

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

INVESTMENT PERFORMANCE REPORT

For periods ended March 31, 2013



PERMANENT EDUCATIONAL TRUST ASSETS

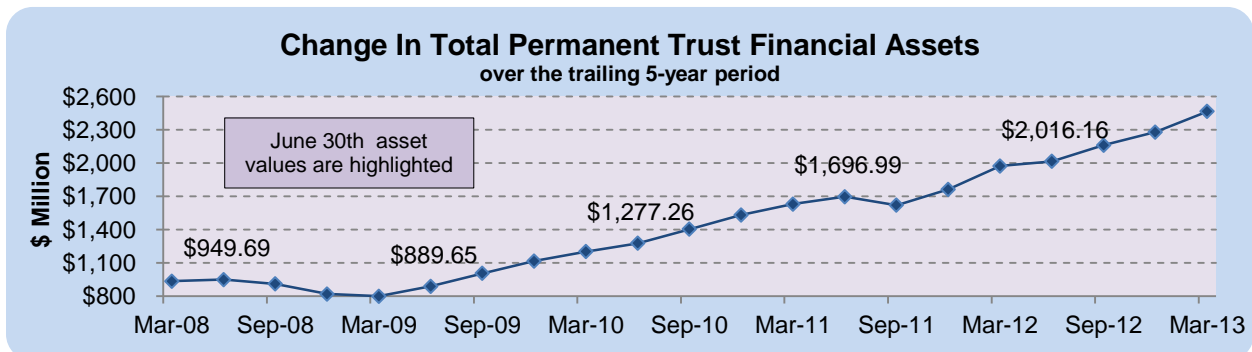
TOTAL TRUST ASSETS

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.

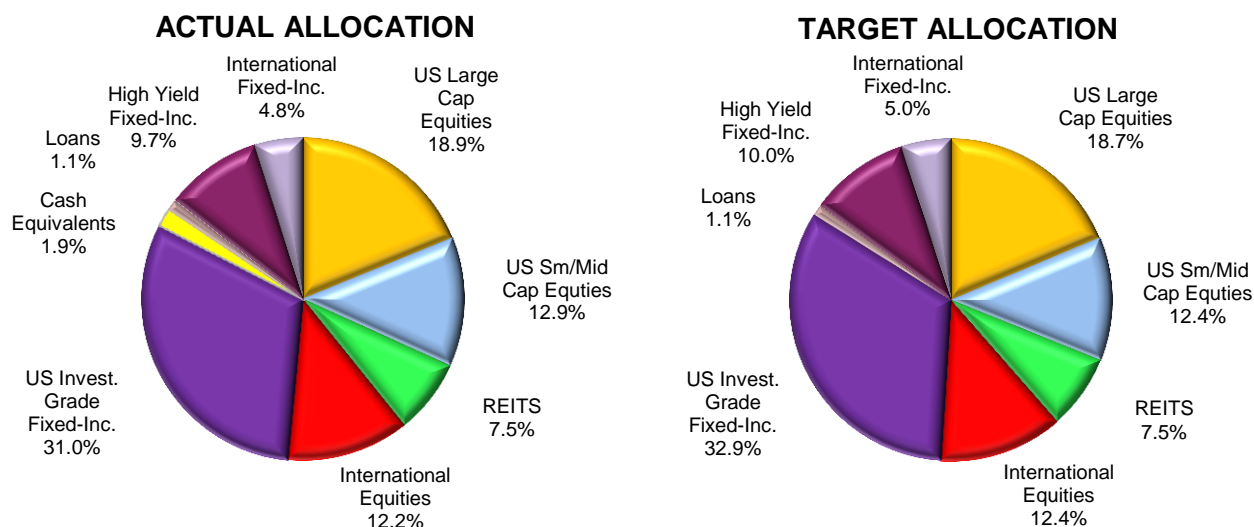
For the schedule below and for all other schedules, tables and charts that follow in this report, all loans, warrants, loan portfolios and certificate of deposits are valued at cost. All other investments in marketable securities, such as stocks, bonds, mutual funds and cash equivalents are valued at 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%
3/31/13 Actual	\$2,466,511,000	\$464,458,000 18.9%	\$318,930,000 12.9%	\$185,157,000 7.5%	\$0 0.0%	\$301,696,000 12.2%	\$1,196,270,000 48.5%
3/31/13 Target	\$2,466,511,000	\$461,237,000 18.7%	\$305,847,000 12.4%	\$184,989,000 7.5%	\$0 0.0%	\$305,847,000 12.4%	\$1,208,591,000 49.0%

