



Board Members

M. Dean Buffington, Chairman	Gavin M. Gee
Max C. Black	Thomas F. Kealey
Vaughn Heinrich	Richelle Sugiyama
Susan K. Simmons	Charles L. Winder
R. John Taylor	

816 W. Bannock St., Ste. 301
 Boise, Idaho 83702
 Phone: (208) 334-3311
 Fax: (208) 334-3786
 Website: www.efib.idaho.gov

Larry Johnson, CFA, CPA
 Manager of Investments

Monthly Report to the Board of Land Commissioners

Since the December 15, 2009 Land Board Meeting thru January 12, 2010

Investment performance thru December 31, 2009

Month: **1.9%** Fiscal year: **18.1%**

Status of endowment fund reserves

For all endowments, estimated reserves as of October 31 were at least **3 times** the size of the approved FY2010 distributions.

Significant actions of the Endowment Fund Investment Board

Meetings: **None.**

Compliance/legal issues, areas of concern

Material deviations from Investment Policy or compliance guidelines for investment managers: **None.**

Material legal issues: The Attorney General issued an **opinion on bond guaranty fees.**

Changes in board membership or agency staffing: **None.**

Upcoming issues/events

Per the request at the last land board meeting, attached is a brief overview of the **investment strategy** for the Endowment Fund.

An **updated forecast** of earnings reserve levels thru FY2012 is attached. It will also be shared with the Joint Finance and Appropriations Committee of the legislature on January 18, as part of the EFIB's budget presentation. The Department of Lands updated their forecast of land revenues as part of this process.

Plans to hire two **new Global Equity managers** are on track, with selection interviews held January 7th. This will shift about 5% of the fund from U.S. equity to foreign equity, in two stages, by the middle of next year.



INVESTMENT REPORT

Final Report (gross of fees & certain income accruals)

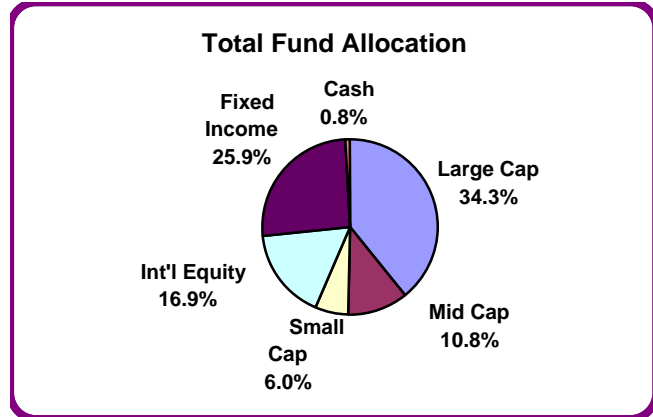
December 31, 2009

Current Value of the Fund	\$	1,071,604,809
Investment Change in Market Value FYTD	\$	166,174,095
Net Contributions FYTD	\$	(12,080,731)
Fiscal Year-to-Date Returns		18.1%
Month-to-Date Returns		1.9%

	<u>Dec-09</u>	<u>Fiscal Year to Date</u>	<u>Last Five Years</u>
Total Fund	1.9%	18.1%	4.4%
Benchmark	1.4%	17.3%	2.9%
U.S Equity	3.6%	25.8%	2.2%
Benchmark	2.8%	23.2%	0.8%
Int'l Equity	1.6%	18.7%	6.7%
Benchmark	2.1%	24.2%	4.0%
Fixed Income	-1.7%	3.6%	5.1%
Benchmark	-1.6%	4.0%	5.0%

Asset Allocation

	<u>Mkt Value</u>	<u>% Alloc</u>
Domestic Equity	\$ 603.9	56.4%
Large Cap	\$ 418.6	39.1%
Mid Cap	\$ 120.6	11.3%
Small Cap	\$ 64.7	6.0%
Int'l Equity	\$ 181.5	16.9%
Fixed Income	\$ 277.2	25.9%
Cash	\$ 9.0	0.8%
Total Fund	\$ 1,071.6	100.0%

