

**MINNESOTA
STATE
BOARD OF
INVESTMENT**



Board Members:

Governor
Mark Dayton

State Auditor
Rebecca Otto

Secretary of State
Mark Ritchie

Attorney General
Lori Swanson

Executive Director:

Howard J. Bicker

60 Empire Drive
Suite 355
St. Paul, MN 55103
(651) 296-3328
FAX (651) 296-9572
E-mail:

minn.sbi@state.mn.us
www.sbi.state.mn.us

An Equal Opportunity
Employer

DATE: January 24, 2013

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, 2012, the SBI utilized 24 domestic stock managers, 14 international stock managers and 8 bond managers for the retirement assets under its control.

The investment performances 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 FY12. Please note that the SBI stopped using the services of one international 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 2012 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 underperformed the broad market by 0.7 percentage point for the fiscal year. The active manager group trailed its respective benchmark while the semi-passive manager group outperformed its respective benchmark. Seventeen of 19 active managers underperformed and two managers outperformed their benchmarks. Three semi-passive managers outperformed the

Russell 1000 benchmark and one matched the benchmark. The passive manager had positive tracking error for the year.

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 0.3 percentage points for the year. For FY 2012, three active managers outperformed the benchmark return while two managers underperformed. All three semi-passive managers outperformed the benchmark.

International Stock Managers

The SBI evaluates individual 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 Net. As a group, the international stock managers underperformed the MSCI Country World Index (ACWI) ex U.S. (net) index by 0.1 percentage point for the fiscal year. Five of the seven active developed markets managers outperformed their respective benchmarks for the year. One active emerging market manager outperformed and one underperformed the MSCI Emerging Markets benchmark for the year. One semi-passive developed markets manager outperformed and two underperformed the benchmark for the year. The passive manager had positive tracking error of 0.2 percentage point to the MSCI World ex U.S. index.

Figure 10. Domestic Stock Manager Performance For Period Ending June 30, 2012

	1 Year		3 Years		5 Years		Market Value
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	(in millions)
Active Managers							
Large Cap Core (Russell 1000)							
New Amsterdam Partners	-5.1	4.4	11.5	16.6	-1.6	0.4	381.4
UBS Global Asset Management	-0.6	4.4	13.6	16.6	-2.2	0.4	372.2
Large Cap Growth (Russell 1000 Growth)							
INTECH	4.0	5.8	18.4	17.5	1.8	2.9	373.5
Jacobs Levy Equity Mgmt.	4.6	5.8	19.5	17.5	1.7	2.9	340.0
Knelman Asset Mgmt.	0.6	5.8	15.4	17.5	1.2	2.9	67.6
Sands Capital Mgmt.	10.0	5.8	26.5	17.5	8.2	2.9	331.4
Winslow Capital Mgmt.	0.8	5.8	16.4	17.5	3.7	2.9	148.9
Zevenbergen Capital	-11.7	5.8	14.7	17.5	2.4	2.9	312.7
Large Cap Value (Russell 1000 Value)							
Barrow, Hanley	0.5	3.0	14.6	15.8	-1.9	-2.2	467.9
Earnest Partners	0.2	3.0	14.2	15.8	-1.2	-2.2	193.3
LSV Asset Mgmt.	-0.7	3.0	14.8	15.8	-3.3	-2.2	428.3
Systematic Financial Mgmt.	-5.1	3.0	14.5	15.8	-2.9	-2.2	308.9
Small Cap Growth (Russell 2000 Growth)							
McKinley Capital	-4.9	-2.7	17.6	18.1	-3.0	2.0	223.6
Next Century Growth	-6.8	-2.7	18.3	18.1	0.8	2.0	280.7
Turner Investment Partners	-8.3	-2.7	16.8	18.1	1.3	2.0	279.3
Small Cap Value (Russell 2000 Value)							
Goldman Sachs	1.2	-1.4	20.3	17.4	2.9	-1.0	168.1
Hotchkis & Wiley	-4.1	-1.4	25.8	17.4	-0.5	-1.0	143.5
Martingale Asset Mgmt.	-2.1	-1.4	17.0	17.4	-3.3	-1.0	127.7
Peregrine Capital Mgmt.	-1.5	-1.4	20.9	17.4	-0.7	-1.0	227.9
Semi-Passive Managers (Russell 1000)							
BlackRock Institutional	6.3	4.4	16.6	16.6	-0.1	0.4	2,384.4
INTECH	4.4	4.4					1,715.2
J.P. Morgan Investment Mgmt.	4.8	4.4	17.3	16.6	1.1	0.4	2,827.7
Mellon Capital Mgmt.	7.3	4.4	17.3	16.6	0.1	0.4	1,795.2
Passive Manager (Russell 3000)							
BlackRock Institutional	3.9	3.8	16.8	16.7	0.5	0.4	8,064.0
Aggregate Domestic Stock Pool (1)							
	3.1	3.8	16.7	16.7	0.2	0.4	21,963.4
Asset Class Target							
Russell 3000		3.8		16.7		0.4	

