

MINNESOTA  
STATE  
BOARD OF  
INVESTMENT

06 - 0118



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Mary Kiffmeyer

Attorney General  
Mike Hatch

**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](mailto:minn.sbi@state.mn.us)  
[www.sbi.state.mn.us](http://www.sbi.state.mn.us)

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DATE: January 23, 2006

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)

*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, 2005, the SBI utilized 32 domestic stock managers, 8 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 two thirds of international stock assets to active management and approximately one third to passive management. Beginning July 1, 2005, a portion of the international portfolio will be semi-passively managed. 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 FY05. Please note that the SBI terminated two domestic stock managers and two international managers in FY05; hired six new active domestic stock managers, four new active international managers, and three new semi-passive international managers.

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 2005 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).

### **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 0.5 percentage point for the fiscal year. The performance of individual domestic common stock managers for FY 2005 was encouraging. Eighteen active managers outperformed their benchmarks, nine underperformed, and one matched its benchmark. One semi-passive manager outperformed, one matched the benchmark, and one underperformed the benchmark. The passive manager matched 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 underperformed the MSCI Country World Index (ACWI) ex U.S. (net) index by 0.8 percentage points for the fiscal year. Three of the four EAFE managers underperformed the index; two of the three emerging markets managers outperformed EMF. The passive manager outperformed the MSCI World ex U.S. index by 0.1 percentage point.

### **Bond Managers**

The SBI evaluates the performance of its bond managers against the Lehman Brothers Aggregate bond index. Four of the five active managers exceeded the benchmark. All three semi-passive bond managers outperformed the index for the year. As a group, the bond managers outperformed the broad bond market by 0.3 percentage point for the year.

Figure 16. Domestic Stock Manager Performance FY 2005

	Actual Return	Benchmark Return
<b>Active Managers</b>		
<b>Large Cap Core (Russell 1000)</b>		
Franklin Portfolio Associates	12.1%	7.9%
New Amsterdam Partners	13.6	7.9
UBS Global Asset Management	10.9	7.9
Voyageur-Chicago Equity	1.8	7.9
<b>Large Cap Growth (Russell 1000 Growth)</b>		
Alliance Capital Management	4.0	1.7
Cohen Klingenstein & Marks	3.8	1.7
INTECH*	0.2	-1.7
Holt-Smith & Yates	5.4	1.7
Jacobs Levy Equity Mgmt.*	-1.6	-1.7
Lazard Asset Mgmt.*	-2.7	-1.7
Sands Capital Mgmt.*	-2.1	-1.7
Winslow Capital Mgmt.*	0.1	-1.7
Zevenbergen Capital	1.9	1.7
<b>Large Cap Value (Russell 1000 Value)</b>		
Barrow, Hanley	19.4	14.1
Earnest Partners	20.8	14.1
Lord Abbett & Co.	5.9	14.1
LSV Asset Mgmt.	18.9	14.1
Oppenheimer Capital	6.8	14.1
Systematic Financial Mgmt.	14.1	14.1
<b>Small Cap Growth (Russell 2000 Growth)</b>		
McKinley Capital	1.8	4.3
Next Century Growth	13.4	4.3
Turner Investment Partners	3.1	4.3
Winslow-Small Cap	6.1	4.3
<b>Small Cap Value (Russell 2000 Value)</b>		
AEAM/Kenwood	13.6	14.4
Goldman Sachs	11.9	14.4
Hotchkis & Wiley	18.5	14.4
Martingale Asset Mgmt.	20.6	14.4
Peregrine Capital Mgmt.	20.8	14.4
<b>Semi-Passive Managers (Russell 1000)</b>		
Barclays Global Investors	8.6	7.9
Franklin Portfolio Associates	7.9	7.9
J.P. Morgan Investment Mgmt.	7.4	7.9
<b>Passive Manager (Russell 3000)</b>		
Barclays Global Investors	8.1	8.1
<b>Historical Aggregate</b>		
SBI Domestic Equity Asset Class Target	8.6	8.0
		8.1

\* Manager was retained January 1, 2005.

Figure 18. Bond Manager Performance FY 2005

	Actual Return	Benchmark Return
<b>Active Managers</b>		
American Express Asset Mgmt.	7.1%	6.8%
Deutsche Asset Mgmt.	7.5	6.8
Dodge & Cox Investment Mgmt.	6.1	6.8
Morgan Stanley Investment Mgmt.	6.9	6.8
Western Asset Mgmt.	7.6	6.8
<b>Semi-Passive Managers</b>		
BlackRock Financial Mgmt.	6.9	6.8
Goldman Sachs Asset Mgmt.	7.2	6.8
Lehman Brothers Asset Mgmt.	7.0	6.8
<b>Aggregate Bond Pool</b>	<b>7.1</b>	<b>6.8</b>
<b>Asset Class Target</b>		
Lehman Aggregate		6.8

Figure 20. International Manager Performance FY 2005

	Actual Return	Benchmark
<b>Active Managers: Developed Markets</b>		
American Express Asset Mgmt.	12.7%	14.6%
Invesco Global Asset Mgmt.	12.0	14.6
Marathon Asset Mgmt.	17.6	14.6
UBS Global Asset Mgmt.	13.3	14.6
<b>Active Managers: Emerging Markets</b>		
Alliance Capital Mgmt.	34.9	34.4
Capital International	32.9	34.4
Morgan Stanley Investment Mgmt.	34.6	34.4
<b>Passive EAFE Manager</b>		
State Street Global Advisors	14.7	14.6
<b>Aggregate International Pool</b>	<b>15.7</b>	
<b>Asset Class Target</b>		
		16.5