

MONTANA

BOARD OF INVESTMENTS



DRAFT

11/6/2015

2015 Annual Report



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The Board is committed to employing proven, long-term investment strategies and finding creative solutions to financial issues facing government entities and new and expanding businesses in the state.

The cover photo is the location of the Montana Board of Investments’ offices at 2401 Colonial Drive, Helena, Montana. The building was designed and constructed under the leadership of the Board’s previous Executive Director, Carroll South, and is administered as an investment of Montana’s nine pension funds. The building was completed in 1999 and houses Board staff and other Montana state agencies.



It is my pleasure to present our 2015 annual report to the Legislature, the Governor and the public.

It is the highest honor and privilege for the Board of Investments to oversee the only program specifically required in the Montana

Constitution, the *Unified Investment Program*. Since its inception in 1972, the Board invests essentially all of the State's money, its operating funds, trust funds, and its pension funds. Today the Board manages over \$16 billion for all state agencies and many local governments.

This is a great responsibility. We must discharge our duties with care, skill, prudence, and diligence. We must be mindful of both maximizing returns and minimizing losses. We must discharge our duties solely in the interest of and for the benefit of the funds forming the Unified Investment Program. ***This is the law.***

We also oversee some of the most important economic development and local government funding programs in the state using the financial strength of Montana's Coal Severance Trust Fund. These programs have helped create hundreds of jobs and have saved local governments millions of dollars in interest expense.

We are a nine member board, chosen by the Governor, confirmed by the Montana Senate, and qualified as required by law. We operate under a strong governance system. We act only through our official capacity in meetings that are open and publically accessible. We delegate by policy only those duties to our staff that are appropriate, as the Board bears the ultimate responsibility to the public.

Our investment horizon is for the very long term for the pension systems, intermediate term for our trust fund clientele, and very short term for the state's daily cash needs. While every year's investment performance is important, I urge we all remember that investing often requires a long term view. We need to be patient, diligent, and thoughtful.

As we further describe in this report, achieving a diversified mix of investment assets is what drives over 90% of total returns.

The Board is mindful about costs, especially managing pension dollars. We conduct an independent study yearly on our pension investments and compare our results and costs to our peers. Over the last five years, we have earned more than our peers and at slightly lower costs. This study is on our website.

Almost \$8 billion in investments is internally managed by our own investment staff, and for these investments our costs are very low and performance is solid. We have a highly trained and professional staff. Many hold advanced degrees, and many hold financial and accounting professional designations.

Our Chief Investment Officer, Clifford A. Sheets, CFA, retired in October. He brought tremendous skills and achievements to our Board. We are very grateful for his service. In November we welcomed

Joseph M. Cullen, CFA to the Board's investment team as the new Chief Investment Officer.

Our website has a great deal of information about the Board's activities, its investment holdings and performance. I invite you to contact me or our Executive Director if you have any questions.



Mark Noennig, Chairman



"Our investment horizon is for the very long term for the pension systems, intermediate term for our trust fund clientele, and very short term for the state's daily cash needs."



BOARD MEMBERS



Mark Noennig
 BILLINGS
 Board Chairman
Representing Business
 Term Ending:
 01/01/2017



Karl Englund
 MISSOULA
 Board Vice Chair
Representing Law
 Term Ending:
 01/01/2019

- Human Resources (HR) Committee, Chair



Marilyn Ryan
 MISSOULA
Representing TRS
 Term Ending:
 01/01/2017

- HR Committee
- Loan Committee



Teresa Olcott Cohea
 HELENA
Representing Financial Community
 Term Ending:
 01/01/2019

- Audit Committee
- Loan Committee



Sheena Wilson
 HELENA
Representing PERS
 Term Ending:
 01/01/2017

- Audit Committee



Kathy Bessette
 HAVRE
Representing Agriculture
 Term Ending:
 01/01/2017

- Loan Committee



Quinton Nyman
 HELENA
Representing Labor
 Term Ending:
 01/01/2019

- HR Committee



Jack Prothero
 GREAT FALLS
Representing Small Business
 Term Ending:
 01/01/2017

- HR Committee
- Loan Committee, Chair



Jon Satre
 HELENA
Representing Business
 Term Ending:
 01/01/2019

- HR Committee
- Audit Committee, Chair

LEGISLATIVE LIAISONS



Representative Kelly McCarthy
 BILLINGS
House of Representatives Liaison
 Term Ending:
 12/31/2016



Senator Bob Keenan
 BIG FORK
Senate Liaison
 Term Ending:
 12/31/2016

Senior Management

- ◆ **David Ewer**
Executive Director
- ◆ **Geri Burton**
Deputy Director
- ◆ **Herbert Kulow, CMB**
Portfolio Manager –
Montana Investments
- ◆ **Clifford A. Sheets, CFA**
Chief Investment Officer
- ◆ **Julie Feldman, CPA**
Financial Manager
- ◆ **Dana Chapman**
Office Manager – Board Secretary

Staff

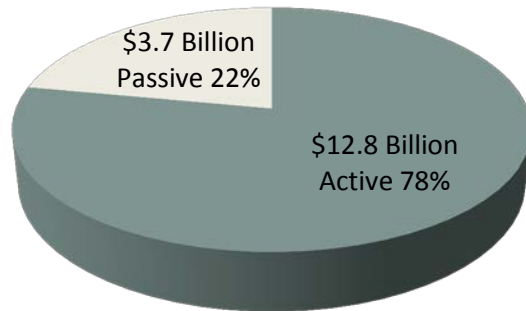
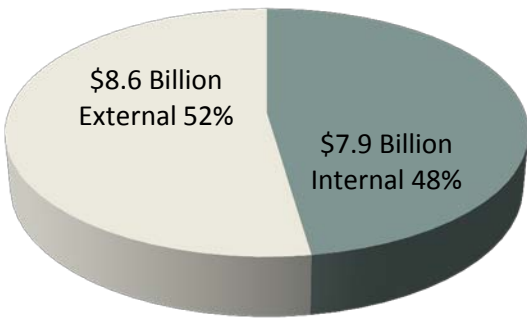
- ◆ **Polly Boutin**
Associate Financial Manager
- ◆ **Jason Brent, CFA**
Investment Analyst
- ◆ **Richard Cooley, CFA**
Portfolio Manager –
Fixed Income/STIP
- ◆ **Frank Cornwell, CPA**
Associate Financial Manager
- ◆ **Craig Coulter**
Investment Analyst
- ◆ **Roberta Diaz**
Investment Accountant
- ◆ **Julie Flynn**
Bond Program Officer
- ◆ **Tim House**
Investment Analyst –
Investment Operations Chief
- ◆ **Ethan Hurley, CAIA**
Portfolio Manager –
Alternative Investments
- ◆ **Edward Kelly**
Investment Analyst
- ◆ **Teri Kolnik, CFA**
Investment Analyst
- ◆ **Eron Krpan, CIPM**
Investment Data Analyst
- ◆ **Tammy Lindgren**
Investment Accountant
- ◆ **April Madden**
Investment Accountant
- ◆ **Savannah McCormack**
Administrative Assistant
- ◆ **Rande Muffick, CFA**
Portfolio Manager –
Domestic & International Equities
- ◆ **Mary Noack**
Network Administrator
- ◆ **Kelsey Poore, CPA**
Investment Accountant
- ◆ **Jon Putnam, CFA, FRM**
Investment Analyst
- ◆ **John Romasko, CFA**
Investment Analyst
- ◆ **Nathan Sax, CFA**
Portfolio Manager –
Fixed Income
- ◆ **Steve Strong**
Investment Analyst
- ◆ **Louise Welsh**
Senior Bond Program Officer
- ◆ **Maria Wise**
Administrative Assistant
- ◆ **Daniel Zarling, CFA**
Director of Research



The Montana Constitution requires that the State’s investments fall under the **UNIFIED INVESTMENTS PROGRAM**. The legislature created the Board of Investments to administer this critical program. State law requires the Board to be prudent and meet various requirements. As of June 30, 2015, State investments total over \$16 billion and generally fall into broad categories: state operating, trust funds, pension funds, insurance

reserves, and certain local government funds. To meet the needs of these four categories, the Board uses a combination of investment pools or when necessary, tailors a specific financial need through individual securities.