- ◆ On March 31, 2013, total trust financial assets stood at \$2.47 billion, up \$185.48 million for the quarter. The value of total trust assets has climbed by more than \$450 million during the first 9 months of fiscal year 2013.
- ◆ The 4.97% total return earned by the overall investment portfolio during the quarter was responsible for approximately \$112.40 million of trust growth. Oil and gas royalties (\$52.83 million) and oil extraction taxes (\$31.12 million) were the other primary drivers of trust growth during the quarter.
- ◆ \$18.0 million was distributed from the Common Schools Trust Fund to K-12 education in North Dakota during the quarter ended March 31, 2013. An additional \$1.48 million was distributed to the beneficiaries of the other 12 permanent trust funds during January of 2013.
- ◆ Total permanent trust fund assets have tripled in size since equity markets last bottomed out back in March, 2009.



ACTUAL ALLOCATION VS. TARGET ALLOCATION AS OF MARCH 31, 2013



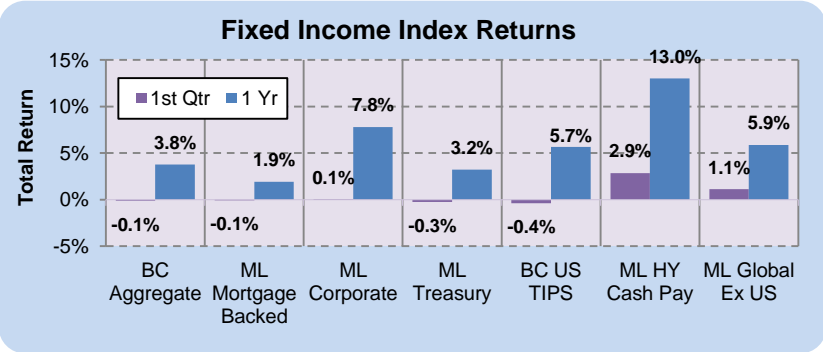
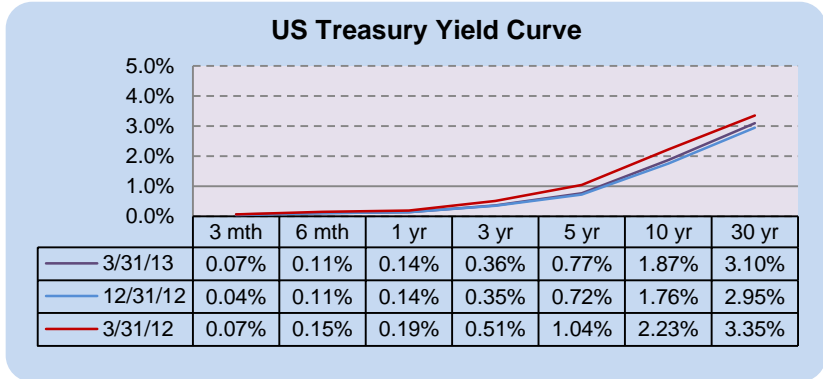
Asset Class	Actual \$ million	Actual %	Target \$ million	Target %	Difference \$ million	% Diff.
US Large Cap Equities	\$ 464.46	18.9%	\$ 461.23	18.7%	\$ 3.23	0.2%
US Sm/Mid Cap Equities	318.93	12.9%	305.85	12.4%	13.08	0.5%
REITS	185.16	7.5%	184.99	7.5%	0.17	0.0%
International Equities	301.69	12.2%	305.85	12.4%	(4.16)	(0.2%)
Total Equities	\$ 1,270.24	51.5%	\$ 1,257.92	51.0%	\$ 12.32	0.5%
US Invest. Grade Fixed-Income	765.45	31.0%	811.65	32.9%	(46.20)	(1.9%)
Cash Equivalents	45.61	1.9%	0.00	0.0%	45.61	1.9%
Loans	26.97	1.1%	26.97	1.1%	0.0	0.0%
High Yield Fixed-Income	238.85	9.7%	246.65	10.0%	(7.80)	(0.3%)
International Fixed-Income	119.39	4.8%	123.32	5.0%	(3.93)	(0.2%)
Total Fixed-Income	\$ 1,196.27	48.5%	\$ 1,208.59	49.0%	(\$ 12.32)	(0.5%)
Total Portfolio	\$ 2,466.51	100.0%	\$ 2,466.51	100.0%		

