

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

INVESTMENT PERFORMANCE REPORT

For periods ended June 30, 2013



PERMANENT EDUCATIONAL TRUST ASSETS

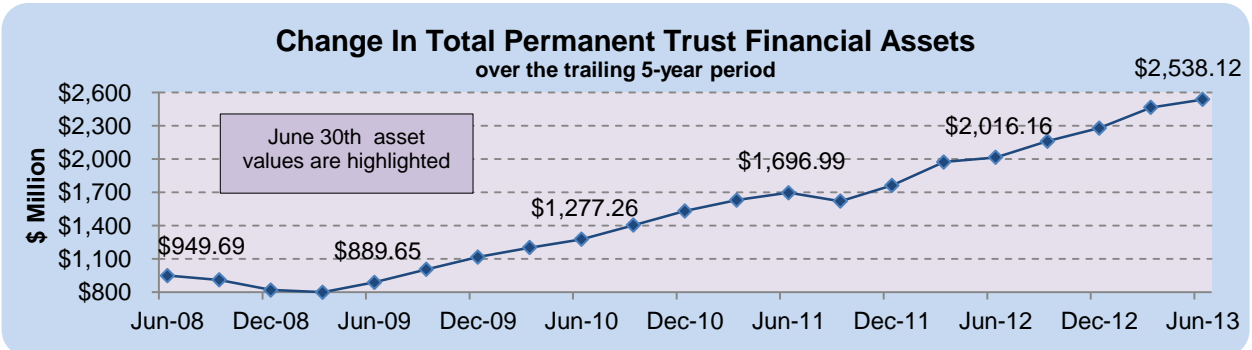
TOTAL TRUST ASSETS

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.

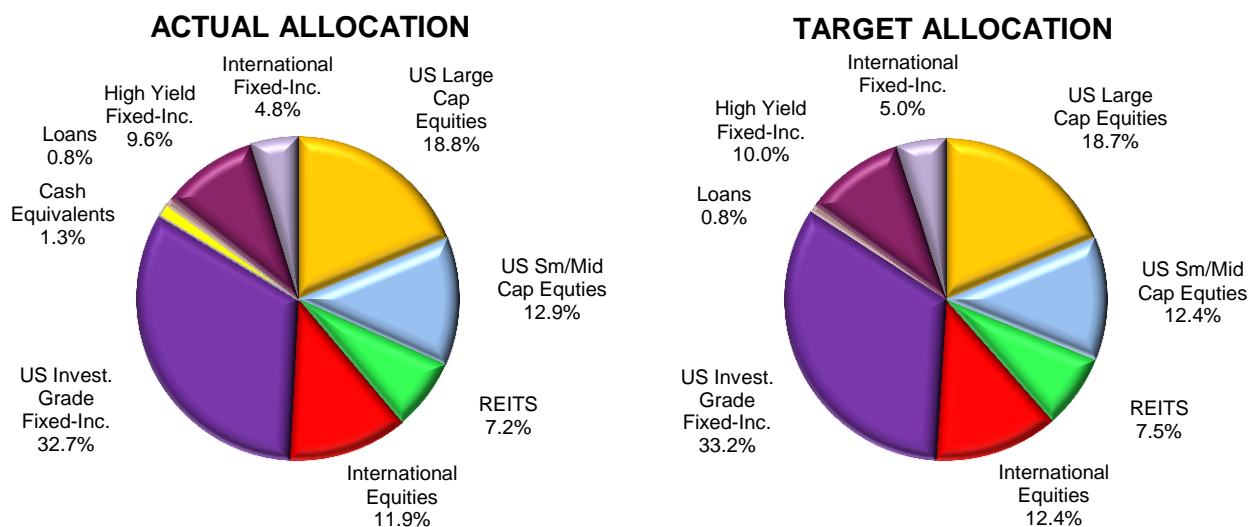
For the schedule below and for all other schedules, tables and charts that follow in this report, all loans, warrants, loan portfolios and certificate of deposits are valued at cost. All other investments in marketable securities, such as stocks, bonds, mutual funds and cash equivalents are valued at 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%
6/30/13 Actual	\$2,538,122,000	\$477,972,000 18.8%	\$326,513,000 12.9%	\$183,018,000 7.2%	\$0 0.0%	\$303,036,000 11.9%	\$1,247,583,000 49.2%
6/30/13 Target	\$2,538,122,000	\$474,629,000 18.7%	\$314,727,000 12.4%	\$190,359,000 7.5%	\$0 0.0%	\$314,727,000 12.4%	\$1,243,680,000 49.0%

