

MINNESOTA STATE BOARD  
OF INVESTMENT  
MEETING  
**June 4, 2003**

&

INVESTMENT ADVISORY  
COUNCIL MEETING  
**June 3, 2003**

**STATE BOARD OF INVESTMENT**

**AGENDA AND MINUTES**

**June 4, 2003**

**AGENDA**  
**STATE BOARD OF INVESTMENT MEETING**  
**Wednesday, June 4, 2003**  
**9:00 A.M. - Room 125**  
**State Capitol - Saint Paul**

- |   |            |
|---|------------|
|   | <b>TAB</b> |
| <b>1. Approval of Minutes of March 5, 2003</b>  |            |
| <b>2. Report from the Executive Director (Howard Bicker)</b>                                      | <b>A</b>   |
| A. Quarterly Investment Review<br>(January 1, 2003 – March 31, 2003)                              |            |
| B. Administrative Report  | <b>B</b>   |
| 1. Reports on budget and travel.  |            |
| 2. Legislative Update.  |            |
| 3. Litigation Update.   |            |
| 4. Reauthorization of the Proxy Voting Committee.   |            |
| 5. Authorization to form Review/Search Committees.  |            |
| <b>3. Report from the SBI Administrative Committee (Peter Sausen)</b>                             | <b>C</b>   |
| 1. Review of Executive Director's proposed workplan for FY04.                                     |            |
| 2. Review of budget plan for FY04.  |            |
| 3. Review of Continuing Fiduciary Education Plan.   |            |
| 4. Review of Executive Director's Evaluation Process.   |            |
| 5. Discussion of Disaster Recovery Plan.  |            |
| 6. Discussion of International Country Guidelines.  |            |
| <b>4. Report from the IAC Membership Review Committee (Peter Sausen)</b>                          | <b>D</b>   |
| <b>5. Reports from the Investment Advisory Council (Mike Troutman)</b>                            |            |
| A. Asset Allocation Committee   | <b>E</b>   |
| 1. Review of proposed asset allocation policy paper and<br>proposed recommendations.              |            |
| B. Stock and Bond Manager Committee   | <b>F</b>   |
| 1. Review of manager performance.   |            |
| 2. Annual review of the domestic equity benchmark quality analysis.                               |            |
| 3. Discussion related to the recommendations from the Asset<br>Allocation Committee.              |            |
| C. Alternative Investment Committee   | <b>G</b>   |
| 1. Review of current strategy.  |            |
| 2. Discussion related to the recommendations from the Asset<br>Allocation Committee.              |            |
| 3. New investments with two existing private equity managers,<br>Goldman Sachs and Piper Jaffray. |            |

**Minutes  
State Board of Investment  
March 5, 2003**

The State Board of Investment (SBI) met at 10:00 A.M. Wednesday, December 10, 2002 in Room 125 State Capitol, St. Paul, Minnesota. Governor Tim Pawlenty; State Auditor Pat Anderson Awada; Secretary of State Mary Kiffmeyer; and Attorney General Mike Hatch were present. The minutes of the December 10, 2002 Board meeting were approved.

**Executive Director's Report**

Mr. Bicker, Executive Director, referred members to Tab A of the meeting materials and reported that the Combined Funds had exceeded inflation over the ten year period ending December 31, 2002 (Combined Funds 7.9% vs. Inflation 2.5%), trailed the median fund (85<sup>th</sup> percentile) for the most recent five year period due to the SBI's higher than average equity exposure and slightly underperformed its composite index (Combined Funds 1.8% vs. Composite 1.9%). He stated that the Basic Funds have slightly underperformed its composite index (Basic Funds 1.8% vs. Composite 1.9%) over the last five years and reported that the Post Fund has also underperformed its composite index over the last five years period (Post Fund 1.7% vs. Composite 1.8%).

Mr. Bicker reported that the Basic Fund's assets increased 4.5% for the quarter ending December 31, 2002 due mostly to positive investment returns. He said that the asset mix is on target. He reported that the Basic Funds underperformed its composite index for the quarter (Basic Funds 4.1% vs. Composite 4.5%) and for the year (Basic Funds -11.6 vs. Composite -10.8%).

Mr. Bicker reported that the market value of the Post Fund's assets increased 2.7% for the quarter ending September 30, 2002 due to positive investment returns. He said the Post Fund asset mix is on target and that the Post Fund underperformed its composite index for the quarter (Post Fund 5.3% vs. Composite 5.7%) and for the year (Post Fund -11.6 vs. Composite -10.4%).

Mr. Bicker reported that the domestic stock manager group underperformed its target for the quarter (Domestic Stock 7.5% vs. Wilshire 5000 Investable 8.1%) and underperformed it for the year (Domestic Stocks -22.4 vs. Wilshire 5000 Investable -21.5%). He said the International Stock manager group outperformed its composite index for the quarter (International Stocks 6.9% vs. Int'l Composite 6.8%) and outperformed it for the year (International Stocks -13.6% vs. Int'l Composite -14.8%). Mr. Bicker stated that the bond segment outperformed its target for the quarter (Bonds 2.0% vs. Lehman Aggregate 1.6%) and underperformed its target for the year (Bonds 8.9% vs. Lehman Aggregate 10.3%). He concluded his report with the comment that as December 31, 2002, the SBI was responsible for over \$40 billion in assets.

### **Executive Director's Administrative Report**

Mr. Bicker referred members to Tab B of the meeting materials for the quarterly updates on budget and travel. Mr. Bicker reported that the legislative auditors had completed the FY02 audit, and that the SBI had received a "clean opinion" on its financial statements.

Mr. Bicker distributed a memo to members updating the legislative activity of interest to the SBI (see **Attachment A**). He reported that the SBI had its first budget hearing before the Senate State Government Budget Division and that staff has not heard when the House budget hearing will take place. He noted that the SBI's current budget recommendation is for a 10% reduction.

Mr. Bicker reported that the Tobacco Endowment Funds are in the process of being liquidated as part of the State's budget resolution.

Mr. Bicker stated that at its December 2002 meeting, the Board instructed him to work with the retirement system directors to determine whether the issue of extending the amortization period for investment gains in the Post Fund benefit increase formula should be brought to the Legislature this session. He then briefly explained the two components that make up the benefit increase calculation. He said he had met with the retirement fund directors who reported that their respective boards were not in favor of introducing this issue during the 2003 Legislative session.

Mr. Bicker said that the Investment Advisory Council (IAC) is one of a number of advisory councils that are covered by a general June 30, 2003 sunset provision. He added that staff will monitor the bill to address the extension of the sunset date when it is introduced.

Mr. Bicker reported that a bill has been introduced to give the Minnesota State Colleges and Universities system (MnSCU) employees the option of having their current defined contribution plan or the Teachers Retirement Association (TRA) defined benefit plan. He noted that MnSCU administration did not introduce this bill and that the bill does contain some provisions to protect the financial integrity of TRA.

Mr. Bicker asked Christie Eller, Assistant Attorney General, to update members on the status of litigation. She noted that the SBI is the plaintiff in five different securities actions, three of which are class actions. She reported that the SBI is receiving approximately \$250,000 from the Mercury Finance settlement. She said that the SBI had approximately \$3 million in losses and that the settlement amount received is actually high by class action standards. She noted that the SBI had pursued additional sources of recovery which helped to increase the amount recovered. Ms. Eller stated that the case against McKesson HBOC is not a class action and that the SBI opted out of the federal class and brought an action with funds from Colorado and Utah in state court in California. She said that the federal case has stayed discovery due to pending criminal charges but that the state actions are proceeding. She noted that the SBI's losses in McKesson are approximately \$20 million. Ms. Eller reported that the Broadcom litigation is a class action for alleged accounting irregularities and that the SBI's losses

are estimated to be approximately \$17 million. She said that discovery is proceeding in that case and that Mr. Bicker is having his deposition taken later in the week. Ms. Eller stated that the case involving WorldCom bonds is not a class action and that it is an action against the investment banks and not against the Company. She said the action was filed in state court and that it has been moved to federal court in New York. She added that nine other pension funds have also filed similar actions. She concluded her update by saying that the SBI is also involved in a class action against AOL Time Warner and that the SBI has been named lead plaintiff. She said the SBI had filed in three different jurisdictions, and that the multi-disciplinary panel moved it to the southern district of New York. She noted that the SBI's losses are approximately \$250 million, which is huge, but small compared to the losses of other funds.

Mr. Hatch stated that new Board members will be solicited directly by firms hoping to represent the SBI in possible legal actions. Members of the Board discussed the process used for designating which lawsuits the SBI participates in and the process for selecting legal counsel to pursue those legal actions. Ms. Eller stated that the SBI's custodian bank routinely files class action claims on the SBI's behalf and that it is only in rare cases that a party pursues being a lead plaintiff. She noted the criteria the Attorney General's staff uses to help make that determination.

In response to a question from Ms. Kiffmeyer, Mr. Hatch said he would prefer not to have the Board make formal decisions about which cases to pursue because he did not wish to discuss the merits of any particular case in a public meeting setting. Ms. Awada requested that either the Attorney General's Office or the SBI send her information on who is soliciting legal services. Mr. Hatch agreed to notify Board members in writing in the future. Mr. Bicker stated that the new federal law encourages institutional investors to be the lead plaintiff in class action suits, and he noted that as seen in the Mercury Case, it was beneficial to have the SBI be the lead plaintiff.

Governor Pawlenty noted that he believes there are two issues involved-the selection of Counsel and secondly, under what circumstances we initiate litigation and who has the authority to do that. Mr. Bicker clarified that the Attorney General would bring potential cases to the Board's attention. Ms. Eller noted that the SBI can be assigned lead plaintiff in no more than four actions. Ms. Awada stated she would like to receive information from the Attorney General's Office on which suits he recommends the SBI be involved with. Mr. Hatch agreed. Governor Pawlenty agreed with Ms. Awada.

Mr. Hatch stated that members may also be approached directly by investment firms regarding particular investments. He said he also believes it is appropriate to direct investment company solicitations directly to Mr. Bicker and he noted the IAC's role in examining these firms with staff. Governor Pawlenty agreed.

### **Stock and Bond Manager Committee Report**

Mr. Troutman introduced himself and commented that in spite of recent turbulent markets, that he believes it is important to remember the long-term horizon of the pension funds and the long-term strategies the SBI has in place during these difficult market

cycles. He referred members to Tab C of the meeting materials and briefly reviewed the performance of the domestic equity, international equity and the fixed income managers.

In response to a question from Ms. Kiffmeyer, Mr. Bicker said that staff could include a 10 year performance comparison in the future. He also noted that since January 1, 1980, the SBI's return has been 11% which is above the 8.5% required rate of return.

Mr. Troutman informed members that the Metropolitan West Asset Management liquidation was largely complete. He noted that staff had controlled costs very well through a well executed transition plan.

Mr. Troutman stated that staff had conducted its annual review of the investment manager guidelines and that all changes were technical in nature and did not involve any policy changes.

Mr. Troutman stated that staff is proceeding on the asset allocation study and program review. He noted that the asset allocation policy is one of the most important decisions that the Board will make. He said that the review will continue and that recommendations will be brought to the Board at the June 2003 meeting.

#### **Alternative Investment Committee Report**

Mr. Troutman referred members to Tab D of the meeting materials and stated that the Committee is recommending an investment for the Post Retirement Fund with an existing private equity manager, CSFB Strategic Partners. He noted that this recommendation is contingent upon changes to the asset allocation policy for the Post Fund. Mr. Bicker added that the first fund had returned 11.8% since January 2001. In response to a question from Ms. Awada, Mr. Bicker stated that this type of investment can be made legally in the Post Fund, but that the fund has more of an equity type investment strategy than is currently approved for the fund. He noted that there is no more allocation available for the Basic Funds and that the SBI has been able to negotiate very favorable terms. He said that the asset allocation review will be examining different types of alternative investments for the Post Fund and that staff believes the most appropriate approach is to recommend it be contingent upon the outcome of changes made to the fund's investment parameters. Mr. Hatch moved approval of the Committee's recommendation as stated in the Committee Report, which reads: "The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$100 million or 20%, whichever is less, in CSFB Strategic Partners II. This commitment is contingent upon changes to the asset allocation parameters for the Post Retirement Fund. These changes are expected to be recommended to the SBI for approval at its June 2003 meeting. This commitment will be allocated to the Post Retirement Fund. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment nor its Executive Director have any liability for reliance by CSFB Strategic Partners upon this

approval. Until a formal agreement is executed by the Executive Director on behalf of the SBI, further due diligence and negotiations may result in the imposition of additional terms and conditions on CSFB Strategic Partners or reduction or termination of the commitment.” Ms. Kiffmeyer seconded the motion. The motion passed. Ms. Kiffmeyer noted that she believes this is a good strategic move to make in order to improve returns for retirees in the Post Fund.

The meeting adjourned at 9:55 a.m.

Respectfully submitted,

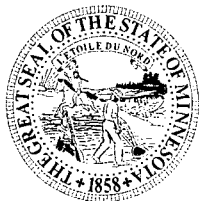
A handwritten signature in cursive script that reads "Howard Bicker".

Howard J. Bicker  
Executive Director



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MINNESOTA  
STATE  
BOARD OF  
INVESTMENT



**Board Members:**

Governor  
Tim Pawlenty

State Auditor  
Pat Anderson Awada

Secretary of State  
Mary Kiffmeyer

Attorney General  
Mike Hatch

**Executive Director:**

Howard J. Bicker

DATE: March 4, 2003

TO: Members, State Board of Investment

FROM: Howard Bicker *AB*

SUBJECT: **Legislative Issues Update**

**SBI Budget (HF \_\_; SF \_\_)**

Hearing March 4 before Senate State Government Budget Division.

**Tobacco Endowment Funds**

At its March 6, 2002 Board meeting, the SBI authorized staff, after consultation with Board deputies, to alter the asset allocation of funds as a result of legislative budget actions. The Board deputies met and initially decided not to liquidate the Tobacco Endowment Fund assets, based upon projections that the Funds would not be needed for budgetary cash flow purposes until mid-2003. The Executive Director was instructed by the deputies to work with the Department of Finance on this issue, and if both the Commissioner of Finance and the Executive Director of the SBI agreed that the Funds should be liquidated, then the bonds and stocks would be converted to cash. Further, the Executive Director would report back to the Board on actions taken.

In late February 2003, the Commissioner of Finance and the SBI's Executive Director discussed the issue of liquidating the Tobacco Endowment Funds. Given the State's current budget situation it was determined that it is prudent to liquidate the Funds.

**Post Retirement Fund Benefit Increase Formula**

At its December 2002 meeting the Board instructed the Executive Director to work with the retirement system directors to determine whether the issue of extending the amortization period for investment gains in the Post Fund formula should be brought to the Legislature this session. The Executive Director met with the directors who reported that their respective boards were not in favor of introducing this issue during the 2003 Legislative Session.

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**Extending Sunset Provision for IAC (HF \_\_\_; SF \_\_\_)**

The Investment Advisory Council (IAC) is one of a number of advisory councils in statute that are covered by a general June 30, 2003 sunset provision. Staff has been notified of the intent of the Legislature to address the issue of extending the sunset date. To date, no bill has been introduced.

**Permitting MnSCU Plan Members the Option to Return to TRA Plan (HF 286; SF \_\_\_)**

HF 286 would give MnSCU employees the option of having their current defined contribution plan or TRA's defined benefit plan. No committee hearing has been scheduled.

**INVESTMENT ADVISORY COUNCIL**

**AGENDA AND MINUTES**

**June 3, 2003**



**AGENDA**  
**INVESTMENT ADVISORY COUNCIL MEETING**  
**Tuesday, June 3, 2003**  
**2:00 P.M. - Board Room – First Floor**  
**60 Empire Drive**  
**St. Paul, MN**

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|---|------------|
|   | <b>TAB</b> |
| <b>1. Approval of Minutes of March 4, 2003</b>  |            |
| <b>2. Report from the Executive Director</b>  | <b>A</b>   |
| A. Quarterly Investment Review<br>(January 1, 2003 – March 31, 2003)                              |            |
| B. Administrative Report  | <b>B</b>   |
| 1. Reports on budget and travel.  |            |
| 2. Legislative Update.  |            |
| 3. Litigation Update.   |            |
| 4. Reauthorization of the Proxy Voting Committee.   |            |
| 5. Authorization to form Review/Search Committees.  |            |
| <b>3. Report from the SBI Administrative Committee</b>  | <b>C</b>   |
| 1. Review of Executive Director's proposed workplan for FY04.                                     |            |
| 2. Review of budget plan for FY04.  |            |
| 3. Review of Continuing Fiduciary Education Plan.   |            |
| 4. Review of Executive Director's Evaluation Process.   |            |
| 5. Discussion of Disaster Recovery Plan.  |            |
| 6. Discussion of International Country Guidelines.  |            |
| <b>4. Report from the IAC Membership Review Committee</b>   | <b>D</b>   |
| <b>5. Reports from the Investment Advisory Council</b>  |            |
| A. Asset Allocation Committee (Mike Troutman)   | <b>E</b>   |
| 1. Review of proposed asset allocation policy paper and<br>proposed recommendations.              |            |
| B. Stock and Bond Manager Committee (John Bohan)  | <b>F</b>   |
| 1. Review of manager performance.   |            |
| 2. Annual review of the domestic equity benchmark quality analysis.                               |            |
| 3. Discussion related to the recommendations from the Asset<br>Allocation Committee.              |            |
| C. Alternative Investment Committee (Ken Gudorf)  | <b>G</b>   |
| 1. Review of current strategy.  |            |
| 2. Discussion related to the recommendations from the Asset<br>Allocation Committee.              |            |
| 3. New investments with two existing private equity managers,<br>Goldman Sachs and Piper Jaffray. |            |

**Minutes  
Investment Advisory Council  
March 4, 2003**

**MEMBERS PRESENT:** Gary Austin; Ken Gudorf; P. Jay Kiedrowski; Han Chin Liu; Malcolm McDonald; Dan McElroy; Mary Stanton; Mike Troutman; Mary Vanek; Elaine Voss, and Judy Mares.

**MEMBERS ABSENT:** John Bohan; Dave Bergstrom; Doug Gorence; Gary Norstrom; and Daralyn Peifer.

**SBI STAFF:** Howard Bicker; Mansco Perry; Jim Heidelberg; Lois Buermann; Andy Christensen; Tammy Brusehaver-Derby; Stephanie Gleeson; John Griebenow; Debbie Griebenow; Mike Menssen; Erol Sonderegger; Charlene Olson; and Carol Nelson.

**OTHERS ATTENDING:** Ann Posey, Richards & Tierney; Christie Eller; Carla Heyl; Peter Sausen; Robert Heimerl, Lloyd Belford, Sue Mills Moriarity; Jerry Irsfeld, REAM; Ed Rapp, Education Minnesota; and Sven Wehrwein, Twin City Business Monthly Magazine.

Mr. Bicker stated that members needed to elect an acting chair until a formal vote on a permanent chair takes place at the June 2003 meeting. Mr. McDonald moved to select Michael Troutman to serve as acting chair. Mr. Gudorf seconded the motion. The motion passed. The minutes of the December 2, 2002 meeting were approved.

**Executive Director's Report**

Mr. Bicker, Executive Director, referred members to Tab A of the meeting materials and reported that the Combined Funds had exceeded inflation over the ten year period ending December 31, 2002 (Combined Funds 7.9% vs. Inflation 2.5%), trailed the median fund (85<sup>th</sup> percentile) for the most recent five year period due to the SBI's higher than average equity exposure and slightly underperformed its composite index (Combined Funds 1.8% vs. Composite 1.9%). He stated that the Basic Funds have slightly underperformed its composite index (Basic Funds 1.8% vs. Composite 1.9%) over the last five years and reported that the Post Fund has also underperformed its composite index over the last five years period (Post Fund 1.7% vs. Composite 1.8%).

Mr. Bicker reported that the Basic Fund's assets increased 4.5% for the quarter ending December 31, 2002 due mostly to positive investment returns. He said that the asset mix is on target. He reported that the Basic Funds underperformed its composite index for the quarter (Basic Funds 4.1% vs. Composite 4.5%) and for the year (Basic Funds -11.6 vs. Composite -10.8%).

Mr. Bicker reported that the market value of the Post Fund's assets increased 2.7% for the quarter ending September 30, 2002 due to positive investment returns. He said the Post Fund asset mix is on target and that the Post Fund underperformed its composite index for the quarter (Post Fund 5.3% vs. Composite 5.7%) and for the year (Post Fund -11.6 vs. Composite -10.4%).

Mr. Bicker reported that the domestic stock manager group underperformed its target for the quarter (Domestic Stock 7.5% vs. Wilshire 5000 Investable 8.1%) and underperformed it for the year (Domestic Stocks -22.4 vs. Wilshire 5000 Investable -21.5%). He said the International Stock manager group outperformed its composite index for the quarter (International Stocks 6.9% vs. Int'l Composite 6.8%) and outperformed it for the year (International Stocks -13.6% vs. Int'l Composite -14.8%). Mr. Bicker stated that the bond segment outperformed its target for the quarter (Bonds 2.0% vs. Lehman Aggregate 1.6%) and underperformed its target for the year (Bonds 8.9% vs. Lehman Aggregate 10.3%). He concluded his report with the comment that as of December 31, 2002, the SBI was responsible for over \$40 billion in assets.

#### **Executive Director's Administrative Report**

Mr. Bicker referred members to Tab B of the meeting materials for the quarterly updates on budget and travel. Mr. Bicker reported that the legislative auditors had completed the FY02 audit, and that the SBI had received a "clean opinion" on its financial statements.

Mr. Bicker distributed a memo to members updating the legislative activity of interest to the SBI (see **Attachment A**). He reported that the SBI had its first budget hearing before the Senate State Government Budget Division and that the SBI's current budget recommendation is for a 10% reduction for both FY04 and FY05.

Mr. Bicker said that at the March 6, 2002 Board meeting, the Board authorized staff, after consultation with Board deputies, to alter the asset allocation of funds as a result of legislative budget actions. The Board deputies met and initially decided not to liquidate the Tobacco Endowment Fund assets, based upon projections that the Funds would not be needed for budgetary cash flow purposes until mid-2003. He said he was instructed by the deputies to work with the Department of Finance on this issue, and if both he and the Commissioner of Finance agreed that the Funds should be liquidated, then the bonds and stocks would be converted to cash. He said that in late February 2003, he met with the Commissioner of Finance and discussed the issue of liquidating the Funds. Given the State's current budget situation it was determined that it is prudent to liquidate the Funds. Mr. Bicker reported that the Funds are in the process of being liquidated as part of the State's budget resolution and that he will give a final update to the IAC at the June 2003



meeting. In response to a question from Ms. Voss, Mr. Bicker said that the funds should all be liquidated within a couple weeks.

Mr. Bicker stated that at its December 2002 meeting, the Board instructed him to work with the retirement system directors to determine whether the issue of extending the amortization period for investment gains in the Post Fund benefit increase formula should be brought to the Legislature this session. He said he had met with the retirement fund directors who reported that their respective boards were not in favor of introducing this issue during the 2003 Legislative session.

Mr. Bicker said that the Investment Advisory Council (IAC) is one of a number of advisory councils that are covered by a general June 30, 2003 sunset provision. He added that staff will monitor the bill to address the extension of the sunset date when it is introduced.

Mr. Bicker reported that a bill has been introduced to give the Minnesota State Colleges and Universities system (MnSCU) employees the option of having their current defined contribution plan or Teachers Retirement Association (TRA's) defined benefit plan. Ms. Stanton noted that MnSCU administration did not introduce this bill and that it was a bargaining unit bill. Mr. Austin added that the bill does contain some provisions to protect the financial integrity of TRA.

In response to questions and comments from Mr. Troutman, Mr. Bicker discussed ways that staff is currently handling the budget reduction and he explained why the SBI's budget has only about 10% that actually comes from the General Fund. Mr. Kiedrowski noted that he believes that the SBI's budget allocation should be compared to the amount most money managers would charge to manage the assets. In response to a request from Mr. McDonald, Mr. McElroy, the Commissioner of Finance, spoke briefly about the statewide budget deficit and the process the Administration used to determine the levels of budget cuts to various agencies. A lengthy discussion followed on how the SBI bills back the majority of its budget to the funds. Mr. McElroy briefly discussed how state agencies may be able to access funds through the General Contingency Account, in an emergency situation. Mr. Bicker stated that by December 2003, staff should have a much clearer picture of how much impact the reduction will have on the SBI's budget.

Mr. Kiedrowski made a motion to have the IAC go on record as opposing any budget cuts for the SBI since in reality it doesn't save the State money. Ms. Voss seconded the motion. Further discussion followed and in response to questions from Ms. Mares, Mr. Bicker stated that legally, he did not believe the retirement systems could make up the difference of any budget cuts. Ms. Vanek stated that the PERA Board is also having discussions about their own budget. Mr. McElroy noted that he would vote against Mr. Kiedrowski's motion and Mr. Liu voiced his concern about the motion. The motion failed.

## **Stock and Bond Manager Committee Report**

Mr. Kiedrowski referred members to Tab C of the meeting materials and began a review of the performance for the quarter. In response to a question from Ms. Mares, Mr. Kiedrowski confirmed that there will be further discussion about reallocating assets among current managers during the asset allocation review process.

Mr. Kiedrowski reported that the Metropolitan West Asset Management liquidation was largely complete. He said that the annual review of the investment manager guidelines had been completed and that the changes were all technical in nature. He said that the asset allocation and program review is proceeding and that the Asset Allocation Committee will meet in April to review staff's recommendations and that the IAC will review the final recommendations at the June 2003 meeting. Mr. Bicker clarified that the full IAC makes up the Asset Allocation Committee. In response to a question from Ms. Mares, Mr. Kiedrowski and Mr. Bicker confirmed that the Emerging Manager Program will also be part of the asset allocation study and program review.

Mr. Troutman referred members back to Item 4 in Tab B which was inadvertently missed. Ms. Eller, Assistant Attorney General, updated members on the status of litigation. She noted that the SBI is the plaintiff in five different securities actions, three of which are class actions. She reported that the SBI is receiving approximately \$250,000 from the Mercury Finance settlement. She said that the SBI had approximately \$3 million in losses and that the settlement amount received is actually high by class action standards. She noted that the SBI had pursued additional sources of recovery from Mercury's auditors and from named executives which helped to increase the amount recovered. Ms. Eller stated that the case against McKesson HBOC is not a class action and that the SBI opted out of the federal class and brought an action with funds from Colorado and Utah in state court in California. She noted that the SBI's losses in McKesson are approximately \$20 million. She said that the federal case has stayed discovery due to pending criminal charges but that the state actions are proceeding. Ms. Eller reported that the Broadcom litigation is a class action for alleged accounting irregularities and that the SBI's losses are estimated to be approximately \$17 million. She said that discovery is proceeding in that case and that Mr. Bicker is having his deposition taken later in the week. Ms. Eller stated that the case involving WorldCom bonds is not a class action and that it is an action against the investment banks and not against the Company. She said the action was filed in state court and that it has been moved to federal court in New York. She added that nine other pension funds have also filed similar actions. She concluded her update by saying that the SBI is also involved in a class action against AOL Time Warner and that the SBI has been named lead plaintiff. She said the SBI had filed in three different jurisdictions, and that the multi-disciplinary panel moved it to the southern district of New York. She noted that the SBI's losses are approximately \$250 million.

## **Alternative Investment Committee Report**

Mr. Gudorf referred members to Tab D of the meeting materials and stated that the Committee is recommending an investment with an existing private equity manager, CSFB Strategic Partners. He briefly explained the strategy of the fund and said that this recommendation is for the Post Retirement Fund. He added that the recommendation is contingent upon changes being approved to the Post Fund's investment parameters during the asset allocation review. Mr. Bicker added that the fund will be doing a second closing in June and that it is in the best interest of the SBI to participate in closing negotiations as early as possible. Mr. Gudorf noted that the SBI has preferential terms since it invested in the prior fund. Mr. McDonald moved approval of the Committee's recommendation. Ms. Mares seconded the motion. The motion passed.

The meeting adjourned at 3:10 P.M.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Howard J. Bicker".

Howard J. Bicker  
Executive Director



**MINNESOTA  
STATE  
BOARD OF  
INVESTMENT**



**Board Members:**

Governor  
Tim Pawlenty

State Auditor  
Pat Anderson Awada

Secretary of State  
Mary Kiffmeyer

Attorney General  
Mike Hatch

**Executive Director:**

Howard J. Bicker

**DATE:** March 4, 2003

**TO:** Members, State Board of Investment

**FROM:** Howard Bicker *AB*

**SUBJECT:** Legislative Issues Update

**SBI Budget (HF \_\_\_; SF \_\_\_)**

Hearing March 4 before Senate State Government Budget Division.

**Tobacco Endowment Funds**

At its March 6, 2002 Board meeting, the SBI authorized staff, after consultation with Board deputies, to alter the asset allocation of funds as a result of legislative budget actions. The Board deputies met and initially decided not to liquidate the Tobacco Endowment Fund assets, based upon projections that the Funds would not be needed for budgetary cash flow purposes until mid-2003. The Executive Director was instructed by the deputies to work with the Department of Finance on this issue, and if both the Commissioner of Finance and the Executive Director of the SBI agreed that the Funds should be liquidated, then the bonds and stocks would be converted to cash. Further, the Executive Director would report back to the Board on actions taken.

In late February 2003, the Commissioner of Finance and the SBI's Executive Director discussed the issue of liquidating the Tobacco Endowment Funds. Given the State's current budget situation it was determined that it is prudent to liquidate the Funds.

**Post Retirement Fund Benefit Increase Formula**

At its December 2002 meeting the Board instructed the Executive Director to work with the retirement system directors to determine whether the issue of extending the amortization period for investment gains in the Post Fund formula should be brought to the Legislature this session. The Executive Director met with the directors who reported that their respective boards were not in favor of introducing this issue during the 2003 Legislative Session.

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**Extending Sunset Provision for IAC (HF \_\_\_; SF \_\_\_)**

The Investment Advisory Council (IAC) is one of a number of advisory councils in statute that are covered by a general June 30, 2003 sunset provision. Staff has been notified of the intent of the Legislature to address the issue of extending the sunset date. To date, no bill has been introduced.

**Permitting MnSCU Plan Members the Option to Return to TRA Plan (HF 286; SF \_\_\_)**

HF 286 would give MnSCU employees the option of having their current defined contribution plan or TRA's defined benefit plan. No committee hearing has been scheduled.

# Tab A





**LONG TERM OBJECTIVES**  
**Period Ending 3/31/2003**

<b>COMBINED FUNDS: \$30.1 Billion</b>	<b>Result</b>	<b>Compared to Objective</b>
<b>Provide Real Return (10 yr.)</b>  Provide returns that are 3-5 percentage points greater than inflation over the latest 10 year period.	7.3% (1)	4.8 percentage points above CPI
<b>Exceed Composite Index (5 yr.)</b>  Outperform a composite market index weighted in a manner that reflects the actual asset mix of the Combined Funds over the latest 5 year period.	-0.4%	0.1 percentage point below composite index
<b>Exceed Median Fund (5 yr.)</b>  Provide returns that are ranked in the top half of universe of public and corporate plans with over \$1 Billion in assets over the latest 5 year period.	85th percentile (2)	below the median fund in TUCS

<b>BASIC RETIREMENT FUNDS: \$15.3 Billion</b>	<b>Result</b>	<b>Compared to Objective</b>
<b>Exceed Composite Index (5 Yr.)</b>  Outperform a composite market index weighted in a manner that reflects the long-term asset allocation of the Basic Funds over the latest 5 year period.	-0.4%	0.1 percentage point below target

<b>POST RETIREMENT FUND: \$14.8 Billion</b>	<b>Result</b>	<b>Compared to Objective</b>
<b>Exceed Composite Index (5 Yr.)</b>  Outperform a composite market index weighted in a manner that reflects the long-term asset allocation of the Post Fund over the latest 5 year period.	-0.5%	0.1 percentage point below target

(1) Reflects performance of Basic Funds only through 6/30/93, Combined Funds thereafter. Performance is calculated net of fees.

(2) The SBI's stated objective is to rank in the top half (above 50th percentile) of the comparative universe. The SBI will strive to achieve performance which ranks in the top third (above 33rd percentile). Performance is ranked gross of fees.

---

**SUMMARY OF ACTUARIAL VALUATIONS**
**MSRS, TRA, PERA General Plans****July 1, 2002**

	<b>Active (Basics)</b>	<b>Retired (Post)</b>	<b>Total (Combined)</b>
<b>Liability Measures</b>			
1. Current and Future Benefit Obligation	\$25.3 billion	\$18.4 billion	\$43.7 billion
2. Accrued Liabilities	18.4	18.4	36.8
<b>Asset Measures</b>			
3. Current and Future Actuarial Value	\$26.1 billion	\$18.4 billion	\$44.5 billion
4. Current Actuarial Value	17.6	18.4	36.1
<b>Funding Ratios</b>			
Future Assets vs. Future Obligations (3 ÷ 1)	103%	100%	102%
Current Actuarial Value vs. Accrued Liabilities (4 ÷ 2)	96%	100%	98%*

\* Ratio most frequently used by the Legislature and Retirement Systems.

**Notes:**

1. Present value of projected benefits that will be due to all current participants.
2. Liabilities attributed to past service calculated using entry age normal cost method.
3. Present value of future statutory contributions plus current actuarial value.
4. Same as required reserves for Post; Difference between actual returns and actuarially expected returns spread over five years.

**Actuarial Assumptions:**

Salary Growth: 6.5%, resulting from a graded rate future increase assumption

Interest/Discount Rate: 8.5% Basics, 6.0% Post

Full Funding Target Date: 2031

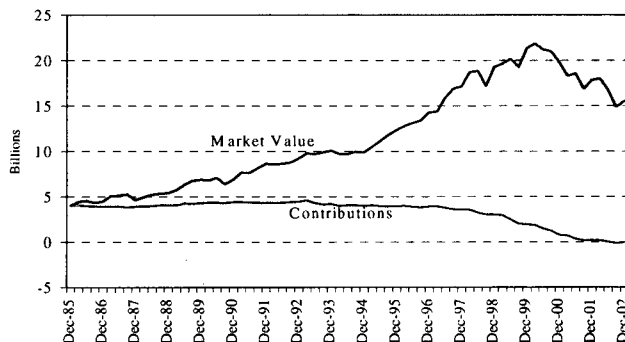
**EXECUTIVE SUMMARY**  
**Basic Retirement Funds (Net of Fees)**

**Asset Growth**

The market value of the Basic Funds decreased 2.0% during the first quarter of 2003. Negative investment returns and negative net contributions accounted for the decrease.

**Asset Growth**  
**During First Quarter 2003**  
**(Millions)**

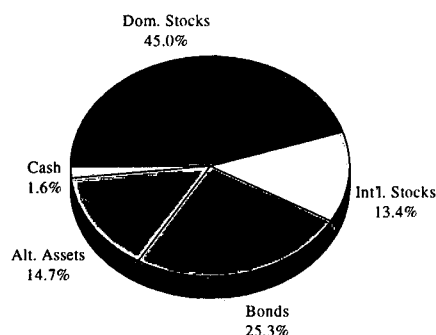
Beginning Value	\$ 15,561
Net Contributions	-19
Investment Return	-285
Ending Value	\$ 15,257



**Asset Mix**

The bond and alternative assets allocations increased over the quarter due to their relative outperformance versus other asset classes.

	Policy Targets	Actual Mix 3/31/2003	Actual Market Value (Millions)
Domestic Stocks	45.0%	45.0%	\$6,862
Int'l. Stocks	15.0	13.4	2,045
Bonds	24.0	25.3	3,864
Alternative Assets*	15.0	14.7	2,238
Unallocated Cash	1.0	1.6	248
	100.0%	100.0%	\$15,257

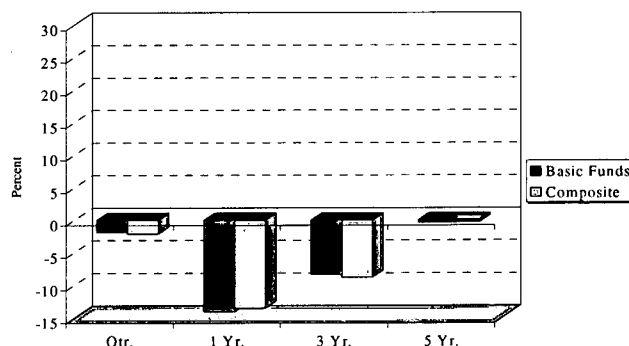


\* Any uninvested allocation is held in domestic stocks

**Fund Performance (Net of Fees)**

The Basic Funds outperformed its composite market index for the quarter and underperformed for the one-year time period.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
Basics	-1.8%	-14.0%	-8.3%	-0.4%
Composite	-2.1	-13.5	-8.7	-0.3



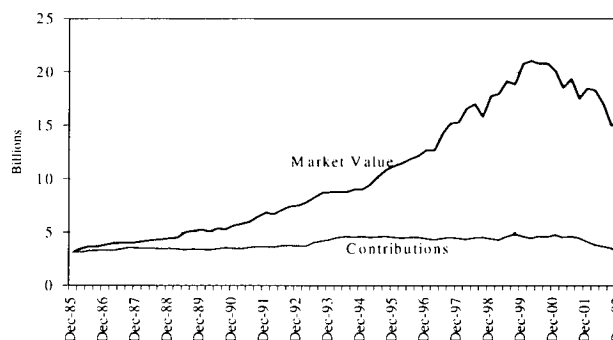
**EXECUTIVE SUMMARY**  
**Post Retirement Fund (Net of Fees)**

**Asset Growth**

The market value of the Post Fund decreased by 3.6% during the first quarter of 2003. Negative investment returns and negative contributions accounted for the decrease.

**Asset Growth**  
**During First Quarter 2003**  
**(Millions)**

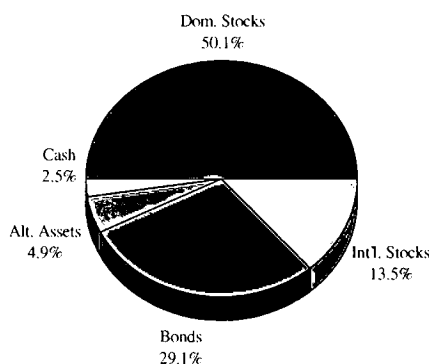
Beginning Value	\$15,403
Net Contributions	-266
Investment Return	-284
Ending Value	\$14,853



**Asset Mix**

The allocation to bonds increased due to positive returns and the international stock allocation decreased due to negative returns. The domestic stock allocation increased and the cash allocation decreased as a result of the negative cash flow in the Post Fund.

	Policy Targets	Actual Mix 3/31/2003	Actual Market Value (Millions)
Domestic Stocks	50.0%	50.1%	\$7,442
Int'l. Stocks	15.0	13.5	2,005
Bonds	27.0	29.1	4,317
Alternative Assets*	5.0	4.9	724
Unallocated Cash	3.0	2.5	365
	100.0%	100.1%	\$14,853

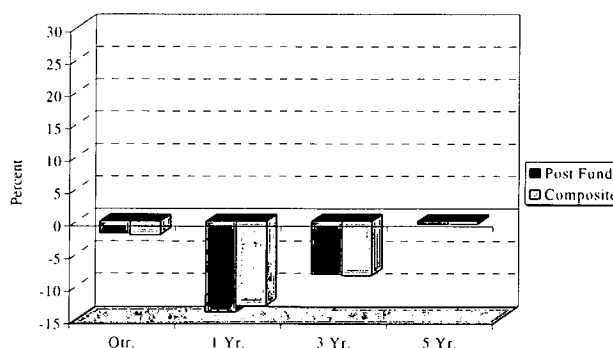


\* Any uninvested allocation is held in bonds

**Fund Performance (Net of Fees)**

The Post Fund outperformed its composite market index for the quarter and underperformed for the one-year time period.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
Post	-1.9%	-13.9%	-8.1%	-0.5%
Composite	-2.1	-13.0	-8.4	-0.4



## EXECUTIVE SUMMARY

### Stock and Bond Manager Performance (Net of Fees)

#### Domestic Stocks

The domestic stock manager group (active, semi-passive and passive combined) outperformed its target for the quarter.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Dom. Stocks</b>	<b>-2.6%</b>	<b>-24.7%</b>	<b>-16.7%</b>	<b>-4.7%</b>
W5000 Investable*	-2.9	-24.4	-16.8	-4.4

\* Restated to incorporate the Wilshire 5000 Investable Index beginning 7/1/99. From 11/1/93 to 6/30/99, the target was the Wilshire 5000 as reported with no adjustments.

#### International Stocks

The international stock manager group (active and passive combined) underperformed its target for the quarter and one-year time periods.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Int'l. Stocks</b>	<b>-8.2%</b>	<b>-22.9%</b>	<b>-18.0%</b>	<b>-6.5%</b>
Composite Index*	-8.0	-22.8	-19.3	-7.1

\* The international benchmark is EAFE Free plus Emerging Markets Free (EMF). The weighting of each index fluctuates with market capitalization. From 12/31/96 to 6/30/99 the benchmark was fixed at 87% EAFE-Free/13% EMF. On 5/1/96 the portfolio began transitioning from 100% EAFE Free to the 12/31/96 fixed weights. 100% EAFE-Free prior to 5/1/96.

#### Bonds

The bond manager group (active and passive combined) outperformed its target for the quarter.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Bonds</b>	<b>1.8%</b>	<b>10.5%</b>	<b>9.8%</b>	<b>7.4%</b>
Lehman Agg.	1.4	11.7	9.8	7.5

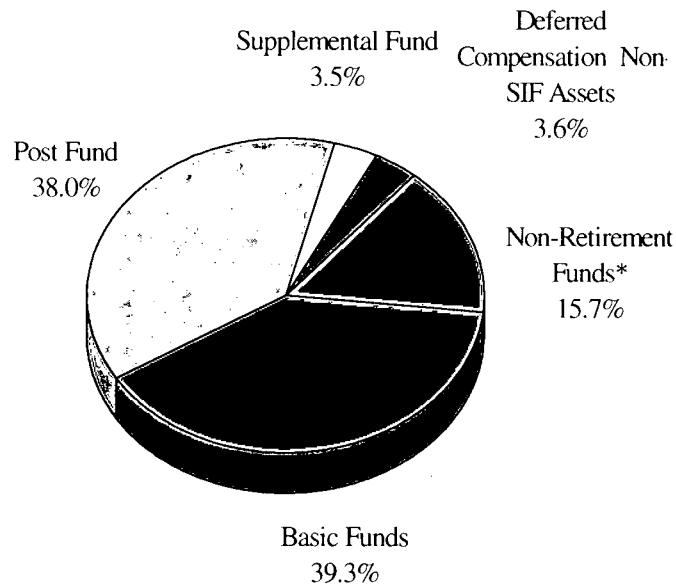
**Wilshire 5000 Investable:** The Wilshire 5000 Investable stock index reflects the performance of a broad range of publicly traded stocks of companies domiciled in the U.S. It does not include the smallest and least liquid securities in the W5000 that generally are not owned by large pension plans.

**Lehman Aggregate:** The Lehman Brothers Aggregate Bond Index reflects the performance of the broad bond market for investment grade (Baa or higher) bonds, U.S. treasury and agency securities, and mortgage obligations with maturities greater than one year.

**EAFE-Free:** The Morgan Stanley Capital International (MSCI) index of 21 stock markets in Europe, Australasia and the Far East. EAFE-Free includes only those securities foreign investors are allowed to hold.

**Emerging Markets Free:** The Morgan Stanley Capital International index of 26 markets in developing countries throughout the world. Emerging Markets Free includes only those securities foreign investors are allowed to hold.

**EXECUTIVE SUMMARY**  
Funds Under Management



	<b>3/31/2003 Market Value (Billions)</b>
<b>Retirement Funds</b>	
Basic Retirement Funds	\$15.3
Post Retirement Fund	14.8
Supplemental Investment Fund	1.4
State Deferred Compensation Plan Non-SIF Assets	1.4
<b>Non-Retirement Funds*</b>	
Assigned Risk Plan	0.2
Permanent School Fund	0.5
Environmental Trust Fund	0.3
Tobacco Prevention Fund	0.4
Medical Education Fund	0.3
Academic Health Center Fund	0.2
State Cash Accounts	4.1
<b>Total</b>	<b>\$39.0</b>

# MINNESOTA STATE BOARD OF INVESTMENT

## QUARTERLY INVESTMENT REPORT

First Quarter 2003

(January 1, 2003 - March 31, 2003)

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## VARIOUS CAPITAL MARKET INDICES

Period Ending 3/31/2003

	Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Domestic Equity</b>					
Wilshire 5000	-3.1%	-24.0%	-16.3%	-3.9%	8.0%
Dow Jones Industrials	-3.6	-21.4	-8.2	-0.1	11.1
S&P 500	-3.1	-24.8	-16.1	-3.8	8.5
Russell 2000	-4.5	-27.0	-11.0	-4.1	6.2
<b>Domestic Fixed Income</b>					
Lehman Aggregate*	1.4	11.7	9.8	7.5	7.2
Lehman Gov't./Corp.	1.6	13.4	10.1	7.6	7.3
3 month U.S. Treasury Bills	0.3	1.5	3.4	4.0	4.4
<b>International</b>					
EAFE**	-8.2	-23.2	-19.5	-7.1	2.0
Emerging Markets Free***	-5.9	-20.6	-16.4	-6.9	0.2
Salomon Non U.S. Gov't. Bond	3.7	28.9	6.3	5.8	6.2
<b>Inflation Measure</b>					
Consumer Price Index****	1.8	3.0	2.5	2.6	2.5

\* Lehman Brothers Aggregate Bond index. Includes governments, corporates and mortgages.

\*\* Morgan Stanley Capital International index of Europe, Australasia and the Far East (EAFE). (Net index)

\*\*\* Morgan Stanley Capital International Emerging Markets Free index. (Gross index)

\*\*\*\* Consumer Price Index (CPI) for all urban consumers, also known as CPI-U.



**FINANCIAL MARKETS REVIEW**

**DOMESTIC STOCKS**

The US stock market, as measured by the Wilshire 5000, declined by -3.1% during the first quarter of 2003. High oil prices, a stalling job market, and the ups and downs of news on the war in Iraq caused considerable volatility during the period. Caution has been the prevailing mood in the equity markets given a slowdown in manufacturing and a decline in consumer spending from the prior quarter. The finance sector was the worst performing sector, while biotechnology, discount retail stores, and oil were positive areas of the market.

Performance of the Wilshire Style Indices for the quarter is shown below:

Large Value	-6.1%
Small Value	-5.9
Large Growth	-0.3
Small Growth	-3.6

The Wilshire 5000 declined -24.0% for the year ending March 31, 2003.

**DOMESTIC BONDS**

The bond market gained 1.4% during the first quarter. Interest rates ended the quarter little changed following significant volatility during the quarter. Mixed economic signals were increasingly obscured, indeed overshadowed, by the buildup to war with Iraq and commencement of the conflict. In a sign of the uncertain times, the Fed removed its "balanced" stance on risks to the economy in favor of no official stance, citing "unusually large uncertainties clouding the geopolitical situation".

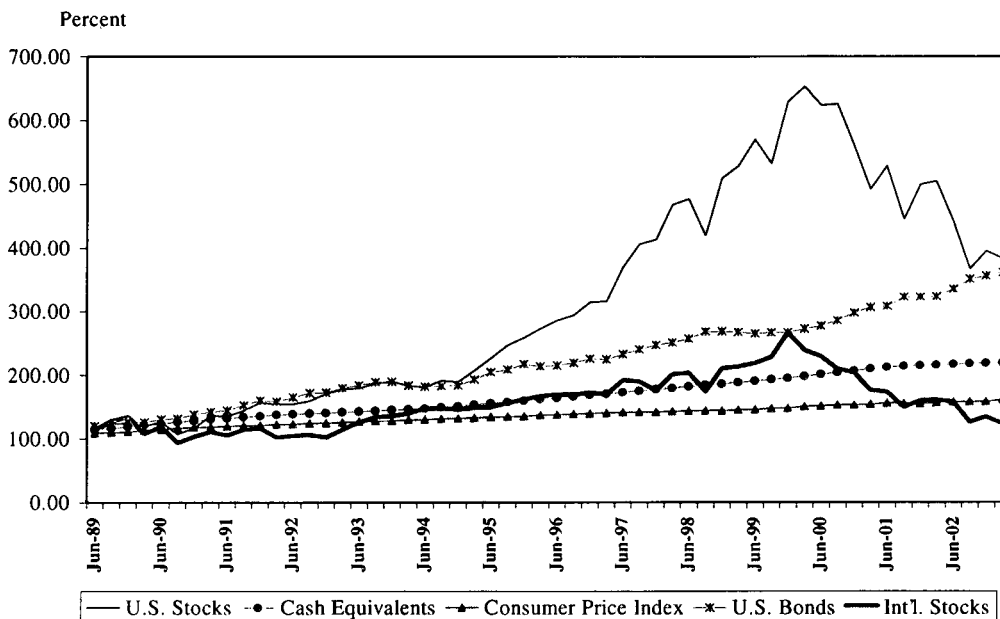
Despite the extant economic and geopolitical risks, investors continued to favor the spread sectors of the market. All of the spread sectors enjoyed positive relative returns over Treasuries. The sub-sector returns for the Aggregate over the quarter were:

Treasury/Agency	1.1%
Credit	0.9
Mortgages	2.4

For the year ending March 31, 2003, the Lehman Aggregate returned 11.7%.