In response to two common questions...how much of the over \$16 billion total is internally managed and how much is actively managed, the information is presented in the following charts:



The first chart shows that almost \$7.9 billion is managed in-house by the Board’s investment staff. Many of the lower risk assets are internally managed which keeps expenses down. External management is generally used where outside expertise is deemed more advisable. The Board’s investment staff chooses the outside investment money managers and closely monitors them to ensure performance meets the Board’s investment expectations.

The second chart shows the proportion of ‘passive’ to ‘active’ investments. Approximately 78% of the Board’s investments are actively managed and 22% are investments that follow both an average market holding of investments and only return the market average. The advantages of active management are more control over investments and generally a better return. Expenses are higher with active selection. Passive selection is generally cheaper; however, some asset classes do not have the option of investing passively.

Total Fund							
Net Asset Value* (In Millions) With Time Weighted Annualized Returns							
As of June 30, 2015							
Fund	NAV	1-Year Return %	10-Year Return %	Fund	NAV	1-Year Return %	10-Year Return %
Pension Funds	10,055.9			Real Property	6.8	3.03	5.29
Firefighters	326.3	4.58	6.56	Regional Water Fund	90.1	3.17	5.42
Game Wardens	148.0	4.57	6.53	Resource Indemnity	111.5	3.21	5.43
Highway Patrol	128.2	4.58	6.59	Smelter Hill Upload	10.5	1.37	-
Judges	86.7	4.58	6.58	Streamside Tailings	43.8	2.97	5.10
Police	320.8	4.57	6.54	Tobacco	195.2	3.21	5.46
Public Employees	5,043.6	4.58	6.59	Treasure State Endowment	267.7	3.19	5.48
Sheriffs	295.0	4.58	6.57	UCFRB Reserve	17.6	2.86	5.24
Teachers	3,673.4	4.60	6.59	UCFRB Restoration	122.9	2.95	5.21
Volunteer Firefighters	33.9	4.67	6.57	Wildlife Habitat	12.1	2.97	5.30
Trust Funds	2,510.3			Zortman/Landusky	15.8	1.64	-
Abandoned Mine	6.2	1.16	3.12	Zortman/Landusky Water	14.5	1.24	5.42
Blackfoot Response	26.1	1.11	-	Insurance Reserves	1,542.6		
Butte Area One Rest	31.7	1.91	-	Group Benefits	47.8	1.20	3.05
Clark Fork River Rs	32.4	2.24	-	MT University Sys Group In	36.3	1.38	-
Clark Fork Site Resp	97.1	2.62	-	State Fund Insurance	1,458.2	3.04	5.21
Cultural Trust	13.8	3.14	5.44	Subsequent Injury Fund	0.3	0.13	-
East Helena Comp. Fund	5.8	1.46	-	State Operating Funds	1,794.5		
Economic Development	85.6	3.17	5.41	FWP License	16.4	0.54	2.54
Endowment For Children	1.3	3.07	-	Montana State University	106.7	0.47	2.18
FWP Mitigation	11.5	1.05	2.98	Montana Tech UofMontana	12.1	0.24	1.88
Montana Pole	33.8	2.58	4.80	State Agency**	455.0	-	-
Noxious Weeds	10.9	3.21	5.21	Treasurers Fund	1,124.3	0.27	1.70
Older Montanans	1.1	3.02	-	University Of Montana	79.8	1.67	2.97
Park Acquisition	25.5	3.11	5.40	Local Government Funds	574.5		
Permanent Coal Trust	559.3	3.32	5.24	Local Governments	574.5	-	-
Trust & Legacy (School)	659.5	3.21	5.44	Total	16,477.7		

*Net Asset Value (NAV) includes net receivable & payable accruals.

**State Agency is an umbrella account for 272 sub-accounts including 5 insurance funds holding \$43.7M in STIP. The insurance funds are broken out on page 19.

Total Fund by Participant Type & Major Asset Type						
Net Asset Value* (In Millions)						
As of June 30, 2015						
	Cash Equivalents	Public Stocks	Fixed Income	Loans	Other (1)	Total
Pension Funds	186.7	5,660.8	2,245.3	-	1,963.1	10,055.9
Trust Funds	91.3	-	2,284.9	134.1	-	2,510.3
Insurance Reserves	57.2	165.4	1,235.5	-	84.6	1,542.6
State Operating Funds**	1,553.3	0.2	240.9	-	-	1,794.5
Local Government Funds	574.5	-	-	-	-	574.5
Total	2,463.0	5,826.4	6,006.6	134.1	2,047.6	16,477.7

(1) Private Equity and Real Estate

*Net Asset Value (NAV) includes net receivable & payable accruals.

**State Operating Funds participant type includes the State Agency account which includes sub-accounts that hold \$248k in public stocks which were donated. Under statute State Agencies may not invest in public corporate capital stock.

Investment Pools

The Board primarily uses seven internal investment pools in managing money. Over \$14 billion (88%) is managed through these pools. Each pool has its own type of investment focus such as domestic stocks, foreign stocks, fixed income (e.g., bonds), real estate, private equity, and cash/cash equivalents. Almost all of the Board’s clients use one or several of these investment pools as a way to invest. Separate securities outside of these seven investment pools are also purchased when circumstances merit. Currently, separate investments account for \$1.9 billion, with the State Fund owning the largest dollar value of such securities, approximately \$1.5 billion.

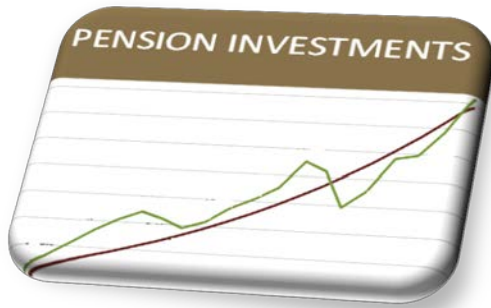
The following are the Board’s current investment pools and principal users:

<u>Name of Pool</u>	<u>Abbreviation</u>	<u>Eligible Participants</u>
• Trust Funds Investment Pool	TFIP	Various state trust funds
• Retirement Funds Bond Pool	RFBP	Retirement systems funds only
• Montana Domestic Equity Pool	MDEP	Retirement systems funds only
• Montana International Equity Pool	MTIP	Retirement systems funds only
• Montana Private Equity Pool	MPEP	Retirement systems funds only
• Montana Real Estate Pool	MTRP	Retirement systems funds only
• Short Term Investment Pool	STIP	Eligible local & state agencies

Total Fund Annual Change by Pool Net Asset Value* (In Millions) As of June 30						
Investment Pool	2015	Total %	2014	Total %	Change \$	Change %
Short Term Investment Pool	2,510.8	15.24	2,511.5	15.60	(0.7)	(0.03)
Montana Domestic Equity Pool	3,992.0	24.23	3,851.6	23.93	140.4	3.64
Montana International Pool	1,669.0	10.13	1,747.6	10.86	(78.6)	(4.50)
Retirement Funds Bond Pool	2,245.3	13.63	2,131.0	13.24	114.3	5.36
Trust Funds Investment Pool	2,256.2	13.69	2,195.7	13.64	60.5	2.76
Montana Private Equity Pool	1,075.4	6.53	1,031.2	6.41	44.3	4.29
Montana Real Estate Pool	887.6	5.39	849.8	5.28	37.9	4.45
All Other Funds	1,904.6	11.56	1,840.7	11.44	63.8	3.47
STIP Included in Investment Pools	(63.3)	(0.38)	(62.0)	(0.39)	(1.3)	2.02
Total	16,477.7	100.00	16,097.1	100.00	380.6	2.36

*Net Asset Value (NAV) includes net receivable & payable accruals.

The State’s largest general operating account is the Treasurer’s Fund and is the largest participant in STIP. Most state agencies are limited where their funds may be invested. If agencies have the legal authority to invest separately from the State’s general cash account (the Treasurer’s Fund) then they may invest in STIP. If an agency has funds other than ordinary operating monies and can prudently have a longer term investment outlook and a need for better returns, then the Trust Funds Investment Pool or separate individual securities are available. The Montana Constitution limits the investment in equities to the state’s retirement systems and to a more limited extent, the state’s workers compensation insurance agency, the State Fund.



