NORTH DAKOTA
BOARD OF UNIVERSITY AND SCHOOL LANDS

INVESTMENT PERFORMANCE REPORT

For periods ended December 31, 2012

DEPARTMENT OF
ND TRUST LANDS
INVESTING FOR EDUCATION

PERMANENT EDUCATIONAL TRUST ASSETS

TOTAL TRUST ASSETS

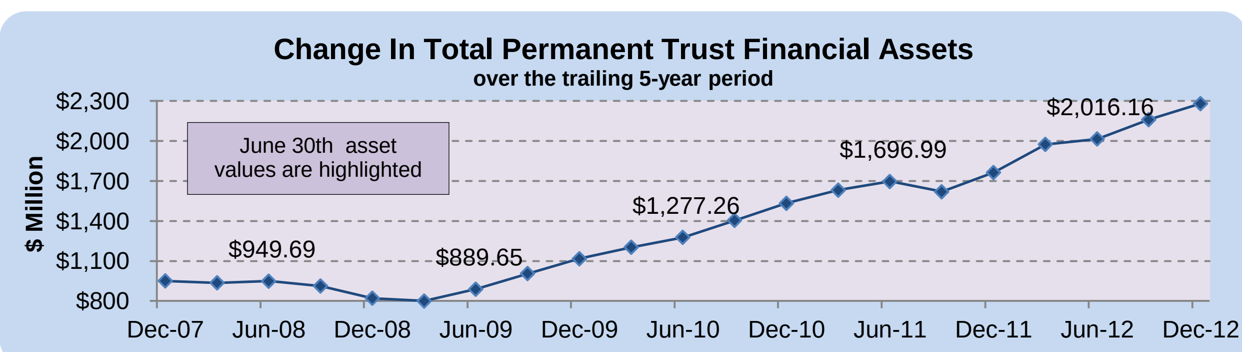
The first section of this report shows combined data for the 13 permanent educational trust funds and the Indian Cultural Education Trust managed by the Board. Most assets of the trusts are invested in a pool. Each trust owns a share of the investments in the pool and each trust shares proportionately 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 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
6/30/12 Rebalanced	$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%
12/31/12 Actual	**$2,281,030,000**	**$419,912,000 18.4%**	**$283,772,000 12.4%**	**$172,976,000 7.6%**	**$0 0.0%**	**$287,573,000 12.6%**	**$1,116,797,000 49.0%**
12/31/12 Target	$2,281,030,000	$426,553,000 18.7%	$282,848,000 12.4%	$171,077,000 7.5%	$0 0.0%	$282,848,000 12.4%	$1,117,704,000 49.0%

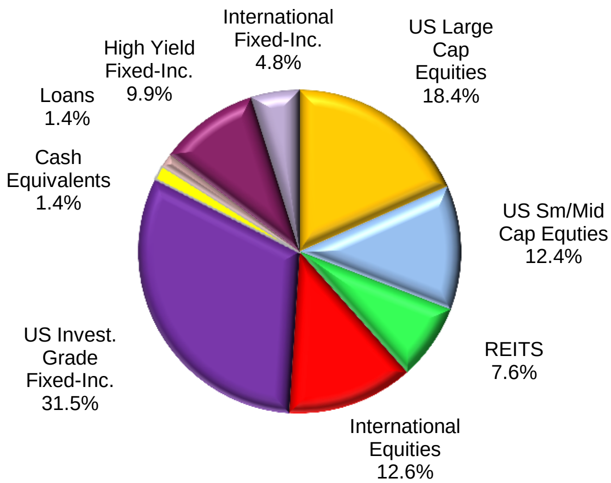
- Total trust financial assets grew by $119.59 million during the quarter ended December 31, 2012; the value of total trust assets increased by $264.87 million during the first six months of fiscal year 2013.
- The 2.02% return earned by the combined investment portfolio during the quarter was responsible for $44.69 million of trust growth. Most of the rest of trust growth during the quarter came from oil and gas royalties ($39.77 million) and oil extraction taxes ($29.10 million).
- $13.2 million was distributed from the Common Schools Trust Fund to K-12 education in North Dakota during the quarter; a total of $46.26 million will be distributed to K-12 education during fiscal year 2013.
- Since equity markets last hit bottom back in March, 2009, total trust assets have increased during 14 of the last 15 quarters. The combination of strong equity markets and growing oil related revenues has resulted in the permanent trusts growing by a remarkable $1.48 billion during the past 3¾ years.



