

**MINNESOTA
STATE
BOARD OF
INVESTMENT**



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Governor
Mark Dayton

State Auditor
Rebecca Otto

Secretary of State
Steve Simon

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DATE: January 15, 2015

TO: The Honorable Mark Dayton
Minnesota Legislative Reference Library

FROM: Mansco Perry III *MP3*
Executive Director and Chief Investment Officer

**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 Legislative Reference Library the cost and investment performance of external investment managers employed by the Board.

On June 30, 2014, the SBI utilized 20 domestic stock managers, 13 international stock managers and 8 bond managers for the defined benefit retirement assets under its control. The SBI also utilized a bond manager and an equity manager for the Assigned Risk Plan and a stable value manager for the conservative option in the defined contribution plan.

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 FY14. Please note that the SBI stopped using the services of two domestic stock managers 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 2014 Annual Report contains additional detail on manager performance and may be accessed online at www.sbi.state.mn.us.

Defined Benefit Plan

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 0.7 percentage point for the fiscal year. For the fiscal year, the active and semi-passive manager groups outperformed their respective benchmarks, and the passive manager matched the benchmark. Twelve of the 15 active managers outperformed their respective benchmarks and two of the four semi-passive managers outperformed the Russell 1000 benchmark, one underperformed, and one matched the benchmark. The passive manager tracked the benchmark 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 0.6 percentage points for the year. For FY 2014, four of the five active managers and all semi-passive managers outperformed the benchmark return.

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 USA (net) and the Emerging Markets (net). As a group, the international stock managers underperformed the MSCI All Country World Index (ACWI) ex USA (net) index by 0.3 percentage points for the fiscal year. Two of the six active developed markets managers outperformed their respective benchmarks for the year. Both active emerging market managers underperformed the MSCI Emerging Markets benchmark for the year. Two of the three semi-passive developed markets managers outperformed the benchmark for the year. The developed markets passive manager outperformed the MSCI World ex USA Index, and the emerging markets passive manager matched the return of the MSCI Emerging Markets Index (net).

Assigned Risk Portfolio

Domestic Stock Manager

The SBI evaluates the performance of the stock manager against the S&P 500 index. During the fiscal year 2014, the stock manager outperformed its benchmark by 0.7 percentage points.

Bond Manager

The SBI evaluates the performance of the bond manager against the Barclays Intermediate Government bond index. During the fiscal year 2014, the bond manager matched its benchmark.

Conservative Option in Defined Contribution Plan

Stable Value Portfolio

The SBI evaluates the performance of the stable value manager against the 3 Year Constant Maturity Treasury + 45 basis points. During the fiscal year 2014, the stable value manager outperformed its benchmark by 0.7 percentage points.

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2014

Domestic Equity Active Managers

Barrow, Hanley, Mewhinney & Strauss, Inc.	\$	1,382,004
Earnest Partners LLC		979,376
Goldman Sachs Asset Management, L.P.		1,912,726
Hotchkis and Wiley Capital Management		2,667,314
INTECH Investment Management LLC		1,553,094
Jacobs Levy Equity Management, Inc.		1,775,659
Knelman Asset Management Group LLC *		190,396
LSV Asset Management		2,160,845
Martingale Asset Management L.P.		1,311,657
McKinley Capital Management LLC		2,098,678
Next Century Growth Investors LLC		2,793,020
Peregrine Capital Management		2,374,465
Sands Capital Management LLC		2,795,974
Systematic Financial Management, L.P.		1,557,896
Turner Investments*		1,173,205
Winslow Capital Management LLC		935,108
Zevenbergen Capital Investments LLC		2,030,293

Domestic Equity Semi-Passive Managers (2)

BlackRock Institutional Trust Co., N.A.	2,755,508
INTECH Investment Management LLC	2,340,403
J.P. Morgan Investment Management, Inc.	3,071,912
Mellon Capital Management Corp.	2,302,611

Domestic Equity Passive Manager (2)

BlackRock Institutional Trust Co. N.A.	913,242
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Fixed Income Active Managers (2)

Aberdeen Asset Management, Inc.	1,635,240
Columbia Management Investment Advisers LLC	1,130,410
Dodge & Cox	1,490,127
Pacific Investment Management Co.LLC (PIMCO)	3,167,356
Western Asset Management Co.	1,437,359

Fixed Income Semi-Passive Managers (2)

BlackRock Financial Management, Inc.	1,021,113
Goldman Sachs Asset Management	1,660,647
Neuberger Berman Fixed Income LLC	720,798

cont.