Montana's **STATE PENSIONS** consist of nine separate retirement plans for state and local government employees, with the largest being the Montana Public Employee Retirement Program and the Montana Teachers' Retirement Program. The Board has established a number of different investment pools to meet the investment needs of the retirement plans. The Montana Constitution allows pension funds to be invested in common stock and the Board has created several

investment pools for this purpose. Altogether, pension monies are invested in six different pools: STIP, the Montana Domestic Equity Pool, the Retirement Funds Bond Pool, the Montana International Equity Pool, the Montana Private Equity Pool and the Montana Real Estate Pool.

In managing the state's pension investments, the Board balances many factors: maximize long term growth, analysis of the liquidity needs of plans, limit risks and be cost conscious. Long term growth is mostly driven by holding various types of domestic stocks or other equities such as international stocks, as they tend to provide the greatest return (but bear the greatest risk) over many years. Generating cash is done primarily by holding cash or investments that provide income such as bonds. Limiting risks is best accomplished by holding both a wide mix of investments and knowing generally which ones do not behave the same in an economic downturn (i.e., avoid over concentration of highly correlating-performing investments). Excessive costs substantially reduce returns. The Board is mindful that expenses must be budgeted to maximize value. Certain types of investments are more expensive to hold and manage than others and the Board requires staff to justify more expensive investment strategies. The Board does an annual cost analysis as part of its annual assessment of performance and efficiency.



Managing Pension Investments requires a skillful balance of:

- Maximizing long term growth
- Analyzing plan liquidity needs
- Limiting risks
- Controlling costs



To obtain an expected positive investment performance requires a long term view, at least 10 years, and accepting that bull and bear markets occur. In practice, this means that news is mostly noise, and that a steady hand, patience, and a professional discipline to rebalance is required. Modern portfolio theory **requires** establishing asset allocation ranges and staying within them even if it requires selling down assets that are performing well and buying into other asset classes.

Almost 90% of total investment performance is driven by asset class allocation. Ranges are determined by the Board, with recommendations from staff. The Board sets a range for each pension asset class, and the staff reports quarterly on how each class is performing and the relative holdings within the permitted ranges. The Board reviews and sets asset allocation ranges at least annually by Board policy.

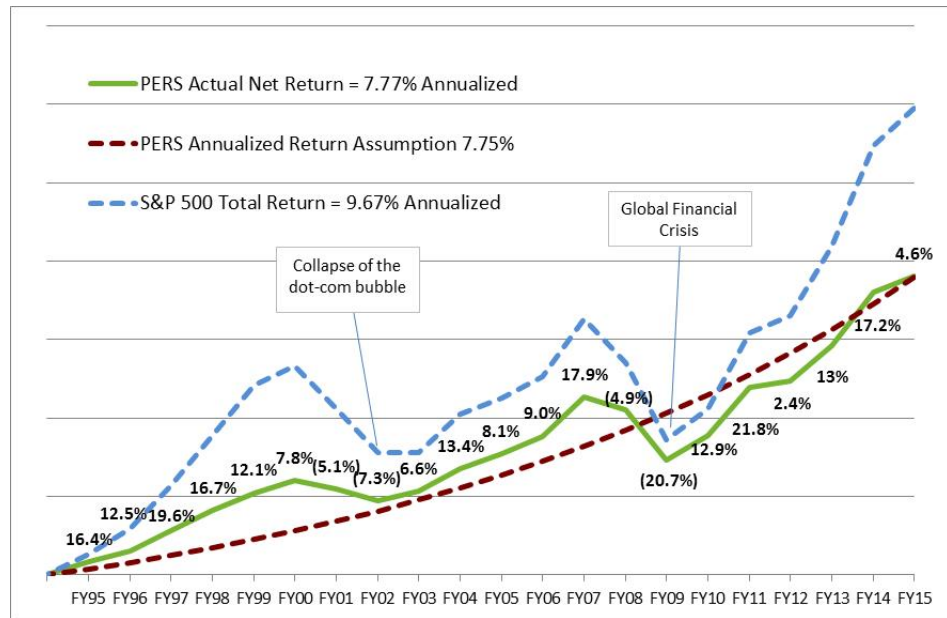
There are many possible investment asset classes and a wide range of possible mixes. In developing its investment rationale, the Board considers the merits of each class: its expected long rate of return, its likely riskiness (generally how volatile are its values), how readily convertible to cash is it (i.e., liquidity), and how it behaves in tandem to all the other asset classes (i.e., correlation). Running various possibilities, the Board determines the asset class ranges to maximize expected investment returns, keep risk within prudent levels, and maintain sufficient liquidity to meet current benefit payments. Some asset classes have been considered but are currently excluded. The Board by policy does not use hedge funds. Commodities and infrastructure investments are not excluded but are not currently part of the Board's asset allocation mix.

The Board's asset allocation mix is critical to the return on pension fund investments. The following major and sub asset classes and their approved ranges have been established by Board policy. The actual dollar amounts and the actual relative weight as of June 30, 2015 are also shown:

Pension Fund Asset Allocations & Board Approved Ranges As of 6/30/15		
Investment Type	%	Annually Approved Range
Asset Class - Domestic Equity	39.7%	28% - 44%
Large	81.1%	72% - 91%
Passive	57.0%	45% - 70%
Enhanced	12.0%	8% - 12%
Equity Long/Short Managers	12.0%	8% - 12%
Mid	12.3%	6% - 17%
Passive	2.1%	0% - 17%
Active	10.2%	0% - 17%
Small	6.6%	3% - 11%
Passive	0.2%	0% - 11%
Active	6.5%	0% - 11%
Asset Class - International Equity	16.6%	14% - 22%
Large	86.5%	79% - 92%
Passive	63.8%	42% - 66%
Active	22.7%	22% - 32%
Small	11.5%	8% - 16%
Passive	1.7%	0% - 16%
Active	9.7%	0% - 16%
Emerging	2.0%	0% - 5%
Passive	2.0%	0% - 5%
Asset Class - Private Equity	10.7%	9% - 15%
Buyouts	69.0%	50% - 80%
Venture Capital	21.8%	10% - 25%
Debt Related	9.2%	0% - 25%
Asset Class - Fixed Income	22.3%	22% - 30%
Domestic High Yield	8.5%	0% - 15%
International	1.9%	0% - 10%
Core (U.S. Investment Grade)	89.6%	80% - 100%
Asset Class - Real Estate	8.8%	6% - 10%
Core/Timberland	44.2%	35% - 65%
Value Added	39.3%	20% - 45%
Opportunistic	16.6%	10% - 30%
Asset Class - Cash Equivalents	1.9%	1% - 5%
All Investment Classes	100.0%	
*Equities represent 67% of the pension portfolio. Policy allows total equity range of 58% - 72%		

The chart below shows investment returns for the Public Employees' Retirement System (PERS) since fiscal year 1995. These returns reflect the effects of the total asset allocation of the various investment pool performances, net of fees. The returns for the other eight retirement systems have been nearly identical to the PERS. As shown by the S&P 500 in the chart, economic conditions heavily influence returns.

When considering the combination of assets to invest, the Board works to optimize three broad investment traits: expected return, risk, and historical performance compared to other investment classes in the same time period. The Board uses various simulation models which assign estimated future returns for each investment category, and then summarizes an expected return for the entire investment mix.



