

State Land Board Common School Fund Annual Portfolio Review

Purpose

To provide the State Land Board an update on the performance, structure, and asset allocation of the Common School Fund for periods ended December 31, 2012.

Market Performance Overview

After a down turn in 2011, markets rebounded strongly in 2012; a comparison of some key public market indices follows:

	<u>2010</u>	<u>2011</u>	<u>2012</u>
Russell 3000 (domestic equity index)	16.9%	1.0%	16.4%
MSCI World ex-US (non-US developed stock index)	9.0	(12.2)	16.4
MSCI Emerging Markets (non-developed markets index)	18.9	(18.4)	18.2
BC Universal Bond Index (broad market bond index)	7.2	7.4	5.5

The U.S. stock market (as measured by the Russell 3000) posted a modest 0.2 percent gain in the fourth quarter as investors weighed the results of the election, additional Fed stimulus and the fiscal cliff. The Russell 3000 concluded calendar year 2012 with a gain of 16.4 percent, marking its fourth consecutive year of positive gains and a 76.5 percent cumulative return since the end of 2008. Of note, uncertainty surrounding tax rates for 2013, and beyond, led corporations to announce more special dividend payouts than in any December since 1955, according to data from S&P. All told, 1,056 special dividends were announced in 2012, up from 460 a year earlier and the most since 1973.

Despite the ongoing fiscal drama in continental Europe, 2012 proved to be a good year for the non-U.S. equity markets overall. European equities were the highest-returning region over the quarter (7.0 percent), with market sentiment being helped by the Spanish government's successful refinancing of some of its debt, and by Greece receiving further conditional assistance. Markets in the Asia-Pacific region enjoyed strong performance, for the quarter and the year, despite the weakening of local currencies. The MSCI Emerging Markets Index gained a solid 5.6 percent for quarter, ending the year with an 18.2 percent advance. Though the Chinese economy grew at "only" 7.4 percent in the third quarter (its slowest rate of expansion since 2009 and below the second quarter's 7.6 percent result), it was enough to buoy the stock market, as China finished the quarter as one of the index's best performing markets, returning 12.9 percent.

Long-term interest rates rose in the month of December. The bellwether 10-year Treasury note ended the year yielding 1.78 percent up from 1.61 percent at the close of November. At month-end, the 30-year bond yield was 2.95 percent with the 3-month T-bill at 0.1 percent. The Barclays Capital US Aggregate Index was down -0.14 percent in December. High Yield was the strongest sector up +1.6 percent as measured by the BofA Merrill Lynch US High Yield Master II index.

