APPENDIX C

CALLAN ASSOCIATES INC.

PAUL M. ERLENDSON
SENIOR VICE PRESIDENT

CAI

SAN FRANCISCO
NEW JERSEY
CHICAGO
ATLANTA
DENVER

October 16, 2008

Mr. Steve Cochrane,
Chief Investment Officer
ND State Investment Board
1930 Burnt Boat Drive
Bismarck, ND 58502

Dear Steve:

Once upon a time in a market not so very far away, market participants made money in almost every single asset class that found its way into their investment programs. The credit markets had been providing abundant liquidity at low cost to all segments of the capital markets for most of the current decade. But as with all fairy tales, the inevitable day of reckoning has arrived. This letter provides some background on what has happened and is accompanied by a set of exhibits that illustrate the evolution of previous cycles.

Beginning in mid-2007, a number of strategies that relied on low cost capital began to show weakness. The first cracks appeared in hedge funds and debt used to finance private equity and collateralized debt programs. Concerns about the sub prime mortgage sector became reality as defaults began to mount as interest rates rose. Investors in other sectors of the capital markets dependent—if only indirectly—on easy credit were similarly beset by fears. Not only were investment strategies put under stress, investors' faith in counter-parties to their transactions also came into question. A seemingly limitless appetite for risk turned into heartburn. "Mark-to-market" rules have forced investors to dispose of assets in order to clean up their balance sheets and meet margin calls. Asset prices have been further impaired by a reduction in liquidity as people start to question how long the declining price trends will continue. Investors' greed has been supplanted by fear.

Adding to the uncertainty, there have been dislocations in basic market functions such as security valuation, risk measurement, asset pricing, and liquidity. A period of above average returns for investors has been superseded by a period of rapidly declining returns, increasing volatility, and unprecedented governmental intervention in private enterprise. That unsettled feeling has been exacerbated as we've watched pillars of finance—Countrywide, Bear Stearns, Lehman Brothers, AIG, Washington Mutual and Wachovia—forced into the arms of acquirers or the clutches of bankruptcy. Perhaps most unsettling is the rapidity with which these things have happened. It's enough to put fear into the hearts of bona fide capitalists.

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The immediate effect of the current environment, or course, is that those who depend on investment returns—pension beneficiaries among them—are seeing a shrinkage of the capital that funds their operations and benefits, as well as a loss of faith in the capital markets. Trading volumes have dropped as investors reassess their programs and risk policies. Regulators and governmental entities around the globe have moved into uncharted territory as they seek to instill confidence in a market that many view with fear and trepidation. Investors who hope for something better than they've experienced over the last 18 months may yet have a long wait ahead of them before the return of a more "normal" environment.

The incontrovertible fact is that significant damage has been wrought on investor wealth. Even more profoundly, basic confidence is no less impaired. Many maintain that we are witnessing the bursting of a credit bubble long in the making. They believe that the excesses will be wrung out of the system and that needed changes will be implemented. These steps, we're told, will eventually lead us to a system where market participants can once again rationally price the tradeoff between risk and reward. While history has shown that markets are unpredictably fickle, it also suggests that a return of rationality is, in all probability, correct

The attached 10-page PowerPoint file illustrates what's happened lately, as well as provides some instructive history of previous market environments.

- The extreme stock market decline of the past 12-months, particularly the past 30 days, understandably has caused great pain and concern.

- The graphs on the following pages attempt to put the current stock market decline in historical context as well as illustrate the level of fear affecting credit markets.

- We don't know when markets will react positively to the extraordinary governmental policy actions taken to restore liquidity to credit markets, but we are confident that they will. The equity results achieved on Monday, October 13th demonstrate what a little confidence—albeit short-lived—can do.

- We believe that risk spreads (both credit & equity) have reached extreme levels; patient investors will be handsomely rewarded from recent price levels. We also believe a long-term investment perspective remains apropos.

- We do not expect credit spreads to return to the slim premiums of 2004 to early 2007. Nonetheless, the yield advantage appears compelling if one can believe that we will avoid a prolonged severe recession.

- Foresight has always provided a fuzzy view. As the graph on slide #6 illustrates, markets tend to begin recovering before recessions end.

- Slides 7–10, courtesy of Martingale Asset Management, illustrate the point that even the worst of times in the markets have been followed by better times. We at Callan believe past is prologue and patience will be rewarded.

As mentioned earlier about opportunistic investors, a number of pension funds and other investors have decided to take advantage of what they see as historically cheap entry prices. For example, distressed mortgage and asset-backed securities funds have raised billions of dollars from opportunistic investors—like North Dakota—although few have achieved positive returns as of today. Prudent long-term investors experience both investment rewards and volatility as a consequence of their participation in the capital markets. Clearly, it is important to evaluate investment performance over intermediate periods and that certainly paints a troubling picture. We must remember, however, that a long-term perspective is an essential element of all investors' ability to balance their strategic investment objectives with funding abilities and risk tolerance. Although sorely tested, we believe that successful investors should stick with their prudently developed investment policies and maintain their resolve.

