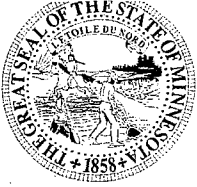


MINNESOTA  
STATE  
BOARD OF  
INVESTMENT

05 - 0090



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DATE: January 21, 2005

TO: The Honorable Tim Pawlenty  
Members of the Minnesota Legislature

FROM: Howard J. Bicker, Executive Director 

SUBJECT: External Money Manager Report Pursuant to Minnesota  
Statutes Section 11A.04, clause (12)

*Minnesota Statutes*, Section 11A.04, clause (12) requires the State Board of Investment (SBI) to report annually to the Governor and Legislature the cost and investment performance of external investment managers employed by the Board.

On June 30, 2004, the SBI utilized 28 domestic stock managers, 10 international stock managers and 8 bond managers for the retirement assets under its control. As a matter of policy, the SBI allocates approximately one third of domestic stock to active management, one third to semi-passive management and one third to passive management. As a matter of policy, the SBI allocates approximately two thirds of international stock assets to active management and approximately one third to passive management; and, approximately one half of all bonds to active management and one half to semi-passive management. The investment performance of each manager, as well as the fees paid to each, are reported in the charts on the following pages. This information is also included in the Board's annual report for FY04. Please note that the SBI terminated six domestic stock managers, and one international manager in FY04.

Nine (9) firms in the Emerging Manager Program are included in the total number of domestic stock managers referenced above. This program is designed to seek out newer or younger firms with limited assets under management. As a group, the Emerging Managers account for about five percent of the total domestic stock assets under the control of the SBI.

It is important to note that all performance data reported by the SBI is *net* of fees and transactions costs associated with the various portfolios. The SBI's FY 2004 Annual Report contains additional detail on manager performance and may be accessed online at [www.sbi.state.mn.us](http://www.sbi.state.mn.us).

**Domestic Stock Managers**

The SBI evaluates domestic stock manager returns against the performance of Russell style indices which reflect the managers' specific investment approaches. The benchmark portfolios take into account the market forces that at times favorably or unfavorably impact certain investment styles. The aggregate domestic stock program is designed to outperform the Russell 3000 Index. Assets are allocated to managers within each Russell style index in the same proportion as in the Russell 3000 Index.

As a group, the managers underperformed the broad market by 0.3 percentage point for the fiscal year. The performance of individual domestic common stock managers for FY 2003 was mixed. Eleven active managers outperformed their benchmarks, while thirteen underperformed. One semi-passive manager outperformed, one matched the benchmark, and one underperformed the benchmark. The passive manager slightly trailed the Russell 3000 benchmark.

**International Stock Managers**

The SBI evaluates international stock managers against market indices published by Morgan Stanley Capital International (MSCI). Two indices are used: the World ex U.S. (net) and the Emerging Markets Free (EMF). As a group, the international stock managers underperformed the MSCI Country World Index (ACWI) ex U.S. (net) index by 1.2 percentage points for the fiscal year. Five of the six EAFE managers underperformed the index; three of four emerging markets managers outperformed EMF. The passive manager outperformed the MSCI World ex U.S. index by 0.1 percentage point.

**Bond Managers**

The SBI evaluates the performance of its bond managers against the Lehman Brothers Aggregate bond index. All five active managers exceeded the benchmark. All three semi-passive bond managers outperformed the index for the year. As a group, the bond managers outperformed the broad bond market by 1.2 percentage point for the year.