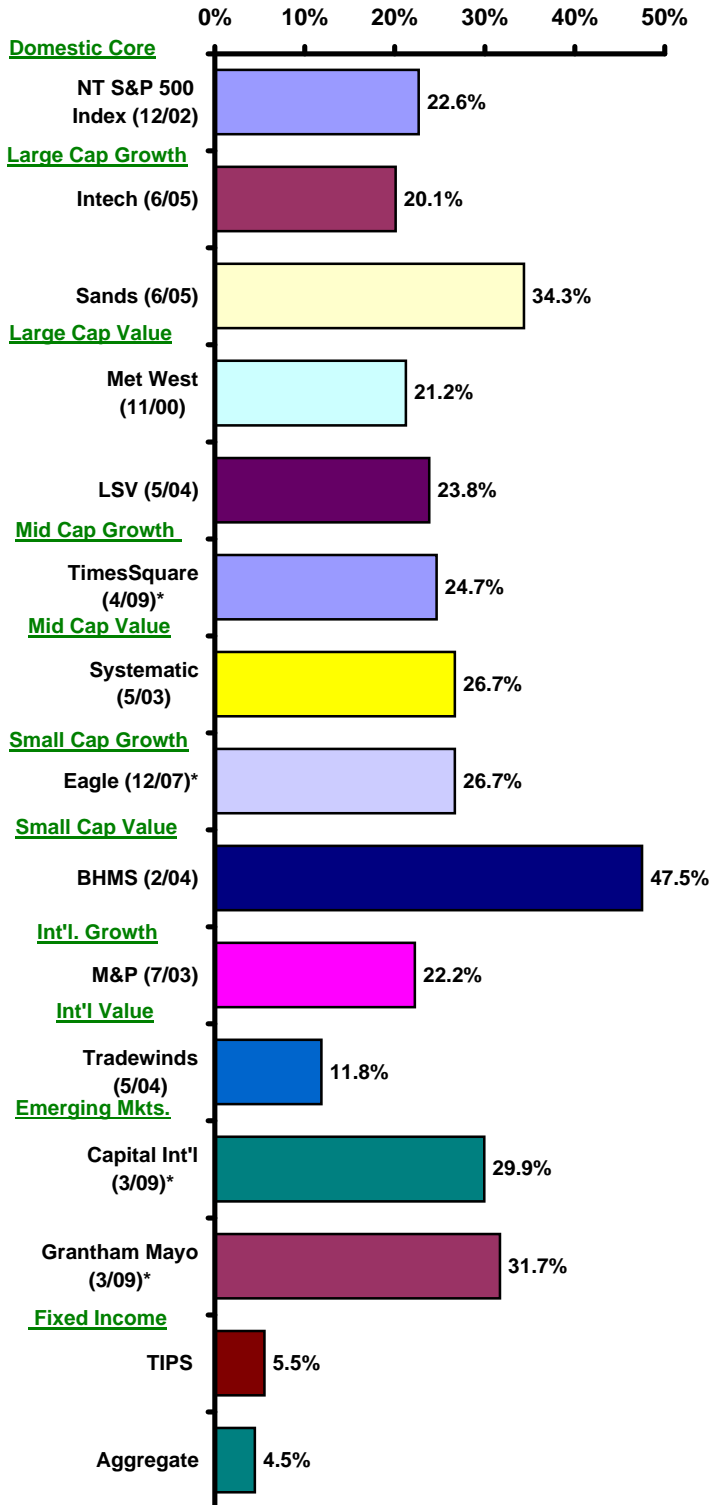


Endowment Fund Staff Comment:

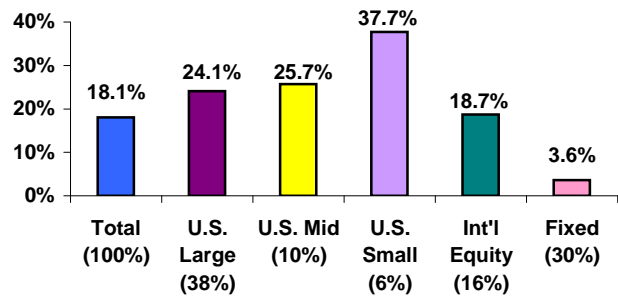
The fund was up 1.9% for the month, 0.5% over benchmark. The Russell 3000 index was up 2.8%, Russell Midcap up 5.7%, and Russell 2000 (small cap) up 8.0%. International equities (MSCI ACWI ex-US) were up 2.1%, and Emerging Markets up 3.9%. Growth outperformed value this month, and small and mid cap outperformed large cap. Bonds, as measured by the BC Aggregate index, were down 1.6% and TIPS down 2.6%. Five of twelve active managers beat their benchmark.

On a Fiscal YTD basis the fund is up 18.1%, 0.8% over benchmark. Six of twelve active managers are ahead of their benchmark.

