

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

INVESTMENT PERFORMANCE REPORT

For periods ended June 30, 2012



PERMANENT EDUCATIONAL TRUST ASSETS

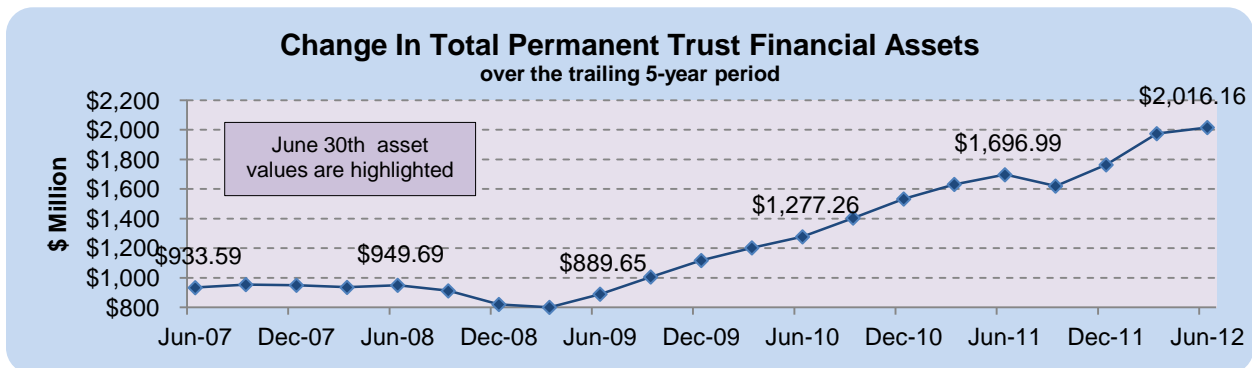
TOTAL TRUST ASSETS

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.

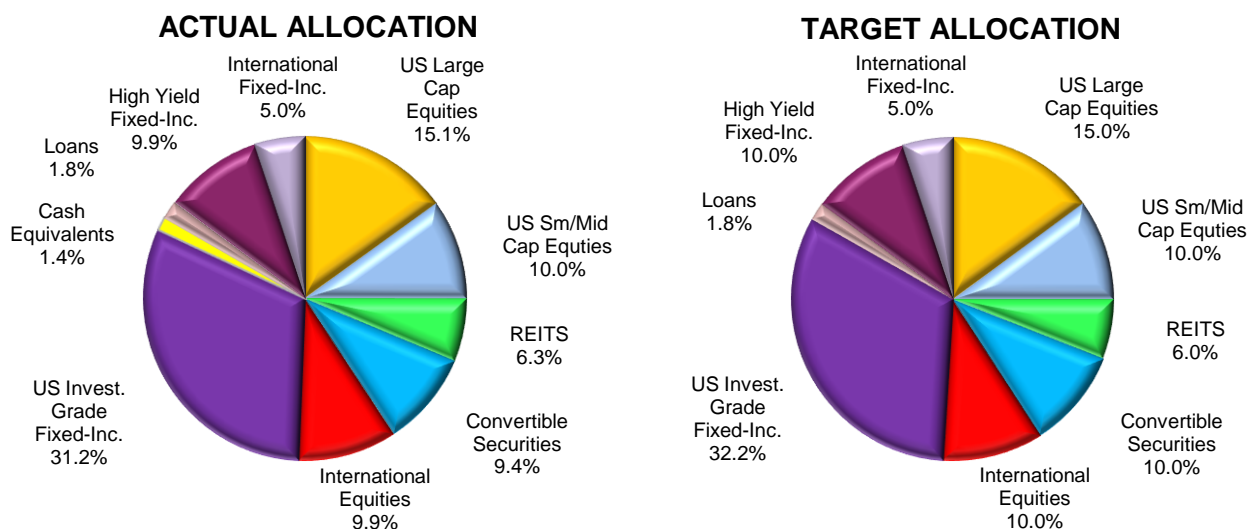
For the schedule below and for all other schedules, tables and charts that follow in this report, all loans, warrants, loan portfolios and certificate of deposits are valued at cost. All other investments in marketable securities, such as stocks, bonds, mutual funds and cash equivalents are valued at 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%
6/30/12 Actual	\$2,016,161,000	\$303,689,000 15.1%	\$200,879,000 10.0%	\$126,698,000 6.3%	\$190,141,000 9.4%	\$199,662,000 9.9%	\$995,092,000 49.3%
6/30/12 Target	\$2,016,161,000	\$302,424,000 15.0%	\$201,616,000 10.0%	\$120,970,000 6.0%	\$201,616,000 10.0%	\$201,616,000 10.0%	\$987,919,000 49.0%