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

Figure 13. Bond Manager Performance For Period Ending June 30, 2012

	1 Year		3 Years		5 Years		Market
	Actual	Bmk	Actual	Bmk	Actual	Bmk	Value
	%	%	%	%	%	%	(in millions)
Active Managers							
Aberdeen Asset Mgmt.	8.7	7.5	10.9	6.9	5.6	6.8	833.5
Columbia Mgmt.	8.7	7.5	8.9	6.9	6.7	6.8	947.8
Dodge & Cox Investment Mgmt.	6.2	7.5	8.6	6.9	7.5	6.8	1,109.3
PIMCO	6.5	7.5	10.0	6.9			1,216.0
Western Asset Mgmt.	8.2	7.5	10.4	6.9	7.2	6.8	1,263.1
Semi-Passive Managers							
BlackRock Financial Mgmt.	7.9	7.5	7.8	6.9	6.3	6.8	1,707.0
Goldman Sachs Asset Mgmt.	8.3	7.5	8.6	6.9	7.1	6.8	1,835.3
Neuberger Investment Mgmt.	7.8	7.5	9.4	6.9	7.4	6.8	1,821.3
Aggregate Bond Pool (1)	7.8	7.5	9.2	6.9	6.8	6.8	10,733.3
Asset Class Target							
Barclays Capital Aggregate		7.5		6.9		6.8	

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

Figure 16. International Manager Performance For Period Ending June 30, 2012

	1 Year		3 Years		5 Years		Market Value
	Actual	Bmk	Actual	Bmk	Actual	Bmk	(in millions)
	%	%	%	%	%	%	
Active Managers							
Developed Mkts (MSCI World ex U.S. net) (1)							
Acadian Asset Mgmt.	-15.2	-14.1	7.3	6.2	-9.0	-5.6	256.2
Columbia Mgmt. Investment Advisers, LLC	-11.6	-14.1	8.7	6.2	-3.5	-5.6	256.7
Invesco Global Asset Mgmt.	-16.9	-14.1	3.5	6.2	-6.2	-5.6	202.6
J.P. Morgan Investment Mgmt. Co.	-12.7	-14.1	7.7	6.2	-4.4	-5.6	223.6
Marathon Asset Management	-10.2	-14.1	8.8	6.2	-2.3	-5.6	521.2
McKinley Capital Management	-13.6	-14.1	7.1	6.2	-8.0	-5.6	214.9
Pyramis Global Advisors Trust Co.	-12.3	-14.1	8.2	6.2	-3.5	-5.6	249.1
Semi-Passive Managers							
Developed Mkts (MSCI World ex U.S. net) (1)							
AQR Capital Management	-16.8	-14.1	6.7	6.2	-6.1	-5.6	238.8
Pyramis Global Advisors Trust Co.	-13.2	-14.1	7.2	6.2	-4.8	-5.6	370.6
State Street Global Advisors	-19.1	-14.1	4.2	6.2	-7.7	-5.6	218.7
Active Managers							
Emerging Mkts (MSCI Emerging Markets Net) (2)							
Capital International, Inc.	-22.7	-16.0	5.5	9.8	-0.7	0.0	650.4
Morgan Stanley Investment Mgmt.	-11.7	-16.0	10.3	9.8	-0.3	0.0	697.5
Passive Managers							
Developed Mkts (MSCI World ex U.S. net) (1)							
State Street Global Advisors	-13.9	-14.1	6.7	6.2	-5.2	-5.6	2,899.2
Emerging Mkts (MSCI Emerging Markets Net) (2)							
State Street Global Advisors	N/A	N/A	N/A	N/A	N/A	N/A	150.0
Aggregate International Stock Pool (3) (4)	-14.7*	-14.6	7.3	7.0	-4.5	-4.6	7,149.8
Asset Class Target							
MSCI ACWI ex U.S. (net)		-14.6		7.0		-4.6	

* Includes six months of performance beginning 7/1/11 of terminated active emerging markets manager, AllianceBernstein, and six months of performance beginning 1/1/11 of newly hired passive emerging markets manager, State Street Global Advisors.