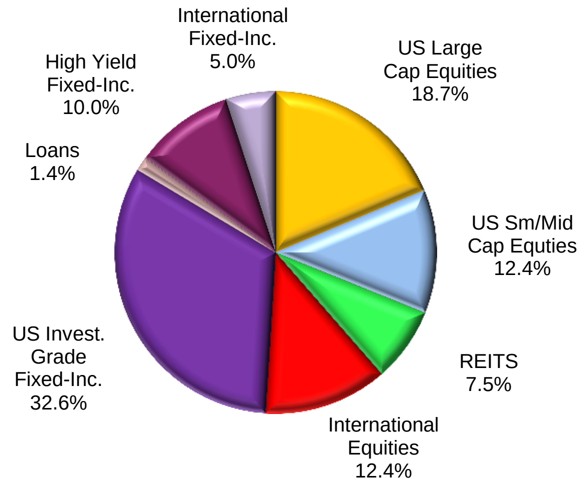
DEPARTMENT OF ND TRUST LANDS INVESTING FOR EDUCATION

ACTUAL ALLOCATION VS. TARGET ALLOCATION AS OF DECEMBER 31, 2012

ACTUAL ALLOCATION



TARGET ALLOCATION



Asset Class	Actual $ million	Actual %	Target $ million	Target %	Difference $ million	% Diff.
US Large Cap Equities	$ 419.91	18.4%	$ 426.55	18.7%	($ 6.64)	(0.3%)
US Sm/Mid Cap Equities	283.77	12.4%	282.85	12.4%	0.92	0.0%
REITS	172.98	7.6%	171.08	7.5%	1.90	0.1%
Convertible Securities	0.00	0.0%	0.00	0.0%	0.00	0.0%
International Equities	287.57	12.6%	282.85	12.4%	4.72	0.2%
Total Equities	**$ 1,164.23**	**51.0%**	**$ 1,163.33**	**51.0%**	**$ 0.90**	**0.0%**
US Invest. Grade Fixed-Income	715.76	31.5%	743.28	32.6%	(27.52)	(1.1%)
Cash Equivalents	32.68	1.4%	0.00	0.0%	32.68	1.4%
Loans	32.27	1.4%	32.27	1.4%	0.0	0.0%
High Yield Fixed-Income	225.95	9.9%	228.10	10.0%	(2.15)	(0.1%)
International Fixed-Income	110.14	4.8%	114.05	5.0%	(3.91)	(0.2%)
Total Fixed-Income	**$ 1,116.80**	**49.0%**	**$ 1,117.70**	**49.0%**	**($ 0.90)**	**(0.0%)**
Total Portfolio	**$ 2,281.03**	**100.0%**	**$ 2,281.03**	**100.0%**		

- The actual asset allocation of the portfolio on December 31, 2012 was very close to the target allocation for the portfolio on that date, with equities being slightly overweighted and fixed income slightly underweighted at quarter's end.

- The biggest overweight position was cash equivalents; the biggest underweight was investment grade fixed income. The cause of this difference was primarily new cash received in January 2013 that was applied back to December for asset allocation purposes. The excess cash was used to rebalance the portfolio in late-January 2013.

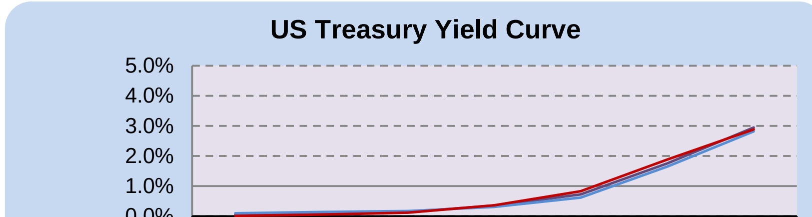
- TCW was relieved of their portfolio management responsibilities in late-September 2012. The portfolio was liquidated during the quarter; the funds in the portfolio were reallocated proportionately to the other equity portfolios during the quarter.