Pension Funds 10-Year Comparison Fair Value (In Millions) As of June 30, 2015						
Fund	Fair Value	% of Total	10-Year Fair Value	% of Total	Change \$	Change %
Firefighters Retirement	326.3	3.25	146.7	2.31	179.6	122.46
Game Wardens Retirement	148.0	1.47	51.8	0.82	96.2	185.95
Highway Patrol Retirement	128.2	1.28	83.6	1.32	44.7	53.43
Judges Retirement	86.7	0.86	48.4	0.76	38.3	79.04
Police Retirement	320.8	3.19	153.7	2.42	167.1	108.68
Public Employees Retirement	5,043.6	50.16	3,232.8	50.92	1,810.8	56.01
Sheriffs Retirement	295.0	2.93	151.0	2.38	143.9	95.32
Teachers Retirement	3,673.4	36.53	2,461.2	38.76	1,212.3	49.26
Vol. Firefighters Retirement	33.9	0.34	20.1	0.32	13.8	69.00
Grand Total	10,055.9	100.00	6,349.2	100.00	3,706.7	58.38
Investment Type						
Montana Domestic Equity Pool	3,991.7	39.70	3,009.3	47.40	982.5	32.65
Montana International Pool	1,669.0	16.60	996.5	15.69	672.6	67.50
Montana Private Equity Pool	1,075.4	10.69	297.4	4.68	778.0	261.58
Montana Real Estate Pool	887.6	8.83	16.5	0.26	871.2	5,287.89
Retirement Funds Bond Pool	2,245.3	22.33	1,928.4	30.37	316.9	16.43
Short Term Investment Pool	186.7	1.86	101.1	1.59	85.6	84.67
Grand Total	10,055.9	100.00	6,349.2	100.00	3,706.7	58.38

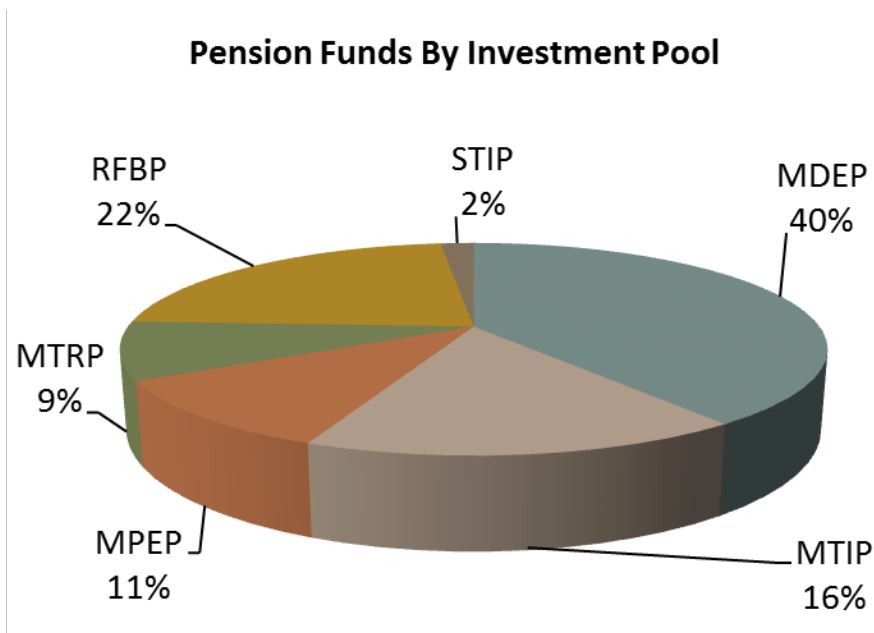
The Board reviews both absolute return performance and performance to internally established benchmarks. It also uses several external sources to compare the Board’s performance with other state and large public pension systems.

The Board’s investment performance and costs relative to its peers can be found on the Board’s website at: [\[include web address here\]](#).

The Board of Investments manages all pension fund investments through six of the Board’s seven investment pools. Each investment pool is governed by a separate investment policy and concentrations into any one pool are limited by the Board’s asset allocation policy. Selective return performance of the retirement systems is shown here:

Pension Fund By Investment Pool					
Fair Value (In Millions) With Time Weighted Annualized Net Returns					
As of June 30, 2015					
Investment Pool	Fair Value	1-Year Return %	2-Year Return %	10-Year Return %	21-Year Return %*
Montana Domestic Equity Pool (MDEP)	3,991.7	7.35	25.18	7.77	
Montana International Pool (MTIP)	1,669.0	(4.21)	21.67	4.64	
Montana Real Estate Pool (MTRP)	887.6	13.12	11.67		
Montana Private Equity Pool (MPEP)	1,075.4	8.44	16.51	10.55	
Retirement Funds Bond Pool (RFBP)	2,245.3	2.30	5.22	5.32	
Short Term Investment Pool (STIP)	186.8	0.12	0.14	1.70	
All Pension Funds	10,055.9	4.58	17.17	6.59	7.77

*Since inception of current custodial bank records.





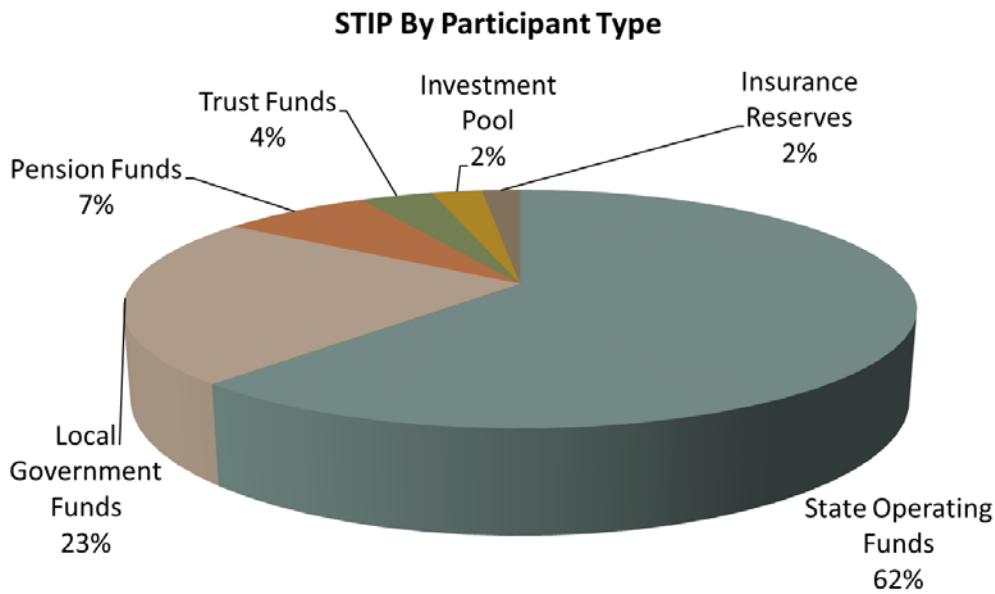
The Board’s **SHORT TERM INVESTMENT POOL (STIP) PROGRAM** is used by state agencies, local governments and the retirement systems as an alternative to idle cash. STIP investments are short, highly liquid and among the safest obtainable. Although not a money market fund, STIP is structured very similar to one although its yield tends to be higher due to lower expenses and an ability to make slightly longer investments due to the predictable nature of government cash needs.

On October 6, 2015 the Board approved, that for financial reporting purposes the STIP portfolio will be reported on a Net Asset Value basis beginning with the month of October 2015 versus amortized cost.

STIP is NOT Federal Deposit Insurance Corporation (FDIC) insured or otherwise insured or guaranteed by the federal government, the State of Montana, the Board or any other entity against investment losses. The Board maintains a reserve fund to offset possible losses and limit fluctuations in STIP’s net asset value (NAV).

Created in 1973, STIP provides participants ready access to cash. Shares are fixed at \$1.00, fractional shares may be purchased, and participants may buy or sell shares with one business days’ notice. The over \$2.5 billion in pool investments are managed by Board Staff. There were 490 accounts invested in STIP during the year, including 170 local government accounts. All investments are made by Board staff and all income is distributed to participants on the first day of the month. The pool reported earnings for state and local government agencies of \$2.82 million (unaudited) in Fiscal Year 2015. The table below shows the percent of shares by major participant type.

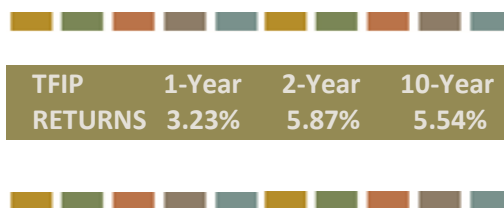
STIP Investments are short, highly liquid and among the safest obtainable.





The Board invests over \$2.5 billion for several **TRUST FUNDS**, some of which were created and protected by the state Constitution. The trusts are managed for income, rather than total rate of return. Other trusts have been created statutorily by the legislature or involve federal funds. Several trust funds were established as part of settlements

between the state and private corporations to ensure environmental clean-up of polluted sites. The fiscal year changes in the trusts' fair value are shown below.