- ◆ Total trust assets grew by \$71.61 million during the quarter ended June 30, 2013, ending the quarter at \$2.54 billion. Trust assets grew by \$521.96 million during fiscal year 2013.
- ◆ The total return loss of -0.42% posted by the overall investment portfolio during the quarter was responsible for a decline in portfolio value of about \$11.6 million. Oil and gas royalties (\$49.03 million), oil extraction taxes collections (\$21.32 million) and tobacco lawsuit proceeds (\$9.04 million) were the primary drivers of trust growth during the quarter.
- ◆ \$6.26 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 was distributed to K-12 education during fiscal year 2013. An additional \$1.48 million was distributed to the beneficiaries of the other 12 permanent trust funds during the quarter, bringing that total to \$2.97 million for the fiscal year.
- ◆ Total permanent trust fund distributions for the 2013-15 biennium will be \$138.68 million, an increase of \$40.24 million (41%) over the \$98.45 million distributed during the 2011-13 biennium. There is a good chance that total permanent trust distributions could top \$200 million during the 2015-17 biennium.



ACTUAL ALLOCATION VS. TARGET ALLOCATION AS OF June 30, 2013



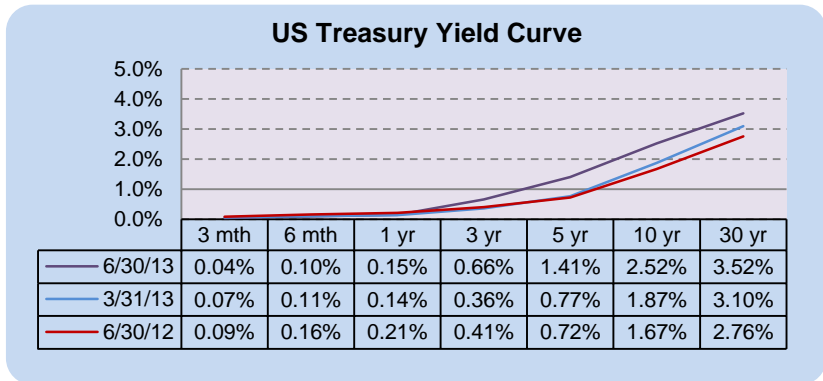
Asset Class	Actual \$ million	Actual %	Target \$ million	Target %	Difference \$ million	% Diff.
US Large Cap Equities	\$ 477.97	18.8%	\$ 474.63	18.7%	\$ 3.34	0.1%
US Sm/Mid Cap Equities	326.51	12.9%	314.73	12.4%	11.78	0.5%
REITS	183.02	7.2%	190.35	7.5%	(7.33)	(0.3%)
International Equities	303.04	11.9%	314.73	12.4%	(11.69)	(0.5%)
Total Equities	\$ 1,290.54	50.8%	\$ 1,294.44	51.0%	(\$ 3.90)	(0.2)%
US Invest. Grade Fixed-Income	830.04	32.7%	842.33	33.2%	(12.29)	(0.5%)
Cash Equivalents	32.56	1.3%	0.00	0.0%	32.56	1.3%
Loans	20.63	0.8%	20.63	0.8%	0.0	0.0%
High Yield Fixed-Income	243.91	9.6%	253.81	10.0%	(9.90)	(0.4%)
International Fixed-Income	120.44	4.8%	126.91	5.0%	(6.47)	(0.2%)
Total Fixed-Income	\$ 1,247.58	49.2%	\$ 1,243.68	49.0%	\$ 3.90	0.2%
Total Portfolio	\$ 2,538.12	100.0%	\$ 2,538.12	100.0%		

