

MINNESOTA
STATE
BOARD OF
INVESTMENT



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Mark Dayton

State Auditor
Rebecca Otto

Secretary of State
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Attorney General
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DATE: January 11, 2016

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, 2015, 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 fiscal year 2015. 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 fiscal year 2015 Annual Report contains additional detail on manager performance will be available on or before January 29, 2016 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 0.4 percentage point for the fiscal year. The active and semi-passive manager groups outperformed their respective benchmarks, and the passive manager matched the benchmark for

the fiscal year. Eleven of the 15 active managers either outperformed or matched their respective benchmark and three of the four semi-passive managers outperformed the Russell 1000 benchmark. The passive manager tracked the benchmark for the year.

International Stock Managers

The SBI evaluates individual international stock managers against market indices published by Morgan Stanley Capital International (MSCI) which reflects the managers' country allocation: the World ex USA (net) for developed countries and the Emerging Markets (net) for emerging countries. The aggregate international stock program is designed to outperform the MSCI All Country World Index (ACWI) ex USA (net) index.

As a group, the managers outperformed the broad market by 1.5 percentage points for the fiscal year. The active, semi-passive and passive manager groups in developed markets and the passive emerging markets group outperformed their respective benchmarks. For developed markets, five of the six active managers, all three semi-passive and the passive manager outperformed the MSCI World ex USA Index for the year. For emerging markets, one of the two active managers and the passive manager outperformed the MSCI Emerging Markets Index (net) for the fiscal 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 0.2 percentage point for the year. During the fiscal year 2015, four of the five active managers and all three semi-passive managers outperformed the benchmark return.

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 2015, the stock manager underperformed its benchmark by 0.7 percentage point.

Bond Manager

The SBI evaluates the performance of the bond manager against the Barclays Intermediate Government bond index. During the fiscal year 2015, the bond manager underperformed its benchmark by 0.1 percentage point.

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 2015, the stable value manager outperformed its benchmark by 0.5 percentage point.

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2015

Domestic Equity Active Managers		
Barrow, Hanley, Mewhinney & Strauss, Inc.	\$	1,586,282
Earnest Partners LLC		1,051,410
Goldman Sachs Asset Management, L.P.		2,066,974
Hotchkis and Wiley Capital Management		2,594,068
INTECH Investment Management LLC		1,697,015
Jacobs Levy Equity Management, Inc.		1,963,547
LSV Asset Management		2,765,332
Martingale Asset Management L.P.		1,529,418
McKinley Capital Management LLC		2,199,796
Next Century Growth Investors LLC		2,641,728
Peregrine Capital Management		2,536,143
Sands Capital Management LLC		2,457,245
Systematic Financial Management, L.P.		1,645,810
Winslow Capital Management LLC		1,055,480
Zevenbergen Capital Investments LLC		2,163,605
Domestic Equity Semi-Passive Managers (2)		
BlackRock Institutional Trust Co., N.A.		2,541,883
INTECH Investment Management LLC		2,539,932
J.P. Morgan Investment Management, Inc.		3,104,592
Mellon Capital Management Corp.		2,573,234
Domestic Equity Passive Manager (2)		
BlackRock Institutional Trust Co. N.A.		952,243
Fixed Income Active Managers (2)		
Aberdeen Asset Management, Inc.		1,787,433
Columbia Management Investment Advisers LLC		1,192,144
Dodge & Cox		1,628,378
Pacific Investment Management Co.LLC (PIMCO)		3,380,365
Western Asset Management Co.		1,517,225
Fixed Income Semi-Passive Managers (2)		
BlackRock Financial Management, Inc.		1,079,376
Goldman Sachs Asset Management		1,825,474
Neuberger Berman Fixed Income LLC		775,699
cont.		

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2015

International Active Developed Markets Managers (2)		
Acadian Asset Management LLC	\$	1,513,990
Columbia Management Investment Advisers LLC		1,146,309
JP Morgan Investment Management Inc.		1,348,872
Marathon Asset Management LLP		2,416,872
McKinley Capital Management LLC		1,322,972
Pyramis Global Advisors Trust Company		1,646,223
International Semi Passive Developed Markets Managers (2)		
AQR Capital Management LLC		1,820,200
Pyramis Global Advisors Trust Company		988,455
State Street Global Advisors		1,426,810
International Passive Developed Markets Manager (2)		
State Street Global Advisors		606,851
International Active Emerging Markets Managers (2)		
Capital International, Inc.		5,281,759
Morgan Stanley Investment Management Inc.		6,115,735
International Passive Emerging Markets Manager		
State Street Global Advisors		310,349
Supplemental Fixed Interest Account(2)		
Galliard Capital Management, Inc.		3,786,909
Assigned Risk Plan (2)		
GE Asset Management, Inc.		175,881
RBC Global Asset Management		236,380