**PERFORMANCE OF CAPITAL MARKETS**

**Cumulative returns**



Indices used are: Wilshire 5000 Stock Index for U.S. Stocks; 3 month Treasury Bills for Cash Equivalents; Consumer Price Index; Lehman Brothers Aggregate Bond Index for U.S. Bonds; and the Morgan Stanley's Index of Europe, Australasia and the Far East (EAFE) for International Stocks.

## FINANCIAL MARKETS REVIEW

### INTERNATIONAL STOCKS

In aggregate, developed international stock markets (as measured by the EAFE index) provided a return of -8.2% for the quarter. The quarterly performance of the five largest stock markets is shown below:

United Kingdom	-8.6%
Japan	-7.9
France	-11.5
Switzerland	-9.1
Germany	-12.6

The EAFE index decreased by -23.2% during the last year.

The EAFE index is compiled by Morgan Stanley Capital International (MSCI) and is a measure of 21 markets located in Europe, Australasia and the Far East. The major markets listed above comprise about 72% of the value of the international markets in the index.

### EMERGING MARKETS

Emerging markets (as measured by MSCI Emerging Markets Free index) provided a return of -5.9% for the quarter. The quarterly performance of the five largest stock markets in the index is shown below:

Korea	-17.2%
Taiwan	-2.8
South Africa	-7.4
Mexico	-5.9
Brazil	5.8

The Emerging Markets Free index decreased by -20.6% during the last year.

The Emerging Markets Free (EMF) index is compiled by MSCI and measures performance of 26 stock markets in Latin America, Asia, Africa and Eastern Europe. EMF includes only those securities foreign investors are allowed to hold. The markets listed above comprise about 66% of the value of the international markets in the index.

### REAL ESTATE

The lackluster performance in both the national and regional economies is contributing to the continued deterioration in property market fundamentals. In this real estate cycle, a significant decline in demand, rather than a gross excess supply as in past cycles, has been the culprit for rising vacancies and sublease space. Analysts expect more restrained supply to lead to improving fundamentals in 2003.

### PRIVATE EQUITY

U.S. private equity firms raised \$55 billion for private equity limited partnerships of all types, from venture capital to buyouts in 2002. That represents a 52% decrease from the revised prior year total of \$114 billion. This is the second year of significant decreases in funds raised.

### RESOURCE FUNDS

During the first quarter of 2003, crude oil averaged \$28.26 per barrel, lower than an average price of \$30.68 during the fourth quarter of 2002. The sustained high oil prices reflect the relative instability in the Middle East.

COMBINED FUNDS

The "Combined Funds" represent the assets of both the Basic and Post Retirement Funds. While the Combined Funds do not exist under statute, the Board finds it instructive to review asset mix and performance of all defined benefit pension assets under its control. This more closely parallels the structure of other public and corporate pension plan assets and therefore allows for more meaningful comparison with other pension fund investors.

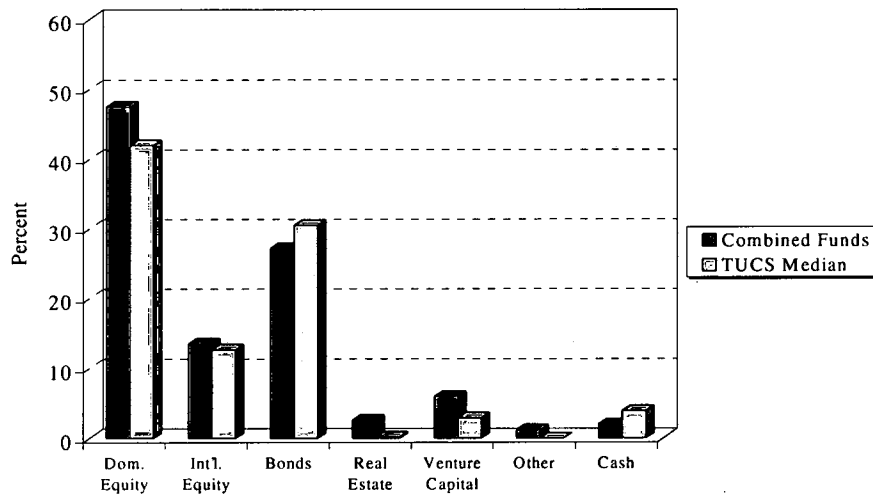
The comparison universe used by the SBI is the Trust Universe Comparison Service (TUCS). Only funds with assets over \$1 billion are included in the comparisons shown in this section.

Asset Mix Compared to Other Pension Funds

On March 31, 2003, the actual asset mix of the Combined Funds was:

	\$ Millions	%
Domestic Stocks	\$14,304	47.5%
International Stocks	4,049	13.5
Bonds	8,182	27.2
Alternative Assets	2,961	9.8
Unallocated Cash	613	2.0
<b>Total</b>	<b>\$30,109</b>	<b>100.0%</b>

Comparisons of the Combined Funds' asset mix to the median allocation to stocks, bonds and other assets of the public and corporate funds in TUCS over \$1 billion are shown below:



	Dom. Equity	Int'l Equity	Bonds	Real Estate	Venture Capital	Other	Cash
<b>Combined Funds</b>	<b>47.5%</b>	<b>13.5%</b>	<b>27.2%</b>	<b>2.6%</b>	<b>6.0%</b>	<b>1.2%</b>	<b>2.0%</b>
Median Allocation in TUCS*	41.3	11.8	31.3	0.2	2.4	0.0	4.1

\* Public and corporate plans over \$1 billion.

**COMBINED FUNDS  
Performance Compared to Other Pension Funds**

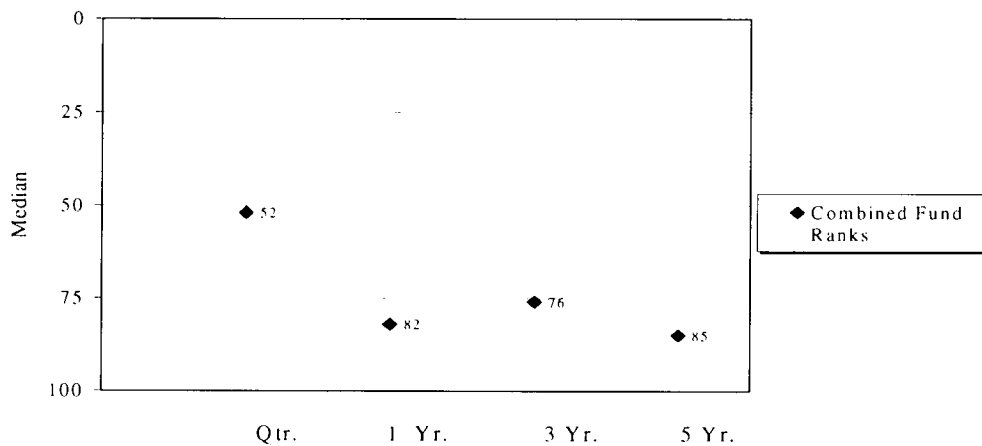
While the SBI is concerned with how its returns compare to other pension investors, universe comparisons should be used with great care. There are several reasons why such comparisons will provide an “apples to oranges” look at performance:

- **Differing Allocations.** Asset allocation will have a dominant effect on return. The allocation to stocks among the funds in TUCS typically ranges from 20-90%, a very wide range for meaningful comparison. In addition, it appears that many funds do not include alternative asset holdings in their reports to TUCS. This further distorts comparisons among funds.
- **Differing Goals/Liabilities.** Each pension fund structures its portfolio to meet its own liabilities and risk tolerance. This will result in different choices on asset mix. Since asset mix will largely determine investment results, a universe ranking is not relevant to a discussion of how well a plan sponsor is meeting its long-term liabilities.

With these considerations in mind, the performance of the Combined Funds compared to other public and corporate pension funds in Trust Universe Comparison Service (TUCS) are shown below.

The SBI’s returns are ranked against public and corporate plans with over \$1 billion in assets. All funds in TUCS report their returns gross of fees.

The SBI’s stated performance objective is that the Combined Funds will rank in the top half of the universe (above the 50th percentile) over the most recent five year period. The SBI will strive to achieve performance which ranks in the top third (above the 33rd percentile).



	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
Combined Funds Percentile Rank in TUCS*	52nd	82nd	76th	85th

\* Compared to public and corporate plans greater than \$1 billion, gross of fees.

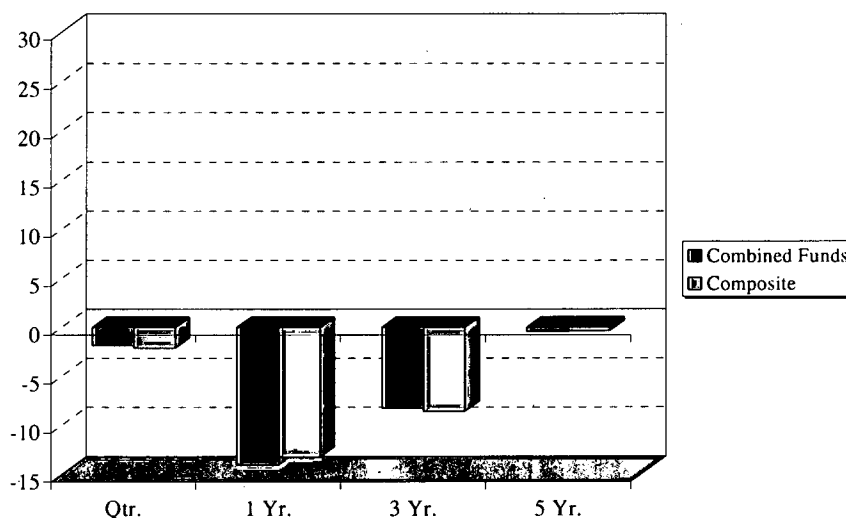
**COMBINED FUNDS**  
**Performance Compared to Composite Index**

The Combined Funds' performance is evaluated relative to a composite of market indices. The composite is

weighted in a manner that reflects the asset allocation of the Combined Funds:

	<b>Market Index</b>	<b>Combined Funds Composite* 1Q03</b>
Domestic Stocks	Wilshire 5000 Investable	47.9%*
Int'l. Stocks	Int'l. Composite	15.0
Bonds	Lehman Aggregate	25.8*
Alternative Assets	Real Estate Funds	2.4*
	Private Equity Funds	5.7*
	Resource Funds	1.2*
Unallocated Cash	3 Month T-Bills	2.0
		100.0%

\* Alternative asset, bond and domestic equity weights are reset in the composite at the start of each month to reflect the amount of unfunded commitments in alternative asset classes. The above Combined Funds Composite weighting was as of the beginning of the quarter.



**Period Ending 3/31/2003**

	<b>Qtr.</b>	<b>1 Yr.</b>	<b>Annualized</b>	
			<b>3 Yr.</b>	<b>5 Yr.</b>
<b>Combined Funds**</b>	-1.8%	-14.0%	-8.2%	-0.4%
<b>Composite Index</b>	-2.1	-13.2	-8.6	-0.3

\*\*Includes performance of Basic Funds through 6/30/93, Basic and Post Funds thereafter. Actual returns are reported net of fees.

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## BASIC RETIREMENT FUNDS

### Investment Objectives

The Basic Retirement Funds are composed of the retirement assets for currently working participants in eight statewide retirement funds. The Funds serve as accumulation pools for the pension contributions of public employees and their employers during the employees' years of active service. Approximately 322,000 public employees participate in the Basic Funds.

Employee and employer contribution rates are specified in state law as a percentage of an employee's salary. The rates are set so that contributions plus expected investment earnings will cover the projected cost of promised pension benefits. In order to meet these

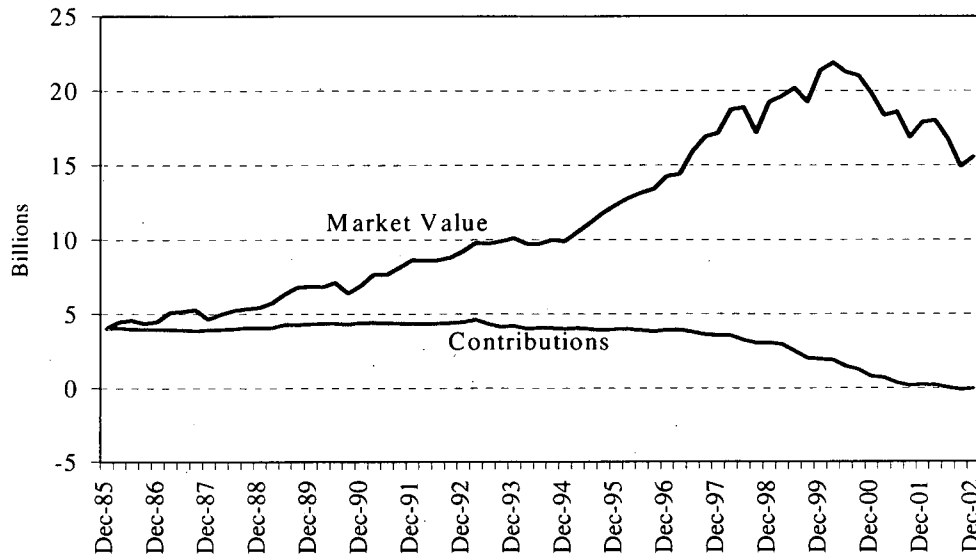
projected pension costs, the Basic Retirement Funds must generate investment returns of at least 8.5% on an annualized basis, over time.

Normally, pension assets will accumulate in the Basic Retirement Funds for thirty to forty years during an employee's years of active service. This provides the Basic Funds with a long investment time horizon and permits the Board to take an aggressive, high expected return investment policy which incorporates a sizeable equity component in order to meet or exceed its actuarial return target.

### Asset Growth

The market value of the Basic Funds decreased 2.0% during the first quarter of 2003. Negative investment

returns and negative net contributions accounted for the decrease.



	Last Five Years					Latest Qtr.
	In Millions					
	12/98	12/99	12/00	12/01	12/02	3/03
Beginning Value	\$17,146	\$19,244	\$21,365	\$19,807	\$17,874	\$15,561
Net Contributions	-539	-1,065	-1,186	-572	-247	-19
Investment Return	2,637	3,186	-372	-1,361	-2,066	-285
Ending Value	\$19,244	\$21,365	\$19,807	\$17,874	\$15,561	\$15,257

## BASIC RETIREMENT FUNDS

### Asset Mix

The long-term asset allocation of the Basic Funds is based on the superior performance of common stocks over the history of the capital markets. The asset allocation policy is designed to add value to the Basic Funds over their long-term investment time horizon.

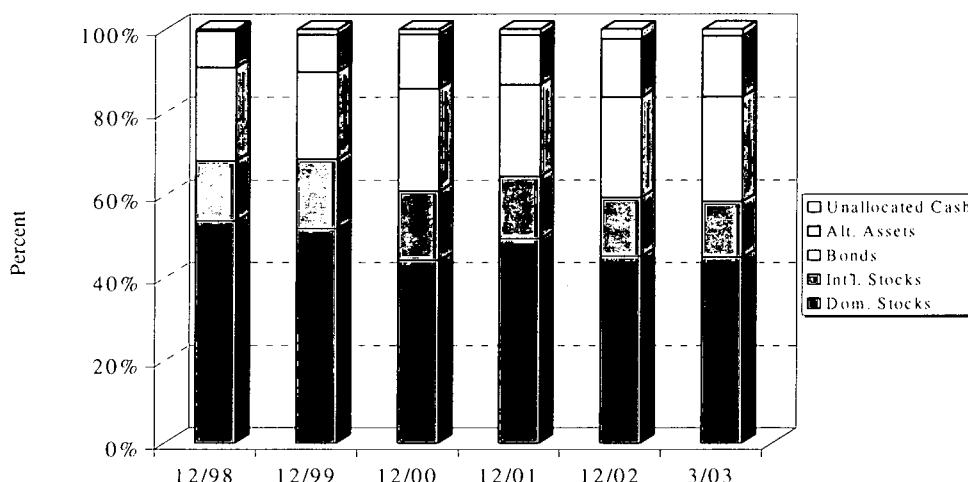
Domestic Stocks	45.0%
Int'l. Stocks	15.0
Bonds	24.0
Alternative Assets*	15.0
Unallocated Cash	1.0

\* Alternative assets include equity-oriented real estate, venture capital and resource funds. Any uninvested allocation is held in domestic stocks.

In October 1995, the Board revised its long term asset allocation targets for the Basic Funds, increasing international stocks from 10% to 15% and decreasing domestic stocks from 50% to 45%. The change was implemented over several quarters.

Over the last year, the allocation to bonds increased due to positive returns. The allocation to domestic stocks and international stocks decreased due to negative returns.

During the quarter, the bond and alternative assets allocation increased over the quarter due to their relative outperformance versus other asset classes.



	12/98	Last Five Years				Latest Qtr.
	12/98	12/99	12/00	12/01	12/02	3/03
Domestic Stocks	53.8%	51.9%	44.3%	49.5%	45.3%	45.0%
Int'l. Stocks	14.4	16.8	16.6	15.0	14.1	13.4
Bonds	22.6	21.0	24.7	22.1	24.2	25.3
Real Estate	3.7	3.5	4.1	3.4	3.8	3.9
Private Equity	4.4	4.8	8.0	7.4	8.7	9.1
Resource Funds	0.7	0.8	1.2	1.3	1.6	1.7
Unallocated Cash	0.4	1.2	1.1	1.3	2.3	1.6
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%



**BASIC RETIREMENT FUNDS**  
**Total Fund Performance (Net of Fees)**

The Basic Funds' performance is evaluated relative to a composite of market indices. The composite is weighted in a manner that reflects the long-term asset allocation of the Funds:

	Basics Target	Market Index	Basics Composite* 1Q03
Domestic Stocks	45.0%	Wilshire 5000 Investable	45.8%*
Int'l. Stocks	15.0	Int'l Composite	15.0
Bonds	24.0	Lehman Aggregate	24.0
Alternative Assets	15.0	Real Estate Funds	3.7*
		Private Equity Funds	8.9*
		Resource Funds	1.6*
Unallocated Cash	1.0	3 Month T-Bills	1.0
	100.0%		100.0%

\* Alternative asset and domestic stock weights are reset in the composite at the start of each month to reflect the uninvested portion of the allocation to alternative assets. The above Basic Funds Composite weighting was as of the beginning of the quarter.



**Period Ending 3/31/2003**

	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Basic Funds**</b>	<b>-1.8%</b>	<b>-14.0%</b>	<b>-8.3%</b>	<b>-0.4%</b>
Composite Index	-2.1	-13.5	-8.7	-0.3

\*\*Returns are reported net of fees.

Effective July 1, 1993, the Basic and Post Funds share the same domestic stock, international stock, and bond managers. See page 15 for the performance of these asset pools. Performance of the Basic Funds' alternative assets is on page 16.

**POST RETIREMENT FUND**

The Post Retirement Investment Fund contains the pension assets of retired public employees covered by statewide retirement plans. Approximately 114,000 retirees receive monthly annuities from the assets of the Fund.

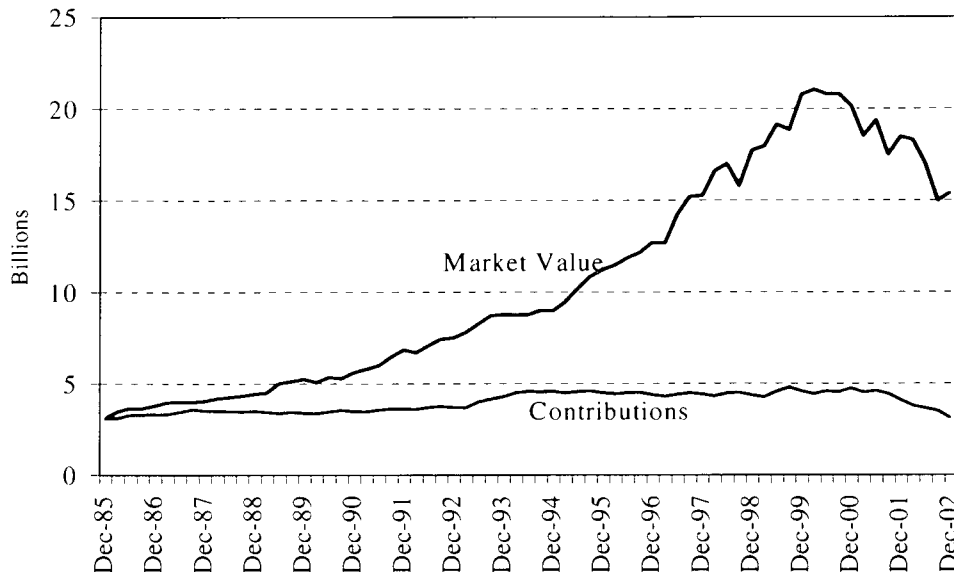
The post retirement benefit increase formula is based on the total return of the Fund. As a result, the Board maintains a long-term asset allocation strategy for the Post Fund which incorporates a substantial commitment to common stocks.

Upon an employee's retirement, a sum of money sufficient to finance the fixed monthly annuity is transferred from accumulation pools in the Basic Funds to the Post Fund. In order to support promised benefits, the Post Fund must "earn" at least 6% on its invested assets on an annualized basis. If the Post Fund exceeds this earnings rate, excess earnings are used to finance permanent benefit increases for eligible retirees.

**Asset Growth**

The market value of the Post Fund decreased by 3.6% during the first quarter of 2003. Negative investment

returns and negative contributions accounted for the decrease.



	Last Five Years In Millions					Latest Qtr.
	12/98	12/99	12/00	12/01	12/02	3/03
Beginning Value	\$20,768	20,153	\$20,768	\$20,153	\$18,475	15,403
Net Contributions	167	-647	167	-647	-1,000	-266
Investment Return	-782	-1,031	-782	-1,031	-2,072	-284
Ending Value	\$20,153	18,475	\$20,153	\$18,475	\$15,403	14,853

**POST RETIREMENT FUND**

**Asset Mix**

The Board adopted an asset allocation strategy for the Post Fund in fiscal year 1993 which reflects the post retirement benefit increase formula enacted by the Legislature. Throughout fiscal year 1993, the actual asset mix of the Post Fund moved toward a 50% allocation to common stocks. In fiscal year 1994, the Board added allocations to international stocks and alternative investments.

The large allocation to common stocks allows the Fund to increase the long-term earning power of its assets and allow the Fund to focus on generating higher long-term total rates of return.

In October 1995, the Board revised its long term asset allocation targets for the Post Fund, increasing international stocks from 10% to 15% and decreasing bonds from 32% to 27%.

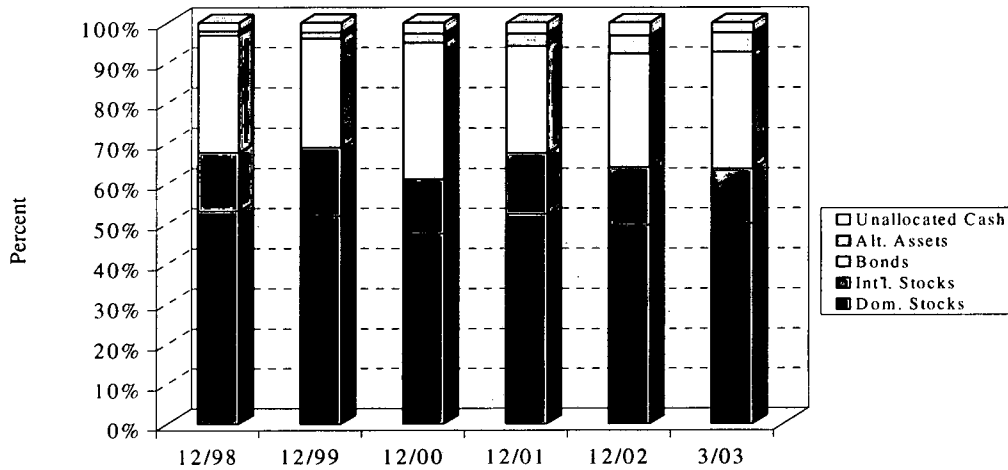
Over the last year, the allocation to bonds increased due to positive returns. The allocation to domestic stocks and international stocks decreased due to negative returns.

The allocation to bonds increased due to positive returns and the international stock allocation decreased due to negative returns. The domestic stock allocation increased and the cash allocation decreased as a result of the negative cash flow in the Post Fund.

Domestic Stocks	50.0%
Int'l. Stocks	15.0
Bonds	27.0
Alternative Assets*	5.0
Unallocated Cash	3.0

100.0%

\* Alternative assets include yield oriented investment vehicles. Any uninvested allocation is held in bonds.



	12/98	Last Five years				Latest Qtr.
		12/99	12/00	12/01	12/02	3/03
Dom. Stocks	53.2	52.0%	47.5%	52.4%	49.6%	50.1%
Int'l. Stocks	14.5	16.9	13.5	15.1	14.4	13.5
Bonds	29.2	27.2	34.0	26.7	28.3	29.1
Alt. Assets	1.1	1.5	2.3	3.1	4.5	4.9
Unallocated Cash	2.0	2.4	2.7	2.7	3.2	2.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

**POST RETIREMENT FUND**  
**Total Fund Performance (Net of Fees)**

The Post Fund's performance is evaluated relative to a composite of market indices. The composite is weighted in a manner that reflects the long-term asset allocation of the Fund:

Asset Class	Post Target	Market Index	Post Composite* 1Q03
Domestic Stocks	50.0%	Wilshire 5000 Investable	50.0%
Int'l. Stocks	15.0	Int'l. Composite	15.0
Bonds	27.0	Lehman Aggregate	27.6*
Alternative Assets	5.0	Real Estate Funds	1.1*
		Private Equity Funds	2.5*
		Resource Funds	0.8*
Unallocated Cash	3.0	3 Month T-Bills	3.0
	100.0%		100.0%

\*Alternative assets and bond weights are reset in the composite at the start of each month to reflect the uninvested portion of the allocation to alternative assets. The above Post Fund Composite weighting was as of the beginning of the quarter.



**Period Ending 3/31/2003**

	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Post Fund**</b>	<b>-1.9%</b>	<b>-13.9%</b>	<b>-8.1%</b>	<b>-0.5%</b>
Composite Index	-2.1	-13.0	-8.4	-0.4

\*\* Returns are reported net of fees.

Effective July 1, 1993, the Basic and Post Funds share the same domestic stock, international stock, and bond managers. See page 15 for the performance of these asset pools.

**STOCK AND BOND MANAGERS**  
**Performance of Asset Pools (Net of Fees)**

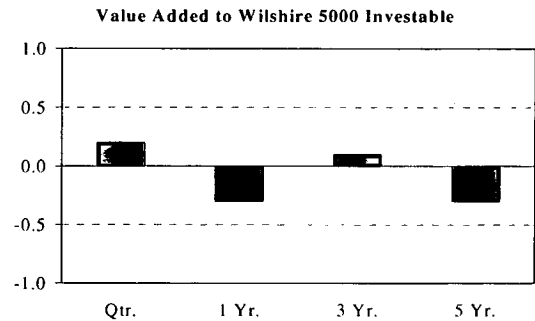
**Domestic Stocks**

**Target:** Wilshire 5000 Investable

**Expectation:** If one-third of the pool is actively managed, one-third is semi-passively managed, and one-third is passively managed, the entire pool is expected to exceed the target by +.18 - .40% annualized, over time.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yrs.	5 Yrs.
<b>Domestic Stocks</b>	<b>-2.6%</b>	<b>-24.7%</b>	<b>-16.7%</b>	<b>-4.7%</b>
W5000 Investable*	-2.9	-24.4	-16.8	-4.4

\* Restated to incorporate the Wilshire 5000 Investable Index beginning 7/1/99. W5000 prior to 7/1/99.



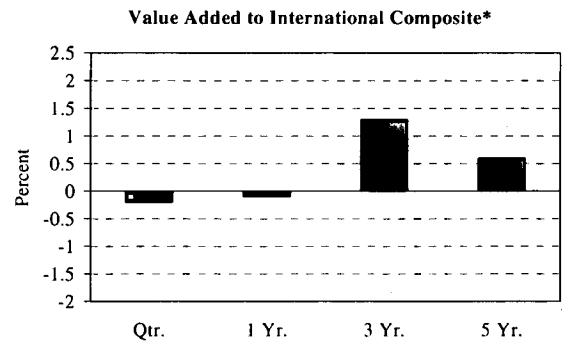
**International Stocks**

**Target:** Composite of EAFE-Free and Emerging Markets Free\*

**Expectation:** If at least one-third of the pool is managed actively and at least one-third is passively managed, the entire pool is expected to exceed the target by +.25%-.75% annualized, over time.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yrs.
<b>Int'l. Stocks</b>	<b>-8.2%</b>	<b>-22.9%</b>	<b>-18.0%</b>	<b>-6.5%</b>
Composite Index*	-8.0	-22.8	-19.3	-7.1

\* The international benchmark is EAFE Free plus Emerging Markets Free (EMF). The weighting of each index fluctuates with market capitalization. From 12/31/96 to 6/30/99 the benchmark was fixed at 87% EAFE-Free/13% EMF. On 5/1/96 the portfolio began transitioning from 100% EAFE to the 12/31/96 fixed weights. 100% EAFE-Free prior to 5/1/96.

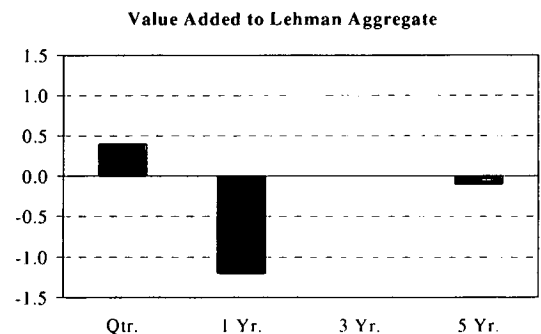


**Bonds**

**Target:** Lehman Brothers Aggregate Bond Index

**Expectation:** If half of the pool is actively managed and half is managed semi-passively, the entire pool is expected to exceed the target by +.20-.35% annualized, over time.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yrs.	5 Yrs.
<b>Bonds</b>	<b>1.8%</b>	<b>10.5%</b>	<b>9.8%</b>	<b>7.4%</b>
Lehman Agg.	1.4	11.7	9.8	7.5



## ALTERNATIVE ASSET MANAGERS

### Performance of Asset Pools (Net of Fees)

#### Real Estate Pool (Basic Funds only)

**Expectation:** Real estate investments are expected to exceed the rate of inflation by 3-5% annualized, over the life of the investment.

The SBI began its real estate program in the mid-1980's and periodically makes new investments. Some of the existing investments, therefore, are relatively immature and returns may not be indicative of future results.

	Period Ending 3/31/2003			
	Qtr.	Yr.	3 Yrs.	5 Yrs.
<b>Real Estate</b>	1.9%	4.3%	8.9%	7.8%
Inflation	1.8	3.0	2.5	2.6

#### Private Equity Pool (Basic Funds only)

**Expectation:** Private equity investments are expected to provide annualized returns at least 3% greater than historical public equity returns, over the life of the investment. This equates to an absolute return of approximately 13-14% annualized.

The SBI began its private equity program in the mid-1980's and periodically makes new investments. Some of the existing investments, therefore, are relatively immature and returns may not be indicative of future results.

	Period Ending 3/31/2003			
	Qtr.	Yr.	3 Yrs.	5 Yrs.
<b>Private Equity</b>	-1.0%	-9.2%	-4.1%	6.5%

#### Resource Pool (Basic Funds only)

**Expectation:** Resource investments (primarily oil and gas) are expected to exceed the rate of inflation by 3-5% annualized, over the life of the investment.

The SBI began its resource program in the mid-1980's and periodically makes new investments. Some of the existing investments, therefore, are relatively immature and returns may not be indicative of future results.

	Period Ending 3/31/2003			
	Qtr.	Yr.	3 Yrs.	5 Yrs.
<b>Resource Funds</b>	8.2%	1.9%	12.8%	1.7%

#### Yield Oriented Pool (Post Fund only)

**Expectation:** Yield oriented investments are expected to provide annualized returns at least 2% greater than historical public debt returns over the life of the investment. This equates to an absolute return of 10-11% annualized.

The SBI made its first commitment to the alternative investment program for the Post Fund in March 1994. Some of the existing investments, therefore, are relatively immature and returns may not be indicative of future results.

	Period Ending 3/31/2003			
	Qtr.	Yr.	3 Yrs.	5 Yrs.
<b>Yield Oriented</b>	3.2%	5.1%	10.8%	11.0%

## SUPPLEMENTAL INVESTMENT FUND

The Minnesota Supplemental Investment Fund is a multi-purpose investment program that offers a range of investment options to state and local public employees. The different participating groups use the Fund for a variety of purposes:

1. It functions as the investment manager for all assets of the Unclassified Employees Retirement Plan, Public Employees Defined Contribution Plan and Hennepin County Supplemental Retirement Plan.
2. It is one investment vehicle offered to employees as part of the state's Deferred Compensation Plan, the Individual Retirement Account Plan and College Supplemental Retirement Plan.
3. It serves as an external money manager for a portion of some local police and firefighter retirement plans.

A wide diversity of investment goals exists among the Fund's participants. In order to meet those needs, the Fund has been structured much like a "family of mutual funds." Participants may allocate their investments among one or more accounts that are appropriate for their needs, within the statutory requirements and rules established by the participating organizations. Participation in the Fund is accomplished through the purchase or sale of shares in each account.

The investment returns shown in this report are calculated using a time-weighted rate of return formula. They are net of investment management fees.

**On March 31, 2003 the market value of the entire Fund was \$1.4 billion.**

### Investment Options

	<b>3/31/2003 Market Value (In Millions)</b>
<b>Income Share Account</b> – a balanced portfolio utilizing both common stocks and bonds.	\$519
<b>Growth Share Account</b> – an actively managed, all common stock portfolio.	\$173
<b>Common Stock Index Account</b> – a passively managed, all common stock portfolio designed to track the performance of the entire U.S. stock market.	\$240
<b>International Share Account</b> – a portfolio of non U.S. stocks that incorporates both active and passive management.	\$41
<b>Bond Market Account</b> – an actively managed, all bond portfolio.	\$157
<b>Money Market Account</b> – a portfolio utilizing short-term, liquid debt securities.	\$102
<b>Fixed Interest Account</b> – a portfolio of guaranteed investment contracts (GIC's) and GIC type investments which offer a fixed rate of return for a specified period of time.	\$129

## SUPPLEMENTAL INVESTMENT FUND ACCOUNTS

### INCOME SHARE ACCOUNT

#### Investment Objective

The primary investment objective of the Income Share Account is similar to that of the Combined Funds. The Account seeks to maximize long-term real rates of return, while limiting short-run portfolio return volatility.

#### Asset Mix

The Income Share Account is invested in a balanced portfolio of common stocks and bonds. Common stocks provide the potential for significant capital appreciation, while bonds act as a deflation hedge and provide portfolio diversification.

	Target	Actual
Stocks	60.0%	55.4%
Bonds	35.0	37.5
Unallocated Cash	5.0	7.1
	100.0%	100.0%

#### Period Ending 3/31/2003

	Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	-1.1%	-12.2%	-7.1%	0.5%
Composite*	-1.2	-11.4	-6.8	0.7

\* 60% Wilshire 5000/35% Lehman Aggregate Bond Index/5% T-Bills Composite.

### GROWTH SHARE ACCOUNT

#### Investment Objective

The Growth Share Account's investment objective is to generate above-average returns from capital appreciation on common stocks.

#### Asset Mix

The Growth Share Account is invested primarily in the common stocks of US companies. The managers in the account also hold varying levels of cash.

#### Period Ending 3/31/2003

	Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	-2.5%	-25.0%	-16.8%	-5.0%
Composite*	-2.9	-24.4	-16.8	-4.4

\* 100% Wilshire 5000 Investable since July 1999. 100% Wilshire 5000 from November 1996 to June 1999. 95% Wilshire 5000/5% T-Bills Composite through October 1996.

### COMMON STOCK INDEX ACCOUNT

#### Investment Objective and Asset Mix

The investment objective of the Common Stock Index Account is to generate returns that track those of the U.S. stock market as a whole. The Account is designed to track the performance of the Wilshire 5000 Investable, a broad-based equity market indicator.

The Account is invested 100% in common stock.

#### Period Ending 3/31/2003

	Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	-3.0%	-24.4%	-16.5%	-4.0%
Wilshire 5000 Investable*	-2.9	-24.4	-16.7	-4.2

\* Wilshire 5000 through June 2000. Wilshire 5000 Investable thereafter.

### INTERNATIONAL SHARE ACCOUNT

#### Investment Objective and Asset Mix

The investment objective of the International Share Account is to earn a high rate of return by investing in the stock of companies outside the U.S. At least one-third of the Account is "passively managed" and is designed to track the return of 21 markets included in the Morgan Stanley Capital International index of Europe, Australasia and the Far East (EAFE-Free). The remainder of the Account is "actively managed" by several international managers and emerging markets specialists who buy and sell stocks in an attempt to maximize market value.

#### Period Ending 3/31/2003

	Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yrs.
<b>Total Account</b>	-8.2%	-22.7%	-17.9%	-6.4%
Composite*	-8.0	-22.8	-19.3	-7.1

\* The international benchmark is EAFE Free plus Emerging Markets Free (EMF). The weighting of each index fluctuates with market capitalization. From 12/31/96 to 6/30/99 the benchmark was fixed at 87% EAFE-Free/13% EMF. On 5/1/96 the portfolio began transitioning from 100% EAFE Free to the 12/31/96 fixed weights. 100% EAFE-Free prior to 5/1/96.



## SUPPLEMENTAL INVESTMENT FUND ACCOUNTS

### BOND MARKET ACCOUNT

#### Investment Objective

The investment objective of the Bond Market Account is to exceed the return of the broad domestic bond market by investing in fixed income securities.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>1.8%</b>	<b>10.6%</b>	<b>9.8%</b>	<b>7.5%</b>
Lehman Agg.	1.4	11.7	9.8	7.5

#### Asset Mix

The Bond Market Account invests primarily in high-quality, government and corporate bonds that have intermediate to long-term maturities, usually 3 to 20 years.

### MONEY MARKET ACCOUNT

#### Investment Objective

The investment objective of the Money Market Account is to purchase short-term, liquid debt securities that pay interest rates that are competitive with those available in the money market.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>0.4%</b>	<b>1.7%</b>	<b>3.9%</b>	<b>4.5%</b>
3 month T-Bills	0.3	1.5	3.4	4.0

#### Asset Mix

The Money Market Account is invested entirely in high quality short-term investments such as U.S. Treasury Bills, bank certificates of deposit, repurchase agreements, and high grade commercial paper. The average maturity of these investments is 30 to 60 days.

### FIXED INTEREST ACCOUNT

#### Investment Objectives

The investment objectives of the Fixed Interest Account are to protect investors from loss of their original investment and to provide competitive interest rates using somewhat longer term investments than typically found in a money market account.

	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>1.2%</b>	<b>5.5%</b>	<b>6.0%</b>	<b>6.1%</b>
Benchmark*	0.6	2.9	4.3	4.9

\* The Fixed Interest Benchmark is the 3 year Constant Maturity Treasury Bill +45 basis points.

#### Asset Mix

The assets in the Account are **invested primarily in stable value instruments** such as insurance company investment contracts, bank investment contracts, and security backed contracts. These instruments are issued by highly rated U.S. financial institutions, typically have maturities of 3-6 years and are rated "A" or better at the time of purchase. The interest rate credited will change, reflecting the blended interest rate available from all investments in the account including cash reserves which are maintained to provide liquidity. The Fixed Interest Benchmark in the 3 year Constant Maturity Treasury Bill +45 basis points.

**ASSIGNED RISK PLAN**

**Investment Objectives**

The Assigned Risk Plan has two investment objectives: to minimize the mismatch between assets and liabilities and to provide sufficient liquidity for the payment of on-going claims and operating expenses.

**Asset Mix**

The Assigned Risk Plan is invested in a portfolio of common stocks and bonds. The actual asset mix will fluctuate in response to changes in the Plan's liability stream.

	3/31/2003 Target	3/31/2003 Actual
Stocks	20.0%	20.5%
Bonds	80.0	79.5
Total	100.0%	100.0%

**Investment Management**

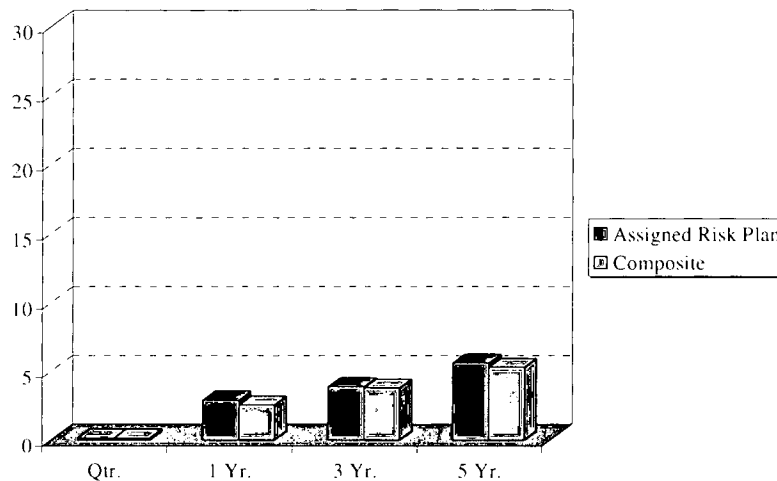
Voyageur Asset Management manages the bond segment of the Fund. GE Investment Management manages the equity segment.

**Performance Benchmarks**

A custom benchmark has been established for the fixed income portfolio. It reflects the duration of the liability stream and the long-term sector allocation of Voyageur Asset Management. Since July 1, 1994, the equity benchmark has been the S&P 500 index. The total fund benchmark is a combination of the fixed income and equity benchmarks, weighted according to the total fund asset allocation targets.

**Market Value**

On March 31, 2003 the market value of the Assigned Risk Plan was \$238 million.



**Period Ending 3/31/2003**

	Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Fund*</b>	0.1%	2.9%	3.9%	5.6%
Composite	0.1	2.5	3.8	5.3
<b>Equity Segment*</b>	-3.2	-24.1	-11.7	-1.1
Benchmark	-3.1	-24.8	-16.1	-3.8
<b>Bond Segment*</b>	0.9	9.8	7.7	6.5
Benchmark	0.9	10.2	9.0	7.3

\* Actual returns are calculated net of fees.

**PERMANENT SCHOOL FUND**

**Investment Objectives**

The investment objective of the Permanent School Fund is to produce a growing level of spendable income, within the constraints of maintaining adequate portfolio quality and liquidity. The income from the portfolio is used to offset expenditures on school aid payments to local school districts.

**Asset Mix**

Effective with FY98, the Permanent School Fund is invested in a balanced portfolio of common stocks and bonds. Common stocks provide the potential for significant capital appreciation, while bonds provide portfolio diversification and a more stable stream of current income.

	3/31/2003 Target	3/31/2003 Actual
Stocks	50.0%	48.6%
Bond	48.0	49.7
Unallocated Cash	2.0	1.7
Total	100.0%	100.0%

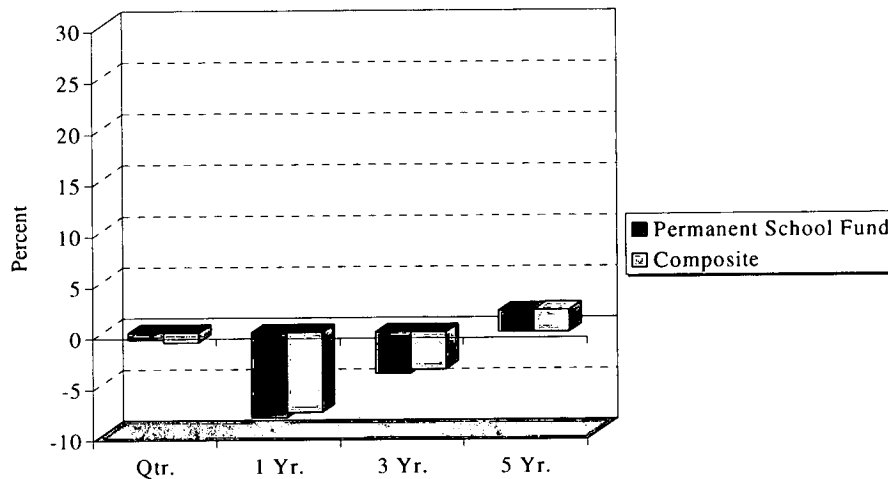
Prior to FY98, the Fund was invested entirely in fixed income securities in order to maximize current income. It is understood that the change in asset mix will reduce portfolio income in the short term, but will enhance the value of the fund, over time.

**Investment Management**

SBI staff manages all assets of the Permanent School Fund. The stock segment is passively managed to track the performance of the S&P 500. The bond segment is actively managed to add incremental value through sector, security and yield curve decisions.

**Market Value**

On March 31, 2003 the market value of the Permanent School Fund was \$484 million.



	Period Ending 3/31/2003			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Fund (1) (2)</b>	-0.7%	-8.3%	-4.0%	2.1%
Composite	-0.9	-7.8	-3.6	2.2
<b>Equity Segment (1) (2)</b>	-3.1	-24.4	-16.0	-3.6
S&P 500	-3.1	-24.8	-16.1	-3.8
<b>Bond Segment (1)</b>	1.7	11.0	9.5	7.6
Lehman Aggregate	1.4	11.7	9.8	7.5

(1) Actual returns are calculated net of fees.

(2) Equities were added to the asset mix effective July 28, 1997. Prior to that date the fund was invested entirely in bonds. The composite Index has been weighted accordingly.

**MEDICAL EDUCATION FUND**

**Investment Objectives**

The investment objective of the Medical Education Fund is to increase the market value of the Fund over time in order to increase the annual amount made available for spending.

**Asset Mix**

The Fund is invested in a balanced portfolio of stocks and bonds. Common stocks provide the potential for significant capital appreciation, while bonds act as a deflation hedge and provide portfolio diversification.

**Investment Management**

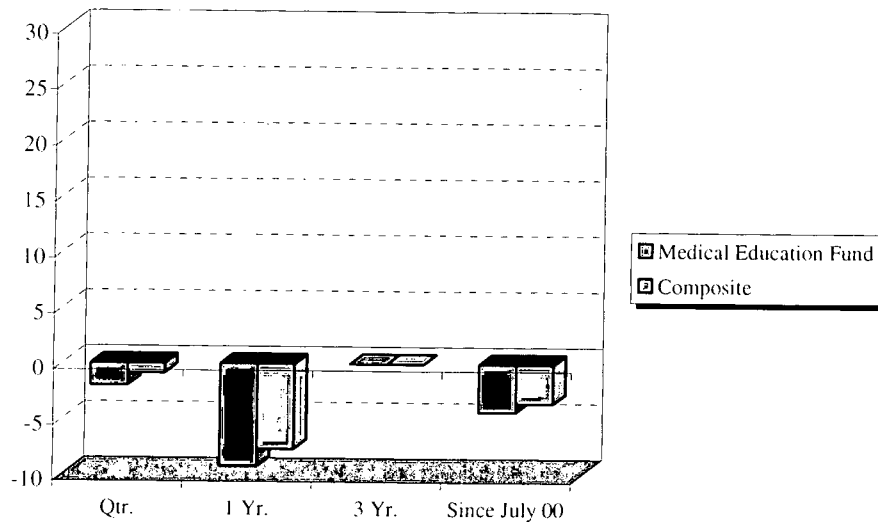
SBI staff manages all assets of the Medical Education Fund.

**Market Value**

On March 31, 2003 the market value of the Medical Education Fund was \$279 million.

In late February 2003 the liquidation of the Medical Education Fund was started to ensure the amount designated in the Governor's 2004-2005 budget proposal would be available with a high degree of certainty. Therefore, the fund will be in cash until needed.