Resolutely,

Paul Erlendson

enclosure

Histogram of Stock Market Calendar-Year Returns

2008 return to October 10th: Negative 46.78%

28th Annual National Conference
2007 Performance in Perspective - History of the U.S. Stock Market
217 Years of Returns

					2007							
					2005							
					1994							
					1992							
					1987							
					1984	**2006**						
					1978	**2004**						
					1970	1993						
					1960	1988						
					1956	1986	**2003**					
					1953	1972	**1999**					
					1948	1971	**1998**					
					1947	1968	1996					
					1939	1965	1983					
				2000	1934	1964	1982					
				1990	1929	1959	1979					
				1981	1923	1952	1976					
				1977	1916	1942	1967					
				1969	1912	1921	1963					
				1966	1911	1909	1961					
				1962	1906	1905	1955					
				1946	1902	1900	1951					
				1941	1896	1899	1950					
				1940	1895	1891	1949					
				1932	1894	1886	1944					
				1914	1892	1878	1943					
				1913	1889	1872	1938					
				1910	1888	1871	1925					
				1890	1882	1868	1924					
				1887	1881	1865	1922					
				1883	1875	1861	1919					
				1877	1874	1855	1918					
				1873	1870	1845	1901	**1997**				
			2001	1869	1867	1844	1898	1995				
			1973	1859	1866	1840	1897	1991				
			1957	1853	1864	1835	1885	1989				
			1926	1838	1851	1829	1880	1985				
			1920	1837	1849	1824	1860	1980				
			1903	1831	1848	1823	1856	1975				
			1893	1828	1847	1821	1834	1945				
			1884	1825	1846	1820	1830	1936				
		2002	1876	1819	1833	1818	1817	1928				
		1974	1858	1812	1827	1813	1809	1927				
		1930	1842	1811	1826	1806	1800	1915	1958	1954		
		1917	1841	1797	1822	1803	1799	1904	1935	1933		
		1907	1839	1796	1816	1802	1798	1852	1908	1862		
1931	1937	1857	1836	1795	1815	1793	1794	1850	1879	1808		1843
1807	1801	1854	1810	1792	1805	1791	1790	1832	1863	1804		1814

-50% -40% -30% -20% -10% 0% 10% 20% 30% 40% 50% 60% 70% 80%

Source: Ibotson, Roger G., Investment Markets (Updated)