- In anticipation of portfolio changes that will most likely occur once an asset allocation is completed, any new money allocated to equities is being allocated to passively managed portfolios, when possible.

FINANACIAL MARKET OVERVIEW

FIXED INCOME MARKETS

- The Treasury curve steepened slightly during the quarter, with long-term rates climbing by a small margin and shorter-term rates falling by a small margin. Interest rates have changed very little over the past year.

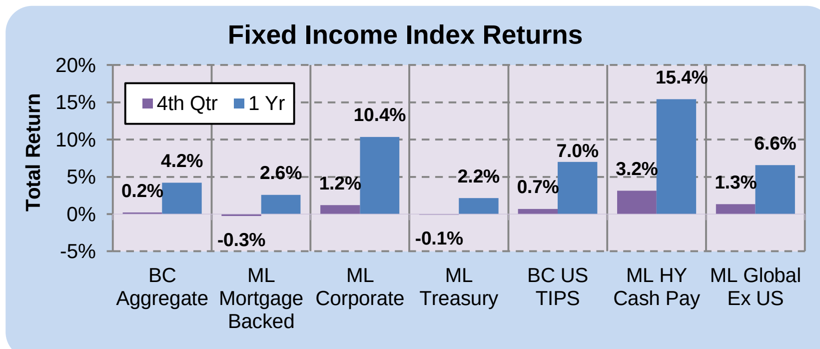


	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr	30 yr
12/31/12	0.04%	0.11%	0.14%	0.35%	0.72%	1.76%	2.95%
9/30/12	0.10%	0.14%	0.17%	0.31%	0.62%	1.65%	2.82%
12/31/11	0.01%	0.06%	0.12%	0.36%	0.83%	1.89%	2.89%

- During the quarter the Fed adopted unemployment and inflation thresholds that would trigger rate increases. According to the Fed, rates will remain near zero as long as the unemployment rate was above 6.5% and inflation was below 2.5%.

- Tightening credit spreads were responsible for the strong returns posted by high yield bonds during both the quarter and year ended December 31, 2012.

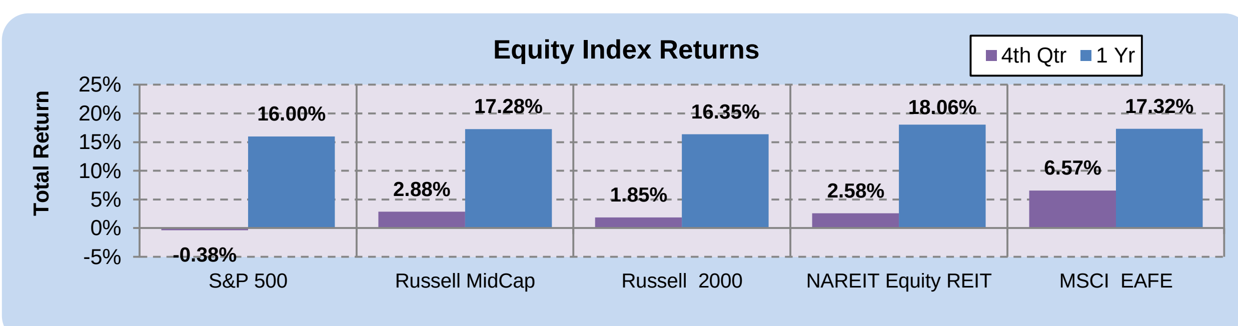
- Mortgage backed securities and US Treasuries both posted small negative returns during the quarter as less negative outlooks for China and Europe lessened the relative appeal of these perceived safe havens.



EQUITY MARKETS

- Large cap U.S. equities were the only asset class in the portfolio to post a negative return during the quarter ended December 31, 2012, as the fiscal cliff and the debt ceiling both had a negative impact on consumer confidence. For the trailing year, all equity asset classes in the portfolio posted strong double-digit returns, with value stocks outperforming growth across all market cap ranges.

- The financial and consumer discretionary sectors were the strongest performers both domestically and internationally during the quarter, while telecommunication stocks were the worst performing sector globally. European stocks were the primary driver of EAFE returns for both the quarter and trailing year ended December 31, 2012.