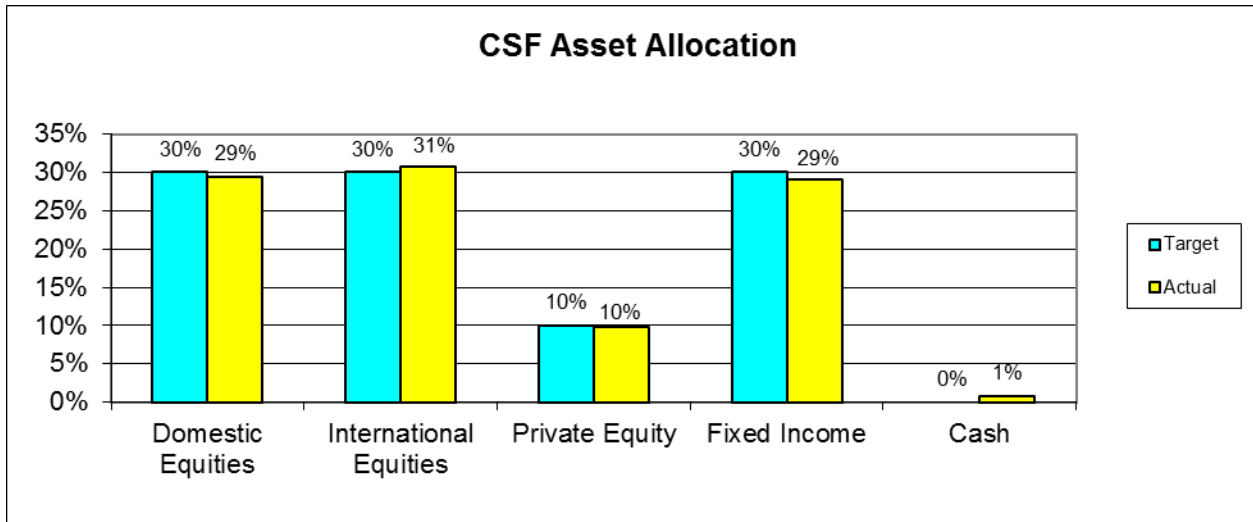
CSF Performance

Overall, the Common School Fund had a calendar year return of 15.5 percent, in line with the fund's policy benchmark. For the calendar year, seven of the eight active public equity managers exceeded their respective benchmarks. A peer comparison of the performance reveals that the CSF ranks very well. According to the Trust Universe Comparison Service (TUCS), the CSF ranked in the top-decile for funds under \$5 billion in total assets over the trailing one and four year periods, and near the top third of funds over the trailing two and three year periods.

The two CSF fixed income managers (Western and Wellington) employ an active investment strategy that seeks to take advantage of the historical benefit given to market participants taking spread risk. The strategy generally involves underweighting treasury securities, relative to the index, and overweighting corporate debt. Over the past three years, Western and Wellington have returned a combined 8.6 percent average annual return. The benchmark for fixed income came in at 6.7 percent over the same period.

As the fund continues to recover from some structural manager changes (2007) and the impact of the Global Financial Crisis (2008), the past four years are encouraging. Over 10 years, the fund has returned 7.1 percent annually, in line with the long-term return objectives of the fund. **Net of contributions and distributions, the fund has grown by over 17 percent, the past three years, from \$1.0 billion, to nearly \$1.2 billion at year end 2012.**

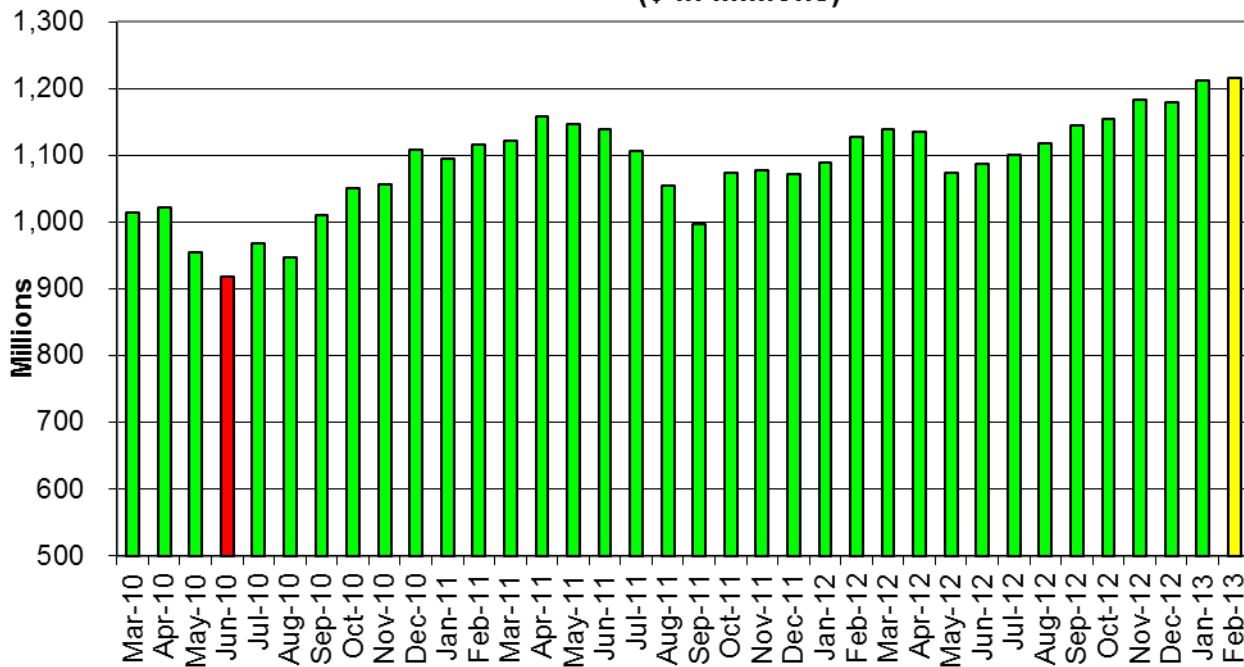
PERIOD	CSF		Alpha
	Net Return	Policy Benchmark	
Calendar Year 2000	(3.63)	(4.07)	0.44
Calendar Year 2001	(7.08)	(7.59)	0.51
Calendar Year 2002	(11.15)	(11.27)	0.12
Calendar Year 2003	24.72	24.09	0.63
Calendar Year 2004	11.73	11.38	0.35
Calendar Year 2005	7.14	6.72	0.42
Calendar Year 2006	15.32	14.45	0.87
Calendar Year 2007	2.77	7.21	(4.44)
Calendar Year 2008	(32.39)	(30.31)	(2.08)
Calendar Year 2009	30.42	27.01	3.41
Calendar Year 2010	12.98	11.37	1.61
Calendar Year 2011	(2.13)	(1.60)	(0.53)
Calendar Year 2012	15.48	15.55	(0.07)