(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, 2015

	1 Year		3 Years		5 Years		Market Value (\$ in millions)
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	
Active Managers							
Large Cap Growth (Russell 1000 Growth)							
INTECH	11.4	10.6	17.7	18.0	18.4	18.6	609.4
Jacobs Levy Equity Mgmt.	10.6	10.6	18.3	18.0	19.5	18.6	709.2
Sands Capital Mgmt.	7.8	10.6	18.8	18.0	21.9	18.6	700.3
Winslow Capital Mgmt.	12.2	10.6	18.6	18.0	18.7	18.6	320.5
Zevenbergen Capital	7.4	10.6	23.4	18.0	18.7	18.6	666.1
Large Cap Value (Russell 1000 Value)							
Barrow, Hanley	6.4	4.1	18.4	17.3	17.4	16.5	844.5
Earnest Partners	9.4	4.1	16.2	17.3	15.2	16.5	575.5
LSV Asset Mgmt.	7.2	4.1	22.5	17.3	18.7	16.5	857.5
Systematic Financial Mgmt.	3.9	4.1	18.1	17.3	16.1	16.5	779.3
Small Cap Growth (Russell 2000 Growth)							
McKinley Capital	10.7	12.3	24.4	20.1	21.1	19.3	430.6
Next Century Growth	15.8	12.3	14.5	20.1	15.8	19.3	421.1
Small Cap Value (Russell 2000 Value)							
Goldman Sachs	4.0	0.8	18.8	15.5	18.2	14.8	281.6
Hotchkis & Wiley	5.7	0.8	22.9	15.5	20.2	14.8	266.2
Martingale Asset Mgmt.	4.7	0.8	20.6	15.5	18.4	14.8	224.1
Peregrine Capital Mgmt.	3.6	0.8	17.3	15.5	16.5	14.8	368.1
Semi-Passive Managers (Russell 1000)							
BlackRock Institutional	8.5	7.4	18.4	17.7	18.4	17.6	2,544.1
INTECH	6.4	7.4	17.1	17.7	17.3	17.6	2,608.6
J.P. Morgan Investment Mgmt.	8.3	7.4	18.6	17.7	18.2	17.6	3,290.4
Mellon Capital Mgmt.	8.3	7.4	18.1	17.7	18.5	17.6	2,809.0
Passive Manager (Russell 3000)							
BlackRock Institutional	7.3	7.3	17.7	17.7	17.5	17.5	10,056.0
Aggregate Domestic Stock Pool (1)							
	7.7	7.3	18.2	17.7	17.8	17.5	29,361.9
Asset Class Target							
Russell 3000		7.3		17.7		17.5	

(1) Aggregate includes the performance of terminated managers.

Figure 13. Bond Manager Performance For Period Ending June 30, 2015

	1 Year		3 Years		5 Years		Market Value (\$ in millions)
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	
Active Managers							
Aberdeen Asset Mgmt.	2.4	1.9	2.9	1.8	4.7	3.3	1,116.2
Columbia Mgmt.	2.2	1.9	2.8	1.8	4.5	3.3	1,220.1
Dodge & Cox Investment Mgmt.	1.5	1.9	3.6	1.8	4.7	3.3	1,530.8
PIMCO	3.0	1.9	3.1	1.8	4.5	3.3	1,629.3
Western Asset Mgmt.	2.0	1.9	3.1	1.8	4.8	3.3	1,685.2
Semi-Passive Managers							
BlackRock Financial Mgmt.	2.1	1.9	2.1	1.8	3.6	3.3	1,950.4
Goldman Sachs Asset Mgmt.	2.0	1.9	2.2	1.8	3.9	3.3	2,722.2
Neuberger Investment Mgmt.	2.0	1.9	2.1	1.8	3.8	3.3	2,577.0
Aggregate Bond Pool (1)	2.1	1.9	2.6	1.8	4.2	3.3	14,431.2
Asset Class Target							
Barclays Capital Aggregate		1.9		1.8		3.3	

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

Figure 16. International Manager Performance For Period Ending June 30, 2015

	1 Year		3 Years		5 Years		Market Value (\$ in millions)
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	
Active Managers							
Developed Mkts (MSCI World ex USA net)							
Acadian Asset Mgmt.	-5.5	-5.3	13.9	11.1	10.7	9.0	378.7
Columbia Mgmt. Investment Advisers, LLC	3.5	-5.3	13.2	11.1	11.8	9.0	372.1
J.P. Morgan Investment Mgmt. Co.	-3.8	-5.3	10.9	11.1	9.5	9.0	305.0
Marathon Asset Management	-0.1	-5.3	14.9	11.1	12.0	9.0	790.6
McKinley Capital Management	0.1	-5.3	13.9	11.1	10.8	9.0	317.6
Pyramis Global Advisors Trust Co.	-2.0	-5.3	13.4	11.1	11.0	9.0	363.2
Semi-Passive Managers							
Developed Mkts (MSCI World ex USA net)							
AQR Capital Management	-4.3	-5.3	13.6	11.1	10.4	9.0	350.5
Pyramis Global Advisors Trust Co.	-2.0	-5.3	13.0	11.1	10.6	9.0	534.7
State Street Global Advisors	-4.5	-5.3	13.4	11.1	9.1	9.0	319.3
Active Managers							
Emerging Mkts (MSCI Emerging Markets net)							
Capital International, Inc.	-7.6	-5.1	3.0	3.7	0.7	3.7	710.5
Morgan Stanley Investment Mgmt.	-3.5	-5.1	5.4	3.7	5.3	3.7	817.3
Passive Managers							
Developed Mkts (MSCI World ex USA net)							
State Street Global Advisors	-4.9	-5.3	11.5	11.1	9.4	9.0	3,595.1
Passive Managers							
Emerging Mkts (MSCI Emerging Markets net)							
State Street Global Advisors	-4.7	-5.1	3.9	3.7			302.2
Aggregate International Stock Pool (1)	-3.8	-5.3	10.7	9.4	8.4	7.8	9,156.7
Asset Class Target							
MSCI ACWI ex USA (net)		-5.3		9.4		7.8	

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

Returns Net of Fees
Period Ending 6/30/2015

	1 Yr.	3 Yr.	5 Yr.
Assigned Risk Portfolio			
GE Investment Management	6.7%	18.1%	16.5%
S&P 500 (Benchmark)	7.4	17.3	17.3
RBC Global Asset Management	1.7	0.9	2.5
Barclays Capital (Benchmark)	1.8	0.9	2.1
Stable Value Portfolio			
Galliard	1.9	2.1	2.6
3 Year Constant Maturity Treasury + 45 Basis Points (Benchmark)	1.4	1.1	1.1