

MINNESOTA
STATE
BOARD OF
INVESTMENT



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Tim Pawlenty

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DATE: January 13, 2010

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, 2009, the SBI utilized 27 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 FY09. Please note that the SBI stopped using the services of three domestic stock managers, one international stock manager and one bond manager during the fiscal year. The SBI retained a replacement only for one bond 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 2009 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 0.3 percentage point for the fiscal year. The active and semi-passive components underperformed the respective benchmark. Nine active managers outperformed; fourteen active managers underperformed. One semi-passive manager outperformed and two, underperformed. The passive manager outperformed by 0.2 percentage point 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 0.1 percentage point for the fiscal year. Four of the seven EAFE managers outperformed the index; one of the three emerging markets managers underperformed the EMF. All three semi-passive EAFE managers underperformed the benchmark. The passive manager exceeded 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 Barclays Capital Aggregate bond index. In a most challenging market environment, all but one manager underperformed the index for the year. As a group, the bond managers underperformed the broad bond market by 3.5 percentage points for the year.

Figure 10. Domestic Stock Manager Performance FY 2009

	Actual Return	Benchmark Return
<u>Active Managers</u>		
Large Cap Core (Russell 1000)		
Mellon Capital Mgmt.	-34.9%	-26.7%
New Amsterdam Partners	-23.8	-26.7
UBS Global Asset Management	-25.0	-26.7
Large Cap Growth (Russell 1000 Growth)		
AllianceBernstein L.P.	-26.3	-24.5
INTECH	-29.4	-24.5
Jacobs Levy Equity Mgmt.	-29.5	-24.5
Knelman Asset Mgmt.	-27.7	-24.5
Sands Capital Mgmt.	-26.2	-24.5
Winslow Capital Mgmt.	-26.6	-24.5
Zevenbergen Capital	-21.4	-24.5
Large Cap Value (Russell 1000 Value)		
Barrow, Hanley	-25.1	-29.0
Earnest Partners	-23.6	-29.0
Lord Abbett & Co.	-25.7	-29.0
LSV Asset Mgmt.	-28.1	-29.0
Systematic Financial Mgmt.	-32.7	-29.0
Small Cap Growth (Russell 2000 Growth)		
McKinley Capital	-38.5	-24.8
Next Century Growth	-36.4	-24.8
Turner Investment Partners	-28.4	-24.8
Small Cap Value (Russell 2000 Value)		
Goldman Sachs	-21.6	-25.2
Hotchkis & Wiley	-30.9	-25.2
Martingale Asset Mgmt.	-30.2	-25.2
Peregrine Capital Mgmt.	-22.0	-25.2
RiverSource/Kenwood	-28.8	-25.2
<u>Semi-Passive Managers (Russell 1000)</u>		
Barclays Global Investors	-27.6	-26.7
J.P. Morgan Investment Mgmt.	-24.5	-26.7
Mellon Capital Mgmt.	-27.7	-26.7
<u>Passive Manager (Russell 3000)</u>		
Barclays Global Investors	-26.4	-26.6
Historical Aggregate		
SBI Domestic Equity Asset Class Target	-26.9	-26.6
Russell 3000		-26.6

Figure 12. Bond Manager Performance FY 2009

	Actual Return	Benchmark Return
Active Managers		
Aberdeen Asset Mgmt.	-6.5%	6.0%
Dodge & Cox Investment Mgmt.	7.0	6.0
PIMCO	N/A	6.0
RiverSource Investments	1.8	6.0
Western Asset Mgmt.	1.9	6.0
Semi-Passive Managers		
BlackRock Financial Mgmt.	1.9	6.0
Goldman Sachs Asset Mgmt.	4.1	6.0
Neuberger Investment Mgmt.	4.1	6.0
Aggregate Bond Pool	2.5*	6.0
Asset Class Target		
Barclays Capital Aggregate		6.0

* Includes nine months of performance of terminated manager Morgan Stanley, and three months of performance of hired manager PIMCO.