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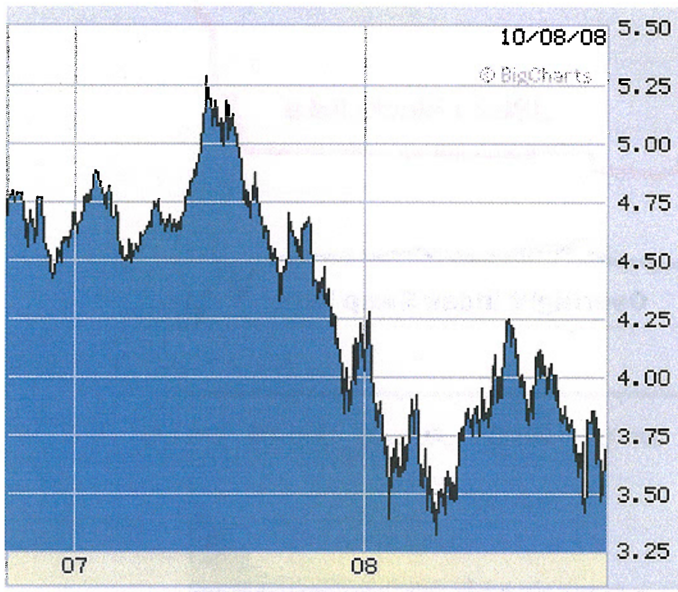
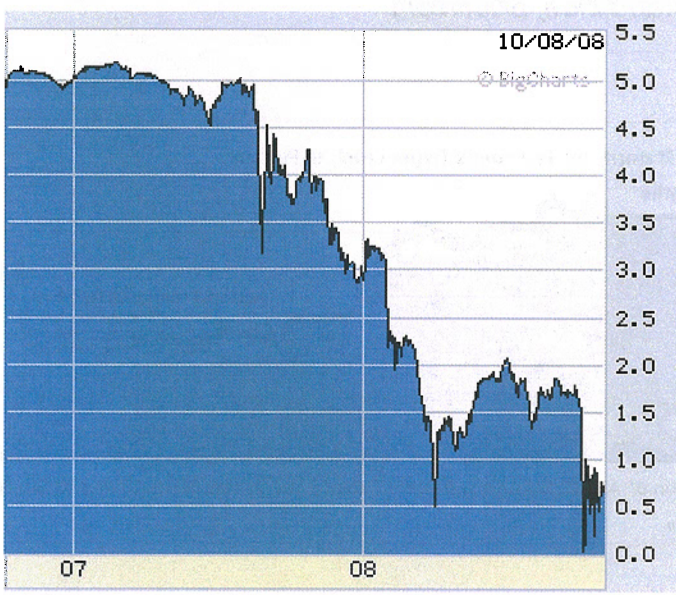
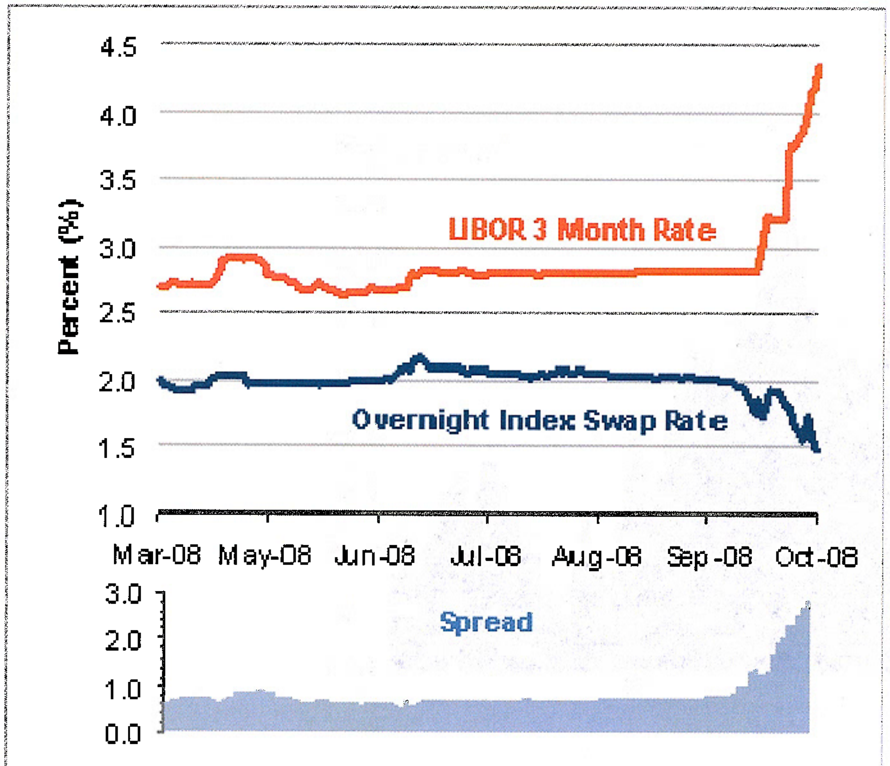
Two year pictures:
10-year and 3-month Treasury Yields

