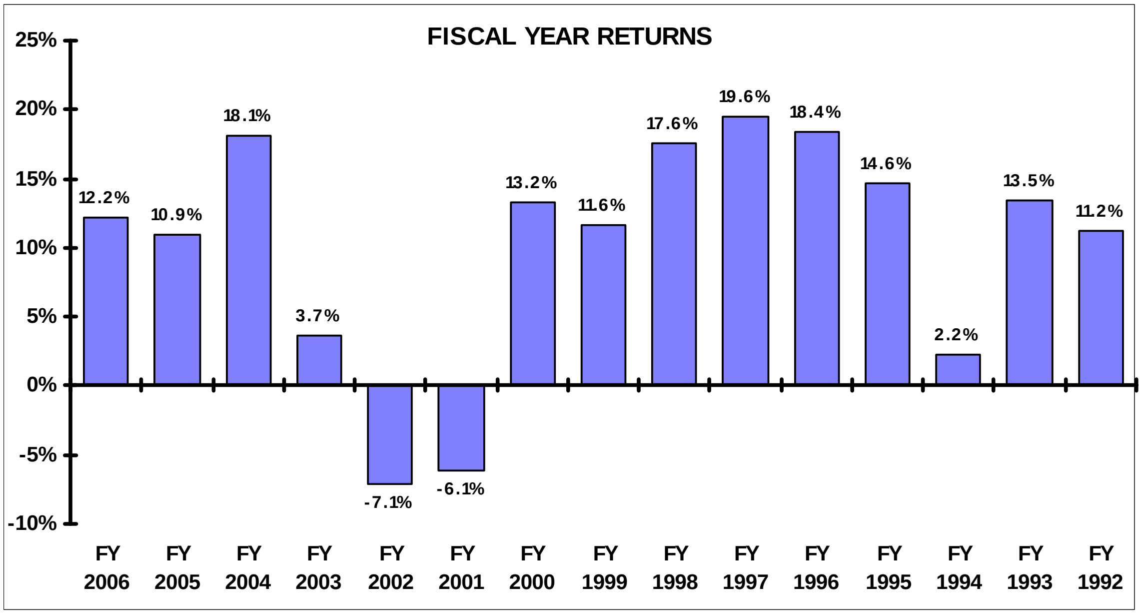
REPORT ON INVESTMENT ACTIVITY
Prepared by Robert M. Maynard, Chief Investment Officer

In the space of five weeks, a spectacular year turned into an average year, and in two more weeks that average year ended up to be a very good year, with a noticeable bounce in the final two days. The Fund ended the fiscal year up 12.2% and at $9,591,291,008. The Fund increased in value by $1.03 billion over the year, with $1.05 billion in investment gains, and $20 million of net payments.



If the path to our ending point had been gradual and smooth over the year, we would be feeling very good about the Fund's posture and performance. The Fund beat its gross hurdle rate, 7.75%, by 4.5% (our net needed return is 7.25%). Not only that, but much of the extra return came from additional fund efforts, which added 3.7%. If the Fund had simply met the strategic benchmark (55% Russell 3000, 15% EAFE, and 30% Lehman Aggregate) and had rebalanced every month, we would have been up 8.5% -- only slightly above our hurdle rate (with no rebalancing, we would have made 9.0%). But, with our emphasis on global equities, REITs, and emerging markets, among other things, we added almost all of the extra return.

The fiscal year was an average year for US equities (The Russell 3000 was up 9.6%), a great year for international equities (MSCI EAFE up 27.1%) and emerging markets (MSCI Emerging Markets up 35.9%), and a bad year for investment grade fixed income (Lehman Aggregate down 0.8%) due to the steadily increasing interest rates led by the Federal Reserve's tightening campaign. US equities were paced by small and mid-cap equities, with the small cap portion up 13.3% for the year, and the large cap (S&P 500) up 8.8%. US large cap growth again was the worst performing segment of the world equity markets, with returns of only 5.1% for the fiscal year. Global equities markets (both US and international) were up 17.5% (MSCI World Index) for the fiscal year – a very good year generally.

PERSI's US only equity returned 12.4%, handily outperforming the general US market by 2.8%. PERSI's outperformance was helped by private equity, REITs, a general small cap equity bias, and Donald Smith. The Adelente REIT portfolio returned 26.4% for the fiscal year (our private real estate was up 10%), and private equity was up 21.6% (time-weighted). Managers that beat the general US equity market returns were led by a tremendous year for Donald Smith, at 24.8%, and by TCW (12.5%) and Mountain Pacific (12.0%). Both Mountain Pacific and TCW slightly underperformed their small and mid cap benchmarks for the year. Our US large cap managers, Tukman (4.4%) and Peregrine (3.4%), with their large cap, quality, and growth or growth at a reasonable price portfolios, had poor absolute and relative to benchmark returns, as both their sector and style orientations continued to be out of favor.

All of our international equity managers, both developed and emerging markets, underperformed their benchmarks for the year. PERSI's international only portfolio returned 26.7% compared to the index return of 27.1%. Thus, PERSI was helped tremendously by our relative overweight to international equity and emerging markets, both through the dedicated international managers and by the international portions of the global portfolio, but were hurt by the underperformance (relative to benchmark) of the international equity managers. Bernstein Emerging Markets (33.7%) and Genesis (32.4%) had the best absolute performances in the total fund, but underperformed their emerging market benchmark for the year (which was up 35.9%). Rowe Price (23.8%) and Mondrian (21.9%) had good absolute years but were behind the EAFE Index Fund run by Mellon Capital (26.3%).

Our global managers, once again, had very good absolute years (some spectacular) and ended up the year being, by far, the greatest contributors to our outperformance of the strategic benchmarks. Zesiger Capital had the third best individual absolute and best relative performance of any portfolio in the PERSI Fund, with a return of 31.9% for the fiscal year, far outperforming the World Index return of 17.5%. Next in line was Bernstein Global, with a return of 25.9%. Capital Guardian (18.7%), Brandes (18.4%), and Barings (16.9%) had good absolute returns roughly in line with the World Equity benchmark (17.5%), and significantly outperformed the general US equity market.

Fixed income did not have a good year, losing around 1.1% – 30 basis points behind the Lehman Aggregate loss of 0.8%. This underperformance was attributable to PERSI's real return portfolio. The TIPS portfolio, which had for many years been a major outperformer, turned into a drag on performance, losing 3.2% for the year as real yields rose in conjunction with the Fed tightening. The movement of around one-third of this money to the Bridgewater real return account helped the Fund in this area, as the Bridgewater account basically broke even (-0.1%) for the fiscal year. The DBF MBS and Clearwater accounts, with 0.6% and 0.4%, led the bond accounts in absolute returns, and Fidelity led the bond accounts in relative returns by returning 0.3%. Western (-0.1%) outperformed the Index for the year, and Barings Fixed (-1.1%) slightly underperformed.

All in all, though, it was a very good year and, considering our outperformance of our strategic benchmark, possibly a great year. But it sure didn't feel that way as the fiscal year wound to its close.

The reason was that, until early May, PERSI was having a spectacular year. Everything was working in our favor. Emerging markets were on a roll, up over 50%, while international equity generally was up over 30%. Small cap US stocks were up over 20%, and, with few exceptions, PERSI managers were ahead of benchmarks. PERSI was beating its strategic benchmark by 3.8%, an almost unheard of advantage, and our peer rankings were at all time highs. The March 31 Callan rankings, for example, had us as follows (1 is highest, 100 is lowest).

RANKINGS IN THE CALLAN PUBLIC FUND UNIVERSE
March 31, 2006
Percentile Rankings over Period
(1 is highest, 100 is lowest)

	QTR	1Yr	2Yrs	3Yrs	4Yrs	5Yrs	7Yrs	10Yrs
Return (%)	**5.3**	**16.5**	**11.8**	**18.6**	**9.9**	**8.1**	**7.0**	**9.5**
Policy Return (%)	4.1	12.1	9.3	15.9	7.6	6.4	4.7	8.4
Median Fund (%)	4.3	13.4	10.2	15.6	8.6	7.3	6.3	8.8
PERSI Rank	**4**	**3**	**11**	**8**	**13**	**27**	**23**	**15**
Policy Rtn Rank	**61**	**72**	**67**	**43**	**76**	**82**	**96**	**63**

Of particular note is that these high rankings were not due to our basic market posture – if we had simply met benchmarks, we would have been a consistently below median or bottom quartile performer, rather than consistently in or near the top quartile or top decile for all time periods. Given our relatively simple approach and desire to be generally a market follower rather than taking many individual active bets, these relative rankings represented an exception to what we could expect over time.

The Fund peaked on May 9th, with 17.44% returns for the fiscal year to date, breaking through the $10 billion level to $10,046,336,627. It was then a wrong-way rollercoaster over the next month, until on June 13th even making our hurdle rate of 7.75% was in jeopardy. By June 13th, in barely over a month, the total fund had dropped 9.4% to 7.9% fiscal year to date returns and had lost over $750 million to $9.236 billion. The drop has been "led" by emerging markets (-35%), EAFE and Small Cap US stocks (-14%), Midcap US stocks (-10%), Large Cap US stocks (-7%), and REITs (-2%), with bonds either flat (TIPS) or up slightly (+0.7%). Our private equity had dropped by about 4%, and our private real estate had not changed in value (with no major cash flows, and no changes in valuations are made during a quarter).