	3/31/2003 Target	3/31/2003 Actual
Stocks	50.0%	0.0%
Bonds	50.0	0.0
Unallocated Cash	0.0	100.0
Total	100.0%	100.0%



**Period Ending 3/31/2003**

	Qtr.	1 Yr.	3 Yr.	Since 7/1/00
<b>Total Fund*</b>	-2.0%	-9.2%	N/A	-4.3%
Composite	-0.9	-7.7	N/A	-3.5

\* Actual returns are calculated net of fees.

**ACADEMIC HEALTH CENTER FUND**

**Investment Objectives**

The investment objective of the Academic Health Center Fund is to increase the market value of the Fund over time in order to increase the annual amount made available for spending.

**Asset Mix**

The Fund is invested in a balanced portfolio of stocks and bonds. Common stocks provide the potential for significant capital appreciation, while bonds act as a deflation hedge and provide portfolio diversification.

**Investment Management**

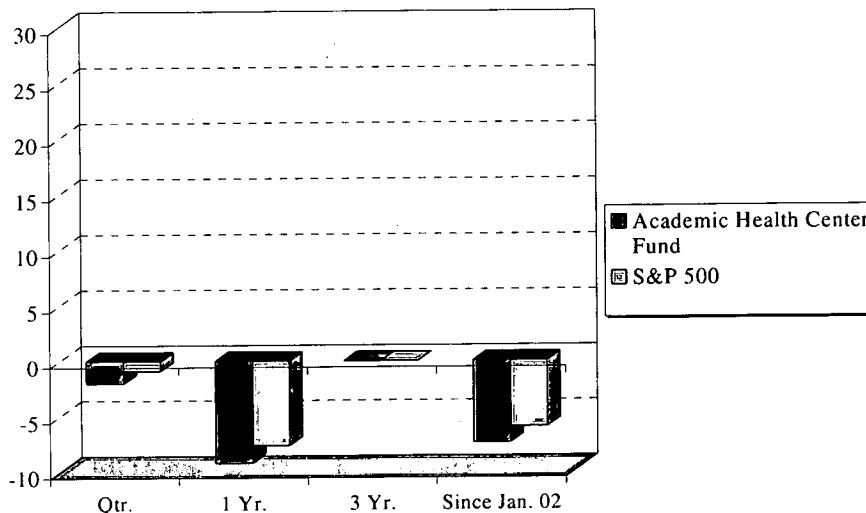
SBI staff manages all assets of the Academic Health Center Fund.

**Market Value**

On March 31, 2003 the market value of the Academic Health Center Fund was \$301.0 million.

In late February 2003 the liquidation of the Academic Health Center Fund was started to ensure the amount designated in the Governor's 2004-2005 budget proposal would be available with a high degree of certainty. Therefore, the fund will be in cash until needed.

	3/31/2003 Target	3/31/2003 Actual
Stocks	50.0%	0.0%
Bonds	50.0	0.0
Unallocated Cash	0.0	100.0
Total	100.0%	100.0%



**Period Ending 3/31/2003**

	Qtr.	1 Yr.	3 Yr.	Since 1/1/02
<b>Total Fund*</b>	-2.0%	-9.2	N/A	-7.4%
Composite	-0.9	-7.7	N/A	-6.0

\* Actual returns are calculated net of fees.

**CLOSED LANDFILL INVESTMENT FUND**

**Investment Objectives**

The investment objective of the Closed Landfill Investment Fund is to generate high returns from capital appreciation. The Fund will be used by the Commissioner of the PCA (Pollution Control Agency) to pay for the long-term costs of maintaining the integrity of landfills in Minnesota once they are closed. However, by statute, the assets of the Fund are unavailable for expenditure until after fiscal year 2020.

**Investment Management**

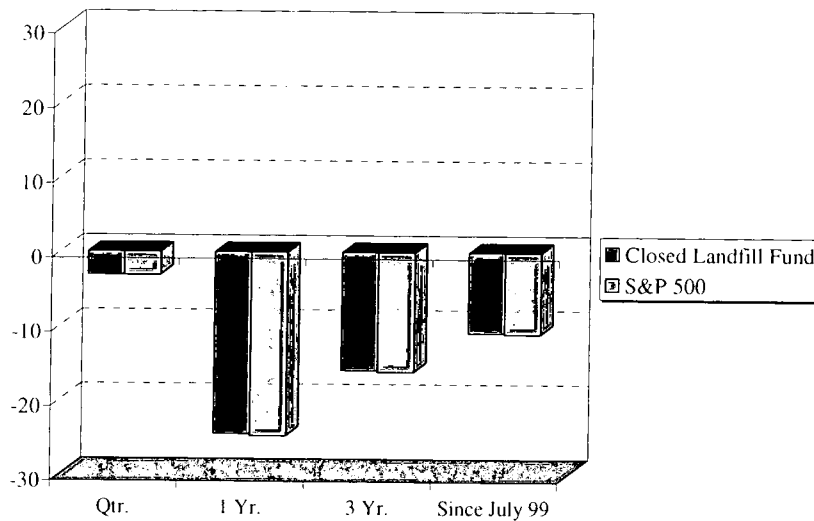
SBI staff manage all assets of the Closed Landfill Investment Fund. The assets are managed to passively track the performance of the S&P 500 index.

**Market Value**

On March 31, 2003, the market value of the Closed Landfill Investment Fund was \$14.5 million.

**Asset Mix**

Effective July 1999, the Closed Landfill Investment Fund is invested entirely in common stock. Given the long time horizon of this Fund and the lack of need for any short or mid-term withdrawals, this strategy will maximize the long-term gain of the Fund.



**Period Ending 3/31/2003**  
**Qtr.    1 Yr.    3 Yr.    Since 7/1/99**

<b>Total Fund (1)</b>	-3.1%	-24.4%	-15.9%	-10.8%
<b>S&amp;P 500 (2)</b>	-3.1	-24.8	-16.1	-11.0

- (1) Actual returns are calculated net of fees.
- (2) The benchmark of the fund is the S&P 500. The portfolio was initially invested in mid July 1999. The benchmark was adjusted to reflect this mid month starting period.

## STATE CASH ACCOUNTS

**Description**

State Cash Accounts represent the cash balances in more than 400 separate accounts that flow through the Minnesota State Treasury. These accounts range in size from \$5,000 to over \$400 million.

Most accounts are invested by SBI staff through two short-term pooled funds:

1. Trust Fund Pool contains the temporary cash balances of certain trusts and retirement-related accounts.
2. Treasurer's Cash Pool contains the cash balances of special or dedicated accounts necessary for the operation of certain State agencies and non dedicated cash in the State Treasury.

In addition, each State of Minnesota bond sale requires two additional pools; one for bond proceeds and one for the debt reserve transfer.

Because of special legal restrictions, a small number of cash accounts cannot be commingled. These accounts are invested separately.

**Investment Objectives**

**Safety of Principal.** To preserve capital.

**Competitive Rate of Return.** To provide a high level of current income.

**Liquidity.** To meet cash needs without the forced sale of securities at a loss.

**Asset Mix**

The SBI maximizes current income while preserving capital by investing all cash accounts in high quality, liquid short term investments. These include U.S. Treasury and Agency issues, repurchase agreements, bankers acceptances, commercial paper, and certificates of deposit.

**Investment Management**

All state cash accounts are managed by the SBI investment staff. As noted above, most of the assets of the cash accounts are invested through two large commingled investment pools.

	Market Value (Millions)	Period Ending 3/31/2003		Annualized	
		Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Treasurer's Cash Pool*</b>	<b>\$3,137</b>	<b>0.4%</b>	<b>2.3%</b>	<b>4.5%</b>	<b>4.9%</b>
Custom Benchmark**		0.2	1.7	4.0	4.3
<b>Trust Fund Cash Pool*</b>	<b>\$49</b>	<b>0.3</b>	<b>1.7</b>	<b>3.9</b>	<b>4.5</b>
Custom Benchmark***		0.2	1.1	3.2	3.9
3 month T-Bills		0.3	1.5	3.4	4.0

\* Actual returns are calculated net of fees.

\*\* Beginning in January 1997, the Treasurer's Cash Pool is measured against a blended benchmark consisting of the Lehman Brother's 1-3 year Government Index and the IBC All Taxable Money Fund Index. The proportion of each component of the blended benchmark is adjusted periodically as the asset allocation of the Cash Pool is modified. From April 1993 through December 1996, the benchmark was 75% State Street Short Term Investment Fund/25% Lehman Brothers 1-3 Year Treasury Index.

\*\*\* Beginning in January 1997, the Trust Fund Pool is measured against the IBC All Taxable Money Fund Index. From April 1993 through December 1996, the benchmark was 75% State Street Short Term Investment Fund/25% 1-3 year Treasuries.

**MINNESOTA STATE BOARD OF INVESTMENT**

**Composition of State Investment Portfolios By Type of Investment**

Market Value March 31, 2003 (in Thousands)

**Cash and**

	Short term Securities	Bonds		Stocks		External Int'l	Alternative Assets	Total
		Internal	External	Internal	External			
<b>BASIC RETIREMENT FUNDS:</b>								
Teachers Retirement Fund	101,606 1.78%	0	1,447,186 25.29%	0	2,569,750 44.91%	765,852 13.38%	837,668 14.64%	5,722,062 100%
Public Employees Retirement Fund	63,597 1.66%	0	967,085 25.32%	0	1,717,916 44.97%	511,782 13.40%	559,765 14.65%	3,820,145 100%
State Employees Retirement Fund	47,969 1.43%	0	850,636 25.37%	0	1,511,056 45.08%	450,157 13.43%	492,369 14.69%	3,352,187 100%
Public Employees Police & Fire	27,486 1.44%	0	485,717 25.38%	13 0.00%	861,705 45.03%	256,525 13.40%	282,265 14.75%	1,913,711 100%
Highway Patrol Retirement Fund	2,640 1.43%	0	46,820 25.37%	0	83,170 45.08%	24,777 13.43%	27,100 14.69%	184,507 100%
Judges Retirement Fund	338 1.43%	0	5,994 25.38%	0	10,647 45.07%	3,172 13.43%	3,470 14.69%	23,621 100%
Correctional Employees Retirement	2,842 1.43%	0	50,403 25.37%	0	89,535 45.08%	26,673 13.43%	29,174 14.69%	198,627 100%
Public Employees Correctional	1,519 3.66%	0	10,295 24.80%	0	18,289 44.05%	5,448 13.12%	5,967 14.37%	41,518 100%
<b>TOTAL BASIC FUNDS</b>	<b>247,997 1.62%</b>	<b>0</b>	<b>3,864,136 25.33%</b>	<b>13 0.00%</b>	<b>6,862,068 44.98%</b>	<b>2,044,386 13.40%</b>	<b>2,237,778 14.67%</b>	<b>15,256,378 100%</b>
<b>POST RETIREMENT FUND</b>	<b>364,986 2.46%</b>	<b>0</b>	<b>4,317,000 29.07%</b>	<b>0</b>	<b>7,441,926 50.10%</b>	<b>2,004,872 13.50%</b>	<b>723,592 4.87%</b>	<b>14,852,376 100%</b>
<b>TOTAL BASIC AND POST</b>	<b>612,983 2.04%</b>	<b>0</b>	<b>8,181,136 27.17%</b>	<b>13 0.00%</b>	<b>14,303,994 47.51%</b>	<b>4,049,258 13.45%</b>	<b>2,961,370 9.83%</b>	<b>30,108,754 100%</b>



	Cash and Short term Securities		Bonds		Bonds		Stocks		Stocks		External Int'l		Alternative Assets		Total	
			Internal	External	Internal	External	Internal	External	Internal	External	Int'l		Assets			
<b>MINNESOTA SUPPLEMENTAL FUNDS:</b>																
Income Share Account	37,075	7.15%	194,395	0	0	0	0	287,146	0	0	0	0	0	0	518,616	100%
			37.48%					55.37%							100%	
Growth Share Account	0		0	0	0	0	0	173,072	0	0	0	0	0	0	173,072	100%
								100.00%							100%	
Money Market Account	34,496		0	0	0	0	0	0	0	0	0	0	0	0	34,496	100%
															100%	
Common Stock Index	0		0	0	0	0	0	240,400	0	0	0	0	0	0	240,400	100%
								100.00%							100%	
Bond Market Account	0		0	157,174	0	0	0	0	0	0	0	0	0	0	157,174	100%
				100.00%											100%	
International Share Account	0		0	0	0	0	0	0	0	0	41,245	0	0	41,245	100%	
											100.00%			100%		
Fixed Interest Account	848	0.66%	0	127,865	0	0	0	0	0	0	0	0	0	128,713	100%	
				99.34%										100%		
Money Market Deferred Comp	67,956		0	0	0	0	0	0	0	0	0	0	0	67,956	100%	
														100%		
<b>TOTAL SUPPLEMENTAL FUNDS</b>	<b>140,375</b>	<b>10.31%</b>	<b>194,395</b>	<b>285,039</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>700,618</b>	<b>41,245</b>	<b>0</b>	<b>41,245</b>	<b>0</b>	<b>0</b>	<b>1,361,672</b>	<b>100%</b>	
			<b>14.28%</b>	<b>20.93%</b>				<b>51.45%</b>	<b>3.03%</b>					<b>100%</b>		
<b>MN DEFERRED COMP PLAN *</b>	<b>0</b>		<b>0</b>	<b>737,136</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>607,419</b>	<b>68,411</b>	<b>0</b>	<b>68,411</b>	<b>0</b>	<b>0</b>	<b>1,412,966</b>	<b>100%</b>	
				<b>52.17%</b>				<b>42.99%</b>	<b>4.84%</b>					<b>100%</b>		
<b>TOTAL RETIREMENT FUNDS</b>	<b>753,358</b>	<b>2.29%</b>	<b>194,395</b>	<b>9,203,311</b>	<b>13</b>	<b>0.00%</b>	<b>15,612,031</b>	<b>4,158,914</b>	<b>2,961,370</b>	<b>32,883,392</b>	<b>100%</b>					
			<b>0.59%</b>	<b>27.99%</b>			<b>47.48%</b>	<b>12.65%</b>	<b>9.00%</b>					<b>100%</b>		

\* includes assets in the MN Fixed Fund, which are invested with three insurance cos.

	<b>Cash and Short Term Securities</b>	<b>Bond Internal</b>	<b>Bond External</b>	<b>Stock Internal</b>	<b>Stock External</b>	<b>External Int'l</b>	<b>Alternative Assets</b>	<b>Total</b>
<b>ASSIGNED RISK PLAN</b>	4,798 2.01%	0	185,733 77.93%	0	47,815 20.06%	0	0	238,346 100%
<b>ENVIRONMENTAL FUND</b>	1,901 0.73%	78,785 30.37%	0	178,724 68.90%	0	0	0	259,410 100%
<b>PERMANENT SCHOOL FUND</b>	8,516 1.76%	240,645 49.68%	0	235,209 48.56%	0	0	0	484,370 100%
<b>TOBACCO SETTLEMENT POOL</b>	1,018,339 98.97%	10,578 1.03%	0	0	0	0	0	1,028,917 100%
<b>CLOSED LANDFILL INVESTMENT</b>	19 0.13%	0	0	14,523 99.87%	0	0	0	14,542 100%
<b>TREASURERS CASH</b>	3,129,945 100.00%	0	0	0	0	0	0	3,129,945 100%
<b>HOUSING FINANCE AGENCY</b>	117,370 43.61%	151,788 56.39%	0	0	0	0	0	269,158 100%
<b>MINNESOTA DEBT SERVICE FUND</b>	80,676 26.82%	220,118 73.18%	0	0	0	0	0	300,794 100%
<b>MISCELLANEOUS ACCOUNTS</b>	252,008 66.52%	101,784 26.87%	0	25,034 6.61%	0	0	0	378,826 100%
<b>GRAND TOTAL</b>	5,366,930 13.77%	998,093 2.56%	9,389,044 24.08%	453,503 1.16%	15,659,846 40.17%	4,158,914 10.67%	2,961,370 7.59%	38,987,700 100%

# **Tab B**

According to statute, committees of this nature must be re-authorized every two years (the last authorization was in June 2001). A resolution to accomplish this is in **Attachment D**.

**RECOMMENDATION:**

**The Executive Director recommends that the SBI adopt the resolution in Attachment D which reauthorizes the Proxy Voting Committee and delegates proxy voting responsibilities according to established guidelines. The proxy voting guidelines are attached for Board review and approval.**

**5. Authorization to form Review/Search Committees**

From time to time, the SBI forms search/review committees for various reasons such as manager searches, IAC appointments and policy reviews. Currently, Staff requests authorization from the Board each time it wishes to form a committee. This proposal seeks to give Staff authorization to assemble a Search/Review Committee when it is deemed necessary by the Executive Director. If approved, this authorization would expedite the Board's ability to react to various needs on an on-going basis.

Any Committee formed would be comprised of a representative of each Board member and appropriate representation from the Investment Advisory Council. The Board would continue to have final authority to approve or disapprove any recommendations made by the Committee.

**RECOMMENDATION:**

**Staff recommends that the Board give the Executive Director authorization to assemble Review/Search Committees at his discretion.**

ATTACHMENT A

**STATE BOARD OF INVESTMENT  
FISCAL YEAR 2003 ADMINISTRATIVE BUDGET REPORT  
GENERAL FUND APPROPRIATION  
FISCAL YEAR TO-DATE THROUGH APRIL 30, 2003**

ITEM	FISCAL YEAR 2003 BUDGET	FISCAL YEAR 2003 EXPENDITURES
<b>PERSONAL SERVICES</b>		
FULL TIME EMPLOYEES	\$ 2,023,035	\$ 1,541,559
SEVERENCE PAYOFF	22,000	231
WORKERS COMPENSATION INSURANCE	1,000	876
MISCELLANEOUS PAYROLL	2,000	0
<b>SUBTOTAL</b>	<b>\$ 2,048,035</b>	<b>\$ 1,542,666</b>
<b>STATE OPERATIONS</b>		
RENTS & LEASES	192,000	139,683
REPAIRS/ALTERATIONS/MAINTENANCE	15,000	14,282
PRINTING & BINDING	15,000	7,954
PROFESSIONAL/TECHNICAL SERVICES	10,000	0
COMPUTER SYSTEMS SERVICES	10,000	7,613
COMMUNICATIONS	20,000	14,566
TRAVEL, IN-STATE	3,000	223
TRAVEL, OUT-STATE	65,000	17,543
SUPPLIES	40,000	17,910
EQUIPMENT	20,000	0
EMPLOYEE DEVELOPMENT	15,000	5,582
OTHER OPERATING COSTS	25,000	7,418
<b>SUBTOTAL</b>	<b>\$ 430,000</b>	<b>\$ 232,774</b>
<b>ORIGINAL BUDGET</b>	<b>\$ 2,478,035</b>	<b>\$ 1,775,440</b>
<b>BUDGET REDUCTION (UNALLOTMENT)</b>	<b>\$ 90,000</b>	
<b>TOTAL GENERAL FUND</b>	<b>\$ 2,388,035</b>	<b>\$ 1,775,440</b>

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ATTACHMENT B

STATE BOARD OF INVESTMENT

Travel Summary by Date  
SBI Travel February 16, 2003 – May 15, 2003

<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
<b>Conference:</b> National Association of Investment Professionals (NASIP)	M. Menssen L. Buermann	Phoenix, AZ 4/6-4/9	\$788.00

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ATTACHMENT C

**Bills of Interest to the Minnesota State Board of Investment  
2003 Legislative Session  
Includes Action Through 5/21/03**

<b>Description of Bill</b>	<b>HF/SF # and Author</b>	<b>Current Status</b>
SBI Budget -In State Agency Appropriation Bill	S. S. HF 1 (Haas)	Passed House 5/20
	S. S. SF 1 (Cohen)	Passed Senate 5/20
Using Tobacco Funds for Budget Purposes - In Omnibus Health & Human Services Approp. Bill	S. S. HF 6 (Bradley)	Introduced 5/20 (article 8, section 39)
Changes in Professional/ Technical Contracts Requirements  - In State Agency Approp. Bill	S. S. HF 1 (Haas)	Passed House and Senate 5/20 (Sections 45-54)
State Deferred Compensation Plan Investment Flexibility -In pension bill	S. S. HF 37(Smith) S. S. SF 22 (Betzold)	Introduced 5/21 Introduced 5/21
Extending Sunset Provision for IAC	S. S. SF 36 ( Robling)	Introduced 5/21
Permitting MnSCU Members to Opt back into TRA	SF 286 (Huntley) SF 1157 (Pogemiller)	Not heard Not heard

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## **EXECUTIVE DIRECTOR'S ADMINISTRATIVE REPORT**

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### **RESOLUTION OF THE MINNESOTA BOARD OF INVESTMENT CONCERNING PROXY VOTING**

WHEREAS, as a stockholder, the Minnesota State Board of Investment (SBI) is entitled to sponsor and cosponsor shareholder resolutions and participate in corporate annual meetings by casting its votes by proxy or through direct attendance at the meetings; and

WHEREAS, the SBI has previously established a Proxy Committee:

NOW THEREFORE, BE IT RESOLVED THAT:

1. To advise and assist the SBI in the implementation of proxy voting guidelines previously adopted by the Board the SBI hereby authorizes and reaffirms the establishment of the SBI Proxy Committee composed of a representative selected by each member of the SBI to be chaired by the designee of the Governor and convened as necessary in accord with the Guidelines.
2. The SBI further authorizes the SBI Proxy Committee to review the Guidelines periodically and report to the SBI as necessary.
3. The SBI further directs its staff to advise and assist the Proxy Committee in the implementation of this resolution and directs its Executive Director to obtain such consulting and reporting services as may be necessary.
4. This resolution shall take effect immediately.

Adopted this 4th day  
of June, 2003

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Governor Tim Pawlenty  
Chair, Minnesota State  
Board of Investment

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## **Proxy Voting Guidelines**

The Minnesota State Board of Investment (SBI) has formulated proxy voting guidelines by which it casts votes on a wide range of corporate governance and social responsibility issues.

As a stockholder, the Board is entitled to participate in corporate annual meetings by casting its votes by proxy or through direct attendance at the meetings. The following guidelines constitute an effort by the SBI to manage and control its proxy voting.

### **Overview of the SBI**

By the Minnesota Constitution, the Board is composed of the Governor, the State Auditor, the State Treasurer, the Secretary of State, and the Attorney General. The Board employs a professional staff to carry out its policies. The Board and staff are assisted by a seventeen member Investment Advisory Council.

The SBI invests the pension assets of the three statewide public employee retirement systems with approximately 320,000 members:

- Public Employees Retirement Association (PERA)
- Teachers Retirement Association (TRA)
- Minnesota State Retirement System (MSRS)

The SBI also invests the cash balances of state government funds and assets of several trust funds.

### **Statutory Purpose**

According to statute, state assets are to be responsibly invested by the SBI to maximize the total rate of return without incurring undue risk.<sup>1</sup> Only a small portion of the SBI's equity holdings are in non-pension accounts. The focus, therefore, of the SBI's proxy voting activities is the extensive domestic and international equity holdings within the pension asset portfolios.

### **Fiduciary Responsibility**

As fiduciaries of pension assets, members of the Board and the executive director owe a fiduciary duty to the members of the plans, to the taxpayers of the state and political subdivisions who help to finance the plans, and to the State of Minnesota.<sup>2</sup>

In addition to the general standard of fiduciary conduct, members of the Board, the executive director, the members of the Investment Advisory Council, staff, and members of Board committees must carry out their duties in accordance with the prudent person standard as articulated in statute.<sup>3</sup>

**Voting  
Process**

The Board recognizes its fiduciary responsibility to cast votes on proxy issues. The Board delegates proxy voting responsibilities to its Proxy Committee. Each Board member appoints one member to the Proxy Committee. The five member Committee meets only if it has a quorum and casts votes on proxy issues based on a majority vote of those present. In the unusual event that it reaches a tie vote or a quorum is not present, the Committee will cast a vote to abstain.

The Committee has formulated guidelines by which it casts votes on a wide range of corporate governance and social responsibility issues. These guidelines encompass both domestic and international proxy issues. Each year the Committee reviews existing guidelines and determines which issues it will review on a case-by-case basis. The Proxy Committee also reviews certain corporate governance issues pertaining to companies headquartered in Minnesota.

Domestic voting: The SBI directly votes shares held in non-pension accounts and shares held in domestic equity manager portfolios.

International voting: The SBI delegates to international equity managers the voting of shares held in the managers' portfolios. The SBI believes that several factors affecting the voting of international proxies, including time constraints and lack of company specific information, support the conclusion that the SBI's international equity managers can more efficiently and effectively vote the proxies in their portfolios.

**Corporate Governance Issues**

**Routine  
Matters**

In general, the SBI **supports** management on routine matters of corporate governance. These issues include:

- uncontested election of directors.
- selection of auditors and approval of financial statements.
- management proposals on non-executive compensation issues including savings plans and stock options.
- limits on director and officer liability or increases in director and officer indemnification permitted under the laws of the state of incorporation.

**Shareholder Rights**

In general, the SBI **opposes** proposals that would restrict shareholder ability to effect change. Such proposals include:

- instituting supermajority requirements to ratify certain or events.
- creating classified boards.
- barring shareholders from participating in the determination of the rules governing the board's actions, such as quorum requirements and the duties of directors.
- prohibiting or limiting shareholder action by written consent.
- granting certain stockholders superior voting rights over other stockholders.

In general, the SBI **supports** proposals that preserve shareholder rights to effect change. Such proposals include:

- having boards of directors comprised of a majority of independent directors.
- having compensation committees comprised entirely of independent directors.
- requiring shareholder approval of poison pill plans.
- repealing classified boards.
- adopting secret ballot of proxy votes.
- reinstating cumulative voting.
- adopting anti-greenmail provisions.

**Executive Compensation**

In general, the SBI **supports** efforts to have executive compensation linked to a company's long-term performance and to encourage full disclosure of compensation packages for principal executives. Accordingly, the SBI evaluates compensation packages on a case-by-case basis, including compensation agreements that are contingent upon corporate change in control.

**Buyouts**

In general, the SBI **supports** friendly takeovers and management buyouts.

**Special Cases**

The SBI evaluates the following proposals on a case-by-case basis:

- hostile takeovers.
- recapitalization plans.
- contested election of directors.

Notwithstanding the above, in general, the SBI reviews corporate governance issues if the company is incorporated or is headquartered in Minnesota.

**Social Responsibility Issues**

**Tobacco**

The SBI supports shareholder resolutions that call for a company to reduce its involvement in liquor and tobacco production, product marketing and other related lines of business in order to diversify its business in a manner that will reduce or eliminate potential liability to legal claims associated with liquor and tobacco that may negatively impact the value of the SBI's holdings.

In furtherance of this policy, the SBI has sponsored and co-sponsored shareholder resolutions to reduce youth access to tobacco products, to request companies to voluntarily comply with FDA regulations, to eliminate smoking in restaurants, and other tobacco related issues.

**Northern  
Ireland**

The SBI **supports** resolutions that call for the adoption of the MacBride Principles as a means to encourage equal employment opportunities in Northern Ireland.

The SBI **supports** resolutions that request companies to submit reports to shareholders concerning their labor practices or their sub-contractors' labor practices in Northern Ireland.

In addition to casting proxy votes, the SBI sponsors and cosponsors Northern Ireland resolutions as required by *Minnesota Statutes*, Section 11A.241.



## MINNESOTA STATE BOARD OF INVESTMENT

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### **Environmental Protection/Awareness**

In general, the SBI **supports** resolutions that require a corporation to report or disclose to shareholders company efforts in the environmental arena.

In general, the SBI **supports** resolutions that request a corporation to report on progress toward achieving the objectives of the CERES Principles, an environmental code of conduct for corporations.

### **South Africa**

In general, the SBI supports resolutions that promote the welfare of black employees and improve the quality of black life outside the work environment.

### **Other Issues**

In general, the SBI **supports** proposals that require a company to report or disclose to shareholders company efforts concerning a variety of social responsibility issues. In the past, these reporting resolutions have included issues such as affirmative action programs, animal testing procedures, and nuclear plant safety procedures ~~and criteria used to evaluate military contract proposals.~~

In general, the SBI **opposes** proposals that require a company to institute a specific business action in response to such issues. As an example, the SBI voted against a shareholder proposal which would have required a utility to phase out operations of a nuclear power plant.

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1 *Minnesota Statutes* ~~2000~~ 2002, Section 11A.01.

2 *Minnesota Statutes* ~~2000~~ 2002, Section 356A.04, subdivision 1.

3 *Minnesota Statutes* ~~2000~~ 2002, Section 11A.09, and Section 356A.04, subdivision 2.

# Tab C

## COMMITTEE REPORT

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DATE: May 27, 2003

TO: Members, State Board of Investment

FROM: Administrative Committee

**SUBJECT: Report from the SBI Administrative Committee**

The Administrative Committee met on May 15, 2003 to consider the following agenda items:

- Review of Executive Director's proposed workplan for FY04.
- Review of budget plan for FY04.
- Review of Continuing Fiduciary Education Plan.
- Review of Executive Director's Evaluation Process.
- Discussion of Disaster Recovery Plan
- Discussion of International Country Guidelines

**1. Review of Executive Director's proposed workplan for FY04.**

Mr. Bicker presented his proposed workplan for FY04. As in previous workplans, the FY04 plan follows the same category order found in the Executive Director's position description. The plan is a compilation of on-going responsibilities as well as the new initiatives the Executive Director will undertake during the next fiscal year.

A summary of the proposed plan is shown in **Attachment A** on **page 5** of this tab. Supporting information was sent to each Board member in May 2003 as part of the FY04 Management and Budget Plan document.

**RECOMMENDATION:**

**The Committee recommends that the SBI approve the FY04 Executive Director's Workplan. Further, the Committee recommends that the workplan serve as the basis for the Executive Director's performance evaluation for FY04.**

## **2. FY04 Administrative Budget Plan.**

The SBI's Administrative budget is funded by a legislative appropriation from the general fund. All expenditures are billed back to the various funds under the supervision of the SBI and the receipts are deposited in the general fund as non-dedicated revenue.

An overview of the budget is in **Attachment B** on **page 7** of this tab. Supporting information was sent to each Board member in May 2003 as part of the FY04 Management and Budget Plan.

### **RECOMMENDATION:**

**The Committee recommends that the SBI approve the FY04 Administrative Budget Plan, as presented to the Committee, and that the Executive Director has the flexibility to reallocate funds between budget categories recognizing that the final budget approved by the Legislature may be different and in the event budgeting needs change during the year.**

## **3. Review of Continuing Fiduciary Education Plan.**

Minnesota Statutes Chapter 356A requires each public pension plan to establish a continuing education plan for its fiduciaries. The plan approved by the Committee is in **Attachment C** on **page 9** of this tab. Please note that the travel allocation policy for Board members and their designees is included in the plan.

### **RECOMMENDATION:**

**The Committee recommends that the SBI adopt the attached Continuing Fiduciary Education Plan.**

## **4. Review of Executive Director's Evaluation Process.**

The Committee discussed the process that will be used by the Board to evaluate the Executive Director for FY03. The Committee members agreed that the performance reviews should be completed prior to the September 2003 meeting of the SBI and should follow the process used in the past.

### **RECOMMENDATION:**

**The Committee recommends that the SBI adopt the following process for the Executive Director's FY03 performance evaluation:**

- **The evaluation will be completed prior to the September 2003 meeting of the SBI and will be based on the results of the Executive Director's workplan for FY03.**

- **The SBI deputies/designees will develop an appropriate evaluation form for use by each member, which will reflect the categories in the Executive Director's position description and workplan.**
- **As the Chair of the Board, the Governor's representative (Department of Finance), will coordinate distribution and collection of the evaluation forms and will forward the completed forms to the Executive Director. Board members are encouraged to meet individually with the Executive Director to review their own evaluation.**

**5. Discussion of Disaster Recovery Plan.**

Staff provided members with a copy of the updated Disaster Recovery Plan. The plan provides information and procedures required to respond to an emergency.

**6. Discussion of International Country Guidelines.**

Staff informed the Committee that it planned to update the International Country Guidelines for review by the Committee during FY04. The Committee expressed a desire to have staff review the current guidelines with the Committee so that an evaluation could be made regarding whether there is a continued need for the guidelines. The Committee requested that staff schedule a meeting prior to the September 2003 SBI meeting to discuss the issue.



**ATTACHMENT A**

**STATE BOARD OF INVESTMENT  
Executive Director's Proposed Workplan**

**FY04**

**(Categories A, B, C, D, E correspond to the position description)**

	<b>Projected Time Frame</b>
<b>A. DEVELOPMENT OF INVESTMENT POLICIES</b>	
1. Review of Asset Class Targets and Structure.	Jul-Jun
2. Review of State Deferred Compensation Plan.	Jul-Mar
3. Review of repurchase agreement program.	Apr-May
4. Review of CD program.	Jan-Apr
<b>B. IMPLEMENTATION OF INVESTMENT POLICIES APPROVED BY THE SBI</b>	
1. Implementation of Asset Allocation Study.	Ongoing
2. Meet or exceed the performance objectives.	Ongoing
3. Conduct Investment Manager Compliance Reviews.	Ongoing
4. Maintain External Investment Manager Short-lists.	Ongoing
5. Investments with New/Existing Alternative Asset Managers.	On-going
6. Review Domestic Equity Benchmark Quality.	Apr-May
<b>C. REVIEW AND CONTROL OF INVESTMENT POLICIES</b>	
1. Monitor and evaluate investment Manager performance.	Semi-annual
2. Annual Review of Investment Manager Guidelines.	Nov-Dec

- |   |         |
|---|---------|
| 3. Monitor Implementation of Northern Ireland Mandate.                                    | Dec-Mar |
| 4. Provide Staff Support to Proxy Committee for Proxy Voting and Shareholder Initiatives. | Mar-May |
| 5. Review of Internal Cash Management Operations Manual.                                  | Jan-Jun |
| 6. Update country guidelines.   | Oct-May |

**D. ADMINISTRATIVE AND MANAGEMENT OF STAFF OPERATIONS**

- |   |         |
|---|---------|
| 1. Coordinate Financial Audit by Legislative Auditor. | Jul-Dec |
| 2. Prepare 2004 Legislative package.                  | Dec-May |
| 3. FY05 Management and Budget Plan.                   | Jan-Jun |
| 4. Update Disaster Recovery Plan.                     | April   |

**E. COMMUNICATION AND REPORTING**

- |   |              |
|---|--------------|
| 1. Prepare reports on investment results.                           | Qtly         |
| 2. Prepare status reports.  | As requested |
| 3. Meet with SBI and IAC.   | Qtly         |
| 4. Meet with Board's designees.                                     | Qtly         |
| 5. FY 2003 Annual Report.   | Jul-Dec      |
| 6. Prepare Annual SIF Investment Options Prospectus.                | Jul-Aug      |
| 7. Coordinate Public Pension Plan Performance Reporting Disclosure. | On-going     |
| 8. Manager Round Tables.  | Periodic     |



**ATTACHMENT B**

**Administrative Budget  
FY 04 - 05 Budget Plan  
Overview**

The FY 04 – 05 budget request is based on budget procedures instituted by the Department of Finance. It appears that the SBI's original request will be reduced by \$241,000 in each of the two years. This reduction is the SBI's share of the cuts required to balance the budget for the next biennium.

	<b>FY04 Request</b>	<b>FY04 Budget</b>	<b>FY05 Request</b>	<b>FY05 Budget</b>
Personal Services	\$2,050,000	\$1,850,000	\$2,050,000	\$1,850,000
Operating Expenses	358,000	317,000	358,000	317,000
	<b>\$2,408,000</b>	<b>\$2,167,000</b>	<b>\$2,408,000</b>	<b>\$2,167,000</b>

**Personal Services: 85% of the budget**  
Salaries, retirement, insurance, FICA, severance

Personnel costs during the next biennium will not be known for certain until after the Legislature ratifies bargaining agreements with the unions representing its various employee groups.

The SBI currently has two vacant Investment Analyst Positions that will not be filled for the duration of this budget cycle. In addition, the incumbent in the Short Term Debt Managers position will be retiring in July of 2003. This position will not be filled until budget conditions improve.

**Operating Expenses: 15% of the budget**  
Rents, leases, printing, data processing  
Professional/technical contracts  
Communications, travel, employee development, misc. fees  
Office equipment, furnishings, supplies

Overall, operating expenses will be reduced to meet the requirements of the budget balancing procedures.

**STATE BOARD OF INVESTMENT  
FISCAL YEAR 2004 BUDGET PLAN  
GENERAL FUND SUMMARY**

DESCRIPTION	FY 2001 ACTUAL	FY 2002 ACTUAL	FY2003 PROJECTED	FY2004 BUDGET
<b>PERSONAL SERVICES</b>				
FULL TIME EMPLOYEES	\$ 1,822,180	\$ 1,877,574	\$ 2,015,000	\$ 1,825,000
PART TIME EMPLOYEES	-	-	-	-
SEVERENCE PAYOFF	42,025	24,339	-	20,000
WORKERS COMPENSATION INSURANCE	911	958	1,120	1,000
MISCELLANEOUS PAYROLL	2,754	5,189	3,880	4,000
<b>SUBTOTAL</b>	<b>\$ 1,867,870</b>	<b>\$ 1,908,060</b>	<b>\$ 2,020,000</b>	<b>\$ 1,850,000</b>
<b>STATE OPERATIONS</b>				
RENTS & LEASES	132,636	128,747	192,000	195,000
REPAIRS/ALTERATIONS/MAINTENANCE	24,280	16,286	15,000	15,000
PRINTING & BINDING	17,868	12,967	15,000	10,000
PROFESSIONAL/TECHNICAL SERVICES	8,659	-	-	-
COMPUTER SYSTEMS SERVICES	12,918	10,966	10,000	10,000
COMMUNICATIONS	27,038	25,442	20,000	20,000
TRAVEL, IN-STATE	544	1,009	3,000	2,000
TRAVEL, OUT-STATE	58,541	44,521	35,000	25,000
SUPPLIES	69,178	45,990	40,000	30,000
EQUIPMENT	105,814	2,201	10,000	-
EMPLOYEE DEVELOPMENT	18,537	11,259	15,000	5,000
OTHER OPERATING COSTS	7,894	31,754	13,000	5,000
<b>SUBTOTAL</b>	<b>\$ 483,907</b>	<b>\$ 331,142</b>	<b>\$ 368,000</b>	<b>\$ 317,000</b>
<b>TOTAL GENERAL FUND</b>	<b>\$ 2,351,777</b>	<b>\$ 2,239,202</b>	<b>\$ 2,388,000</b>	<b>\$ 2,167,000</b>
<b>PERCENT INCREASE OVER PRIOR YEAR</b>		-4.8%	6.6%	-9.3%

## ATTACHMENT C

### CONTINUING FIDUCIARY EDUCATION PLAN

#### REQUIRED BY MS 356A.13

The State Board of Investment (SBI) undertakes the following activities related to fiduciary education. Taken as a group, these activities shall constitute the plan for continuing fiduciary education required by Minnesota Statutes 356A.13 (copy attached). In addition, pursuant to statutory requirements of qualification, the SBI executive director and many members of the Board's Investment Advisory Council (IAC) can be reasonably considered to be experts with respect to their duties as fiduciaries.

#### **1. Briefing for New Board/IAC Members**

Shortly after election to the Board or appointment to the IAC, each new member is briefed on SBI operations and policies. As part of the briefing, SBI's legal counsel will review the member's fiduciary obligations and responsibilities as specified in Minnesota Statutes Chapters 11A and 356A.

#### **2. Development and Review of Investment Policies**

The SBI adopts comprehensive investment policies for each fund under its control. The policies cover investment objectives, asset allocation, management structure and performance evaluation. Policy papers or reports on these topics are developed and written by SBI staff in conjunction with the IAC and consultants. Relevant research and analyses from the academic and professional investment fields are used to formulate these policy guidelines.

After they are formally adopted by the Board, these written policies guide the management of all assets under the SBI's control. The SBI intends to review its stated investment policies periodically. This review may occur within the framework of the SBI's regular quarterly meetings or may take place at special meetings or seminars specifically designated for this purpose.

#### **3. Input from Board's Consultants**

The SBI retains outside investment consultants to advise the Board members on a wide variety of investment management issues. As part of their contracts with the SBI, the consultants offer to meet with the Board members or their designees to discuss investment-related issues. These individual consultations occur throughout the year. In addition, the general consultant is available at each meeting of the Board and IAC. These meetings are supplemented by quarterly reports on investment performance prepared by the general consultant.

#### 4. **Manager Round Tables**

The SBI intends to convene small groups of its external money managers to discuss issues related to investment management and the financial markets. These round table discussions will be held periodically throughout the year and will be open to Board members and their designees, IAC members and other interested parties. It is anticipated that 1-2 round tables will be held each year.

#### 5. **Travel Allocation**

The SBI allocates \$2,500 annually to each Board member (or their designee) for costs associated with attendance at investment-related seminars and conferences. This allocation is used at the discretion of each Board member.

Date: May, 2003

#### **1996 Minnesota Statutes**

##### 356A.13. CONTINUING FIDUCIARY EDUCATION.

Subdivision 1. **Obligation of fiduciaries.** A fiduciary of a covered pension plan shall make reasonable effort to obtain knowledge and skills sufficient to enable the fiduciary to perform fiduciary activities adequately. At a minimum, a fiduciary of a covered pension plan shall comply with the program established in accordance with subdivision 2.

Subd. 2. **Continuing fiduciary education program.** The governing boards covered pension plans shall each develop and periodically revise a program for the continuing education of any of their board members and any of their chief administrative officers who are not reasonably considered to be experts with respect to their activities as fiduciaries. The program must be designed to provide those persons with knowledge and skills sufficient to enable them to perform their fiduciary activities adequately.

# Tab D

## COMMITTEE REPORT

---

DATE: May 27, 2003

TO: Members, State Board of Investment

FROM: IAC Membership Review Committee

**SUBJECT: Recommended Appointments to IAC**

The terms of five members of the Investment Advisory Council expired in January 2003. The members continue to serve until their successors are appointed. If a successor has not been appointed by July 1, 2003, then the member's term will extend until January 2007. The five members are as follows:

- John Bohan                      Vice President/Pension Investments, Retired  
Grand Metropolitan-Pillsbury
- Malcolm McDonald            Director and Corporate Secretary  
Space Center, Inc.
- Gary Norstrem                 Treasurer, Retired  
City of St. Paul
- Daralyn Peifer                 Director, Benefit Finance  
General Mills, Inc.
- Michael Troutman             Vice President, Finance and Investments  
Board of Pensions, ELCA

Each of the above named have submitted applications for reappointment to the IAC. The above named applicants have extensive professional plan sponsor and institutional investor experience, which are meaningful characteristics for service on the IAC.

Additionally, a position on the IAC is vacant due to the resignation of Jan Yeomans, former Treasure of 3M Company. The term of this vacant position will expire in January 2007, as well.



# Tab E



## COMMITTEE REPORT

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DATE: May 27, 2003

TO: Members, State Board of Investment  
Members, Investment Advisory Council

FROM: **Asset Allocation Committee**

The Asset Allocation Committee met on April 22, 2003 to review the long-term asset allocation strategy for the Basic Retirement Funds and the Post Retirement Fund. As a result of the review, the Board and the Investment Advisory Council (IAC) are requested to take action on the following items:

- new long-term asset allocation policy for the Basic and Post Retirement Funds;
- risk exposure and composition of the alternative investment portfolios for the Basic and Post Retirement Funds; and,
- changes for the reporting of returns and the long-term objectives for the Basic, Post and Combined Retirement Funds.

The State Board of Investment (SBI) determines overall strategy for each fund through its long-term asset allocation policy. This decision is the single largest determinant of a fund's return and reflects the Board's tolerance for risk.

The last major change in the Basic and Post Funds occurred in 1995 when allocations to international stocks were increased from 10% to 15% in each Fund.

### ***Proposal and Committee Action***

The full report begins on **page 7**. It provides additional background information, reviews long-term assumptions about risk and return, and examines several proposed allocations for each Fund. The recommendations focus on making changes that would enhance the risk/return profile of the Retirement Funds.

Following are the recommendations included in the proposal:

- Increase the allocation for alternative investments in the Basic Retirement Funds from 15% to 20%. The increase in this allocation to alternative investments would be funded by a corresponding decrease in the allocation to fixed income, which would decline from 25% to 20%.

- Increase the allocation for alternative investments in the Post Retirement Fund from 5% to 12%. The increase in this allocation to the Post Fund's alternative investments would be funded by a corresponding decrease in the domestic equity target from 50% to 45% and a decrease in the fixed income target from 27% to 25%.
- The composition and risk exposure of the alternative investment portfolios of the Basic and Post Retirement Funds would be identical. To accomplish this recommendation, the current yield-oriented portfolio in the Post Fund and the equity-oriented portfolio from the Basics would be pooled. This accounting treatment would prospectively allow the Basic and Post Retirement Funds to have the same risk and return exposure. New alternative investments would be purchased for the pool and would be funded on a prorated share from the Basic and Post Funds. (Note that this approach is the same method used by the Basics and the Post Funds for investments in domestic equities, international equities, and fixed income.)
- Change the reporting of returns and the long-term objectives for the Basic, Post and Combined Retirement Funds. The recommended changes would extend the time periods over which the Funds' return objectives are evaluated:

Combined Retirement Funds:

1. Achieve Real Return over a twenty-year period; currently, over ten years.
2. Match or exceed Composite Index over a ten-year period; currently, over five years.
3. Transfer the Trust Universe Comparison Service (TUCS) comparison of performance from the Long Term Objectives Section of the Board Report to the Investment Report Section for the Combined Funds.

Basic Retirement Funds:

1. Match or exceed Composite Index over a ten-year period; currently, over five years.

Post Retirement Fund:

1. Match or exceed Composite Index over a ten-year period; currently, over five years.

### *Implementational Issues*

The changes being proposed reflect the fact that the asset allocation policies for the Basic and Post Retirement Funds are long-term. If the Board adopts the recommendation, it is anticipated that it could take up to five years for the SBI to reach the asset allocation targets being proposed. For purposes of rebalancing or developing composite indices for the Funds, staff will develop procedures to monitor the transition of assets from domestic equities and fixed income to alternative investments. Staff will present the procedures as part of the discussion regarding asset class program structures which will take place during the third quarter and be presented to the Board at its September, 2003, meeting.

A chart showing the recommended asset allocation policy targets appears as **Attachment A** on page 5.

### **RECOMMENDATION:**

**The Committee recommends that the SBI adopt the proposed asset allocation policy targets; the proposal to combine the alternative investment portfolios; and the proposed changes in reporting of returns and long-term objectives for the Basic Retirement Funds and the Post Retirement Fund. Further, the Committee recommends that the SBI adopt the position paper which begins on page 7 of this tab section as its policy statement regarding the asset allocation for the Basic and Post Retirement Funds.**

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**ATTACHMENT A**

**Asset Allocation Policy — Proposal**

	<b>Basics Current</b>	<b>Basics Proposed</b>	<b>Post Current</b>	<b>Post Proposed</b>
<b>Equity</b>	<b>60.0%</b>	<b>60.0%</b>	<b>65.0%</b>	<b>60.0%</b>
Domestic	45.0	45.0	50.0	45.0
International-unhgd.	13.5	13.5	13.5	13.5
Emerging Markets	1.5	1.5	1.5	1.5
<b>Altern. Assets*</b>	<b>15.0%</b>	<b>20.0%</b>	<b>5.0%</b>	<b>12.0%</b>
Private Equity	10.0	10.0	—	5.0
Real Assets	5.0	5.0	—	2.0
Yield Oriented	—	5.0	5.0	5.0
<b>Total Equity</b>	<b>75.0%</b>	<b>80.0%</b>	<b>70.0%</b>	<b>72.0%</b>
<b>Fixed Income</b>	<b>25.0%</b>	<b>20.0%</b>	<b>30.0%</b>	<b>28.0%</b>
Domestic Bonds	24.0	19.0	27.0	25.0
Cash Equivalents	1.0	1.0	3.0	3.0
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Annual Expected Return (Nominal)</b>	<b>8.88%</b>	<b>8.98%</b>	<b>8.35%</b>	<b>8.56%</b>
High Return**	21.05	21.36	19.84	20.04
Low Return**	-3.29	-3.40	-3.14	-2.92
<b>Annual Expected Risk/Stand. Dev.</b>	<b>±12.17</b>	<b>±12.38</b>	<b>±11.49</b>	<b>±11.48</b>

\* Market value. Unfunded commitments plus market value may be up to 1.5 times market value.

\*\* Annual range of expected returns within plus or minus one standard deviation. Approximately 67% of annual returns can be expected to fall within this range.

