

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

INVESTMENT PERFORMANCE REPORT

For periods ended December 31, 2011



PERMANENT EDUCATIONAL TRUST ASSETS

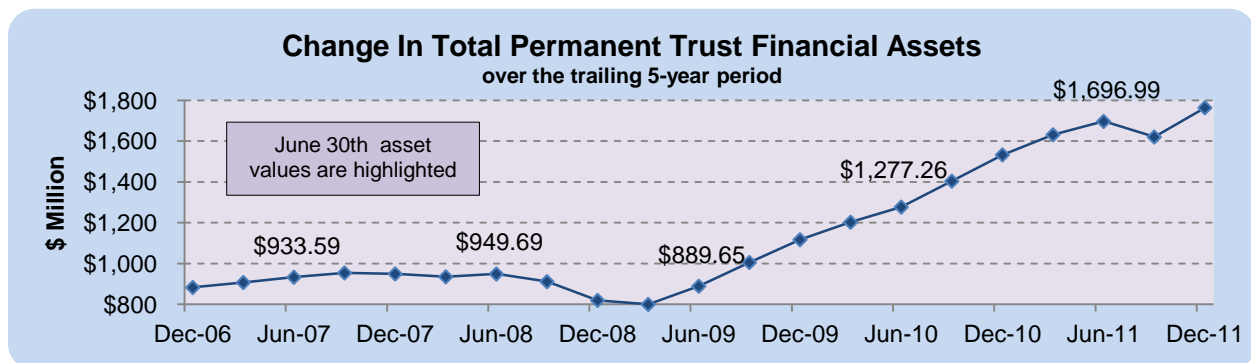
TOTAL TRUST ASSETS

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.

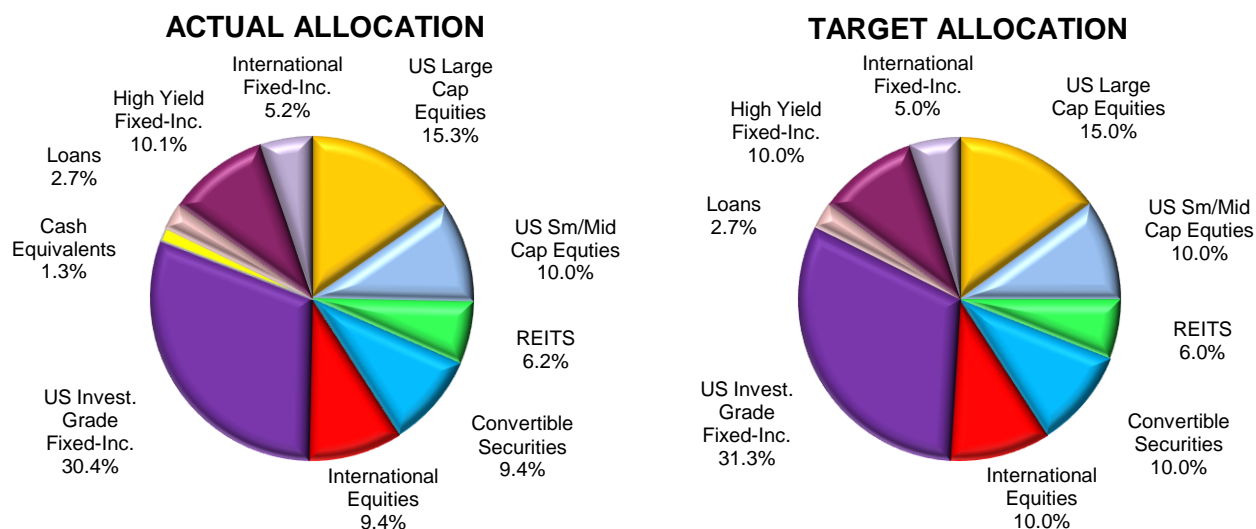
For the schedule below and for all other schedule es, tables and charts that follow in this report, all loans, warrants, loan portfolios and certificate of deposits are valued at cost. All other investments in marketable securities, such as stocks, bonds, mutual funds and cash equivalents are valued 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%
12/31/11 Actual	\$1,763,945,000	\$270,972,000 15.3%	\$175,758,000 10.0%	\$110,392,000 6.2%	\$165,127,000 9.4%	\$165,636,000 9.4%	\$876,060,000 49.7%
12/31/11 Target	\$1,763,945,000	\$264,592,000 15.0%	\$176,395,000 10.0%	\$105,836,000 6.0%	\$176,395,000 10.0%	\$176,395,000 10.0%	\$864,332,000 49.0%

