.65	4.68	6.61	5.61	
BND - Project Notes	\$213.60	6.5%	1.45	3.19	-	-	-	
PAYDEN & RYSEL – Low Duration	\$2.15	0.1%	5.14	6.63	4.09	5.07	5.44	
PAYDEN & RYSEL – Cash	\$214.52	6.5%	0.40	1.56	2.80	3.83	4.14	
PAYDEN & RYSEL – Cash	\$67.51	2.0%	(0.01)	(0.06)	0.00	0.04	1.66	
Barclay's Capital US Aggregate Index			2.04	4.38	3.67	4.86	4.94	
Barclay's Intermediate Govt./Corp.			1.23	2.85	-	-	-	
6 Month T-Bill			0.01	0.04	0.09	0.15	1.74	
Loans								
BND - Farm Loan Pool	\$21.72	0.7%	1.39	6.13	5.82	6.12	-	
BND - Farm Loan Pool	\$20.19	0.6%	1.40	6.22	5.84	6.12	6.82	
BND – Energy Construction Loans	\$1.53	0.1%	1.21	5.06	5.39	-	-	
US High Yield Fixed Income								
LAZARD ASSET MANAGEMENT	127.29	3.9%	1.85	9.62	7.93	10.64	7.39	
Merrill Lynch US High Yield Cash Pay Index			2.49	11.70	9.15	13.75	8.80	
Merrill Lynch BB/B Index			2.50	11.31	8.99	12.58	8.27	
International Invest. Grade Fixed Income								
FIRST INT'L ADVISORS	\$155.45	4.7%	3.74	7.76	5.94	5.72	5.30	
Merrill Lynch Broad Global (Ex-US) Index – Hedged			1.95	5.79	5.17	4.57	4.74	
TOTAL FIXED INCOME	\$1,017.68	31.0%	1.62	4.80	4.44	6.16	5.52	
TOTAL PORTFOLIO	\$3,277.71	100.0%	2.82	13.85	8.84	11.74	6.60	
All return figures for periods of 1 year or greater have been annualized. All returns are net of fees.								

PORTFOLIO REVIEW

EQUITIES

- ◆ During the quarter ended June 30, 2014, the combined equity portfolio posted a total return of 3.63%. This portfolio earned 22.70% for the trailing-year ended June 30, 2014 and has earned an annualized return of 17.04% over the trailing 5-year period there ended.
- ◆ Both active equity portfolios were transitioned during the month. The SSGA International Alpha active fund was transitioned to an ACWI Ex US passive fund at SSGA during June 2014. The former small/mid cap portfolio managed by Northern Trust was transitioned to a small cap domestic portfolio during June.
- ◆ The allocation to Large Cap domestic equities (S&P 500 Index) was reduced by \$150 million during the June to get it much closer to its long-term target allocation.
- ◆ New emerging market equity portfolios managed by Dimensional Fund Advisors and Harding Loevner were funded during the quarter, while the Delaware REIT portfolio will now be considered part of the trusts' new Real Estate allocation

ABSOLUTE RETURN

- ◆ All three absolute return managers, Grantham, Mayo, Van Otterloo (GMO), PIMCO and Westwood Management Corp. were funded in June. For performance purposes, July 1, 2014 will be considered the inception date.
- ◆ Each manager posted a positive return for the partial month they were funded; the combined absolute return portion of the portfolio returned 0.36% for the partial month

REAL ESTATE

- ◆ In June 2014, the Board directed the Commissioner hire both Morgan Stanley and UBS to manage core real estate portfolios for permanent trusts. It could take up to 18 months to fund the full 8% allocation dedicated to these two managers. A non-core real estate may also be hired in the next few months
- ◆ The Delaware REIT portfolio will now be considered part of the real estate portion of the overall portfolio; it was previously considered to be part of the equity portfolio. In the long run, the REIT portion of the real estate allocation will shrink as the core portfolios, and potentially non-core managers, are hired and funded.

REAL ASSETS

- ◆ The real asset portion of the portfolio is intended to protect the trusts from negative impacts of inflation. To date, no work has been done on this part of the portfolio. RVK and staff will be working on the structure of the real assets portfolio during the 3rd quarter of 2014.
- ◆ The Northern Trust TIPS portfolio will now be considered part of the real assets portion of the overall portfolio. It was previously considered to be part of the fixed income portfolio.

FIXED INCOME

- ◆ The fixed income portion of the portfolio was reduced dramatically during June from 49% of assets to 31% of assets. This was done by reducing amount allocated to the Payden and Rygel Aggregate, JP Morgan Intermediate, Payden and Rygel Low Duration and Lazard High Yield portfolios and also by moving the TIPS portfolio over to the real assets category.
- ◆ The high yield portfolio was reduced substantially in June from 8.7% of assets to 4.0%, the new target allocation for high yield bonds. The reduction in other fixed income portfolios just brought them closer to their ultimate portfolio target allocation, not to target allocations.
- ◆ The fixed income portfolio as a whole will remain somewhat overweight its 23% target allocation until the real asset and real estate portions of the portfolio are fully funded.