- ◆ The actual asset allocation of the portfolio on March 31, 2013 was close to the target allocation for the portfolio on that date, with equities being overweighted by about \$12.3 million (0.5%) and fixed income being underweighted by the same amount.
- ◆ Cash equivalents were the biggest overweight position at quarter's end due to the practice of counting the following month's cash flows (\$42.5 million in April 2013) in month ending asset totals. The program generally maintains a cash balance of approximately \$3 million after rebalancing at the end of each month.
- ◆ In April, the overweight position in cash equivalents was used to rebalance to various other fixed income portfolios. No funds were moved from equities to fixed income during the rebalancing process, as the overweight position was not of enough concern to sell equity assets to rebalance.
- ◆ Staff continued with the practice of using cash flows to rebalance the portfolio. Although this practice results in a slight overweight to equities during rising equity markets, it greatly reduces trading costs involved with selling equities one month and then turning around and buying more equities a month or two later.

FINANACIAL MARKET OVERVIEW

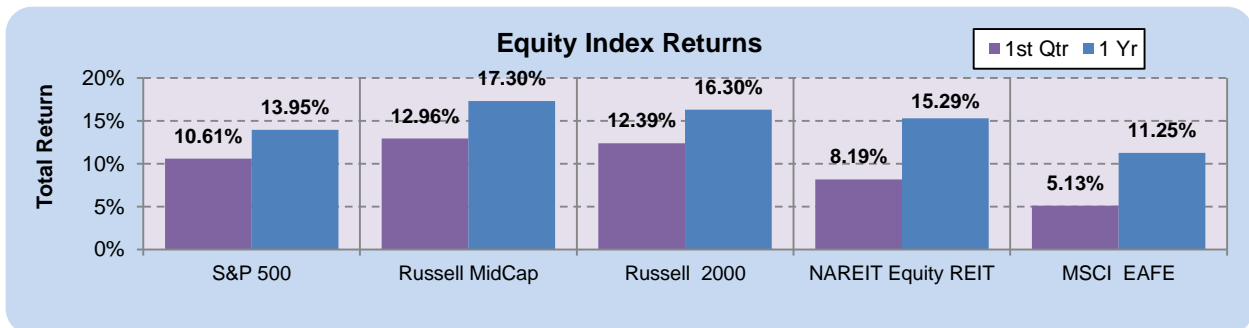
FIXED INCOME MARKETS

- ◆ The Treasury curve once again steepened slightly during the quarter, with longer-term rates climbing by 10-15 basis points while shorter-term rates remained relatively stable. On March 31, 2013, rates along all points on the yield curve were less than they were a year ago.
- ◆ The Fed continued to endorse a monetary easing policy when it reiterated that it will keep short-term rates near zero until unemployment falls below 6.5% or inflation expectations rise to more than 2.5%.
- ◆ Domestic credit spreads were mixed during the quarter, resulting in small or negative returns for many fixed income asset classes during the quarter. Tightening credit spreads resulted in high yield bonds being the best performing fixed income asset class during both the quarter and trailing year ended March, 31 2013.