- ◆ Total permanent trust financial assets grew by close to \$143.4 million during the quarter ended December 31, 2011, more than offsetting the \$76.4 million decline in assets that occurred during the first quarter of the fiscal year.
- ◆ During the quarter ended December 31, 2011, the combined investment portfolio posted a total return of 5.65%. The investment portfolio's return was responsible for close to \$91.2 million of trust growth during the quarter; the other large contributors to growth were oil and gas royalties (\$24.98 million), oil extraction taxes (\$19.92 million) and mineral bonuses (\$9.8 million).
- ◆ During the quarter, \$13.2 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.
- ◆ After more than two years of historic, one-directional trust growth, the past 6 months have been a reminder that markets do not always generate positive returns. Although the portfolio has grown, that growth has come primarily from oil and gas related revenues, not the investment portfolio.



ACTUAL ALLOCATION VS. TARGET ALLOCATION AS OF DECEMBER 31, 2011



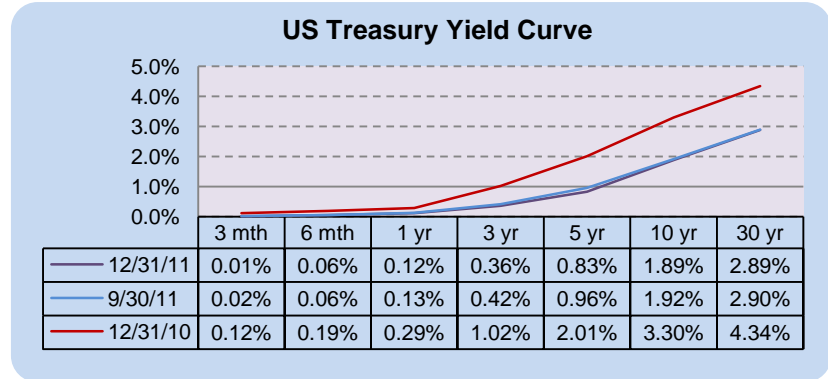
Asset Class	Actual \$ million	Actual %	Target \$ million	Target %	Difference \$ million	% Diff.
US Large Cap Equities	\$ 270.97	15.3%	\$ 264.60	15.0%	\$ 6.37	0.3%
US Sm/Mid Cap Equities	175.76	10.0%	176.39	10.0%	(0.63)	(0.0%)
REITS	110.39	6.2%	105.84	6.0%	4.55	0.2%
Convertible Securities	165.13	9.4%	176.39	10.0%	(11.26)	(0.6%)
International Equities	165.63	9.4%	176.39	10.0%	(10.76)	(0.6%)
Total Equities	\$ 887.88	50.3%	\$ 899.61	51.0%	(\$ 11.73)	(0.7%)
US Invest. Grade Fixed-Income	536.88	30.4%	552.69	31.3%	(15.81)	(0.9%)
Cash Equivalents	22.86	1.3%	0.00	0.0%	22.86	1.3%
Loans	47.05	2.7%	47.05	2.7%	0.00	0.0%
High Yield Fixed-Income	177.57	10.1%	176.39	10.0%	1.18	0.1%
International Fixed-Income	91.70	5.2%	88.20	5.0%	3.50	0.2%
Total Fixed-Income	\$ 876.06	49.7%	\$ 864.33	49.0%	\$ 11.73	0.7%
Total Portfolio	\$ 1,763.94	100.0%	\$ 1,763.94	100.0%		

- ◆ The actual portfolio was very close to being in balance with the target allocation on December 31, 2011, although the equity portion of the portfolio was slightly underweighted.
- ◆ Within the equity portfolio, both the convertible securities and international equities portfolios were underweight at quarter's end. This is due to the fact that these two portfolios produced single-digit returns for the quarter, while the other equity portfolios all produced double-digit returns.
- ◆ The underweight position to equities was remedied in late-January 2012 with the transfer of \$12.0 million from cash equivalents to various equity portfolios. \$2.0 million was also added to the GNMA/Short Bond Fund account at that time.
- ◆ During the quarter, all rebalancing activity was once again funded by the large, primarily oil and gas related, cash flows that are currently being received by this office.