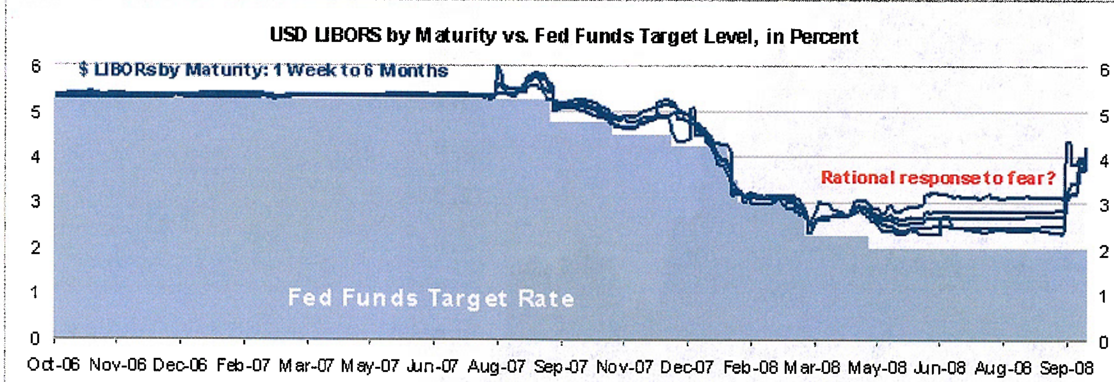




Illustrations of Credit Fears



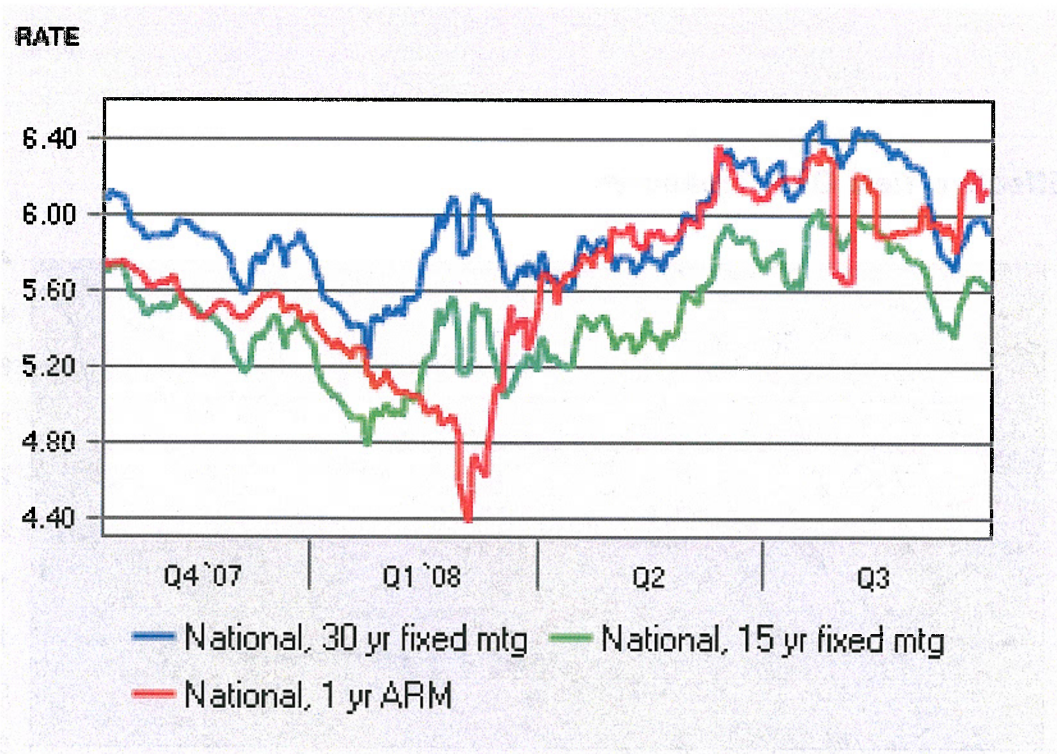
Source: British Bankers Association, Bloomberg



Source: Federal Reserve, British Bankers Association

Mortgage Rates Still Under Stress

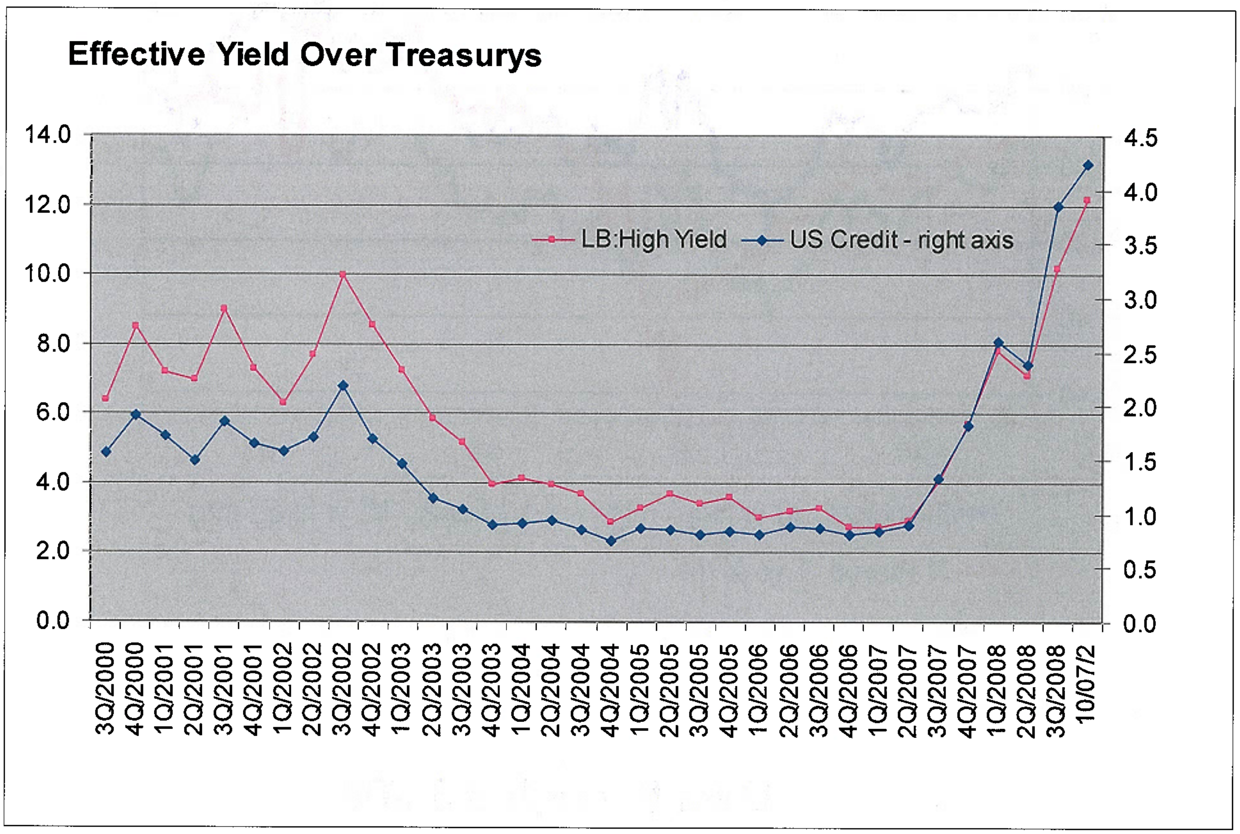
Despite Explicit Federal Government Intervention and Protection