Figure 16. Domestic Stock Manager Performance FY 2004

	Actual Return	Benchmark Return
<b>Active Managers</b>		
<b>Large Cap Core (Russell 1000)</b>		
Franklin Portfolio Associates	21.1%	20.6%
New Amsterdam Partners	24.5	23.0
UBS Global Asset Management	19.2	19.6
Voyageur-Chicago Equity (Emerging)	18.3	19.5
<b>Large Cap Growth (Russell 1000 Growth)</b>		
Alliance Capital Management	11.9	17.3
Cohen Klingenstein & Marks	15.1	19.1
Holt-Smith & Yates (Emerging)	14.3	19.6
Zevenbergen Capital (Emerging)	26.7	19.0
<b>Large Cap Value (Russell 1000 Value)</b>		
Barrow, Hanley*	2.7	0.9
Bay Isle Financial (Emerging)	18.0	22.1
Earnest Partners (Emerging)	23.9	25.1
Lord Abbett & Co.*	1.7	0.9
LSV Asset Mgmt.*	2.0	0.9
Oppenheimer Capital	21.0	20.8
Systematic Financial Mgmt.*	1.2	0.9
<b>Small Cap Growth (Russell 2000 Growth)</b>		
McKinley Capital**	4.0	5.7
Next Century Growth (Emerging)	29.0	30.5
Turner Investment Partners**	4.6	5.7
Winslow-Small Cap (Emerging)	23.2	31.5
<b>Small Cap Value (Russell 2000 Value)</b>		
AEAM/Kenwood (Emerging)**	10.6	7.8
Goldman Sachs**	5.2	7.8
Hotchkis & Wiley**	11.0	7.8
Martingale Asset Mgmt.**	12.3	7.8
Peregrine Capital Mgmt. (Emerging)**	35.2	35.6
<b>Semi-Passive Managers (Russell 1000)</b>		
Barclays Global Investors	20.2	19.5
Franklin Portfolio Associates	19.1	19.5
J.P. Morgan Investment Mgmt.	19.5	19.5
<b>Passive Manager (Russell 3000)</b>		
Barclays Global Investors	20.5	20.6
<b>Historical Aggregate</b>	20.3	20.5
<b>SBI Domestic Equity Asset Class Target</b>		20.6

\* Manager was retained April 1, 2004.

\*\* Manager was retained January 1, 2004.

Figure 18. Bond Manager Performance FY 2004

	<b>Actual Return</b>	<b>Benchmark Return</b>
<b>Active Managers</b>		
American Express Asset Mgmt.	0.5%	0.3%
Deutsche Asset Mgmt.	1.0	0.3
Dodge & Cox Investment Mgmt.	2.0	0.3
Morgan Stanley Investment Mgmt.	2.6	0.3
Western Asset Mgmt.	3.8	0.3
<b>Semi-Passive Managers</b>		
BlackRock Financial Mgmt.	0.5	0.3
Goldman Sachs Asset Mgmt.	1.5	0.3
Lincoln Capital Mgmt.	0.6	0.3
<b>Aggregate Bond Pool</b>	<b>1.5</b>	<b>0.3</b>
<b>Asset Class Target</b>		
Lehman Aggregate	0.3	

Figure 20. International Manager Performance FY 2004

	<b>Actual Return</b>	<b>Benchmark</b>
<b>Active Managers: Developed Markets</b>		
American Express Asset Mgmt.	24.8%	32.0%
Britannic Capital Mgmt.	30.3	32.0
Invesco Global Asset Mgmt.	31.2	32.0
Marathon Asset Mgmt.*	41.2	35.3
T. Rowe Price International, Inc.	21.6	32.0
UBS Global Asset Mgmt.	28.7	32.0
<b>Active Managers: Emerging Markets</b>		
Alliance Capital Mgmt.	34.0	33.1
Capital International	28.7	33.1
Morgan Stanley Investment Mgmt.	33.4	33.1
<b>Passive EAFE Manager</b>		
State Street Global Advisors	32.1	32.0
<b>Aggregate International Pool</b>	<b>30.9</b>	
<b>Asset Class Target**</b>	<b>32.1</b>	

\* Marathon's performance was measured against a custom benchmark through 9/30/03 and against the MSCI World ex U.S. index (net) beginning 10/1/03.

\*\* The asset class target was comprised of the EAFE Free and Emerging Markets Free (EMF) index through 9/30/03 and the MSCI All Country World Index (ACWI) ex U.S. beginning 10/1/03. The weighting of each index fluctuates with changes in market capitalization.