EQUITY MARKETS

- ◆ Every equity asset class in the portfolio posted a positive return of more than 5.0% for the quarter ended March 31, 2013 and a return of more than 11.0% for the trailing year there ended.
- ◆ Small and mid-sized domestic equities posted the strongest returns for both the quarter and trailing year ended March 31, 2013, while large cap foreign equities, as measured by the EAFE Index, posted the weakest performance during both the quarter and year there ended.
- ◆ All sectors in the S&P 500 Index posted positive returns during the quarter ended March 31, 2013. Non-cyclical health care, consumer staples and utilities sectors posted the strongest returns during the quarter, while the materials and information technology were the weakest performing sectors during the quarter. Global monetary stimulus and an improving US economy helped drive the positive return posted by large cap foreign stocks (EAFE Index) during the quarter.



MANAGER AND PORTFOLIO RETURNS

RETURNS FOR PERIODS ENDED MARCH 31, 2013								
<u>Asset Class</u> MANAGER Benchmark/Index	3/31/13 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	\$464.46	18.9%	10.61	13.94	12.68	-	-	
S&P 500 Index			10.61	13.95	12.67	5.81	8.53	
Small/Mid Cap US Equities	\$318.93	12.9%	12.38	16.41	13.38	-	-	
NORTHERN TRUST	\$123.78	5.0%	11.51	15.81	12.59	7.62	10.45	
STATE STREET - Small/Mid Index	\$195.15	7.9%	12.94	16.92	14.43	-	-	
60% R2000/40% Russell Mid Cap			12.62	16.71	13.99	8.84	11.88	
Russell Completeness Index			12.93	16.78	14.27	8.64	12.09	
Real Estate Investment Trusts (REITS)								
DELAWARE INVESTMENT ADVISORS	\$185.16	7.5%	6.91	13.00	17.66	6.93	-	
NAREIT Equity REIT Index			8.19	15.29	17.17	6.83	12.44	
TOTAL DOMESTIC EQUITIES	\$968.55	39.3%	10.45	13.98	12.34	-	-	
International Equities								
STATE STREET - International Alpha	\$301.69	12.2%	4.87	10.61	3.45	-	-	
NTGI - EAFE Index	\$245.86	10.0%	4.80	10.71	3.48	(2.36)	-	
MSCI EAFE Index	\$55.83	2.2%	5.17	-	-	-	-	
MSCI EAFE Index			5.13	11.25	5.00	(0.89)	9.69	
TOTAL EQUITIES	\$1,270.24	51.5%	9.07	13.29	10.63	3.78	8.42	
US Investment Grade Fixed Income								
PAYDEN & RYSEL - Aggregate	\$811.06	32.9%	0.54	5.77	6.60	-	-	
JP MORGAN - Intermediate	\$242.87	9.8%	0.02	6.15	6.87	7.09	5.85	
BND - Project Notes	\$242.58	9.8%	0.23	-	-	-	-	
PAYDEN & RYSEL - GNMA/Short Bond	\$2.70	0.1%	1.17	2.91	4.85	5.53	5.15	
NORTHERN TRUST - TIPS	\$97.47	4.0%	0.43	4.04	4.50	4.79	4.22	
PAYDEN & RYSEL - Cash	\$179.83	7.3%	(0.43)	5.62	8.62	5.92	-	
Barclay's Capital US Aggregate Index	\$45.61	1.9%	0.01	0.06	0.05	0.33	1.80	
Barclay's Intermediate Govt./Corp.			(0.12)	3.78	5.54	5.48	5.03	
Barclay's Capital TIPS			0.26	-	-	-	-	
6 Month T-Bill			(0.37)	5.67	8.55	5.88	-	
			0.10	0.22	0.20	0.52	1.86	
Loans	\$26.97	1.1%	1.25	5.64	6.13	-	-	
BND - Farm Loan Pool	\$24.89	1.0%	1.24	5.65	6.12	6.47	7.06	
BND - Energy Construction Loans	\$2.08	0.1%	1.37	5.55	-	-	-	
US High Yield Fixed Income								
LAZARD ASSET MANAGEMENT	\$238.85	9.7%	2.06	9.38	9.32	8.88	-	
Merrill Lynch US High Yield Cash Pay Index			2.85	13.03	10.90	11.19	-	
Merrill Lynch BB/B Index			2.37	12.44	10.76	10.12	-	
TOTAL DOMESTIC FIXED INCOME	\$1,076.88	43.7%	0.56	5.61	6.83	-	-	
International Invest. Grade Fixed Income								
FIRST INT'L ADVISORS	\$119.39	4.8%	0.88	7.21	5.45	5.85	-	
Merrill Lynch Broad Global (Ex-US) Index - Hedged			1.12	5.87	4.46	4.70	-	
TOTAL FIXED INCOME	\$1,196.27	48.5%	0.59	5.77	6.68	6.45	5.82	
TOTAL PORTFOLIO	\$2,466.51	100.0%	4.97	9.76	9.05	5.74	7.40	