FINANACIAL MARKET OVERVIEW

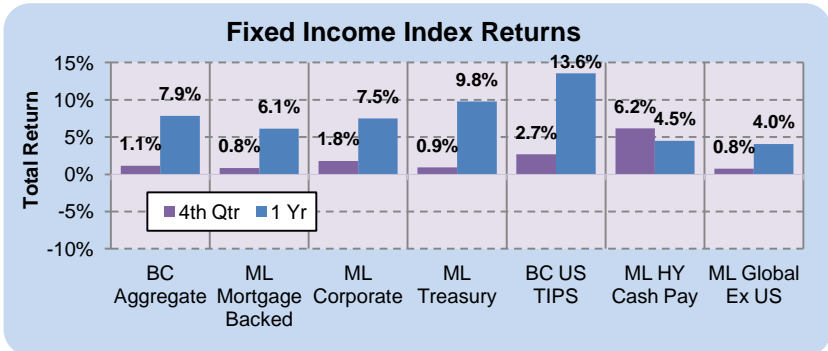
FIXED INCOME MARKETS

- ◆ Treasury rates remained steady during the quarter ended December 31, 2011. Rates at all levels of the maturity spectrum were at or near all time lows.
- ◆ The target fed funds rate has now stayed at a range of 0% - 0.25% for more than three years; the Fed has pledged to keep interest rates low until at least 2014.



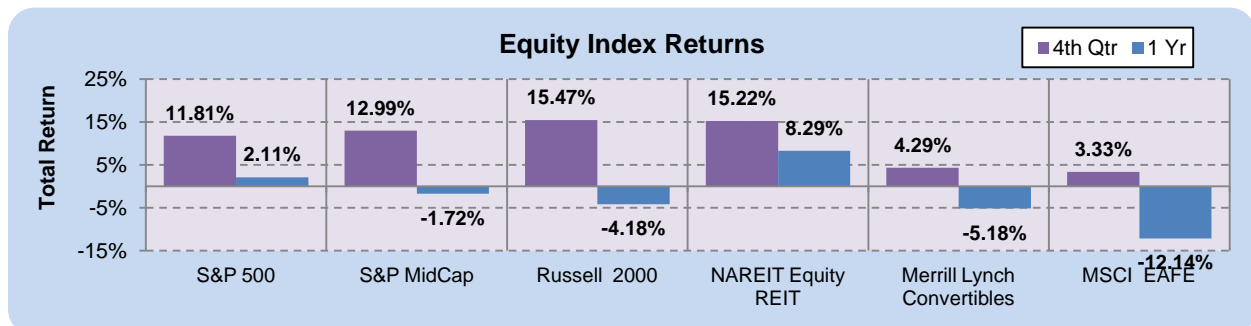
- ◆ As long-term rates fell over the past year, the Treasury curve flattened. The 10-year Treasury was yielding 1.89% on December 31, 2011, while the 30-year Treasury was yielding 2.89%.
- ◆ High yield bonds were the best performing asset class in the portfolio during the quarter, as they recovered pretty much all of the value lost during the previous quarter, TIPS also performed well during the quarter.

- ◆ For the trailing year, TIPS and Treasury securities were the strongest performers, as fear drove investors to both of these government backed fixed income securities.