Going Forward

As we regularly report, staff and the OIC’s consultant will continue to monitor the performance and risk of the equity manager structure, which will continue to draw upon the OPERF manager line up. Additionally, we will continue to add private equity investments as opportunities arise: KKR Asia was added in 2012. The private equity portfolio is still nascent, but delivered an 18.6 percent return for 2012.

CSF NAV
Three years ending February 2013
 (\$ in Millions)



Following is the longer term performance of the Common School Fund.

Performance Summary through December 31, 2012

	EMV		1 YEAR	3 YEARS	5 YEARS	7 YEARS	10 YEARS
	\$(000's)	%					
TOTAL COMMON SCHOOL FUND	1,178,826	100	15.48	8.49	2.40	4.21	7.14
OREGON CSF POLICY INDEX			15.55	8.19	2.31	4.66	7.33
TOTAL DOMESTIC EQUITY	287,072	24.4	17.65	10.74	1.89	3.41	7.04
RUSSELL 3000			16.42	11.20	2.04	4.34	7.68
BLACKROCK S&P 500 INDEX	87,214	7.4	16.05	10.97			
S&P 500			16.00	10.87			
WELLS CAPITAL MGMT	79,549	6.7	19.65	10.75			
Russell 1000 Growth Index			15.26	11.35			
MFS ADVISORS	80,874	6.9	17.14	9.67			
Russell 1000 Value Index			17.51	10.86			
COLUMBIA WANGER	25,060	2.1	17.90	12.30			
RUSSELL 2500			17.88	13.34			
BOSTON COMPANY	14,374	1.2	18.90	11.49			
RUSSELL 2000 VALUE			18.05	11.57			
TOTAL INTERNATIONAL EQUITY	292,212	24.8	20.97	6.40	(0.59)	4.24	9.76
OREGON CSF CUSTOM INTL INDEX			16.83	3.87	(2.85)	3.05	9.00
PYRAMIS SELECT	110,944	9.4	19.32	5.19			
MSCI WORLD EX US (NET)			16.41	3.65			
ARROWSTREET	113,461	9.6	22.68	7.43			
MSCI World Ex US IMI Net			16.55	4.05			
GENESIS ASSET MANAGEMENT	34,431	2.9	21.31	8.60			
MSCI Emerging Markets IMI Index (Net)			18.68	4.64			
ARROWSTREET EMERGING MARKET	33,376	2.8	20.59				
MSCI EMERGING MARKETS (NET)			18.22				
BLACKROCK ACWI IMI INDEX	131,435	11.1	16.83				
MSCI ACWI IMI NET			16.38				
WELLINGTON MANAGEMENT COMPANY	161,370	13.7	8.42	8.37	7.58	6.91	6.08
WESTERN ASSET MANAGEMENT COMPANY	162,789	13.8	9.49	9.14	7.10	6.54	6.58
BC UNIVERSAL			5.53	6.70	6.19	6.06	5.33
CSF PRIVATE EQUITY	115,564	9.8	18.60	13.08	1.57		
RUSSELL 3000+300 BPS QTR LAG			34.02	16.62	5.18		
DEPARTMENT OF REVENUE LOAN	19,126	1.6	0.58				
CASH FUND	9,259	0.8	1.65	0.88	1.25	2.37	2.25
91 DAY T-BILL			0.11	0.11	0.52	1.78	1.80