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 portfolio posted a total return of 9.07% during the quarter. The equity portfolio posted positive returns of 13.29% and 10.63% for the trailing one and three-year periods ended March 31, 2013. It has earned an annualized return of 8.42% over the past 10 years.
- ◆ All of the permanent trusts' active equity portfolios (Northern Trust Small/Mid, Delaware REIT and State Street - International Alpha) underperformed versus their benchmarks for both the quarter and trailing year ended March 31, 2013.
- ◆ The equity index funds (State Street S&P 500 and Russell Completeness Funds and Northern Trust EAFE Index Fund) continue to follow index performance with acceptable amounts of tracking error. Any new money being added to equities will be added to these index funds, when possible, in anticipation of asset allocation changes that could occur once the asset allocation study is completed.
- ◆ As the Board may recall, the TCW convertible securities portfolio was liquidated during the 4th quarter of 2012 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.

Northern Trust – Small/Mid Cap

- ◆ Northern Trust has underperformed the benchmark for this account for all periods shown in the table on page 4; however, they have outperformed their benchmark since inception of this account in April 1996.
- ◆ The adjustments to both the benchmark and manager lineup that were made to this portfolio in late 2011 have not worked out as well as expected to date. The portfolio has underperformed the new benchmark by 48 basis points (after fees) since the changes were made 15 months ago.
- ◆ During the quarter, two of the portfolio's value managers (CRM and Rutabaga) lagged their benchmarks by large margins. The portfolio's slightly higher than benchmark P/B and lower P/E hurt performance. Stock selection in the industrial and consumer discretionary sectors also hurt performance.

Delaware Investment Advisors

- ◆ Delaware underperformed versus the benchmark for this portfolio for both the quarter and trailing one-year period ended March 31, 2013; they have outperformed the index by a small margin for the trailing three and five-year periods there ended.
- ◆ Smaller, more highly leveraged REITs once again outperformed the higher quality, larger cap focus of the REIT portfolio Delaware manages for the Board.
- ◆ Strong stock selection in the lodging and industrials sectors added to performance, while the small to large cap return bias mentioned previously was especially evident in the healthcare and office sectors.

State Street Global Advisors (SSGA) – International Alpha

- ◆ State Street has underperformed the benchmark for this account for all periods shown in the table on page 4 and since inception of the account in early 2006.
- ◆ The portfolio's poor performance in March (105 bps < benchmark) wiped out the excess return that had been earned by the portfolio since a dynamic component was added to SSGA's quantitative model in early 2012.
- ◆ The Commissioner and staff met with SSGA in May to discuss the performance of this portfolio and the investment process. This portfolio will continue to be watched closely going forward.

FIXED INCOME PORTFOLIO REVIEW

- ◆ The combined fixed income portfolio posted a total return of 0.59% during the quarter ended March 31, 2013 and 5.77% for the trailing year there ended. Over the past 10 years the combined fixed income portfolio has returned an average of 5.82% per year.
- ◆ The only portfolio that didn't post a positive return for the quarter ended March 31, 2013 was the Northern Trust TIPS Index portfolio, which earned a total return of -0.43% for the quarter. Every fixed income portfolio posted a positive return for trailing year ended March 31, 2013.
- ◆ Absolute fixed income returns varied greatly during the quarter from a high of 2.06% for the Lazard high yield bond portfolio to the above noted -0.43% for the Northern Trust TIPS portfolio. .

