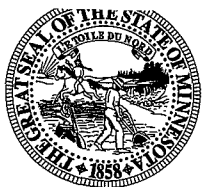


MINNESOTA  
STATE  
BOARD OF  
INVESTMENT

DATE: January 13, 2009

09 - 0098



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)**

**Board Members:**

Governor  
Tim Pawlenty

State Auditor  
Rebecca Otto

Secretary of State  
Mark Ritchie

Attorney General  
Lori Swanson

**Executive Director:**

Howard J. Bicker

*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, 2008, the SBI utilized 28 domestic stock managers, 15 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; and approximately one half of all bonds to active management and one half to semi-passive management. As a matter of policy, the SBI allocated approximately 54 percent of international stock assets to active management, approximately one-third to passive management, and about 12 percent 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 FY08. Please note that the SBI stopped using the services of one domestic stock manager during the fiscal year.

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 2008 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).

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### **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 0.4 percentage point for the fiscal year. The active and semi-passive components underperformed the respective benchmark. Eleven active managers outperformed; thirteen active managers underperformed. The three semi-passive managers underperformed. The passive manager outperformed by 0.1 percentage point 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 outperformed the MSCI Country World Index (ACWI) ex U.S. (net) index by 0.7 percentage point for the fiscal year. Four of the eight EAFE managers outperformed the index; one of the three emerging markets managers matched the EMF. One of the three semi-passive EAFE managers outperformed the benchmark. The passive manager outperformed the MSCI World ex U.S. index by 0.4 percentage point.

### **Bond Managers**

The SBI evaluates the performance of its bond managers against the Lehman Brothers Aggregate bond index. In a most challenging market environment, every manager underperformed the index for the year. As a group, the bond managers underperformed the broad bond market by 2.8 percentage points for the year.

**Figure 16. Domestic Stock Manager Performance FY 2008**

	<b>Actual Return</b>	<b>Benchmark Return</b>
<b><u>Active Managers</u></b>		
<b>Large Cap Core (Russell 1000)</b>		
Franklin Portfolio Associates	-13.6%	-12.4%
New Amsterdam Partners	-12.8	-12.4
UBS Global Asset Management	-18.9	-12.4
<b>Large Cap Growth (Russell 1000 Growth)</b>		
AllianceBernstein L.P.	-3.6	-6.0
INTECH	-6.9	-6.0
Jacobs Levy Equity Mgmt.	-9.6	-6.0
Lazard Asset Mgmt.	-4.5	-6.0
Sands Capital Mgmt.	-0.6	-6.0
Voyageur-Chicago Equity	-7.4	-6.0
Winslow Capital Mgmt.	3.5	-6.0
Zevenbergen Capital	-5.0	-6.0
<b>Large Cap Value (Russell 1000 Value)</b>		
Barrow, Hanley	-19.6	-18.8
Earnest Partners	-17.1	-18.8
Lord Abbett & Co.	-15.0	-18.8
LSV Asset Mgmt.	-22.0	-18.8
Systematic Financial Mgmt.	-14.4	-18.8
<b>Small Cap Growth (Russell 2000 Growth)</b>		
McKinley Capital	-14.0	-10.8
Next Century Growth	-1.3	-10.8
Turner Investment Partners	-6.4	-10.8
<b>Small Cap Value (Russell 2000 Value)</b>		
Goldman Sachs	-15.7	-21.6
Hotchkis & Wiley	-29.2	-21.6
Martingale Asset Mgmt.	-24.4	-21.6
Peregrine Capital Mgmt.	-30.0	-21.6
RiverSource/Kenwood	-25.0	-21.6
<b><u>Semi-Passive Managers (Russell 1000)</u></b>		
Barclays Global Investors	-13.3	-12.4
Franklin Portfolio Associates	-13.9	-12.4
J.P. Morgan Investment Mgmt.	-13.4	-12.4
<b><u>Passive Manager (Russell 3000)</u></b>		
Barclays Global Investors	-12.6	-12.7
<b>Historical Aggregate</b>	-13.1	-12.7
<b>SBI Domestic Equity Asset Class Target</b>		
Russell 3000		-12.7

**Note:** Cohen Klingenstein & Marks had all assets removed in June pending a recommendation for termination at the September Board meeting.

**Figure 18. Bond Manager Performance FY 2008**

	<b>Actual Return</b>	<b>Benchmark Return</b>
<b>Active Managers</b>		
Aberdeen Asset Mgmt.	3.0%	7.1%
Dodge & Cox Investment Mgmt.	4.5	7.1
Morgan Stanley Investment Mgmt.	-2.1	7.1
RiverSource Investments	5.3	7.1
Western Asset Mgmt.	3.0	7.1
<b>Semi-Passive Managers</b>		
BlackRock Financial Mgmt.	6.5	7.1
Goldman Sachs Asset Mgmt.	5.8	7.1
Lehman Brothers Asset Mgmt.	4.8	7.1
<b>Aggregate Bond Pool</b>	<b>4.3</b>	<b>7.1</b>
<b>Asset Class Target</b>		
Lehman Aggregate		7.1