- ◆ The value of the permanent trust financial assets was just over \$2.0 billion as of June 30, 2012. Total trust financial assets grew by \$41.36 million during the quarter ended June 30, 2012 and by \$319.18 million during fiscal year 2012.
- ◆ The combined investment portfolio posted a negative total return of -1.22% during the quarter ended June 30, 2012, resulting in a decrease in the value of the portfolio of \$23.75 million. Revenues from oil and gas royalties (\$45.17 million), oil extraction taxes (\$23.27 million) and tobacco lawsuit settlement proceeds (\$9.01 million) were more than enough offset the investment losses experienced during the quarter.
- ◆ During April 2012, \$6.26 million was distributed from the Common Schools Trust Fund to K-12 education in North Dakota; a total \$46.26 million was distributed to K-12 education during fiscal year 2012.
- ◆ An additional \$1.48 million was paid to the beneficiaries of the other 12 permanent trust funds in June 2012, bringing total distributions to other beneficiaries to \$2.97 million for fiscal year 2012.



ACTUAL ALLOCATION VS. TARGET ALLOCATION AS OF JUNE 30, 2012



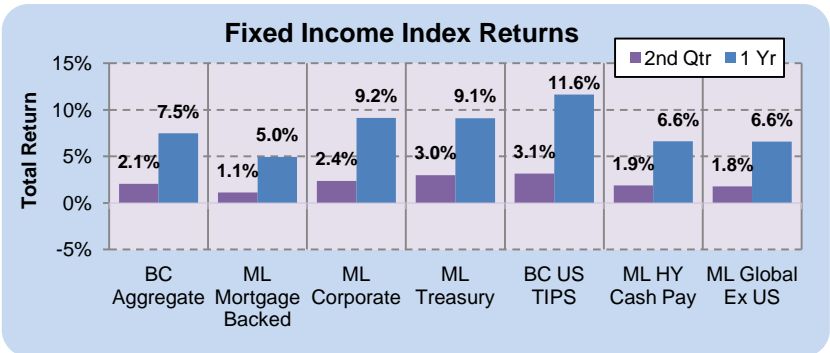
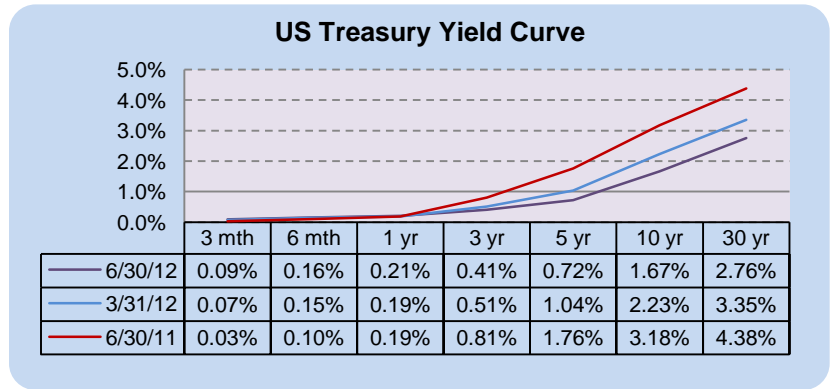
Asset Class	Actual \$ million	Actual %	Target \$ million	Target %	Difference \$ million	% Diff.
US Large Cap Equities	\$ 303.69	15.1%	\$ 302.41	15.0%	\$ 1.28	0.1%
US Sm/Mid Cap Equities	200.88	10.0%	201.62	10.0%	(0.74)	(0.0%)
REITS	126.70	6.3%	120.97	6.0%	5.73	0.3%
Convertible Securities	190.14	9.4%	201.62	10.0%	(11.48)	(0.6%)
International Equities	199.66	9.9%	201.62	10.0%	(1.96)	(0.1%)
Total Equities	\$ 1,021.07	50.7%	\$ 1,028.24	51.0%	(\$ 7.17)	(0.3%)
US Invest. Grade Fixed-Income	629.81	31.2%	648.30	32.2%	(18.49)	(1.0%)
Cash Equivalents	27.90	1.4%	0.00	0.0%	27.90	1.4%
Loans	37.19	1.8%	37.19	1.8%	0.0	0.0%
High Yield Fixed-Income	199.58	9.9%	201.62	10.0%	(2.04)	(0.1%)
International Fixed-Income	100.61	5.0%	100.81	5.0%	(0.20)	(0.0%)
Total Fixed-Income	\$ 995.09	49.3%	\$ 987.92	49.0%	\$ 7.17	0.3%
Total Portfolio	\$ 2,016.16	100.0%	\$ 2,016.16	100.0%		