The unusual part of this market drop was that it was primarily driven by an increase in uncertainty – global growth was still robust, corporate profits and balance sheets remained strong, earnings expectations were still reasonable, and global equity valuations (with the possible exception of US small cap stocks) appeared supportable (and for the S&P 500, even attractive). What changed was uncertainty about the longer term path of inflation, central bank monetary policy, and growth. The fear was that growth would stall, and the central banks would tighten too much, with new people (Bernanke in particular) at the helm and untested. A prime indicator of this increase in uncertainty was the Volatility (VIX) Index, which priced current expectations about stock market volatility - in a little less than a month the annual risk (standard deviation) of the S&P 500 priced by the futures market nearly doubled, from 11% (near historic lows) to over 21% (higher than long-term averages – which are about 19%). With increases in uncertainty came decreases in existing asset prices. Particularly hard hit were the emerging markets and small cap stocks. Our international and emerging markets exposures, which were particularly vulnerable over this period, proved to be the greatest short-term detriment to both our absolute and our peer returns. That drop, in miniature, showed what could happen when everything in the PERSI portfolio went wrong, rather than uniformly right as the experience had been for some time.

A few points, in particular, stood out. First, emerging markets had almost entirely reversed its outperformance for the fiscal year at that point, dropping almost 35% since the end of April. It was then only slightly outperforming the developed markets for the fiscal year to date, and, thus as a strategic and active bet, had gone from being a major driver of our outperformance of benchmarks, to neutral.

Second, as is usually the case, Mountain Pacific and some other underperformers for the last few years held up relatively well compared to benchmarks when the other bets in our portfolio didn't do well. This is one of the reasons they are in our portfolio – unfortunately, their joy is usually our sorrow, and their pain is usually our gain. In fact, our US only portfolio, which has been an underperformer against benchmark for some time, was now substantially outperforming the R3000 --- due to the value/quality bias and the REIT and private equity bets. Tukman was another manager who also held up relatively well during this period. REITs held their own and private equity and private real estate, because of the valuation conventions, did relatively well.

We lost ground against our general benchmark – about 60 basis points over that month. About 50 basis points of the 60 basis points underperformance was due to the emerging markets drop – we had lived by the sword, and, for that period, appeared to die by it. This was the pain of being a "long-term investor" – the short-term bumps in the road. On the other hand, REITs, private equity, and real estate (due to the method of valuation), TIPS, and our US only equity all softened what could have been a worse blow over this period.

The managers hired by Callan over the past year and a half held up quite well relative to benchmarks in this decline. Overall, they added about 45 basis points of value (after fees) against benchmarks for the fiscal year to date, led by Donald Smith (which maintained that advantage as the fiscal year closed). The new bond managers also held up well, although the overall portfolio contribution (as is typical for bonds over any short period of time) was small.

The large cap quality growth comeback appeared to be stalled, as shown by the reversal of the previous comeback by Rowe Price and Barings Global Equity, and the slide in the Peregrine and TCW portfolios. Tukman, however, as mentioned previously, held up a bit better than most.

The final three weeks of the fiscal year since June 13th showed a very gradual improvement, until a significant bounce was added in the final two days as the Federal Reserve took its last action of the fiscal year. The Fed came out with a quarter point hike (as expected) with language that was a bit "softer" than expected -- one that people interpreted as raising the possibility of a pause (by dropping a line from a previous statement that indicated a continuing rate hike bias, among other things). In the final two days, the Fund gained 2.6%, as global equity markets rallied on relief that the Fed had not taken or indicated more draconian actions. And, over that last three weeks, the Fund recovered almost all of its relative outperformance of its strategic benchmarks for the year.

This fiscal year has capped a seven to ten year run that has been extraordinary – a run that is not likely to be repeated. Over the past 10 years, PERSI has returned 9.0% per year, well in excess of the 7.6% annual return (without rebalancing) that PERSI would have received if it had been simply indexed to its strategic benchmark of 55% US equities (Russell 3000), 15% international equities (MSCI EAFE), and 30% investment grade fixed income (Lehman Aggregate). In fact, PERSI beat each and every one of those general asset types, outperforming not only the US equity market (8.5%), but also the general international equity markets (6.8%) and the investment grade fixed income market (6.2%). There was even greater outperformance over the last 7-year period.

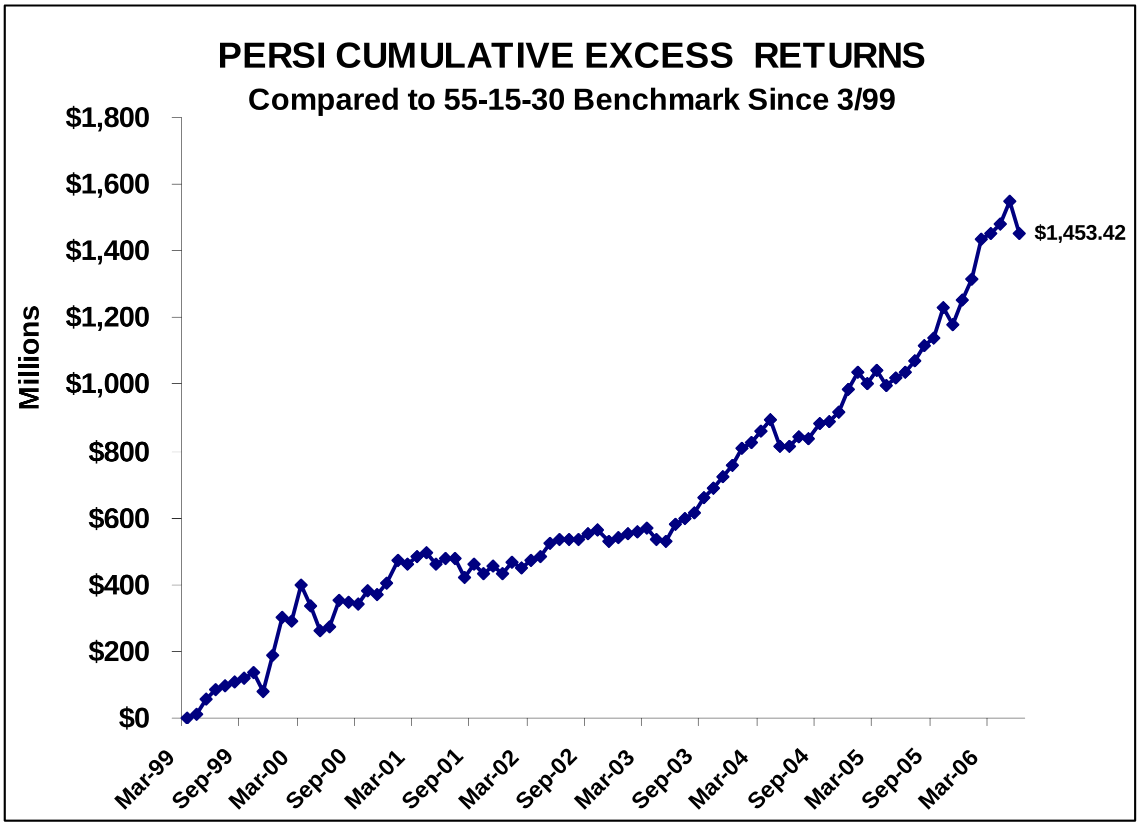
This is a spectacular result – one that would have been unimaginable at the start of this period. Prior to mid 1996, the general large cap indices had been very difficult to beat, and the S&P 500, in particular, was one of the best performing markets in the world (actually, this continued to be the case until early 1999). Active management had been generally lackluster, and to beat any large cap index, much less all of them, with a diversified portfolio, would have been seen as a pipe dream. Further, in late 1996, Alan Greenspan came out with his “irrational exuberance” remarks, casting a pall on any enthusiasm for equities in general, much less the prospects for diversified portfolios to meet long-term hurdle rates of around 8% over the long haul.

The pessimists could not have been more wrong. Despite a period of the worst equity bear market since the great depression (2000-2003), the overall 10 years have been quite good, and excellent for PERSI. The market return over the ten years for the strategic benchmark of 7.6% would have been only slightly under PERSI’s hurdle rate – our actual return of 9.0% handily exceeded it.

And, this outperformance was not isolated to one asset type for PERSI – each and every asset type outperformed its strategic asset benchmark: PERSI’s US equity beat the Russell 3000 over the past 10 years by 8.9% to 8.5%, PERSI’S global equity beat the MSCI World Index by 11.5% to 7.4%, PERSI’S international equity beat the MSCI EAFE by 7.9% to 6.8%, and PERSI’s fixed income beat the Lehman Aggregate by 7.0% to 6.2% (all returns annualized).