- ◆ The actual asset allocation was very close to the target allocations on June 30, 2013, when the actual size of the equity portfolio was just \$3.90 million (0.2%) less than the target rate.
- ◆ Within equities, the domestic small/mid cap allocation was overweight by approximately 0.5%, while the international equity allocation was underweight a similar amount. This difference is due primarily to the strong performance of small/mid cap domestic stocks (15.04%) versus international stocks (5.31%) over the past six months.
- ◆ The overweight position to cash equivalents was used to rebalance the portfolio in late-July, when \$4.0 million was added to international equities and another \$25.0 million was spread among high yield bonds, international fixed income and domestic investment grade fixed income.
- ◆ Rebalancing continues to be accomplished primarily by the use of monthly cash flows; this approach keeps transaction costs at a minimum. However, this occasionally results in individual portfolio's being a bit out of balance, even though the overall balance between equities and fixed income is in line with the target allocation.
- ◆ RV Kuhns began work on an investment study that will entail revising the permanent trusts' asset allocation, updating investment policies, evaluating various implementation options and providing recommendations as to possible ways to manage and invest the Strategic Investment and Improvements Fund.

FINANACIAL MARKET OVERVIEW

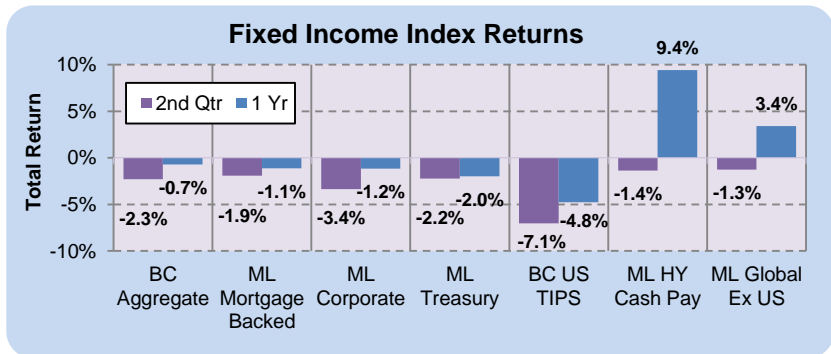
FIXED INCOME MARKETS

◆ The Treasury curve steepened substantially during the quarter ended June 30, 2013, as short-term rates remained relatively steady and longer-term rates climbed by anywhere from 69 to 85 basis points. The rise in longer-term rates was driven primarily by the surprise announcement by the Fed in May that it may tighten monetary policy this fall by reducing the purchase of government bonds much sooner than anyone had expected.



◆ The sharp rise in rates during the quarter is the primary reason that all domestic investment grade fixed income asset classes posted negative returns for both the quarter and fiscal year ended June 30, 2013. Bonds posted their worst “first half of the year” return numbers in almost 20 years.

◆ Although both international bonds and high yield bonds were down for the quarter, both posted solid, single-digit returns for the trailing-year ended June 30, 2013.

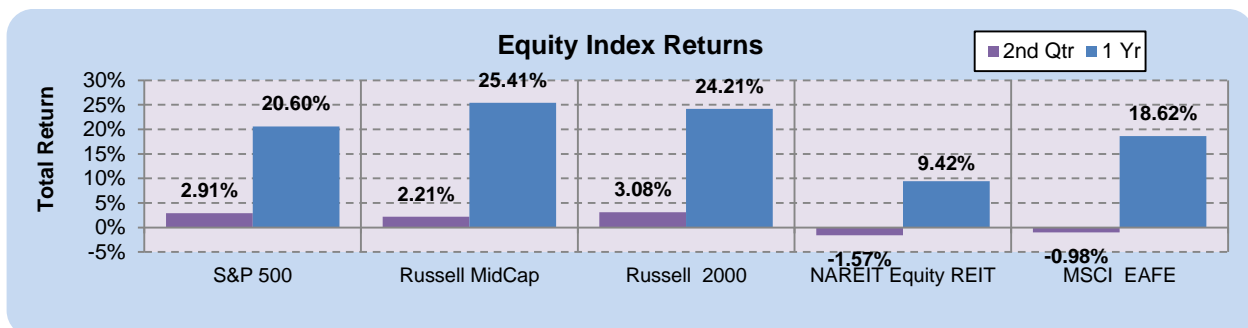


EQUITY MARKETS

◆ The equity asset class in the portfolio posted either a small positive or negative return for the quarter; every equity asset class posted strong positive returns for the trailing-year ended June 30, 2013.