Data through 9/30/08

Credit Spreads at Historic Highs

Option adjusted spreads based on Lehman Indexes
U.S. Credit = Investment Grade
High Yield Index yields on left of graph



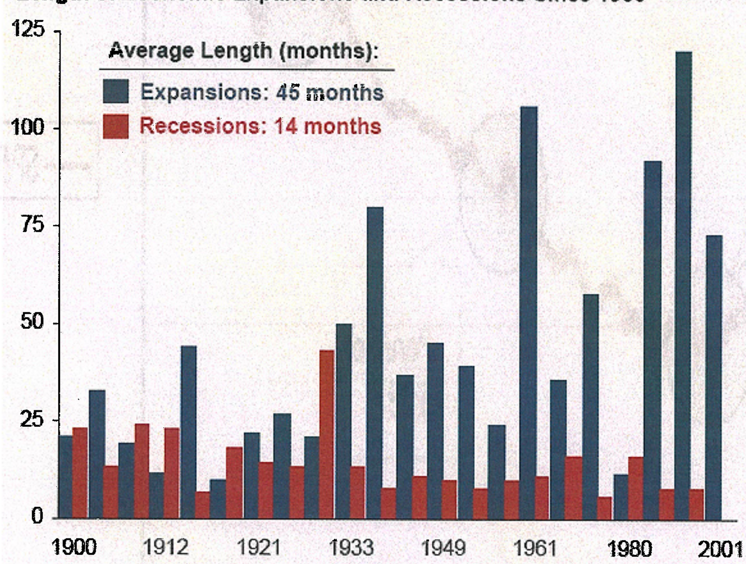
A view to past recessions and market performance

Economic Expansions and Recessions

Market Insight Series

Economy

Length of Economic Expansions and Recessions Since 1900



Recessions and Market Returns

Year	Length (months)	Return: During Recession	Return: 6-mo's After
1948	11	3.9%	12.2%
1953	10	18.3%	16.4%
1957	8	-7.6%	20.4%
1960	10	11.6%	9.0%
1969	11	-7.5%	20.6%
1973	16	-17.9%	1.1%
1980	6	8.1%	8.2%
1981	16	7.0%	18.8%
1990	8	3.4%	4.0%
2001	8	-4.7%	-4.5%
AVG	**10**	**1.4%**	**10.6%**

Source: NBER, Standard & Poor's, JPMorgan Asset Management.

(Left chart) Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). This data can be found at www.nber.org/cycles/ and reflects data through December 2007.

(Right chart) Data computed using the S&P 500 Index price return (does not include dividends). Dates used are based on NBER dates for the beginning and end of recession periods. Dates shown reflect the year in which each respective recession began. Returns are calculated based on the average monthly S&P 500 Index value as recessions do not begin or end on a specified day.