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**DRAFT**

## **Asset Allocation Review**

**Basic Retirement Funds  
Post Retirement Fund  
Combined Retirement Funds**

**Minnesota State Board of Investment**

**May 2003**

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**ASSET ALLOCATION REVIEW**  
**Basic Retirement Funds**  
**Post Retirement Fund**  
**Combined Retirement Funds**

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## **ASSET ALLOCATION REVIEW**

### **Basic, Post and Combined Retirement Funds**

#### **Executive Summary**

Long-term asset allocation policy is the core focus of the State Board of Investment (“the Board” or “SBI”) in the oversight of the assets under its charge. The asset allocation decision is the most significant determinant of an investment fund’s return and risk.

The asset allocation policy of the Basic and Post Retirement Funds are reviewed periodically. The most recent formal review of the Funds’ policy asset allocations occurred in 1995. The 1995 review resulted in the Board increasing its allocation to international equities from 10% to 15% in both the Basic and Post Funds. This was accomplished by reducing the domestic equity allocation in the Basic Funds from 50% to 45% and reducing the allocation to fixed income in the Post Fund from 35% to 30%.

The present review is prompted by the general discipline of a periodic review and the desire to determine the appropriateness of the SBI’s existing asset allocation policies given current expectations for capital market returns and volatility. While the asset allocation is most appropriately treated as a long-term guideline to achieve desired performance levels, it is prudent to review its status and make refinements given changing economic environments and advances in the capital markets. Over time, much of the change in the asset allocation of the Retirement Funds has come from the availability of an increasingly diversifiable array of investment products. Domestic common stocks, once the only available source of equity returns, are now just one of a variety of investable equity vehicles for pension funds. As do many major pension plan sponsors, the SBI now utilizes international stocks, private equity and venture capital, real estate, and resource investments in combination with domestic equities. This is expected to achieve higher long-term rates of return while experiencing lower rates of volatility than can be achieved by using domestic stocks alone. The lower volatility is due to the diversification benefits of owning a variety of investment vehicles, which perform

differently over time. Fixed income products have also expanded, giving the plan sponsor a broader base of investment opportunities from which to choose.

The balancing of long-term returns with appropriate levels of risk is the goal of a proper asset allocation policy. The current review results in recommendations that continue to refine the return and risk relationship for the Basic and Post Funds.

- The review recommends that the SBI increase its allocation for alternative investments in the Basic Retirement Funds from 15% to 20%. The increase in this allocation to alternative investments would be funded by a corresponding decrease in the fixed income target, which would decline from 25% to 20%.
- The review recommends that the SBI increase its allocation for alternative investments in the Post Retirement Fund from 5% to 12%. The increase in this allocation to the Post Fund's alternative investments would be funded by a corresponding decrease in the domestic equity target from 50% to 45% and a decrease in the fixed income target from 27% to 25%.
- The review recommends that the make up and risk exposure of the alternative investments portion of the portfolio for the Basic and Post Retirement Funds be identical. To accomplish this recommendation, the current yield-oriented portfolio in the Post and the equity-oriented portfolio in the Basics would be pooled. This accounting treatment would prospectively allow the Basic and Post Funds to have the same risk and return exposure. New alternative investments would be purchased for the pool and would be funded on a prorated share from the Basic and Post Funds.
- The review recommends that the SBI change the reporting of returns and the long-term objectives for the Basic, Post and Combined Retirement Funds. The recommended changes would extend the time periods over which the Funds' return objectives are evaluated:

#### Combined Retirement Funds:

1. Achieve Real Return over a twenty-year period; currently, over ten years.
2. Match or exceed Composite Index over a ten-year period; currently, over five years.
3. Transfer the Trust Universe Comparison Service (TUCS) comparison of performance from the Long Term Objectives Section of the Board Report to the Investment Report Section for the Combined Funds.

#### Basic Retirement Funds:

1. Match or exceed Composite Index over a ten-year period; currently, over five years.

#### Post Retirement Fund:

1. Match or exceed Composite Index over a ten-year period; currently, over five years.

### Current Asset Allocation Policy

The current long-term asset allocation policy for the Basic and Post Funds are shown below. While the Board does not set a specific policy for the Combined Retirement Funds, the policy is derived using the market values of the two underlying funds. (Because market values fluctuate, the policy for the Combined Retirement Funds will not be constant.)

	Basics	Post	Combined*
<b>Stocks</b>	<b>60.0%</b>	<b>65.0%</b>	<b>62.5%</b>
Domestic	45.0	50.0	47.5
International	15.0	15.0	15.0
<b>Alternative Assets**</b>	<b><u>15.0</u></b>	<b><u>5.0</u></b>	<b><u>10.0</u></b>
<b>Total Equity</b>	<b>75.0</b>	<b>70.0</b>	<b>72.5</b>
<b>Bonds</b>	<b>24.0</b>	<b>27.0</b>	<b>25.5</b>
<b>Cash</b>	<b><u>1.0</u></b>	<b><u>3.0</u></b>	<b><u>2.0</u></b>
<b>Total Fund</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

\*Based on 12/31/02 market values. Basics \$15.6 billion; Post \$15.4 billion.

\*\*Market value. Unfunded commitments plus market value may be up to 1.5 times market value.

## Comparison to Other Pension Plans

The median allocations to stocks, bonds, and cash in the master trust portion of the Trust Universe Comparison Service (TUCS) are as follows:

<b>Median Allocation*</b>	<b>Stocks**</b>	<b>Bonds**</b>	<b>Cash</b>
all funds	56.9%	32.4%	3.8%
public only	54.8%	35.2%	3.9%
corporate only	58.1%	32.4%	4.0%

\* Median allocation to each asset class as of 12/31/02. Will not add to 100%.

\*\* Includes both domestic and international.

The data indicate that the asset allocation policy for the Basics and the Post have more stocks and less bonds than many plans included in the comparison universe.

## Considerations in Determining Strategic Asset Allocation Policy

There are a number of factors to consider when determining an appropriate strategic asset allocation policy for an investment portfolio. The review considered the following factors in determining the asset allocation mix for the Basic and Post Funds:

- Fund Objective
- Time Horizon
- Return Objective
- Liquidity Needs
- Risk Tolerance
- Accounting Considerations

## **BASIC RETIREMENT FUNDS**

- **Fund Objective:** The objective of the Basic Retirement Funds is to ensure that sufficient assets are available to pay promised benefits at the time of retirement.
- **Time Horizon:** The expected time horizon of the investment period is determined by the nature of the liabilities. Everything being equal, long-term liability streams afford the investor the opportunity to withstand short-term volatility in pursuit of higher returns. A shorter time horizon requires investors to take less equity risk. The Basic Retirement Funds consist of assets for active (working) employees. It has an investment horizon of 30 to 40 years.
- **Return Objective:** The stated return objective directly influences the asset allocation by focusing the decision on allocations to investment vehicles with sufficient expected return. The Basic Retirement Funds have a statutorily required rate of return of 8.5% which must be achieved over the long term in order to meet the Fund's investment and actuarial assumptions. The return objective has a significant influence on the plan's allocation to equity assets.
- **Liquidity Needs:** A plan's cash needs over the investment horizon must be considered in forming an effective asset allocation policy. Plans with higher liquidity needs should maintain a higher liquid cash balance than plans with little need for cash. In addition, the liquidity impact due to allocations to non-marketable securities should be carefully considered. The Basic Funds have minimal liquidity needs, since transfers to fund retiree benefits from the Basic Funds to the Post Fund are accomplished with the transfer of assets via pool units, not cash.

- **Risk Tolerance:** Rather than a purely independent factor, risk tolerance is, in part, an outcome of the time horizon, return objective and liquidity decisions. For example, a 30-year time horizon combined with high return objectives and low liquidity needs allow for a high risk tolerance. This review recommends that the Basic Funds should have a high tolerance for risk. This decision is based upon the length of the investment horizon (30 to 40 years), low liquidity needs, and importantly, the aggressive return objective of 8.5% for the Funds. A higher risk tolerance suggests a greater emphasis on equity-type investments that offer higher absolute levels of return.
- **Accounting Considerations:** The retirement funds that make up the Basic Funds have statutorily required employer and employee contribution rates and assumed rates of return that will fully fund the plans by specific dates. (The dates range from 2020 to 2031.) Unlike corporate pension plans, the State has the ability to withstand short-term negative results without being required to make one-time cash contributions or make contribution rate changes. These factors further support the assertion that the Basic Funds have a high tolerance for investment risk, and therefore a high level of equity exposure is appropriate.

## **POST RETIREMENT FUND**

- **Fund Objective:** The Post Retirement Fund's objective is to earn sufficient returns to ensure that assets are available to pay initially promised benefits as well as any increases granted for all participants in the Fund.
- **Time Horizon:** The Post Fund has an investment horizon of 15 to 20 years, which represents the length of time a typical beneficiary is expected to draw a benefit.



- **Return Objective:** The Post Fund's return objective is the sum of the actuarial assumed rate of return (6%) used in the Post Fund's funding calculation plus a promised inflation-based benefit adjustment of up to 2.5% per year.
- **Liquidity Needs:** The Post Fund makes monthly benefit payments to retirees, and therefore has specific liquidity needs. Based on historical cash flows of monthly annuity payments and ongoing funding for new retirees, the Post Fund experiences net outflows of approximately \$500 million over a six-month period, or about 3% of the fund. The review recommends that the Post continue to allocate 3% of its assets to cash and 25% to fixed income securities, which in combination will be an appropriate source of liquidity for the Post Fund.
- **Risk Tolerance:** This review recommends the Post Fund, like the Basic Funds, should have a high tolerance for risk. This decision is based upon the length of the investment horizon, 15 to 20 years, moderate liquidity needs, and importantly, the aggressive return objective of 8.5% for the Fund. This objective suggests that a commensurate level of investment risk must be accepted in order to achieve the required return over the long term. To accomplish this goal the Post Fund should have a high level of equity exposure. In addition, the Post Fund should have a higher level of liquidity than the Basic Funds.
- **Accounting Considerations:** In the Post Fund, sufficient assets (discounted at the 6% return assumption) are transferred from the Basic Funds to the Post Fund to support the initially promised benefit. An inflation increase of up to 2.5% is granted annually. If returns exceed the 6% return assumption and the inflation component, an investment based increase may be granted. If investment performance does not meet the return assumption and the inflation component, an unfunded liability occurs in the Post Fund. No investment

component benefit increase will be granted until the unfunded liability is recovered. The need for the Post Fund to fund the initially promised benefits and to fund benefit increases support the assertion that the Post Fund has a high tolerance for investment risk. Therefore, a high level of equity exposure is appropriate.

### **Assumptions and Simulations**

With the above considerations in mind, several asset mix simulations were run for the Basic and Post Funds that utilize various combinations of assets.

The expected return, standard deviation and correlation assumptions used in the simulations are in **Attachment A**. The figures in Attachment A take into consideration long-term historical returns, data from consultants and long-term capital market assumptions from a number of investment management organizations (shown in **Attachment B**.) The assumptions used by the SBI in its 1995 asset allocation review are included for reference.

The results of the simulations for the Basic Funds, Post Fund and Combined Retirement Funds are shown in **Attachments C, D and E**.

## Recommended Proposal

After reviewing the results of the simulations, the review recommends that the Board adopt the specific policies for the Basic and Post Funds that follow:

### Asset Allocation Policy — Proposal

	<b>Basics Current</b>	<b>Basics Proposed</b>	<b>Post Current</b>	<b>Post Proposed</b>
<b>Equity</b>	<b>60.0%</b>	<b>60.0%</b>	<b>65.0%</b>	<b>60.0%</b>
Domestic	45.0	45.0	50.0	45.0
International-unhgd.	13.5	13.5	13.5	13.5
Emerging Markets	1.5	1.5	1.5	1.5
<b>Altern. Assets*</b>	<b>15.0%</b>	<b>20.0%</b>	<b>5.0%</b>	<b>12.0%</b>
Private Equity	10.0	10.0	—	6.0
Real Assets	5.0	5.0	—	3.0
Yield Oriented	—	5.0	5.0	3.0
<b>Total Equity</b>	<b>75.0%</b>	<b>80.0%</b>	<b>70.0%</b>	<b>72.0%</b>
<b>Fixed Income</b>	<b>25.0%</b>	<b>20.0%</b>	<b>30.0%</b>	<b>28.0%</b>
Domestic Bonds	24.0	19.0	27.0	25.0
Cash Equivalents	1.0	1.0	3.0	3.0
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Annual Expected Return (Nominal)</b>	<b>8.88%</b>	<b>8.98%</b>	<b>8.35%</b>	<b>8.60%</b>
High Return**	33.22	33.74	31.33	31.74
Low Return**	-15.46	-15.78	-14.63	-14.54
<b>Annual Expected Risk/Stand. Dev.</b>	<b>±12.17</b>	<b>±12.38</b>	<b>±11.49</b>	<b>±11.57</b>

\* Market value. Unfunded commitments plus market value may be up to 1.5 times market value.

\*\* Annual range of expected returns within plus or minus one standard deviation. Approximately 95% of annual returns can be expected to fall within this range.

The proposed changes raise the expected return in the Basic Funds by an estimated 10 basis points (see Attachment C) and by an estimated 25 basis points in the Post Fund (see Attachment D), with a modest increase in risk.

## **Performance Reporting**

This review recommends that performance reporting for the Funds should more closely reflect the long-term nature of the Funds' investment objectives and time horizon. The current performance evaluation period for the Basic and Post Retirement Funds is five years, while the Combined Retirement Funds are evaluated over a ten-year period. The objectives of these funds is to meet the long-term needs of public employees and therefore, focusing on long-term results is more important than focusing on short-term results. In 1995, a major factor in recommending the five-year and ten-year reporting period was the relatively short period over which data was available. Performance data for the Basics dates back to 1980. However, the time series for the Basic Funds' composite index began in 1984. Data for the Post Fund, as it exists today, dates back to 1993. With the passage of time and the availability of more performance data, this review now recommends that the time periods be extended over which the Funds' return objectives are evaluated. The recommended changes detailed below are consistent with the Funds' long-term investment objectives and time horizon.

### Combined Retirement Funds:

1. Achieve Real Return over a twenty-year period; currently, over ten years.
2. Match or Exceed Composite Index over a ten-year period; currently, over five years.

### Basic Retirement Funds:

1. Match or Exceed Composite Index over a ten-year period; currently, over five years.

### Post Retirement Fund:

1. Match or Exceed Composite Index over a ten-year period; currently, over five years.

The review also recommends that the comparison of the Combined Retirement Funds to the Trust Universe Comparison Service (TUCS) be shifted from the long-term objectives section of the quarterly report to the investment reporting section. Any comparison of fund performance to a universe of other plans has inherent problems. Plans within the TUCS universe have varying levels of investment flexibility, different assumed rates of return, and different asset / liability issues which lead to different asset allocation policies. As a result, the Combined Retirement Funds' ranking in the universe will be based upon factors relating to the Funds' design and funded status, and not solely upon relative performance.

## Attachment A

### Assumptions Used in Simulations

Asset Class	Real*	Nominal**	Risk/ Std. Dev.
<b>Return/Risk</b>			
<b>Equity</b>			
Domestic	6.25	9.25	17.00
International-unhedged	6.25	9.25	19.00
International-hedged	6.05	9.05***	17.00
Emerging markets	8.50	11.50	25.00
<b>Alternative Assets</b>			
Private equity	10.00	13.00	30.00
Real assets	5.00	8.00	12.00
Yield oriented	5.50	8.50	13.00
<b>Fixed Income</b>			
Domestic bonds	3.50	6.50	7.00
Non dollar bonds-unhedged	3.50	6.50	8.00
Non dollar bonds-hedged	3.30	6.30***	7.00
High Yield	4.50	7.50	10.00
Cash equivalents	1.00	4.00	2.00
<b>Inflation</b>		3.00	

\* Real return = nominal return - inflation.

\*\* Nominal return is the long-term (20+ years) expected return.

\*\*\* Unhedged return less assumed hedging cost of 20 b.p.

### Correlation Matrix

	1	2	3	4	5	6	7	8	9	10	11	12
1 US stocks	1.00											
2 Intl.-unhed.	.60	1.00										
3 Intl.-hed.	.70	.80	1.00									
4 Emerg. mkts.	.55	.50	.50	1.00								
5 Priv. equity	.50	.20	.40	.10	1.00							
6 Real assets	.40	.25	.30	.30	.30	1.00						
7 Yield oriented	.45	.30	.35	.00	.40	.15	1.00					
8 US bonds	.30	.20	.25	-.10	.15	.20	.50	1.00				
9 Non US-un.	.10	.40	.25	-.20	.00	.10	.05	.60	1.00			
10 Non US-hed.	.25	.20	.30	-.10	.10	.15	.15	.75	.50	1.00		
11 Cash equiv.	-.10	-.10	.00	.00	.00	.15	.10	.10	-.10	.10	1.00	
12 High yield	.50	.35	.40	.30	.30	.25	.60	.40	.00	.25	.00	1.00

**ATTACHMENT B  
COMPARATIVE DATA**

**Long Term Expected Real Returns**

	<b>SBI 2003 Study</b>	<b>SBI-1995*</b>	<b>PCA</b>	<b>UBS</b>	<b>JP Morgan</b>	<b>Wilshire</b>	<b>Goldman Sachs</b>	<b>Ibottson</b>
<b>Equities</b>								
Domestic	6.25	6.50	6.50	6.01	5.25	5.75	6.10	6.89
International-unhedged	6.25	6.50	6.50	N/A	5.25	5.75	5.80	6.79
Emerging Markets	8.50	9.50	N/A	10.05	6.00	5.75	6.80	-1.45
<b>Alternative Assets</b>								
Private Equity	10.00	9.50	10.50	10.31	6.95	8.75	8.90	N/A
Real Assets	5.00	4.50	5.00	5.60	4.45	4.50	3.50	8.92
Yield Oriented	5.50	5.50	N/A	N/A	N/A	N/A	N/A	N/A
<b>Fixed Income</b>								
Domestic Bonds	3.50	3.50	2.50	3.78	4.85	3.00	2.30	6.01
Non-dollar Bonds-unhedged	3.50	3.50	2.40	N/A	N/A	2.75	N/A	7.37
Cash Equivalents	1.00	1.00	1.50	2.45	2.00	1.00	N/A	0.68
<b>Inflation</b>								
		4.50	2.50	2.25	2.25	2.25	2.00	3.10

**Standard Deviations**

	<b>SBI 2003 Study</b>	<b>SBI-1995*</b>	<b>PCA</b>	<b>UBS</b>	<b>JP Morgan</b>	<b>Wilshire</b>	<b>Goldman Sachs</b>	<b>Ibottson</b>
<b>Equities</b>								
Domestic	17.00	17.00	20.00	15.00	15.40	17.00	15.90	21.91
International-unhedged	19.00	19.00	20.00	N/A	17.40	20.00	17.40	18.89
Emerging Markets	25.00	23.00	N/A	25.00	24.60	27.00	25.30	25.75
<b>Alternative Assets</b>								
Private Equity	30.00	23.00	35.00	32.60	30.00	32.00	29.00	N/A
Real Assets	12.00	12.00	14.00	10.60	7.60	14.00	9.30	16.89
Yield Oriented	13.00	13.00	N/A	N/A	N/A	N/A	N/A	N/A
<b>Fixed Income</b>								
Domestic Bonds	7.00	8.50	9.00	4.60	3.80	7.00	4.50	6.66
Non-dollar Bonds-unhedged	8.00	12.00	10.00	N/A	N/A	13.00	N/A	11.60
Cash Equivalents	2.00	3.00	1.50	0.50	0.30	3.00	N/A	0.90

\* SBI-1995 reflects the data used in the previous asset allocation study conducted in July 1995. PCS, UBS, JP Morgan, Wilshire and Goldman Sachs reflects the data currently used by those organizations. Ibottson reflects longest available observed historical data.

PCA = Pension Consulting Alliance. UBS = UBS PaineWebber Asset Management.

## Attachment C

### Asset Mix Simulations - Basic Funds

	Current Policy	Option 1 Recommended	Option 2	Option 3
<b>Equity</b>	<b>60.0%</b>	<b>60.0%</b>	<b>55.0%</b>	<b>55.0%</b>
Domestic	45.0	45.0	40.0	40.0
International Unhedged	13.5	13.5	13.5	13.5
Emerging Markets	1.5	1.5	1.5	1.5
<b>Alternative Assets</b>	<b>15.0</b>	<b>20.0</b>	<b>20.0</b>	<b>25.0</b>
Private Equity	10.0	10.0	15.0	15.0
Real Assets	5.0	5.0	5.0	5.0
Yield Oriented	—	5.0	—	5.0
<b>Fixed Income</b>	<b>25.0</b>	<b>20.0</b>	<b>25.0</b>	<b>20.0</b>
Domestic Bonds	24.0	19.0	24.0	19.0
Cash Equivalents	1.0	1.0	1.0	1.0
<b>Expected Return*</b>	<b>8.88</b>	<b>8.98</b>	<b>9.07</b>	<b>9.17</b>
<b>Standard Deviation</b>	<b>±12.17</b>	<b>±12.38</b>	<b>±12.39</b>	<b>±12.60</b>
<b>Sharpe Ratio**</b>	<b>0.40</b>	<b>0.40</b>	<b>0.41</b>	<b>0.41</b>
<b>Return change from current</b>		+0.10	+0.19	+0.29
<b>Risk change from current</b>		+0.21	+0.22	+0.43

\* Nominal return (Real return + expected inflation of 3%)

\*\* Sharpe ratio, developed by William Sharpe, is a universal measure of reward per unit of risk, calculated as the return of an asset in excess of that of the risk-free asset divided by the standard deviation of the returns of the asset. Return of risk-free asset assumed to be 1%, consistent with the assumed real return for cash equivalents.

#### Changes from Current Policy

Option 1     -increase yield oriented 5%  
              -decrease bonds 5%

Option 2     -increase private equity 5%  
              -decrease domestic equity 5%

Option 3     -increase private equity 5%; increase yield oriented 5%  
              -decrease domestic equity 5%; decrease bonds 5%



## Attachment D

### Asset Mix Simulations - Post Fund

	Current Policy	Option 1	Option 2	Option 3 Recommended
<b>Equity</b>	<b>65.0%</b>	<b>60.0%</b>	<b>65.0%</b>	<b>60.0%</b>
Domestic	50.0	45.0	50.0	45.0
International Unhedged	13.5	13.5	13.5	13.5
Emerging Markets	1.5	1.5	1.5	1.5
<b>Alternative Assets</b>	<b>5.0</b>	<b>10.0</b>	<b>10.0</b>	<b>12.0</b>
Private Equity	—	5.0	5.0	6.0
Real Assets	—	—	—	3.0
Yield Oriented	5.0	5.0	5.0	3.0
<b>Fixed Income</b>	<b>30.0</b>	<b>30.0</b>	<b>25.0</b>	<b>28.0</b>
Domestic Bonds	27.0	27.0	22.0	25.0
Cash Equivalents	3.0	3.0	3.0	3.0
<b>Expected Return*</b>	<b>8.35</b>	<b>8.53</b>	<b>8.67</b>	<b>8.60</b>
<b>Standard Deviation</b>	<b>±11.49</b>	<b>±11.45</b>	<b>±12.11</b>	<b>±11.57</b>
<b>Sharpe Ratio**</b>	<b>0.38</b>	<b>0.40</b>	<b>0.39</b>	<b>0.40</b>
<b>Return change from current</b>		+0.18	+0.32	+0.25
<b>Risk change from current</b>		-0.04	+0.62	+0.08

\* Nominal return (Real return + expected inflation of 3%)

\*\* Sharpe ratio, developed by William Sharpe, is a universal measure of reward per unit of risk, calculated as the return of an asset in excess of that of the risk-free asset divided by the standard deviation of the returns of the asset. Return of risk-free asset assumed to be 1%, consistent with the assumed real return for cash equivalents.

#### Changes from Current Policy

- Option 1     -increase private equity 5%  
              -decrease domestic equity 5%
  
- Option 2     -increase private equity 5%  
              -decrease bonds 5%
  
- Option 3     -increase private equity 5%; increase real assets 2%  
              -decrease domestic equity 5%; decrease bonds 2%

## Attachment E

### Asset Mix Simulations - Combined Retirement Funds

	Current Policy	Proposed*	Median State Fund**
<b>Equity</b>	<b>62.5%</b>	<b>60.0%</b>	<b>57.6%</b>
Domestic	47.5	45.0	44.9
International Unhedged	13.5	13.5	13.0
Emerging Markets	1.5	1.5	1.4
<b>Alternative Assets</b>	<b>10.0</b>	<b>16.0</b>	<b>5.8</b>
Private Equity	5.0	8.0	3.3
Real Assets	2.5	4.0	2.7
Yield Oriented	2.5	4.0	N/A
<b>Fixed Income</b>	<b>27.5</b>	<b>24.0</b>	<b>36.6</b>
Domestic Bonds	25.5	22.0	32.7
Cash Equivalents	2.0	2.0	2.0
<b>Expected Return (Nom.)</b>	<b>8.61</b>	<b>8.79</b>	<b>8.37</b>
<b>Standard Deviation</b>	<b>±11.76</b>	<b>±11.93</b>	<b>±11.04</b>
<b>Return change from current</b>		+0.18	-0.24
<b>Risk change from current</b>		+0.17	-0.72

Combined Retirement Funds Policy is calculated assuming the Basic and Post Funds are equal in size.

\* Combination of Basics Proposed (Option 1) and Post Proposed (Option 3).

\*\* Source: Greenwich Associates Market Dynamics Report. Median fund data normalized to total 100%. Assumed 2% cash allocation. Allocation to emerging market equities assumed as a pro-rata share of the international equity allocation based on the market capitalization weight of emerging markets.

# Tab F

## COMMITTEE REPORT

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DATE: May 27, 2003

TO: Members, State Board Investment  
Members, Investment Advisory Council

FROM: **Stock and Bond Manager Committee**

The Stock and Bond Manager Committee met on Thursday, May 15, 2003 to consider the following agenda items:

- Review the manager performance for the period ending March 31, 2003.
- Annual review of the domestic equity benchmark quality analysis.
- Discussion related to the recommendations from the Asset Allocation Committee.

No action is required by the SBI / IAC.

### INFORMATION ITEMS:

#### 1. Review of manager performance for the period ending March 31, 2003.

- *Domestic Equity Managers*

For the period ending March 31, 2003, the **Domestic Equity Manager Program** out-performed the Wilshire 5000 Investable during the quarter and the three-year time periods, and under-performed over the one and five-year time periods. The **current managers** out-performed the Aggregate Benchmark during the quarter and five-year time periods, but under-performed during the one and three-year time periods.

Time period	Total Program	Wilshire 5000 Investable	Current Mgrs. Only	Aggregate Benchmark
Quarter	-2.6%	-2.9%	-2.6%	-2.9%
1 Year	-24.7	-24.4	-24.7	-24.1
3 Years	-16.7	-16.8	-16.6	-16.0
5 Years	-4.7	-4.4	-3.7	-3.8

The performance evaluation reports for the domestic equity managers start on the blue page A-1 of this Tab.

- **Fixed Income Managers**

For the period ending March 31, 2003, the **Fixed Income Manager Program** out-performed the Lehman Aggregate for the quarter, matched the benchmark during the three-year period, and under-performed over the one and five-year time periods. The **current managers** out-performed the Aggregate Benchmark over the quarter, three and five-year time periods and under-performed during the one-year time period.

Time period	Total Program	Lehman Aggregate
Quarter	1.8%	1.4%
1 Year	10.5	11.7
3 Years	9.8	9.8
5 Years	7.4	7.5

Current Mgrs. Only	Aggregate Benchmark
1.8%	1.4%
11.0	11.7
10.0	9.8
7.6	7.5

The performance evaluation reports for the fixed income managers start on the **blue page A-33** of this Tab.

- **International Equity Managers**

For the period ending March 31, 2003, the **International Equity Program** and the **equity managers** (excluding the currency overlay) out-performed over the three and five-year time periods, but under-performed during the quarter and the one-year time period.

Time Period	Total* Program	Composite Index**
Quarter	-8.2	-8.0
1 Year	-22.9	-22.8
3 Year	-18.0	-19.3
5 Year	-6.5	-7.1

Equity*** Mgrs. Only
-8.2
-22.9
-18.0
-6.4

\* Includes impact of currency overlay on the passive EAFE portfolio from 12/1/95-10/31/00.

\*\* The international benchmark is MSCI EAFE-Free plus Emerging Markets Free (net). The weighting of each index fluctuates with market capitalization. From 12/31/96 to 6/30/99, the benchmark was fixed at 87% EAFE-Free (net) / 13% Emerging Markets Free (net). On 5/1/96, the portfolio began transitioning from 100% EAFE-Free (net) to the 12/31/96 fixed weights. Prior to 5/1/96, the benchmark was 100% EAFE-Free (net).

\*\*\* Includes impact of terminated managers, but excludes impact of currency overlay.

The performance evaluation reports for the international equity managers start on the **blue page A-45** of this Tab.

## **2. Annual review of the domestic equity benchmark quality analysis.**

In accordance with the SBI's Manager Continuation Policy, staff reviews all custom benchmarks for active domestic stock managers on an annual basis. The purpose of the analysis is to determine whether a benchmark adequately reflects the manager's unique investment style and therefore can be used as a valid performance measurement standard for the manager.

This year's review of the custom benchmarks for the active domestic stock managers are generally satisfactory and continue to show characteristics of benchmarks that reflect the investment style of each manager. During the past year, several of the managers' benchmark construction processes were examined and modified to improve various benchmark quality characteristics. Those managers included Forstmann-Leff, Artemis, and Earnest Partners. As a result of this year's quality review, it is apparent that the benchmark of Earnest Partners may need further modifications.

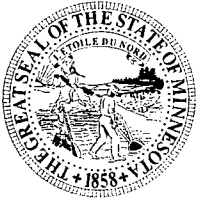
Staff continues to monitor, evaluate, and discuss all of the custom benchmarks with the active managers to ensure that an appropriate custom benchmark is in place. A summary of the benchmark quality evaluation and a description of the benchmark quality measures are included beginning on **page 5** of this tab.

## **3. Discussion related to the recommendations from the Asset Allocation Committee.**

The Committee discussed the Asset Allocation Review Paper on **page 7** of **Tab E**. There was a brief review of the major proposals in the paper and a discussion of the return assumptions used in the analysis. The Committee supported the recommendations of the Asset Allocation Committee as presented in the Asset Allocation Review Paper.

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**MINNESOTA  
STATE  
BOARD OF  
INVESTMENT**



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Tim Pawlenty

State Auditor  
Pat Anderson Awada

Secretary of State  
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DATE: May 8, 2003  
TO: Members, Stock and Bond Manager Committee  
FROM: Lois Buermann *LB*  
SUBJECT: **Annual Custom Benchmark Evaluation**

The SBI's Manager Continuation Policy requires staff to review all custom benchmarks for active domestic stock managers on an annual basis. The purpose of the analysis is to determine whether a benchmark adequately reflects the manager's unique investment style and therefore can be used as a valid performance measurement standard for the manager.

Attached is a summary of the benchmark evaluation showing the key characteristics of the benchmarks through December 2002. A glossary of terms is included for your reference.

The custom benchmarks for the active domestic stock managers are generally satisfactory showing characteristics of benchmarks that reflect the investment style of each manager. During the past year, several of the managers' benchmark construction processes were examined and modified to improve various benchmark quality characteristics. Some of the changes include the following:

- Forstmann-Leff's custom benchmark was modified to reduce a value bias that had crept into the benchmark over the past few years. The attached benchmark evaluation uses revised benchmarks going back eight quarters to demonstrate that the new benchmark has dealt with any deficiencies. The revised benchmark became effective on April 1, 2002. Forstmann-Leff's long-term performance continues to be measured against the original custom benchmarks.
- Artemis revised its stock-weighting scheme for their custom benchmark in April 2002. The process sets the sector weights of the benchmark equal to the portfolio's sector weights, and then equal weights the stocks within each sector. Previously, all stocks in the benchmark were equally weighted. The resulting benchmark appears to be a fair representation of their investment style.
- Earnest Partners also revised its stock-weighting process as of the 3<sup>rd</sup> quarter 2002. These changes should improve some of the benchmark characteristics going forward.

As a result of this year's quality review, it is apparent that the benchmark of Earnest Partners may need further modifications. Staff will continue to work with all of the active managers to ensure that an appropriate custom benchmark is in place.



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## GLOSSARY

**Benchmark coverage** measures the percentage of securities held in the actual portfolio which also are contained in the benchmark portfolio. If a benchmark truly captures the securities on which the manager has an investment opinion, it will have a high coverage ratio. Coverage ratios vary according to the level of discipline exhibited in a manager's definition and implementation of the investment process. A valid benchmark should produce a coverage ratio of 80% or greater.

An **active position** is the difference between the actual portfolio weight of a security less the corresponding benchmark weight of the same security. A good benchmark will generate positive active positions with very rare exceptions. The weighting of each holding in the active portfolio should exceed the corresponding weights assigned to the same securities in the benchmark because if a manager finds a particular stock attractive, he will hold more than the benchmark position. Conversely, if a manager feels a security is unattractive, he will not hold the security at all.

**Benchmark turnover** measures the proportion of the benchmark's market value allocated to purchases and reinvestment of income during a periodic rebalancing. A valid and investable benchmark should experience reasonable levels of turnover. Semi-annual turnover in the 20 to 30% range is consistent with a passive investment in the benchmark.

**Active Risk** analysis is a useful measure in determining explanatory power of a customized benchmark. It is the variability (standard deviation) of the manager's active return (active portfolio return less benchmark return). Since a customized benchmark is constructed to capture a manager's investment style, a good benchmark should produce lower active risk than using a market index as the benchmark. This indicates that the benchmark more effectively screens out random noise associated with factors unrelated to a manager's investment style. To indicate the amount of return the manager generates relative to the risk they take, an information ratio (IR) can be calculated. An IR is calculated by dividing the Value of Active Management (VAM or active return) by the active risk. Holding everything else constant, the lower active risk resulting from a valid benchmark will produce a higher information ratio (IR) than a market index. In general, the higher the information ratio the shorter the time frame needed to determine whether the manager can or cannot add value at a statistically significant level.

**Correlation analysis:** The explanatory power of a manager's benchmark can also be evaluated by looking at the correlation between three residual return series: the manager's actual returns versus those of the market, the benchmark returns versus those of the market, and the actual portfolio returns versus those of the benchmark.

A good benchmark should exhibit significantly positive correlation between portfolio vs market and benchmark vs market, because when the manager's benchmark, or investment style, performs well relative to the market, the actual portfolio should also do well relative to the market. A good benchmark will have a correlation between portfolio vs market and benchmark vs market greater than 0.50.

If a manager's investment style is accurately reflected in the benchmark, the manager's ability to add value relative to the benchmark should not be affected by the performance of its investment style relative to the market. Therefore, the correlation between benchmark vs market and portfolio vs benchmark should be essentially zero over time.



# BENCHMARK QUALITY EVALUATION

For Period Ending  
December 2002

General Guidelines	Alliance Capital	Cohen, Klingenstein & Marks	Forstmann-Leff	Franklin Portfolio
<b>Benchmark Provider</b>	Manager	Mngr 5/94-6/98 R&T 7/98-10/00 Mngr 11/00-12/02	R&T	Manager
<b>Benchmark Evaluation Period</b>	1/86 - 12/02	5/94 - 12/02	1/86 - 12/02	5/89 - 12/02
<b>Benchmark Coverage (Recent)</b>	90%	99%	83%	100%
<b>Positive Active Positions (Recent)</b>	95%	100%	98%	100%
<b>Turnover (Recent semi-annual)</b>	22%	28%	35%	5%
<b>Active Risk</b>				
Annualized Std. Dev. of VAM - Portfolio vs. Target	6.51	8.88	8.88	6.26
- Portfolio vs. Bnmk	4.98	8.60	8.84	4.85
Risk Reduction	24%	3%	0%	23%
<b>Correlation Analysis</b>				
Portfolio vs S&P500 correlation to Bnmk vs Target	0.643	0.361	0.323	0.634
Portfolio vs Bnmk correlation to Bnmk vs Target	-0.020	-0.271	-0.311	0.018
<b>Relative Style Coordinate Analysis</b> (Portfolio located closer to bnmk than published index?)	Yes	No	Yes	Yes
<b>Risk Characteristics (B/P, E/P, Growth, Etc.)</b> (Portfolio similar to bnmk over time?)	Yes	Yes	Yes	Yes
<b>Economic Sector Weights</b> (Portfolio similar to bnmk over time?)	Yes	Yes	Yes	Yes

# BENCHMARK QUALITY EVALUATION

For Period Ending  
December 2002

General Guidelines	GeoCapital Corporation	Lincoln Capital	New Amsterdam Partners	Oppenheimer Capital
<b>Benchmark Provider</b>	Barra 5/90-6/91 R&T 7/91-12/02	R&T	R&T	Barra 8/93-6/00 R&T 7/00-12/02
<b>Benchmark Evaluation Period</b>	5/90 - 12/02	8/93 - 12/02	5/94 - 12/02	8/93 - 12/02
<b>Benchmark Coverage (Recent)</b>	82%	95%	100%	93%
<b>Positive Active Positions (Recent)</b>	98%	99%	100%	99%
<b>Turnover (Recent semi-annual)</b>	25%	15%	26%	13%
<b>Active Risk</b>				
Annualized Std. Dev. of VAM - Portfolio vs. Target	14.89	9.00	6.50	8.17
- Portfolio vs. Bnmk	9.80	4.57	6.09	6.78
Risk Reduction	34%	49%	6%	17%
<b>Correlation Analysis</b>				
Portfolio vs S&P500 correlation to Bnmk vs Target	0.766	0.865	0.481	0.558
Portfolio vs Bnmk correlation to Bnmk vs Target	-0.246	0.146	-0.353	-0.029
<b>Relative Style Coordinate Analysis</b> (Portfolio located closer to bnmk than published index?)	Yes	Yes	Yes	Yes
<b>Risk Characteristics (B/P, E/P, Growth, Etc.)</b> (Portfolio similar to bnmk over time?)	Yes	Yes	Yes	Yes
<b>Economic Sector Weights</b> (Portfolio similar to bnmk over time?)	Yes	Yes	Yes	Yes

# BENCHMARK QUALITY EVALUATION

For Period Ending  
December 2002

General Guidelines	UBS Global	Artemis Partners	Bay Isle Financial	Earnest Partners
<b>Benchmark Provider</b>	R&T	FR2 8/00-9/00 Mngr 10/00-12/02	FR1V 8/00-9/00 R&T 10/00-12/02	FR1V 8/00-9/00 Mngr 10/00-12/02
<b>Benchmark Evaluation Period</b>	8/93 - 12/02	10/00-12/02	10/00-12/02	10/00-12/02
<b>Benchmark Coverage (Recent)</b>	97%	97%	90%	95%
<b>Positive Active Positions (Recent)</b>	100%	100%	100%	100%
<b>Turnover (Recent semi-annual)</b>	8%	30%	20%	23%
<b>Active Risk</b>				
<b>Annualized Std. Dev. of VAM - Portfolio vs. Target</b>	9.40	13.30	8.38	8.50
<b>- Portfolio vs. Bnmk</b>	8.46	8.62	5.88	11.19
<b>Risk Reduction</b>	10%	35%	30%	-32%
<b>Correlation Analysis</b>				
<b>Portfolio vs S&amp;P500 correlation to Bnmk vs Target</b>	0.450	0.814	0.717	0.007
<b>Portfolio vs Bnmk correlation to Bnmk vs Target</b>	0.117	-0.442	0.115	-0.645
<b>Relative Style Coordinate Analysis</b> (Portfolio located closer to bnmk than published index?)	Yes	Yes	Yes	No
<b>Risk Characteristics (B/P, E/P, Growth, Etc.)</b> (Portfolio similar to bnmk over time?)	Yes	Yes	Yes	No
<b>Economic Sector Weights</b> (Portfolio similar to bnmk over time?)	Yes	Yes	No	No

# BENCHMARK QUALITY EVALUATION

For Period Ending  
December 2002

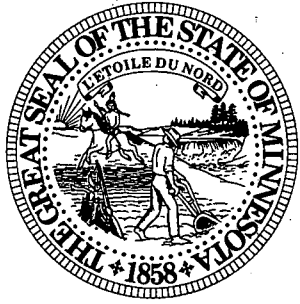
General Guidelines	Holt-Smith & Yates	Next Century Growth	Peregrine Capital	Valenzuela Capital
<b>Benchmark Provider</b>	S&P500 8/00-9/00 Mngr 10/00-12/02	FR25G 8/00-9/00 Mngr 10/00-12/02	FR2V 8/00-9/00 Mngr 10/00-12/02	R&T
<b>Benchmark Evaluation Period</b>	10/00-12/02	10/00-12/02	10/00-12/02	5/94 - 12/02
<b>Benchmark Coverage (Recent)</b>	98%	94%	87%	90%
<b>Positive Active Positions (Recent)</b>	100%	100%	100%	100%
<b>Turnover (Recent semi-annual)</b>	25%	24%	12%	23%
<b>Active Risk</b>				
Annualized Std. Dev. of VAM - Portfolio vs. Target	8.10	24.42	17.73	9.72
- Portfolio vs. Bnmk	8.63	13.89	6.69	6.76
<b>Risk Reduction</b>	-7%	43%	62%	30%
<b>Correlation Analysis</b>				
Portfolio vs S&P500 correlation to Bnmk vs Target	0.323	0.847	0.938	0.735
Portfolio vs Bnmk correlation to Bnmk vs Target	-0.459	0.353	0.377	-0.221
<b>Relative Style Coordinate Analysis</b> (Portfolio located closer to bnmk than published index?)	No	No	Yes	Yes
<b>Risk Characteristics (B/P, E/P, Growth, Etc.)</b> (Portfolio similar to bnmk over time?)	Yes	Yes	No	Yes
<b>Economic Sector Weights</b> (Portfolio similar to bnmk over time?)	No	Yes	Yes	Yes

# BENCHMARK QUALITY EVALUATION

For Period Ending  
December 2002

General Guidelines	Voyageur- Chicago Equity	Winslow Capital- Small Cap	Zevenbergen Capital
Benchmark Provider	FR1G 8/00-9/00 Mngr 10/00-12/02	FR2G 7/00-9/00 R&T 10/00-12/02	Manager
Benchmark Evaluation Period	10/00-12/02	10/00-12/02	5/94 - 12/02
Benchmark Coverage (Recent)	98%	95%	92%
Positive Active Positions (Recent)	100%	100%	97%
Turnover (Recent semi-annual)	20%	20%	48%
Active Risk	7.80	18.88	16.49
Annualized Std. Dev. of VAM - Portfolio vs. Target	5.89	10.23	11.83
- Portfolio vs. Bnmk	24%	46%	28%
Risk Reduction			
Correlation Analysis			
Portfolio vs S&P500 correlation to Bnmk vs Target	0.667	0.841	0.697
Portfolio vs Bnmk correlation to Bnmk vs Target	-0.165	-0.030	0.029
Relative Style Coordinate Analysis (Portfolio located closer to bnmk than published index?)	Yes	No	Yes
Risk Characteristics (B/P, E/P, Growth, Etc.) (Portfolio similar to bnmk over time?)	Yes	No	Yes
Economic Sector Weights (Portfolio similar to bnmk over time?)	No	Yes	Yes





# STATE BOARD OF INVESTMENT

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## Stock Manager Evaluation Reports

First Quarter, 2003



**COMBINED RETIREMENT FUNDS  
DOMESTIC STOCK MANAGERS  
Periods Ending March, 2003**

	Quarter		1 Year		3 Years		5 Years		Since Inception (1)		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active Managers</b>												
Alliance Capital	-1.0	-3.5	-24.7	-25.2	-20.4	-19.5	-1.2	-3.1	14.8	10.5	\$774.9	5.2%
Cohen, Klingenstein & Marks	-0.2	-0.1	-32.5	-25.1	-23.3	-18.8	-7.9	-2.7	7.2	9.1	\$417.9	2.8%
Forstmann-Leff	1.1	-0.9	-33.5	-25.4	-26.1	-6.1	-4.4	1.4	10.5	10.9	\$435.5	2.9%
Franklin Portfolio	-4.9	-2.8	-31.6	-24.1	-13.1	-10.3	-3.7	-2.0	10.1	10.0	\$533.5	3.6%
GeoCapital	2.2	-3.3	-29.3	-25.1	-29.1	-16.4	-10.6	-6.7	6.1	8.0	\$221.6	1.5%
Lincoln	1.0	-0.7	-24.8	-25.4	-27.1	-24.3	-8.8	-6.3	6.2	7.9	\$434.1	2.9%
New Amsterdam Partners	-3.2	-3.3	-21.4	-26.8	-6.9	-9.2	2.0	2.1	12.0	11.3	\$276.0	1.8%
Oppenheimer	-4.7	-4.7	-19.9	-26.3	-6.3	-10.4	-0.6	-0.9	11.3	9.8	\$651.4	4.3%
UBS Global	-3.5	-3.2	-20.1	-24.1	-0.8	-14.5	-3.6	-2.8	8.8	8.5	\$661.9	4.4%
<b>Emerging Managers (2)</b>	-4.0	-3.8	-27.7	-24.5	-15.3	-9.7	-2.7	1.7	8.7	11.7	\$545.9	3.6%
<b>Semi-Passive Managers</b>												
Barclays Global Investors	-2.0	-3.0	-21.3	-22.6	-14.4	-16.7	-4.9	-5.5	8.9	8.1	\$2,097.8	14.0%
Franklin Portfolio	-3.8	-3.0	-23.6	-22.6	-16.4	-16.7	-6.5	-5.5	7.6	8.1	\$1,310.5	8.7%
JP Morgan	-3.1	-3.0	-24.7	-22.6	-15.9	-16.7	-5.6	-5.5	8.1	8.1	\$1,822.1	12.1%
<b>Passive Manager</b>												
Barclays Global Investors	-3.0	-2.9	-24.4	-24.4	-16.5	-16.7	-4.0	-4.2	7.0	6.7	\$4,821.6	32.1%
Current Aggregate	-2.6	-2.9	-24.7	-24.1	-16.6	-16.0	-3.7	-3.8	12.2	10.2	\$15,004.6	100.0%
<b>Historical Aggregate (3)</b>	-2.6	-2.9	-24.7	-24.1	-16.7	-16.0	-4.7	-4.0	10.6	10.9		
Wilshire 5000 Investable (4)		-2.9		-24.4		-16.8		-4.4		10.8		
Wilshire 5000		-3.1		-24.0		-16.3		-3.9		11.1		

(1) Since retention by the SBI. Time period varies for each manager.

(2) Aggregate of emerging manager group. The benchmark reflects a composite of the individual manager customized benchmarks since inception of the program on 4/1/94.

(3) Includes the performance of terminated managers.

(4) Restated to incorporate the Wilshire 5000 Investable Index beginning 7/1/99.

From 11/1/93 to 6/30/99, the target was the Wilshire 5000 as reported with no adjustments.

Prior to 11/1/93, the Wilshire 5000 was adjusted to reflect SBI mandated restrictions, which included liquor and tobacco, American Home Products and South Africa.



**ALLIANCE CAPITAL MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Jack Koltes**

**Assets Under Management: \$774,857,278**

**Investment Philosophy**

Alliance searches for companies likely to experience high rates of earnings growth, on either a cyclical or secular basis. Alliance invests in a range of medium to large growth and cyclically sensitive companies. There is no clear distinction on the part of the firm as to an emphasis on one particular type of growth company over another. However, the firm's decision-making process appears to be much more oriented toward macroeconomic considerations than is the case with most other growth managers. Accordingly, cyclical earnings prospects, rather than secular, appear to play a larger role in terms of stock selection. Alliance is not an active market timer, rarely raising cash above minimal levels.

**Staff Comments**

On May 1, 2003, Alfred Harrison will give up his leadership role on the large cap growth team, and Jim Reilly will assume those responsibilities. Jim has been on the large growth team as a senior portfolio manager for approximately 14 years. The SBI's portfolio manager continues to be Jack Koltes. Staff does not anticipate a change to the investment philosophy or process, but will monitor the firm closely over the next few quarters.