- ◆ The actual asset allocation of the portfolio was very close to the target allocation for the portfolio on June 30, 2012, with equities being slightly underweight and fixed income slightly overweight.
- ◆ The overweight position to cash equivalents at the end of the quarter is primarily new cash received in July that is allocated back to June 30, 2012 for asset allocation purposes. This cash was put to work in late-July to rebalance the portfolio when \$7 million was added to various equity accounts, \$2 million was added to the high yield portfolio and \$16 million was added to Payden & Rygel's Low Duration Fund.
- ◆ The Commissioner continued to deliberately keep the size of the convertible securities portfolio at less than the full target weight for convertible securities. The Commissioner is doing so due to the poor performance of the portfolio over the past year and the likelihood that the upcoming investment study will result in no allocation to converts going forward.
- ◆ The permanent trusts continue to fund all rebalancing activities with cash flows, primarily from oil and gas activities. The large cash flows being generated by trust lands continue to help keep rebalancing costs far lower than most plan sponsors experience.

FINANACIAL MARKET OVERVIEW

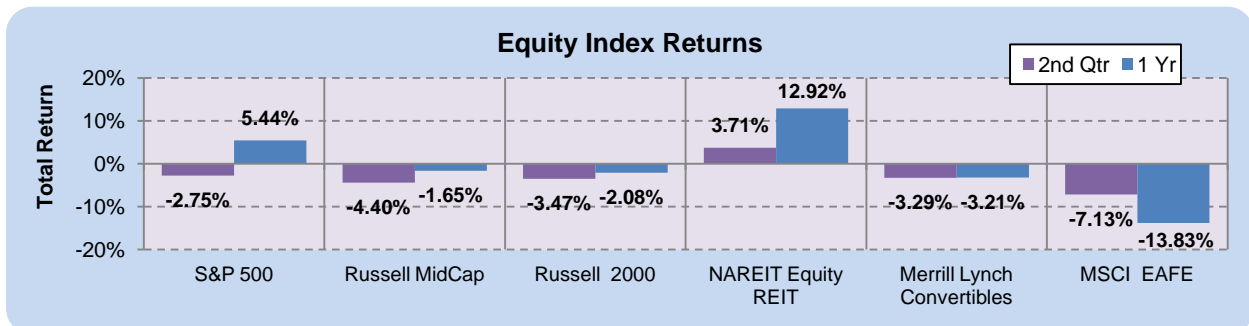
FIXED INCOME MARKETS

- ◆ The Treasury curve flattened during the quarter as short-term rate rose slightly, while long-term rates fell to historic lows.
- ◆ The Fed reaffirmed their pledge to keep short-term interest rates low until at least 2014.
- ◆ 10-year Treasury bonds were yielding 1.67% on June 30, 2012, 56 basis points less than they were March 31, 2012 and 151 basis points less than they were on June 30, 2011. 30-year Treasuries were yielding 2.76% at quarter's end, down 59 basis points for the quarter and 162 basis points over the trailing year.
- ◆ During the quarter, Treasuries and TIPS were the best performing fixed income sectors, as investors sought out safe investment assets. For the trailing year, TIPS outperformed all other fixed income setors, corporate bonds and Treasuries also posted strong returns for the fiscal year ended June 30, 2012.