JPMorgan
Asset Management

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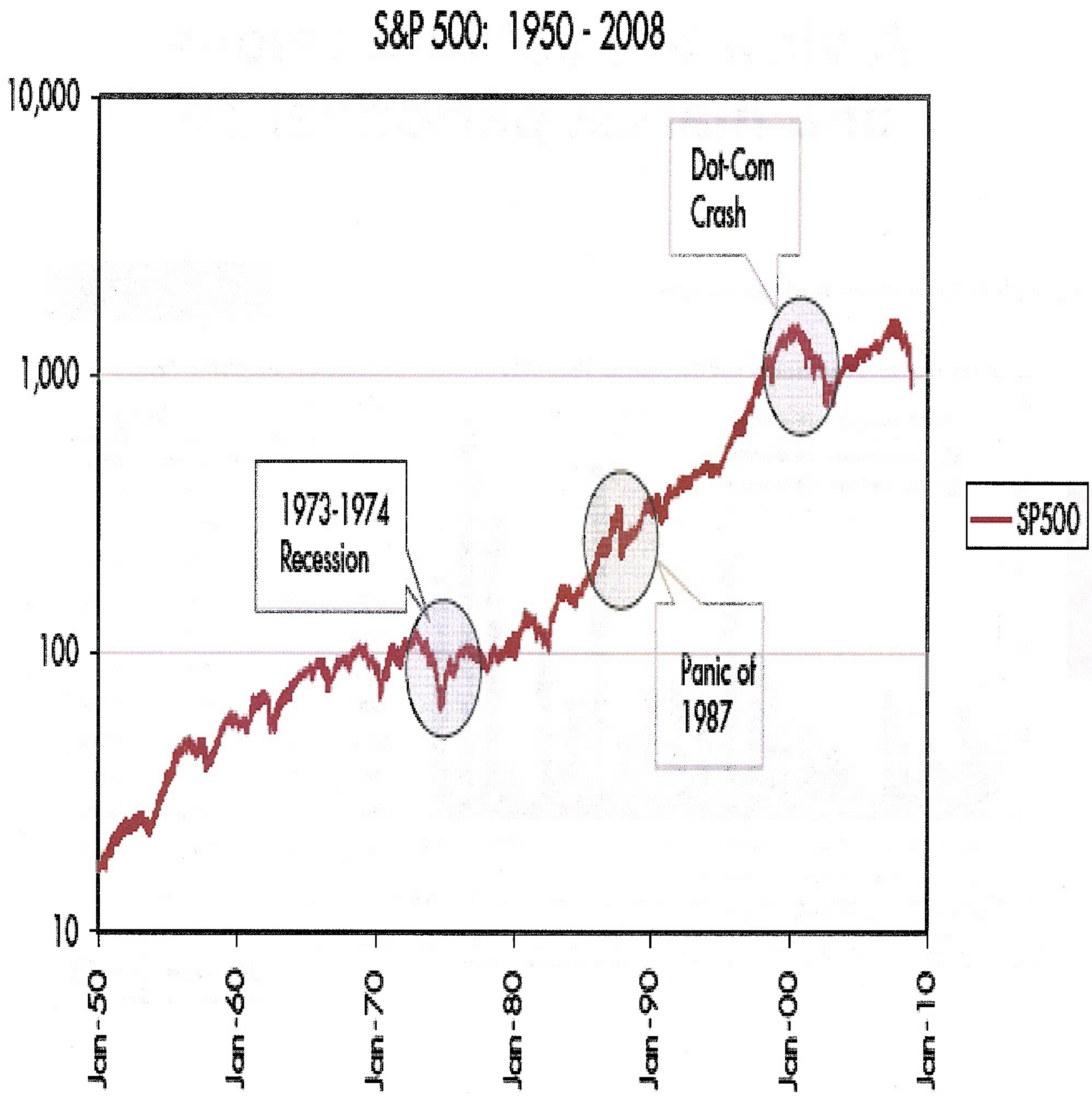
Reproduced from JP Morgan Guide to Markets September 30, 2008

Chart 1 The Blips



Source: Martingale Asset Management, 10/10/08.