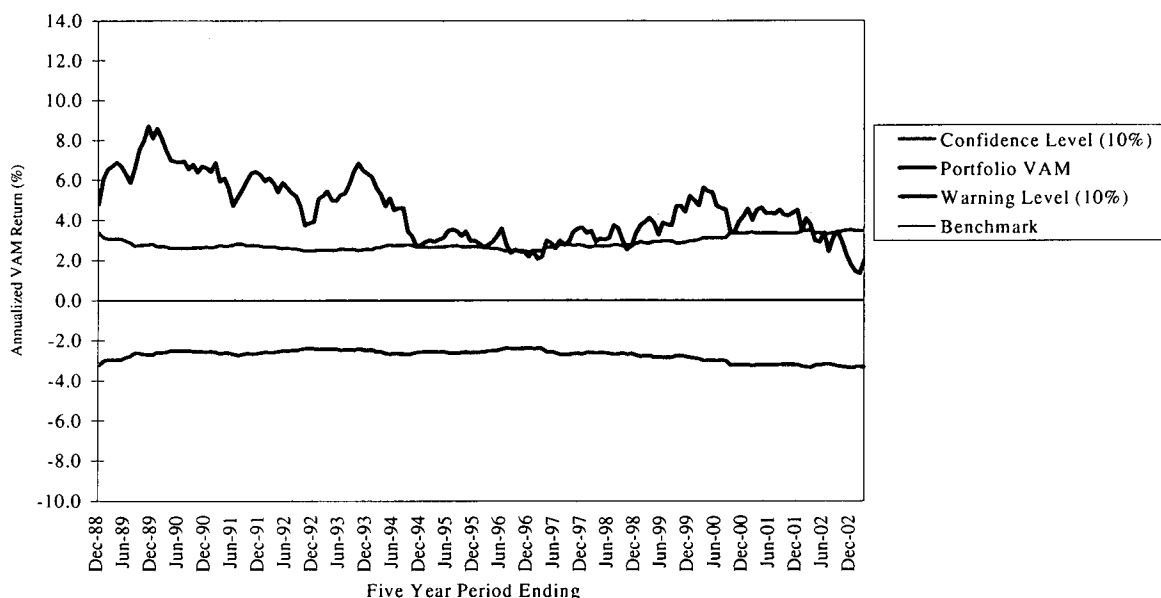
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-1.0%	-3.5%
Last 1 year	-24.7	-25.2
Last 2 years	-14.3	-14.2
Last 3 years	-20.4	-19.5
Last 4 years	-9.4	-9.8
Last 5 years	-1.2	-3.1
Since Inception (1/84)	14.8	10.5

**Recommendation**

No action required.

**ALLIANCE CAPITAL MANAGEMENT**  
**Rolling Five Year VAM**



**COHEN KLINGENSTEIN & MARKS INCORPORATED**  
**Periods Ending March, 2003**

**Portfolio Manager: George Cohen**

**Assets Under Management: \$417,883,921**

**Investment Philosophy**

Cohen Klingenstein & Marks Inc. (CKM) seeks to outperform the market by focusing on two variables: 1) economic cycles; and 2) security valuation. Within economic cycles, they believe that stocks exhibit predictable patterns that reflect changing expectations on corporate profits and interest rates. Similarly, they believe that stock prices normally reflect earnings expectations. CKM exploits short run inefficiencies through an unbiased process that relates the price of a stock to the consensus earnings expectations.

**Staff Comments**

Performance for the quarter closely tracked the custom benchmark, however longer-term performance lags significantly as a result of an over weight to technology and telecommunication stocks during the past two years. The manager had positioned the portfolio for a faster economic recovery than we have experienced.

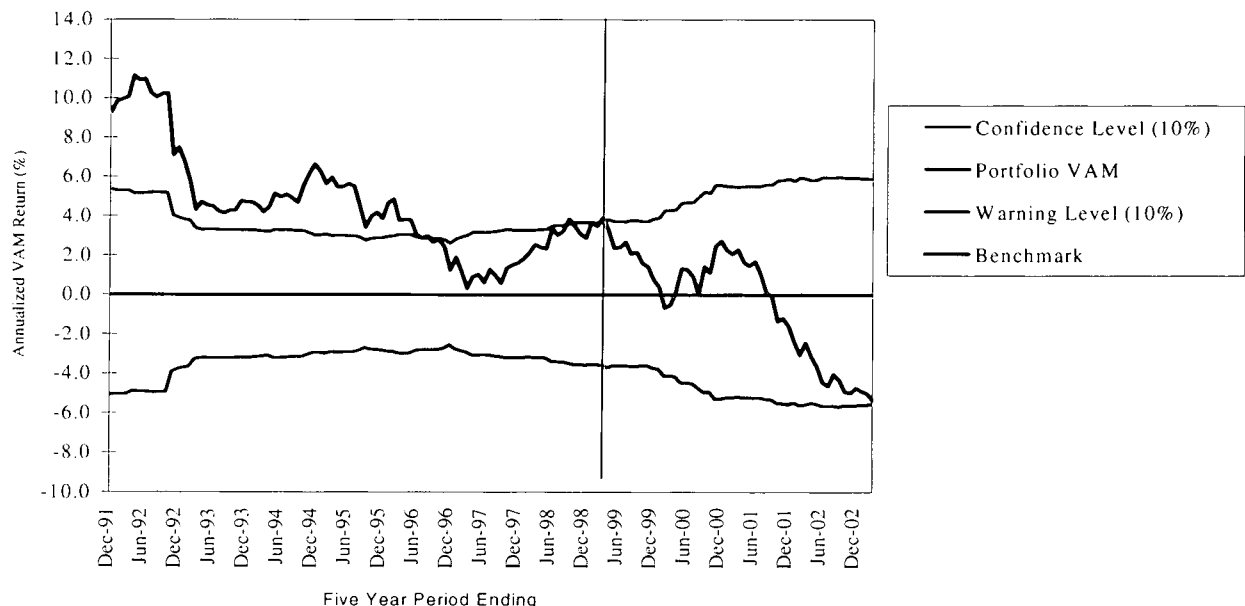
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.2%	-0.1%
Last 1 Year	-32.5	-25.1
Last 2 Years	-24.8	-11.4
Last 3 Years	-23.3	-18.8
Last 4 Years	-15.2	-7.6
Last 5 Years	-7.9	-2.7
Since Inception (4/94)	7.2	9.1

**Recommendation**

No action required.

**COHEN KLINGENSTEIN & MARKS**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**FORSTMANN-LEFF ASSOCIATES**  
**Periods Ending March, 2003**

**Portfolio Manager: Bill Harnisch**

**Assets Under Management: \$435,490,524**

**Investment Philosophy**

Forstmann-Leff is a classic example of a "rotational" manager. The firm focuses initially on sector weighting decisions. Based upon its macroeconomic outlook, the firm will move aggressively into and out of equity sectors over the course of a market cycle. The firm tends to purchase liquid, medium to large capitalization stocks.

**Staff Comments**

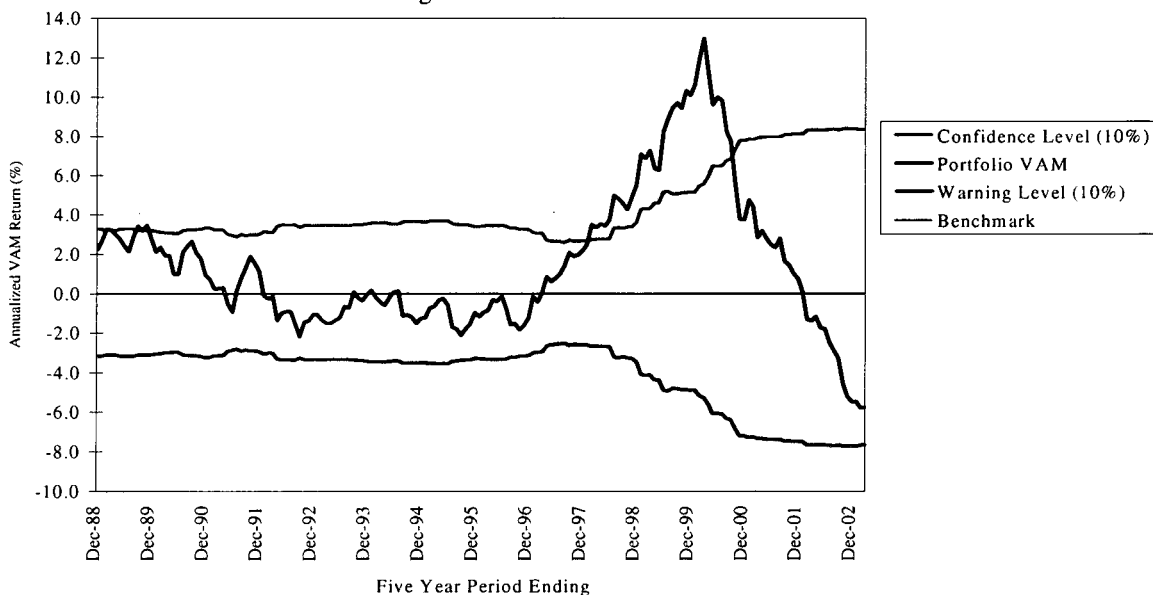
Forstmann beat their benchmark by 2% for the quarter as a result of good performance from Ebay, Amazon.com, and several healthcare names. Healthsouth was a large detractor from performance, as the SEC is investigating the firm for accounting fraud. They have since sold their position. Over longer periods, they lagged the benchmark as a result of stock selection in healthcare and information technology. Tenet Healthcare and Healthsouth were the largest detractors over the past year.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	1.1%	-0.9%	No action required.
Last 1 year	-33.5	-25.4	
Last 2 years	-21.2	-9.8	
Last 3 years	-26.1	-6.1	
Last 4 years	-10.9	1.4	
Last 5 years	-4.4	1.4	
Since Inception (1/84)	10.5	10.9	

**Recommendation**

**FORSTMANN-LEFF ASSOCIATES**  
**Rolling Five Year VAM**



**FRANKLIN PORTFOLIO ASSOCIATES**  
**Periods Ending March, 2003**

**Portfolio Manager: John Cone**

**Assets Under Management: \$533,494,229**

**Investment Philosophy**  
**Active**

Franklin believes that rigorous and consistent application of fundamentally based valuation criteria will produce value added investment returns. Franklin builds a portfolio by using a series of more than 30 integrated computer models that value a universe of 3500 stocks. Their models rank each security based on fundamental momentum, relative value, future cash flow, and supplementary models, then a composite ranking provides one ranked list of securities reflecting their relative attractiveness. Stocks that fall below the median ranking are sold and proceeds reinvested in stocks from the top deciles in the ranking system. Franklin uses the BARRA E3 risk model to monitor the portfolio's systematic risk and industry weightings, relative to the selected benchmark, to achieve a residual risk of 4.0 to 4.5 percent for the active portfolio.

**Staff Comments**

During the quarter, the portfolio under performed the benchmark by 2.1% due to stock selection in the finance sector. ConAgra Foods and Boeing also hurt performance during the quarter. For the past year, a number of retail, finance, and electronic technology companies hurt relative performance.

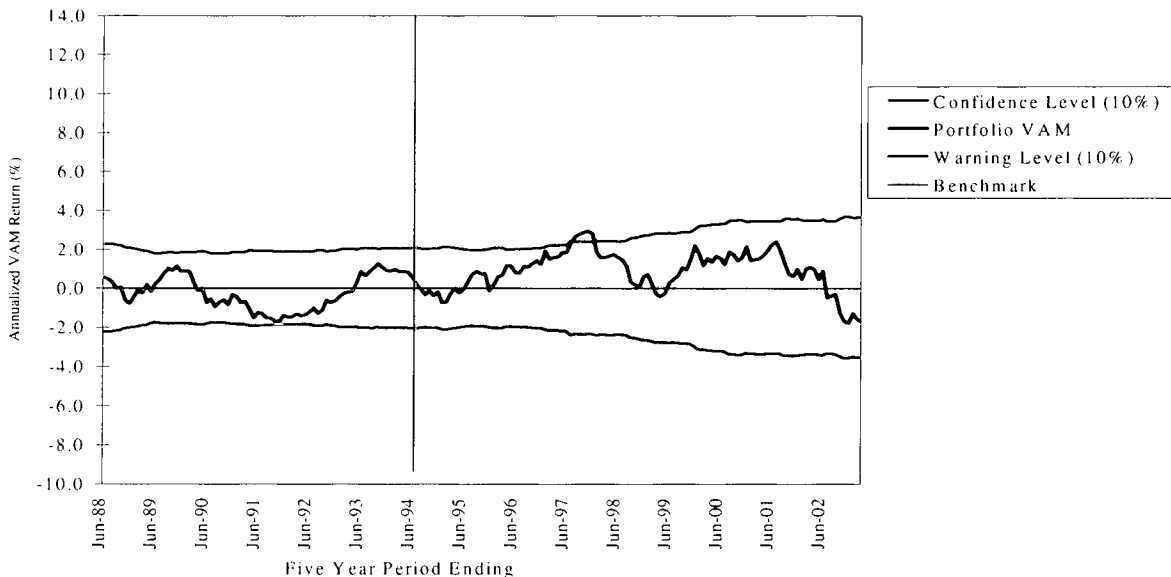
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-4.9%	-2.8%
Last 1 year	-31.6	-24.1
Last 2 years	-15.4	-10.6
Last 3 years	-13.1	-10.3
Last 4 years	-4.7	-4.4
Last 5 years	-3.7	-2.0
Since Inception (4/89)	10.1	10.0

**Recommendation**

No action required.

**FRANKLIN PORTFOLIO ASSOCIATES - Active**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.



**GEOCAPITAL CORP.**  
**Periods Ending March, 2003**

**Portfolio Manager: Barry Fingerhut**

**Assets Under Management: \$221,583,811**

**Investment Philosophy**

GeoCapital invests primarily in small capitalization equities with the intent to hold them as they grow into medium and large capitalization companies. The firm uses a theme approach and individual stock selection analysis to invest in the growth/technology and special situation areas of the market. In the growth/technology area, GeoCapital looks for companies that will have above average growth due to good product development and limited competition. In the special situation area, the key factors are corporate assets, free cash flow, and a catalyst that will cause a positive change in the company. The firm generally stays fully invested, with any cash positions due to a lack of attractive investment opportunities.

**Staff Comments**

GeoCapital outperformed their custom benchmark by 5.5% for the quarter as a result of good stock selection in the business services, software, and semiconductor industries. Over the past year, software and educational stocks hurt performance.

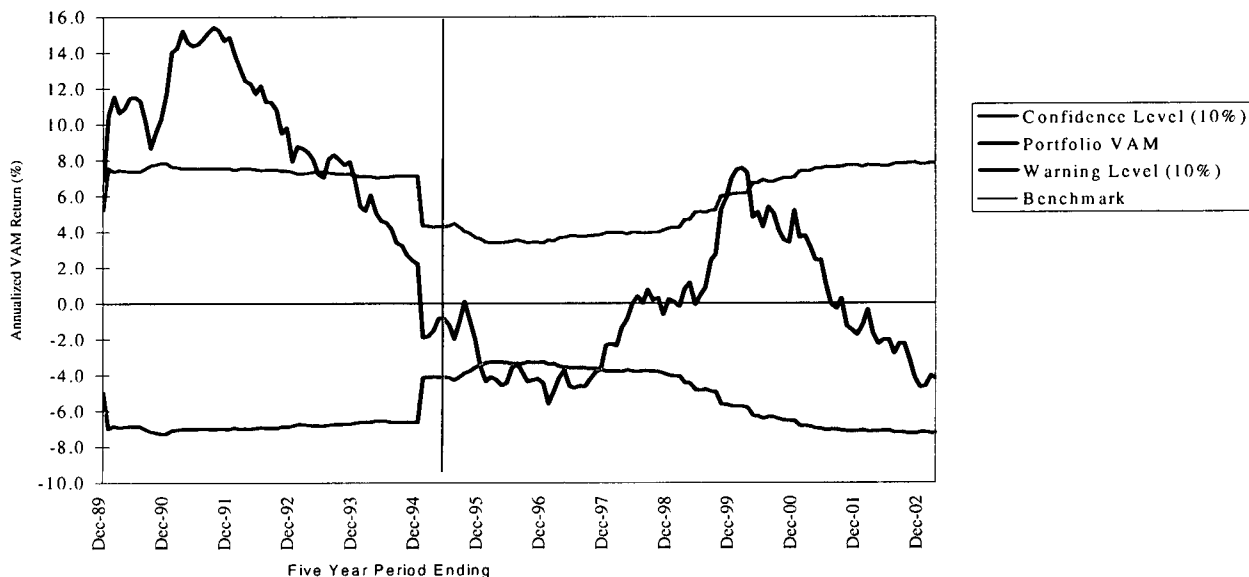
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.2%	-3.3%
Last 1 year	-29.3	-25.1
Last 2 years	-19.6	-10.0
Last 3 years	-29.1	-16.4
Last 4 years	-10.6	-3.5
Last 5 years	-10.6	-6.7
Since Inception (4/90)	6.1	8.0

**Recommendation**

No action required.

**GEOCAPITAL CORP.**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**LINCOLN EQUITY MANAGEMENT, LLC**  
**Periods Ending March, 2003**

**Portfolio Manager: David Fowler**

**Assets Under Management: \$434,130,435**

**Investment Philosophy**

Lincoln Capital concentrates on established medium to large capitalization companies that have demonstrated historically strong growth and will continue to grow. The firm uses traditional fundamental company analysis and relative price/earnings valuation disciplines in its stock selection process. In addition, companies held by Lincoln generally exhibit premium price/book ratios, high return on equity, strong balance sheets and moderate earnings variability.

**Staff Comments**

Lincoln outperformed their benchmark by 1.8% for the quarter due to strong performance from Comcast, Zimmer Holdings, and Amgen. For the year, they were ahead by 0.6% due to companies held in the technology and cyclical growth areas. During the quarter, Lincoln's equity team purchased the equity business now named Lincoln Equity Management. The firm has \$1.9 billion in assets under management. They replaced their healthcare analyst, and are currently searching for a financial services analyst.

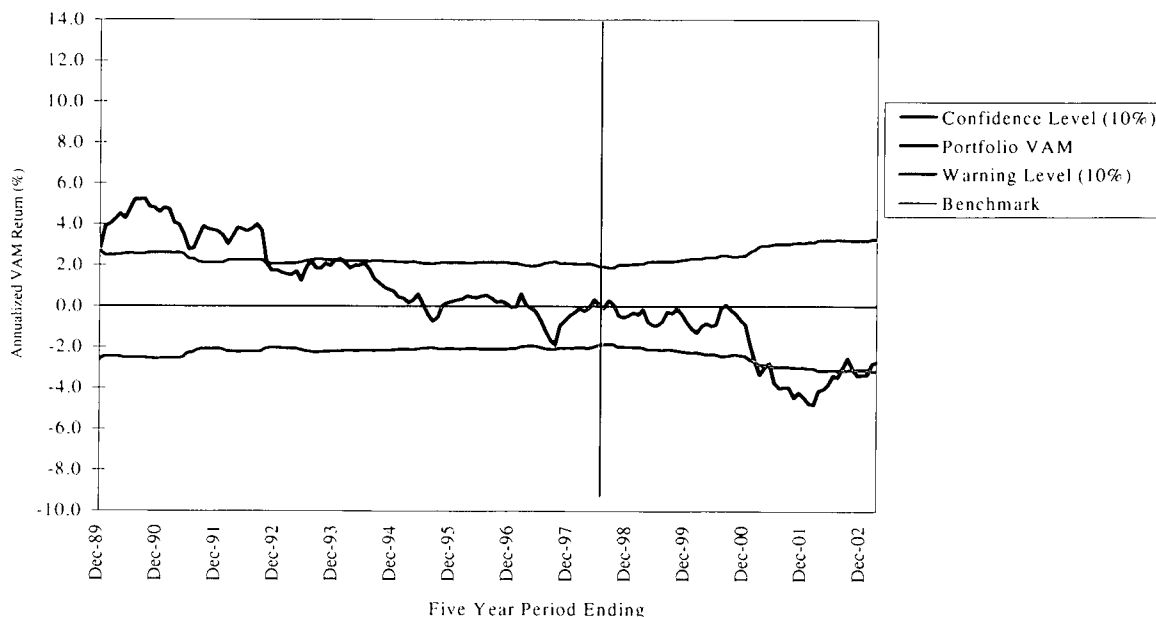
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.0%	-0.7%
Last 1 year	-24.8	-25.4
Last 2 years	-14.2	-12.7
Last 3 years	-27.1	-24.3
Last 4 years	-17.2	-14.0
Last 5 years	-8.8	-6.3
Since Inception (7/93)	6.2	7.9

**Recommendation**

We continue to monitor the firm very closely.

**LINCOLN EQUITY MANAGEMENT - Domestic Equity**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**NEW AMSTERDAM PARTNERS**  
**Periods Ending March, 2003**

**Portfolio Manager: Michelle Clayman**

**Assets Under Management: \$276,010,207**

**Investment Philosophy**

New Amsterdam Partners believes that investment results are evaluated by actual return, and therefore, investment opportunities should be evaluated by expected return. They believe that all valid techniques depend on forecasts of the amounts and timing of future cash flows. Thus, the firm focuses on forecasted earnings growth, yield, price-to-book ratio, and forecasted return on equity. They believe that the disciplined application of their valuation techniques, in conjunction with sound financial analysis of companies, is the key to understanding and maximizing investment returns.

**Staff Comments**

No comments at this time.

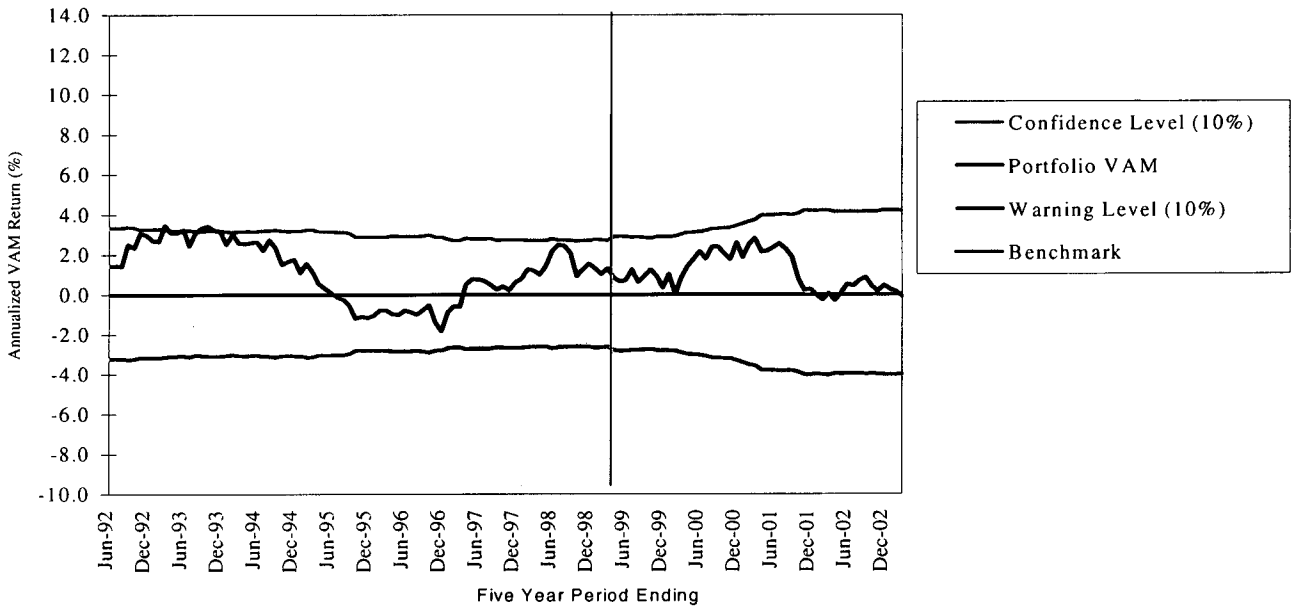
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.2%	-3.3%
Last 1 Year	-21.4	-26.8
Last 2 Years	-9.4	-7.3
Last 3 Years	-6.9	-9.2
Last 4 Years	0.7	1.0
Last 5 Years	2.0	2.1
Since Inception (4/94)	12.0	11.3

**Recommendation**

No action required.

**NEW AMSTERDAM PARTNERS**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**OPPENHEIMER CAPITAL**  
**Periods Ending March, 2003**

**Portfolio Manager: John Lindenthal**

**Assets Under Management: \$651,373,366**

**Investment Philosophy**

Oppenheimer's objectives are to: 1) preserve capital in falling markets; 2) manage risk in order to achieve less volatility than the market; and 3) produce returns greater than the market indices, the inflation rate and a universe of comparable portfolios with similar objectives. The firm achieves its objectives by purchasing securities considered to be undervalued on the basis of known data and strict financial standards and by making timely changes in the asset mix. Oppenheimer focuses on five key variables when evaluating companies: management, financial strength, profitability, industry position, and valuation.

**Staff Comments**

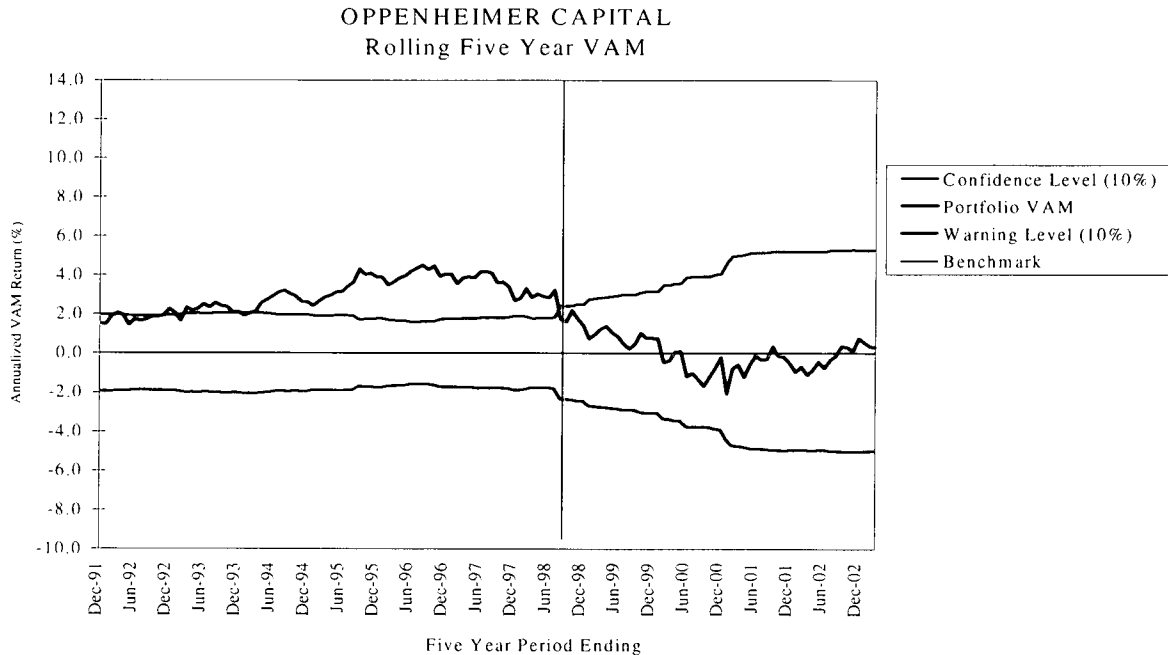
Staff spoke with Oppenheimer during the quarter. The organization remains stable. David Phillips, a respected analyst with Oppenheimer, was promoted to Co-Director of Research responsible for administrative duties. The SBI's portfolio manager reaffirmed the team's focus on bottom up stock selection, and on identifying undervalued companies where they understand the business, its competitive advantages, and whether those business drivers can be maintained. Long-term performance continues to be good.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-4.7%	-4.7%
Last 1 year	-19.9	-26.3
Last 2 years	-10.6	-14.7
Last 3 years	-6.3	-10.4
Last 4 years	-2.7	-4.4
Last 5 years	-0.6	-0.9
Since Inception (7/93)	11.3	9.8

**Recommendation**

No action required.



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**UBS GLOBAL ASSET MANAGEMENT, INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: John Leonard**

**Assets Under Management: \$661,931,901**

**Investment Philosophy**

UBS uses a relative value approach to equity investing. They believe that the market price will ultimately reflect the present value of the cash flows the security will generate for the investor. They focus on a bottom-up stock selection process to provide insight into finding opportunistic investments. UBS uses their own discounted free cash flow model as their primary analytical tool for estimating the intrinsic value of a company.

**Staff Comments**

Staff met with the portfolio manager during the quarter. Organizational changes included the loss of their finance analyst and the addition of a healthcare analyst. The team continues to focus on the intrinsic value of a company and the opportunity offered by discrepancies between market price and intrinsic value. Themes in the portfolio include an underweight to leisure, retail, food & beverage, and other areas that provided a safe haven during the recent past. They own industrial cyclicals, transports, and other industries that will benefit from a strengthening economy.

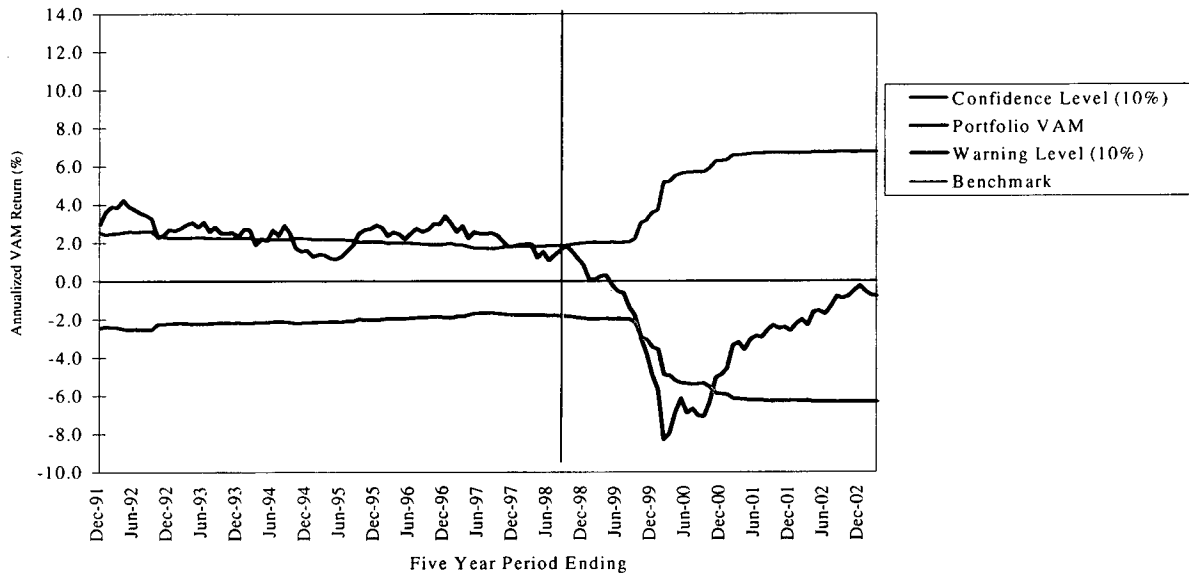
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.5%	-3.2%
Last 1 year	-20.1	-24.1
Last 2 years	-5.9	-11.7
Last 3 years	-0.8	-14.5
Last 4 years	-4.4	-5.1
Last 5 years	-3.6	-2.8
Since Inception (7/93)	8.8	8.5

**Recommendation**

No action required.

**UBS GLOBAL ASSET MANAGEMENT, INC.**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**BARCLAYS GLOBAL INVESTORS**  
**Periods Ending March, 2003**

**Portfolio Manager: Rhonda Vitanye**

**Assets Under Management: \$2,097,781,746**

**Investment Philosophy**  
**Semi-Passive**

The Core Alpha Model desegregates individual equity returns for each of the 3500 stocks in their universe into fundamental, expectational, and technical components. The fundamental factors look at measures of underlying company value including earnings, book value, cash flow, and sales. These factors help identify securities that trade at prices below their true economic value. The expectational factors incorporate future earnings and growth rate forecasts made by over 2500 security analysts. The technical factors provide a measure of recent changes in company fundamentals, consensus expectations, and performance. Estimated alphas are then calculated and are used in a portfolio optimization algorithm to identify the optimal portfolio.

**Staff Comments**

No comments at this time.

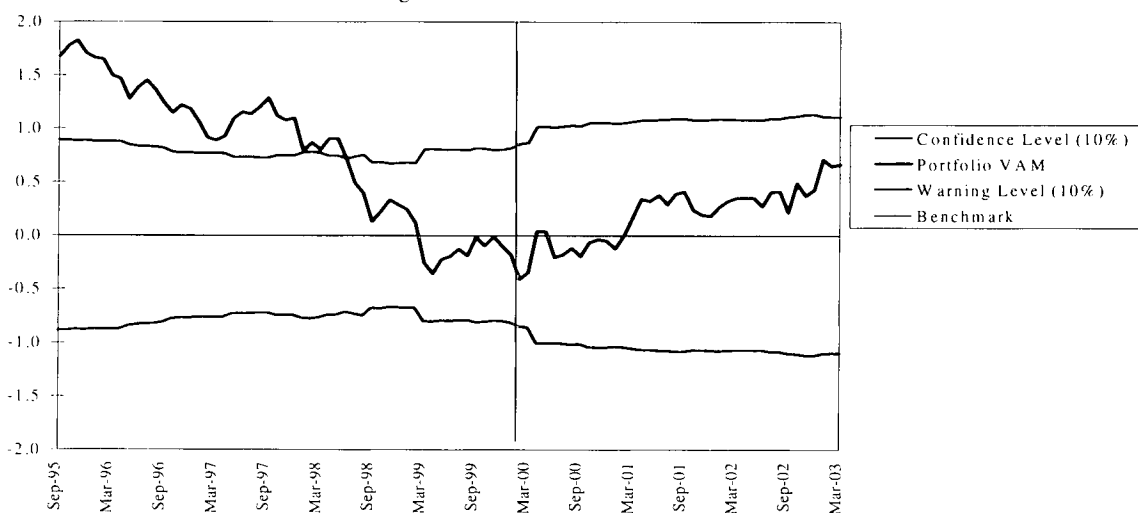
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>	
Last Quarter	-2.0%	-3.0%	No action required.
Last 1 year	-21.3	-22.6	
Last 2 years	-9.0	-10.2	
Last 3 years	-14.4	-16.7	
Last 4 years	-7.9	-9.6	
Last 5 years	-4.9	-5.5	
Since Inception (1/95)	8.9	8.1	

**Recommendation**

\* Completeness Fund

**BARCLAYS GLOBAL INVESTORS - SEMI-PASSIVE**  
**Rolling Five Year VAM**



Five Year Period Ending  
 Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**FRANKLIN PORTFOLIO ASSOCIATES**  
**Periods Ending March, 2003**

**Portfolio Manager: John Cone**

**Assets Under Management: \$1,310,495,893**

**Investment Philosophy**  
**Semi-Passive**

Franklin believes that rigorous and consistent application of fundamentally based valuation criteria will produce value added investment returns. Franklin builds a portfolio by using a series of more than 30 integrated computer models that value a universe of 3500 stocks. Their models rank each security based on fundamental momentum, relative value, future cash flow, and supplementary models. A composite ranking then provides one ranked list of securities reflecting their relative attractiveness. Stocks that fall below the median ranking are sold, and proceeds are reinvested in stocks from the top deciles in the ranking system. They use the BARRA risk model to monitor the portfolio's systematic risk and industry weightings relative to the selected benchmark. For this semi-passive mandate, they seek to achieve a residual risk of 1.5% or less. The firm remains fully invested at all times.

**Staff Comments**

No comments at this time.

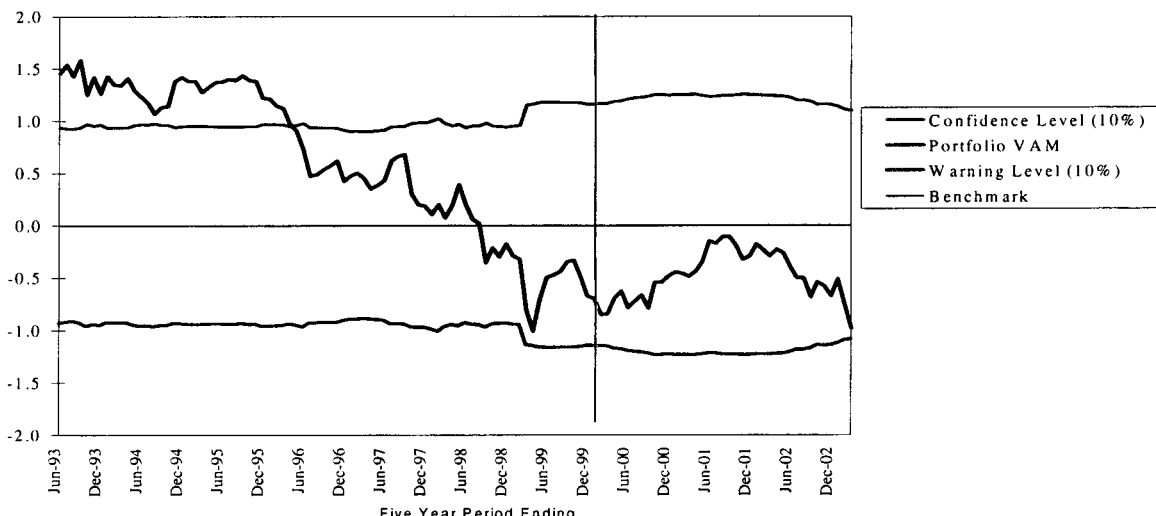
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>	
Last Quarter	-3.8%	-3.0%	No action required.
Last 1 year	-23.6	-22.6	
Last 2 years	-10.9	-10.2	
Last 3 years	-16.4	-16.7	
Last 4 years	-9.5	-9.6	
Last 5 years	-6.5	-5.5	
Since Inception (1/95)	7.6	8.1	

**Recommendation**

\* Completeness Fund

**FRANKLIN PORTFOLIO ASSOCIATES - SEMI-PASSIVE**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**J.P. MORGAN INVESTMENT MANAGEMENT, INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: Tim Devlin**

**Assets Under Management: \$1,822,076,662**

**Investment Philosophy**  
**Semi-Passive**

J.P. Morgan believes that superior stock selection is necessary to achieve excellent investment results. To accomplish this objective, they use fundamental research and a systematic valuation model. Analysts forecast the earnings and dividends for the 650 stock universe and enter them into a stock valuation model that calculates an expected return for each security. The stocks are ranked according to their expected return within their economic sectors. The most undervalued stocks are placed in the first quintile. The portfolio includes stocks from the first four quintiles, always favoring the highest ranked stocks whenever possible. Stocks in the fifth quintile are sold. In addition, the portfolio closely approximates the sector, style, and security weightings of the index chosen by the plan sponsor. The firm remains fully invested at all times.

**Staff Comments**

Staff met with the firm during the quarter to discuss organizational changes, which included the loss of their Head of U.S. Equity, Rick Nelson. Paul Quinsee, who had been Head of Structured and Active Portfolio Management reporting to Mr. Nelson, has been promoted to fill that position. Changes to the team of 20+ fundamental analysts during the past year included the loss of two analysts and the termination/transfer of 3 others. There were no changes to the structured portfolio manager team responsible for SBI's portfolio. JPM continues to manage \$28 billion in structured equity products.

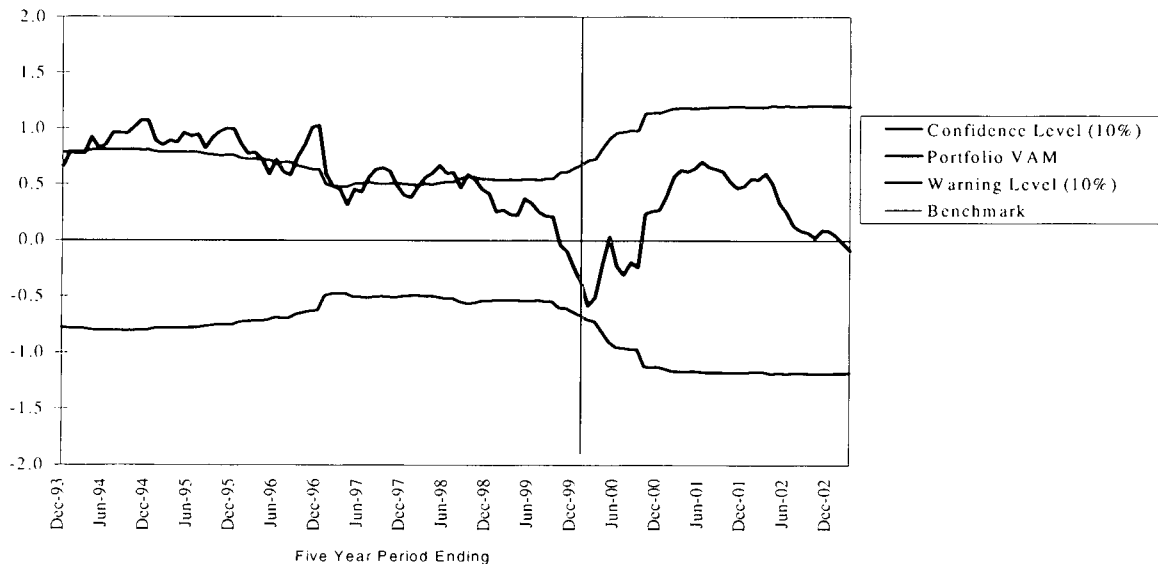
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>	
Last Quarter	-3.1%	-3.0%	No action required.
Last 1 year	-24.7	-22.6	
Last 2 years	-11.9	-10.2	
Last 3 years	-15.9	-16.7	
Last 4 years	-9.6	-9.6	
Last 5 years	-5.6	-5.5	
Since Inception (1/95)	8.1	8.1	

**Recommendation**

\* Completeness Fund

**JP MORGAN - SEMI-PASSIVE**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.



**BARCLAYS GLOBAL INVESTORS**  
**Periods Ending March, 2003**

**Portfolio Manager: Amy Schioldager**

**Assets Under Management: \$4,821,613,862**

**Investment Philosophy**

**Passive**

Barclays Global Investors passively manages the portfolio against the Wilshire 5000 Investable by minimizing tracking error and trading costs, and maximizing control over all investment and operational risks. Their strategy is to invest across the broad market while excluding smaller, illiquid securities from the investment universe. An optimized approach is taken to security selection. The optimizer weighs the cost of a trade against its contribution to expected tracking error to determine which trades should be executed.

**Staff Comments**

No comments at this time.

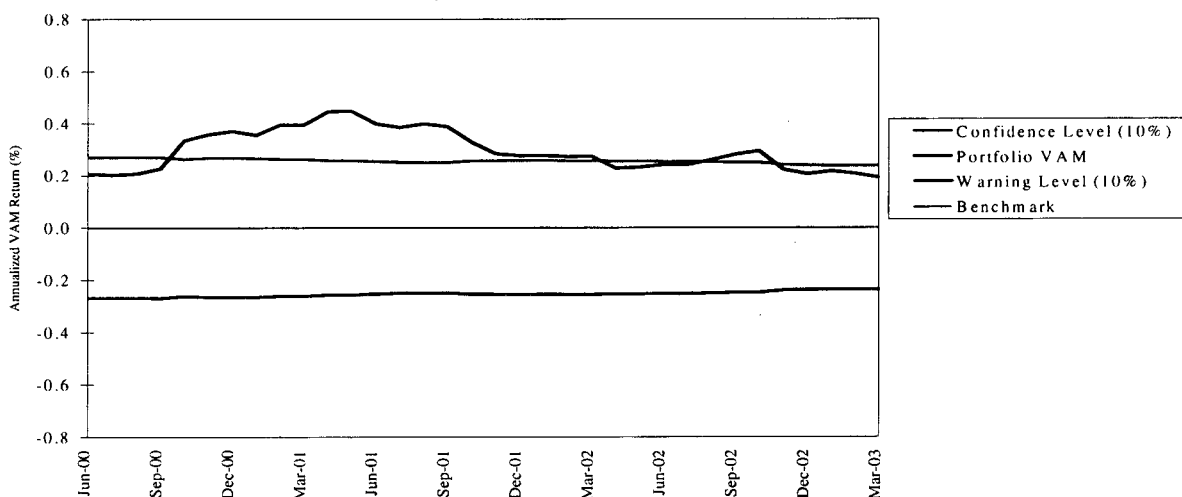
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.0%	-2.9%
Last 1 year	-24.4	-24.4
Last 2 years	-12.3	-12.2
Last 3 years	-16.5	-16.7
Last 4 years	-7.9	-8.1
Last 5 years	-4.0	-4.2
Since Inception (7/95)	7.0	6.7

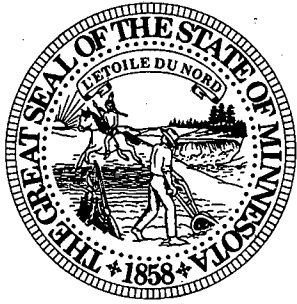
**Recommendation**

No action required.

**BARCLAYS GLOBAL INVESTORS - PASSIVE**  
**Rolling Five Year VAM**



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# STATE BOARD OF INVESTMENT

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## Emerging Stock Manager Evaluation Reports

First Quarter, 2003



**COMBINED RETIREMENT FUNDS  
EMERGING EQUITY MANAGERS  
Periods Ending March, 2003**

	Quarter		1 Year		3 years		5 Years		Since Inception (1)		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active Managers</b>												
Artemis	-5.5	-4.7	-27.2	-27.2					-16.6	-8.8	\$30.5	5.6%
Bay Isle Financial	-7.1	-3.9	-32.8	-23.2					-12.7	-7.4	\$34.4	6.3%
Earnest Partners	-2.5	-3.5	-19.5	-19.9					-10.1	2.9	\$37.5	6.9%
Holt-Smith & Yates	-5.6	-3.5	-29.4	-25.0					-15.8	-7.8	\$31.5	5.8%
Next Century Growth	-3.4	-2.4	-31.3	-28.2					-28.9	-20.3	\$19.8	3.6%
Peregrine Capital	-8.1	-5.7	-26.8	-20.4					6.0	8.9	\$107.0	19.6%
Valenzuela Capital	-1.6	-3.7	-24.7	-21.0	-5.8	-0.9	-5.7	-0.5	7.9	9.6	\$59.6	10.9%
Voyageur-Chicago Equity	-3.8	-3.3	-24.1	-25.8					-14.3	-15.7	\$33.2	6.1%
Winslow-Small Cap	-4.9	-4.4	-29.0	-30.7					-17.0	-17.2	\$105.3	19.3%
Zevenbergen Capital	2.6	-1.1	-30.2	-24.0	-34.6	-19.4	-5.9	1.3	6.8	11.5	\$86.9	15.9%
											<b>\$545.9</b>	<b>100.0%</b>
									<b>Since 4/1/94</b>			
Current Aggregate	-4.0	-3.8	-27.7	-24.5	-17.2	-10.7	-1.3	2.3	10.2	11.7		
<b>Historical Aggregate (2)</b>	<b>-4.0</b>	<b>-3.8</b>	<b>-27.7</b>	<b>-24.5</b>	<b>-15.3</b>	<b>-9.7</b>	<b>-2.7</b>	<b>1.7</b>	<b>8.7</b>	<b>11.7</b>		

(1) Since retention by the SBI. Time period varies for each manager.

(2) Includes the performance of terminated managers.



**ARTEMIS INVESTMENT MANAGEMENT, LLC**  
**Periods Ending March, 2003**

**Portfolio Manager: Joyce Capuano**

**Assets Under Management: \$30,538,483**

**Investment Philosophy**

Artemis believes that excess rates of return above benchmark indices are derived from investments in companies that initiate and embrace change in their businesses. They want to identify those small cap companies that they believe (1) have catalysts that can accelerate future earnings and cash flow growth rates; and (2) are attractively valued relative to their respective peer groups. In order to implement their investment philosophy, they use relative value analysis, which is a bottom-up, stock picking approach driven by fundamental research and frequent meetings with company managements. The portfolio is diversified in terms of growth rates and opportunities for exposure in all economic sectors.

**Staff Comments**

No comments at this time.

