

**MONTANA BOARD OF INVESTMENTS
DEPARTMENT OF COMMERCE
Montana State University
Room 275, Strand/Student Union Building, Bozeman, MT
Thursday, September 16, 2004**

MINUTES

BOARD MEMBERS PRESENT:

Dick Anderson, Chairman
Dennis Beams
Karen Fagg
Maureen Fleming
Jay Klawon
Joel Long
Terry Moore
Calvin Wilson

BOARD MEMBERS ABSENT:

Tim Ryan

STAFF PRESENT:

Robert T. Bugni, CFA, Chief Investment Officer - Interim
Richard Cooley, CFA, Senior Investment Officer
Kimberly Dallas, Program Assistant
David Ewer, Senior Portfolio Manager
Edward Kelly, Assistant Investment Officer
Herbert Kulow, Senior Portfolio Manager
Rande Muffick, CFA, Assistant Investment Officer
Delrene Rasmussen, Assistant Investment Officer
Carroll V. South, Executive Director
Louise Welsh, Bond Program Officer

GUESTS:

Gordon Hoven, Piper Jaffray
Kelly Williams, Managing Director, Credit Suisse First Boston
Trent Williams, Principal, Regional Technology Strategies, Chapel Hill, NC.
Joni McKown, Associate, Credit Suisse First Boston
Mark Solon, Managing Partner, Highway 12 Ventures
Karen Powell, Deputy Securities Commissioner, State Auditor's Office
John O'Donnell, TechRanch
David L. Johnson, Credit Suisse First Boston
Jon Marchi, Glacier Venture Fund
David Almolovar, Vice President, Credit Suisse First Boston
Mike Arpey, Managing Director, Credit Suisse First Boston
Jeff Batton, PrintingForLess.com
Cathy Conover, Montana State University
Frank Cote
Jodie DeLay, Montana State University

Linda Leening, Gallatin County Finance
Brian S. O'Keefe, Associate, AA Capital Partners, Inc.
Mark Semmens, D.A. Davidson
Dave Gibson, Governor's Office
Louise Croset, Director, Pacific Basin Portfolio Manager, Schroders
Connie Moak Mazur, Senior Vice President, Marketing and Client Services, Schroders
Richard Sennitt, Regional Fund Manager, Pacific Basin Team, Schroders

CALL TO ORDER

Chairman Anderson called the regular meeting of the Board of Investments (Board) to order at 9:15 a.m. in Room 275 of the Strand Union Building on the Montana State University Campus, Bozeman. As noted above, the meeting convened with eight members of the Board present. Member Ryan was absent.

Chairman Anderson called for approval of the August 26, 2004 Regular Meeting Minutes. Member Moore requested that the minutes be amended and clarified explaining the reason for the "Nay" vote regarding the Residential Mortgage Loan Program. Member Moore further explained that the Residential Mortgage Loan Program is not a prudent investment of the pension funds. In addition, Member Moore requested that the minutes reflect that Bob Bugni, Chief Investment Officer - Interim, was directed to present and make staff recommendation regarding the issues discussed.

Member Klawon also corrected the minutes stating that he was in attendance during the afternoon session of the August 26, 2004 Regular Meeting of the Board.

With these clarifications and corrections made, Member Beams motioned for approval of the August 26, 2004 minutes; Member Wilson seconded the motion and the motion was passed 8-0.

PUBLIC COMMENT - Public Comment on Board-Related Items

Chairman Anderson called for Public Comment of Board-Related Items. No Public Comment was made.

EXECUTIVE DIRECTOR REPORTS

Presentation - Venture Capital - Credit Suisse First Boston

Mr. Carroll South presented to the Board a report on "Pension Fund Venture Capital Investments". This report states that the state constitution/law precludes the investment of state trust funds in equity investments, state law actually encourages the Board to prudently invest up to 3.0 percent of retirement funds in venture capital companies. Section 17-6-201(3)(b), MCA states:

(b) The board is urged under the prudent expert principle to invest up to 3% of retirement funds in venture capital companies. Whenever possible, preference would be given to investments in those venture capital companies that demonstrate an interest in making investments in Montana.