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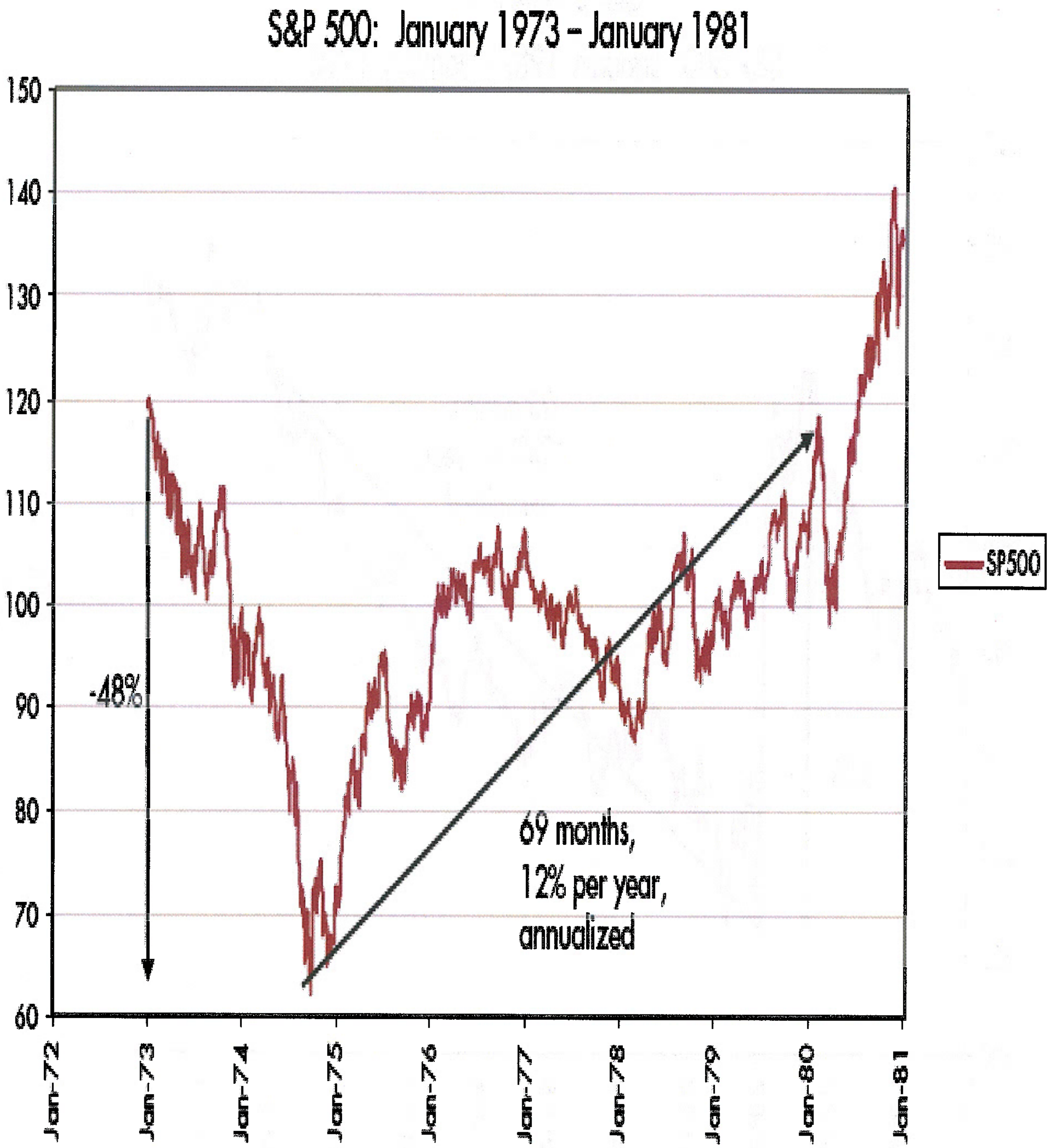
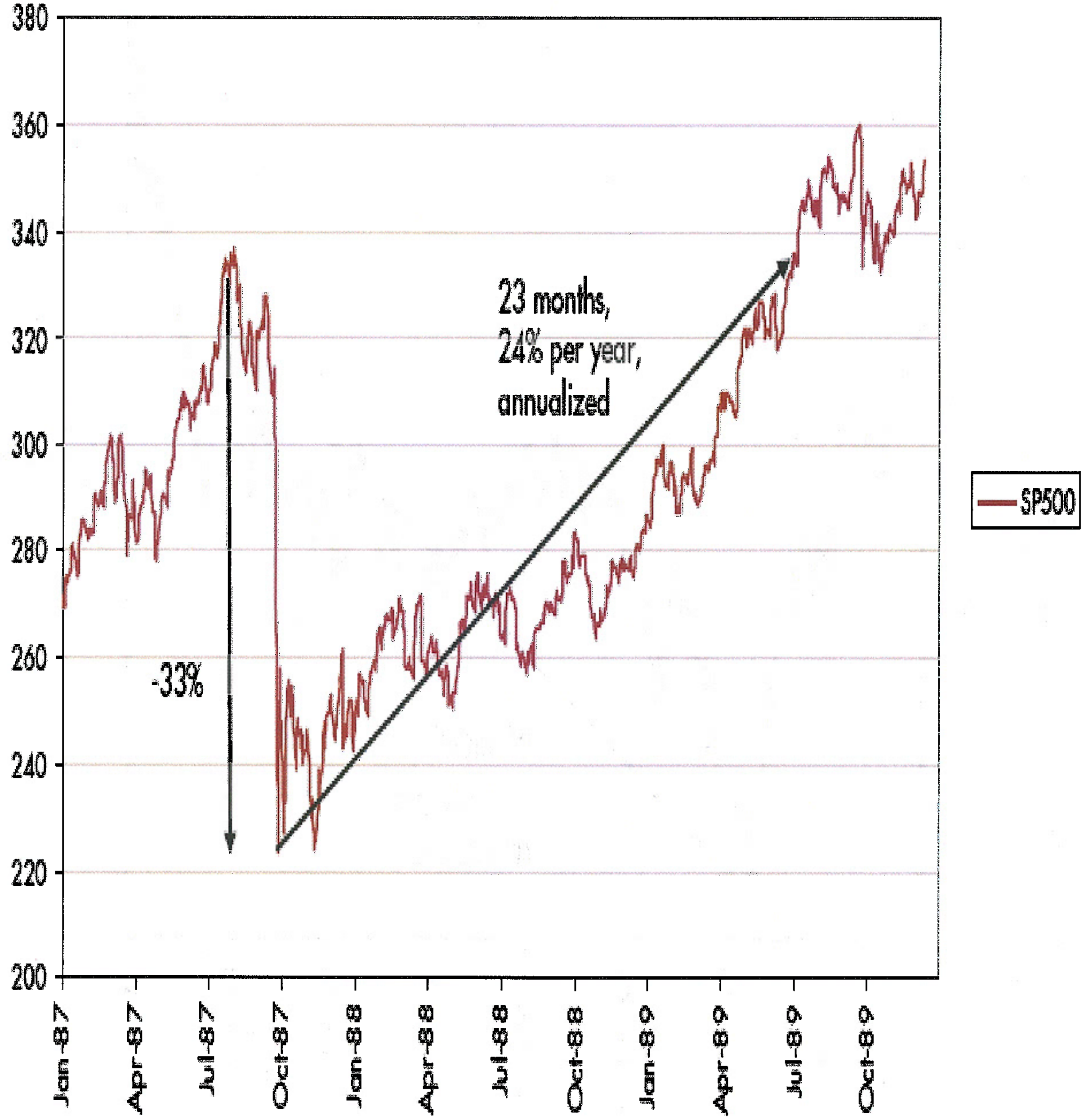
Chart 2 '73-'74 Recession