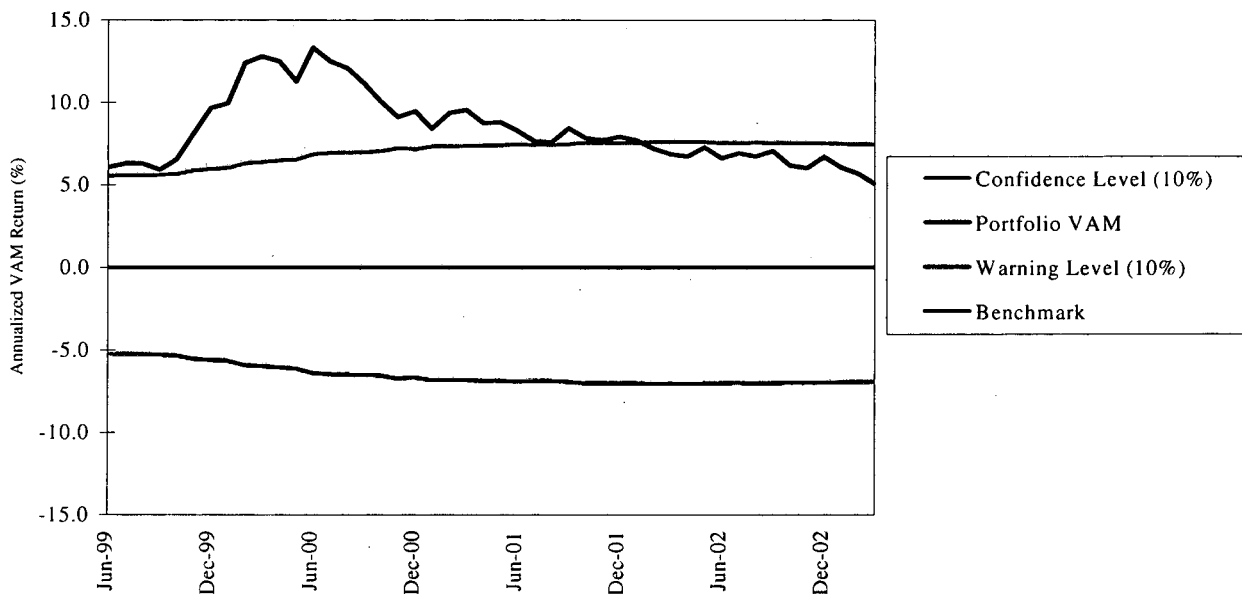
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-5.5%	-4.7%
Last 1 Year	-27.2	-27.2
Last 2 Years	-8.6	-5.0
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	-16.6	-8.8

**Recommendation**

No action required.

**Artemis Investment Management  
Rolling Five Year VAM**



Five Year Period Ending  
Note: Shaded area includes performance prior to the retention by the SBI.

**BAY ISLE FINANCIAL CORP.**  
**Periods Ending March, 2003**

**Portfolio Manager: William Schaff**

**Assets Under Management: \$34,430,700**

**Investment Philosophy**

Bay Isle Financial believes that companies with strong fundamentals and management will outperform and that these companies can be found at a discount to fair value. To capitalize on these ideas, they perform rigorous fundamental analysis on cash flow growth and balance sheet strength and evaluate a company's business, major competitors and management strength. Bay Isle closely monitors risk levels relative to the benchmark and the portfolio is diversified across most industry sectors.

**Staff Comments**

On January 1, 2003, Bay Isle's parent company, Stilwell, merged with Janus Capital Corporation to form Janus Capital Group Inc. The investment team and process have not changed. For the quarter, finance, manufacturing, and healthcare stock picks hurt performance. Tyco is a holding that hurt performance during the quarter and the one-year period. One-year performance trailed the benchmark by 9.6% primarily due to stock selection in finance and healthcare sectors. The portfolio is positioned for improving business trends and an economic rebound, which has not yet materialized.

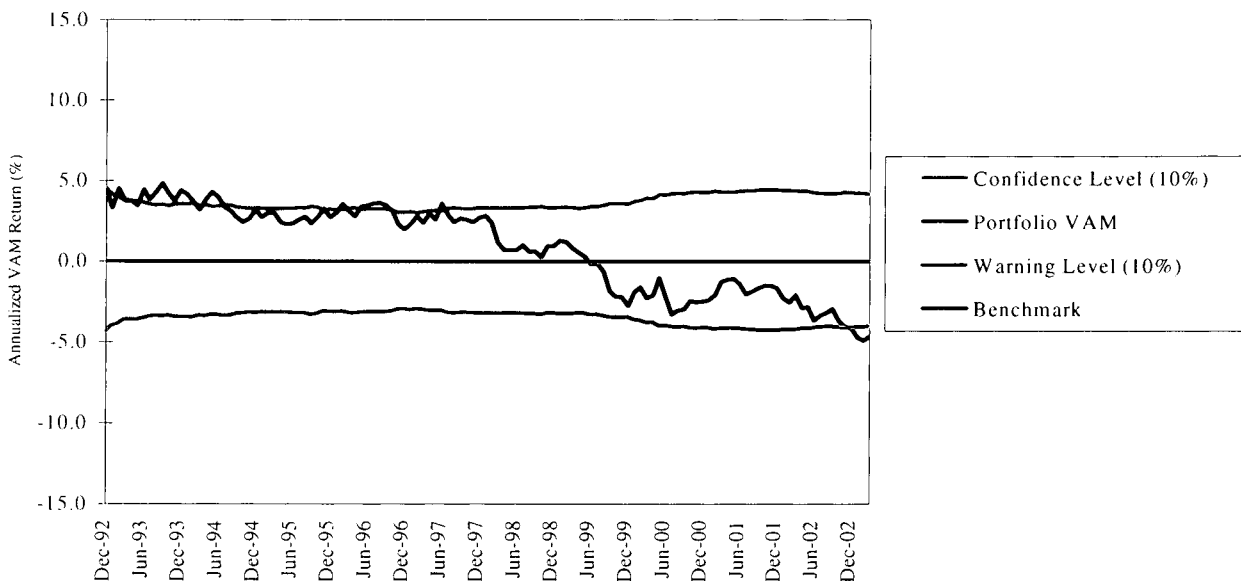
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-7.1%	-3.9%
Last 1 Year	-32.8	-23.2
Last 2 Years	-16.3	-9.8
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	-12.7	-7.4

**Recommendation**

No action required.

**Bay Isle Financial Management  
Rolling Five Year VAM**



Five Year Period Ending  
Note: Shaded area includes performance prior to retention by the SBI.



# EARNEST PARTNERS, LLC

Periods Ending March, 2003

Portfolio Manager: Paul Viera

Assets Under Management: \$37,508,946

## Investment Philosophy

Earnest Partners utilizes its proprietary Return Pattern Recognition model and rigorous fundamental review to identify stocks with the most attractive relative returns. They have identified six performance drivers – valuation measures, operating trends, market trends, growth measures, profitability measures and macroeconomic measures – and have done extensive research to determine which combination of performance drivers, or return patterns, precede out-performance for stocks in each sector. They select stocks whose return patterns suggest favorable performance and control risk using a statistical program designed to measure and control the prospects of substantially under-performing the benchmark. The portfolio is diversified across industry groups.

## Staff Comments

No comments at this time.

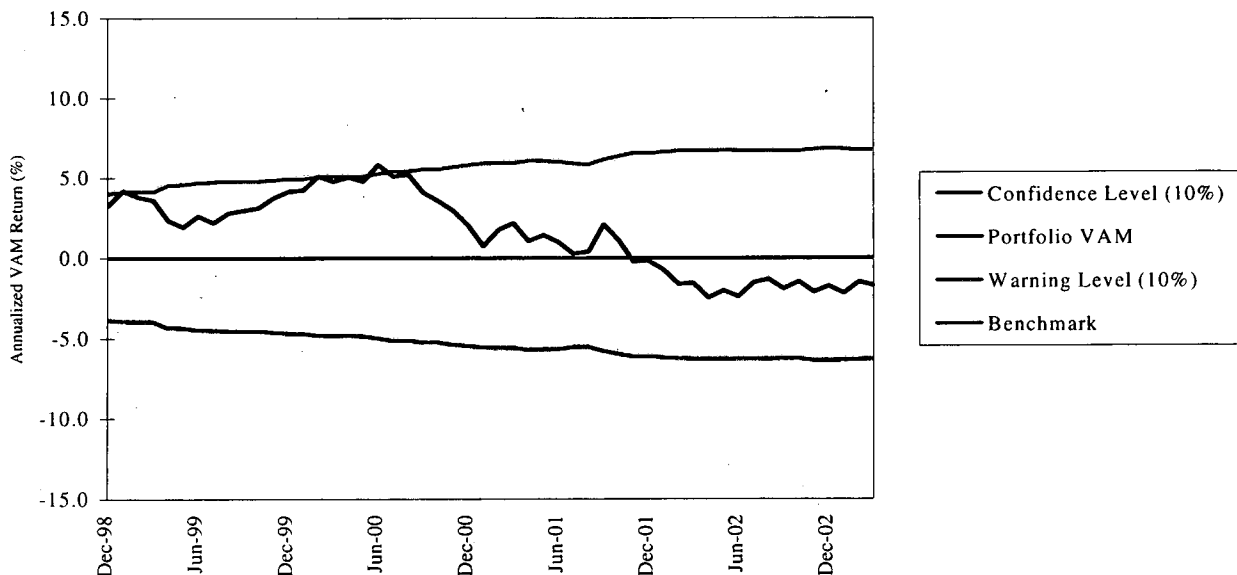
## Quantitative Evaluation

	Actual	Benchmark
Last Quarter	-2.5%	-3.5%
Last 1 Year	-19.5	-19.9
Last 2 Years	-8.9	-0.3
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	-10.1	2.9

## Recommendation

No action required.

EARNEST Partners  
Rolling Five Year VAM



Five Year Period Ending  
Note: Shaded area includes performance prior to retention by the SBI.

**HOLT-SMITH & YATES ADVISORS**  
 Periods Ending March, 2003

**Portfolio Manager: Kristin Yates**

**Assets Under Management: \$31,536,316**

**Investment Philosophy**

Holt-Smith & Yates invest in companies demonstrating superior growth in earnings over a long period of time. They use bottom-up fundamental analysis, focusing on historical and forecasted sales and earnings trends, profit margin trends, debt levels and industry conditions. They seek to purchase large-cap companies that meet their strict valuation criteria and that have superior fundamentals to that of the benchmark. Companies must currently have a five year projected growth rate of over 20% and a PEG (P/E ratio to growth rate) ratio of below 150%. They hold concentrated portfolios, industry positions are limited to one stock per industry, and the portfolio has low turnover.

**Staff Comments**

For the quarter, the portfolio under performed the benchmark by 2.1% primarily due to Concord EFS, an electronic transaction processing company. During the past year, Concord EFS, Best Buy, and Home Depot caused much of the 3.6% underperformance.

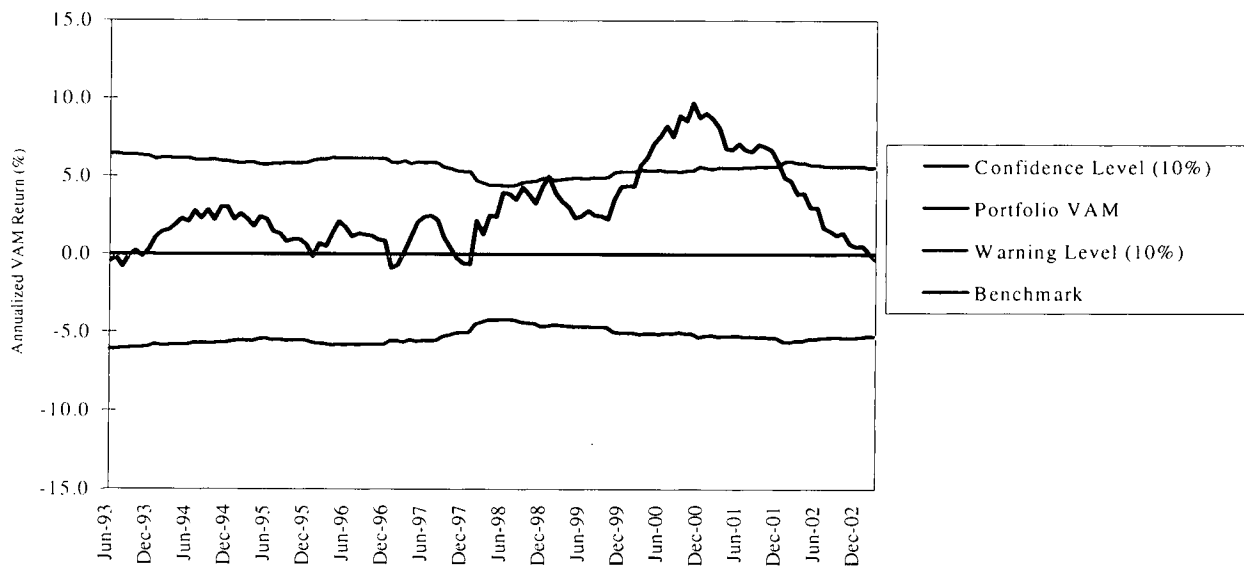
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-5.6%	-3.5%
Last 1 Year	-29.4	-25.0
Last 2 Years	-12.5	-5.8
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	-15.8	-7.8

**Recommendation**

No action required.

**Holt-Smith & Yates**  
**Rolling Five Year VAM**



Five Year Period Ending  
 Note: Shaded area includes performance prior to the retention by the SBI.

**NEXT CENTURY GROWTH INVESTORS, LLC**  
**Periods Ending March, 2003**

**Portfolio Manager: Thomas Press and Don Longlet**

**Assets Under Management: \$19,798,607**

**Investment Philosophy**

Next Century Growth's (NCG) goal is to invest in the highest quality and fastest growing companies in America. They believe that growth opportunities exist regardless of the economic cycle. NCG uses fundamental analysis to identify companies that will surpass consensus earnings estimates which they believe to be the number one predictor of future out-performance. Their investment process focuses on growth companies that have superior top line revenue growth (15% or greater), high profitability, and strong balance sheets that are well poised to outperform the market. NCG believes in broad industry diversification; sector exposures are limited to twice the benchmark weighting and individual positions to five percent.

**Staff Comments**

No comments at this time.

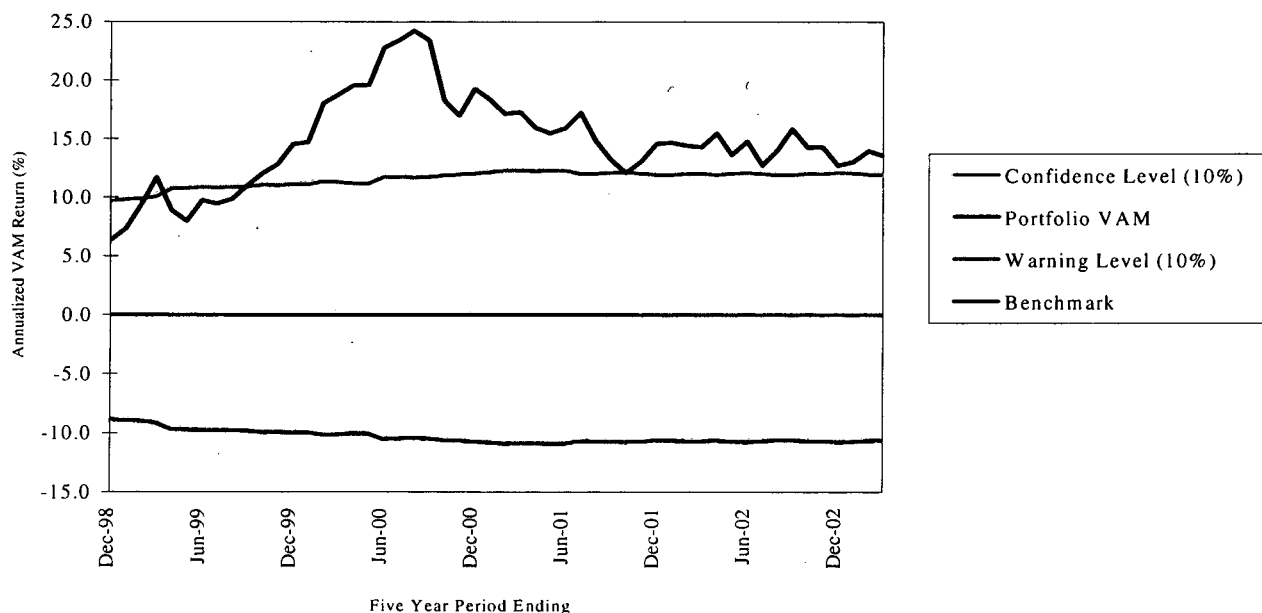
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.4%	-2.4%
Last 1 Year	-31.3	-28.2
Last 2 Years	-17.3	-8.2
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	-28.9	-20.3

**Recommendation**

No action required.

**Next Century Growth Investors  
Rolling Five Year VAM**



Note: Shaded area includes performance prior to the retention by the SBI.

**PEREGRINE CAPITAL MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Doug Pugh and Tasso Coin**

**Assets Under Management: \$106,991,650**

**Investment Philosophy**

Peregrine's Small Cap Value investment process begins with the style's proprietary valuation analysis, which is designed to identify the small cap value stocks most likely to outperform. The valuation analysis identifies the most under-priced securities on a sector-by-sector basis. Drawing on thirty years of data, the analysis looks at different combinations of sixty fundamental factors most relevant in each independent sector, to identify stocks that offer significant value relative to the companies' underlying fundamentals. The focus of the team's fundamental research is to determine if one or more of the style's "Value Buy Criteria" are present – these include short-term problems, unrecognized assets, take-over potential, and catalysts for change. The portfolio is diversified and sector weights are aligned closely to the benchmark. This allows stock selection to drive performance.

**Staff Comments**

No comments at this time.

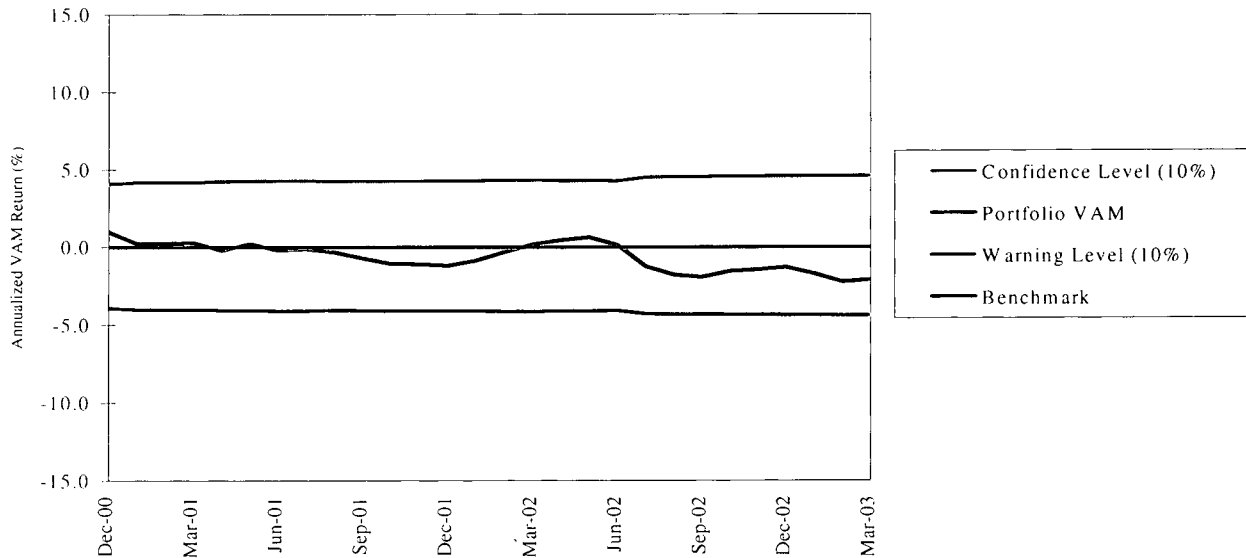
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-8.1%	-5.7%
Last 1 Year	-26.8	-20.4
Last 2 Years	-2.5	2.7
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	6.0	8.9

**Recommendation**

No action required.

Peregrine Capital Management  
 Rolling Five Year VAM



Five Year Period Ending  
 Note: Shaded area includes performance prior to the retention by the SBI.

**VALENZUELA CAPITAL MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Tom Valenzuela**

**Assets Under Management: \$59,647,632**

**Investment Philosophy**

Valenzuela Capital Management (VCM) believes that stock selection and adherence to valuation analysis are the backbone of superior performance. Their investment philosophy is one of risk averse growth. VCM seeks companies undergoing strong rates of change in earnings, cash flow and returns. These companies are experiencing positive changes in revenues, gross and operating margins and financial structure. To be considered for investment, these stocks must sell at or below market valuations. VCM believes that below-market valuations provide downside protection during weak market periods. In strong markets, the portfolios will be driven by both earnings growth and multiple expansion.

**Staff Comments**

During the quarter Valenzuela announced that they would be acquiring CIC/HCM Asset Management, Inc. for their large cap value product. This will allow Valenzuela to offer a full complement of value products including Large Cap, Mid Cap, and Small Cap. Jorge Castro, current President of CIC, will take the lead role company-wide in business development and marketing. There will be no change in the mid cap investment team managing the SBI's account.

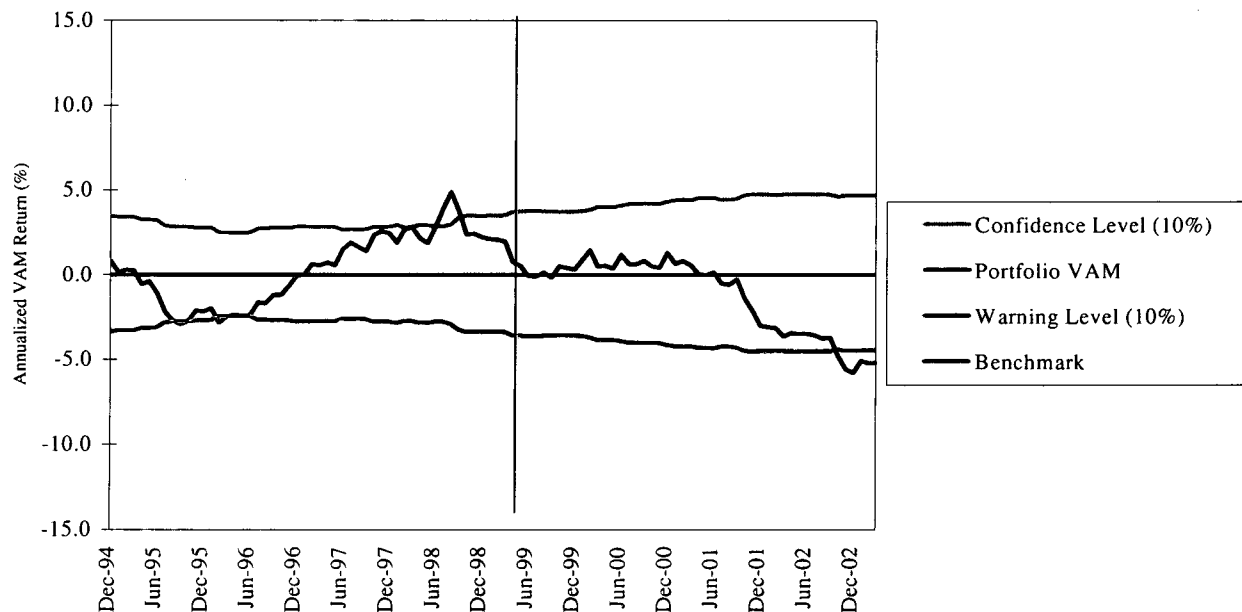
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-1.6%	-3.7%
Last 1 Year	-24.7	-21.0
Last 2 Years	-11.1	-4.3
Last 3 Years	-5.8	-0.9
Last 4 Years	-3.5	2.3
Last 5 Years	-5.7	-0.5
Since Inception (4/94)	7.9	9.6

**Recommendation**

We are closely monitoring Valenzuela.

**Valenzuela Capital Partners**  
**Rolling Five Year VAM**



Five Year Period Ending  
 Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**VOYAGEUR ASSET MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Charles Henderson**

**Assets Under Management: \$33,194,962**

**Investment Philosophy**

Voyageur's Large Cap Growth Equity strategy is focused on achieving consistent, superior performance with near-benchmark risk. They seek high quality growth companies with exceptional financial strength and proven growth characteristics. They believe that sound fundamental analysis reveals those companies with superior earnings achievement and potential. Their screening process identifies companies that over the past five years have had higher growth in sales, earnings, return on equity, earnings stability and have lower debt ratios relative to their benchmark. Because they focus on diversification and sector limitations, they believe they can continue to outperform as different investment styles move in and out of favor.

**Staff Comments**

No comments at this time.

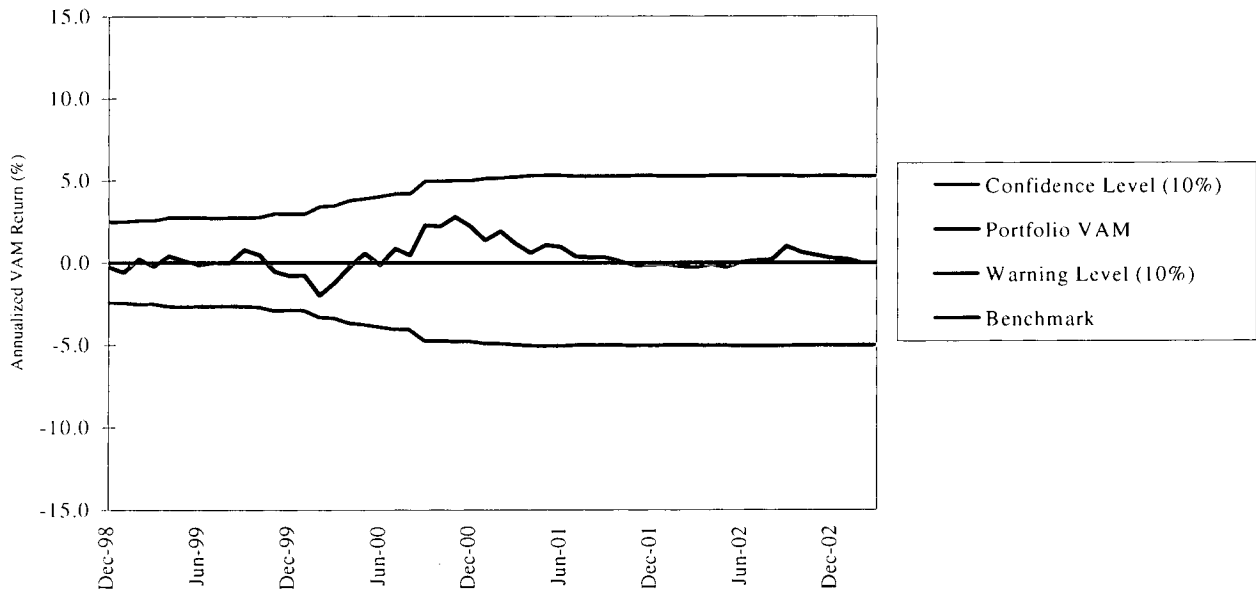
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.8%	-3.3%
Last 1 Year	-24.1	-25.8
Last 2 Years	-13.1	-11.0
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	-14.3	-15.7

**Recommendation**

No action required.

**Voyageur Asset Management  
Rolling Five Year VAM**



Five Year Period Ending  
Note: Shaded area includes performance prior to the retention by the SBI.

**WINSLOW CAPITAL MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Joseph Docter**

**Assets Under Management: \$105,320,712**

**Investment Philosophy**

Winslow Capital believes that companies with above average earnings growth rates provide the best opportunities for superior portfolio returns. They look for companies with three to five year records of increased sales and earnings, steady 20-30% growth, low financial leverage with strong cash flow, and significant management ownership. Through internal fundamental research, they calculate projected fundamentals – earnings projections, forecasts of relative P/E ratios, and projected 12-18 month returns – which are used in the valuation model to rank securities. Individual positions do not exceed five percent. The portfolio is diversified across sectors.

**Staff Comments**

No comments at this time.

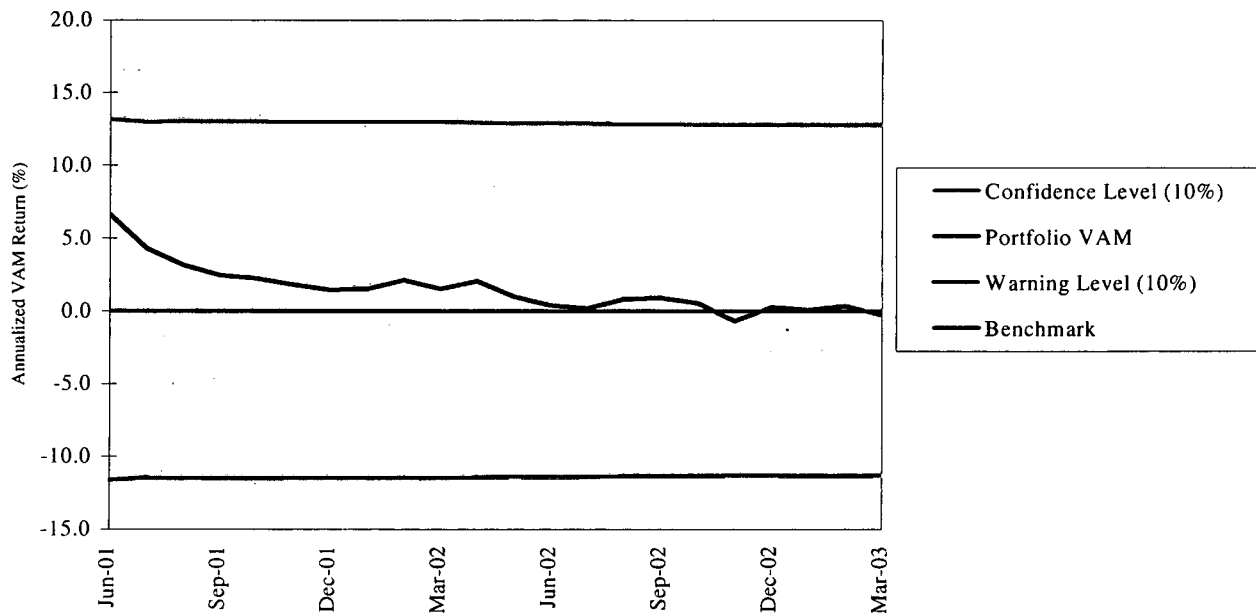
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-4.9%	-4.4%
Last 1 Year	-29.0	-30.7
Last 2 Years	-9.0	-8.8
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (7/00)	-17.0	-17.2

**Recommendation**

No action required.

**Winslow Capital Management  
Rolling Five Year VAM**



Five Year Period Ending  
Note: Shaded area includes performance prior to the retention by the SBI.

**ZEVENBERGEN CAPITAL INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: Nancy Zevenbergen**

**Assets Under Management: \$86,921,236**

**Investment Philosophy**

Zevenbergen is an equity growth manager. The investment philosophy is based on the belief that earnings drive stock prices while quality provides capital protection. Hence, portfolios are constructed with companies showing above-average earnings growth prospects and strong financial characteristics. They consider diversification for company size, expected growth rates and industry weightings to be important risk control factors. Zevenbergen uses a bottom-up fundamental approach to security analysis. Research efforts focus on finding companies with superior products or services showing consistent profitability. Attractive buy candidates are reviewed for sufficient liquidity and potential diversification. The firm emphasizes that they are not market timers.

**Staff Comments**

Staff met with the firm during the quarter to discuss performance. The organization remains stable and the process unchanged. They continue to focus on revenue and earnings growth even as the market did not favor those companies during 2002. For the quarter, the portfolio outperformed the benchmark by 3.7% due to strong performance from Starbucks and eBay and several consumer and finance companies. For the year, performance was hurt by stock selection and a large under weight to biotech and pharmaceuticals and by several financial stocks.

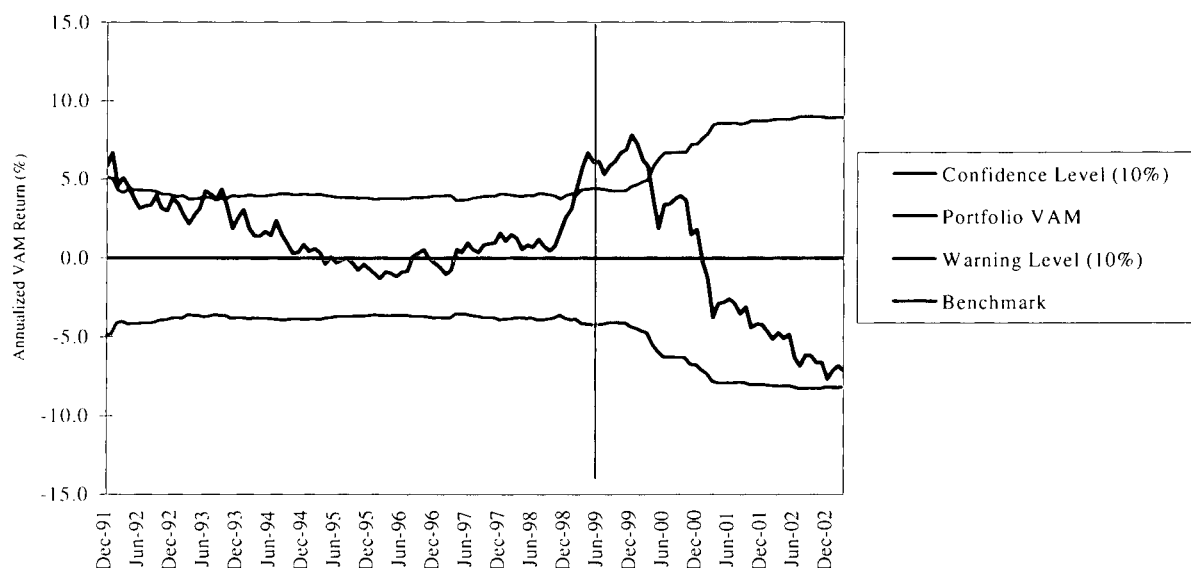
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.6%	-1.1%
Last 1 Year	-30.2	-24.0
Last 2 Years	-19.2	-12.1
Last 3 Years	-34.6	-19.4
Last 4 Years	-17.7	-2.8
Last 5 Years	-5.9	1.3
Since Inception (4/94)	6.8	11.5

**Recommendation**

No action required.

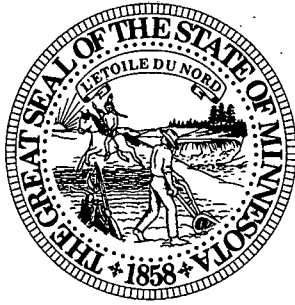
Zevenbergen Capital Management  
Rolling Five Year VAM



Five Year Period Ending

Note: Area to the left of vertical line includes performance prior to retention by the SBI.





# STATE BOARD OF INVESTMENT

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## Bond Manager Evaluation Reports

First Quarter, 2003



**COMBINED RETIREMENT FUNDS  
BOND MANAGERS  
Periods Ending March, 2003**

	Quarter		1 Year		3 Years		5 Years		Since (1) Inception		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active Managers</b>												
American Express (AMG)	1.5	1.4	6.9	11.7	8.4	9.8	6.7	7.5	6.8	7.2	\$759.8	9.1%
Deutsche	1.6	1.4	12.3	11.7	10.1	9.8			10.3	10.0	\$609.5	7.3%
Dodge & Cox	2.0	1.4	12.5	11.7	11.0	9.8			11.2	10.0	\$758.2	9.1%
Morgan Stanley	1.6	1.4	9.6	11.7	9.8	9.8	7.2	7.5	10.2	10.0	\$729.9	8.8%
Western	2.7	1.4	11.7	11.7	10.7	9.8	8.1	7.5	11.1	9.9	\$1,257.8	15.1%
<b>Semi-Passive Managers</b>												
BlackRock	1.5	1.4	12.0	11.7	9.9	9.8	7.8	7.5	8.1	7.8	\$1,450.9	17.4%
Goldman	1.8	1.4	10.6	11.7	9.6	9.8	7.4	7.5	7.3	7.1	\$1,368.9	16.4%
Lincoln	1.4	1.4	11.5	11.7	10.0	9.8	7.6	7.5	8.6	8.6	\$1,397.5	16.8%
											<b>\$8,332.5</b>	<b>100.0%</b>
									<b>Since 7/1/84</b>			
Current Aggregate	1.8	1.4	11.0	11.7	10.0	9.8	7.6	7.5	10.4	10.0		
<b>Historical Aggregate (2)</b>	<b>1.8</b>	<b>1.4</b>	<b>10.5</b>	<b>11.7</b>	<b>9.8</b>	<b>9.8</b>	<b>7.4</b>	<b>7.5</b>	<b>10.0</b>	<b>9.9</b>		
Lehman Aggregate (3)		1.4		11.7		9.8		7.5		10.0		

(1) Since retention by the SBI. Time period varies for each manager.

(2) Includes performance of terminated managers.

(3) Prior to July 1994, this index reflects the Salomon BIG.



**AMERICAN EXPRESS ASSET MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Colin Lundgren**

**Assets Under Management: \$759,789,173**

**Investment Philosophy**

American Express manages portfolios using a top-down approach culminating with in-depth fundamental research and credit analysis. Five portfolio components are actively managed: duration, maturity structure, sector selection, industry emphasis, and security selection. Duration and maturity structure are determined by the firm's economic analysis and interest rate outlook. This analysis also identifies sectors and industries expected to produce the best risk adjusted return. In-depth fundamental research and credit analysis combined with proprietary valuation disciplines is used to identify attractive individual securities. American Express was retained by the SBI in July 1993.

**Staff Comments**

American Express slightly outperformed over the last quarter, but underperformed over the full year. For the quarter, the portfolio's allocation to high yield bonds added value, as did the firm's issue selection in investment grade corporates. Underperformance over the full year was due largely to poor issue selection in investment grade corporates and an overweight to the riskier segments of that market.

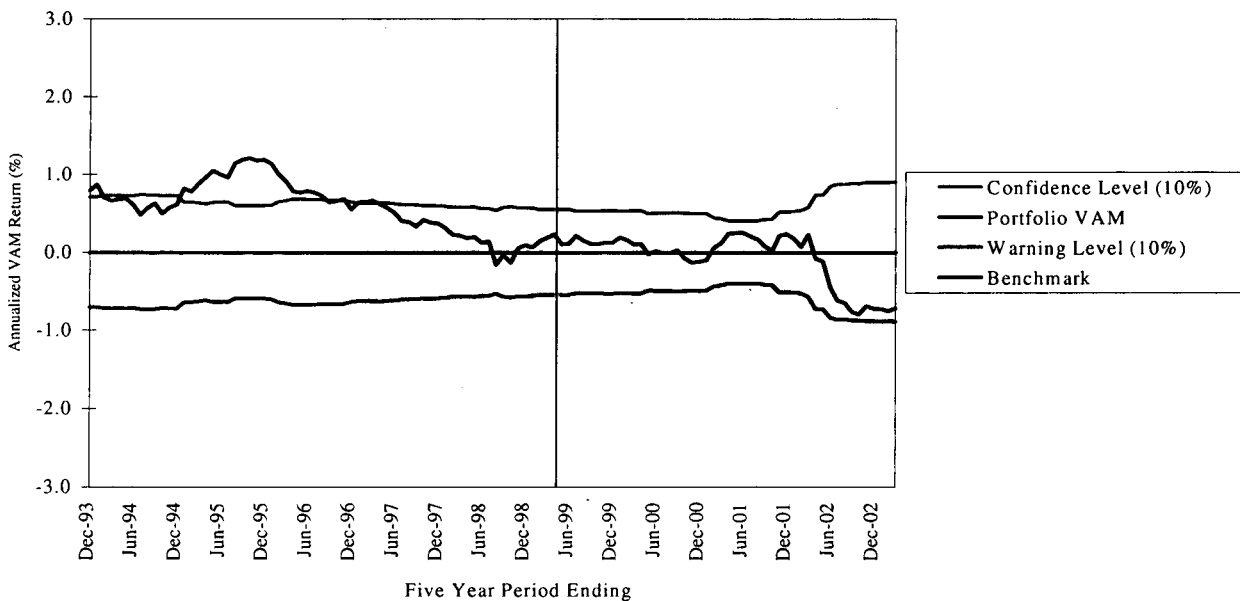
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.5%	1.4%
Last 1 year	6.9	11.7
Last 2 years	6.4	8.5
Last 3 years	8.4	9.8
Last 4 years	6.7	7.8
Last 5 years	6.7	7.5
Since Inception (7/93)	6.8	7.2

**Recommendations**

No action required.

**AMERICAN EXPRESS ASSET MANAGEMENT - FIXED INCOME**  
**Rolling Five Year VAM**



Note: Area to the left of the vertical line includes performance prior to retention by the SBI.

**DEUTSCHE ASSET MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Warren Davis**

**Assets Under Management: \$609,473,364**

**Investment Philosophy**

Deutsche believes there are significant pricing inefficiencies inherent in bond markets and that diligent credit analysis, security structure evaluation, and relative value assessment can be used to exploit these inefficiencies. The firm avoids interest rate forecasting and sector rotation because they believe these strategies will not deliver consistent out performance versus the benchmark over time. The firm's valued added is derived primarily from individual security selection. Portfolio managers and analysts research bonds within their sector of expertise and construct portfolios from the bottom-up, bond by bond. Sector weightings are a byproduct of the bottom-up security selection. Deutsche was retained by the SBI in February 2000.

**Staff Comments**

Deutsche outperformed for the quarter and year as the firm's mortgage emphasis added value, as did an emphasis on BBB-rated corporates, particularly within the Utilities sector, which posted strong excess returns. For the full year, the firm's somewhat cautious approach in corporates paid off as the portfolio avoided a number of credit blowups during 2002.

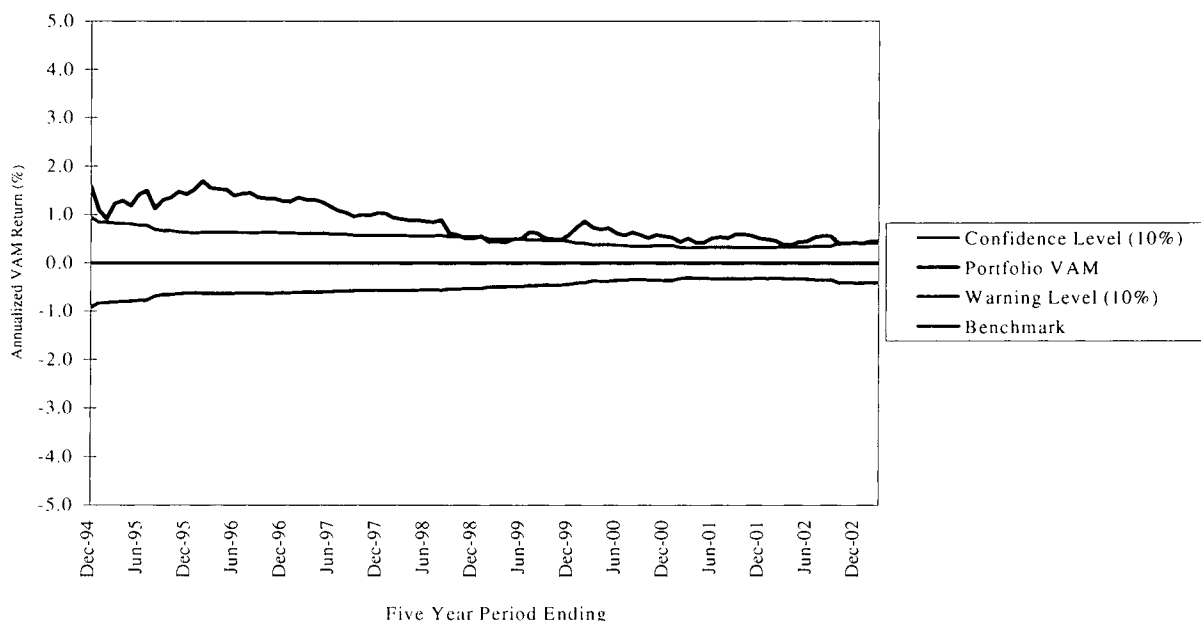
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.6%	1.4%
Last 1 year	12.3	11.7
Last 2 years	8.8	8.5
Last 3 years	10.1	9.8
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (2/00)	10.3	10.0

**Recommendations**

No action required.

**DEUTSCHE ASSET MANAGEMENT**  
**Rolling Five Year VAM**



Note: Shaded area includes performance prior to the retention by the SBI.

**DODGE & COX INVESTMENT MANAGERS**  
**Periods Ending March, 2003**

**Portfolio Manager: Dana Emery**

**Assets Under Management: \$758,165,059**

**Investment Philosophy**

Dodge & Cox manages a high quality, diversified portfolio of securities that are selected through fundamental analysis. The firm believes that by combining fundamental research with a long-term investment horizon it is possible to uncover inefficiencies in market sectors and individual securities. The firm combines this fundamental research with a disciplined program of risk analysis. To seek superior returns over the long-term, Dodge & Cox emphasizes sector and security selection, strives to build portfolios that have a higher yield than the broad bond market, and analyzes portfolio and individual security risk. Dodge & Cox was retained by the SBI in February 2000.

**Staff Comments**

Dodge & Cox posted strong results for the quarter and year, as the firm successfully managed an overweight to corporate bonds with effective security selection. An overweight to mortgage product and good selection within mortgages also added to returns.

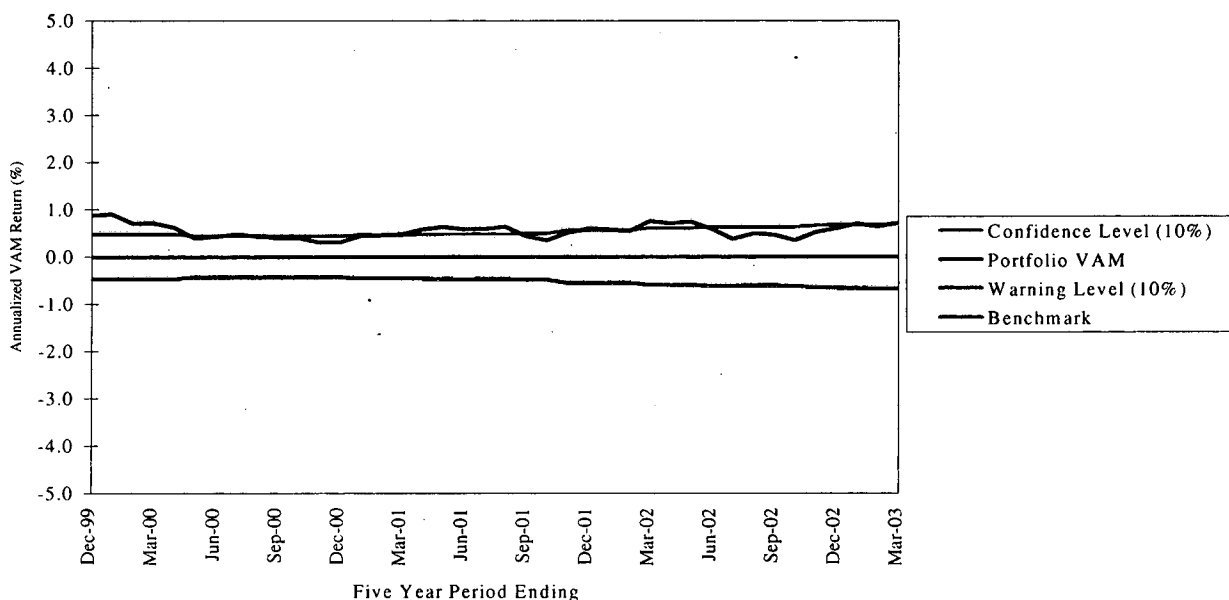
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.0%	1.4%
Last 1 year	12.5	11.7
Last 2 years	9.9	8.5
Last 3 years	11.0	9.8
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (2/00)	11.2	10.0

**Recommendations**

No action required.

**DODGE & COX INVESTMENT MANAGERS**  
**Rolling Five Year VAM**



Note: Shaded area includes performance prior to the retention by the SBI.

**MORGAN STANLEY DEAN WITTER INVESTMENT MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: David Horowitz**

**Assets Under Management: \$729,938,910**

**Investment Philosophy**

MSDW focuses on four key portfolio decisions: interest-rate sensitivity, yield-curve exposure, credit quality, and prepayment risk. The firm is a value investor, purchasing securities they believe are relatively cheap and holding them until relative values change or until other securities are identified which are better values. In developing interest-rate strategy, the firm relies on value-based criteria to determine when markets are offering generous compensation for bearing interest-rate risk, rather than trying to anticipate interest rates. Value is added in the corporate sector by selecting the cheapest bonds and controlling credit risk through diversification. MSDW has developed significant expertise in mortgage securities, which are often used to replace U.S. Treasuries in portfolios. Morgan Stanley was retained by the SBI in July 1984.

**Staff Comments**

Morgan outperformed over the quarter, but underperformed over the full year as poor credit selection impacted meaningfully on returns. During the quarter, the portfolio was helped by an overweight to corporates and mortgages, while the portfolio's underweight duration position hurt performance.