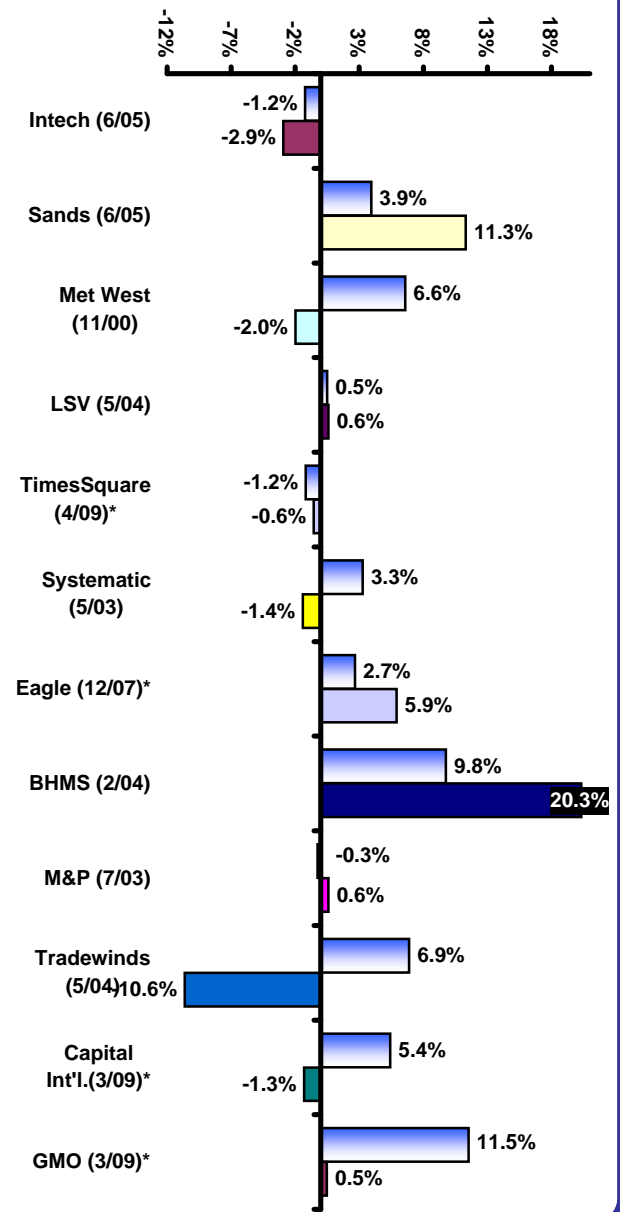
FYTD Manager Returns



Fiscal YTD Total Endowment Returns



FYTD Active Manager Relative Returns 3-Yr. Annualized Relative Returns*



* ITD return used when manager has less than 3 years with EFIB.

Endowment Fund Investment Strategy Overview

Board of Land Commissioners
January 19, 2010



**Basic guidelines for fund management are
in the Land Board's Asset Management Plan**



Fund Investment Management Philosophy (page 1)

As perpetual funds, per state Constitution and statute, the endowment funds have a long-term investment horizon. All of the portfolios managed by the EFIB are subject to the variability of the financial markets and to the threat of eroding purchasing power due to inflation. The EFIB will mitigate some of the market risk by investing in diversified portfolios of assets so that the expected variation in the whole portfolio is less than the sum of the variations of each part.

Source: Land Board Asset Management Plan (underscores added)

3

Fund Investment Management Philosophy (page 2)

With a citizen board and small staff, the EFIB will make strategic allocations and generally avoid making tactical calls, maintaining an asset mix that is expected to have reasonable performance over a market cycle. The asset mix of the fund takes into account the entire endowment portfolio – i.e. the fact that the revenues of the endowment lands, net of IDL expenses, will be contributed to the endowment funds.

Source: Land Board Asset Management Plan (underscores added)

4

Five Elements of Fund Diversification

1. **Risk of return:** equity vs. fixed income
 - Endowment: 70% stocks, 30% bonds
2. **Region:** U.S. vs. International
 - Endowment: 84% U.S., 16% International (Equity 77%/23%)
3. **Investment Style:** Value vs. Growth
 - Endowment: Evenly balanced
4. **Size:** Large, medium and small companies
 - Endowment: Slight overweight to mid-size
5. **Active vs. Passive** security and industry selection
 - Endowment: Passive for 100% of bonds, 18% of equities

Elements 1 thru 5 correspond with the numbers in boxes on the fund map on the next page

5

Endowment Fund Asset Diversification Map

Region	Size	Investment Style			Total	Return Risk
		Value	Core	Growth		
U.S.	Large Cap	13%	13%	13%	38%	S t o c k s
	Mid Cap	5%		5%	10%	
	Small Cap	3%		3%	6%	
	International	8%		8%	16%	B o n d s
U.S.	Bonds		27%	3%	30%	
				Infl. Index		
	Total	29%	40%	32%	100%	

Active or Passive (securities, sectors)

Passive/index approach (remainder take an active approach to securities and sectors within their area of expertise)

6

Expected Return

	<u>Return</u>	<u>Mix</u>
Equities	9.50%	70%
Bonds	5.25%	30%
Total	<u>8.23%</u>	<u>100%</u>