MANAGER AND PORTFOLIO RETURNS

RETURNS FOR PERIODS ENDED DECEMBER 31, 2012							
Asset Class **MANAGER** Benchmark/Index	**12/31/12 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	**$419.91**	**18.4%**	**(0.39)**	**15.96**	**10.86**	**-**	**-**
S&P 500 Index			(0.38)	16.00	10.87	1.66	7.10
Small//Mid Cap US Equities	**$283.77**	**12.4%**	**3.15**	**17.65**	**11.88**	**-**	**-**
NORTHERN TRUST	**$111.01**	**4.9%**	**3.39**	**17.46**	**11.29**	**2.36**	**8.81**
STATE STREET - Small/Mid Index	**$172.76**	**7.5%**	**3.09**	**18.14**	**12.98**	**-**	**-**
60% R2000/40% Russell Mid Cap			2.26	16.73	12.74	4.18	10.06
Russell Completeness Index			3.05	18.05	12.83	3.83	10.38
Real Estate Investment Trusts (REITS)							
DELAWARE INVESTMENT ADVISORS	**$172.98**	**7.6%**	**2.45**	**17.05**	**18.31**	**5.76**	**-**
NAREIT Equity REIT Index			2.58	18.06	17.83	5.45	11.63
TOTAL DOMESTIC EQUITIES	**$876.66**	**38.4%**	**1.43**	**14.54**	**10.81**	**-**	**-**
International Equities	**$287.57**	**12.6%**	**8.26**	**17.23**	**2.13**		
STATE STREET - International Alpha	**$234.54**	**10.3%**	**8.43**	**17.42**	**2.19**	**(5.17)**	**-**
NTGI - EAFE Index (return for 2 months)	**$53.03**	**2.3%**	**5.58**	**-**	**-**	**-**	**-**
MSCI EAFE Index			6.57	17.32	3.56	(3.69)	8.21
TOTAL EQUITIES	**$1,164.23**	**51.0%**	**2.91**	**15.30**	**9.24**	**0.03**	**7.09**
US Investment Grade Fixed Income	**$748.44**	**32.9%**	**0.54**	**5.77**	**6.60**	**-**	**-**
PAYDEN & RYGEL - Aggregate	**$219.73**	**9.6%**	**0.65**	**8.87**	**7.73**	**6.96**	**5.98**
JP MORGAN - Intermediate	**$217.82**	**9.6%**	**0.31**	**-**	**-**	**-**	**-**
BND - Project Notes	**$2.67**	**0.1%**	**0.64**	**3.27**	**5.19**	**5.89**	**5.03**
PAYDEN & RYGEL – GNMA/Short Bond	**$119.04**	**5.2%**	**0.66**	**4.50**	**4.87**	**5.11**	**4.28**
NORTHERN TRUST - TIPS	**$156.50**	**6.9%**	**0.66**	**6.90**	**9.01**	**7.14**	**-**
PAYDEN & RYGEL – Cash	**$32.68**	**1.5%**	**0.05**	**0.04**	**0.05**	**0.56**	**1.84**
Barclay's Capital US Aggregate Index			0.22	4.22	6.20	5.96	5.19
Barclay's Capital TIPS			0.70	6.98	8.89	7.03	-
6 Month T-Bill			0.05	0.11	0.17	0.79	1.89
Loans	**$32.27**	**1.4%**	**1.38**	**5.87**	**6.26**	**-**	**-**
BND - Farm Loan Pool	**$30.15**	**1.3%**	**1.39**	**5.89**	**6.25**	**6.59**	**7.13**
BND – Energy Construction Loans	**$2.12**	**0.1%**	**1.32**	**5.58**	**-**	**-**	**-**
US High Yield Fixed Income							
LAZARD ASSET MANAGEMENT	**$225.95**	**9.9%**	**2.45**	**11.61**	**9.59**	**8.15**	**-**
Merrill Lynch US High Yield Cash Pay Index			3.15	15.44	11.61	9.90	-
Merrill Lynch BB/B Index			3.08	14.70	11.47	9.11	-
TOTAL DOMESTIC FIXED INCOME	**$1,006.66**	**44.2%**	**1.00**	**7.06**	**7.30**	**-**	**-**
International Invest. Grade Fixed Income							
FIRST INT'L ADVISORS	**$110.14**	**4.8%**	**1.82**	**7.53**	**6.13**	**6.08**	**-**
Merrill Lynch Broad Global (Ex-US) Index – Hedged			1.32	6.57	4.62	4.80	-
TOTAL FIXED INCOME	**$1,116.80**	**49.0%**	**1.08**	**7.11**	**7.17**	**6.63**	**5.89**
TOTAL PORTFOLIO	**$2,281.03**	**100.0%**	**2.02**	**11.35**	**8.54**	**3.90**	**6.80**