While there were a number of reasons for this long-term outperformance, a few stand out. The US equity outperformance was primarily driven by two factors: a commitment to REITs and an overweight to small cap stocks. Global equity managers simply outperformed their benchmarks, some due to style (e.g. Brandes), others due to strategic overweights (Zesiger). The international equity outperformance was solely due to the strategic dedication to emerging markets and the outperformance of PERSI’s emerging market managers (particularly Genesis) – PERSI’s developed market international equity managers actually underperformed over that longer period. And, the fixed income outperformance was driven by the real return (TIPS) and mortgage allocations.

This outperformance really began in March of 1999, and over the past seven years, has meant huge monetary gains for PERSI – almost $1.5 billion dollars of excess returns ($1.453 billion, to be exact) over what would have been received if PERSI had simply been passively indexed. Starting at a level of $5.8 billion in March of 1999, and with net contributions of only $11 million since that point, the PERSI Fund has grown to $9.6 billion, when simply getting market returns would have grown PERSI to only $8.1 billion. The pattern of cumulative excess dollar returns over the months since March of 1999 has been as follows:



($415 million of this excess return was generated in the past fiscal year. The excess return since July of 1994, when this data was first tracked, has been $1.056 billion; this lower number reflects the outperformance of the large cap indices in the mid 1990s. As a matter of interest, in July of 1994, the Fund was at $2.75 billion, net contributions since that date have totaled $372 million – the remaining $6.45 billion to make up the current $9.57 billion have come from investment returns).

All in all, quite a year, with a bit more excitement than one likes for an investment portfolio. As a final note, PERSI's peer rankings at fiscal year ranking held up better than expected – PERSI continued to rank in the top quartile or top decile of public funds for most time periods as shown in the table on the following page:

RANKINGS IN THE CALLAN PUBLIC FUND UNIVERSE
June 30, 2006
Percentile Rankings over Period
(1 is highest, 100 is lowest)

	1Yr	2Yrs	3Yrs	4Yrs	5Yrs	7Yrs	10Yrs
Return (%)	**12.2**	**11.5**	**13.7**	**11.1**	**7.2**	**6.0**	**9.0**
Policy Return (%)	8.8	8.7	11.1	9.1	5.4	3.9	8.0
Median Fund (%)	10.5	10.0	11.8	9.7	6.5	5.6	8.5
PERSI Rank	**8**	**10**	**9**	**13**	**29**	**31**	**24**
Policy Rtn Rank	**71**	**74**	**60**	**68**	**83**	**100**	**64**

Two clear trends over the next 3-5 years will be (1) the secular end of the “tailwind” of steadily declining interest rates and the resulting expansion of price earnings ratios (which has been discussed at length in meetings and previous reports); and (2) the ending of the severe underperformance of the large cap equity indices, and particularly the underperformance of the typical high earnings quality large cap equity. In fact, at some point over the next year or two we are likely to see a return to the mid 1990s, when large cap indices were very tough benchmarks to beat. Over the past seven years, any active management activity away from indexing has yielded very nice extra returns – emerging markets, REITs, small cap equities, and the like have been only the tip of the iceberg in terms of the advantages of active investment. PERSI’s outperformance of its strategic benchmarks by a wide margin over the past seven to ten years is not an exception to the general trends. But, before that outperformance, there were a number of years where PERSI had very good absolute returns, but poor returns compared to its strategic benchmarks because of the excellent performance of the capitalization weighted indices. We could very likely enter one of those prolonged periods again.

But this past fiscal year has seen the continuation of a long period of very good absolute and relative performance by the PERSI portfolio. We do not depend on this type of outperformance for the health of the PERSI system: nonetheless, it is very enjoyable when it happens.

Investment Summary as of the Year Ended June 30, 2006

Types of Investment		Market Value		Percent of Total Market Value
Short-term investments		$551,186,344		5.6%
Fixed income				
Domestic	2,331,488,484		23.8%	
International	52,052,665		0.5%	
Commercial mortgages	276,765,613		2.8%	
Total fixed income		2,660,306,762		27.1%
Common stock				
Domestic equity	3,917,534,424		39.9%	
International equity	2,191,333,193		22.4%	
Total common stock		6,108,867,617		62.3%
Private equity		301,624,233		3.1%
Real estate		178,238,005		1.8%
Total Base Plan investments		$9,800,222,961		100.0%
Other funds:				
Sick Leave Insurance Reserve Fund		196,689,774		
Choice Plan 414(k)		162,457,183		
Choice Plan 401(k)		61,159,220		
Total investments in all funds		$10,220,529,138		

Schedule of Investments by Account as of June 30, 2006
(including interest and dividends receivable)

Adelante Capital Management	$323,714,629
Apollo Management, LP	14,518,738
Baring Asset Management-Global Equity	285,901,667
Baring Asset Management-Global Fixed Income	212,462,763
Bernstein-Emerging Markets	285,727,621
Bernstein-Global Equity	286,718,190
Blackstone Capital Partners, LP	4,344,920
Brandes Investment Partners	529,847,011
Brandes International Equity Fund - Choice Plan	6,836,663
Bridgepoint Capital, LTD	1,601,289
Bridgewater Associates	257,608,340
Capital Guardian	363,682,375
Chisholm Management, LP	22,543,838
Clearwater Advisors, LLC	153,211,626
CVC European Equity	10,593,283
D.B. Fitzpatrick & Co.-Fixed Income	142,913,169
D.B. Fitzpatrick & Co.-Idaho Mortgages	283,331,656
Dodge and Cox Income Fund - Choice Plan	3,254,247
Donald Smith & Co.	209,841,805
Dreyfus Prem Midcap Stock Fund - Choice Plan	3,580,340
Enhanced Equity, LP	2,465,427
Fidelity Management Trust Company	203,936,616
Frazier Technology Ventures II, LP	6,407,781
Furman Selz Investments, LP	8,140,970
Galen Associates, LP	37,000,642
Genesis Asset Managers	291,409,637
Goense Bounds & Partners, LP	4,848,274
Gores Capital Partners, LLP	13,406,286
Green Equity Investors IV, LP	9,716,985
Hamilton Lane Co-Investment Fund, LP	6,492,705
Hamilton Lane Secondary Fund, LP	4,806,045
Harvest Partners III, LP	6,763,888
Highway 12 Ventures, LP	4,918,245
Ida-West	3,275,000
JH Whitney & Co., LLC	6,304,866
Kohlberg & Co.	6,543,727
Koll Partners, LLP	98,204,387
Littlejohn, LP	13,318,434
McCown DeLeeuw & Co. IV, LP	2,670,145
Mellon Aggregate Bond Index - Choice Plan	1,108,572
Mellon Capital Management-R2000 Small Cap	146,325,501
Mellon Capital Management-S&P 500 Large Cap	1,265,960,157

(Continued)

Mellon Capital Management-Mid Cap Completion	176,133,066
Mellon Capital Management-International Stock Index	370,532,686
Mellon International EAFE Fund - Choice Plan	1,489,042
Mellon S&P 500 - Choice Plan	5,988,752
Mellon Transition Management Services	287,858
Mellon Wilshire 5000 - Choice Plan	1,257,364
Mondrian Investment Partners	290,958,751
Mountain Pacific Investment Advisors	302,263,916
Newbridge Asia, LP	9,576,122
Oaktree Capital Management, LLC	6,914,653
Olympic IDA Fund II, LLC	39,000,788
Pareto Partners	(3,611,958)
Peregrine Capital Management	163,183,847
PERSI Cash in Short-Term Investment Pool	25,401,779
PERSI Choice Plan Contribution Holding Account	989,123
PERSI Choice Plan Loan Fund	1,918,367
Providence Equity Partners, LLP	44,378,816
Prudential Investments	44,390,010
Rowe Price International	274,823,229
Rowe Price Small Cap Fund - Choice Plan	5,878,635
SEI Stable Asset Fund - Choice Plan	7,721,107
State Street Global Advisors-Fixed Income	622,846,894
State Street Global Advisors-TIPS	583,135,717
State Street Global Advisors-Sick Leave Insurance Reserve	196,689,774
T3 Partners, LP	45,925,079
TCW Domestic	179,012,066
Thomas H. Lee, LP	4,250,883
Tukman Capital Management	252,418,035
Vanguard Growth & Income Fund - Choice Plan	7,139,066
W. Capital Partners, LP	5,545,843
Western Asset Management	203,963,803
Zesiger Capital Group	404,077,804
Zesiger Capital Group-Private Equity	14,402,684
Total market value, including investment receivables and payables	$9,835,142,060
Add: Investments purchased payable	1,354,245,770
Less: Investments sold receivable	(923,679,953)
Less: Interest and dividends receivable	(45,178,739)
Total market value, net of investment receivables and payables	$10,220,529,138

(Concluded)

Investment Results (Defined Benefit Plans Only)