Returns are before investment management and EFIB oversight fees of approximately 0.4%

Source: EFIB estimates, Callan Associates (2/09)

7

Allocation of Expected Return

Expected gross return*	8.2%
Investment management costs	0.4%
Expected net return	<u>7.8%</u>
Retain in corpus for inflation	2.8%
Expected real net return	5.0%

*As of 2/09

Returns over the last ten years are well below long-term, 30-year expectations

8

Expected Return Variation

Annual Return Over 3 Years 7 Years

Probability Of returns greater than:

5%	20.1%	15.8%
25%	12.9%	11.3%
50%	8.2%	8.2%

Of returns less than:

25%	3.7%	5.2%
5%	-2.5%	1.1%

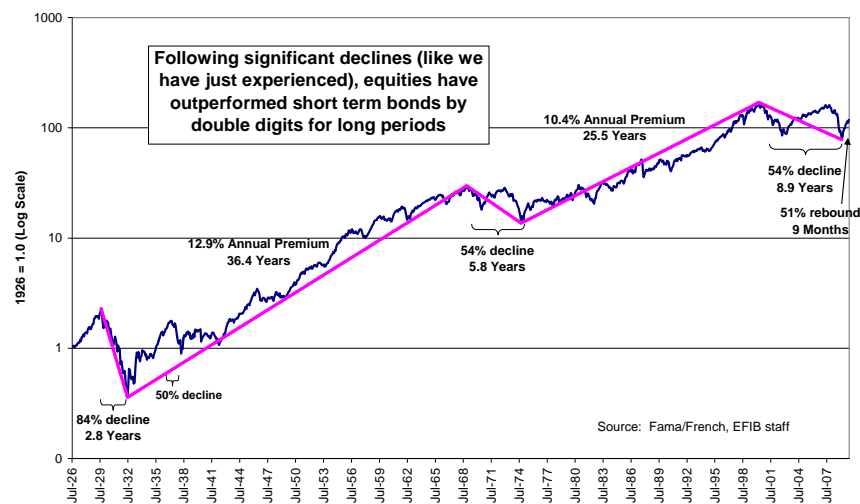
Returns are before investment management and EFIB oversight fees of approximately 0.4%

Source: EFIB estimates, Callan Associates (2/09)

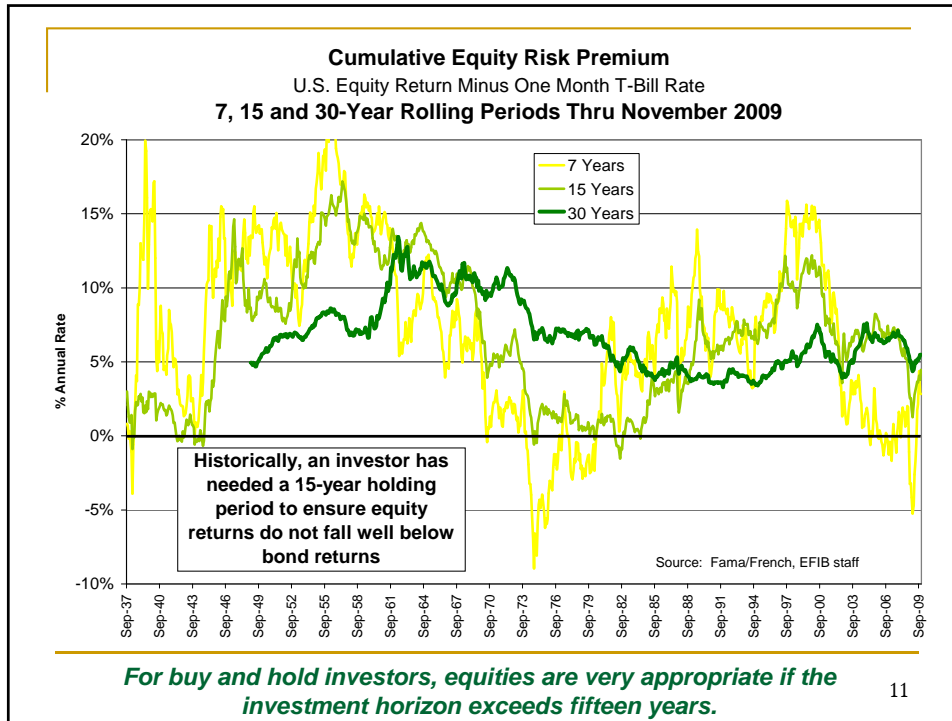
9

Cumulative Equity Risk Premium

U.S. Equity Return Minus One Month T-Bill Rate
1926 Thru November 2009



10



Strategic changes to the Idaho Endowment Fund

- Plan to increase international equities from 16% of the fund to 21%
 - Equivalent reduction in U.S. equities, maintaining total equities at 70% of the fund
 - Implement the change over 6-12 months by hiring Global Equity managers; delegates authority for regional allocation to managers
- EFIB staff regularly explores other investments which could further improve fund diversification
 - Currently examining non-Idaho Real Estate