Figure 14. International Manager Performance FY 2009

	Actual Return	Benchmark
Active Managers: Developed Markets		
Acadian Asset Management	-41.5%	-31.6%
Invesco Global Asset Mgmt.	-24.1	-31.6
J.P. Morgan Investment Mgmt. Co.	-28.5	-31.6
Marathon Asset Management	-26.5	-31.6
McKinley Capital Management	-43.3	-31.6
Pyramis Global Advisors Trust Co.	-31.9	-31.6
RiverSource Investments, LLC	-30.0	-31.6
Semi-Passive Managers: Developed Markets		
AQR Capital Management	-32.4	-31.6
Pyramis Global Advisors Trust Co.	-34.4	-31.6
State Street Global Advisors	-33.6	-31.6
Active Managers: Emerging Markets		
AllianceBernstein L.P.	-34.8	-28.1
Capital International, Inc.	-20.6	-28.1
Morgan Stanley Investment Mgmt.	-28.4	-28.1
Passive EAFE Manager: Developed Markets		
State Street Global Advisors	-31.5	-31.6
Aggregate International Pool	-31.0	-30.9
Asset Class Target		
MSCI ACWI ex U.S. (net)		-30.9

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2009

Active Domestic Stock Managers

Alliance Bernstein L.P.	\$	286,826
Barrow, Hanley, Mewhinney & Stauss, Inc.		725,969
Cohen, Klingenstein & Marks, Inc. ~		0
EARNEST Partners, LLC		380,151
Mellon Capital Management Corp. (Franklin)		439,305
Goldman Sachs Asset Management, LP		761,494
Hotchkis and Wiley Capital Management, LLC		267,260
Intech Investment Management, LLC (Enhanced InvTec)		824,091
Jacobs Levy Equity Management, Inc.		750,227
Knelman Asset Management Group, LLC (Lazard)		255,771
Lord, Abbet,t & Co., LLC		568,220
LVS Asset Management		894,841
Martingale Asset Management L.P.		466,882
McKinley Capital Management Inc.		695,330
New Amsterdam Partners, LLC		720,966
Next Century Growth Investors, LLC		1,493,367
Peregrine Capital Management		856,859
RiverSource Investments		274,497
Sands Capital Management, LLC		392,268
Systematic Financial Management, LP		769,288
Turner Investment Partners, Inc.		1,094,672
UBS Global Asset Management (Americas) Inc.		617,332
Voyageur Asset Management, Inc.		198,129
Winslow Capital Management, Inc. (Large Cap.)		457,572
Zevenbergen Capital Investments, LLC		1,105,515

Passive Domestic Stock Managers

Barclays Global Investors		762,296
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Semi-Passive Domestic Stock Managers

Barclays Global Investors, N.A.		2,499,084
Mellon Capital Management Corp. (Franklin)		1,702,903
JPMorgan Investment Management, Inc.		2,129,669

Active Domestic Bond Managers (2)

Aberdeen Asset Management (Deutsche)		1,456,189
Dodge & Cox		992,932
Morgan Stanley		248,242
PIMCO		1,431,286
RiverSource Investments (American Express)		821,381
Western Asset Management		1,258,662

cont.

External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2009

Semi-Passive Domestic Bond Managers (2)		
BlackRock Inc.	\$	892,360
Goldman Sachs		1,124,721
Lehman Brothers Asset Management, LLC (Lincoln)		538,191
Developed-International Active Stock Managers		
Acadian Asset Management		1,027,101
Invesco Global Asset Management		753,764
JP Morgan Investment Management Co.		774,940
Marathon Asset Management		1,305,488
McKinley Capital Management		811,833
Pyramis Global Advisors Trust Co.- Active (Fidelity)		654,228
RiverSource Investments (American Express)		632,734
UBS Global Asset Management (Brinson) *		600,667
Developed-International Semi-Passive Stock Managers		
AQR Capital Management		1,021,838
Pyramis Global Advisors Trust Co. - Semi Passive (Fidelity)		857,171
State Street Global Advisors - Semi Passive		918,605
Developed-International Passive Stock Managers		
State Street Global Advisors - Passive		383,339
Emerging-International Active Stock Managers		
AllianceBernstein L.P.		1,507,019
Capital International		2,981,341
Morgan Stanley Investment Management		3,407,761
Assigned Risk Plan		
GE Investment Management		196,801
Voyager Asset Management *		252,431

* Manager Terminated in Fiscal '09
 ~ Manager Terminated June 30, 2008

- (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.