MANAGERS	TOTAL MKT VAL (MILLIONS)	% OF TOTAL FUND	Investment Performance for Periods Ending FISCAL	1 YR	3 YRS*	5 YRS*
U.S. EQUITY						
MELLON CAPITAL MANAGEMENT MID CAP	$176.1	1.8%	12.6%	12.6%	18.4%	7.1%
MELLON CAPITAL MANAGEMENT R2000 SMALL CAP	146.3	1.5%	13.9	13.9	18.2	8.5
MELLON CAPITAL MANAGEMENT S&P 500 LC	1,266.0	13.2%	8.2	8.2	11.1	2.4
MOUNTAIN PACIFIC	302.3	3.2%	12.0	12.0	15.2	8.4
TUKMAN CAPITAL MGMT	252.4	2.6%	4.4	4.4	4.5	1.3
TCW	179.0	1.9%	12.5	12.5		
DONALD SMITH & CO.	209.8	2.2%	24.8	24.8		
PEREGRINE	163.2	1.7%	3.4	3.4		
TOTAL U.S. PUBLICLY TRADED EQUITY	$2,695.1	28.1%	10.0%	10.0%	12.0%	3.2%
BENCHMARK - Russell 3000			9.6%	9.6%	12.6%	3.5%
PRIVATE EQUITY						
IDA-WEST	$3.3	0.0%	44.3%	44.3%	41.0%	31.1%
GALEN III	37.0	0.4%	(8.2)	(8.2)	2.4	1.6
HARVEST PARTNERS	6.8	0.1%	(35.4)	(35.4)	(11.6)	(7.8)
FURMAN SELZ	8.1	0.1%	45.5	45.5	63.0	29.9
MCCOWN DE LEEUW	2.7	0.0%	(98.6)	(98.6)	(75.2)	(58.3)
PROVIDENCE EQ PARTNERS	44.4	0.5%	33.6	33.6	74.2	22.2
CHISOLM PARTNERS	22.5	0.2%	37.4	37.4	11.3	(8.8)
LITTLEJOHN II L.P.	13.3	0.1%	0.6	0.6	36.2	9.8
OAKTREE CAP	6.9	0.1%	(1.0)	(1.0)	19.1	8.6
GOENSE BOUNDS	4.8	0.1%	16.8	16.8	92.1	44.4
HWY 12 FD VENTURE LP	4.9	0.1%	14.7	14.7	1.1	
T3 PARTNERS II L.P.	45.9	0.5%	70.4	70.4	25.7	
THOMAS LEE L.P.	4.3	0.0%	(0.7)	(0.7)	12.3	
APOLLO MGMT LP	14.5	0.2%	56.3	56.3	59.4	
GREEN EQUITY IV L.P.	9.7	0.1%	(8.8)	(8.8)		
GORES CAPITAL AD LLC	13.4	0.1%	23.8	23.8		
W CAPITAL PARTNERS	5.5	0.1%	11.8	11.8		
FRAZIER TECH VENTURES II	6.4	0.1%	1.5	1.5		
KOHLBERG & CO.	6.5	0.1%	(21.3)	(21.3)		
HAMILTON SECONDARY	4.8	0.1%	36.3	36.3		
CVC EUROPEAN EQUITY**	10.6	0.1%				
HAMILTON LANE CO-INVESTMENT FUND**	6.5	0.1%				
BRIDGEPOINT EUROPE III**	1.6	0.0%				
NEWBRIDGE ASIA LP**	9.6	0.1%				
JH WHITNEY EQUITY PARTNERS IV**	6.3	0.1%				
BLACKSTONE CAPITAL PARTNERS**	4.3	0.0%				
ENHANCED EQUITY FUND LP**	2.5	0.0%				
ZESIGER CAPITAL GROUP	14.4	0.2%	27.3	27.3	8.1	(8.9)
TOTAL PRIVATE EQUITY	$321.7	3.4%	21.4%	21.4%	22.2%	7.1%
REAL ESTATE						
KOLL PARTNERS	$98.2	1.0%	1.5%	1.5%		
OLYMPIC IDA FUND II**	39.0	0.4%				
ADELANTE - PUBLIC R/E	323.7	3.4%	26.4	26.4	31.0%	23.4%
PRUDENTIAL	44.4	0.5%	24.1	24.1	16.7	14.7
TOTAL R/E MANAGERS	$505.3	5.3%	21.8%	21.8%	26.8%	20.9%
BENCHMARK - NCREIF			18.7%	18.7%	15.8%	12.0%
TOTAL U.S. EQUITY	$3,522.1	36.6%	12.4%	12.4%	14.3%	5.0%
BENCHMARK - Russell 3000			9.6%	9.6%	12.6%	3.5%
GLOBAL EQUITY						
BARING ASSET MANAGEMENT	$285.9	3.0%	16.9%	16.9%	15.5%	4.9%
BRANDES INVST PARTNERS	529.8	5.5%	18.4	18.4	21.4	10.5
CAPITAL GUARDIAN	363.7	3.8%	18.7	18.7	17.2	
ZESIGER CAPITAL GROUP	404.1	4.2%	31.9	31.9	21.3	12.3
BERNSTEIN GLOBAL	286.7	3.0%	25.9	25.9		
TOTAL GLOBAL EQUITY	$1,870.2	19.5%	22.0%	22.0%	19.7%	8.8%
TOTAL U.S./GLOBAL EQUITY	$5,392.4	56.1%	15.4%	15.4%	16.0%	6.2%
BENCHMARK - Russell 3000			9.6%	9.6%	12.6%	3.5%

(Continued)

Investment Results (Defined Benefit Plans Only)

MANAGERS	TOTAL MKT VAL (MILLIONS)	% OF TOTAL FUND	Investment Performance for Periods Ending FISCAL	1 YR	3 YRS. *	5 YRS. *
INTERNATIONAL EQUITY						
GENESIS INVESTMENTS	$291.4	3.0%	32.4%	32.4%	37.5%	25.2%
MELLON CAPITAL MANAGEMENT INTL STK INDX	370.5	3.9	26.3	26.3	23.5	10.0
T.ROWE PRICE	274.8	2.9	23.8	23.8	19.9	8.1
MONDRIAN	291.0	3.0	21.9	21.9		
BERNSTEIN EMERGING	285.7	3.0	33.7	33.7		
TOTAL INTERNATIONAL EQUITY	$1,513.5	15.8%	27.1%	27.1%	25.9%	11.6%
TOTAL INT'L EQUITY (HEDGED)[1]	$1,509.8	15.7%	26.7%	26.7%	25.5%	11.0%
EAFE INDEX NET			26.6%	26.6%	23.9%	10.0%
TOTAL EQUITY	$6,902.2	71.9%	17.7%	17.7%	18.0%	7.2%
BENCHMARK - Russell 3000			9.6%	9.6%	12.6%	3.5%
U.S. FIXED INCOME						
DBF & CO FIXED	$142.9	1.5%	0.6%	0.6%	2.3%	4.7%
DBF & CO-IDAHO MTGS	283.3	3.0	(1.2)	(1.2)	1.4	5.4
STATE ST ADV-FX	622.8	6.5	(1.5)	(1.5)	1.6	5.1
SSGA-TIPS	583.1	6.1	(3.2)	(3.2)	4.0	7.6
CLEARWATER-TBA	153.2	1.6	0.4	0.4	3.1	
TOTAL U.S. FIXED INCOME	$1,785.4	18.6%	(1.6)%	(1.6)%	2.7%	6.1%
GLOBAL FIXED INCOME						
BARING ASSET MANAGEMENT	$212.5	2.2%	(1.1)%	(1.1)%	3.0%	5.3%
FIDELITY	203.9	2.1	0.3	0.3		
BRIDGEWATER	257.6	2.7	(0.1)	(0.1)		
WESTERN ASSET	204.0	2.1	(0.1)	(0.1)		
TOTAL GLOBAL FIXED INCOME	$878.0	9.2%	(0.3)%	(0.3)%	3.3%	4.4%
TOTAL FIXED INCOME	$2,663.4	29.5%	(1.1)%	(1.1)%	2.8%	5.8%
BENCHMARK - LB Aggregate			(0.8)%	(0.8)%	2.1%	5.0%
OTHER						
UNALLOCATED CASH	$25.4	0.3%	9.4%	9.4%	5.7%	5.8%
MELLON TRANSITION MANAGEMENT SERVICES	0.3	0.0	838.7	838.7		
TOTAL OTHER	$25.7					
COMBINED TOTAL	$9,591.3	100.0%	12.2%	12.2%	13.6%	7.2%
BENCHMARK - 55% Russell 3000 30% Lehman Aggregate 15% MSCI EAFE Index			8.8%	8.8%	11.1%	5.4%

Add: Mutual Fund Holdings in 401(K) Plan	$47.1
Sick Leave Fixed Income Investments	76.6
Sick Leave Equity Securities	120.1
Investments Purchased	1,354.2
Less: Interest and Dividends Receivable	(45.2)
Investments Sold	(923.7)
Total Pension Fund Investments Net of Receivables	$10,220.5

*Rates of Return are annualized
[1]Includes Pareto Partners currency overlay account
**Accounts opened less than one year
^Includes performance from closed accounts

Prepared using a time-weighted rate of return in accordance with AIMR's Performance Presentation Standards per Mellon Analytical Solutions-a division of Mellon Global Security Services.