Total Trust Funds By Type & Major Asset Type Fair Value (In Millions) As of June 30, 2015					
Trust Fund	Cash Equivalents	Fixed Income	Fixed Income/Real Estate (TFIP)	Loans	Total
Abandoned Mine Trust	1.09	5.13	0.00	-	6.22
Blackfoot Response	13.77	6.74	5.60	-	26.10
Butte Area One Rest	9.51	6.53	15.59	-	31.63
Clark Fork River Rs	6.88	6.94	18.60	-	32.41
Clark Fork Site Resp	7.00	10.80	79.29	-	97.09
Cultural Trust	0.17	-	13.61	-	13.78
East Helena Comp. Fund	3.32	-	2.45	-	5.77
Economic Development Tr	1.29	-	84.35	-	85.64
Endowment For Children	0.00	-	1.35	-	1.35
FWP Mitigation	2.00	9.47	0.00	-	11.48
Montana Pole	6.70	-	27.08	-	33.78
Noxious Weeds	0.00	-	10.86	-	10.86
Older Montanans Trust Fur	0.03	-	1.09	-	1.12
Park Acquisition	0.44	-	25.08	-	25.52
Permanent Coal Trust	17.97	-	407.15	133.68	558.80
Public School Trust	0.00	-	659.46	-	659.46
Real Property Trust	0.35	-	6.44	-	6.78
Regional Water Fund	1.29	-	88.81	-	90.10
Resource Indemnity Trust	0.02	-	111.48	-	111.50
Smelter Hill Upload	4.84	2.72	2.94	-	10.49
Streamside Tailings	2.80	0.06	40.98	-	43.84
Tobacco Trust	0.28	-	194.97	-	195.24
Treasure State Endowmen	2.24	-	265.07	0.41	267.72
UCFRB Reserve	0.71	-	16.89	-	17.60
UCFRB Restoration	7.23	-	115.72	-	122.95
Wildlife Habitat	0.55	-	11.52	-	12.07
Zortman Trust	0.02	15.76	0.00	-	15.77
Zortman Water	0.17	14.38	0.00	-	14.55
Total	90.66	78.51	2,206.37	134.08	2,509.62

Table excludes the receivable and payables accruals.

COAL SEVERANCE TAX TRUST FUND. Article IX, Section 5 of the state Constitution requires that 50 percent of all coal severance tax revenues be deposited in a permanent trust fund (Trust), in which the principal "shall forever remain inviolate unless appropriated by a three-fourths vote of each house" of the legislature. The Board is encouraged to invest 25 percent of the Trust in Montana economy with emphasis on new or expanding businesses.

The legislature has partitioned the Trust into several sub-funds. The Permanent Fund was initially established when the Trust was created, while the Severance Tax Bond Fund, created later, provides debt service guarantees and is invested solely in STIP. There is currently no new coal severance tax revenue dedicated to the Permanent Fund.

The Treasure State Endowment Fund was created July 1, 1993, with a \$10.0 million transfer from the Permanent Fund. From July 1, 1993 through June 30, 1999 one-half of the coal severance tax earmarked for the Trust was deposited in the Permanent Fund and the remaining 50 percent was deposited in the Treasure State Endowment Fund. The deposit of coal severance tax revenue to this fund terminates June 30, 2016.



Coal Severance Tax Trust Fund

... "principal of the trust shall forever remain inviolate unless appropriated by vote of three-fourths (3/4) of the members of each house of the legislature."

Montana Constitution – Article IX



Effective July 1, 1999, a new Treasure State Endowment Regional Water Fund sub-fund was created and 25 percent of Trust revenues were dedicated to that account. The deposit of coal severance tax revenue to this fund terminates June 30, 2016.

Effective July 1, 2005, a new Big Sky Economic Development Fund sub-fund was created and 25 percent of Trust revenues were dedicated to that account.

Income from the Permanent Fund and the Bond Fund is deposited in the Permanent Fund Income Fund where it is transferred periodically to the state general fund. Effective July 1, 2015 through July 1, 2018, on July 1 of each year, up to \$21 million of the interest income that is transferred to the general fund is statutorily appropriated to the Public Employees’ Retirement System Defined Benefit Plan Trust Fund. Effective July 1, 2019, on July 1 of each year, up to \$24 million of the interest income that is transferred to the general fund is statutorily appropriated to the Public Employees’ Retirement System Defined Benefit Plan Trust Fund. All sub-funds, except the income fund, are protected by the Constitution and may be appropriated only by a three-fourths vote of each house of the legislature. Income from the Treasure State Endowment Fund is appropriated by the legislature for local government infrastructure projects. Treasure State Endowment Regional Water Fund income is appropriated by the legislature for local government water projects. Big Sky Economic Development Fund income is appropriated by the legislature for economic development projects.

The annual change in the fair values of the Coal Severance Tax Trust sub-funds is shown below:

Coal Severance Tax Trust Fair Value (In Millions)						
Annual Change By Sub Fund & Investment Type						
As of June 30						
Sub Fund	2015	Total %	2014	Total %	Change \$	Change %
Permanent Coal Trust	558.8	55.64	559.88	57.30	(1.08)	(0.19)
Treasure State Endowment	267.7	26.66	254.08	26.00	13.64	5.37
Regional Water Fund	90.1	8.97	83.05	8.50	7.05	8.50
Economic Development Trust	85.6	8.53	78.56	8.04	7.08	9.01
Severance Tax Bond Fund	2.1	0.21	1.48	0.15	0.62	42.05
Permanent Fund Income	0.0	0.00	0.04	0.00	(0.04)	(88.29)
Grand Total	1,004.4	100.00	977.09	100.00	27.28	2.79
Investment Type						
Fixed Income (TFIP)	845.37	84.17	821.84	84.11	23.53	2.86
Loans - Commercial	68.68	6.84	74.71	7.65	(6.02)	(8.06)
Loans - Local Gov Infrastructure	21.34	2.13	22.65	2.32	(1.31)	(5.78)
Loans - Value Added	0.60	0.06	1.07	0.11	(0.47)	(43.74)
Loans - Science & Tech	10.04	1.00	10.18	1.04	(0.15)	(1.44)
Loans - Montana Facility Finance	2.26	0.22	3.15	0.32	(0.89)	(28.36)
Loans - Intermediary	3.24	0.32	3.28	0.34	(0.03)	(0.96)
Loans - Veterans	27.91	2.78	22.88	2.34	5.03	22.00
Cash Equivalents (STIP)	24.91	2.48	17.33	1.77	7.58	43.76
Grand Total	1,004.37	100.00	977.09	100.00	27.28	2.79

Table excludes the receivable and payables accruals.



OTHER TRUST FUNDS

Abandoned Mine - an expendable trust funded by federal grants under the Surface Mining Control and Reclamation Act of 1977, Article IV. Ten percent of Montana’s annual grant amount is deposited into this trust to fund programs related to abandoned mine land reclamation.

Butte Area One Restoration - funds derived from the 2008 consent decree between the Montana Department of Justice (DOJ) and Atlantic Richfield Company (ARCO) for projects that restore, replace or acquire the equivalent of injured natural resources or lost services at Butte Area One.

Clark Fork River Restoration - funds derived from the 2008 consent decree between the DOJ and ARCO for restoration of the Clark Fork River and associated riparian areas from Warm Springs Ponds to Milltown Reservoir and related projects.

Clark Fork Site Response Action - funds derived from the 2008 consent decree between the Montana Department of Environmental Quality (DEQ), the U.S. Environmental Protection Agency (EPA), and ARCO to remediate the environmental contamination at the Clark Fork River Operable Unit of a federal Superfund site.

Coal Tax Parks/Cultural Trust Funds (i.e. Cultural Trust & Parks Acquisition) - A portion of the coal severance tax is dedicated to a statutorily created Parks Trust Fund and a Cultural Trust Fund (Trusts). Investment income generated by the Trusts is appropriated by the legislature to acquire/operate state parks and to fund cultural and aesthetics projects. The 1997 legislature appropriated \$3.9 million of Cultural Trust principal to purchase historical properties.