**Figure 20. International Manager Performance FY 2008**

	<b>Actual Return</b>	<b>Benchmark</b>
<b>Active Managers: Developed Markets</b>		
Acadian Asset Management	-13.5%	-8.6%
Invesco Global Asset Mgmt.	-13.7	-8.6
J.P. Morgan Investment Mgmt. Co.	-10.7	-8.6
Marathon Asset Management	-5.8	-8.6
McKinley Capital Management	-5.6	-8.6
Pyramis Global Advisors Trust Co.	-2.7	-8.6
RiverSource Investments, LLC	-6.9	-8.6
UBS Global Asset Management	-14.3	-8.6
<b>Semi-Passive Managers: Developed Markets</b>		
AQR Capital Management	-11.1	-8.6
Pyramis Global Advisors Trust Co.	-3.5	-8.6
State Street Global Advisors	-10.9	-8.6
<b>Active Managers: Emerging Markets</b>		
AllianceBernstein L.P.	5.3	5.3
Capital International, Inc.	3.4	5.3
Morgan Stanley Investment Mgmt.	2.4	5.3
<b>Passive EAFE Manager: Developed Markets</b>		
State Street Global Advisors	-8.2	-8.6
<b>Aggregate International Pool</b>	<b>-6.6</b>	<b>-6.4</b>
<b>Asset Class Target</b>		
MSCI ACWI ex U.S. (net)		-6.4

## External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2008

### Active Domestic Stock Managers

Alliance Bernstein L.P.	\$	901,125
Barrow, Hanley, Mewhinney & Stauss, Inc.		989,819
Cohen, Klingenstein & Marks, Inc.		421,585
EARNEST Partners, LLC		501,757
Enhanced Investment Technologies, LLC		1,248,141
Franklin Portfolio Associates, LLC		586,454
Goldman Sachs Asset Management, LP		1,046,784
Hotchkis and Wiley Capital Management, LLC		750,751
Jacobs Levy Equity Management, Inc.		1,139,253
Lazard Asset Management Group, LLC		343,350
Lord, Abbet,t & Co., LLC		786,053
LVS Asset Management		1,390,252
Martingale Asset Management L.P.		764,064
McKinley Capital Management Inc.		1,318,353
New Amsterdam Partners, LLC		839,659
Next Century Growth Investors, LLC		2,275,107
Peregrine Capital Management		1,276,239
RiverSource Investments		380,603
Sands Capital Management, LLC		701,845
Systematic Financial Management, LP		1,050,048
Turner Investment Partners, Inc.		1,630,114
UBS Global Asset Management (Americas) Inc.		1,175,178
Voyageur Asset Management, Inc.		273,765
Winslow Capital Management, Inc. (Large Cap.)		594,921
Zevenbergen Capital Investments, LLC		1,323,759

### Passive Domestic Stock Managers

Barclays Global Investors		851,738
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### Semi-Passive Domestic Stock Managers

Barclays Global Investors, N.A.		3,419,686
Franklin Portfolio Associates, LLC		2,255,584
JPMorgan Investment Management, Inc.		2,716,441

### Active Domestic Bond Managers (2)

Aberdeen Asset Management (Deutsche)		1,863,559
Dodge & Cox		1,267,409
Morgan Stanley		1,407,788
RiverSource Investments (American Express)		1,038,800
Western Asset Management		1,448,222

cont.

## External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2008

Semi-Passive Domestic Bond Managers (2)		
BlackRock Inc.	\$	1,111,298
Goldman Sachs		1,515,348
Lehman Brothers Asset Management, LLC (Lincoln)		670,571
Developed-International Active Stock Managers		
Acadian Asset Management		1,407,673
Invesco Global Asset Management		973,025
JP Morgan Flemming		1,197,376
Marathon Asset Management		1,870,128
McKinley Capital Management		1,408,449
Pyramis Global Advisors Trust Co.- Active (Fidelity)		878,833
RiverSource Investments(American Express )		969,880
UBS Global Asset Management (Brinson)		901,362
Developed-International Semi-Passive Stock Managers		
AQR Capital Management		1,607,700
Pyramis Global Advisors Trust Co. - Semi Passive (Fidelity)		1,181,173
State Street Global Advisors - Semi Passive		1,410,401
Developed-International Passive Stock Managers		
State Street Global Advisors - Passive		461,480
Emerging-International Active Stock Managers		
Alliance Bernstein L.P.		2,429,635
Capital International		3,711,921
Morgan Stanley Investment Management		3,918,559
Assigned Risk Plan		
GE Investment Management		231,945
Voyager Asset Management		264,118

(1) Most active stock managers, with the exception of those managing small portfolios, are compensated on a performance-based fee formula. Four fee options are available and fees earned range from zero to twice the manager's base fee, depending on the manager's performance relative to an established benchmark.

(2) Active bond managers and semi-passive bond managers are compensated based on a specified percentage of assets under management.