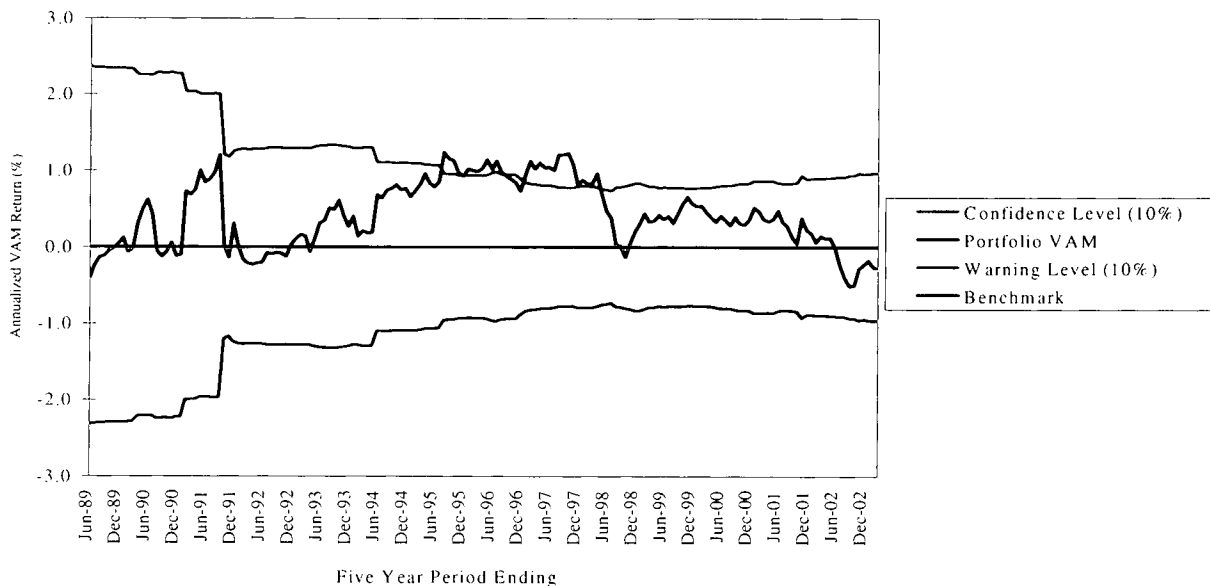
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.6%	1.4%
Last 1 year	9.6	11.7
Last 2 years	8.2	8.5
Last 3 years	9.8	9.8
Last 4 years	7.6	7.8
Last 5 years	7.2	7.5
Since Inception (7/84)	10.2	10.0

**Recommendations**

No action required.

**MORGAN STANLEY INVESTMENT MANAGEMENT**  
**Rolling Five Year VAM**





**WESTERN ASSET MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Ken Leech**

**Assets Under Management: \$1,257,763,204**

**Investment Philosophy**

Western emphasizes the use of multiple strategies and active sector and issue selection, while constraining interest rate risk. Multiple strategies are proportioned so that results do not depend on one or two opportunities. This approach adds consistent value over time and can reduce volatility. Long term value investing is Western's fundamental approach. In making their sector decision, the firm seeks out the greatest long-term value by analyzing all fixed income market sectors and their economic expectations. Individual issues are identified based on relative credit strength, liquidity, issue structure, event risk, and market valuation. Western believes that successful interest rate forecasting is extremely difficult and consequently keeps portfolio duration within a narrow band around the benchmark. Western was retained by the SBI in July 1984

**Staff Comments**

Western outperformed strongly during the quarter, and matched the benchmark's performance for the full year. The portfolio's overweight to spread product materially helped performance, as did the portfolio's allocation to high yield bonds and TIPS. For the full year, Western managed to match the benchmark's performance on strength in the current quarter making up for lost ground in the second half of 2002.

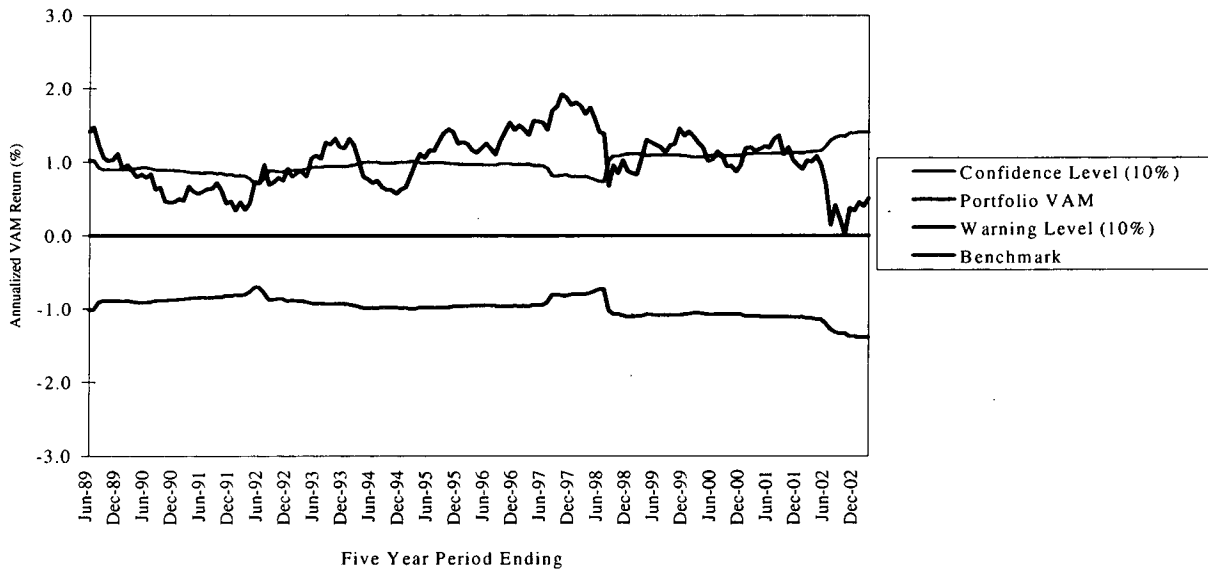
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.7%	1.4%
Last 1 year	11.7	11.7
Last 2 years	9.3	8.5
Last 3 years	10.7	9.8
Last 4 years	8.6	7.8
Last 5 years	8.1	7.5
Since Inception (7/84)	11.1	9.9

**Recommendations**

No action required.

**WESTERN ASSET MANAGEMENT**  
**Rolling Five Year VAM**



**BLACKROCK, INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: Keith Anderson**

**Assets Under Management: \$1,450,864,332**

**Investment Philosophy**

BlackRock manages an enhanced index portfolio closely tracking the Lehman Aggregate. The firm's enhanced index strategy is a controlled-duration, sector rotation style, which can be described as active management with tighter duration, sector, and quality constraints. BlackRock seeks to add value through: (i) controlling portfolio duration within a narrow band relative to the benchmark, (ii) relative value sector/sub-sector rotation and security selection, (iii) rigorous quantitative analysis to the valuation of each security and of the portfolio as a whole, (iv) intense credit analysis and review, and (v) the judgment of experienced portfolio managers. Advanced risk analytics measure the potential impact of various sector and security strategies to ensure consistent value added and controlled volatility. BlackRock was retained by the SBI in April 1996.

**Staff Comments**

BlackRock outperformed on the quarter as positive issue selection in mortgages and corporates, as well as duration positioning, benefited the portfolio. The portfolio's underweight to corporate bonds hurt performance as this sector did well. For the year, Blackrock outperformed the index though active sector selection and modestly positive performance from duration and yield curve management.

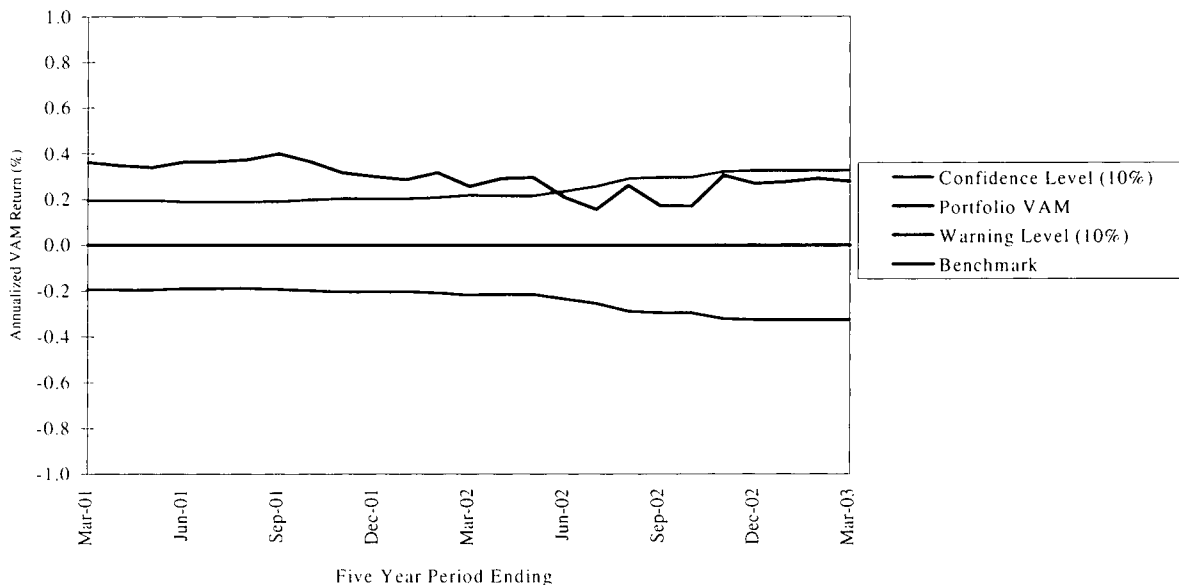
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.5%	1.4%
Last 1 year	12.0	11.7
Last 2 years	8.6	8.5
Last 3 years	9.9	9.8
Last 4 years	8.0	7.8
Last 5 years	7.8	7.5
Since Inception (4/96)	8.1	7.8

**Recommendation**

No action required.

**BLACKROCK, INC.**  
**Rolling Five Year VAM**



**GOLDMAN SACHS ASSET MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Jonathon Beinner**

**Assets Under Management: \$1,368,924,884**

**Investment Philosophy**

Goldman manages an enhanced index portfolio closely tracking the Lehman Aggregate. Goldman's process can be viewed as active management within a very risk-controlled framework. The firm relies primarily on sector allocation and security selection strategies to generate incremental return. To a lesser degree, term structure strategies are also implemented. Goldman combines long-term strategic investment tilts with short-term tactical trading opportunities. Strategic tilts are based on fundamental and quantitative sector research and seek to optimize the long-term risk/return profile of portfolios. Tactical trades between sectors and securities within sectors are implemented to take advantage of short-term market anomalies. Goldman was retained by the SBI in July 1993.

**Staff Comments**

Goldman outperformed for the quarter as the portfolio's corporate exposure, which hurt performance in the second half of 2002, continued to rebound strongly. The portfolio's mortgage and TIPS holdings also contributed to outperformance. Over the full year, Goldman underperformed by nearly 100 basis points as the portfolio's corporate overweight underperformed materially.

Over the last four months, three senior managing directors left the firm: Michael Pasternak, Head of High Yield, Leslie Barbi, Co-Head of Investment Grade Credit, and Colin Teichholtz, Head of Emerging Markets. Staff takes seriously any turnover at a senior level within the firm, and has been closely monitoring the firm's response to the recent turnover.

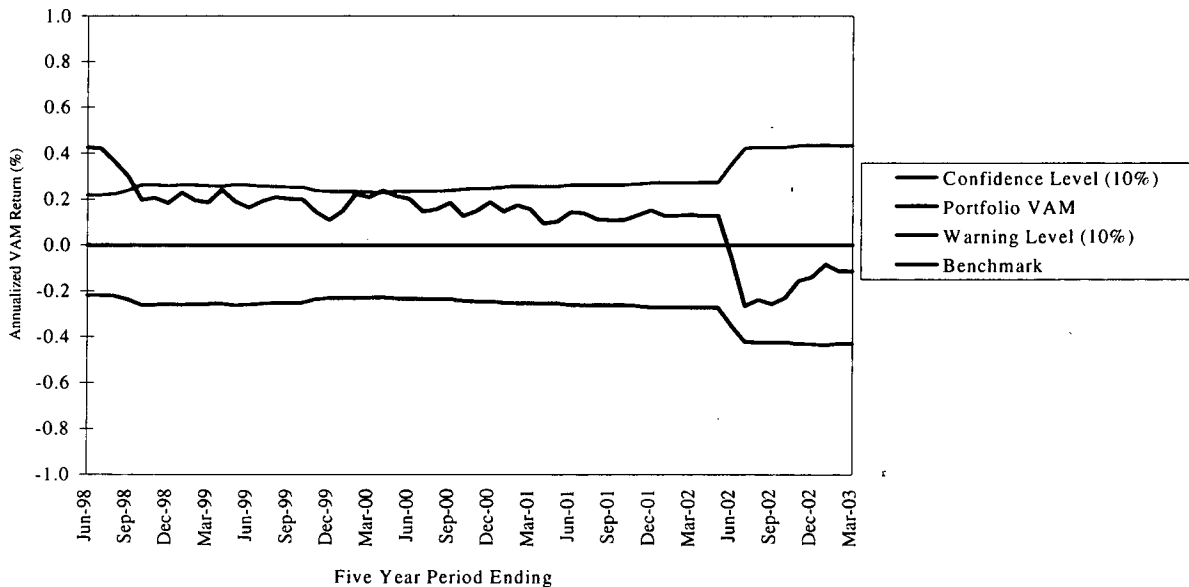
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.8%	1.4%
Last 1 year	10.6	11.7
Last 2 years	8.3	8.5
Last 3 years	9.6	9.8
Last 4 years	7.8	7.8
Last 5 years	7.4	7.5
Since Inception (7/93)	7.3	7.1

**Recommendations**

Staff has had several discussions with the firm regarding personnel and process, and has scheduled in May a full review meeting with the firm's key investment personnel. Staff is proposing no further action at this time.

**GOLDMAN SACHS ASSET MANAGEMENT**  
**Rolling Five Year VAM**



**LINCOLN CAPITAL FIXED INCOME MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Andrew Johnson**

**Assets Under Management: \$1,397,540,799**

**Investment Philosophy**

Lincoln manages an enhanced index portfolio closely tracking the Lehman Aggregate. Lincoln's process relies on a combination of quantitative tools and active management judgment. Explicit quantification and control of risks are at the heart of their process. Lincoln uses proprietary risk exposure measures to analyze 25 interest rate factors, and over 30 spread-related factors. For each interest rate factor, the portfolio is very closely matched to the index to ensure that the portfolio earns the same return as the index for any change in interest rates. For each spread factor, the portfolio can deviate slightly from the index as a means of seeking value-added. Setting target active risk exposures that must fall within pre-established maximums controls risk. To control credit risk, corporate holdings are diversified across a large number of issues. Lincoln was retained by the SBI in July 1988.

**Staff Comments**

Lincoln's performance matched the benchmark for the quarter as somewhat negative security selection within asset-backed securities detracted from the positive contribution of a slight overweight to corporate bonds. For the year, the portfolio lagged the benchmark by 20 basis points, entirely as the result of poor performance in the asset-backed sector, where an investment in National Premier Financial Trust suffered a major loss due to fraud.

During the quarter, Lincoln closed its transaction with Lehman Brothers whereby Lincoln's fixed income operation became a unit of Lehman Brothers. While staff will monitor the new entity closely, staff has been reassured by the fact that the Lincoln index team has remained intact and that the process is unchanged.

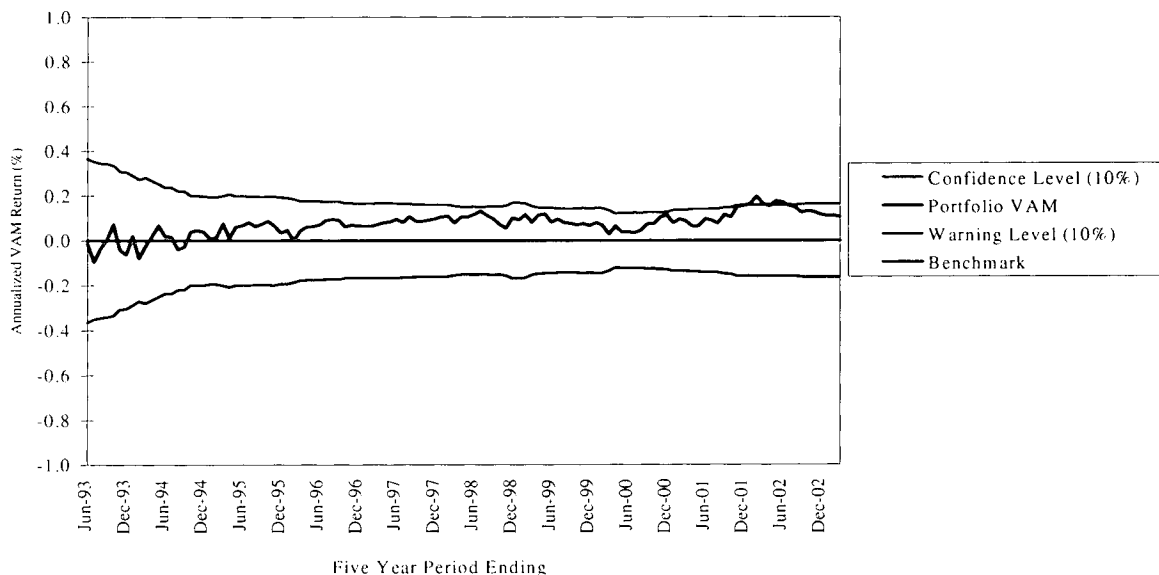
**Quantitative Evaluation**

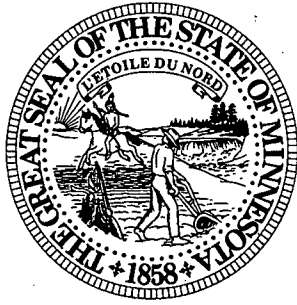
	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.4%	1.4%
Last 1 year	11.5	11.7
Last 2 years	8.6	8.5
Last 3 years	10.0	9.8
Last 4 years	7.9	7.8
Last 5 years	7.6	7.5
Since Inception (7/88)	8.6	8.6

**Recommendations**

No action required.

**LINCOLN CAPITAL FIXED INCOME MANAGEMENT**  
**Rolling Five Year VAM**





# STATE BOARD OF INVESTMENT

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## International Manager Evaluation Reports

First Quarter, 2003



**COMBINED RETIREMENT FUNDS  
INTERNATIONAL STOCK MANAGERS  
Periods Ending March, 2003**

	Quarter		1 Year		3 Years		5 Years		Since (1) Inception		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active EAFE</b>												
American Express	-9.2	-8.2	-23.5	-23.0	-23.8	-19.5			-22.4	-18.0	\$351.6	8.6%
Britannic (Blairlogie)	-8.3	-8.2	-24.5	-23.0	-20.9	-19.5			-19.2	-18.0	\$217.7	5.3%
Invesco	-8.2	-8.2	-21.3	-23.0	-12.8	-19.5			-11.7	-18.0	\$429.5	10.5%
Marathon (5)	-5.6	-6.5	-18.1	-19.7	-10.2	-16.0	-1.5	-5.7	3.4	0.4	\$444.9	10.9%
T. Rowe Price	-9.9	-8.2	-25.5	-23.0	-20.7	-19.5	-6.9	-7.1	1.3	0.0	\$371.0	9.1%
UBS Global	-9.8	-8.2	-22.5	-23.0	-12.4	-19.5	-3.2	-7.1	4.2	2.0	\$447.0	10.9%
<b>Active Emerging Markets</b>												
Alliance Capital	-7.1	-6.0	-18.2	-20.2					-12.3	-11.3	\$100.2	2.5%
Capital International	-5.7	-6.0	-25.6	-20.2					-16.4	-11.3	\$90.6	2.2%
Morgan Stanley	-6.7	-6.0	-21.6	-20.2					-12.0	-11.3	\$93.7	2.3%
Schroders	-7.4	-6.0	-22.6	-20.2					-15.1	-11.3	\$94.7	2.3%
<b>Passive EAFE</b>												
State Street	-8.2	-8.2	-23.1	-23.0	-19.3	-19.5	-6.8	-7.1	2.8	2.6	\$1,449.7	35.4%
<b>Since 10/1/92</b>												
Equity Only (2) (4)	-8.2	-8.0	-22.9	-22.8	-18.0	-19.3	-6.4	-7.1	3.1	2.3	\$4,090.5	100.0%
<b>Total Program (3) (4)</b>	<b>-8.2</b>	<b>-8.0</b>	<b>-22.9</b>	<b>-22.8</b>	<b>-18.0</b>	<b>-19.3</b>	<b>-6.5</b>	<b>-7.1</b>	<b>3.5</b>	<b>2.3</b>	<b>\$4,090.5</b>	
EAFE Free (net)		-8.2		-23.2		-19.5		-7.1		2.6		
Emerging Markets Free (net)		-6.0		-20.8		-16.5		-7.0		1.3		

(1) Since retention by the SBI. Time period varies for each manager.

(2) Equity managers only. Includes impact of terminated managers.

(3) Includes impact of currency overlay on the passive EAFE portfolio from 12/1/95-10/31/00.

(4) From October 1, 2001 to May 31, 2002 all international benchmarks being reported were the MSCI Provisional indices. The overall international benchmark is EAFE-Free plus Emerging Markets Free (net). The weighting of each index fluctuates with market capitalization. From 12/31/96 to 6/30/99 the benchmark was fixed at 87% EAFE-Free (net)/13% Emerging Markets Free (gross). On 5/1/96, the portfolio began transitioning from 100% EAFE Free (net) to the 12/31/96 fixed weights. 100% EAFE-Free (net) prior to 5/1/96.

(5) Marathon is measured against a custom composite benchmark: 55% Salomon Smith Barney EMI EPAC and 45% Salomon Smith Barney PMI EPAC.





**AMERICAN EXPRESS ASSET MANAGEMENT INTERNATIONAL, INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: Mark Burgess**

**Assets Under Management: \$351,595,630**

**Investment Philosophy**

American Express Asset Management's (AEAM) process identifies investment themes which they feel will drive improved return on capital, and will provide attractive investment opportunities. AEAM's core international equity approach is a blend of top-down and bottom up styles with an emphasis on large cap growth stocks. They start the decision making process with the development of their geopolitical and macroeconomic outlook. The bottom-up stage of their process begins with real-time relative valuation comparisons of the stocks in their investable universe. The most attractively priced stocks then go through in depth fundamental analysis.

**Staff Comments**

The portfolio underperformed during the quarter due to stock selection losses within the European and Japanese industrials, information technology, and materials sectors. European financials also hurt performance.

For the year, negative stock selection in Japan contributed to the portfolio's modest underperformance.

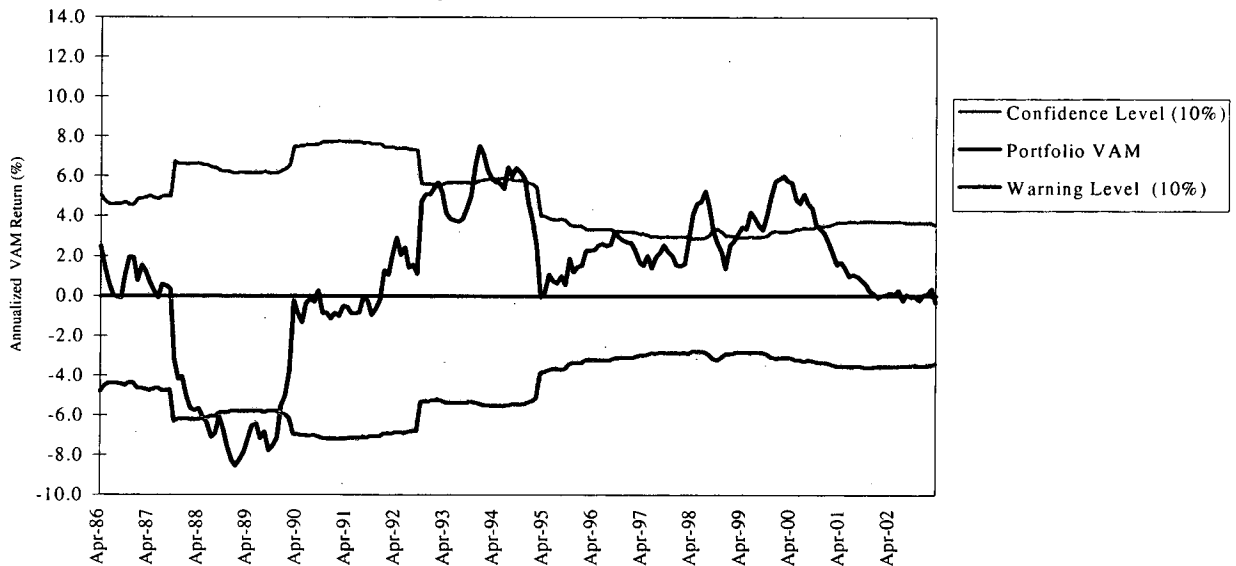
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-9.2%	-8.2%
Last 1 year	-23.5	-23.0
Last 2 years	-17.6	-16.1
Last 3 years	-23.8	-19.5
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/00)	-22.4	-18.0

**Recommendations**

No action required.

**AMERICAN EXPRESS ASSET MANAGEMENT INT'L**  
**Rolling Five Year VAM**



5 Year Period Ending

Note: Shaded area includes performance prior to managing SBI account.

**BRITANNIC ASSET MANAGEMENT (Blairlogie)**  
**Periods Ending March, 2003**

**Portfolio Manager: James Smith**

**Assets Under Management: \$217,655,796**

**Investment Philosophy**

Britannic's process incorporates a top-down model, with bottom-up stock selection. They seek to combine qualitative and quantitative judgment, but believe that objective, measurable facts must always be the starting point for making sound investment decisions. Britannic has developed country and sector models which analyze a broad-based collection of current and historical data. The models rank countries and sectors according to their overall score on variables which are grouped into five categories including Value, Macro, Earnings, Monetary and Technical. Regional analysts then select the best companies by region and sector based on fundamental analysis. The objective of the process is to add value over the benchmark consistently in any market environment while controlling risk and volatility. Britannic's portfolio is broadly diversified in developed markets both by country and by sector, and has a large-cap emphasis.

**Staff Comments**

While stock selection in the portfolio was positive, country allocation decisions detracted from performance during the quarter. The portfolio's underweight to Spain and Denmark, and overweight to the Netherlands were negative contributors.

For the year, stock selection was weak in Europe and Japan.

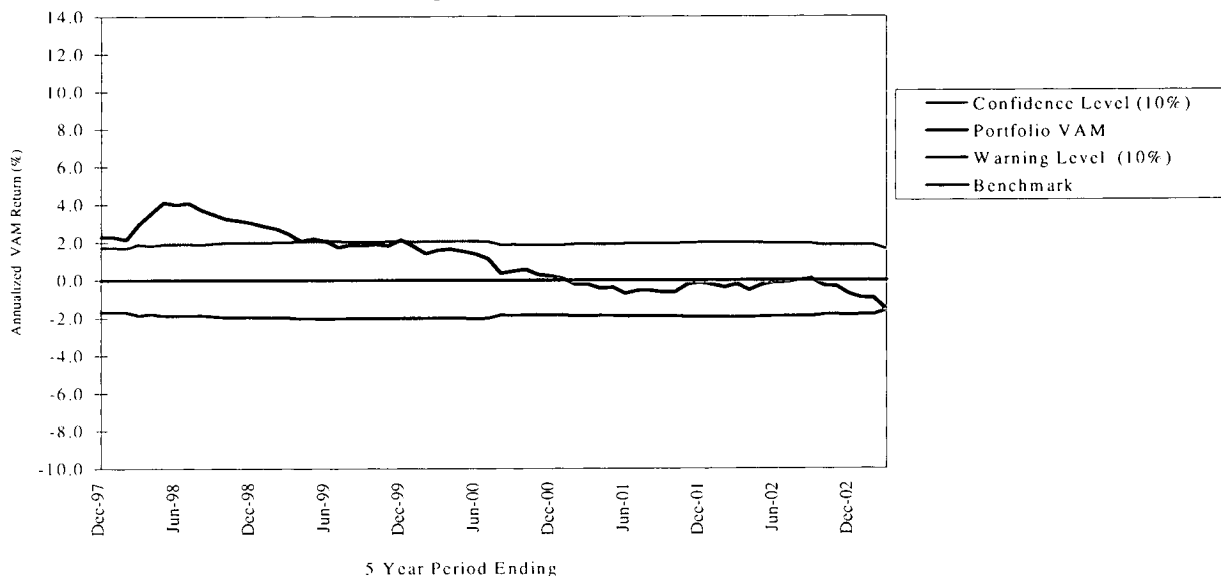
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-8.3%	-8.2%
Last 1 year	-24.5	-23.0
Last 2 years	-16.6	-16.1
Last 3 years	-20.9	-19.5
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/00)	-19.2	-18.0

**Recommendations**

No action required.

**BRITANNIC ASSET MANAGEMENT**  
**Rolling Five Year VAM**



Note: Shaded area includes performance prior to managing SBI account.

**INVESCO GLOBAL ASSET MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Erik Granade**

**Assets Under Management: \$429,450,071**

**Investment Philosophy**

INVESCO believes they can add value by identifying and investing in companies whose share price does not reflect the proven and sustainable growth of the company's earnings and assets. They also believe that a systematic process that identifies mis-valued companies, combined with a consistently applied portfolio design process, can control the predictability and consistency of returns. Portfolios are constructed on a bottom-up basis; they select individual companies rather than countries, themes, or industry groups. This is the first of four cornerstones of their investment approach. Secondly, they conduct financial analysis on a broad universe of non-U.S. companies whose key financial data is adjusted to be comparable across borders and currencies. Third, Invesco believes that using local investment professionals enhances fundamental company research. Finally, they manage risk and assure broad diversification relative to clients' benchmarks through a statistics-based portfolio construction approach rather than resorting to country or industry constraints.

**Staff Comments**

The portfolio matched the benchmark for the quarter. Performance was helped by strong stock selection in the utility and healthcare sectors, which was offset by weakness in the Japanese portion of the portfolio.

During the year, the portfolio's significant outperformance was driven by strong stock selection across sectors, particularly consumer staples and energy.

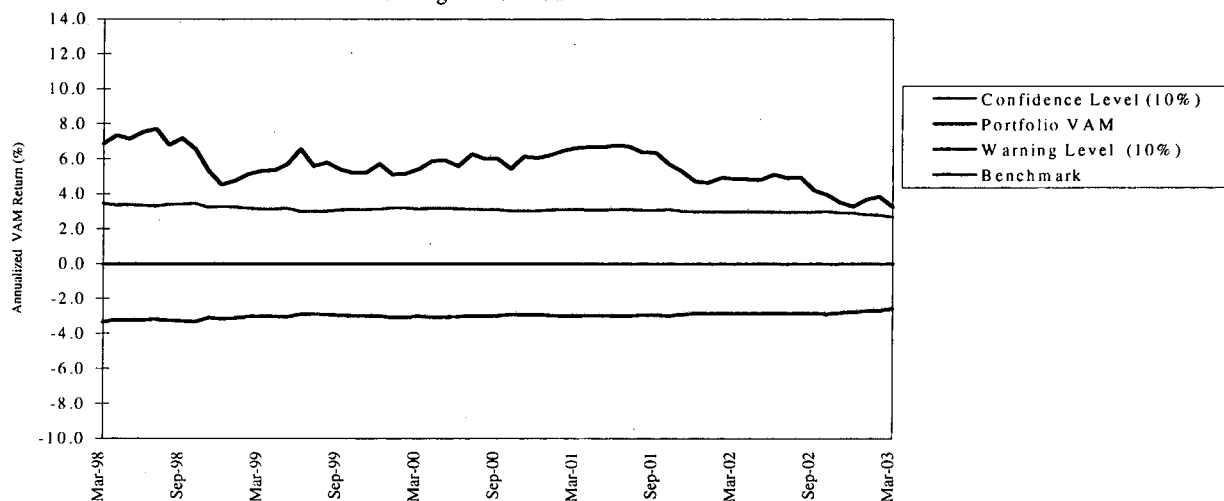
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-8.2%	-8.2%
Last 1 year	-21.3	-23.0
Last 2 years	-12.4	-16.1
Last 3 years	-12.8	-19.5
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/00)	-11.7	-18.0

**Recommendations**

No action required.

**INVESCO GLOBAL ASSET MANAGEMENT**  
**Rolling Five Year VAM**



5 Year Period Ending  
 Note: Shaded area includes performance prior to managing SBI account.

**MARATHON ASSET MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: William Arah**

**Assets Under Management: \$444,918,858**

**Investment Philosophy**

Marathon uses a blend of flexible, qualitative disciplines to construct portfolios which exhibit a value bias. Style and emphasis will vary over time and by market, depending on Marathon's perception of lowest risk opportunity. Since they believe that competition determines profitability, Marathon is attracted to industries where the level of competition is declining and they will hold a sector position as long as the level of competition does not increase. At the stock level, Marathon tracks a company's competitive position versus the attractiveness of their products or services and attempts to determine whether the company is following an appropriate reinvestment strategy for their current competitive position.

**Staff Comments**

During the quarter, strong stock selection across most markets, as well as an underweight to Europe and an overweight to Asia ex. Japan, contributed to the portfolio's outperformance.

For the year, stock selection was the primary positive contributor. Japanese stock selection, with a focus on medium capitalization and domestic oriented stocks, added significantly to portfolio performance.

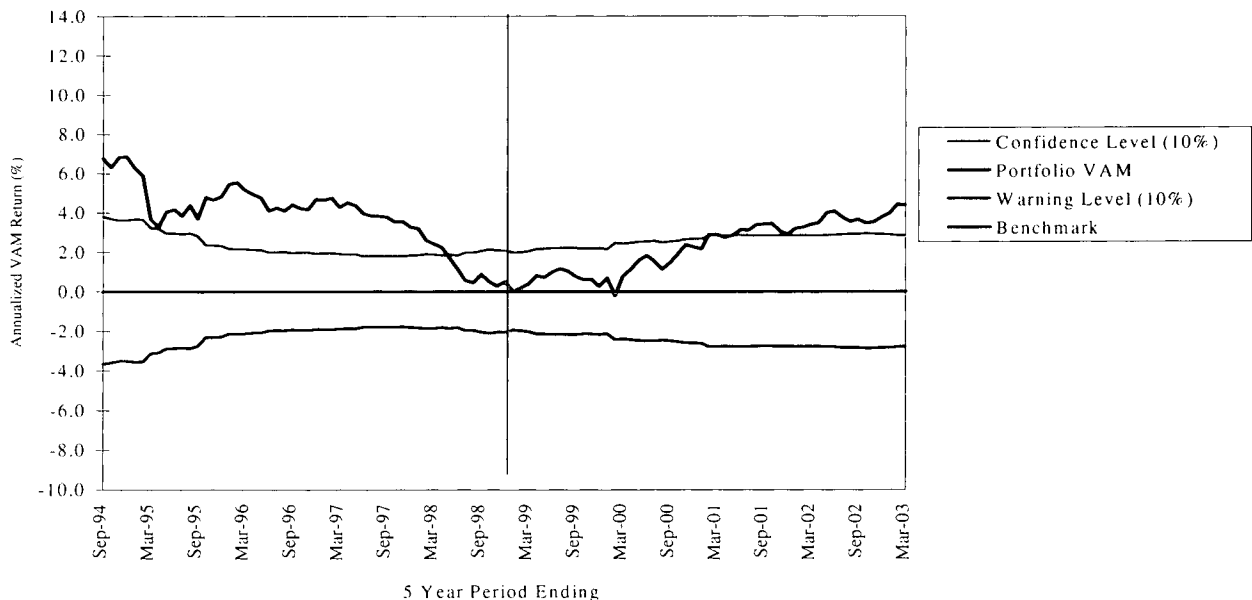
**Quantitative Evaluation**

	<b>Actual</b>	<b>Custom Benchmark</b>
Last Quarter	-5.6%	-6.5%
Last 1 year	-18.1	-19.7
Last 2 years	-9.3	-12.2
Last 3 years	-10.2	-16.0
Last 4 years	-2.2	-7.3
Last 5 years	-1.5	-5.7
Since Inception (11/93)	3.4	0.4

**Recommendations**

No action required.

**MARATHON ASSET MANAGEMENT**  
**Rolling Five Rolling VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**T. ROWE PRICE INTERNATIONAL, INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: David Warren**

**Assets Under Management: \$371,039,300**

**Investment Philosophy**

T. Rowe Price believes that world stock markets are segmented. The firm attempts to add value by identifying and exploiting the resulting pricing inefficiencies. In addition, they believe that growth is frequently under priced in the world markets. T. Rowe Price establishes its economic outlook based largely on interest rate trends and earnings momentum. The portfolio management team then assesses the country, industry and currency profile for the portfolio. Within this framework, stock selection is the responsibility of regional portfolio managers. Stocks are selected using fundamental analysis that emphasizes companies with above-market earnings growth at reasonable valuations. Information derived from the stock selection process is a key factor in country allocation as well.

**Staff Comments**

Staff met with T. Rowe Price during the quarter to discuss the investment process and performance. The portfolio underperformed during the quarter due to negative stock selection particularly in Dutch financials and Japanese industrials. An underweight to Australia, which was one of the better relative performers due to a strong currency, also hurt performance.

For the year, negative stock selection in Japan and several smaller European countries, along with the portfolio's overweight in media and commercial services, contributed to underperformance.

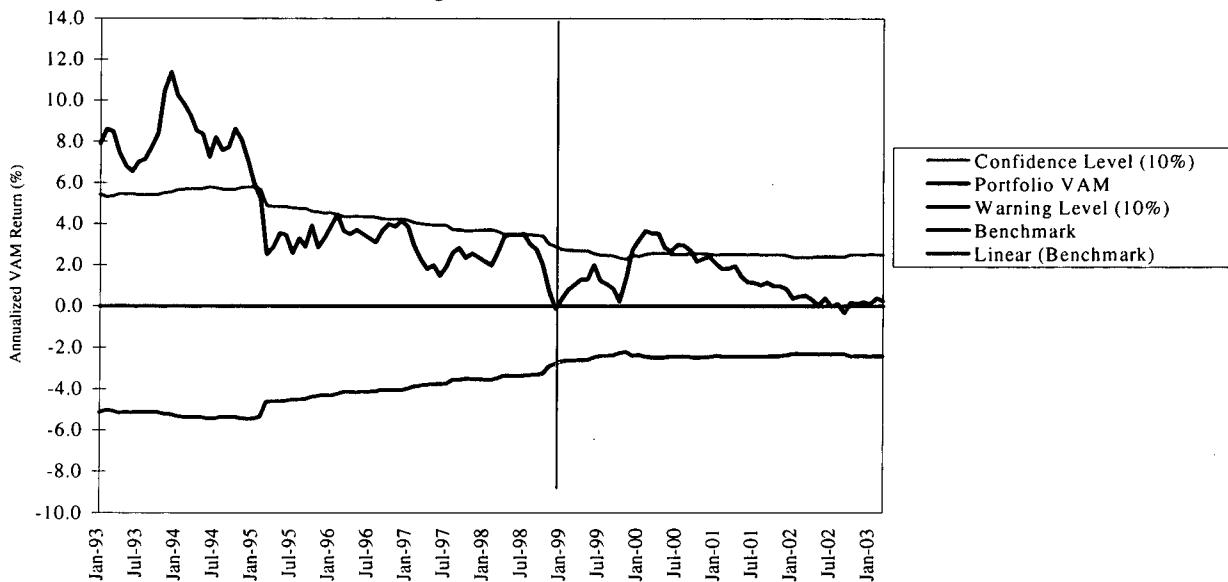
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-9.9%	-8.2%
Last 1 year	-25.5	-23.0
Last 2 years	-16.8	-16.1
Last 3 years	-20.7	-19.5
Last 4 years	-9.4	-10.1
Last 5 years	-6.9	-7.1
Since Inception (11/93)	1.3	0.0

**Recommendations**

No action required.

**T. ROWE PRICE INTERNATIONAL**  
**Rolling Five Year VAM**



5 Year Period Ending

Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**UBS GLOBAL ASSET MANAGEMENT, INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: Thomas Madsen**

**Assets Under Management: \$447,011,682**

**Investment Philosophy**

UBS is a fundamental, long-term, value-oriented investor. UBS uses a proprietary valuation model to rank the relative attractiveness of individual markets based on fundamental considerations. Inputs include forecasts for growth, inflation rates, risk premiums and foreign exchange movements. Quantitative tools are used to monitor and control portfolio risk, while qualitative judgments from the firm's professionals are used to determine final allocations. UBS establishes an allocation range around the target index to define the limits of their exposure to individual countries and to assure diversification.

UBS utilizes currency equilibrium bands to determine which currencies are over or under valued. The firm will hedge to control the potential risk for real losses from currency depreciation.

**Staff Comments**

During the quarter, negative stock selection across several markets, including the U.K., the Netherlands, and Switzerland did not add value. Stock selection in the industrials, utilities, and telecom sectors also detracted from performance.

For the year, the portfolio benefited from positive stock selection and currency strategy. The currency over and underweights, particularly in the Euro, Yen, and British Pound made positive contributions.

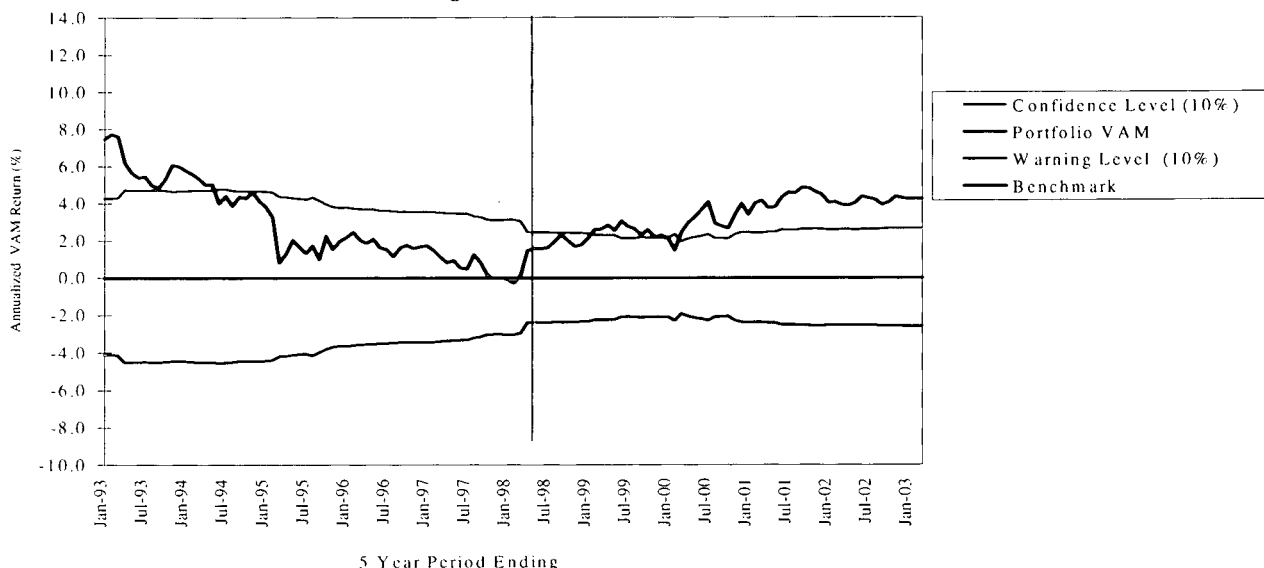
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-9.8%	-8.2%
Last 1 year	-22.5	-23.0
Last 2 years	-13.3	-16.1
Last 3 years	-12.4	-19.5
Last 4 years	-5.8	-10.1
Last 5 years	-3.2	-7.1
Since Inception (4/93)	4.2	2.0

**Recommendations**

No action required.

UBS GLOBAL ASSET MANAGEMENT, INC. (INT'L)  
 Rolling Five Year VAM



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

**ALLIANCE CAPITAL MANAGEMENT INTERNATIONAL**  
**Periods Ending March, 2003**

**Portfolio Manager: Edward Baker**

**Assets Under Management: \$100,218,301**

**Investment Philosophy**

Alliance employs a growth style of investment management. They believe that fundamental research-driven stock selection, structured by industries within regions, will produce superior investment performance. Their strategy emphasizes bottom-up, large capitalization stock selection. Country and industry exposures are a by-product of stock selection. Alliance looks for companies with the best combination of forward-looking growth and valuation attractiveness.

**Staff Comments**

The portfolio underperformed during the quarter due to negative stock selection in Taiwan, Brazil, and Korea. Holdings in the financials, consumer discretionary, and materials sectors also detracted from performance.

For the year, the portfolio out performed due to positions in Russian oil and telecom companies, Central European banks, and Israeli generic pharmaceuticals.

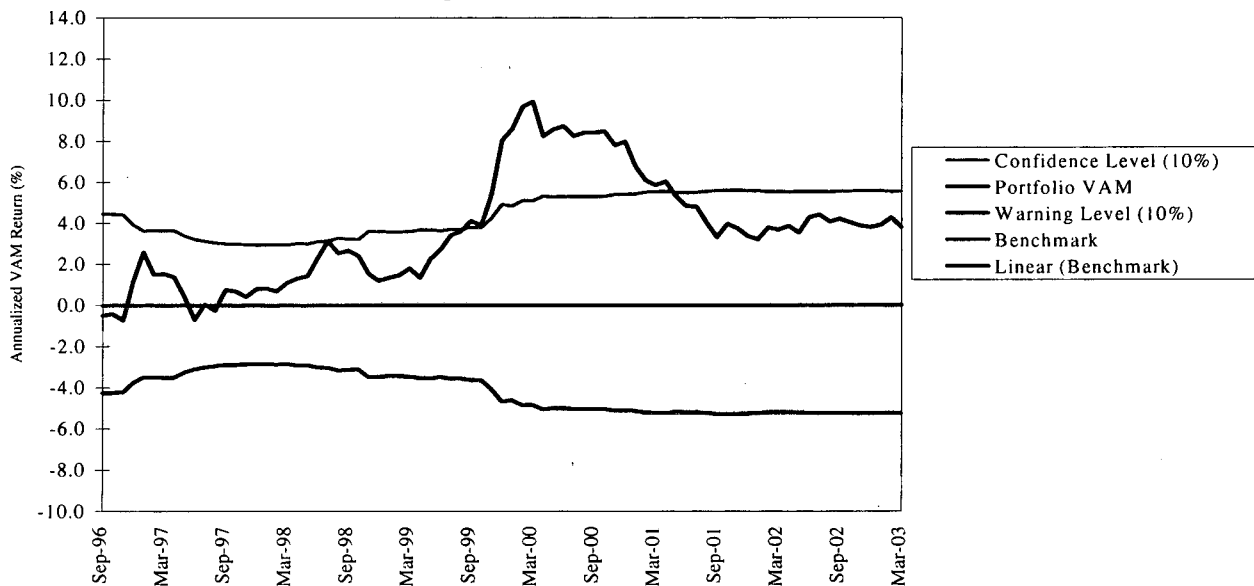
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-7.1	-6.0
Last 1 year	-18.2	-20.2
Last 2 years	-2.9	-3.6
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/01)	-12.3	-11.3

**Recommendations**

No action required.

**ALLIANCE CAPITAL MANAGEMENT**  
**Rolling Five Year VAM**



5 Year Period Ending

Note: Shaded area includes performance prior to managing SBI account.

**CAPITAL INTERNATIONAL, INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: Victor Kohn**

**Assets Under Management: \$90,583,123**

**Investment Philosophy**

Capital International's philosophy is value-oriented, as they focus on identifying the difference between the underlying value of a company and the price of its securities in its home market. Capital International's basic, fundamental, bottom-up approach is blended with macroeconomic and political judgments on the outlook for economies, industries, currencies and markets. The team of portfolio managers and analysts each select stocks for the portfolio based on extensive field research and direct company contact.

**Staff Comments**

The portfolio modestly outperformed during the quarter due to an underweight position in Korea, an overweight to Brazil, and positive stock selection in both Mexico and India. Stock selection in the financials, consumer discretionary and staples, and telecom sectors was positive.

For the year, stock selection in Taiwan contributed negatively to the portfolio's performance. An underweight to South Africa, a market that performed well due to currency appreciation, also detracted.