◆ Domestic equities of all size posted the highest returns for both the quarter and trailing-year. Although there is some concern that low interest rates have driven markets to unsustainable levels, given current interest rates, valuations are in line with historical levels.

◆ Both REITs and international stocks posted small negative returns for the quarter and solid positive returns for the trailing-year. REITs were hit especially hard by the increase in interest rates during May and June. Some of the excitement caused by a change in Japanese monetary policy earlier in the year faded during the quarter, resulting in a small negative return for international equities.



MANAGER AND PORTFOLIO RETURNS

RETURNS FOR PERIODS ENDED JUNE 30, 2013							
Asset Class MANAGER Benchmark/Index	6/30/13 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	\$477.97	18.8%	2.90	20.55	18.43	7.01	-
S&P 500 Index			2.91	20.60	18.45	7.01	7.30
Small/Mid Cap US Equities	\$326.51	12.9%	2.36	25.25	18.15	-	-
NORTHERN TRUST	\$127.28	5.0%	2.82	25.20	17.36	7.73	8.88
STATE STREET - Small/Mid Index	\$199.23	7.9%	2.08	25.39	19.38	-	-
60% Russell 2000/40% Russell Mid Cap			2.74	24.69	19.04	8.89	10.06
Russell Completeness Index			2.10	25.36	19.23	8.57	10.20
Real Estate Investment Trusts (REITS)							
DELAWARE INVESTMENT ADVISORS	\$183.02	7.2%	(1.28)	7.91	18.14	7.62	-
NAREIT Equity REIT Index			(1.57)	9.40	18.18	7.57	10.88
TOTAL DOMESTIC EQUITIES	\$987.50	38.9%	1.93	19.51	16.29	-	-
International Equities							
STATE STREET - International Alpha	\$303.04	11.9%	0.42	22.11	9.12	-	-
NTGI - EAFE Index	\$247.64	9.7%	0.70	22.56	9.25	(1.99)	-
MSCI EAFE Index	\$55.40	2.2%	(0.78)	-	-	-	-
			(0.98)	18.62	10.04	(0.63)	7.67
TOTAL EQUITIES	\$1,290.54	50.8%	1.57	19.86	14.86	4.25	6.93
US Investment Grade Fixed Income							
PAYDEN & RYSEL - Aggregate	\$862.60	34.0%	(3.06)	(0.48)	3.95	-	-
JP MORGAN - Intermediate	\$261.30	10.3%	(2.85)	1.16	4.58	6.44	5.24
BND - Project Notes	\$264.15	10.4%	(1.71)	-	-	-	-
PAYDEN & RYSEL - GNMA/Short Bond	\$2.69	0.1%	(0.59)	1.52	3.69	5.27	5.01
NORTHERN TRUST - TIPS	\$134.69	5.3%	(0.71)	2.10	3.64	4.72	4.05
PAYDEN & RYSEL - Cash	\$167.21	6.6%	(7.02)	(4.75)	4.68	4.43	-
Barclay's Capital US Aggregate Index	\$32.56	1.3%	0.00	0.05	0.04	0.21	1.76
Barclay's Intermediate Govt./Corp.			(2.33)	(0.67)	3.52	5.20	4.52
Barclay's Capital TIPS			(1.70)	-	-	-	-
6 Month T-Bill			(7.05)	(4.77)	4.63	4.40	-
			0.03	0.15	0.16	0.48	1.82
Loans	\$20.63	0.8%	0.94	5.14	5.89	-	-
BND - Farm Loan Pool	\$19.12	0.7%	0.92	5.12	5.88	6.30	6.96
BND - Energy Construction Loans	\$1.51	0.1%	1.16	5.33	-	-	-
US High Yield Fixed Income							
LAZARD ASSET MANAGEMENT	\$243.91	9.6%	(1.22)	6.75	8.68	8.30	-
Merrill Lynch US High Yield Cash Pay Index			(1.58)	9.19	10.31	10.44	-
Merrill Lynch BB/B Index			(1.54)	8.52	10.10	9.45	-
TOTAL DOMESTIC FIXED INCOME	\$1,127.14	44.4%	(2.56)	1.26	5.09	-	-
International Invest. Grade Fixed Income							
FIRST INT'L ADVISORS	\$120.44	4.8%	(2.41)	2.80	3.71	5.87	-
Merrill Lynch Broad Global (Ex-US) Index - Hedged			(1.24)	3.43	3.52	4.90	-
TOTAL FIXED INCOME	\$1,247.58	49.2%	(2.55)	1.42	4.95	5.89	5.30
TOTAL PORTFOLIO	\$2,538.121	100.0%	(0.42)	10.65	10.17	5.72	6.49