EQUITY MARKETS

- ◆ Returns posted by the various equity asset classes held by the portfolio varied substantially during both the quarter and trailing year ended June 30, 2012. The dispersion of quarterly returns was more than 10% from best to worst, while for the trailing year the dispersion of returns was more than 26% from best to worst.
- ◆ REITs were the strongest performing equity asset class for both the quarter and year ended June 30, 2012, while international large cap equities, as measured by the MSCI EAFE Index, were the worst performing equity asset type during both the quarter and trailing year.
- ◆ Renewed concerns about Europe's sovereign debt crisis, slowing growth in China and a lackluster recovery in the U.S. were all factors in the poor returns posted by most equity asset classes over the past year.



MANAGER AND PORTFOLIO RETURNS

RETURNS FOR PERIODS ENDED JUNE 30, 2012									
<u>Asset Class</u> MANAGER Benchmark/Index	6/30/12 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	\$303.69	15.1%	(2.76)	5.42	16.40	-	-		
S&P 500 Index			(2.75)	5.44	16.39	0.22	5.33		
Small/Mid Cap US Equities	\$200.88	10.0%	(4.86)	(3.34)	16.89	-	-		
NORTHERN TRUST	\$101.67	5.1%	(4.89)	(4.03)	16.05	(0.37)	5.96		
STATE STREET - Small/Mid Index	\$99.21	4.9%	(4.82)	(2.48)	18.73	-	-		
60% R2000/40% Russell Mid Cap			(3.84)	(2.12)	18.46	1.39	7.53		
Russell Completeness Index			(4.88)	(2.68)	18.58	1.25	8.07		
Real Estate Investment Trusts (REITS)									
DELAWARE INVESTMENT ADVISORS	\$126.70	6.3%	3.38	14.29	31.55	3.20	-		
NAREIT Equity REIT Index			3.72	12.92	34.42	2.60	10.32		
Convertible Securities									
TRUST COMPANY OF THE WEST	\$190.14	9.4%	(4.60)	(7.08)	8.76	(1.52)	3.54		
Merrill Lynch All US Convertibles Index			(3.29)	(3.21)	13.30	2.02	6.46		
Merrill Lynch All US Investment Grade Index			(2.85)	(1.23)	8.65	(0.99)	2.83		
TOTAL DOMESTIC EQUITIES	\$821.41	40.8%	(2.80)	1.41	16.92	-	-		
International Equities									
STATE STREET - International Alpha	\$199.66	9.9%	(9.03)	(18.55)	3.74	(8.57)	-		
MSCI EAFE Index			(7.13)	(13.83)	5.96	(6.10)	5.14		
TOTAL EQUITIES	\$1,021.07	50.7%	(4.00)	(2.71)	14.35	(2.44)	5.00		
US Investment Grade Fixed Income									
PAYDEN & RYSEL - Aggregate	\$657.71	32.6%	1.77	7.01	7.50	-	-		
PAYDEN & RYSEL - Intermediate	\$138.53	6.9%	1.95	7.34	8.82	6.96	6.16		
JP MORGAN - Intermediate	\$199.91	9.9%	(0.18)	Performance for part of June, 2012 only					
BND - Project Notes	\$3.30	0.2%	0.77	4.18	5.77	6.73	5.22		
PAYDEN & RYSEL - GNMA/Short Bond	\$135.85	6.7%	1.17	4.76	5.19	5.59	4.49		
NORTHERN TRUST - TIPS	\$152.22	7.5%	3.11	11.81	10.0	8.56	-		
PAYDEN & RYSEL - Cash	\$27.90	1.4%	0.01	0.02	0.07	1.05	3.35		
Barclay's Capital US Aggregate Index			2.05	7.47	6.94	6.80	5.64		
Barclay's Capital TIPS			3.14	11.64	9.62	8.43	-		
6 Month T-Bill			0.00	0.06	0.19	1.32	1.98		
Loans									
BND - Farm Loan Pool	\$37.19	1.8%	1.42	6.18	6.45	-	-		
BND - Energy Construction Loans	\$34.80	1.7%	1.43	6.19	6.43	6.79	7.24		
BND - Energy Construction Loans	\$2.39	0.1%	1.37	5.79	-	-	-		
US High Yield Fixed Income									
LAZARD ASSET MANAGEMENT	\$199.58	9.9%	1.22	7.44	12.32	7.16	-		
Merrill Lynch US High Yield Cash Pay Index			1.88	6.61	16.01	8.07	-		
Merrill Lynch BB/B Index			2.01	7.18	14.41	7.56	-		
TOTAL DOMESTIC FIXED INCOME	\$894.48	44.3%	1.63	7.14	8.50	-	-		
International Invest. Grade Fixed Income									
FIRST INT'L ADVISORS	\$100.61	5.0%	1.18	7.34	5.73	5.34	-		
Merrill Lynch Broad Global (Ex-US) Index - Hedged			1.79	6.58	4.64	4.50	-		
TOTAL FIXED INCOME	\$995.09	49.3%	1.64	7.15	8.25	6.89	5.95		
TOTAL PORTFOLIO	\$2,016.16	100.0%	(1.22)	2.42	11.44	2.71	5.89		