Payden & Rygel – Aggregate

- ◆ This portfolio continues to post strong performance versus the benchmark and once again outperformed the Barclay's Capital Aggregate Index for all periods shown in the table on page 4.
- ◆ The portfolio's exposure to corporate bonds helped performance during the quarter as credit spreads continued to compress. Strong security selection also helped performance during the quarter. Slightly higher interest rates had a negative impact on the portfolio as did weak returns for mortgage securities.

J.P. Morgan – Intermediate

- ◆ The J.P. Morgan intermediate portfolio underperformed the benchmark Barclays Capital Govt./Corp. Intermediate Index by 3 basis points (net of fees) during the quarter ended March 31, 2013. It has outperformed the index by 29 basis points since inception of the account in August 2012.
- ◆ The portfolio's overweight position in mortgages hurt performance somewhat as did the portfolio's underweight to credit. The portfolio's underweight position in Treasuries added to the portfolio's performance for the quarter.

Northern Trust - TIPS

- ◆ This index portfolio continues to perform as one would expect over time.
- ◆ The Commissioner has the discretion to fund a TIPS portfolio up to 10% of the total investment portfolio. \$24 million was added to this portfolio in March of 2013.

Bank of North Dakota (BND) – Farm Loan Pool

- ◆ No new loans have been funded since April 2012, when it was decided that it wouldn't be prudent for the Board to lock up funds long-term at today's historic low interest rates. BND now makes the loans this office used to fund.
- ◆ As principal pay downs continue in this portfolio cash is swept out of the account and reinvested in other fixed income strategies. \$5.5 million of un-needed cash was transferred out of this account during March of 2013.

Lazard – High Yield

- ◆ Lazard has 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.
- ◆ As usual, the high quality nature of this portfolio was the primary driver of underperformance, as CCC securities returned 5.5% during the quarter while BB bonds earned an average of 1.9%. Lazard's conservative investment strategy cannot keep up with index returns that are driven by the historic spread tightening that has taken place since the credit crises in 2007/2008.

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.

	3/31/13 Asset Balances	Current Yield
Capitol Building Trust	\$ 2,818,000	0.17%
Strategic Investment and Improvements Fund	\$ 650,523,000	0.16%

- ◆ The Capitol Building Trust continues to grow from higher than expected royalty revenues, even as funds continue to be drawn down to complete the \$2.6 million of Capitol Building improvements authorized by the 2011 legislature.
- ◆ The unobligated balance of the SIIF reached \$300 million in January 2013. According to law, once this happened, 25% of the oil tax money that was being deposited in the SIIF must now be deposited instead into the Legacy Fund. In addition, 25% of the royalty, bonus and other revenues earned by the SIIF each month must now be transferred to the Legacy Fund.
- ◆ In today’s low interest rate environment, it is expected that the yield of this portfolio will continue to decline going forward; at least until such time as the asset allocation study is complete and new investment policies and guidelines are adopted for the SIIF.

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.

	3/31/13 Asset Balances	Current Yield
Coal Development Trust Fund		
Coal Warrants	\$ 8,118,000	3.86%
School Construction Loans	\$ 35,140,000	2.09%
Marketable Securities	<u>\$ 21,879,000</u>	N/A - see returns below
Total	\$ 65,137,000	

Payden and Rygel – Coal

- ◆ Payden & Rygel has outperformed the benchmark Merrill Lynch 1-3 Year Treasury Index by various amounts for all periods shown in the table below. This portfolio continues to perform as expected.

	3/31/13 Asset Balance	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Payden & Rygel Coal Dev.	\$21.88	0.36	1.63	1.82	2.16	2.68
ML 1-3 Year Treasury Index		0.12	0.63	1.24	1.74	2.67
All return figures for periods of 1 year or greater have been annualized. Returns are net of fees						