East Helena Compensation - funds derived from the 2008 settlement between the DOJ and the American Smelting and Refining Company (ASARCO) for purposes of the restoration and oversight of environmental cleanup on and around the former site of the ASARCO smelter in East Helena.

Endowment for Children - funds derived from state appropriation, gifts, grants, and donations, or any other source for programs and services related to child abuse and neglect, primarily prevention activities and family resource programs.

Fish, Wildlife, and Parks (FWP) Mitigation - an expendable trust funded by a 1988 agreement between the Montana FWP and the Bonneville Power Administration to provide protection, mitigation, and enhancement of wildlife and wildlife habitat affected by the development of Libby and Hungry Horse Dams.

FWP Real Property - a non-expendable trust funded with proceeds from the sale of real property, oil, gas or mineral deposits, and from leases for the operation, development, and maintenance of real property under management of the Montana FWP.



Trust Investments are managed primarily to generate income for the Board's Trust Fund clientele.



Montana Post and Pole - funds derived from the 1996 consent decree between the DEQ, EPA, ARCO, Burlington Northern Railroad, Montana Resources, Inc., and other responsible parties for the environmental cleanup of the former Montana Pole and Treatment Plant in Butte.

Noxious Weed Management - a non-expendable \$10 million trust that receives funding from state and federal contributions and private donations for programs and services related to noxious weed control.

Older Montanans - funds derived from contributions and gifts to be used towards programs and services that promote dignity, respect, and enable an independent lifestyle in the least restrictive setting for Montana residents 60 years of age or older.

Resource Indemnity Trust Fund - Article IX, Section 2 of the state Constitution requires that revenues from the Resource Indemnity Tax on minerals be deposited in the Resource Indemnity Trust Fund, the principal of which "shall forever remain inviolate" until the principal reaches \$100 million. The fund's book value reached \$100 million in fiscal year 2002.

Smelter Hill Uplands Restoration - funds derived from the 2008 consent decree between the DOJ and ARCO for the restoration of the environment, vegetation and soils on lands affected by the Anaconda smelter.

Streamside Tailing - funds derived from a 1998 consent decree between the DEQ, EPA, ARCO, and other responsible parties, for the purpose of remediating the mine waste contamination at the Streamside Tailings Operable Unit of the Silver Bow Creek/Butte Area.

Tobacco - funds derived from a 1999 master settlement agreement between the states and the nation's largest tobacco companies payable over 25 years beginning fiscal year 2000. Forty percent of Montana's share is deposited in this trust and funds programs related to health care benefits, services, or coverage and tobacco disease prevention.

Trust and Legacy (Schools) Fund - Article X, Sections 2 and 3 of the state Constitution requires that all royalties and other proceeds received from school lands granted to the state under federal enabling legislation be deposited in the Trust and Legacy (Schools) Fund, where it shall forever remain inviolate and guaranteed by the state against loss or diversion.

Upper Blackfoot Mine Complex - funds derived from the 2008 settlement agreement between the DOJ, DEQ, EPA, ASARCO, and ARCO to be used, in consultation with the U.S. Forest Service, for conducting response and restoration activities within the Upper Blackfoot Mining Complex Site.

UCFRB Restoration/Reserve - funds derived from the 1998 consent decree between ARCO and the DOJ for the restoration, replacement, or acquisition of equivalent state natural resources injured in the Upper Clark Fork River Basin.

Wildlife Habitat - a non-expendable trust funded by twenty percent of the non-resident hunting license revenue collected between 1989 and 1994 for the acquisition, development, and maintenance of wildlife habitat.

Zortman/Landusky - funds paid by the Pegasus mining company and its insurer to provide long-term water treatment at the closed Zortman and Landusky mines near Malta.

Zortman/Landusky LT H2O - funds derived from state appropriations of \$1.2 million a year until there are sufficient funds to generate \$19.3 million by January 1, 2018 for long-term water treatment at the closed Zortman/Landusky mines near Malta.





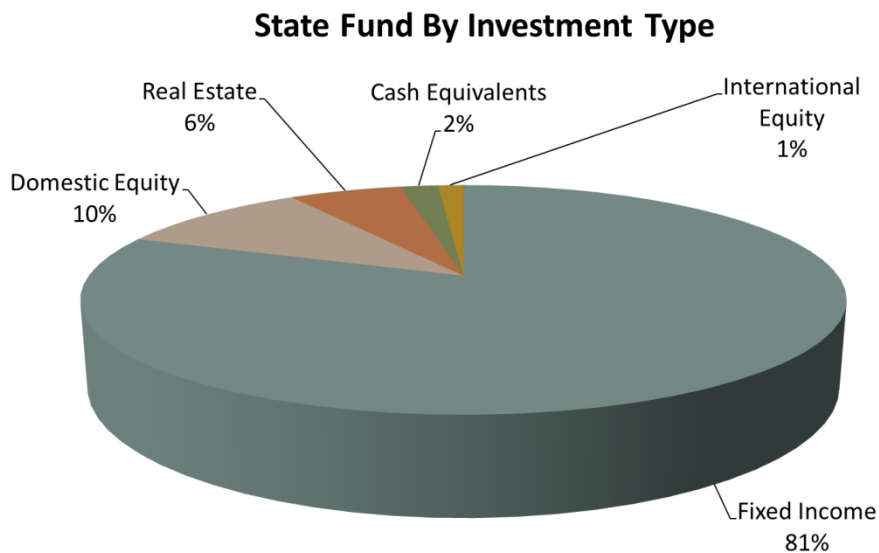
The Board invests over \$1.5 billion for several **INSURANCE PROGRAMS**, with the State Fund owning the largest dollar value of such securities.

The State Compensation Insurance Fund (State Fund) provides workers' compensation and occupational disease insurance for claims arising from injuries including those that occurred prior to July 1, 1990.

STATE FUND INSURANCE RETURNS	1-Year	2-Year	10-Year
	3.04%	6.13%	5.20%

State Fund Insurance Fair Value (In Millions) Annual Change As of June 30						
	2015	Total %	2014	Total%	\$ Change	Change %
Corporate/Asset-Backed Bonds	697.3	69.42	685.2	48.57	12.1	1.76
International Government	21.2	2.11	20.9	1.48	0.4	1.68
US Govt Direct Obligations	196.6	19.58	177.3	12.57	19.3	10.89
US Agency Bonds	256.1	25.49	254.9	18.07	1.2	0.45
Blackrock ACWI EX US Super Fund	19.1	1.90	20.1	1.43	(1.0)	(5.20)
Blackrock Equity Index (S&P 500)	146.3	14.56	147.4	10.45	(1.1)	(0.75)
American Core Realty	44.8	4.46	42.0	2.98	2.7	6.54
TIAA CREF Asset Management	39.8	3.97	32.1	2.27	7.8	24.24
Cash Equivalents (STIP)	28.0	2.79	31.0	2.20	(3.0)	(9.66)
Grand Total	1,449.1	100.00	1,410.9	100.00	38.3	2.71

Table excludes receivable & payable accruals.





OTHER INSURANCE FUNDS INVESTMENTS

Other Insurance Funds By Investment Type			
Fair Value (In Millions)			
As of June 30, 2015			
Other Insurance Funds	Cash		Total
	Equivalents	Fixed Income	
Agency Insurance*	15.9		15.9
Group Benefits	11.3	36.3	47.6
Hail Insurance*	3.0		3.0
MT University Sys Group Ins	8.1	28.1	36.2
Subsequent Injury Fund	0.3		0.3
Unemployment Insurance Benefits*	5.2		5.2
Uninsured Employees*	1.6		1.6
University Workers Compensation*	18.0		18.0
Total	63.5	64.3	127.8

Table excludes the receivable and payables accruals.

*These are sub-accounts of the State Agency account and are included under State Operating Funds rather than Insurance Reserves on pg.6.

Agency Insurance - reserve account for the state's property self-insurance program (including liability, property, flood, etc.).

Group Benefits - created in 1981, provides health and life insurance to non-university state employees.

Hail Insurance - provides benefits to producers engaged in the growing of crops subject to hail damage.

Montana University Group Insurance - reserve account for the Montana University System's self-insured health plan.

Subsequent Injury - provides benefits to workers who are vocationally handicapped and whose Workers' Compensation benefits have expired.