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 negative total return of -4.00% during the quarter ended June 30, 2012; it posted a return of -2.71% for the trailing year there ended. Over longer periods of time the combined portfolio has performed much better, returning an annualized rate of 14.35% for the trailing 3-year period ended June 30, 2012, and 5.00% over the trailing 10-year period there ended.
- ◆ All of the permanent trusts' active equity managers underperformed their benchmarks for the quarter ended June 30, 2012; Delaware was the only active equity manager to outperform for the trailing year there ended.
- ◆ The TCW convertible securities and the SSGA International Alpha portfolios both continued to struggle during the quarter. The Commissioner has been in discussions with both companies and expects to report back to the Board with specific recommendations for both portfolios shortly.

Northern Trust – Small/Mid Cap

- ◆ Northern Trust underperformed the new benchmark for this account for the quarter ended June 30, 2012 and has underperformed by a small margin since the portfolio was rearranged and the new benchmark was implemented effective January 1, 2012.
- ◆ The changes to the portfolio were implemented at the recommendation of Northern Trust, so that the benchmark would better reflect the actual way managers invest in mid and small cap markets. Northern also adjusted the manager lineup of the portfolio slightly to better reflect the characteristics of the new benchmark.

Delaware Investment Advisors

- ◆ Delaware has either outperformed or underperformed the benchmark for this portfolio by relatively small margins for all periods shown in the table on page 4. Since inception of the account in late 2003, they have essentially matched the index, net of fees.
- ◆ An overweight position in malls and good stock selection in the self storage sector both added to performance during the quarter. The portfolio's position in apartment REITs hurt performance during the quarter.

Trust Company of the West (TCW)

- ◆ TCW once again underperformed versus the broad Merrill Lynch All US Convertibles Index for all periods shown in the table on page 4. Over the past 12 months TCW has underperformed the broad index by more the 400 basis points and the higher quality investment grade index by more than 500 basis points.
- ◆ Between the poor performance of this portfolio, and the upcoming sale of TCW to the Carlyle Group, the Commissioner has serious concerns about this portfolio going forward. The Commissioner intends to keep this portfolio at below target weight until such time as the investment study is complete, but may seek further action from the Board before a study is complete if the situation warrants it.

State Street Global Advisors (SSGA) – International Alpha

- ◆ SSGA has underperformed the benchmark for this account by 190 basis points or more for all periods shown in the table on page 4.
- ◆ Representatives of SSGA met with the Commissioner and staff in Bismarck in late June to discuss the portfolio. During that meeting SSGA explained how they had made significant changes to the computer model used to run this portfolio. They also offered the Board an improved fee schedule for the product.
- ◆ SSGA is currently preparing a detailed performance attribution analysis for department staff to review. The Commissioner will report back to the Board soon as to the findings of the review and will have a specific recommendation for the Board at that time.

FIXED INCOME PORTFOLIO REVIEW

- ◆ During the quarter ended June 30, 2012, the combined fixed income portfolio posted a total return of 1.64%. The combined portfolio earned 7.15% for the trailing year ended June 30, 2012 and has earned an average return of 5.95% each year over the past 10 years.
- ◆ All established fixed income portfolios posted positive returns for both the quarter and trailing year ended June 30, 2012; the only exception is the new J.P Morgan intermediate bond portfolio which funded in late June.
- ◆ On March 29, 2012, the Board approved a 10% allocation to the J.P. Morgan intermediate bond portfolio and also approved a 10% allocation to an Aggregate bond portfolio to be managed by Payden & Rygel. The funding needed to meet those target allocations will come primarily from the GNMA/Short Bond Account. These changes will help diversify the portfolio by both manager and maturity/duration.

