

MINNESOTA
STATE
BOARD OF
INVESTMENT



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Governor
Mark Dayton

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Rebecca Otto

Secretary of State
Mark Ritchie

Attorney General
Lori Swanson

Executive Director:

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DATE: January 18, 2011

TO: The Honorable Mark Dayton
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, 2010, the SBI utilized 26 domestic stock managers, 14 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 half of international stock assets to active management, approximately 40 percent to passive management, and about 10 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 FY10. Please note that the SBI stopped using the services of two domestic stock managers during the fiscal year. The SBI retained one additional semi-passive domestic equity manager.

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 2010 Annual Report contains additional detail on manager performance and may be accessed online at 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 outperformed the broad market by 0.1 percentage point for the fiscal year. The active and semi-passive components outperformed the respective benchmark. Thirteen of twenty-one active managers outperformed. Of the semi-passive managers that were funded over the full fiscal year, two outperformed and one underperformed. The passive manager had positive tracking error to 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 1.3 percentage points for the fiscal year. Five of the seven EAFE managers outperformed the index; two of the three emerging markets managers outperformed the EMF. Two of the three semi-passive EAFE managers outperformed the benchmark. The passive manager had positive tracking error of 0.1 percentage point to the MSCI World ex U.S. index.

Bond Managers

The SBI evaluates the performance of its bond managers against the Barclays Capital Aggregate bond index. As a group, the bond managers outperformed the broad bond market by 5.0 percentage points for the year. All five active managers and all three semi-passive managers outperformed the benchmark.

Figure 10. Domestic Stock Manager Performance

	1 Year		3 Years		5 Years		Market Value (in millions)
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	
Active Managers							
Large Cap Core (Russell 1000)							
New Amsterdam Partners	7.2	15.2	-10.7	-9.5	-2.6	-0.6	294.8
UBS Global Asset Management	15.8	15.2	-11.0	-9.5	-1.1	-0.6	293.7
Large Cap Growth (Russell 1000 Growth)							
AllianceBernstein L.P.	10.3	13.6	-7.8	-6.9	-0.8	0.4	229.2
INTECH	16.3	13.6	-8.6	-6.9	-1.3	0.4	261.7
Jacobs Levy Equity Mgmt.	16.0	13.6	-9.6	-6.9	-2.4	0.4	230.9
Knelman Asset Mgmt.	10.5	13.6	-8.6	-6.9	-0.1	0.4	48.7
Sands Capital Mgmt.	25.9	13.6	-2.6	-6.9	1.1	0.4	206.1
Winslow Capital Mgmt.	11.8	13.6	-5.3	-6.9	2.3	0.4	105.5
Zevenbergen Capital	20.4	13.6	-3.5	-6.9	4.3	0.4	249.7
Large Cap Value (Russell 1000 Value)							
Barrow, Hanley	12.2	16.9	-12.2	-12.3	-2.6	-1.6	348.5
Earnest Partners	15.3	16.9	-10.0	-12.3	-0.6	-1.6	149.5
Lord Abbett & Co.	13.9	16.9	-10.4	-12.3	-0.8	-1.6	255.6
LSV Asset Mgmt.	17.6	16.9	-13.0	-12.3	-1.4	-1.6	333.2
Systematic Financial Mgmt.	17.2	16.9	-12.3	-12.3	-1.4	-1.6	241.5
Small Cap Growth (Russell 2000 Growth)							
McKinley Capital	20.1	18.0	-14.0	-7.5	-2.7	1.1	165.2
Next Century Growth	19.2	18.0	-9.2	-7.5	2.9	1.1	202.0
Turner Investment Partners	18.5	18.0	-7.4	-7.5	2.1	1.1	207.7
Small Cap Value (Russell 2000 Value)							
Goldman Sachs	26.7	25.1	-5.7	-9.8	2.1	-0.5	122.2
Hotchkis & Wiley	47.1	25.1	-10.4	-9.8	-2.9	-0.5	106.0
Martingale Asset Mgmt.	20.7	25.1	-14.0	-9.8	-5.4	-0.5	96.2
Peregrine Capital Mgmt.	32.9	25.1	-10.2	-9.8	-1.5	-0.5	171.5
Semi-Passive Managers (Russell 1000)							
BlackRock Institutional	13.1	15.2	-10.8	-9.5	-1.4	-0.6	2,086.4
INTECH							885.9
J.P. Morgan Investment Mgmt.	16.6	15.2	-8.6	-9.5	0.0	-0.6	2,349.0
Mellon Capital Mgmt.	13.8	15.2	-10.8	-9.5	-1.6	-0.6	1,101.1
Passive Manager (Russell 3000)							
BlackRock Institutional	16.1	15.7	-9.3	-9.5	-0.4	-0.5	6,803.3
Aggregate Domestic Stock Pool (1)							
	15.8	15.7	-9.7	-9.5	-0.8	-0.5	17,545.2
Asset Class Target							
Russell 3000		15.7		-9.5		-0.5	

(1) Aggregate represents Combined Funds performance and includes the performance of terminated managers.