Venture Capital is described as "funds made available for startup firms and small businesses with exceptional growth potential." Venture Capital may also be called "risk capital." The Board has invested pension funds in venture capital since 1988, when Adams Street Partners was selected to manage the investments. Occasionally, staff may ask Adams Street to consider individual Montana businesses that come to us seeking equity financing. The decision to invest rests solely with Adams Street's professional investment staff. To date, these investments have provided a good return for the pension funds but very little of the funds have been invested in Montana. Venture capital investing is a highly specialized, illiquid, and risky asset class that requires expertise and experience the Board does not possess.

Mr. South continued by explaining that venture capital investing and economic development are sometimes intertwined during public policy discussions, but the two concepts have different motives and goals. Venture capitalists invest primarily to receive a return on the investment that adequately rewards them for the risk taken. What matters most is

that the business is likely to be successful and that there is a potential exit strategy that will not only return the investor's capital but a handsome profit as well. Economic development efforts are usually tied to a specific state or region within the state and may involve state/local government financial assistance, favorable tax treatment, grants, and low interest loans to businesses agreeing to locate in the jurisdiction. These efforts are aimed at creating jobs, providing additional tax revenues, and provide a benefit to the region's economy.

The Interim Economic Affairs Committee has been studying the "venture capital" issue and recently invited Credit Suisse First Boston (CSFB) to report on how it had facilitated the establishment of venture capital investment programs in other states. Mr. South suggested that CSFB present a similar report to the Board of Investments with a focus on the viable investment opportunities that may exist in the state and the potential ability to raise private venture capital for investment in Montana. CSFB spent time in Montana meeting with key economic development, financial and university personnel, and prepared a report for presentation to the Board on their observations and recommendations.

Mike Arpey, representing CSFB, gave its presentation to the Board on the opportunities of venture capital investments in Montana. Mr. Arpey explained that the Customized Fund Investment Group (CFIG) of Credit Suisse First Boston analyzed the opportunity for an in-state private equity program in the State of Montana. The CFIG team found several investment opportunities in the State and in the surrounding region, including the states of Idaho and Utah and the areas of Eastern Washington and Eastern Oregon. Considering the depth of research and the extent of the report, the complete report will be kept on file with a copy of the Board minutes.

Additional comment was made by Mr. Mark Semmens, representing D.A. Davidson stating that the firm has been involved in the research that the CFIG team has done, and they would consider further involvement and investment in this fund if the determination is made that it would be a prudent investment.

Carroll South concluded the presentation by further explaining that the law encourages the Board to give preference to venture capital firms interested in investing in Montana and that the 2005 Legislature will likely consider a venture capital bill of some type. The Legislature will focus on the creation of a venture capital program to spur economic development, any Board involvement in venture capital activities must focus on return on investments. Any firm hired by the Board to invest pension funds must first and foremost invest for return commensurate with the risk and any beneficial economic impact on the state's economy will be incidental.

This presentation was provided to the Board to give Members the opportunity to hear about potential investment opportunities that may be available in the state and the region. If the Board is comfortable with the concept of a regional venture capital fund as presented staff will continue working with CSFB and present more information at the October meeting.

Member Fagg motioned to direct staff to proceed to the next level and prepare for the October meeting specific recommendations from staff requiring Board action. Member Wilson seconded the motion. Further discussion took place and comments were made. Member Moore requested that Mr. Bugni be involved in the decision making process and his comments be included in the discussion that takes place in October and going forward. The motion was passed 8-0.

Out-of-State Travel

Executive Director Carroll South presented Board Member travel requests for:

" Karen Fagg to attend the Investment Management/Institutional Investors Conference in Phoenix, November 12 - 18, 2004. Estimated cost of trip, including airfare, lodging, registration fee (if any), meals and misc. expense is: \$2,535.00.