(1) Since 6/1/08 the developed markets manager's benchmark is the MSCI World ex U.S. Standard (large + mid) (net) unhedged. From 10/1/07 through 5/31/08 the benchmark was the Provisional MSCI World ex U.S. Standard (net) unhedged. From 10/1/03 to 9/30/07 the benchmark was MSCI World ex U.S. (net). Prior to that date, it was MSCI EAFE Free (net) unhedged.

(2) Since 6/1/08 the emerging markets manager's benchmark is the MSCI Emerging Markets Standard (large + mid) (net) unhedged. From 10/1/07 through 5/31/08 the benchmark was the Provisional MSCI Emerging Markets Free Standard (net) unhedged. From 1/1/01 to 9/30/07 the benchmark was MSCI Emerging Markets Free (net) unhedged. Prior to that date, it was MSCI Emerging Markets Free (gross) unhedged.

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

(4) Since 6/1/08 the International Equity asset class target is the MSCI ACWI ex U.S. Standard (large + mid) (net) unhedged. From 10/1/07 through 5/31/08 the benchmark was the Provisional MSCI ACWI ex U.S. Standard (net) unhedged. From 10/1/03 to 9/30/07 the target was MSCI ACWI ex U.S. (net) unhedged.

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2012

Domestic Equity Active Managers

Barrow, Hanley, Mewhinney & Strauss, LLC	\$	892,401
Earnest Partners LLC		444,847
Goldman Sachs Asset Management, L.P.		1,305,908
Hotchkis and Wiley Capital Management		1,318,515
INTECH Investment Management LLC		1,112,698
Jacobs Levy Equity Management, Inc.		1,061,697
Knelman Asset Management Group LLC		344,612
LSV Asset Management		749,846
Martingale Asset Management L.P.		647,027
McKinley Capital Management LLC		962,248
New Amsterdam Partners LLC		570,324
Next Century Growth Investors LLC		2,182,575
Peregrine Capital Management		1,560,872
Sands Capital Management LLC		1,716,890
Systematic Financial Management, L.P.		905,508
Turner Investment Partners, Inc.		1,529,688
UBS Global Asset Management, Inc.		648,024
Winslow Capital Management, Inc.		613,280
Zevenbergen Capital Investments LLC		1,409,151

Domestic Equity Semi-Passive Managers (2)

BlackRock Institutional Trust Co., N.A.	2,469,978
INTECH Investment Management LLC	1,688,423
J.P. Morgan Investment Management, Inc.	2,648,579
Mellon Capital Management Corp.	1,595,719

Domestic Equity Passive Manager (2)

BlackRock Institutional Trust Co. N.A.	862,405
--	---------

Fixed Income Active Managers

Aberdeen Asset Management, Inc.	1,364,046
Columbia Management Investment Advisers LLC	957,123
Dodge & Cox, Inc.	1,183,508
Pacific Investment Management Co. (PIMCO)	2,661,063
Western Asset Management Co.	1,289,026

Fixed Income Semi-Passive Managers (2)

BlackRock Financial Management	967,617
Goldman Sachs Asset Management	1,353,746
Neuberger Berman Fixed Income LLC	597,448

cont.

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2012

International Active Developed Markets Managers (2)		
Acadian Asset Management LLC	\$	1,165,501
Columbia Management Investment Advisers LLC		816,466
INVESCO Global Asset Management (N.A.), Inc.		717,080
JP Morgan Investment Management Inc.		995,896
Marathon Asset Management LLP		1,690,636
McKinley Capital Management LLC		945,037
Pyramis Global Advisors Trust Company		1,263,828
International Semi Passive Developed Markets Managers (2)		
AQR Capital Management LLC		1,292,078
Pyramis Global Advisors Trust Company		771,506
State Street Global Advisors		1,062,016
International Passive Developed Markets Manager (2)		
State Street Global Advisors		441,585
International Active Emerging Markets Managers (2)		
AllianceBernstein, L.P.*		441,770
Capital International, Inc.		4,950,210
Morgan Stanley Investment Management Inc.		5,528,045
International Passive Emerging Markets Manager		
State Street Global Advisors		83,510
Supplemental Fixed Interest Account(2)		
Galliard Capital Management, Inc.		2,914,908
Assigned Risk Plan (2)		
GE Asset Management, Inc.		190,430
RBC Global Asset Management		209,422

* Manager Terminated in Fiscal '12

(1) Compensation is based 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) Compensation is based on a specified percentage of assets under management.