Appendix

Mission of Idaho Endowments: Provide a perpetual stream of income by:

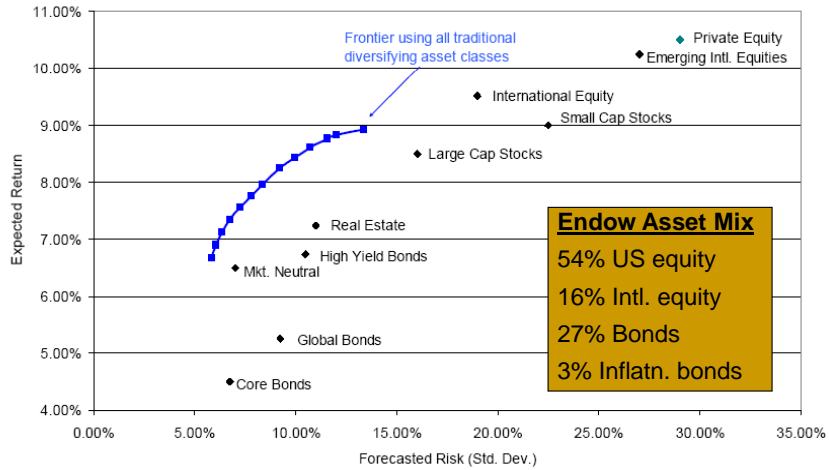
- ❖ Maximizing total return over time at a prudent level of risk
- ❖ Protecting future generations' purchasing power
- ❖ Providing a relatively stable and predictable payout

These objectives often conflict, requiring balance, tradeoffs

Source: Land Board Asset Management Plan

14

Efficient Frontier



Source: NEPC

15

Risk/Return Tradeoff

<u>% Equity</u>	<u>Expected Return</u>	<u>Annual ± Variation</u>
13	5.8%	5%
26	6.3%	6%
40	6.8%	8%
52	7.3%	9%
66	7.8%	11%

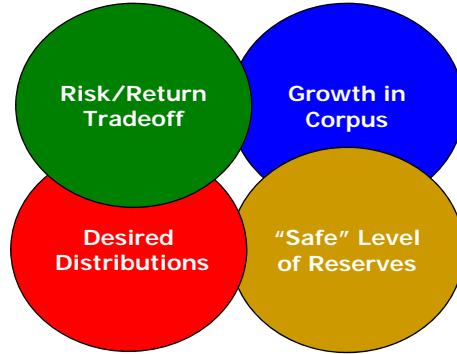
Source: Callan Associates

16

Fiduciary tradeoffs

Must evaluate the interaction of these four policy drivers in order to establish asset mix, current spending, future growth

- Higher long-term return means more potential short-term volatility
- How much downside variation can the fund endure?



- How fast should the fund grow over time? With inflation? Faster than inflation?
- How much risk of a cut in distributions should beneficiaries face?

- Minimum required distribution given level of asset volatility
- Spend a lot, save a little or spend little now and more later

These tradeoffs are determined by the Land Board (based on EFIB recommendations) within limits prescribed by state statute, the state constitution, and federal statutes

17

Outlook for Earnings Reserves and Distributions

Presentation to the Land Board
January 19, 2010

Also presented to the Joint Finance-Appropriations
Committee
January 18, 2010



FY 2011 Distribution Summary *Categorized by legislative budget unit*

Endowment Beneficiary	FY 2010		FY 2011		% of Total
	Approp.	Change	Approv. Dist.	Change	
Public Schools	\$ 31,292	-	31,292	-	69%
All University Endowments	9,616	-	\$ 9,616	-	21%
State Hospital South	1,532	131	1,663	8.5%	3%
Penitentiary	1,040	-	1,040	-	2%
Corrections	790	-	790	-	2%
State Hospital North	790	-	790	-	2%
Veterans Home	494	-	494	-	1%
School for the Deaf and Blind	99	-	99	-	0.2%
Grand Total	45,655	131	45,786	0.3%	100%