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 1.57% for the quarter ended June 30, 2013; it returned 19.86% for the year there ended. The portfolio returned an annualized 14.86% per year over the past 3 years and 6.93% per year over the trailing 10-year period ended June 30, 2013.
- ◆ All of the permanent trusts' active equity portfolios (Northern Trust Small/Mid, Delaware REIT and State Street - International Alpha) outperformed their benchmarks for the quarter ended June 30, 2013; the NTGA and State Street portfolios also outperformed for the trailing-year there ended.
- ◆ Any new money being added to equities will continue to be added to one of the portfolio's index funds, when possible, in anticipation of asset allocation changes that will most likely occur once the current investment study is completed. The only equity asset class where there is not an index option at the present time is REITs.
- ◆ The equity index funds currently being used in the permanent trusts' portfolio continue to generate index like returns while maintaining acceptable tracking error to the respective indices.

Northern Trust – Small/Mid Cap

- ◆ Northern Trust outperformed the custom benchmark for this account for both the quarter and trailing-year ended June 30, 2013. Although they underperformed for the three, five and ten-year periods shown in the table on page 4, they have outperformed the benchmark since inception of this account back in April 1996.
- ◆ Even though the performance of this portfolio seems to have stabilized somewhat over the past year, all new money going into small and mid cap domestic stocks will continue to go into the Russell Completeness index fund until the investment study is completed.
- ◆ During the quarter, the portfolio's two mid cap value managers both outperformed their benchmarks while the portfolio's lone mid cap growth manager lagged. The opposite occurred in the small cap arena where the portfolio's three value managers lagged their benchmark and the two growth managers outperformed.

Delaware Investment Advisors

- ◆ Delaware outperformed versus the benchmark for this portfolio for the quarter ended June 30, 2013, but underperformed for the trailing one-year period there ended. Delaware has essentially matched the index, after fees, for the trailing three and five-year periods ended June 30, 2013, and since inception of the account in December 2003.
- ◆ The portfolio's underweight position to suburban office space helped performance, as did overweight in strong performing Boston Properties, SL Green Realty and Kilroy Realty Group. Holdings in a couple of merger targets, CapLease and Colonial Properties Trust, also added to the performance of the portfolio during the quarter.
- ◆ Portfolio holdings in the industrial, shopping center and specialty sectors all hurt performance during the quarter.

State Street Global Advisors (SSGA) – International Alpha

- ◆ State Street outperformed the benchmark for this account for the quarter and trailing-year ended June 30, 2013. They have underperformed for all other periods shown in the table on page 4, and since inception of the account in early 2006.
- ◆ The portfolio has performed especially well over the past year, besting its benchmark by almost 400 basis points. Performance has been quite strong since the dynamic component was added to SSGA's quantitative model in early 2012.
- ◆ Although short-term performance has been strong, the Commissioner and staff still have concerns about this product that will be addressed as part of the investment study currently under way.

FIXED INCOME PORTFOLIO REVIEW

- ◆ The combined fixed income portfolio posted a total return loss of -2.55% during the quarter ended June 30, 2013; the fixed income portfolio posted a positive return of 1.42% for the trailing-year there ended.
- ◆ The Payden & Rygel Cash portfolio, which earned essentially nothing, was the only fixed income securities portfolio to post a return that wasn't negative during the quarter ended June 30, 2014. News that the Federal Reserve would end its bond purchase program (QE3) sooner than expected, pushed interest rates higher and credit spreads wider, both bad for bond returns.
- ◆ The only fixed income assets to post positive returns for the quarter were the farm loan pool and energy construction loan program; the primary reason they posted positive returns is that we do not mark them to market value each month like we do all securities portfolios.