OTHER TRUSTS MANAGED BY THE LAND BOARD

The **Strategic Investment and Improvements Fund (SIIF)** was created effective July 1, 2011, with the merger of the Lands and Minerals Fund and the Permanent Oil Tax Trust Fund. It holds the assets and collects the revenues earned from more than 750,000 sovereign mineral acres, including those formerly owned by the Bank of North Dakota and State Treasurer, as well as the minerals located under navigable rivers and lakes. The SIIF also receives a substantial portion of the oil and gas production and extraction taxes collected by the State.

	6/30/14 Asset Balances	Current Yield
Strategic Investment and Improvements Fund		
Medical Facility Loan Fund	\$ 50,026,000	0.09%
Loan Guarantee – Fuel Production	\$ 18,003,000	0.05%
School Construction Loans	\$ 100,798,000	1.45%
Cash Equivalents	\$ 18,939,000	0.04%
Treasury Securities	<u>\$ 1,064,839,000</u>	0.20%
Total	\$ 1,252,605,000	

- ◆ The SIIF collected about \$48.6 million of royalty and lease bonus income during the quarter ended June 30, 2014.
- ◆ During the quarter \$183.6 million of gross production and oil extraction taxes were deposited into the SIIF by the State Treasurer; current projections indicate a total of \$1.19 billion of oil taxes will be deposited into the SIIF during the 2013-15 biennium.
- ◆ The SIIF earned a small amount of income from the Medical Facility Loan Fund and Loan Guarantee for the biomass fuel production facility in Spiritwood. Both of these program will provide only modest amounts of income going forward as the loan guarantee fund will generate short-term fixed income rates and medical facility loans, once funded, will generate a return of less than 1% to the SIIF
- ◆ During the quarter ended June 30, 2014, Grafton (\$14.0 million), West Fargo (\$9.4 million) and Bismarck (\$15.0 million) closed on new school construction loans from the SIIF. After factoring in the principal payments received on June 1, 2014, the balance of SIIF funded school loans stood at \$100.80 million at quarter's end.
- ◆ As of June 30, 2014 a total of \$103.67 million of school construction loans have been funded from the SIIF, out of the total of \$150 million allocated to the program by the 63rd Legislative Assembly. It is expected that the full \$150 million will be obligated to school loans by the December 31, 2014 deadline established by the legislature.
- ◆ Due to the fact that the SIIF is fully expendable, it is currently invested in short-term Treasury securities that mature on or before June 30, 2015. The Commissioner and staff are researching possible ways to enhance the yield and expected return of the SIIF's investment portfolio, without adding undue risk. The Commissioner expects to bring a recommended SIIF investment policy to the Board during the 3rd quarter of 2014.
- ◆ The unobligated balance of the SIIF hit \$300 million in June, 2014. As a result, starting in July of 2014, 25% of all mineral revenues received by the SIIF will be transferred to the Legacy Fund and 25% of the gross production and oil extraction tax previously allocated to the SIIF will now be deposited directly into the Legacy Fund.

The **Capitol Building Trust** was created for the construction and maintenance of “public buildings at the capital.” It generates revenues from the almost 10,000 surface and 27,700 mineral acres it owns. Because the entire balance of this trust can be appropriated by the legislature each biennium, it is invested in conservative, short-term fixed income securities which tend to have maturities of two years or less.

	6/30/14 Asset Balances	Current Yield
Capitol Building Trust		
Treasury Securities	\$ 4,543,000	0.23%

- ◆ No new monies were appropriated out of this fund for the current biennium, however, \$1.0 million of carryover authority remains from the 2011-13 biennium. Facilities Management informed the Commissioner during the quarter the \$1.0 million would not be needed this fall as expected and that they would be seeking further carry over authority from the legislature.
- ◆ The Treasury securities held in this portfolio all mature prior to the end of the current biennium. The yield on cost of these securities was 0.23% at quarter’s end. This trust also held about \$190,000 of cash at BND on June 30, 2014 earning about 0.5%.
- ◆ The more the topic is researched, the more it seems likely that the investment policy being developed for the SIIF will also be applicable to the Capitol Building Trust as well.

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. As directed in the Constitution, the income earned by this fund is transferred to the General Fund each year.

	6/30/14 Asset Balances	Current Yield
Coal Development Trust Fund		
Coal Warrants	\$ 7,428,000	3.79%
School Construction Loans	\$ 28,543,000	2.14%
Marketable Securities	\$ 30,185,000	N/A - see returns below
Total	\$ 66,156,000	

- ◆ During the quarter, no new loans or warrants were funded. Principal pay downs on school construction loans received on June 1, 2014 were reinvested in marketable securities.
- ◆ \$800,000 of income was transferred from the Coal Development Trust to the State General Fund during the quarter. This figure represents the estimated income earnings of the trust for fiscal year 2014.

Payden and Rygel – Coal

- ◆ Payden & Rygel has outperformed the benchmark for this account for all periods shown in the table below, except for the trailing 10-year period. Over the past 10 years the portfolio underperformed by a modest 10 basis points, after fees.

	6/30/14 Asset Balance	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Payden & Rygel Coal Dev.	\$30.19	0.30	1.04	1.22	1.86	2.63
ML 1-3 Year Treasury Index		0.27	0.91	1.00	1.40	2.73
All return figures for periods of 1 year or greater have been annualized. Returns are net of fees						