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

DEPARTMENT OF ND TRUST LANDS
INVESTING FOR EDUCATION

EQUITY PORTFOLIO REVIEW

- ♦ During the quarter ended December 31, 2012, the combined equity portfolio posted a total return of 2.91%; the portfolio returned 15.30% over the trailing year there ended. For the first time in a long time, the combined equity portfolio shows positive returns for all periods shown in the table on page 4.

- ♦ Northern Trust (Small/Mid) and State Street (International) outperformed their benchmarks for both the quarter and trailing year ended December 31, 2012, while Delaware (REITs) underperformed for both of those periods.

- ♦ During the quarter, the TCW convertible securities portfolio was liquidated and the funds were reallocated to the other equity portfolios in proportion to their previous target percentages. The revised target asset allocations are reflected in the pie charts on page 2 of this report.

- ♦ In anticipation of the forthcoming asset allocation study, when possible, the funds were added to passive index accounts. A new passive EAFE portfolio was opened during the quarter to handle the international portion of the proceeds from the TCW liquidations and any future new money that is dedicated to international equities.

<u>Northern Trust – Small/Mid Cap</u>

- ♦ Northern Trust outperformed the benchmark for both the quarter and trailing year ended December 31, 2012. Although they have still underperformed for the trailing 3, 5 and 10 year periods there ended, they have outperformed the benchmark for the account by 95 basis points since inception in April 1996.

- ♦ The adjustments to both the benchmark and manager lineup that were made in late 2011 to better reflect the actual way managers invest in mid and small cap markets seem to have had a positive impact on the portfolio's performance.

<u>Delaware Investment Advisors</u>

- ♦ Delaware underperformed the benchmark for this portfolio for both the quarter and trailing one-year period ended December 31, 2012; they have outperformed the index by a small margin for the trailing three and five-year periods there ended and have essentially matched the benchmark since inception.

- ♦ Delaware's overweight positions in healthcare REITS helped the performance of the portfolio over the trailing year, while the poor performance of two office REITS hurt performance.

<u>Trust Company of the West (TCW)</u>

- ♦ The liquidation/transition of this portfolio began in late-October and was completed in early-December, 2012. It took slightly longer than expected because State Street (and staff) didn't want to sell a number of the less liquid securities in the portfolio at fire sale prices. In the end the cost of the transition was about 60 basis points, well within the expected cost of the transition.

<u>State Street Global Advisors (SSGA) – International Alpha</u>

- ♦ SSGA outperformed the benchmark for this account by 185 basis points for the quarter ended December 31, 2012 and by a12 basis points for the trailing year.

- ♦ The Commissioner and staff continue to monitor this portfolio closely, and have been receiving quarterly attribution reports. In the meantime, no new money will be added to this portfolio.

- ♦ A performance based fee went into effect for this portfolio as of October 1, 2012. The fee will be 10 basis points unless SSGA outperforms the benchmark over a 3 year trailing period. SSGA would have to outperform the benchmark by more than 325 basis points per year to earn the 65 basis point fixed fee that was previously charged for this product.

FIXED INCOME PORTFOLIO REVIEW

- The combined fixed income portfolio posted a total return of 1.08% during the quarter ended December 31, 2012 and 7.11% for the trailing year there ended. Over the past 10 years the combined fixed income portfolio has returned an average of 5.89% per year.

- Every fixed income portfolio posted a positive return for both the quarter and trailing year ended December 31, 2012. The Lazard high yield bond portfolio produced the highest absolute returns of any fixed income portfolio for both the quarter and trailing year there ended.