Unemployment Insurance Benefits - Unemployment benefits are paid from this fund to eligible recipients.

Uninsured Employees - accounts for activity related to uninsured workers compensation employers and related benefits paid.

University Workers Compensation - accounts for self-insured workers compensation coverage for employees of the Montana University System.





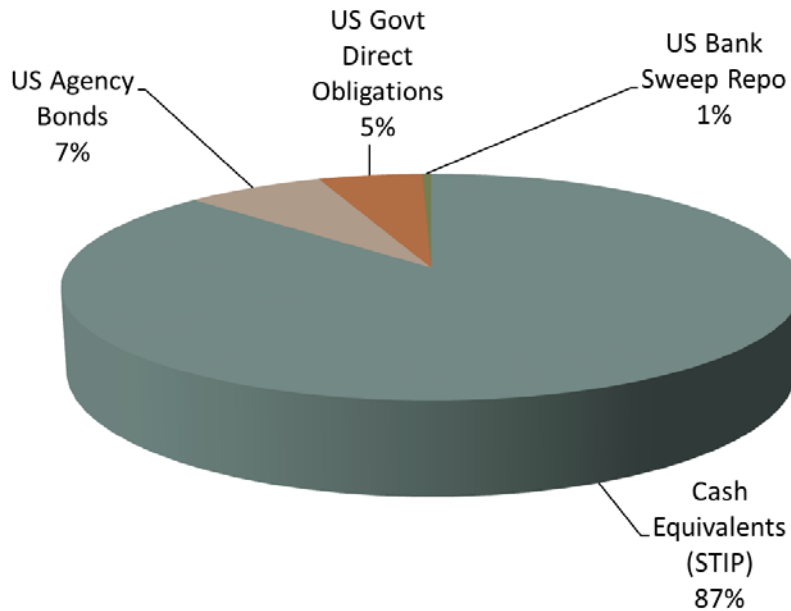
The **TREASURER'S FUND** (Fund) is comprised of surplus cash in all state accounts that do not retain their investment earnings. All earnings are deposited in the state general fund. State law authorizes the Board to determine the amount of surplus cash in the Fund to be invested and the type of investments to be made. Invested balances at book value vary widely due to varying levels of excess cash in the state's general fund and other accounts comprising the Fund. The Fund

is managed to maximize income, rather than for total rate of return. This Fund has been a major participant in STIP since 1973 when STIP was created.

Treasurer's Fund Balance
as of June 30, 2015
is \$1.1 Billion.

TREASURER'S FUND RETURNS	1-Year	2-Year	10-Year
	.27%	.21%	1.70%

Treasurer's Fund By Investment Type

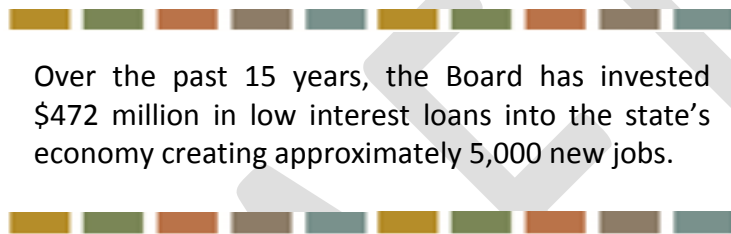




Over the years, the Montana Legislature has directed that the Board provide certain financial incentives, typically at below-market interest rates, to certain borrowers who meet the program requirements set in law.

The In-State Loan Program, created in 1984 as part of the "Build Montana" program, invests Coal Tax Trust (Trust) funds in Montana to stimulate the state's economy. State law authorizes the Board to invest the Trust to increase employment and business opportunities, while maintaining and improving the state's physical environment.

Over the past 15 years staff has funded 530 loans, totaling \$472.1 million creating approximately 5,000 new jobs in the state of Montana. The current reservations and commitments anticipate creating an additional 680 jobs, when funded.



Loan Types – Four different loan types are available in the In-State Investment Program, some of which offer a job credit interest rate reduction equal to 0.05 percent for each qualifying job created, up to a maximum reduction of 2.5 percent.

- **The Commercial Loan Participation Program** allows the In-State Loan Program to participate up to 80% in a loan originated by an approved lender. Unencumbered land, buildings, and equipment may be financed with the loan proceeds. The financial institutions charge a fee to service the loan and the Board's loan is collateralized proportionally to the Board's share of the loan. These loans may not exceed 25 percent of the Trust and the individual loans may not exceed 10 percent of the Trust. Loans exceeding 6percent of the Trust must have lender participation of at least 30 percent.
- **The Infrastructure Loan Program** provides loans to eligible local governments for constructing or purchasing infrastructure to be used by a basic sector business. Total loans outstanding in this Program are limited by law to \$80 million.
- **The Value-added Loan Program** provides low interest loans to value-added type businesses that create or retain jobs. Total loans outstanding in this Program are limited by law to \$70 million.
- **The Intermediary Re-lending Program** provides loans to local economic development organizations with revolving loan programs. Individual loans may not exceed \$500,000 and total loans outstanding in this Program are limited by law to \$5 million.

The Veteran's Home Loan Program provides low interest loans for Montana Veterans who are first-time home buyers. By law, the Montana Board of Housing administers the Program; however, the Board of Investments approves and funds all loans. Total loans outstanding in this Program are limited by law to \$30 million (increased to \$40 million July 1, 2015).

Annual Change by Loan and Mortgage Type						
Fair Value (In Millions)						
As of June 30						
	2015	Total %	2014	Total %	Change \$	Change %
Commercial Loans	68.7	56.40	74.7	59.96	(6.0)	(8.06)
Infrastructure Loans	21.3	17.53	22.7	18.18	(1.3)	(5.78)
Veteran's Home Loan Mortgage	27.9	22.92	22.9	18.36	5.0	22.00
Intermediary Program Loans	3.2	2.66	3.3	2.63	(0.0)	(0.96)
Value-added Loans	0.6	0.50	1.1	0.86	(0.5)	(43.74)
Total	121.8	100.00	124.6	100.00	(2.8)	(2.25)

In addition to the Coal Tax Loan Program, the Board also invests other state funds in Montana and guarantees bonds as shown below:

In-State Loans, Other In-State Investments and Bond Guarantees						
Fair Value (In Millions)						
As of June 30						
	2015	Total %	2014	Total %	Change \$	Change %
Coal Tax Trust Loans	93.9	25.82	101.7	25.46	(7.8)	(7.70)
Veteran's Home Loan Mortgage	27.9	7.68	22.9	5.73	5.0	22.00
Montana Science and Technology	10.0	2.76	10.2	2.55	(0.1)	(1.44)
Montana Facility Finance Authority Loans	2.3	0.62	3.2	0.79	(0.9)	(28.36)
Total AOF Loans and Mortgages	134.1	36.88	137.9	34.52	(3.8)	(2.78)
Med Map LLC (St. Vincent Hospital, Billings)	7.9	2.17	8.5	2.13	(0.6)	(7.06)
Board of Housing	0.8	0.22	0.8	0.20	0.0	0.00
Total Bonds	8.7	2.39	9.3	2.33	(0.6)	(6.45)
Totals RFBP Residential Mortgages	8.0	2.20	10.6	2.65	(2.6)	(24.34)
Total MTRP Direct Real Estate	19.5	5.36	19.1	4.79	0.3	1.80
Bond Guarantees (1)	193.3	53.17	222.6	55.72	(29.3)	(13.16)
Total Other In-State and Bond Guarantees	220.8	60.73	252.3	63.15	(31.5)	(12.50)
Total	363.6	100.00	399.5	100.00	(36.6)	(8.94)

(1) Guarantees of INTERCAP and Montana Facility Finance Bonds

The above table reflects only what the Board of Investments directly manages or directly guarantees. The Montana Legislature has authorized other programs to use coal tax monies from various sub-funds. See page 15 for more information on these sub-funds.