(Concluded)

Schedule of Investment Income for the Last Six Years

Year	Interest	Dividends	Gains & Losses*	Total
2001	165,528,342	63,318,176	(669,263,570)	(440,417,052)
2002	120,190,309	68,412,290	(663,804,822)	(475,202,223)
2003	107,626,722	82,726,663	47,095,088	237,448,473
2004	105,106,092	99,565,950	1,005,291,439	1,209,963,481
2005	108,964,781	121,363,908	622,839,336	853,168,025
2006	128,071,925	135,998,068	804,450,498	1,068,520,491

* Includes realized and unrealized gains and losses and other investment income

List of Largest Assets Held

Largest Bond Holdings (by Market Value) June 30, 2006

	Par	Bonds	Description	Market Value
1	$221,516,262	US TREASURY INFLATION INDEX BD	3.875% 04/15/2029 DD 04/15/99	$274,091,817
2	242,948,201	US TREASURY INFLATION INDEX NT	4.250% 01/15/2010 DD 01/15/00	258,094,564
3	108,953,809	US TREASURY INFLATION INDEX BD	2.000% 01/15/2026 DD 01/15/06	99,752,333
4	45,330,000	COMMIT TO PUR FNMA SF MTG	5.000% 07/01/2036 DD 07/01/06	42,369,407
5	44,500,000	COMMIT TO PUR FHLMC GOLD SFM	5.000% 08/01/2035 DD 08/01/05	41,537,991
6	39,000,000	COMMIT TO PUR FNMA SF MTG	5.500% 08/01/2036 DD 08/01/06	37,427,832
7	36,110,697	US TREASURY INFLATION INDEX BD	2.375% 01/15/2025 DD 07/15/04	35,145,855
8	33,960,000	U S TREASURY BONDS	5.375% 02/15/2031 DD 02/15/01	34,546,353
9	32,090,000	COMMIT TO PUR FNMA SF MTG	5.500% 07/01/2035 DD 07/01/05	30,816,412
10	25,449,908	US TREASURY INFLATION INDEX BD	3.375% 04/15/2032 DD 10/15/01	30,042,828

Largest Stock Holdings (by Market Value) June 30, 2006

	Shares	Stock	Market Value
1	2,245,594	GENERAL ELECTRIC CO.	$ 74,014,778
2	2,453,823	MICROSOFT CORP.	57,174,076
3	801,145	EXXON MOBIL CORP.	49,150,246
4	298,104	GOLDMAN SACHS GROUP, INC.	44,843,785
5	755,041	AMERICAN INTERNATIONAL GROUP, INC.	44,585,171
6	456,320	VORNADO REALTY TRUST	44,514,016
7	825,054	CITIGROUP, INC.	39,800,605
8	1,640,786	PFIZER, INC.	38,509,247
9	797,960	WAL MART STORES, INC.	38,437,733
10	565,987	WELLS FARGO & CO.	37,966,408

A complete list of portfolio holdings is available upon request.

Schedules of Fees and Commissions for the Year Ended June 30, 2006

Investment fees by type	Average assets under management	Fees	Basis points
Investment manager fees			
Equity managers	$6,724,617,111	$22,892,960	34
Fixed income managers	1,843,049,104	1,617,852	9
Private equity managers	333,302,940	6,043,002	181
Real estate managers	516,764,261	4,408,208	85
Total investment manager fees	$9,417,733,417	34,962,022	37
Other investment service fees			
Custodian/recordkeeping fees		3,939,018	
Investment consultant fees		923,298	
Legal fees		736,957	
Actuary/audit service fees		280,247	
Total investment service fees		5,879,519	6
Total defined benefit plans' fees		$40,841,542	43
Total defined contribution plans' fees		197,432	
Total other trust funds' fees		90,175	
Total investment fees		**$41,129,149**	

(Continued)

Schedules of Fees and Commissions for the Year Ended June 30, 2006

Broker Commissions	Base Commission	Total Shares	Commission per Share
DEUTSCHE BK SECS INC, NY	$ 243,367	20,014,988	0.0122
CREDIT SUISSE, NEW YORK	185,150	25,188,040	0.0074
SALOMON BROS INTL LTD, LONDON	182,720	19,525,650	0.0094
MERRILL LYNCH PIERCE FENNER, WILMINGTON	156,913	25,682,952	0.0061
MORGAN STANLEY & CO INC, NEW YORK	152,554	20,008,815	0.0076
GOLDMAN SACHS & CO, NEW YORK	146,799	9,698,397	0.0151
DEUTSCHE BK INTL EQ, LONDON	134,262	12,362,487	0.0109
UBS WARBURG ASIA LTD, HONG KONG	130,634	21,125,537	0.0062
LEHMAN BROS INC, NEW YORK	129,807	5,076,357	0.0256
LEHMAN BROS INTL, LONDON	116,790	6,061,550	0.0193
BANC OF AMERICA SECS LLC, CHARLOTTE	114,299	3,607,210	0.0317
BEAR STEARNS & CO INC, NEW YORK	111,907	10,275,685	0.0109
MERRILL LYNCH PIERCE FENNER SMITH INC, NEW YORK	109,700	3,342,245	0.0328
JEFFERIES & CO INC, NEW YORK	109,356	2,496,641	0.0438
UBS SECURITIES LLC, STAMFORD	106,289	4,173,051	0.0255
BERNSTEIN SANFORD C & CO, NEW YORK	101,228	2,452,707	0.0413
MERRILL LYNCH INTL LONDON EQUITIES	96,963	5,002,285	0.0194
CITIGROUP GBL MKTS INC, NEW YORK	89,087	20,167,483	0.0044
J P MORGAN SECS LTD, LONDON	83,538	5,880,508	0.0142
JP MORGAN SECS ASIA PACIFIC, HONG KONG	79,925	33,304,376	0.0024
CREDIT SUISSE (EUROPE), LONDON	73,599	14,522,603	0.0051
INVESTMENT TECHNOLOGY GROUPS, NEW YORK	71,838	6,072,713	0.0118
GOLDMAN SACHS INTL, NEW YORK	69,474	1,389,470	0.0500
MORGAN STANLEY & CO, LONDON	66,851	4,755,561	0.0141
MACQUARIE SECS (SINGAPORE), SINGAPORE	66,647	15,593,620	0.0043
B TRADE SVCS LLC, NEW YORK	64,255	1,083,300	0.0593
GOLDMAN SACHS INTL, LONDON	60,703	3,700,038	0.0164
OTHER BROKERS UNDER $60,000	2,858,908	399,439,735	0.0072
TOTAL BROKER COMMISSIONS	$5,913,564	702,004,004	0.0084

A complete list of broker commissions is available from PERSI. PERSI does not require that investment managers use specific brokers.

(Concluded)

STATEMENT OF INVESTMENT POLICY AND GUIDELINES

I. Introduction
The Retirement Board of the Public Employee Retirement System of Idaho (“the Board”)(“the System”) hereby establishes its Statement of Investment Policy for the investment of the trust funds (“the Trust”) in accord with Idaho Code Chapter 13, Title 59.

II. Statutory Requirements
The investment of the Trust will be in accord with all applicable laws of the State of Idaho.

A. Sole Interest of Beneficiaries
Investments will be solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to the participants and their beneficiaries and defraying reasonable expenses of administration.

B. Prudent Investments
Investments will be made with the judgment and care under the circumstances then prevailing, which people of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable outcome as well as the probable safety of their capital. Investments will be diversified so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.

C. Fiduciary Duties
The Board and its agents, including staff, consultants, and investment managers, will discharge their duties with respect to the fund solely in the interest of the members and retired employees, and with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

III. Investment Goals
A. General Objective
1. Purpose
The purpose of the investment of Trust assets is to provide funds to meet the obligations of the Public Employee Retirement System of Idaho (PERSI) while incurring the appropriate amount of risk consistent with attaining that goal. The Board will invest the assets of the Trust so as to meet the projected obligations of the System, and will reduce risk through diversification of the assets of the Trust.
2. Considerations
In determining the returns needed by the system, the acceptable risk levels, and the allowable investments, the Board will consider:
* The effect of particular investments on the total portfolio,
* The purpose of the plan,
* The diversification of the portfolio,
* Liquidity needs and the current return relative to the anticipated cash flow requirements, and
* The projected return of the portfolio as it relates to the funding objectives of the plan.

B. Specific PERSI return and risk objectives
1. Investment Returns
(a) Actuarial Assumptions
In projecting obligations and the returns needed to meet those obligations, the Board will consider studies performed by actuaries hired by the Board. The actuary uses an investment return assumption of 8% before fees and expenses in balancing projected obligations, projected contributions, and projected returns on assets. Assuming all of the actuarial assumptions are accurate, this 8% return will suffice to: (1) assure the payment of statutorily required benefits, which includes a 1% Cost of Living Adjustment (COLA); and (2) maintain the reduction of the level of the unfunded liability (if any) on the scheduled amortization (one year at a time). The assumed 8% return will not be sufficient to fund either

discretionary COLAs (2-6%), retroactive COLAs, accelerate the amortization of the unfunded liability, build a stabilization reserve, or allow for gain-sharing distributions.