Payden & Rygel – Aggregate

- ◆ Although Payden underperformed during the quarter ended June 30, 2013, they have outperformed versus the benchmark for this portfolio for all other periods shown in the table on page 4.
- ◆ The portfolio's exposure to corporate bonds hurt performance during the quarter as credit spreads widened; its exposure to mortgage securities also had a negative impact on quarterly performance.

J.P. Morgan

- ◆ The J.P. Morgan intermediate portfolio essentially matched the performance of the Barclays Capital Gov/Corp. Intermediate Index during the quarter ended June 30, 2013. The portfolio has outperformed the index by 16 basis points, net of fees, since inception of the account in August 2012.
- ◆ The portfolio's exposure to mortgages (44%) and corporate bonds (26%) dragged down performance during the quarter, while the portfolio's 27% exposure to short-term Treasury securities helped minimize relative losses.

Payden & Rygel – GNMA/Short Bond

- ◆ This portfolio will continue to be used to invest cash flows short-term until either the investment study is completed or they are redeployed to other fixed income strategies.

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 historic low interest rates. Over the past 14 months this portfolio has shrunk to \$19.1 million, about half the size it was before the permanent trusts stopped funding new loans.
- ◆ A total of \$6.0 million of principal pay downs were transferred out of the account during the quarter ended June 30, 2013.

Lazard

- ◆ Lazard outperformed both the broad Cash Pay index and the higher quality BB/B index for the quarter ended June 30, 2013, it has underperformed both indexes by various amounts for all other periods shown in the table on page 4.
- ◆ Lazard's outperformance for the quarter was helped by the portfolio's shorter than index maturity structure, overweight positions in the automotive sector and underweight positions in the bank and financial sectors.

First International Advisors

- ◆ First International underperformed for both the quarter and trailing-year ended June 30, 2013; they have outperformed the index for the trailing three and five-year periods there ended and since inception of the account in April 2004.

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.

	6/30/13 Asset Balances	Current Yield
Capitol Building Trust	\$ 2,723,000	0.14%
Strategic Investment and Improvements Fund	\$ 879,084,000	0.17%

- ◆ The Capitol Building Trust ended the biennium with approximately \$2.7 million of financial assets on hand, about 40% in cash due to a June 27, 2013 maturity. All cash on hand was reinvested in early July. There is a carryover appropriation of \$1.0 million from the 2011-13 biennium to the 2013-15 biennium, but no new appropriation from the fund for the 2013-15 biennium.
- ◆ The SIIF held investment securities worth just over \$879.0 million as of June 30, 2013. More than \$712.3 million of oil taxes were deposited into the SIIF during the biennium; a total of \$7.4 million of cash was transferred from the SIIF to the Legacy Fund during the biennium.
- ◆ A total of \$768.75 million was either appropriated or obligated to various programs from the SIIF during the 2013-15 biennium. The transfers/obligations include \$520 million to the general fund, \$200 million to school medical facility construction loan programs, \$25 million to a bio-fuels loan guarantee program, and \$21.2 million to the Department of Commerce, the AG’s Office and the Department of Human Services for energy development related grant programs.

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.

	6/30/13 Asset Balances	Current Yield
Coal Development Trust Fund		
Coal Warrants	\$ 7,983,000	3.85%
School Construction Loans	\$ 32,162,000	2.11%
Marketable Securities	<u>\$ 24,808,000</u>	N/A - see returns below
Total	\$ 64,953,000	

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.

	6/30/13 Asset Balance	Last Qtr.	Last 1 Year	Last 3 Years	Last 5 Years	Last 10 Years
Payden & Rygel Coal Dev.	\$24.81	(0.36)	1.01	1.41	2.16	2.56
ML 1-3 Year Treasury Index		(0.10)	1.31	1.15	2.09	2.69
All return figures for periods of 1 year or greater have been annualized. Returns are net of fees						