Report on Investments – As of March 31, 2012

Economic Update
(Prepared by Strategic Investment Solutions, a consultant of the OIC)

From a macroeconomic standpoint, the Oregon Investment Council’s consultant, Strategic Investment Solutions, reports the following:

U.S. equity
Easing concerns about the euro zone’s debt crisis and improving U.S. economic data have lifted the S&P 500 more than 12% for the year and over 25% from an October low. The first quarter (until the last few days) was very kind to risky assets.

March was once again a positive month for domestic equity markets and concluded a very strong first quarter. Growth performed in-line with Value for the month and large caps outperformed small caps. The Russell 1000 Growth Index was up 3.3% for the month and the Russell 1000 Value Index was up 3.0%. The Russell 2000 Growth Index was up 2.0% and the Russell 2000 Value was up 3.1%. The S&P 500 Index ended the month up 3.3%.

The S&P 500 Index has a trailing 12-month P/E ratio of 16.3 (estimated P/E ratio of 13.4 on forward looking twelve-month operating earnings) and a dividend yield of 2.0%.

Corporate stockpiles of cash reached a record $2.23 trillion in the 4th quarter, up from $2.12 trillion in the 3rd quarter. U.S. based companies stockpiled an additional $187 billion in untaxed overseas profits over the past year, boosting their offshore holdings by 18.4%.

Fixed income
U.S. employers’ added 227,000 jobs to their payrolls in February, the Labor Dept. reported, while the unemployment rate held at a 3-year low of 8.3%.

The Federal Reserve in mid-March offered a more positive view of the economy but left its current efforts to boost the recovery unchanged. Bernanke commented to economists that the U.S. job market remains weak despite three months of strong hiring, implying that the Fed will stick with its plan for low interest rates. GDP rose 3.0% (annualized) in the fourth quarter and year-over-year, rose 1.6%.

Long-term interest rates were higher in the month of March. The bellwether 10-year Treasury note ended the month yielding 2.21% up from 1.97% at the close of February. At month-end, the 30-year bond yield was 3.35% with the 3-month T-bill at 0.07%. The Barclays Capital US Aggregate Index was down -0.55% in March.

In the next five years, a total of $5.9 trillion in debt will come due in the U.S. The average maturity on the Treasury’s marketable debt is 62.8 months and the average rate of interest is 2.2%.

Non-U.S. Markets
GDP fell -0.3% in Q4 in the UK, slightly worse than the -0.2% originally reported. GDP has now fallen in three of the last five quarters. Consumer confidence eroded in March in the UK with the headline sentiment index falling 2 points on the month to -31, its lowest this year.
Euro-zone countries formally approved Greece’s second bailout. Greece shortly thereafter received the first $9.9 billion of aid from its new bailout, with the bulk of it going to repay bonds held by the euro zone’s central banks.

The European Central Bank disbursed $712 billion in a second round of three-year loans to banks at a low current interest rate of 1.0%. The first round of lending in the ECB’s Long-Term Refinancing Operation (LTRO) last December provided much needed liquidity to these banks that were struggling to refinance their debt in the credit markets.

Germany says it is speeding up its plans to cut borrowing as it works to balance its budget by 2016. Spain’s long-term borrowing costs rose above Italy for the first time in 8 months, after Mariano Rajoy, the Spanish prime minister stated that Spain’s deficit this year would be above that agreed with the EU. Industrial production for the overall Eurozone showed tentative signs of stabilizing early this year after falling sharply over the final four months of 2011. Output edged up 0.2 % in January.

The German labor market continues to be quite strong. The number of unemployed is at just 2.84 million, the lowest since December 1991 and the unemployment rate is at 6.7% the lowest in the over 20-year history of the series.

Overall Eurozone consumer price (CPI) inflation decelerated to 2.6% year-over-year in March from 2.7% one month earlier. Ireland dropped back into recession at the end of 2011, a worrying sign for its efforts to emerge from a bailout. Japanese labor market data was quite strong in February. Employment rose by 290,000 and the unemployment rate fell a tick to 4.5%. Retail sales appear to be picking up in Japan with sales rising 1.3% in February following a 2.1% increase in January.

China’s government pronounced that it will aim for an economic growth rate of 7.5% this year, the first time in eight years that the official target has been below 8%. China reported a trade deficit of $31.5 billion in February, the largest in at least a decade, as imports grew at twice the rate of exports.

Non-U.S. equities were slightly down for the month of March. The MSCI ACWI Ex-U.S. was down -1.3% (US dollars) in March. Developed stocks (EAFE) were down -0.4% while Emerging Markets lost -3.3% for the month.

**Conclusion**

The first quarter was very strong for global equities which were bolstered by signals of improved growth prospects in the U.S. and added global central bank liquidity. As we look forward to the second quarter, investors are reassessing opportunities for equities and other risk assets. Investors may be concerned with the continued negative outlook in Europe; specifically that of Spain and Portugal, high oil prices, and slowing in both China and India. Seemingly ever-present geopolitical tensions accompanied by a major U.S. election year will likely impact business and consumer confidence. As Abraham Gulkowitz states in the latest issue of *The Punchline*, “The uncomfortable truth is that this readjustment course may turn out to be a long-winded process with many ups and downs.”

**HIED Endowment Fund**
*(Prepared by the Oregon State Treasury)*

**Fund performance**

The HIED Endowment Fund total return was 6.2 percent for the quarter, and 2.5 percent for the current fiscal YTD. The quarter’s performance was 195 basis points under the passive policy benchmark for the quarter, which was 8.2 percent. The relative underperformance was driven by the difference between the
quarterly performance of the alternative investments and its benchmark (the Russell 3000 index + 300bps one quarter lagged). Public market securities, and private market assets, when viewed over short time periods like this, do not provide meaningful results. Over the most recent 3 year time horizon, the fund’s total return was 19.4 percent, besting the policy benchmark of 17.8 percent.

**The OUS Fund**
*(Prepared by staff of the Chancellor’s Office)*

The OUS Fund showed a positive total return for the quarter of 0.6%. Both the intermediate term pool and the individually held longer-term investments outperformed their benchmarks.

In addition to total return, we monitor the accounting return which is used to distribute investment income to the campuses. During the quarter we distributed investment earnings to the campuses totaling $1,925,000. We also made the final investment earnings payment to the State of Oregon in the amount of $1,962,000 which represented investment earnings that accrued to the State from June 1, 2011 through December 31, 2011.

Comparison with old treasury structure:

| Actual investment earnings distributed for the quarter | $1,925,000  | 1.25% annualized |
| Est. interest earnings using the old treasury structure | $ 813,000   | .51% annualized  |

**Staff Recommendation to the Committee:**
Staff recommends the Committee accept the Investment Report as of March 31, 2012.