(b) Inflation and Salary Assumptions

This 8% rate assumes an inflation rate of 4.25% and an annual general state salary growth of 5.25%. To the extent that either inflation or salary growth are higher or lower than these rates, then the investment returns needed will also be higher or lower than the assumed 8%, although not on a 1:1 ratio. Consequently, the investment returns actually needed by the system do not have a nominal rate which can be determined with precision in advance -- the 8% rate currently used by the actuary is only a general midpoint accurate over long (15-20) year periods and is only as accurate as are the inflation and salary assumptions.

(c) Relation to Funding Policy

As set out in the Board's funding policy, to the extent investment markets allow, it is the desire of the Board to provide discretionary COLAs, accelerate the amortization of any unfunded liability, and provide for gain-sharing. It is also the goal of the Board to maintain a reasonable amortization of any unfunded liability, and not to exceed the 25 year amortization period set by statute. Therefore, it is the goal of the Board to set an expected rate of return above the actuarially assumed return so that (1) discretionary COLAs will have a reasonable chance of being consistently funded and (2) the scheduled amortization of any unfunded liability is not unreasonably jeopardized. Returns above that amount will be used to build a stabilization reserve and to distribute to the System participants through gain-sharing.

(d) Periodic Specific Return Goals

Because of the inflation sensitivity of both the returns needed by the system and the size of annual COLAs, an exact target return (either real or nominal) cannot be set in advance. Nonetheless, under most reasonable actuarial assumptions, PERSI has a relatively stable real return goal of between 4.75% - 5.25% if consistent funding of discretionary COLAs and providing for gain sharing is included as an objective. Consequently, specific return goals for upcoming periods will be set out in the strategic asset allocations periodically adopted by the Board.

2. Investment Risk and Strategic Asset Allocations

(a) Diversification Among Asset Classes

In controlling the risk level that is appropriate for the Trust, the Board will diversify the assets of the Trust among various asset classes as the Board may from time to time adopt as appropriate asset classes. The specific asset classes to be used will be set in conjunction with the strategic asset allocation adopted from time to time by the Board.

(b) Review of Asset Classes and Asset Allocation

In setting strategic allocations, the Board will focus on assuring that the expected long-term returns will meet expected long-term obligations with the appropriate level of risk sufficient to meet those objectives. The Board will at least once every four years determine the appropriate asset classes for the investment of Trust assets and conduct asset allocation studies to help determine the long term strategic allocations among desired asset classes so as to meet long-term return objectives with the appropriate level of risk.

(c) Content of Strategic Asset Allocations

The strategic asset allocation will set out the asset classes to be used, the long-term strategic "normal" percentage of assets to be invested in each asset class, the short to intermediate term ranges that will be considered allowable temporary deviations from the strategic normal allocation, the investment risk and return expectations for each asset class, the numerical investment return and risk expected to be realized, and the relation of the expected investment return to the real and actuarially assumed investment return.

(d) Strategic Policies

In addition to asset allocation, the Board may from time to time adopt strategic policies. "Strategic policies" are actions by the Board to invest in asset types that have not been singled out as "asset classes" in the asset allocation process, to overweight particular sectors within an asset class, or to employ particular strategies in the investment of Trust assets. The purposes of these actions are either to increase the return above the expected return or to reduce risk. Examples of types of strategic policies include: a tilt towards small capitalization stocks in U.S. equity allocations; a tilt toward mortgage exposures in fixed income; hedging international currency exposures through a currency overlay program, and adding international emerging markets exposure in international equities.

IV. Investment Structure

A. Overall Structure

In making individual investment policy decisions, the Board will have as an overall goal a flexible, simplified structure with clear roles and accountability.

1. Board Ultimately Responsible

The Board is ultimately responsible for all investment activities. In exercising this responsibility, the Board will hire investment personnel and agents and delegate various investment functions to those personnel and agents. Where the Board does not delegate investment powers or duties, the Board will either satisfy itself that it is familiar with such matters, or will retain persons who are familiar with such matters to consult or assist the Board in the exercise of those responsibilities. Where the Board delegates a responsibility, it will be delegated to a person who is familiar with such matters, and the Board will monitor and review the actions of those to whom responsibilities are delegated.

2. General Roles and Responsibilities of Board and Agents

The Board will favor a structure that accommodates a citizen Board and a small staff. The Board and staff will concentrate their activities on:

* Strategic decisions, primarily concerning asset allocation and strategic policies;
* Adjusting the mix between passive and active managers depending on, among other considerations, near-term concerns regarding the U.S. and other capital markets; and
* Delegating and monitoring all other activities, including hiring and monitoring investment managers.

The Board will rely on outside agents, and primarily investment managers, to be responsible for non-strategic decisions. This responsibility includes those investment decisions with shorter-term consequences such as the best near-term securities, regions, asset types, or asset classes.

B. Direct (Non-Delegated) Responsibilities of the Board

1. Specific Responsibilities

The Board will be directly responsible for

* Setting investment policy,
* Determining the investment structure of the Trust,
* Determining the asset classes to be utilized,
* Setting the strategic asset allocation,
* Determining strategic policies;
* Hiring agents to implement the strategic asset allocation;
* Hiring agents to implement strategic policies; and
* Monitoring the compliance of those agents with the investment policies and strategic allocations set by the Board.

2. Delegation and Monitoring of Specific Investment Activities

The Board will normally delegate investment decisions concerning specific securities or assets, or the tactical allocations of assets among asset types, to outside agents. The Board will retain direct responsibility for the monitoring of the activities of those agents through periodic reports from its staff or consultants. The Board may choose to exercise direct investment responsibility if unusual market conditions or other circumstances so indicate.

C. Employees, Consultants, and Advisors to the Board

1. Investment Staff

(a) Duties of Chief Investment Officer and Other Staff

The Board will hire a Chief Investment Officer and such other staff as it considers appropriate who will be generally responsible for the oversight of the investment of Trust assets, and, as part of that overall responsibility, will: (1) supervise, monitor, and evaluate the performance of the investment managers hired by the Board to assure compliance with investment policy and individual guidelines; (2) assist the Board in developing and adjusting investment policy, including reviewing and modifying the asset allocation as conditions warrant; (3) research current market conditions, evaluate new products, and seek out new approaches to improve portfolio return, reduce risk, and reduce costs and fees; (4) work with the consultants, custodians, investment managers, and other agents in the performance of their assigned duties; and (5) assist the Board with education and other efforts to promote good decision making. Except in special circumstances, PERSI staff will not be responsible for the investment, purchase, or sale of specific assets.

(b) Allocation of New Net Contributions

The Chief Investment Officer shall allocate new net contributions to or withdraw net distributions from the system among investment managers in accordance with the strategic and tactical ranges established by the Board in the strategic asset allocation. The Chief Investment Officer shall report to the Board regularly on the allocation of new net contributions or the withdrawal of net distributions.

(c) Tactical Asset Allocation

With prior notice to the Board, the Chief Investment Officer may shift assets among managers (including between passive and active managers) as long as the asset allocation is maintained within the strategic ranges. If conditions do not permit giving prior Board notice, the Chief Investment Officer is authorized to move assets among investment managers within the strategic ranges established by the Board. If such action is taken, the Chief Investment Officer shall notify the Chairman of the Board as soon as is practical either that action is contemplated or has been taken, as circumstances warrant.

(d) Minimum Qualifications of Chief Investment Officer

The Chief Investment Officer shall at least: (a) have a graduate degree in finance, law, business administration, or a related field, or (b) be a Chartered Financial Analyst; or (c) have three or more years experience in the investment of trust assets.

2. Actuaries

The Board will hire an actuary to provide studies that will: (1) determine the long term obligations faced by the System through annual actuarial valuations, (2) set out return objectives or assumptions that will be sufficient to meet those obligations; and (3) provide reviews at least once every four years of the actuarial valuation process, including updating the projections and assumptions in light of the experience of the System. The Board will set its long-term return objectives after considering information provided by those studies.

3. Investment Consultants

The Board will hire a qualified independent consultant, whose relationship does not impose a conflict of interest with the Board or staff, to provide investment performance measurement at least quarterly with the report available to the Board within three months of the quarter end. The report will at least compare actual investment returns of the system -- in total, by each asset class, and for each managed portfolio -- with both the investment objectives of the system and a composite of returns of other institutional investors. The Board may hire other independent investment consultants as needed to assist the Board in the management of its investment activities, including, but not limited to: (1) performing asset allocation studies, and reviewing and recommending modifications of the asset allocation as conditions warrant; (2) assisting in monitoring the investment managers to assure they are in compliance with the investment policy and their individual guidelines; (3) performing manager evaluations and searches as may be necessary; and (4) assisting in the development and adjustment of investment policy. Except for consultants retained solely for purposes of performance measurement, consultants will be fiduciaries of the Trust.

