

## TRUST FUNDS INVESTMENT POOL INVESTMENT POLICY STATEMENT

### INTRODUCTION

The purpose of this policy statement is to provide a broad strategic framework for investments within the Trust Funds Investment Pool (TFIP). The pool's participants consist primarily of the state's trust funds. The pool is designed to provide the participants exposure to a portfolio of diversified income-producing assets. The pool's assets include an investment grade fixed income portfolio managed internally by MBOI staff, one or more core real estate funds, and one or more high yield fixed income funds. Allocation across these asset classes is limited to the following ranges. The use of high yield fixed income and core real estate investments are justified in order to diversify the sources of income provided by the pool, however are constrained to prudent levels of maximum exposure given their unique and somewhat more volatile return patterns.

Asset Class	Minimum	Maximum
Investment grade fixed income	0%	100%
High yield fixed income	0%	10%
Core real estate	0%	8%

The primary component of the pool consists of the investment grade fixed income portfolio. The investment guidelines governing the management of that portfolio are contained herein. The other asset categories represented in the pool are advised by external managers. Specific portfolio guidelines that prohibit or constrain certain types of securities or real estate investments will be addressed in the managers' specific investment guidelines. A brief description of these other asset classes follows.

**High Yield Fixed Income:** This sector consists of predominantly U.S. corporate credits, whether in the form of bonds or loans that are rated below investment grade. These assets carry a higher risk of default than investment grade securities and accordingly provide a higher level of income or yield commensurate with that risk.

**Core Real Estate:** Equity investment in operating and substantially-leased institutional quality real estate in the traditional property types (apartment, office, retail, industrial and hotel). Net long-term returns historically have been in the 4.0 percent to 6.0 percent range (inflation-adjusted and net of fees) and are typically comprised of greater levels of income (i.e., two-thirds of long-term total returns) with appreciation matching or exceeding inflation.

### **OBJECTIVES: Investment Grade Fixed Income Portfolio**

**Strategic:** Attaining a competitive stream of income in the fixed income markets while diversifying investment risk. The primary objective of the Trust Fund Bond Pool portfolio is to provide diversified exposure to the various sectors of the investment grade bond market for the benefit of fund participants in a prudent and cost effective manner. In this sense the portfolio investment strategy is core-like and is to be benchmarked against the Barclays Capital Aggregate Bond Index. The portfolio will also provide primary liquidity to fund participants and to facilitate allocation between the other asset classes held in the pool.

**Performance:** The objective of the TFBP is to achieve a moderate yield to advantage to the Barclays Capital Aggregate bond index. Ideally, the annualized time weighted total return will exceed that of the Barclays Capital Aggregate Bond Index over a three year rolling period.

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### PERMITTED INVESTMENTS: Investment Grade Fixed Income Portfolio

- Debt obligations of the U.S. Government, including its agencies and instrumentalities. These include Treasuries, Treasury Inflation Protected Securities (TIPS) and fixed and floating rate agency obligations.
- Dollar denominated debt obligations of developed country foreign governments.
- Dollar denominated debt obligations of index-eligible supranational agencies.
- Dollar denominated debt obligations of domestic and foreign corporations (Yankee bonds) up to 2% of portfolio assets per issuer. These may include Trust Preferred securities and be fixed or floating rate coupon structures.
- Securitized assets, including U.S. Agency mortgage pass-through securities (MBS), non-agency MBS (limited to 3% of portfolio market value in total), collateralized mortgage obligations (CMO's), commercial mortgage backed securities (CMBS), hybrid ARMS and asset backed securities (ABS).
- When issued securities.
- Rule 144a securities.
- Medium term notes.
- Short term investment pool (STIP).
- Loans for the Montana CRP Program.

### PROHIBITED INVESTMENTS: Investment Grade Fixed Income Portfolio

- Over the counter derivatives, including interest rate swaps and credit default swaps.
- Short sales and securities margin loans.
- Bank loans.
- Interest only (IO) and principal only (PO) mortgage strips.
- Companion/residual/equity tranches of CMO's or other structured securities.
- Capital securities (convertible from fixed to floating).
- Inverse floaters.
- Convertible bonds.

### CONSTRAINTS: Investment Grade Fixed Income Portfolio

**Credit quality:** Individually held securities must be rated investment grade, or no lower than triple-B minus, by one nationally recognized securities rating organization (NRSRO) at the time of purchase. Split rated securities may not exceed 3% of portfolio market value.

**Duration:** The weighted average effective duration of the portfolio, including cash, must be within 20% of the duration of the Barclays Capital Aggregate Bond index.

**Sector:** The portfolio sector exposure will be maintained within the ranges highlighted in the table below. Recent exposures by sector for the portfolio and benchmark index are shown for reference.

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**ASSET ALLOCATION SECTORS & RANGES**

3/31/09  
(At market)

<u>Sectors</u>	<u>TFBP</u>	<u>Agg Index</u>	<u>Policy Ranges</u>
U.S. Treasury	7.82	26.17	<b>10-35</b>
Government Related	23.33	13.90	<b>5-25</b>
<b>Total Government</b>	<b>31.15%</b>	<b>40.07%</b>	<b>20-55</b>
MBS (Fixed Rate)	24.47	36.04	<b>20-50</b>
Hybrid ARMS	0.00	2.67	<b>0-10</b>
Asset Backed Securities	1.12	0.55	<b>0-5</b>
CMBS	4.79	3.25	<b>0-10</b>
<b>Total Structured</b>	<b>30.38%</b>	<b>42.51%</b>	<b>20-75</b>
Corporate Credit	<b>35.53%</b>	<b>17.42%</b>	<b>10-35</b>
Cash (STIP)	<b>2.94%</b>	<b>0.00%</b>	<b>0-10</b>
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

Current portfolio exceptions to the above policy ranges will be addressed over time depending upon market conditions with the objective of moving within compliance.

**LIQUIDITY: Investment Grade Fixed Income Portfolio**

Liquidity needs for the fixed income program are low, as participant capital allocated to the pool is not expected to change dramatically on short notice. Nevertheless, the underlying assets held are predominantly publicly traded securities which can normally be liquidated in a relatively short period to accommodate asset allocation changes between the internally managed fixed income portfolio and other asset categories held by the Trust Funds pool. Assets considered to be generally illiquid will be limited to 10% of the portfolio's market value.