Member Moore moved for approval of this recommendation; Member Klawon seconded the motion and the motion was passed 8-0.

BOND PROGRAM

Activity Report

The Board reviewed this report for the period ending August 31, 2004.

Staff Approved Loans Report

Ms. Louise Welsh reported that:

Borrower: Swan River Elementary District #4 (Bigfork)

Purpose: To finance costs associated with paving the parking lot.

Staff Approval Date August 2, 2004

Board Loan Amount: \$19,435

Term: 10 Years

Borrower: City of Missoula

Purpose: To finance costs associated with the Special Improvement District No. 530 road improvements.

Staff Approval Date August 10, 2004

Board Loan Amount: \$8,990.00

Term: 10 Years

Borrower: Glacier County

Purpose: To purchase a gravel crusher for the Road Department.

Staff Approval Date August 20, 2004

Board Loan Amount: \$125,000

Term: 5 Years

Borrower: City of Thompson Falls

Purpose: To finance various types of fire equipment.

Staff Approval Date August 20, 2004

Board Loan Amount: \$35,000

Term: 5 Years

Borrower: Town of Whitehall

Purpose: To purchase a new police vehicle.

Staff Approval Date August 25, 2004

Board Loan Amount: \$25,500

Term: 3 Years

Borrower: Brady County Water and Sewer District

Purpose: To finance a portion of the costs associated with a preliminary engineering report.

Staff Approval Date August 26, 2004

Board Loan Amount: \$20,000

Term: 3 Years

has been approved by staff.

INTERCAP

Ms. Louise Welsh presented staff's recommendation that the Board authorize staff to proceed with processing and closing the following loans using the Board's standard Bond Program Office procedures:

Borrower: Frontier Elementary District #3 (Wolf Point)

Board Loan Amount: \$264,000

Term: 5 Years

Purpose: To finance costs associated with building an addition.

Borrower: Park County Rural Fire District (Livingston)

Board Loan Amount: \$280,000

Term: 10 Years

Purpose: To purchase and equip a 2004 Conventional Freightliner structure engine.

Member Beams moved for approval of this recommendation; Member Klawon seconded the motion and the motion was passed 8-0.

LOAN PROGRAMS

Consideration of Commercial Loan Participation - Permanent Coal Trust Fund

Ms. Delrene Rasmussen presented staff's recommendation to participate in the following loan request:

Borrower: Fox Meadows, LLC.

Lender: Stockman Bank, Billings

Purpose of Loan: To purchase an existing loan funded by Stockman Bank.

Amount of Loan: \$2,689,868

Board Loan Amount: \$1,882,908

Board Participation: 70%

Term of Loan: 237 Months

Interest Rate: 7.25% to .50% LSF

Recommendation: Approval, subject to the terms and conditions in Schedule A.

Loan Committee Recommendation: Approved as presented.

Member Fleming moved for ratification of loan committee recommendation; Member Klawon seconded the motion and the motion was passed 8-0.

Coal Tax Loan Program Activity Report

Ms. Delrene Rasmussen presented and the Board reviewed this report for the month of July.

Pension Mortgage Program Activity Report

The Board reviewed this report for the month of July.

Member Beams updated the Board on the brief discussion that took place during the loan committee meeting about the method at which pricing is set. Member Beams asked staff to please review the method and return with a recommendation at the October meeting. Chairman Anderson added that Mr. Bob Bugni be included in determining the method used for pricing.

CHIEF INVESTMENT OFFICER REPORTS

Performance Review

Mr. Bob Bugni presented to the Board the Performance Review for the fiscal year ending June 30, 2004.

Board requested that in the future, staff include the manager's fees as part of the performance review.

Asset Allocation Plan

Mr. Bob Bugni presented the Retirement Funds Asset Allocation Plan for the period ending August 31, 2004. Member Fleming moved for approval of the Asset Allocation Plan as presented, but requested that the Target range not be included in the Policy Statements. The concern is that the Target range would create confusion and misunderstanding between the actual percentage and the Staff recommended range(s). Member Klawon seconded the motion and the motion was passed 8-0.