D. Managers or Agents with Delegated Responsibilities

1. Custodian

(a) Responsibilities

The Board will hire custodians and other agents who will be fiduciaries of the Trust and who will assume full responsibility for the safekeeping and accounting of all assets held on behalf of the Trust. Among other duties as may be agreed to, the custodian will be responsible for: (a) the receipt, delivery, and safekeeping of securities; (b) the transfer, exchange, or redelivery of securities; (c) the claiming,

receipt, and deposit of all dividend, interest, and other corporate actions due the Trust; (d) the daily sweep of all uninvested funds into a cash management account or accounts; and, (e) the provision of reports to PERSI upon agreed time intervals that will include all purchases and sales of securities, all dividend declarations on securities held by the Trust, a list of securities held by the Trust, and a cash statement of all transactions for the Trust account.

(b) Authorization of Collective Investment Trusts

Assets of the Trust may be invested in any collective investment trust, which at the time of the investment provides for the pooling of the assets of plans described in Section 401(a) of the Internal Revenue Code of 1986, as amended, and which is exempt from Federal income tax. Assets of the Trust may be commingled with assets of other trusts if invested in any collective investment trust authorized by this policy. The provisions of the trust agreement, as amended by the trustee thereof from time to time, of each collective investment trust in which Trust assets are invested are by this reference incorporated as a part of the trust estate comprising the Trust. The provisions of the collective investment trust will govern any investment of Trust assets in that trust.

2. Investment Managers

The Board will hire investment managers who will be fiduciaries of the Trust and who will be responsible for the investment of Trust assets in specific securities or assets within or among the asset classes.

(a) Minimum Qualifications

Investment managers shall be registered with the Securities and Exchange Commission (unless they are banks, insurance companies, or other category exempted from such registration requirements), have been in the business of investment management at least two years (or the main personnel of the investment management firm have worked together in the business of investment management for at least two years), and, usually, have other United States pension fund assets under management.

(b) Guidelines

Investment Managers shall manage assets in accordance with additional guidelines established by contract and as may be added to or modified from time to time. The additional guidelines will contain minimum diversification requirements that must be followed by that manager. These guidelines will also set out the investment return expected to be achieved by that manager, and shall be linked to a benchmark that represents the passive index fund that would be used to replicate the manager’s assignment.

(c) Responsibilities and Discretion

Subject to the restrictions set out in this policy or as may be set out in individual contracts or guidelines, an investment manager shall have full discretionary power to direct the investment, exchange, and liquidation of the assets entrusted to that manager. The manager shall place orders to buy and sell securities and, by notice to the custodian, cause the custodian to deliver and receive securities on behalf of the Trust.

(d) Corporate Governance

The Board, unless otherwise stated, will delegate the voting of proxies to the investment manager or custodian. The Board will adopt and from time to time modify a proxy voting policy. The staff will review the investment manager’s policies governing the voting of proxies to assure consistency both with the policy of the Board and, to the extent feasible, among the various investment managers.

(e) Transactions and Brokerage

All securities transactions shall be executed by reputable broker/dealers or banks, and shall be on a best price and best execution basis.

3. Use of Passive and Active Managers

(a) Purpose and Use of Active Management

The Board recognizes that passive (index fund) investing has lower costs than active investing, with regard to both management fees and transaction costs. Further, the Board also recognizes that there is uncertainty concerning whether active investing can generally outperform passive investing, particularly in the large, liquid, and efficient portions of the capital markets. Also, the Board has great confidence that a passive investment of assets in an efficient asset allocation will likely meet long-term (20 year) obligations.

Contribution rates, COLAs, and the ability to provide for gain-sharing, however, are based on 1-5 year returns. The Board does have concern that over 1-5 year periods the ability consistently to fund COLAs and to keep contribution rates stable are in considerable jeopardy from two sources: (1) expected "normal" market fluctuations are such that annual returns will likely not meet hurdle rates approximately 40% of the time, with actual negative returns to be expected once every six years; and (2) that most of Trust assets under the strategic asset allocation will be invested in U.S. capital markets, and are thus vulnerable to poor U.S. returns.

One purpose of active management of Trust assets is to address these two concerns. Active managers will be hired for the purpose of providing greater stability of returns, and better returns, than would be achievable under purely passive management over rolling 3-5 year periods. Active managers will be responsible for timing of markets and the tactical allocation of assets among and within the capital markets (including between the U.S. and international markets).

In addition to providing extra returns, active managers will also be employed to smooth returns, provide higher long-term returns, provide protection in adverse markets, and to add exposure and additional diversification to the portfolio than that achievable solely through investment in passive indices representing the strategic asset allocation and strategic policies.

(b) Structure

In using outside managers, the Board will favor a structure using a reasonable number of managers with broad mandates and benchmarks. This preference will be implemented so as to achieve the following goals: to relieve the Board from making timing decisions in allocating assets among numerous specialized managers, to simplify the structure of the fund, and to reduce the number of active managers and thus expenses to the Trust.

Passive managers will be favored for the core, liquid, efficient markets (such as S&P 500 stocks and U.S. Government/Corporate bonds), and active managers will be favored for relatively inefficient markets (such as international emerging markets). Global managers will be used to provide flexibility in reacting to near-term concerns that may arise concerning any particular region or market, particularly the U.S. capital markets, and to provide an appropriate balance between efficient long-term asset allocations (which favor US assets) and near-term allocations (which have a greater preference for international assets) to meet the real (inflation adjusted) return needs of the System. Consequently, actual allocations to international equities in the overall portfolio from time to time may be above that in the strategic asset allocation due to the activities of the global equity managers. The actual exposure to international equities will be maintained within the strategic range unless there is prior review by the Board before those ranges are exceeded.

(c) Balance between Passive and Active Management

The balance between active and passive management will be set from time to time with the following considerations in mind: concentration of active investment efforts where there is the most potential for excess returns, implementation of views concerning the state of the U.S. and international capital markets, and reduction of fees and other costs.

(d) Monitoring Standards

Active managers will be monitored under two standards: First, over rolling 3-5 year periods, managers will be expected to exceed, after fees, the benchmark index that represents the passive alternative to the mandate given the manager, and to rank in the top half of the universe of managers that best fits that manager's mandate. Second, over shorter periods of time, managers will be expected to maintain key personnel, a consistent style, and investment capability. Passive managers will be monitored on their ability to track their benchmark index over both short (1 quarter to one year) and long periods (3 to 5 year). The Board may consider other information it considers relevant, including composite manager indices, in determining whether to retain or terminate managers.

V. Asset Class Policies

A. U.S. Equities

1. Objective

The overall objective of the U.S. equity asset class is to obtain, over time, a return after fees that equals or exceeds the returns of the Russell 3000 Index, both absolutely and on a risk-adjusted basis.

2. Allowable Investments

Managers may invest in stocks that do not pay dividends. Managers may invest in equity securities outside of the Russell 3000 Index. Managers may use derivative securities for purposes of enhancing liquidity, reducing transaction or other costs, or partially hedging an existing exposure in the portfolio.

3. Manager Styles

Managers for this asset class may include index funds, style managers (such as value and growth), "core" managers, and global managers. Global managers are managers who may invest in securities located anywhere in the world, both within and outside of the United States.

4. Benchmarks

The Russell 3000 index will be the benchmark for the passive index funds, core managers, and global managers. Other style or capitalization indices maintained by a qualified organization may be used as the benchmark for style managers. Active U.S. equity managers are expected to exceed, over rolling 3-5 year intervals, the applicable benchmark by 75 basis points annually after fees, and to rank in the top 50^{th} percentile of active managers with similar mandates.

B. International Equities

1. Objective

The overall objective of the International Equity Asset Class is to obtain, over time, a return after fees that equals or exceeds the returns of the Morgan Stanley Capital International Europe, Australia, and Far East (MSCI EAFE) Index (unhedged), or the FT Actuaries World ex U.S. Index, both absolutely and on a risk-adjusted basis.

2. Allowable Investments

Managers may invest in stocks that do not pay dividends. Managers may invest in American Depository Receipts or American Depository Shares. Managers may invest in equity securities of companies or in countries that are not included in the indices. Managers may use derivative securities for purposes of enhancing liquidity, reducing transaction or other costs, or partially hedging an existing exposure in the portfolio. Managers may, at their discretion, hedge the currency exposure of all or part of their portfolios. Managers may not overhedge their portfolio, although proxy hedging for purposes of liquidity and cost savings is allowed.

3. Manager Styles

Managers for this asset class may include index funds, general international managers, regional or specialized managers (such as emerging markets), and global managers. The Board may from time to time hire a currency overlay manager to hedge the currency exposure in those portfolios where managers do not actively or normally consider hedging their exposure.

4. Benchmarks

The MSCI EAFE Index (unhedged), or the FT Actuaries World ex U.S. (unhedged) will be the benchmark for the passive index funds, general international managers, and global managers. Regional or specialized indices (unhedged) maintained by a qualified organization may be used as the benchmark for other active managers. Active international equity managers are expected to exceed, over rolling 3-5 year intervals, the applicable benchmark by 75 basis points annually after fees, and to rank in the top 50th percentile of active managers with similar mandates.