Source: Martingale Asset Management, 10/10/08.

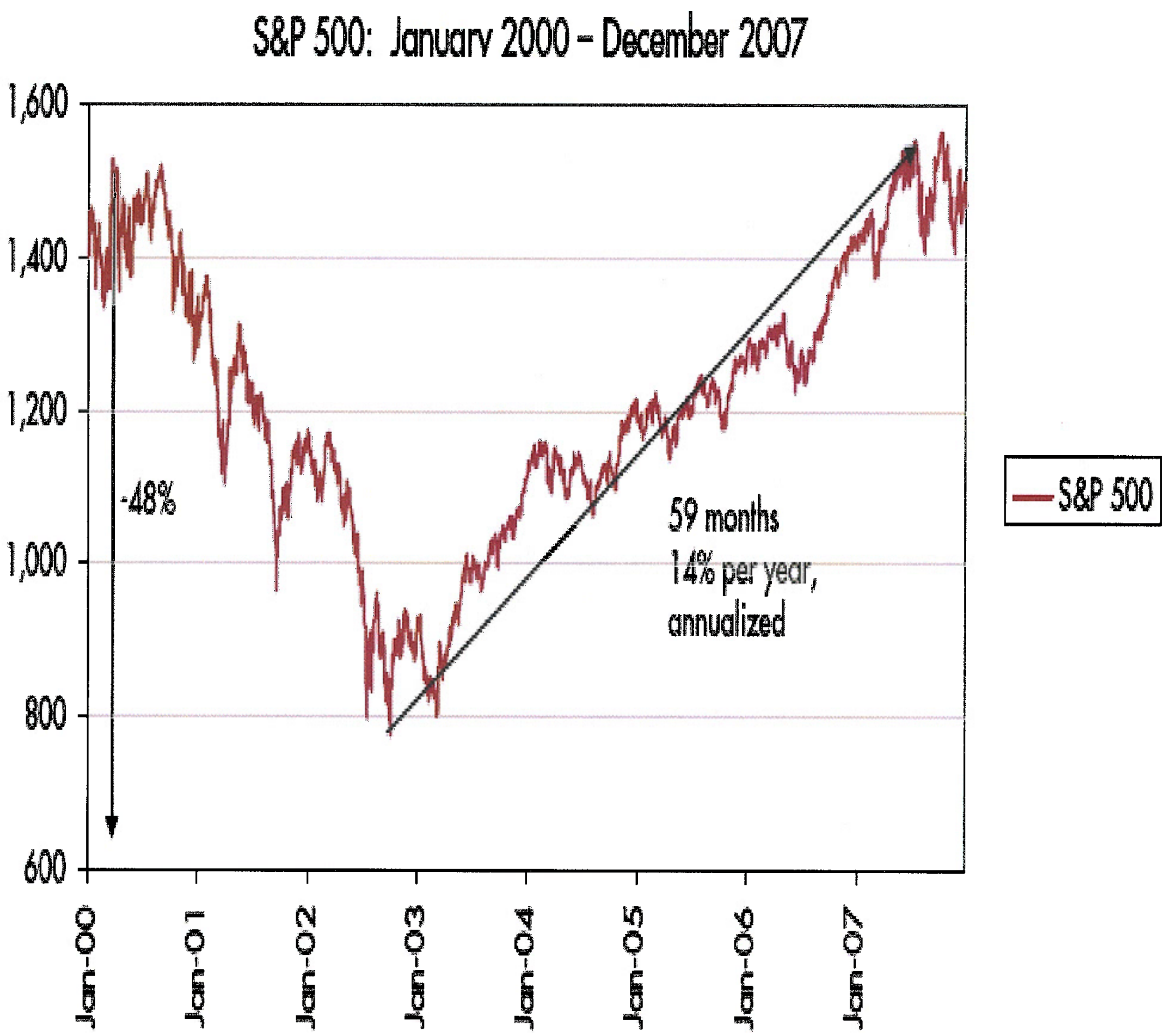
Chart 3 Panic of '87

S&P 500: January 1987 – January 1990



Source: Martingale Asset Management, 10/10/08.

Chart 4 Dot-Com Crash



Source: Martingale Asset Management, 10/10/08.