ADJOURNMENT

Chairman Anderson adjourned the meeting at 12:00 p.m. for lunch.

CALL TO ORDER

The meeting was reconvened at 1:00 p.m.

INVESTMENT ACTIVITY

Presentation - Schroders Asset Management

Ms. Louise Croset, Ms. Connie Moak-Mazur, and Mr. Richard Sennitt presented the annual review of the Schroders managed Pan Pacific Equities fund for the Board of Investments.

Investment Process/Portfolio Management

Mr. David Ewer began the report by updating the Board about the equity group restructuring, with a staffing update. Mr. Ewer reported that there are currently 5 staff persons performing the duties of Investment Analyst. Three additional positions are in the early stages of the hiring process. Two positions being advertised, Investment Analyst and Trader, closes on Monday, September 20; the position of Technology Analyst is being advertised and closes on October 12. Once these positions are hired, that will increase the equity group to a staff of 8.

Mr. Rande Muffick continued by presenting to the Board a report on the portfolio management portion of the restructuring that was deferred until this meeting. This presentation discussed the Montana Domestic Equity Pool (MDEP), Montcomp, Large and Small Cap exposure, Montcomp Returns compared to the S & P 500 and S & P 100, Portfolio Characteristics, and Risk Factors - Industry & Style.

Mr. Muffick presented the following Portfolio Management Recommendations which would increase the flexibility in managing Montcomp:

1. The sector weightings, beta, turnover, dividend yield, and price to book constraints should be eliminated;
2. The holdings constraint should include a minimum number of 100 issues and no maximum limit on the number of holdings;
3. The additional purchases constraint should prohibit additional purchases if the issue would amount to greater than 10% of the total portfolio (Montcomp);
4. The STIP account should be reinstated to complement the SPIFF by allowing the portfolio manager an opportunity to choose either account based upon market conditions.

Mr. Muffick suggested that in lieu of the constraints that he recommended eliminating in number 1, tracking error could be used as a more reasonable constraint and suggested that 400 basis points tracking error to the S & P 500 Index would be an appropriate number.

Member Klawon moved for approval of the staff recommendation with the addition of the establishment of a 400 basis points tracking error to the S & P 500 Index. Member Beams seconded the motion. Member Fleming also added that she would like the Chief Investment Officer to review these recommendations to determine if another "side bar" should be included. The motion was passed 7-1. Member Moore voted "Nay".

Montcomp

Mr. Rande Muffick presented July transactions, the holdings report as of July 31, 2004 and the current investment strategy. Member Klawon moved for approval of the Montcomp strategy as presented; Member Beams seconded the motion and the motion was passed 6-0. Member Fleming was not present at the time of the vote.

Chairman Anderson left the meeting at this time.

Montana International Equity Pool

Mr. Rich Cooley presented to the Board the Montana International Pool Overview.

Intermediate Funds

Mr. Richard Cooley also presented July Treasurer's Fund transactions the Treasurer's Fund holdings report as of July 31, 2004, the July State Fund transactions, the State Fund holdings report as of July 31, 2004 and the current investment strategy for both of these funds. Member Klawon moved for approval of the Treasurer's Fund and State Fund strategy as presented; Member Wilson seconded the motion and the motion was passed 6-0. Member Moore was not present at the time of the vote.

Long Term Funds

Mr. Richard Cooley presented July transactions, and the current investment strategy. Member Wilson moved for approval of the Fixed Income strategy as presented; Member Klawon seconded the motion and the motion was passed 7-0.

Montana Private Equity Pool (MPEP)

The presentations scheduled for MPEP, by Ed Kelly were postponed due to time constraints.

NEXT MEETING: The next regularly scheduled meeting of the Board will be October 21, 2004.

ADJOURNMENT: There being no further business, the meeting was adjourned at 4:30 p.m.

BOARD OF INVESTMENTS

APPROVE:

Dick Anderson, Chairman

ATTEST:

Carroll South, Executive Director