- With Treasury rates near all-time lows and credit spreads as tight as they currently are, the chances of generating more than low single-digit returns from the overall fixed income portfolio over the next few years are minimal.

Payden & Rygel – Aggregate

- This portfolio outperformed its Barclay's Capital Aggregate Index benchmark for the quarter, trailing year and all other periods shown in the table on page 4.

- The portfolio's exposure to corporate bonds was the primary reason that the portfolio outperformed the benchmark by more than 465 basis points over the past year.

J.P. Morgan – Intermediate

- The J.P. Morgan intermediate portfolio underperformed the benchmark Barclays Capital Govt./Corp. Intermediate Index by a small margin during the quarter ended December 31, 2012, however the portfolio has outperformed the index by 20 basis points since inception of the account in August 2012.

- During the quarter J.P. Morgan increased the portfolio's exposure to credit while decreasing its exposure to both Treasury and Mortgage backed securities.

Payden & Rygel - Cash

- Between historic low short-term interest rates and the huge cash flows that flow through this account, Payden and Rygel has to work hard to post positive returns in this portfolio.

Bank of North Dakota (BND) – Farm Loan Pool

- Since April 2012 no new loans have been funded in this portfolio. With long-term rates at or near historic lows, the Commissioner has not wanted to add new loans to the portfolio at this time. BND has agreed to fund these loans until such time that rates rise to a level more in line with the permanent trusts objectives.

- As principal pay downs continue in this portfolio the cash will be swept out of the account and reinvested in other fixed income strategies. $3.84 million of un-needed cash was transferred out of this account during December, 2012.

Lazard

- Lazard underperformed both the broad Cash Pay index and the higher quality BB/B index by various amounts for all periods shown in the table on page 4 of this report.

- The high quality nature of this portfolio was once the primary reason for the weak relative performance. CCC bonds returned 3.5% during the quarter, while higher quality BB bonds returned 2.7%. Approximately 79% of the portfolio is rated BB or better.

- The Commissioner has been informed that the long-term manager of this portfolio, Bill Charlton, will be semi-retiring in the near future. The Commissioner has scheduled a meeting for May to discuss the change in portfolio managers, and will also discuss the changes, and the relatively weak performance of this portfolio with the investment consultant that is expected to be hired shortly.

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.

	12/31/12 Asset Balances	Current Yield
Capitol Building Trust	$ 2,715,000	0.17%
Strategic Investment and Improvements Fund	$ 696,865,000	0.15%

- During the quarter more than $221 million of gross production and oil extraction taxes were deposited into the SIIF. Based on current estimates, more than $700 million of oil tax revenue will be deposited into the fund before the end of the biennium.

- The current yield of the SIIF continues to fall as all new monies received in the fund are being invested in Treasury securities maturing before June 30, 2013. This is being done as it is unknown how much will be transferred or appropriated out of the SIIF by the 63rd Legislative Assembly.

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.

	12/31/12 Asset Balances	Current Yield
Coal Development Trust Fund		
Coal Warrants	$ 8,252,000	3.87%
School Construction Loans	$ 35,140,000	2.09%
Marketable Securities	$ 21,422,000	**N/A - see returns below**
Total	$ 64,814,000	

- The increase in the size and current yield of the school construction loan portfolio is due to a $10.0 million loan to Minot PSD being funded during December at a rate of 2.57%. Current school loan rates are far higher than the yield currently being earned by the investment securities portfolio.

Payden and Rygel – Coal

- Payden & Rygel outperformed the benchmark Merrill Lynch 1-3 Year Treasury Index by 157 basis points over the trailing year ended December 31, 2012. Payden has essentially matched the index for longer time periods.

- Tightening credit spreads have been the primary driver of the portfolio's strong outperformance versus the benchmark over the past 3 years.

	12/31/12 Asset Balance	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Payden & Rygel Coal Dev.	**$21.42**	**0.15**	**2.00**	**1.95**	**2.38**	**2.73**
ML 1-3 Year Treasury Index		0.06	0.42	1.44	2.32	2.72
All return figures for periods of 1 year or greater have been annualized. Returns are net of fees						