EQUITY MARKETS

- ◆ After posting double-digit negative returns in the volatile 3rd quarter of 2011, stocks rebounded nicely during the 4th quarter.
- ◆ All sizes and shapes of domestic equities posted double-digit returns during the quarter ended December 31, 2011; convertible securities and international equities lagged domestic equities, although they still posted positive quarterly returns.
- ◆ REITs were the best performing equity asset class for the trailing year; large cap domestic equities were the only other equity asset class to post a positive return over that time period.
- ◆ Foreign equities were the worst performing asset class over the trailing 1-year period, as concerns over the Euro-zone debt crisis continued.



MANAGER AND PORTFOLIO RETURNS

RETURNS FOR PERIODS ENDED DECEMBER 31, 2011								
<u>Asset Class</u> MANAGER Benchmark/Index	12/31/11 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	\$270.97	15.3%	11.80	2.10	14.12	-	-	
S&P 500 Index			11.81	2.11	14.11	(0.25)	2.92	
Small/Mid Cap US Equities								
NORTHERN TRUST	\$175.76	10.0%	12.72	(4.58)	-	-	-	
STATE STREET - Small/Mid Index	\$94.58	5.4%	12.27	(5.25)	16.92	0.25	4.94	
STATE STREET - Small/Mid Index	\$81.18	4.6%	13.28	(3.61)	-	-	-	
60% R2000/40% S&P Mid Cap			14.48	(3.18)	17.23	1.45	6.23	
Russell Completeness Index			13.24	(3.92)	18.77	1.40	6.14	
Real Estate Investment Trusts (REITS)								
DELAWARE INVESTMENT ADVISORS	\$110.39	6.2%	15.26	11.08	19.89	(0.64)	-	
NAREIT Equity REIT Index			15.22	8.29	21.05	(1.41)	8.41	
Convertible Securities								
TRUST COMPANY OF THE WEST	\$165.13	9.4%	4.76	(4.25)	13.37	(0.28)	1.77	
Merrill Lynch All US Convertibles Index			4.29	(5.18)	18.19	2.10	4.84	
Merrill Lynch All US Investment Grade Index			2.54	(3.14)	9.46	(1.04)	1.59	
TOTAL DOMESTIC EQUITIES	\$722.25	40.9%	10.73	0.09	-	-	-	
International Equities								
STATE STREET - International Alpha	\$165.63	9.4%	3.64	(15.19)	6.37	(6.89)	-	
MSCI EAFE Index			3.33	(12.14)	7.65	(4.72)	4.67	
TOTAL EQUITIES	\$887.88	50.3%	9.35	(3.00)	13.69	(2.38)	3.49	
US Investment Grade Fixed Income								
BND - Project Notes	\$559.74	31.7%	1.52	7.34	-	-	-	
BND - Project Notes	\$3.67	0.2%	0.50	2.36	6.34	6.73	5.56	
PAYDEN & RYGEL - Long Term	\$135.35	7.7%	0.90	5.38	9.40	6.36	6.11	
PAYDEN & RYGEL - Long Term	\$251.53	14.2%	1.28	5.31	5.57	5.42	-	
NORTHERN TRUST - TIPS	\$146.33	8.3%	2.64	13.86	10.37	8.09	-	
NORTHERN TRUST - TIPS	\$22.86	1.3%	0.00	0.03	0.15	1.58	2.07	
PAYDEN & RYGEL - Cash	\$22.86	1.3%	0.00	0.03	0.15	1.58	2.07	
Barclay's Capital US Aggregate Index			1.12	7.86	6.78	6.51	5.78	
Barclay's Capital TIPS			2.69	13.55	10.38	7.95	-	
6 Month T-Bill			0.03	0.19	0.24	1.84	2.08	
Loans								
BND - Farm Loan Pool	\$47.05	2.7%	1.53	6.20	-	-	-	
BND - Farm Loan Pool	\$44.72	2.6%	1.59	6.36	6.58	6.96	7.34	
BND - Energy Construction Loans	\$2.33	0.1%	1.45	5.97	-	-	-	
US High Yield Fixed Income								
LAZARD ASSET MANAGEMENT	\$177.57	10.1%	5.69	5.99	17.19	6.57	-	
Merrill Lynch US High Yield Cash Pay Index			6.17	4.50	23.46	7.24	-	
Merrill Lynch BB/B Index			5.89	5.47	20.84	6.72	-	
TOTAL DOMESTIC FIXED INCOME	\$784.36	44.5%	2.43	7.04	-	-	-	
International Invest. Grade Fixed Income								
FIRST INT'L ADVISORS (Evergreen)	\$91.70	5.2%	0.52	4.83	5.37	5.26	-	
Merrill Lynch Broad Global (Ex-US) Index - Hedged			0.76	4.04	4.00	4.34	-	
TOTAL FIXED INCOME	\$876.06	49.7%	2.22	6.80	9.34	6.51	6.69	
TOTAL PORTFOLIO	\$1,763.94	100.0%	5.65	2.09	11.80	2.55	5.20	