C. Fixed Income

1. Objectives

The overall objective of the Fixed Income Asset Class is to obtain, over time, a return after fees that equals or exceeds the returns of the Lehman Brothers Aggregate Bond Index (Aggregate Bond Index) both absolutely and on a risk-adjusted basis.

The Fixed Income Asset Class shall consist of investments in mortgages and in both dollar and non-dollar fixed income securities. Mortgages shall consist of investments in mortgage backed securities, and direct ownership of commercial mortgages through the Idaho Commercial Mortgage Program.

The objective of the non-mortgage fixed income securities is to obtain, over time, a return after fees that equals or exceeds the returns of the Lehman Brothers Government/Credit Bond Index (Government/Credit Bond Index) on a risk-adjusted basis. The overall objective of the mortgage securities is to obtain, over time, a return after fees that equals or exceeds the returns of the Lehman Brothers Mortgage Index (Mortgage Index) on a risk-adjusted basis.

2. Allowable Investments

Managers may invest in debt securities that do not pay interest. Active managers may invest in securities in companies or countries not included in the indices. Managers may use derivative securities for purposes of enhancing liquidity, reducing transaction or other costs, or partially hedging an existing exposure in the portfolio. Fixed income managers may, at their discretion and to the extent allowed by their contracts and guidelines, use currency forward or futures markets as may be considered appropriate to implement fixed income strategies.

3. Manager Styles

Managers in this asset class may include index funds, domestic bond managers, specialized managers, and global managers.

4. Benchmarks

The Government/Corporate Index or Aggregate Index will be the benchmark for all non-mortgage fixed income managers. The Mortgage Index will be the benchmark for all mortgage managers. The Aggregate Index will be the benchmark for the asset class. Active fixed income managers are expected to exceed, over rolling 3-5 year intervals, the applicable benchmark by 25 basis points annually after fees, and to rank in the top 50th percentile of active managers with similar mandates.

D. Real Estate

1. Objectives

Private equity real estate investments will be considered part of the U.S. Equity asset class. The overall objective of private equity real estate investments is to attain a 6% real rate of return overall, over a long-term holding period, as long as this objective is consistent with maintaining the safety of principal. The 6% real rate of return includes both income and appreciation, is net of investment management fees, and is net of inflation as is measured annually by the Consumer Price Index. Over a short term basis, the objective is to earn a nominal minimum income yield of 6% on each individual investment, or inflation plus 3%, whichever is greater.

2. Allowable Investments

Allowable private equity real estate investments will include open-end and closed-end commingled real estate funds, publicly traded real estate investment trusts, and direct real estate investments originated by selected real estate advisors who structure similar investments with other institutional investors. The real estate asset sector will not include solely debt obligations; in particular, straight mortgage interests will be considered part of the fixed income asset class.

3. Need for Income Component of Return

Upon acquisition, each real estate investment must have as a goal the expectation of production of annual income measured by realized return and not capital appreciation. Thus, a significant proportion of income producing properties and not purely development properties should be the objective of any commingled fund acquired.

4. Protection of the Trust

Investment vehicles should be chosen that will protect the Trust, including provision for investments that do not contain debt or liability with recourse beyond the Trust commitment to the related business entity, provision for inspection and evaluation of environmental hazards prior to the purchase of any property, and the provision of insurance coverage to protect against environmental and natural hazards.

5. Reporting

A comprehensive reporting system for individual investments or funds will be maintained so that poorly performing investments and deficiencies in portfolio diversification can be identified and active portfolio management facilitated. Investment managers shall be required to present opinions of fair market value as part of quarterly and annual reporting requirements, and audited financial statements shall be required at least annually for each investment entity.

E. Alternative Investments

1. Definition and Board Approval

The Board may from time to time authorize the investment of Trust assets in entities or structures that do not fit the asset descriptions listed above. Examples of such investments are venture capital partnerships, private equity, leveraged buy-out funds, private debt, and direct ownership of individual assets such as oil and gas partnerships. These investments shall only be entered into with the specific approval by the Board or a subcommittee given specific delegation by the Board of each investment vehicle, or investment manager.

2. Objectives and Benchmarks

If the alternative investment is an equity investment, the objective for the investment will be to exceed, over time and after fees, the return achieved by the Russell 2000 Index times 1.35. If the alternative investment is a debt investment, then the objective will be to exceed, over time and after fees, the returns achieved by the Lehman Brothers Government/Credit Index plus 3%. It is recognized that these investments will experience greater volatility than the comparable publicly traded securities and indices.

VI. GASB 40 Reporting (Section VI adopted May 26, 2005)

A. Purpose

The Governmental Accounting Standards Board has identified that state and local governments have deposits and investments which are exposed to risks that may result in losses. GASB Statement number 40 (GASB 40) is intended to inform users of the financial statements about the risks that could affect the ability of a government entity to meet its obligations. GASB 40 has identified general deposit and investment risks as credit risk, including concentration of credit risk and custodial credit risk, interest rate risk, and foreign currency risk and requires disclosures of these risks and of policies related to these risks. This portion of the Investment Policy addresses the monitoring and reporting of those risks.

In general, the risks identified in GASB 40, while present, are diminished when the entire portfolio is viewed as whole. For example, interest rate risk experienced by fixed income instruments often react in the exact opposite direction as that experienced by equities. Thus, interest rate exposure as set out in GASB 40 will not reflect the cross-influences of impacts across the broad range of investments that make up the PERSI portfolio. And, in fact, the general underlying measures used in GASB 40 across most of the risks identified (credit, concentration, and interest rate risk in particular) were tools that were developed primarily for portfolios dominated by fixed income investments, and are often only poorly transferred, if at all, to portfolios, like PERSI's, that are dominated by equity interests.

Consequently, it is the policy of PERSI that the risks addressed in GASB 40 are to be monitored and addressed primarily through the guidelines agreed to by those managers, and by regular disclosures in reports by managers of levels of risks that may exceed expected limits for those portfolios.

B. Specific Areas of Risk

1. Credit Risk

Summary: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to PERSI.

Policy: Managers will provide PERSI with expected credit risk exposures in their portfolio guidelines. If the actual credit risk exposure falls outside of these expectations, managers will be required to report these occurrences to Staff and these disclosures are to be made available to the Board.

2. Custodial Credit Risk

Summary: Custodial credit risk is the risk that in the event of a financial institution or bank failure, the System would not be able to recover the value of their deposits and investments that are in the possession of an outside party.

Policy: PERSI minimizes exposure to custodial credit risk by requiring that investments, to the extent possible, be clearly marked as to PERSI ownership and further to the extent possible, be held in the System's name.

3. Concentration of Credit Risk

Summary: Concentration of credit risk is the risk of loss that may be attributed to the magnitude of a government's investment in a single issue.

Policy: Managers will provide PERSI with expected concentration of credit risk exposures in their portfolio guidelines. If the concentration of credit risk exceeds expectations, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board. For the portfolio as a whole, staff will report to the Board at a regular Board meeting if the exposure to a non-US government guaranteed credit exceeds 5% of the total PERSI portfolio.

4. Interest Rate Risk

Summary: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Interest rate risk to PERSI's fixed income portfolio is monitored using the effective duration methodology. Effective duration measures the volatility of the price of a bond given a change in interest rates, taking into account the optionality on the underlying bond.

Policy: Managers will provide PERSI with the expected portfolio duration in their portfolio guidelines. If the duration of the portfolio differs from expectations, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board.

5. Foreign Currency Risk

Summary: Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. PERSI's currency risk exposures, or exchange rate risk, primarily reside within the international equity investment holdings.

Policy: The PERSI Board recognizes that international investments (equity or fixed income) will have a component of currency risk associated with it. Currency risk and hedging exposures are dependent on the underlying international exposure, which fluctuates over time. The individual manager guidelines will outline the expected currency exposures (either specifically or through ranges of security exposures to particular currency areas) of the underlying portfolio and if the actual currency exposure differs from the expected, managers are to be required to report these occurrences to staff and these disclosures are to be made available to the Board.

VII. Asset Allocation

For purposes of asset allocation, alternative equity investments will be treated as part of the U.S. equity asset class, and alternative debt investments will be treated as part of the fixed income asset class.

STRATEGIC ASSET ALLOCATION

Asset Class	Expected Return	Expected Risk	Strategic Normal	Strategic Ranges	Actual Allocation Year Ended June 30, 2006
U.S. Equity	10.4%	19%	54%	44% - 57%	56.2%
International Equity	11.0%	22%	15%	12% - 25%	15.7%
Total Equities			69%	66% - 75%	71.9%
Fixed Income	6.6%	7%	30%	27% - 33%	27.8%
Cash	4.0%	1%	1%	0% - 5%	0.3%

Total Fund	Expected Return	Expected Inflation	Expected Real Return	Expected Risk
Actuary	7.75%	3.75%	4.00%	n/a
Portfolio	8.50%	3.50%	5.00%	11.70%