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2014

International Active Developed Markets Managers (2)		
Acadian Asset Management LLC	\$	1,518,402
Columbia Management Investment Advisers LLC		1,138,091
INVESCO Global Asset Management (N.A.), Inc.**		24,732
JP Morgan Investment Management Inc.		1,368,745
Marathon Asset Management LLP		2,406,931
McKinley Capital Management LLC		1,339,916
Pyramis Global Advisors Trust Company		1,648,507
International Semi Passive Developed Markets Managers (2)		
AQR Capital Management LLC		1,848,532
Pyramis Global Advisors Trust Company		995,934
State Street Global Advisors		1,447,929
International Passive Developed Markets Manager (2)		
State Street Global Advisors		614,149
International Active Emerging Markets Managers (2)		
Capital International, Inc.		5,500,162
Morgan Stanley Investment Management Inc.		6,118,135
International Passive Emerging Markets Manager		
State Street Global Advisors		312,122
Supplemental Fixed Interest Account(2)		
Galliard Capital Management, Inc.		3,216,862
RBC Wealth Management		445,894
Assigned Risk Plan (2)		
GE Asset Management, Inc.		174,871
RBC Global Asset Management		224,970

* Manager Terminated in Fiscal '14.

**Manager Terminated in Fiscal '13.

(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. Negative amounts represent performance based refunds.

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

Figure 10. Domestic Stock Manager Performance For Period Ending June 30, 2014

	1 Year		3 Years		5 Years		Market Value
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	(\$ in millions)
Active Managers							
<i>Large Cap Growth (Russell 1000 Growth)</i>							
INTECH	26.3	26.9	15.1	16.3	19.4	19.2	547.1
Jacobs Levy Equity Mgmt.	29.1	26.9	16.1	16.3	20.7	19.2	641.2
Sands Capital Mgmt.	33.2	26.9	19.6	16.3	25.8	19.2	649.4
Winslow Capital Mgmt.	27.5	26.9	14.4	16.3	18.6	19.2	285.7
Zevenbergen Capital	37.6	26.9	15.6	16.3	21.4	19.2	620.1
<i>Large Cap Value (Russell 1000 Value)</i>							
Barrow, Hanley	24.1	23.8	16.1	16.9	18.6	19.2	793.4
Earnest Partners	22.3	23.8	12.9	16.9	16.4	19.2	526.2
LSV Asset Mgmt.	27.9	23.8	19.4	16.9	21.0	19.2	800.0
Systematic Financial Mgmt.	26.6	23.8	14.6	16.9	18.9	19.2	750.3
<i>Small Cap Growth (Russell 2000 Growth)</i>							
McKinley Capital	32.3	24.7	18.3	14.5	23.1	20.5	389.2
Next Century Growth	11.3	24.7	6.5	14.5	16.5	20.5	363.5
<i>Small Cap Value (Russell 2000 Value)</i>							
Goldman Sachs	27.1	22.5	17.7	14.6	22.9	19.9	270.6
Hotchkis & Wiley	33.0	22.5	18.9	14.6	28.5	19.9	251.9
Martingale Asset Mgmt.	28.0	22.5	17.9	14.6	21.8	19.9	214.1
Peregrine Capital Mgmt.	22.6	22.5	15.4	14.6	22.5	19.9	355.3
<i>Semi-Passive Managers (Russell 1000)</i>							
BlackRock Institutional	25.6	25.4	17.6	16.6	19.4	19.3	2,345.4
INTECH	24.8	25.4	16.4	16.6			2,589.9
J.P. Morgan Investment Mgmt.	25.8	25.4	17.3	16.6	20.0	19.3	3,039.0
Mellon Capital Mgmt.	25.4	25.4	17.7	16.6	19.7	19.3	2,728.5
<i>Passive Manager (Russell 3000)</i>							
BlackRock Institutional	25.2	25.2	16.5	16.5	19.3	19.3	9,909.5
Aggregate Domestic Stock Pool (1)	25.9	25.2	16.5	16.5	19.5	19.3	28,070.3
<i>Asset Class Target</i>							
Russell 3000		25.2		16.5		19.3	

(1) Aggregate includes the performance of terminated managers.