All amounts in thousands of dollars

Measuring security of distributions using the Coverage Ratio

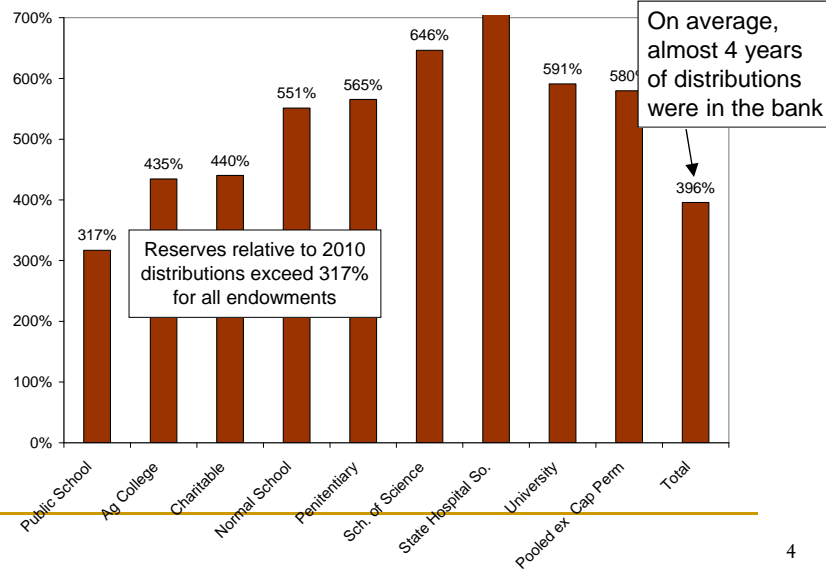
- The risk of a shortfall in distributions is measured by comparing the Earnings Reserve balance with the amount of distributions
- This ratio measures the degree of reserve to maintain the distribution into future years

$$\frac{\text{Balance in Reserves}}{\text{Annual Distribution}}$$

3

Coverage Ratio, By Endowment

October 2009 Unaudited Estimate



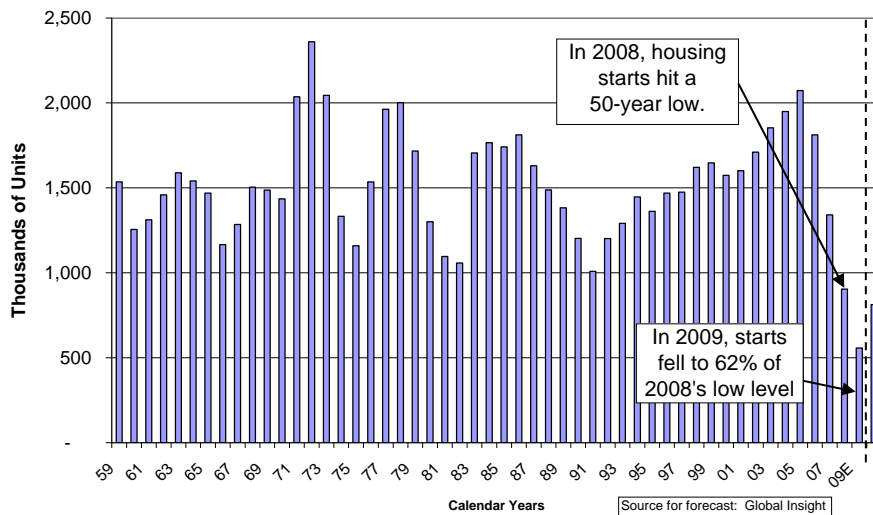
4

Security of future distributions

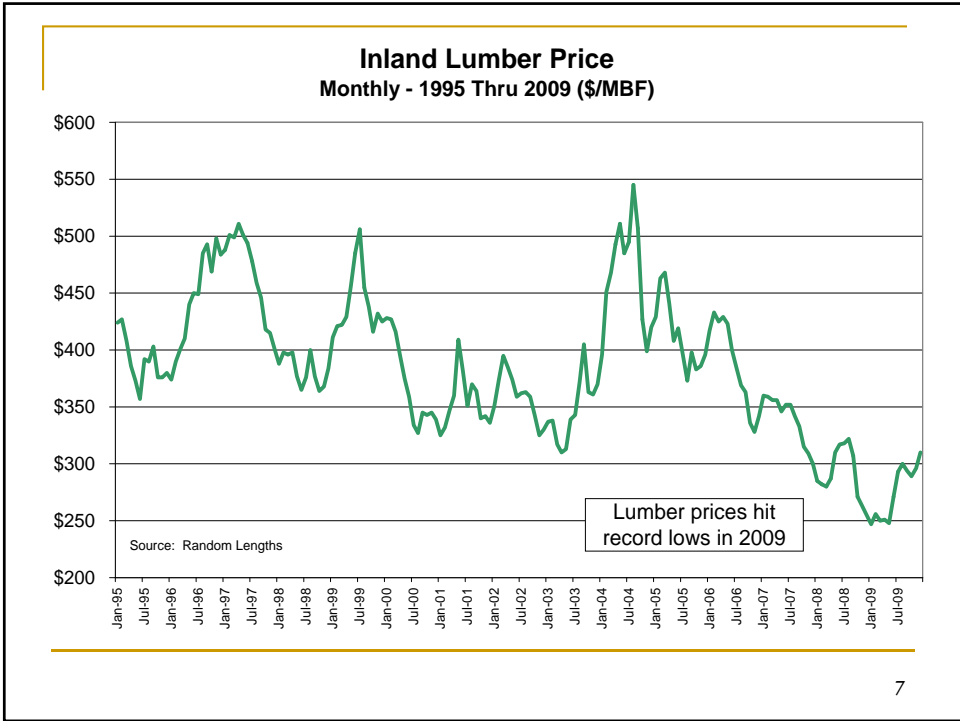
- Current reserves are sufficient to guarantee payment of appropriated FY2010 distributions and approved FY2011 distributions
- Will now consider the outlook beyond FY2011...
 - Can the level of distributions be maintained given the current depressed level of timber revenue, low interest rates?
 - I.e., do we need to start planning now for a potential reduction in distributions?

