

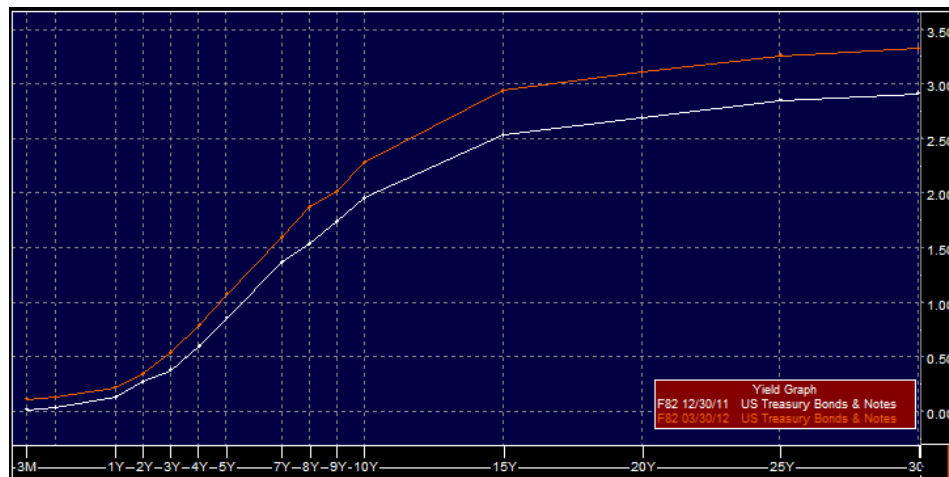
Strategic Report

Idaho State Treasurer Diversified Bond Fund

For the Period Ending March, 31 2012

Fixed Income Market and Portfolio Review

The U.S. fixed income markets declined during the 1st quarter. The U.S. Treasury yield curve shifted upward during the period with most of the increase taking place in the longer half of the curve. The 10-Year Treasury benchmark yield rose sharply higher in March from under 2.00% to 2.38% before finishing the quarter at 2.22%. The 5-Year Treasury yield also moved higher, up 22 basis points to finish at 1.07%. The yield spread between the 30-Year Treasury and 2-Year Treasury widened almost 40 basis points to 3.00%. Yield spreads between the 5-Year Treasury and 5-Year Corporate A Index tightened significantly from 192 basis points to 141 basis points.



Source: Bloomberg

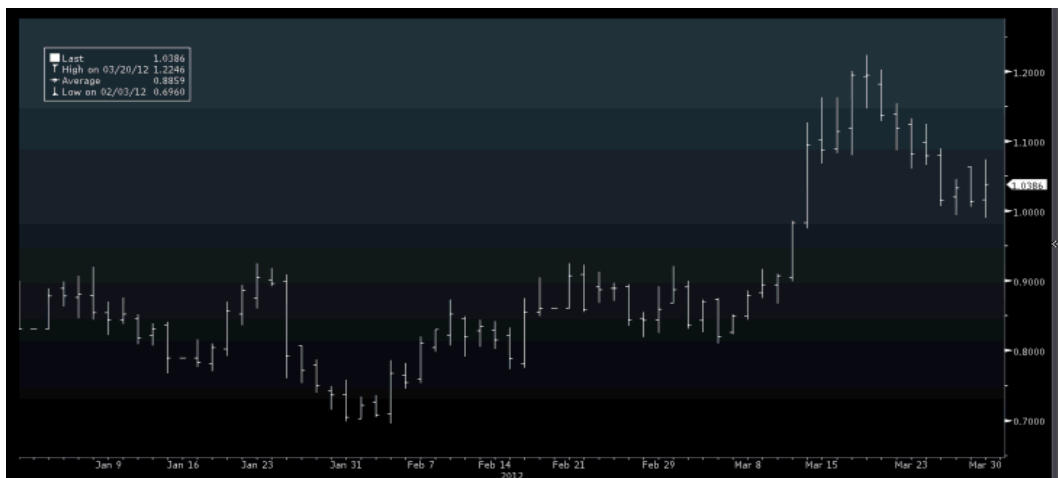
The increase in rates across the entirety of the curve resulted in negative movement for U.S. Treasury prices, with the Intermediate U.S. Treasury down -0.48% for the quarter, but still up 6.10% over the last 12 months. The U.S. Intermediate Corporate sector and U.S. Mortgage Backed Securities sector fought rate headwinds to finish solidly higher for the quarter, up 2.75% and 0.56% respectively. The Barclay's Capital Intermediate Aggregate A+ Index (the portfolio's market benchmark) posted a positive return of 0.33% for the quarter and had a return of 5.98% for the trailing 12 months.

The Diversified Bond Fund (DBF) returned 0.67% for the quarter and 5.94% for the last 1 year (excluding sweep cash). A short duration relative to the index and overweight exposure to the mortgage-backed and corporate sectors contributed heavily to the outperformance for the quarter. Since its inception in June of 2000, the DBF has returned

89.52% which corresponds to a 5.63% annualized return. At quarter end, the current yield to maturity for the DBF was 1.64% and its effective weighted average duration was 3.05 years, compared to the comparable index duration of 3.50 years.

Investment Strategy Commentary

After a fairly range bound two months, the fixed income markets finished the final month of the quarter with increased volatility, and meaningfully higher rates (see chart below). U.S. Treasury prices fell over all maturities on declining concerns over Europe and speculation the Federal Reserve would not introduce further accommodative monetary policy. While Federal Reserve members did sound relatively “hawkish” compared to prior statements, we still maintain the world’s central banks, especially the Federal Reserve, will introduce further liquidity measures if conditions warrant. While GDP Growth (3.0%) and unemployment (8.2%) have improved recently, the national housing markets and higher global oil prices could weigh on further economic improvement. We believe the global developed economies are still fragile and susceptible to further “headline shocks,” which should provide demand for U.S. Treasury and Agency securities, and keep interest rates in the U.S. at or near historically low levels.



Source: Bloomberg

We maintain our overweight allocations to Mortgage-Backed Securities and Corporate Credits due to the relative value they provide over Treasuries. The weighted average duration of the portfolio has been slightly increased over the past few quarters in response to the Fed’s promise to keep interest rates low and the lack of stability in the Eurozone financial institutions. While rates remain at historically low levels, we continue to look for relative value along the curve and among sectors while maintaining our overriding goal of investing in high quality assets.

Portfolio-Specific Issues

Total return in a fixed-income portfolio is made up of income and principal fluctuations due to changes in interest rates. In a rising interest rate environment, the principal value of fixed-income securities can decrease. If participants invest principal for a time period shorter than the portfolio duration they could face a situation where they could lose

The above statistics have been obtained from sources we believe to be reliable but we cannot guarantee its accuracy or completeness. Past performance is not a guarantee of future results.

money on a total return basis. Accordingly, participants are encouraged to place only assets that are expected to be invested over a 3 year or longer period in The Idaho State Treasurer's Diversified Bond Fund. In addition, participants are encouraged to reinvest as much of the income as possible to fully participate in the benefits of the Diversified Bond Fund and its focus on total return.

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