Figure 13. Bond Manager Performance For Period Ending June 30, 2014

	1 Year		3 Years		5 Years		Market Value
	Actual	Bmk	Actual	Bmk	Actual	Bmk	(\$ in millions)
	%	%	%	%	%	%	
Active Managers							
Aberdeen Asset Mgmt.	5.1	4.4	5.0	3.7	7.7	4.9	1,089.8
Columbia Mgmt.	5.2	4.4	4.9	3.7	6.5	4.9	1,193.4
Dodge & Cox Investment Mgmt.	6.7	4.4	5.2	3.7	7.0	4.9	1,508.3
PIMCO	3.5	4.4	4.3	3.7			1,582.1
Western Asset Mgmt.	6.1	4.4	5.2	3.7	7.7	4.9	1,609.2
Semi-Passive Managers							
BlackRock Financial Mgmt.	4.6	4.4	4.0	3.7	5.5	4.9	1,911.0
Goldman Sachs Asset Mgmt.	4.8	4.4	4.3	3.7	6.0	4.9	2,549.6
Neuberger Investment Mgmt.	4.6	4.4	4.0	3.7	6.4	4.9	2,526.2
Aggregate Bond Pool (1)	5.0	4.4	4.5	3.7	6.6	4.9	13,969.7
Asset Class Target							
Barclays Capital Aggregate		4.4		3.7		4.9	

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

Figure 16. International Manager Performance For Period Ending June 30, 2014

	1 Year		3 Years		5 Years		Market Value
	Actual	Bmk	Actual	Bmk	Actual	Bmk	(\$ in millions)
	%	%	%	%	%	%	
Active Managers							
Developed Mkts (MSCI World ex USA net)							
Acadian Asset Mgmt.	28.7	23.8	9.8	7.6	14.1	11.7	400.7
Columbia Mgmt. Investment Advisers, LLC	17.5	23.8	7.3	7.6	12.5	11.7	359.4
J.P. Morgan Investment Mgmt. Co.	21.0	23.8	7.4	7.6	12.1	11.7	317.0
Marathon Asset Management	24.2	23.8	10.9	7.6	14.4	11.7	791.7
McKinley Capital Management	22.3	23.8	8.5	7.6	12.6	11.7	317.2
Pyramis Global Advisors Trust Co.	20.8	23.8	9.3	7.6	13.5	11.7	370.6
Semi-Passive Managers							
Developed Mkts (MSCI World ex USA net)							
AQR Capital Management	23.4	23.8	8.5	7.6	13.3	11.7	366.2
Pyramis Global Advisors Trust Co.	24.1	23.8	8.5	7.6	12.6	11.7	545.6
State Street Global Advisors	25.9	23.8	7.3	7.6	11.5	11.7	334.2
Active Managers							
Emerging Mkts (MSCI Emerging Markets net)							
Capital International, Inc.	13.3	14.3	-2.9	-0.4	6.8	9.2	769.1
Morgan Stanley Investment Mgmt.	12.0	14.3	2.3	-0.4	10.3	9.2	847.0
Passive Managers							
Developed Mkts (MSCI World ex USA net)							
State Street Global Advisors	24.3	23.8	7.9	7.6	12.2	11.7	3,780.8
Passive Managers							
Emerging Mkts (MSCI Emerging Markets net)							
State Street Global Advisors	14.3	14.3					317.1
Aggregate International Stock Pool (1)	21.4	21.7	6.3	5.7	11.7	11.1	9,516.8
Asset Class Target							
MSCI ACWI ex USA (net)		21.7		5.7		11.1	

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

**Returns Net of Fees
Period Ending 6/30/2014**

	1 Yr.	3 Yr.	5 Yr.
Assigned Risk Portfolio			
GE Investment Management	25.3%	16.5%	16.9%
S&P 500 (Benchmark)	24.6	16.6	18.8
RBC Global Asset Management	1.5	1.9	4.8
Barclays Capital (Benchmark)	1.5	2.0	2.9
Stable Value Portfolio			
Galliard	1.9	2.5	3.1
3 Year Constant Maturity Treasury + 45 Basis Points (Benchmark)	1.2	1.0	1.2