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

EQUITY PORTFOLIO REVIEW

- ◆ During the quarter ended December 31, 2011, the combined equity and convertible securities portfolio earned a total return of 9.35%. This was a huge improvement from the -16.54% total return loss posted by the equity portfolio during the 3rd quarter of 2011.
- ◆ All equity portfolios posted positive returns for the quarter ended December 31, 2011. Domestic equity portfolios of all capitalization sizes outperformed both the convertible securities and international equity portfolios by a large margin.
- ◆ Of active managers, Delaware, TCW and State Street each outperformed their benchmarks for the quarter, while Northern Trust underperformed versus its benchmark. Delaware and TCW also outperformed their benchmarks for the trailing year ended December 31, 2011.

Northern Trust – Small/Mid Cap

- ◆ Northern Trust underperformed versus the benchmark for all other periods shown in the table on page 4.
- ◆ Recent discussions with Northern indicate that much of the problem relates to how the current benchmark has drifted away from the actual make up of the small and mid cap markets over the years. Based on those discussions the Commissioner and Northern agreed to adjust the benchmark going forward to better reflect the overall small/mid cap market, and to adjust the manager lineup/allocation slightly to better match the new benchmark.
- ◆ The changes noted above were put into place January 1, 2012. An update on the transition to the new benchmark/allocation will be included in the Board's 1st Quarter 2012 investment performance report.

Delaware Investment Advisors

- ◆ Although Delaware underperformed this portfolio's benchmark for the trailing 3-year period ended December 31, 2011, they outperformed the benchmark for all other periods shown in the table on page 4.
- ◆ According to Delaware, larger cap, and stronger balance sheet companies were the best performing REITs during calendar 2011.

Trust Company of the West (TCW)

- ◆ TCW outperformed the broad Merrill Lynch All US Convertibles Index for both the quarter and trailing year ended December 31, 2011. TCW has underperformed the broad index for all other periods shown in the table on page 4.
- ◆ The performance of the high quality (investment grade average quality) portfolio TCW manages for the trusts more closely tracks the return of the Merrill Lynch investment grade convertible securities index.
- ◆ Security sector in the technology, capital goods and consumer non-cyclical sectors was the primary reason the portfolio outperformed both the broad and investment grade indexes during the quarter ended December 31, 2011.

State Street Global Advisors (SSGA) – International Alpha

- ◆ SSGA outperformed the benchmark for this account by a small amount for the quarter ended December 31, 2011. They have underperformed the benchmark for all other periods shown in the table on page 4.
- ◆ The portfolio's solid quarterly performance was not enough to offset the more than 300 basis points of underperformance that occurred during last quarter's downturn.
- ◆ This portfolio has now experienced two fear driven market downturns since it was established in 2006. Quantitative model driven portfolios like this one generally perform poorly when fear drives returns. SSGA continues to work on the models they use to manage this portfolio so that it will respond better to conditions that deviate substantially from market norms.

FIXED INCOME PORTFOLIO REVIEW

- ◆ During the quarter ended December 31, 2011, the combined fixed income portfolio posted a total return of 2.22%. The fixed income portfolio posted a return of 6.80% for the trailing year ended December 31, 2011.
- ◆ The high yield portfolio managed by Lazard posted the highest absolute return during the quarter at 5.69%, while the TIPS index portfolio managed by Northern Trust was the next best performer in absolute terms at 2.64%.
- ◆ With the large amount of cash flowing into the permanent trusts, the Commissioner and Investment Director are becoming concerned about the large amount of fixed income assets (more than \$430 million) currently invested through Payden and Rygel. Although Payden has done a fine job for the trusts, there is a risk of investing too much money with one company.