Figure 13. Bond Manager Performance

	1 Year		3 Years		5 Years		Market Value (in millions)
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	
Active Managers							
Aberdeen Asset Mgmt.	17.8	9.5	4.3	7.5	3.7	5.5	858.1
Columbia Mgmt.	12.4	9.5	6.4	7.5	5.1	5.5	917.9
Dodge & Cox Investment Mgmt.	13.5	9.5	8.2	7.5	6.4	5.5	1,029.3
PIMCO	17.1	9.5					1,025.4
Western Asset Mgmt.	16.7	9.5	7.0	7.5	5.5	5.5	1,193.2
Semi-Passive Managers							
BlackRock Financial Mgmt.	11.5	9.5	6.6	7.5	5.0	5.5	1,716.8
Goldman Sachs Asset Mgmt.	12.9	9.5	7.5	7.5	5.6	5.5	1,752.3
Neuberger Investment Mgmt.	15.4	9.5	8.0	7.5	5.8	5.5	1,696.3
Aggregate Bond Pool (1)	14.5	9.5	7.0	7.5	5.4	5.5	10,189.4
Asset Class Target							
Barclays Capital Aggregate		9.5		7.5		5.5	

(1) Aggregate represents Combined Funds performance and includes the performance of terminated managers.

Figure 14.

Bond Pool Sector Weights*
As of June 30, 2010

	Active Managers %	Semi-Passive Managers %	Aggregate Bond Pool %	Barclays Capital Benchmark %
Governments	23.1	28.8	25.9	42.3
Corporates	29.9	20.0	24.6	20.1
Mortgages	33.0	39.4	36.2	37.2
ABS	2.5	2.4	2.5	0.3
Miscellaneous	0.9	1.8	1.3	0.4
International**	6.9	6.4	6.6	5.6
High Yield	5.4	0.2	2.8	0.0
Cash	5.6	4.0	4.8	0.0

* May not equal 100% due to rounding and some bonds being included in more than one category.

** Includes Non-dollar denominated bonds as well as dollar-denominated Yankee bonds.

Portfolio Characteristics
As of June 30, 2010

	Active Managers %	Semi-Passive Managers %	Aggregate Bond Pool %	Barclays Capital Benchmark %
Average Quality	AA+	AAA	AA+	AAA
Average Coupon	4.55	4.21	4.38	4.46
Average Yield to Maturity	3.77	3.17	3.47	2.75
Effective Duration***	4.62	4.62	4.62	4.32
Weighted Average Life****	6.8 Yrs.	6.4 Yrs.	6.6 Yrs.	6.0 Yrs.

*** Measures the interest rate sensitivity of a bond. It is the approximation of the percentage price change of the bond per 100 bp increase or decrease in prevailing market interest rates. Effective duration takes into consideration how the cash flows of the bonds change when interest rates change. This measure is most appropriate for bonds (and portfolios) with optionality, such as callable bonds and mortgage bonds.

**** The weighted average life (WAL) of a bond is the average number of years for which each dollar of unpaid principal of a bond remains outstanding. Once calculated, WAL tells how many years it will take to pay half of the outstanding principal.

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2010

Active Domestic Stock Managers

Alliance Bernstein L.P.	\$	246,423
Barrow, Hanley, Mewhinney & Stauss, Inc.		754,427
EARNEST Partners, LLC		440,184
Mellon Capital Management Corp. (Franklin) *		-644,888
Goldman Sachs Asset Management, LP		942,895
Hotchkis and Wiley Capital Management, LLC		760,964
INTECH Investment Management, LLC (Enhanced InvTec)		923,544
Jacobs Levy Equity Management, Inc.		856,660
Knelman Asset Management Group, LLC (Lazard)		294,654
Lord, Abnett & Co., LLC		630,073
LSV Asset Management		887,076
Martingale Asset Management L.P.		520,707
McKinley Capital Management Inc.		838,567
New Amsterdam Partners, LLC		189,434
Next Century Growth Investors, LLC		1,746,464
Peregrine Capital Management		1,120,323
RiverSource Investments *		4,769
Sands Capital Management, LLC		745,434
Systematic Financial Management, LP		831,535
Turner Investment Partners, Inc.		1,330,879
UBS Global Asset Management (Americas) Inc.		585,493
Winslow Capital Management, Inc. (Large Cap.)		509,171
Zevenbergen Capital Investments, LLC		1,373,780

Passive Domestic Stock Managers

Black Rock Institutional Trust Co. N.A.		840,177
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Semi-Passive Domestic Stock Managers

Black Rock Institutional Trust Co. N.A.		2,780,412
INTECH Investment Management, LLC (Enhanced InvTec)		277,189
Mellon Capital Management Corp. (Franklin)		1,761,441
JPMorgan Investment Management, Inc.		2,492,531

Active Domestic Bond Managers (2)

Aberdeen Asset Management (Deutsche)		1,482,752
Dodge & Cox		1,019,825
Morgan Stanley		0
PIMCO		2,036,064
Columbia Management Investment Advisers, LLC		858,322
Western Asset Management		1,277,071

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2010

Semi-Passive Domestic Bond Managers (2)

BlackRock Inc.	\$	923,194
Goldman Sachs		1,180,230
Lehman Brothers Asset Management, LLC (Lincoln)		545,115

Developed-International Active Stock Managers

Acadian Asset Management		1,290,488
Invesco Global Asset Management		863,379
JP Morgan Investment Management Co.		965,874
Marathon Asset Management		1,575,235
McKinley Capital Management		931,024
Pyramis Global Advisors Trust Co.- Active (Fidelity)		860,880
Columbia Management Investment Advisers, LLC		757,440

Developed-International Semi-Passive Stock Managers

AQR Capital Management		1,278,045
Pyramis Global Advisors Trust Co. - Semi Passive (Fidelity)		911,822
State Street Global Advisors - Semi Passive		1,087,869

Developed-International Passive Stock Managers

State Street Global Advisors - Passive		436,408
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Emerging-International Active Stock Managers

AllianceBernstein L.P.		1,150,255
Capital International		4,900,560
Morgan Stanley Investment Management		5,257,189

Assigned Risk Plan

GE Investment Management		171,163
RBC Global Asset Management		255,326

* Manager Terminated in Fiscal '10

- (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.