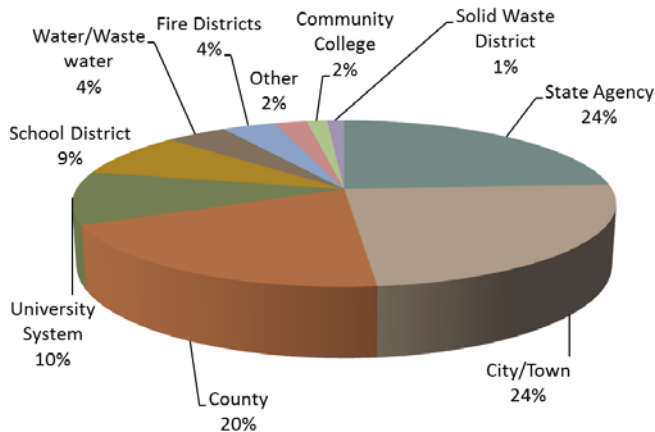


For nearly 30 years, the Board has provided low interest loans to Montana state agencies, universities, and local governments for various projects. Since the program's inception, the Board's INTERCAP Loan Program (INTERCAP) has loaned \$456.5 million statewide and issued \$148.0 million in bonds with \$106.4 million outstanding at June 30, 2015. The Board makes firm one-year commitments to fund the loans. On

average, over the past five fiscal years, the program committed to \$35.1 million and funded \$26.3 million in loans. In fiscal year 2014, the program estimated fiscal year 2015 commitments and fundings would be ~\$30 million. In fiscal year 2015, the program committed to \$26.2 million and funded \$28.2 million in loans. For fiscal year 2016, the program estimates the Board will commit to and fund approximately \$30 million.

Loan interest rates are reset every February; the loan rate through February 15, 2016 is 1.25%.

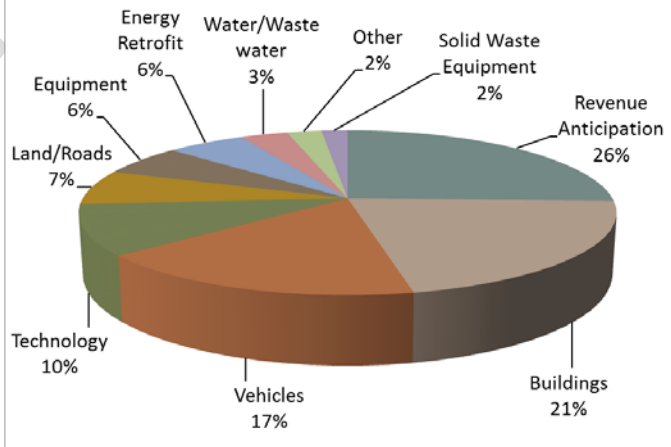
Loans By Borrower Type Since Inception



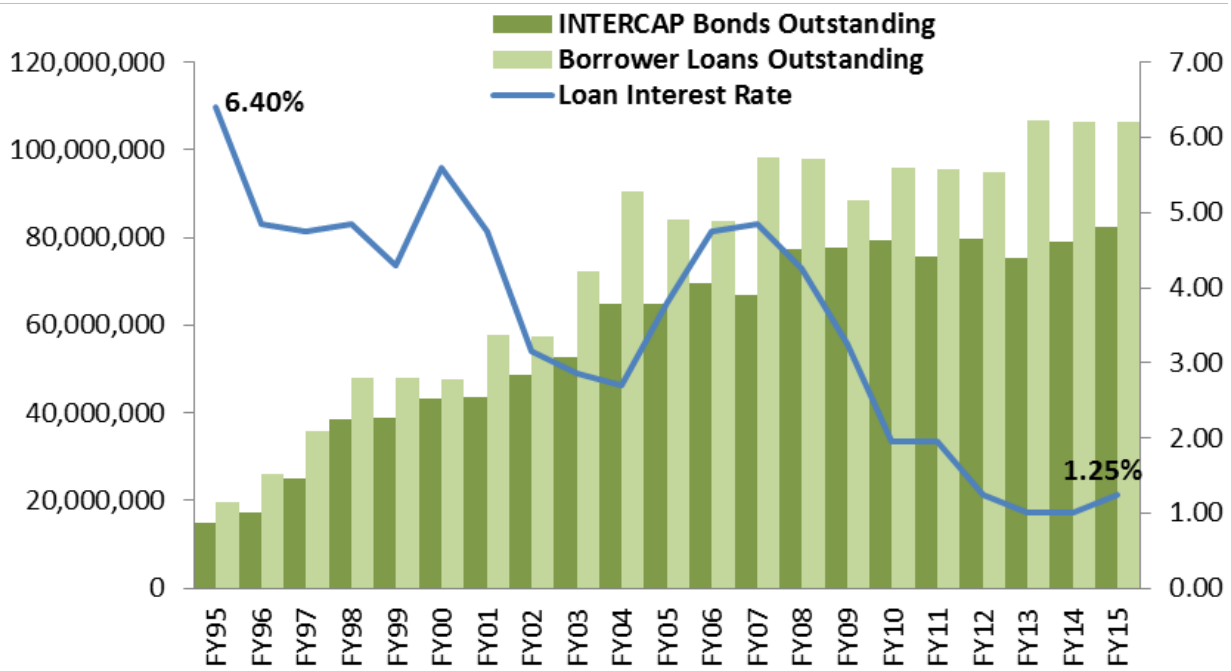
Over 75% of all Montana counties and municipalities have financed projects through INTERCAP.



Loans By Project Type Since Inception



The table below compares the INTERCAP bonds outstanding vs. borrower loans in relation to the loan interest rate in effect at the time.



Through a statutory mechanism, the Board is allowed to pledge certain moneys as a guarantee on these loans, which allows for the low interest rate. To date (without intending any limitation) the Board has identified two funds, the Treasurer's Fund and the Coal Severance Tax Trust Fund, as being legally available for such purposes.

INTERCAP loans have been very high credit quality, and to date, the Board has never suffered a loss, due in part to reasonable underwriting standards and the credit soundness of State of Montana agencies, boards, and authorities and Montana local governments.

Other programs the Board administers under the Bond Program are as follows:

- **Qualified Zone Academy Bond Program (QZAB)**

This program allows qualifying school districts to borrow money at no or nominal interest rates by issuing qualified zone academy bonds. The Board acts as a legal funding conduit only and has no pecuniary liability for the repayment of the bonds. Nine school districts have issued over \$9.98 million in QZAB bonds as of June 30, 2015.

- **Qualified School Construction Bond Program (QSCB)**

This program allows qualifying school districts to borrow money at no or nominal interest rates by issuing qualified school construction bonds. The Board acts as a legal funding conduit only and has no pecuniary liability for the repayment of the bonds. Two school districts have issued over \$8.37 million in QSCB bonds as of June 30, 2015.



JOB GROWTH IN GREAT FALLS



The Board's In-State Loan Program, in cooperation with the City of Great Falls and Great Falls Developments was able to attract ADF International, Inc., a complex structural steel fabrication company with headquarters in Toronto, Ontario Canada, through the use of Board's Infrastructure Loan Program that provided \$4,999,800 at 1.98% fixed interest rate for 15 years. In consideration for the terms of the loan, ADF International, Inc. has agreed to create 300 jobs over a four-year period. The Infrastructure Loan Program also provides tax incentives to

...ADF has agreed to create 300 jobs...

ADF International, Inc., which over the term of the loan, would at least equal the total amount of the loan.

LOW INCOME HOUSING IN KALISPELL



The Board's In-State Loan Program provided long-term, fixed-rate financing for the construction of a 40-unit low income housing facility in Kalispell, Montana through the use of its Low Income Housing Tax Credit loan program. The facility has been very well received.



Expanding Health Services in Seeley

INTERCAP leveraged almost \$550,000 loan to help finance a \$1.14 million expansion and renovation of the Seeley-Swan Hospital District's Medical Center.

The project allows the District to provide expanded services offered by Partnership Health Center at the Seeley Lake location. The dental and behavior health services now offered had previously been intermittently available and at the patient's expense. The expansion provides these additional services on a regular and more affordable basis, to greatly enhance the health care opportunities for area residents.



Frenchtown Rural Fire District used INTERCAP financing to purchase a new water tender. One of many equipped and ready units financed through INTERCAP used to extinguish the fires of 2015.

Improving Public Safety around the State

Musselshell County used an INTERCAP loan to replace an aging ambulance that faced expensive major repairs. The new ambulance will help the Ambulance Service continue to meet the needs of residents throughout the large, rural county.