Payden & Rygel – Aggregate

- ◆ Although the portfolio underperformed versus the Barclay's Capital Aggregate Index for the quarter and trailing year, it has outperformed the index over longer time periods.
- ◆ As a result of Board action in March, this portfolio will be transitioned into an actively managed aggregate bond portfolio going forward. It is expected that this transition will occur during the 3rd quarter of 2012 and will involve transferring about \$60 million from the GNMA/Short Bond account.

J.P Morgan – Intermediate

- ◆ This new portfolio was funded in late June with an initial transfer of \$50 million. The balance of funding for this account will be transferred during the first one-half July. All of the funding from this portfolio will come from the GNMA/Short Bond Fund account. It is expected that the portfolio will be fully invested and ready to be monitored for performance purposes by August 1st.

Payden & Rygel - Cash

- ◆ As cash flows have increased and short-term interest rates have remained low, it is almost impossible for Payden & Rygel to earn any income or add any value to a cash equivalents portfolio at this time.

Bank of North Dakota (BND) – Farm Loan Pool

- ◆ In April, the Commissioner met with BND to explore the possibility of lowering or eliminating the rate floors that have been set by the Board. These floors have left the Board about 100 basis points out of the market for 10-year adjustable and 25-year fixed rate loans the Board has historically funded.
- ◆ With interest rates at historic lows, the Commissioner was not interested in funding a large volume of long-term loans, so instead, the Commissioner agreed to let BND fund these loans until such time that the Board lowers the rate floors or rates rise above the Boards current rate floors.
- ◆ Without no new loans being funded, a total of \$10 million of cash has been transferred out of this portfolio and moved to other fixed income investments over the past 6 months.

Lazard

- ◆ Although Lazard underperformed the benchmark for this account for the quarter, they outperformed over the trailing year. They have underperformed the benchmark by various amounts for longer periods of time.
- ◆ Underweight positions in the volatile and uncertain bank and finance sectors detracted from performance during the quarter, as did an overweight position to the automotive sector and underweight positions in gaming and metals
- ◆ The high quality of this portfolio should help going forward if financial markets stumble or if interest rates or spreads should rise.

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 **Strategic Investment and Improvements Fund (SIIF)** was created effective July 1, 2011, by way of House Bill 1451, which merged the roles of the former Budget Stabilization Fund and the former Lands and Minerals Trust Fund. 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.

	6/30/12 Asset Balances	Current Yield
Capitol Building Trust	\$3,181,000	0.50%
Strategic Investment and Improvements Fund	\$ 353,618,000	0.27%

- ◆ Any new money coming into these two funds is currently being invested in Treasury securities that are being held in custody at BND. BND used to offer these trusts BND CDs at T-Bill/T-Bond equivalent rates; however, that option is no longer available.
- ◆ It is expected that starting in September, 100% of the state's share of oil and gas taxes will begin being deposited into the SIIF. Due to the uncertainty as to when SIIF money will be spent, all new money received in SIIF will be invested in Treasury securities maturing prior to June 30, 2013.

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.

	6/30/12 Asset Balances	Current Yield
Coal Development Trust Fund		
Coal Warrants	\$ 8,451,000	3.90%
School Construction Loans	\$ 21,438,000	1.87%
Marketable Securities	<u>\$ 34,049,000</u>	N/A - see returns below
Total	\$ 63,938,000	

- ◆ During June, two school construction loans, totaling almost \$1 million were paid off ahead of schedule. School loan commitments outstanding stood at \$19.33 million at quarter's end.

Payden and Rygel – Coal

- ◆ Payden & Rygel outperformed the benchmark for this account for the quarter ended June 30, 2012 and trailing 1 and 3-year periods there ended. They have underperformed the benchmark by small margins for the trailing 5 and 10-year periods ended June 30, 2012, and since inception of the account.
- ◆ The portfolio benefited from the flattening of the yield curve as well as its exposure to corporate bonds and mortgage and asset backed securities.

	6/30/12 Asset Balance	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Payden & Rygel Coal Dev.	\$34.05	0.37	1.60	2.41	3.02	3.00
ML 1-3 Year Treasury Index		0.19	0.78	1.60	3.27	3.02
All return figures for periods of 1 year or greater have been annualized. Returns are net of fees						