Payden & Rygel – Long-Term

- ◆ Although this portfolio continues to be managed for consistent, high quality yield, Payden is also trying to bring it more closely in line with the characteristics of the Barclay's Capital Aggregate Index.
- ◆ The Investment Director has talked to Payden about possibly moving the remaining \$3 million of securities in the BND Project Notes portfolio to this portfolio.

Payden & Rygel – GNMA/Short Bond

- ◆ The GNMA/Short Bond Fund account topped \$250 million at quarter's end. This account was initially funded almost 10 years ago to temporarily park fixed income assets in shorter-term, liquid fixed income securities until such time that interest rates rose to more normal level.
- ◆ Although the GNMA account continues to be rated 5 stars by Morningstar, the Commissioner is making plans to reduce the amount invested in both of these funds going forward.

Bank of North Dakota (BND) – Farm Loan Pool

- ◆ During the quarter, the foreclosure process was completed on a farm loan pool property in Richland County. This property will be put up for sale during the spring of 2012; the sale is expected to generate more than enough money to cover the write down of the foreclosed upon loan.
- ◆ As of December 31, 2011, none of the 220 loans in this pool of loans was delinquent.

Bank of North Dakota – Energy Construction Loan Program

- ◆ During December 2011, this program invested \$707,477 to acquire one-quarter of the total loan for an apartment complex in Williston.
- ◆ Demand for this program continues to grow. BND currently has close to \$14.0 million of additional loans for various future projects in which they would like the Land Board to participate.

Lazard

- ◆ Although the Lazard high yield bond portfolio outperformed the benchmark Merrill Lynch High Yield Cash Pay Index for the trailing year ended December 31, 2011, it has underperformed versus this broad benchmark for all other periods noted in the table on page 4.
- ◆ Lazard has also underperformed versus the more quality driven BB/B index for most periods, but by a lesser amount than the broad index.

First International Advisors

- ◆ Although this portfolio underperformed versus the benchmark for the quarter ended December 31, 2011, it has outperformed the index for all other periods.
- ◆ During 2011, the primary source of value added over the benchmark index was country selection .

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, U.S. T-Bonds, and BND CDs, all of which tend to have maturities of 2 years or less.

	12/31/11 Asset Balances	Current Yield
Capitol Building Trust	\$3,396,000	0.47%
Strategic Investment and Improvements Fund	\$ 271,251,000	0.28%

- ◆ 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.
- ◆ Historic low interest rates continue to keep the yield of both these portfolios down.

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.

	12/31/11 Asset Balances	Current Yield
Coal Development Trust Fund		
Coal Warrants	\$ 8,704,000	3.92%
School Construction Loans	\$ 27,138,000	2.10%
Marketable Securities	<u>\$ 27,937,000</u>	N/A - see returns below
Total	\$ 63,779,000	

- ◆ During the quarter, a \$4.0 million school construction loan to West Fargo was funded, while two schools districts, Mandan and Central Valley, paid off their school construction loans early. In addition, a \$4.5 million coal loan to Mercer County was funded for the purpose of building a new county courthouse.

Payden and Rygel – Coal

- ◆ Payden & Rygel outperformed the benchmark for this portfolio during the quarter ended December 31, 2011, and for the trailing 3-year period there ended. They underperformed versus the benchmark by relatively small margins for the 1, 5 and 10-year periods ended December 31, 2011.
- ◆ As spreads tightened during the quarter, the corporate credits in this portfolio were responsible for a good portion of the portfolio's outperformance.

	12/31/11 Asset Balance	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Payden & Rygel Coal Dev.	\$27.94	0.30	1.48	3.03	3.22	3.15
ML 1-3 Year Treasury Index		0.20	1.56	1.56	3.69	3.25
All return figures for periods of 1 year or greater have been annualized. Returns are net of fees						