5

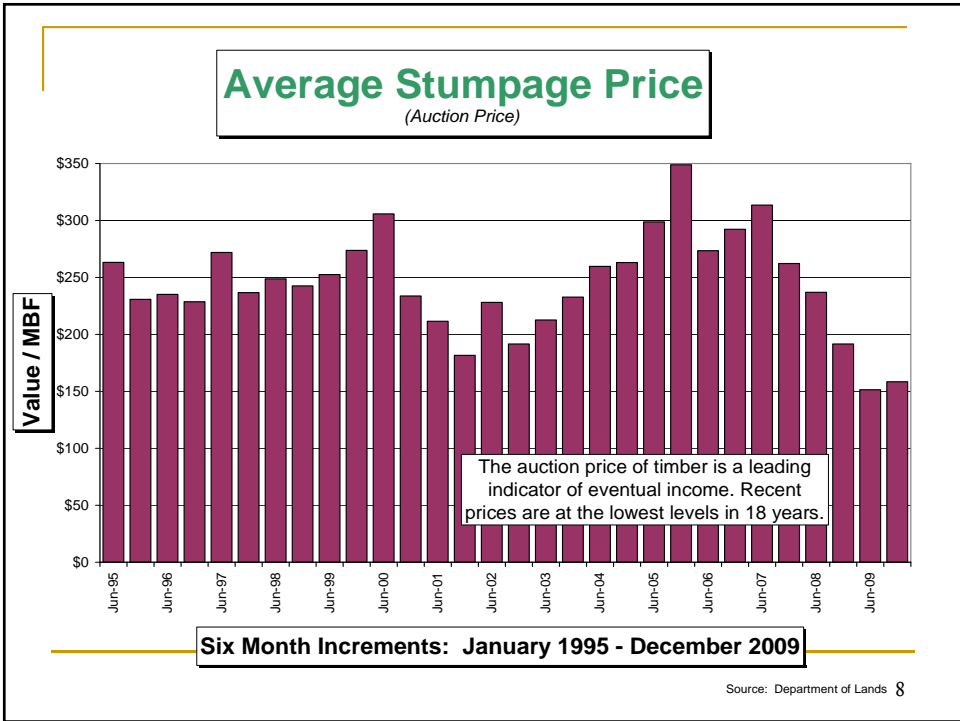
Housing Starts
1959-2010



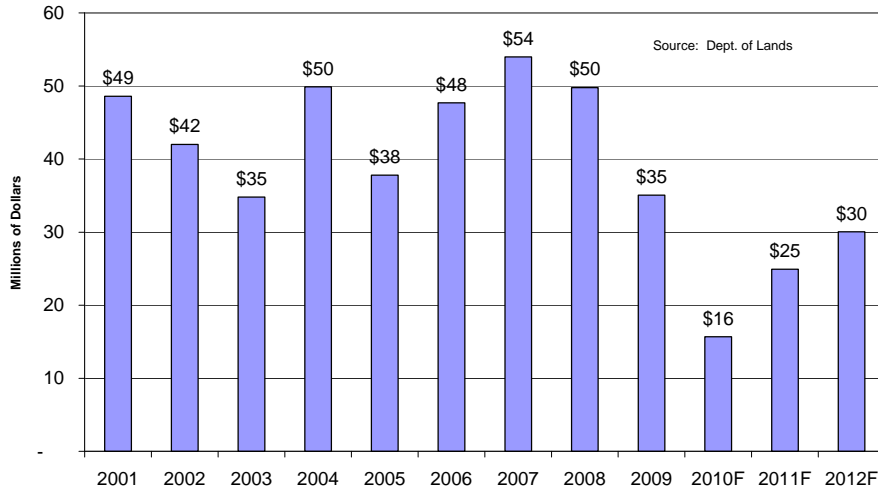
6



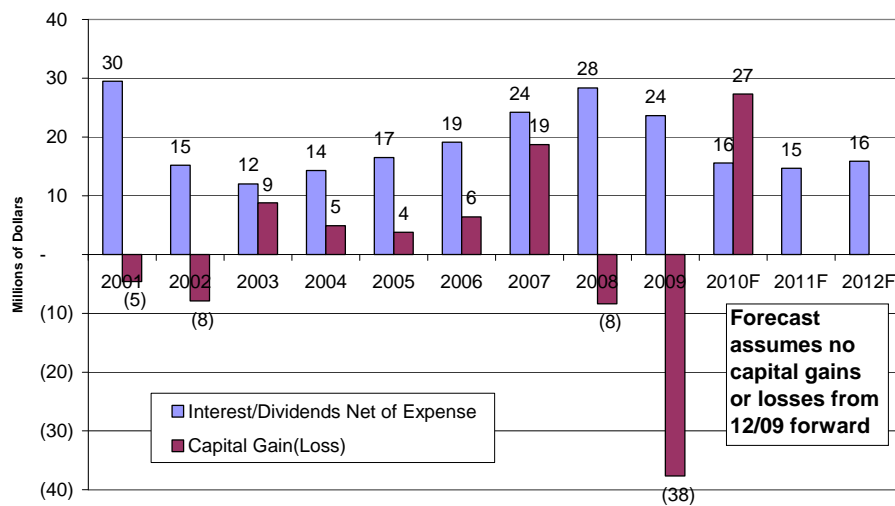
7



Net Endowment Land Revenues
Actual 2001-2009, "Low" Forecast 2010-2012



Net Endowment Fund Revenues
Actual 2001-2009, "Low" Forecast 2010-2012

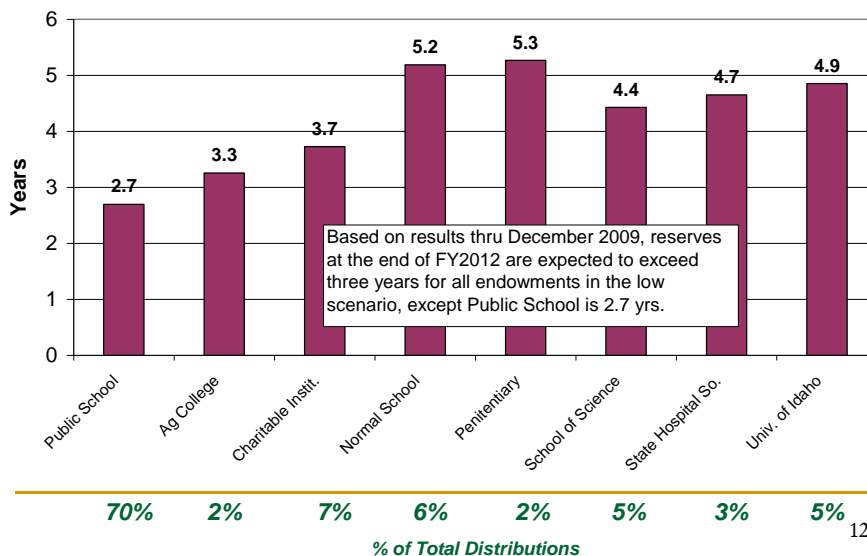


Outlook for FY2012 and beyond: Guarded optimism

- Assuming:
 - Land revenue equal to the “Low” case from the Dept. of Lands
 - No price appreciation (or loss) in the fund
 - FY2012 distributions = FY2011 distributions
- Then:
 - At June 2012, reserves are still expected to be at least 3 years for all endowments, except Public School (2.7 years)
 - I.e., no need to start planning now for a possible reduction in distributions

11

Years of Distributions In Earnings Reserves Forecast of June 2012 Low Land Income, Zero Fund Capital Gain/Loss Scenario



12

Caveats

- Forecasted coverage ratios under the “low” scenario are near minimum acceptable levels for some endowments (e.g. Public School) by FY2012
- Current and expected land revenues and fund returns will need to be closely monitored. Reductions in FY2012 distributions may be necessary if, for example:
 - Future returns on the fund are materially negative
 - Additional hardship extensions are offered on existing timber contracts
 - A material number of existing timber contracts are abrogated by purchaser defaults/bankruptcies
 - Future timber prices fall below the level assumed in the “low” revenue scenario