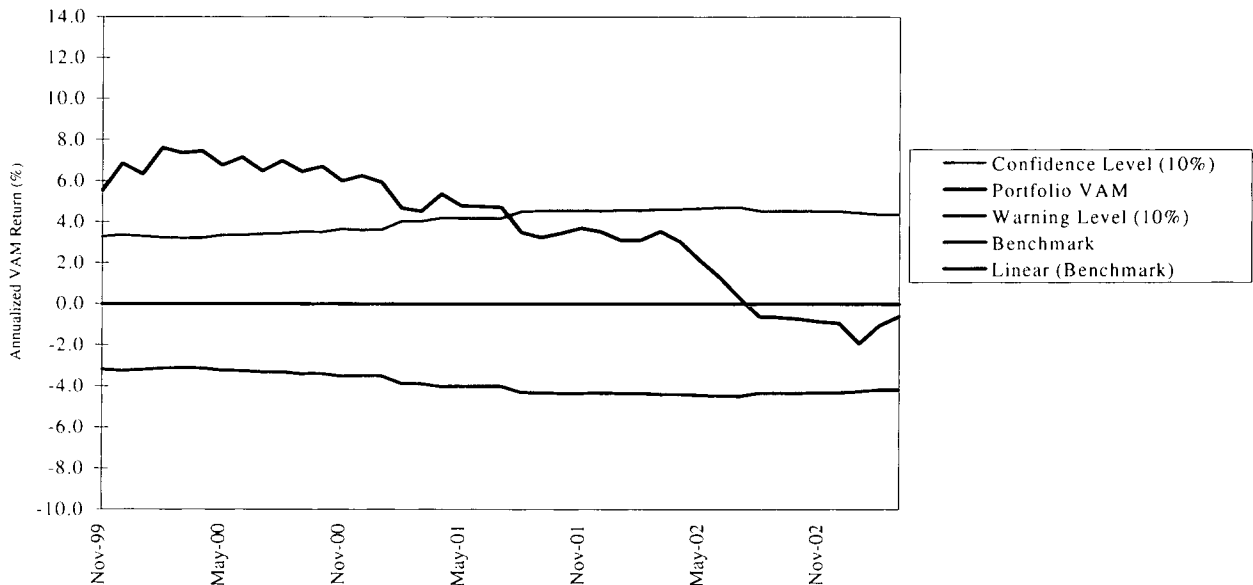
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-5.7	-6.0
Last 1 year	-25.6	-20.2
Last 2 years	-6.4	-3.6
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/01)	-16.4	-11.3

**Recommendations**

No action required.

**CAPITAL INTERNATIONAL, INC.**  
**Rolling Five Year VAM**



5 Year Period Ending

Note: Shaded area includes performance prior to managing SBI account.



**MORGAN STANLEY INVESTMENT MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Narayan Ramachandran**

**Assets Under Management: \$93,661,860**

**Investment Philosophy**

Morgan Stanley's style is core with a growth bias. They follow a top-down approach to country allocation and a bottom-up approach to stock selection. Morgan Stanley's macro-economic and stock selection analyses are qualitative as well as quantitative, concentrating on fundamentals. Their top-down analysis highlights countries with improving fundamentals and attractive valuations. Their bottom-up approach to stock selection focuses on purchasing companies with strong operating earnings potential at attractive valuations.

**Staff Comments**

Morgan Stanley narrowly underperformed during the quarter due to an underweight position in Brazil and negative stock selection in Taiwan and Korea.

For the year, negative stock selection in Taiwan, Russia, and South Africa detracted from performance. An overweight position in Turkey also hurt returns.

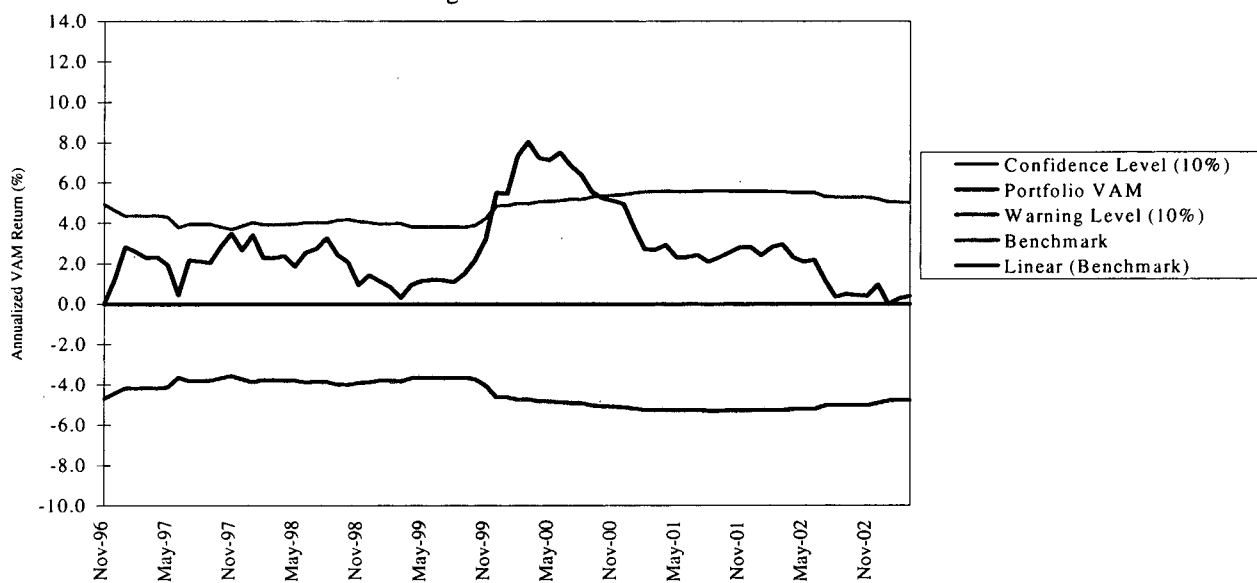
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-6.7%	-6.0%
Last 1 year	-21.6	-20.2
Last 2 years	-2.3	-3.6
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/01)	-12.0	-11.3

**Recommendations**

No action required.

**MORGAN STANLEY INVESTMENT MANAGEMENT**  
**Rolling Five Year VAM**



5 Year Period Ending  
 Note: Shaded area includes performance prior to the retention by the SBI

**SCHRODERS INVESTMENT MANAGEMENT NORTH AMERICA INC.**  
**Periods Ending March, 2003**

**Portfolio Manager: Peter Clark**

**Assets Under Management: \$94,684,781**

**Investment Philosophy**

Schroders believes in investing in growth at a reasonable price. They focus on identifying companies that can leverage the superior economic growth in emerging markets to generate above-average growth in earnings and cash flow. Their style aims to generate consistency of performance by taking multiple active positions in what are highly inefficient markets. Schroders uses a combination of top-down analysis and bottom-up stock selection, which varies with the state of development of the market.

**Staff Comments**

Both stock selection and country allocation decisions detracted from performance during the quarter. Stock selection in Korea, Malaysia and Taiwan was negative. Holdings in the financials, industrials, and healthcare sectors also did not add value.

The main detractors from performance for the year were an overweight position in Taiwanese technology stocks, an underweight position in South Africa, and an overweight position in Brazil.

In January, the portfolio manager Peter Clark announced that he will take on an additional management role within Schroders, as CEO of Schroders North America (SIMNA).

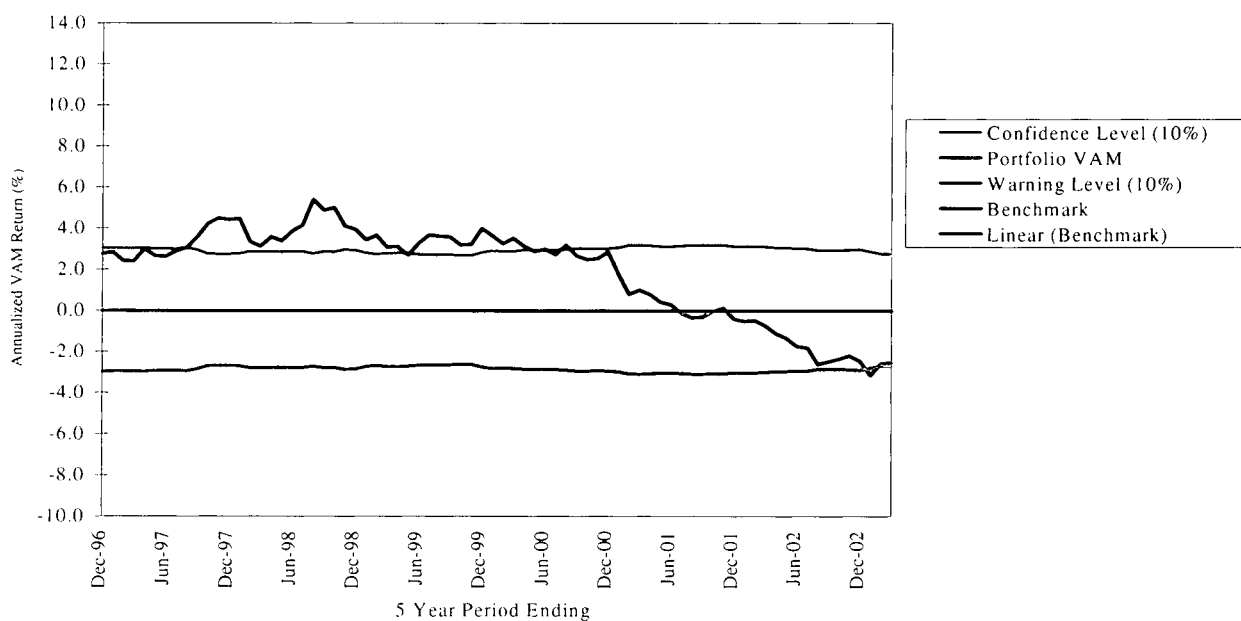
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-7.4	-6.0
Last 1 year	-22.6	-20.2
Last 2 years	-7.1	-3.6
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/01)	-15.1	-11.3

**Recommendations**

Staff is closely monitoring the firm due to organizational change and performance concerns.

**SCHRODERS INVESTMENT MANAGEMENT**  
**Rolling Five Year VAM**



Note: Shaded area includes performance prior to the retention by the SBI.

**STATE STREET GLOBAL ADVISORS**  
**Periods Ending March, 2003**

**Portfolio Manager: Lynn Blake**

**Assets Under Management: \$1,449,664,138**

**Investment Philosophy**

State Street Global Advisors passively manages the portfolio against the Morgan Stanley Capital International (MSCI) index of 21 markets located in Europe, Australia and the Far East (EAFE). They buy only securities which are eligible for purchase by foreign investors, therefore they are benchmarked against the MSCI EAFE-Free (net) index. SSgA fully replicates the index whenever possible because it results in lower turnover, higher tracking accuracy and lower market impact costs. The MSCI EAFE-Free (net) index reinvests dividends assuming a withholding tax on dividends, according to the Luxembourg tax rate. Whereas the portfolio reinvests dividends using all available reclaims and tax credits available to a U.S. pension fund, which should result in modest positive tracking error, over time.

**Staff Comments**

The portfolio closely tracked the benchmark during the quarter and the year.

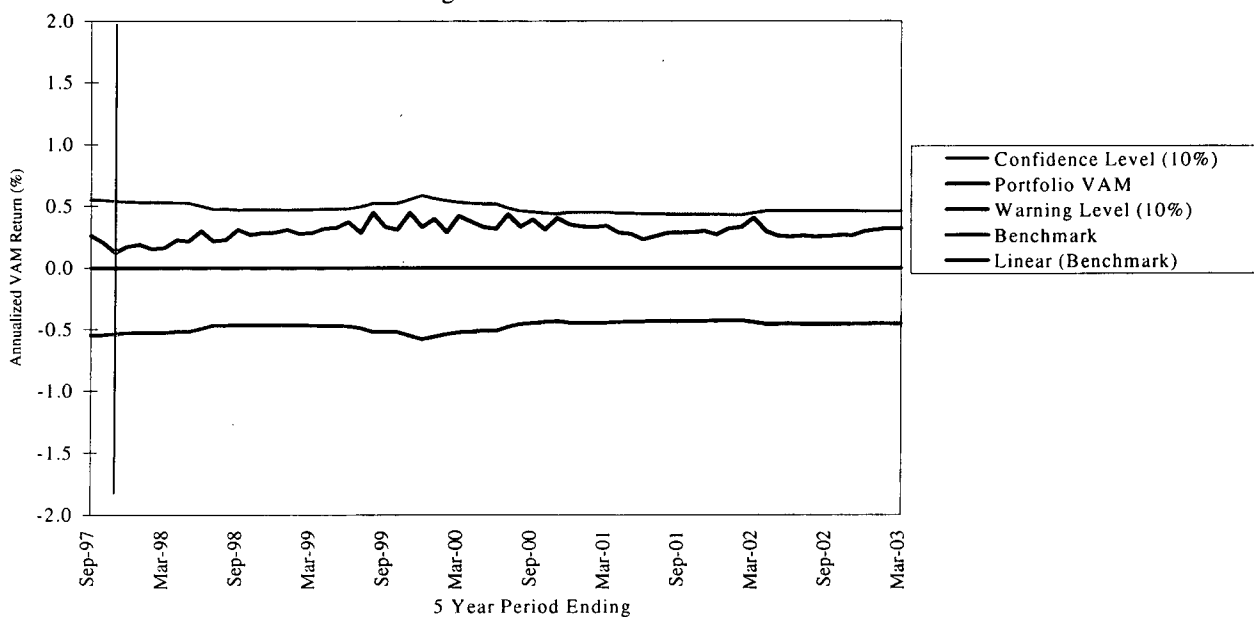
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-8.2%	-8.2%
Last 1 year	-23.1	-23.0
Last 2 years	-15.8	-16.1
Last 3 years	-19.3	-19.5
Last 4 years	-9.9	-10.1
Last 5 years	-6.8	-7.1
Since Inception (10/92)	2.8	2.6

**Recommendation**

No action required.

**STATE STREET GLOBAL ADVISORS**  
**Rolling Five Year VAM**



Note: Area to the left of vertical line includes performance prior to retention by the SBI.

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**A-62**

**NON - RETIREMENT MANAGERS**  
**Periods Ending March, 2003**

	Quarter		1 Year		3 Years		5 Years		Since (1) Inception		Market Value (in millions)
	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk	
	%	%	%	%	%	%	%	%	%	%	
GE Investment Management (S&P 500 Index)*	-3.2	-3.1	-24.1	-24.8	-11.7	-16.1	-1.1	-3.8	11.2	9.5	\$48.7
Voyageur Asset Management (Custom Benchmark)*	0.9	0.9	9.8	10.2	7.7	9.0	6.5	7.3	7.4	7.5	\$189.6
Galliard Capital Management (3 yr. Constant Maturity Treasury + 45 bp)*	1.2	0.6	5.5	2.9	6.0	4.3	6.1	4.9	6.4	5.5	\$128.7
Internal Stock Pool (S&P 500 Index)*	-3.1	-3.1	-24.4	-24.8	-16.0	-16.1	-3.6	-3.8	8.8	8.7	\$453.5
Internal Bond Pool - Income Share (Lehman Aggregate)*(2)	1.5	1.4	10.2	11.7	9.3	9.8	7.4	7.5	8.6	8.4	\$194.4
Internal Bond Pool - Trust (Lehman Aggregate)*	1.7	1.4	11.0	11.7	9.5	9.8	7.6	7.5	8.4	8.1	\$348.9

\* Benchmarks for the Funds are notated in parentheses below the Fund names.

(1) Since retention by the SBI. Time period varies by manager.

(2) Prior to July 1994, the benchmark was the Salomon BIG.



**GE ASSET MANAGEMENT - Assigned Risk Plan**  
**Periods Ending March, 2003**

**Portfolio Manager: Gene Bolton**

**Assets Under Management: \$48,726,340**

**Investment Philosophy**  
**Assigned Risk Plan**

GE's Multi-Style Equity program attempts to outperform the S&P 500 consistently while controlling overall portfolio risk through a multiple manager approach. Three portfolio managers with value or growth orientations are supported by a team of analysts. The three portfolios are combined to create a well diversified equity portfolio while maintaining low relative volatility and a style-neutral position between growth and value. All GE managers focus on stock selection from a bottom-up perspective.

**Staff Comments**

GE slightly trailed the benchmark for the quarter, primarily due to an underweight in technology. The portfolio outperformed the one-year benchmark due to solid stock selection across several sectors.

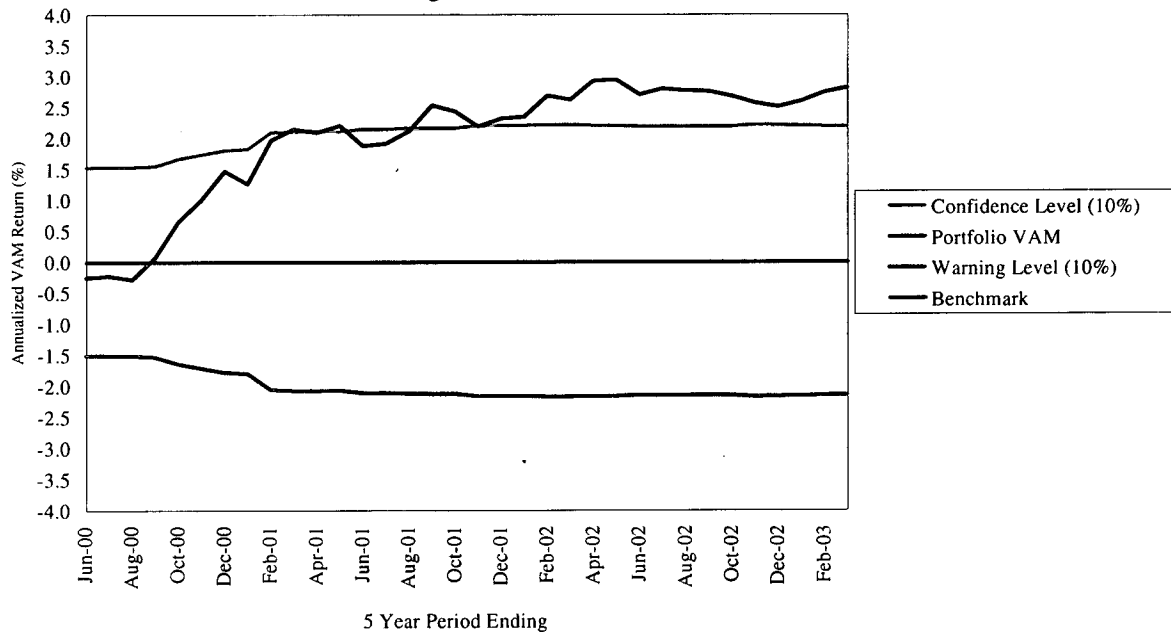
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.2%	-3.1%
Last 1 year	-24.1	-24.8
Last 2 years	-12.3	-13.2
Last 3 years	-11.7	-16.1
Last 4 years	-5.3	-8.6
Last 5 years	-1.1	-3.8
Since Inception (1/95)	11.2	9.5

**Recommendation**

No recommendation at this time.

**GE INVESTMENT MANAGEMENT**  
**Rolling Five Year VAM**



**VOYAGEUR ASSET MANAGEMENT - Assigned Risk Plan**  
**Periods Ending March, 2003**

**Portfolio Manager: Tom McGlinch**

**Assets Under Management: \$189,586,737**

**Investment Philosophy**  
**Assigned Risk Plan**

Voyageur uses a top-down approach to fixed income investing. Their objective is to obtain superior long-term investment returns over a pre-determined benchmark that reflects the quality constraints and risk tolerance of the Assigned Risk Plan. Due to the specific liability requirement of the plan, return enhancement will focus on sector analysis and security selection. Yield curve and duration analysis are secondary considerations.

**Staff Comments**

Voyageur matched the quarterly benchmark. The one-year underperformance was due to its shorter duration and over-weight in the mortgage sector.

**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	0.9%	0.9%
Last 1 year	9.8	10.2
Last 2 years	6.7	7.8
Last 3 years	7.7	9.0
Last 4 years	6.5	7.4
Last 5 years	6.5	7.3
Since Inception (7/91)	7.4	7.5

No action required.

\*Custom benchmark since inception date.

**VAM Graph will be drawn for period ending 3/31/04.**



**GALLIARD CAPITAL MANAGEMENT**  
**Periods Ending March, 2003**

**Portfolio Manager: Karl Tourville**

**Assets Under Management: \$128,713,194**

**Investment Philosophy**

**Staff Comments**

Galliard Capital Management manages the Fixed Interest Account in the Supplemental Investment Fund. The stable value fund is managed to protect principal and provide competitive interest rates using instruments somewhat longer than typically found in money market-type accounts. The manager invests cash flows to optimize yields. The manager invests in high quality instruments diversified among traditional guaranteed investment contracts (GIC's) and alternative investment contracts with U.S. and non-U.S. financial institutions. To maintain necessary liquidity, the manager invests a portion of the portfolio in its Stable Return Fund and in cash equivalents. The Stable Return Fund is a large, daily priced fund consisting of a wide range of stable value instruments that is available to retirement plans of all sizes.

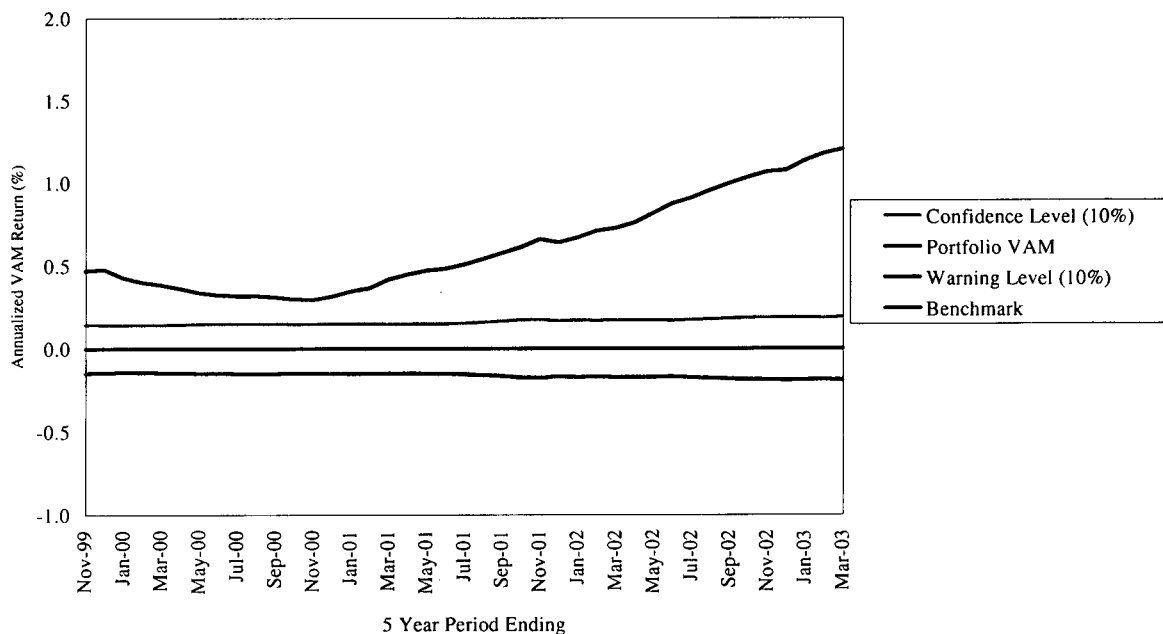
No comments at this time.

**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	1.2%	0.6%	No action required.
Last 1 year	5.5	2.9	
Last 2 years	5.9	3.5	
Last 3 years	6.0	4.3	
Last 4 years	6.1	4.8	
Last 5 years	6.1	4.9	
Since Inception (11/94)	6.4	5.5	

**Galliard Capital Management**  
**Rolling Five Year VAM**



**INTERNAL STOCK POOL - Trust/Non-Retirement Assets**  
**Periods Ending March, 2003**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$453,489,610**

**Investment Philosophy**  
**Environmental Trust Fund**  
**Permanent School Fund**  
**Tobacco Endowment Funds**

**Staff Comments**

The Internal Equity Pool is managed to closely track the S&P 500 Index. The strategy replicates the S&P 500 by owning all of the names in the index at weightings similar to those of the index. The optimization model's estimate of tracking error with this strategy is approximately 10 basis points per year.

The portfolio matched the index for the quarter and outperformed for the year. The positive tracking error for the one-year period was due to the timing of the high volume of trading in the index.

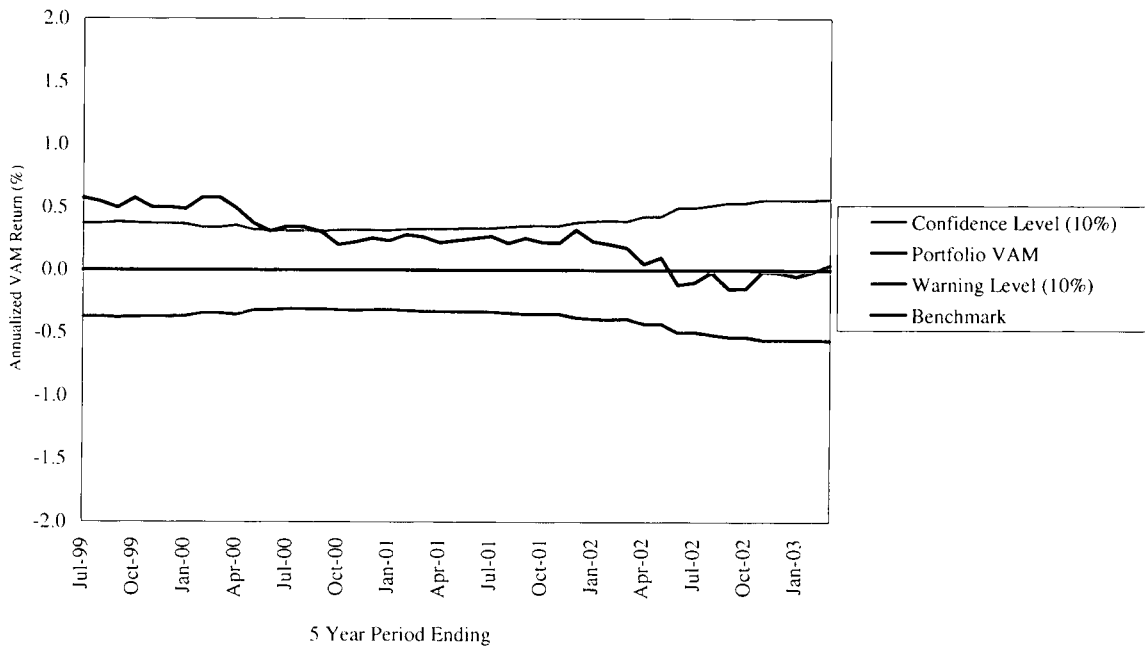
**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.1%	-3.1%
Last 1 year	-24.4	-24.8
Last 2 years	-13.1	-13.2
Last 3 years	-16.0	-16.1
Last 4 years	-8.5	-8.6
Last 5 years	-3.6	-3.8
Since Inception (7/93)	8.8	8.7

No action required.

**INTERNAL BOND POOL - TRUST/NON-RETIREMENT ASSETS**  
**Rolling Five Year VAM**



**INTERNAL BOND POOL - Income Share Account**  
**Periods Ending March, 2003**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$194,395,468**

**Investment Philosophy**  
**Income Share Account**

The investment approach emphasizes sector and security selection. The approach utilizes sector trading and relative spread analysis of both sectors and individual issues. The portfolio weightings in mortgage and corporate securities are consistently equal to or greater than the market weightings. The portfolio duration remains close to the benchmark duration but may be shortened or lengthened depending on changes in the economic outlook.

**Staff Comments**

The internal bond pool outperformed the quarterly benchmark. The outperformance was primarily due to an overweight in the corporate sector. An overweight in the telecommunications, cable, media and automotive sectors hurt the one-year performance.

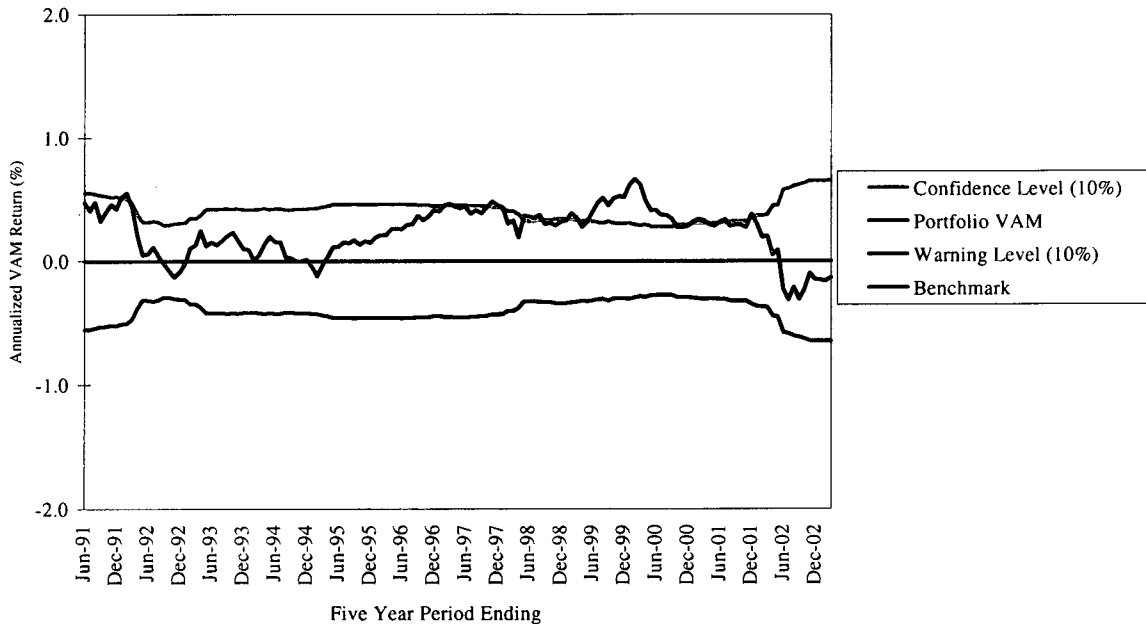
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.5%	1.4%
Last 1 year	10.2	11.7
Last 2 years	7.8	8.5
Last 3 years	9.3	9.8
Last 4 years	7.5	7.8
Last 5 years	7.4	7.5
Since Inception (7/86)	8.6	8.4

**Recommendation**

No action required.

**INTERNAL BOND POOL - INCOME SHARE ACCOUNT**  
**Rolling Five Year VAM**



**INTERNAL BOND POOL - Trust/Non-Retirement Assets**  
**Periods Ending March, 2003**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$348,912,140**

**Investment Philosophy**  
**Environmental Trust Fund**  
**Permanent School Trust Fund**  
**Tobacco Endowment Funds**

**Staff Comments**

The internal bond portfolio's investment approach emphasizes sector and security selection. The approach utilizes sector trading and relative spread analysis of both sectors and individual issues. The portfolio weightings in mortgage and corporate securities are consistently equal to or greater than the market weightings. The portfolio duration remains close to the benchmark duration but may be shortened or lengthened depending on changes in the economic outlook.

The internal bond pool outperformed the quarterly benchmark. The outperformance was primarily due to an overweight in the corporate sector. An overweight in the telecommunications, cable, media and automotive sectors hurt the one-year performance.

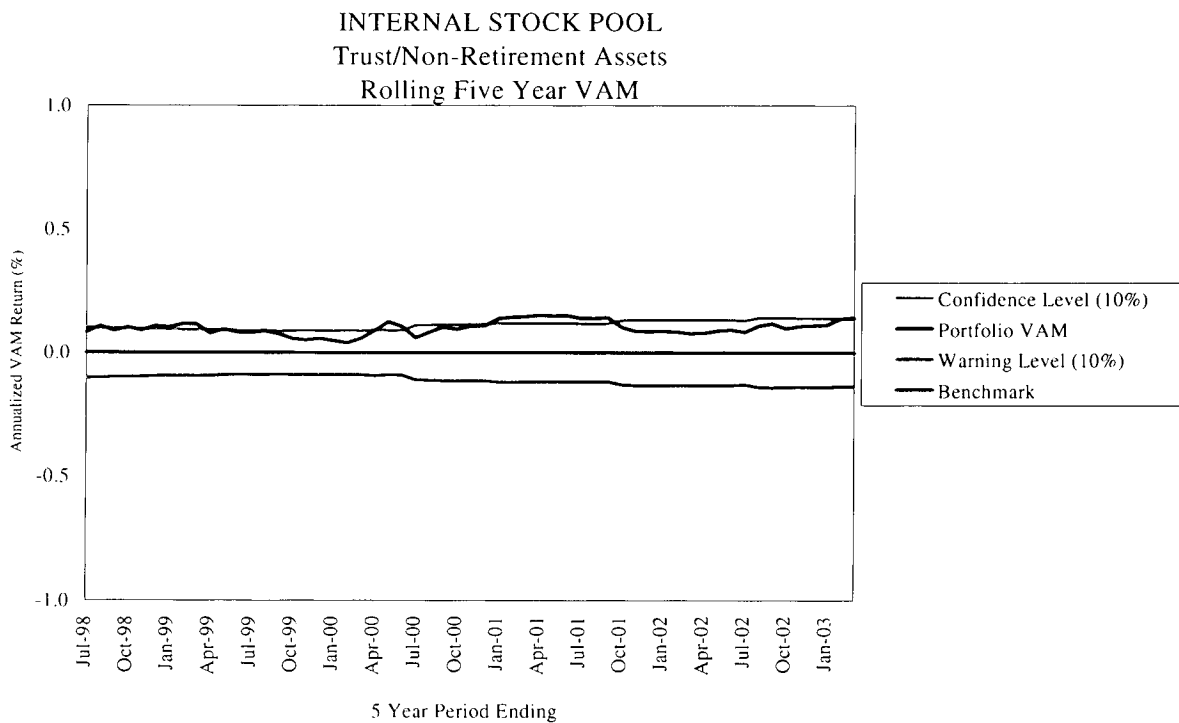
**Quantitative Evaluation**

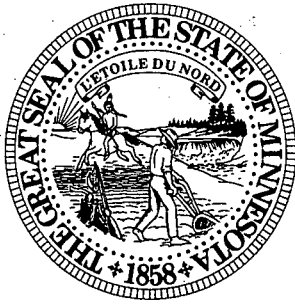
**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.7%	1.4%
Last 1 year	11.0	11.7
Last 2 years	8.3	8.5
Last 3 years	9.5	9.8
Last 4 years	7.8	7.8
Last 5 years	7.6	7.5
Since Inception (7/94)*	8.4	8.1

No action required.

\* Date started managing the Permanent School Fund against the Lehman Aggregate.





# STATE BOARD OF INVESTMENT

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## Deferred Compensation Plan Evaluation Reports

First Quarter, 2003



**MN STATE 457 DEFERRED COMPENSATION PLAN**  
**MUTUAL FUND MANAGERS**  
**Periods Ending March, 2003**

457 Mutual Funds	Quarter		1 Year		3 Years		5 Years		Since Retention by SBI*		State's Participation
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	%	%	In Fund (\$ millions)
<b>Large Cap Equity:</b>											
Janus Twenty (S&P 500)**	-0.5	-3.1	-19.8	-24.8	-30.0	-16.1	-2.7	-3.8	-16.6	-10.8	\$191.2
<b>Mid Cap Equity:</b>											
Morgan Stanley Mid-Cap Value Instl. (S&P Mid-Cap 400)	-5.1	-4.5	-33.0	-23.4	-12.4	-4.7	-1.9	3.7	-26.7	-14.9	\$8.10
<b>Small Cap Equity:</b>											
T. Rowe Price Small-Cap Stock (Russell 2000)**	-4.8	-4.5	-21.6	-27.0	-2.2	-11.0	0.9	-4.1	3.1	-4.6	\$212.5
<b>Equity Index:</b>											
Vanguard Institutional Index Plus (S&P 500)**	-3.1	-3.1	-24.7	-24.8	-16.0	-16.1	-3.7	-3.8	-10.7	-10.8	\$144.8
<b>Balanced:</b>											
INVESCO Total Return (60% S&P 500/40% Lehman Gov-Corp)**	-3.3	-1.3	-16.4	-11.3	-5.8	-6.9	-3.6	0.6	-7.5	-3.7	\$77.2
<b>Bond:</b>											
Dodge & Cox Income Fund (Lehman Aggregate)**	1.4	1.4	11.2	11.7	10.3	9.8	7.7	7.5	9.0	8.6	\$74.1
<b>International:</b>											
Fidelity Diversified International (MSCI EAFE-Free)**	-5.8	-8.2	-16.7	-23.0	-12.3	-19.5	0.6	-7.1	-1.9	-11.4	\$68.4

Numbers in black are returns since retention by SBI.

Numbers in blue include returns prior to retention by SBI.

\*Morgan Stanley was retained in January 2002; all others, July 1999.

\*\*Benchmarks for the Funds are noted in parentheses below the Fund names.

<b>Fixed Fund:</b>	%
Blended Yield Rate for current quarter***:	5.6
Bid Rates for current quarter:	
Great West Life	3.9
Minnesota Life	3.9
Principal Life	4.2

\*\*\*The Blended Yield Rate for the current quarter includes the return on the existing portfolio assets and also the Liquidity Buffer Account (money market). The Bid Rates for the current quarter determine the allocation of new cash flow.





**MN STATE 457 DEFERRED COMPENSATION PLAN  
LARGE CAP EQUITY - JANUS TWENTY  
Periods Ending March, 2003**

**Portfolio Manager: Scott W. Schoelzel**

**State's Participation in Fund: \$191,348,798  
Total Assets in Fund: \$9,069,747,000**

**Investment Philosophy  
Janus Twenty**

The investment objective of this fund is long-term growth of capital from increases in the market value of the stocks it owns. The fund will concentrate its investments in a core position of between twenty to thirty common stocks. This non-diversified fund seeks to invest in companies that the portfolio manager believes have strong current financial positions and offer growth potential.

**Staff Comments**

Janus outperformed the quarterly and one-year benchmark. An overweight position in healthcare services and strong stock selection in the financial services industry helped the Fund's performance for the quarter.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	-0.5%	-3.1%
Last 1 year	-19.8	-24.8
Last 2 years	-15.8	-13.2
Last 3 years	-30.0	-16.1
Last 4 years	-16.6	-8.6
Last 5 years	-2.7	-3.8
Since Retention by SBI (7/99)	-16.6	-10.8

**Recommendation**

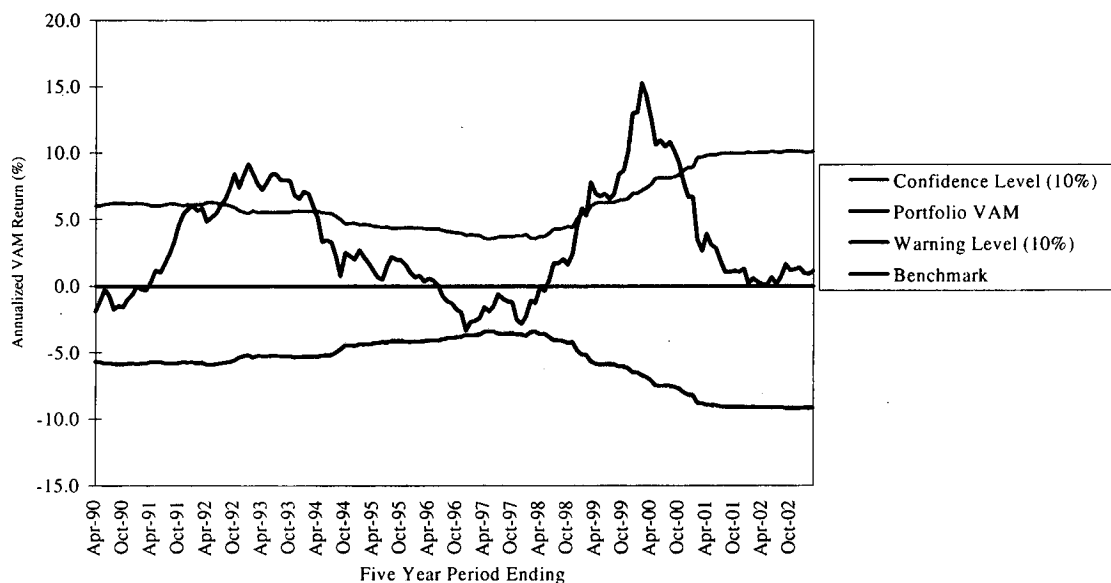
No action required.

\*Benchmark is the S&P 500.

Numbers in black are returns since retention by SBI.

Numbers in blue include returns prior to retention by SBI.

**LARGE CAP EQUITY - JANUS TWENTY  
Rolling Five Year VAM**



Note: Shaded area includes performance prior to managing SBI account.

**MN STATE 457 DEFERRED COMPENSATION PLAN  
MORGAN STANLEY MID-CAP VALUE INSTITUTIONAL  
Periods Ending March, 2003**

**Portfolio Manager: William Gerlach**

**State's Participation in Fund: \$8,101,597  
Total Assets in Fund: \$511,530,698**

**Investment Philosophy  
Morgan Stanley Mid-Cap Value Institutional**

The investment objective of this fund is capital growth. The strategy is to produce a portfolio that focuses on medium-sized companies that are viewed as undervalued. The fund normally invests in all economic sectors of the market and distinguishes itself through a value-driven approach to security selection, which combines quantitative and fundamental elements. Economic sector weights are normally kept within 5 percentage points of those of the S&P MidCap 400 Index. The fund focuses on companies with market capitalizations from \$500 million to \$5 billion.

**Staff Comments**

Morgan Stanley underperformed the benchmark for the quarter and one-year periods. The portfolio trailed the quarterly benchmark due to stock selection.

Morgan Stanley's VAM reflects the portfolio's top holdings that were impacted by corporate fraud and liquidity concerns in early 2002. Staff continues to monitor the fund.

**Quantitative Evaluation**

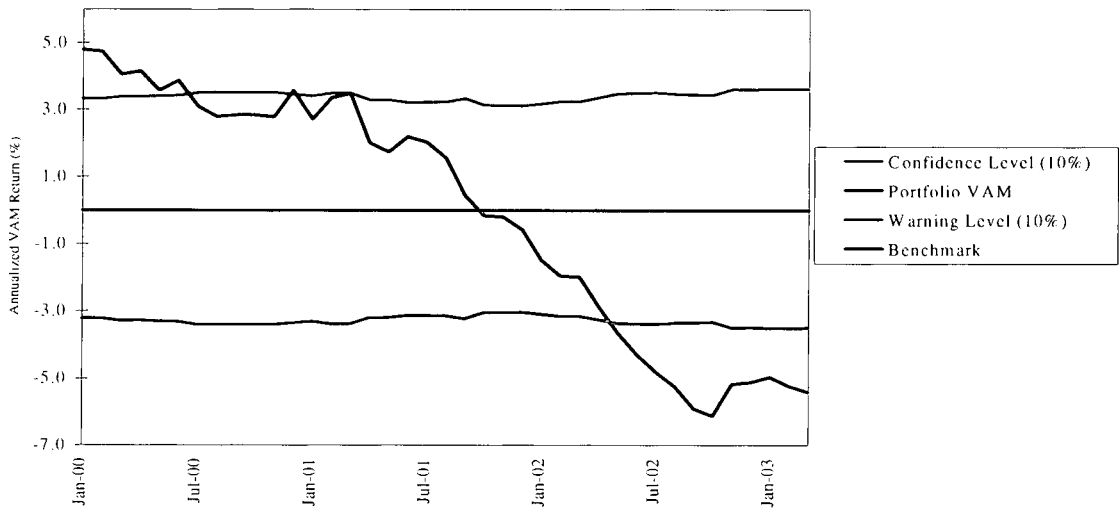
	Actual	Benchmark*
Last Quarter	-5.1%	-4.5%
Last 1 year	-33.0	-23.4
Last 2 years	-15.4	-4.3
Last 3 years	-12.4	-4.7
Last 4 years	-2.3	4.7
Last 5 years	-1.9	3.7
Since Retention		
By SBI	-26.7	-14.9
(1/02)		

**Recommendation**

No action required.

\*Benchmark is the S&P Midcap 400.  
Numbers in black are returns since retention by SBI.  
Numbers in blue include returns prior to retention by SBI.

**MID CAP EQUITY - MORGAN STANLEY  
Rolling Five Year VAM**



Note: Shaded area includes performance prior to managing SBI account.

**MN STATE 457 DEFERRED COMPENSATION PLAN**  
**SMALL CAP EQUITY – T. ROWE PRICE SMALL CAP STOCK FUND**  
**Periods Ending March, 2003**

**Portfolio Manager: Gregory A. McCrickard**

**State's Participation in Fund: \$212,475,914**  
**Total Assets in Fund: \$3,360,870,179**

**Investment Philosophy**  
**T. Rowe Price Small Cap Equity Fund**

The strategy of this fund is to invest primarily in stocks of small to medium-sized companies that are believed to offer either superior earnings growth or appear undervalued. The fund normally invests at least 80% of assets in equities traded in the U.S over-the-counter market. The manager does not favor making big bets on any particular sector or any particular stock. The fund's combination of growth and value stocks offers investors relatively more stable performance compared to other small cap stock funds.

**Staff Comments**

T. Rowe-Price was hurt during the quarter by an overweight in the industrials and business services sector. The one-year outperformance was due to strong stock selection in a variety of sectors.

**Quantitative Evaluation**

	Actual	Benchmark*
Last Quarter	-4.8%	-4.5%
Last 1 year	-21.6	-27.0
Last 2 years	-2.3	-8.7
Last 3 years	-2.2	-11.0
Last 4 years	6.5	-0.8
Last 5 years	0.9	-4.1
Since Retention by SBI (7/99)	3.1	-4.6

**Recommendation**

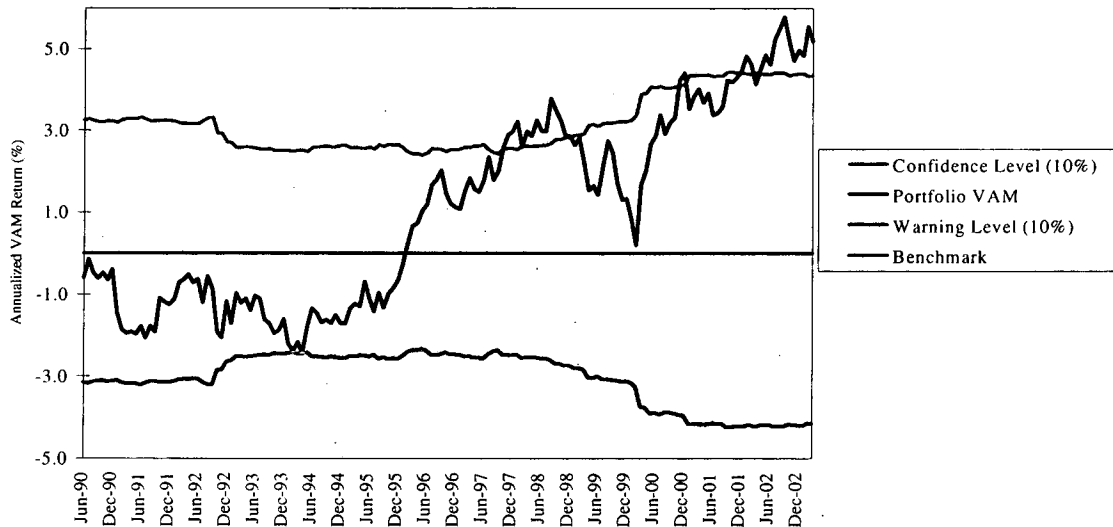
No action required.

\*Benchmark is the Russell 2000.

Numbers in black are returns since retention by SBI.

Numbers in blue include returns prior to retention by SBI.

**SMALL CAP EQUITY - T. ROWE PRICE SMALL CAP EQUITY FUND**  
**Rolling Five Year VAM**



Five Year Period Ending  
 Note: Shaded area includes performance prior to managing SBI account.

**MN STATE 457 DEFERRED COMPENSATION PLAN  
EQUITY INDEX – VANGUARD INSTITUTIONAL INDEX PLUS  
Periods Ending March, 2003**

**Portfolio Manager: George U. Sauter**

**State's Participation in Fund: \$144,833,084  
Total Assets in Fund: \$8,370,301,000**

**Investment Philosophy  
Vanguard Institutional Index**

This fund attempts to provide investment results, before fund expenses, that parallel the performance of the Standard & Poor's 500 Index. The fund invests in all 500 stocks listed in the S&P 500 index in approximately the same proportions as they are represented in the index. The managers have tracked the S&P 500's performance with a high degree of accuracy. The fund may use futures and options for temporary purposes, but generally remains fully invested in common stock.

**Staff Comments**

No comment at this time.

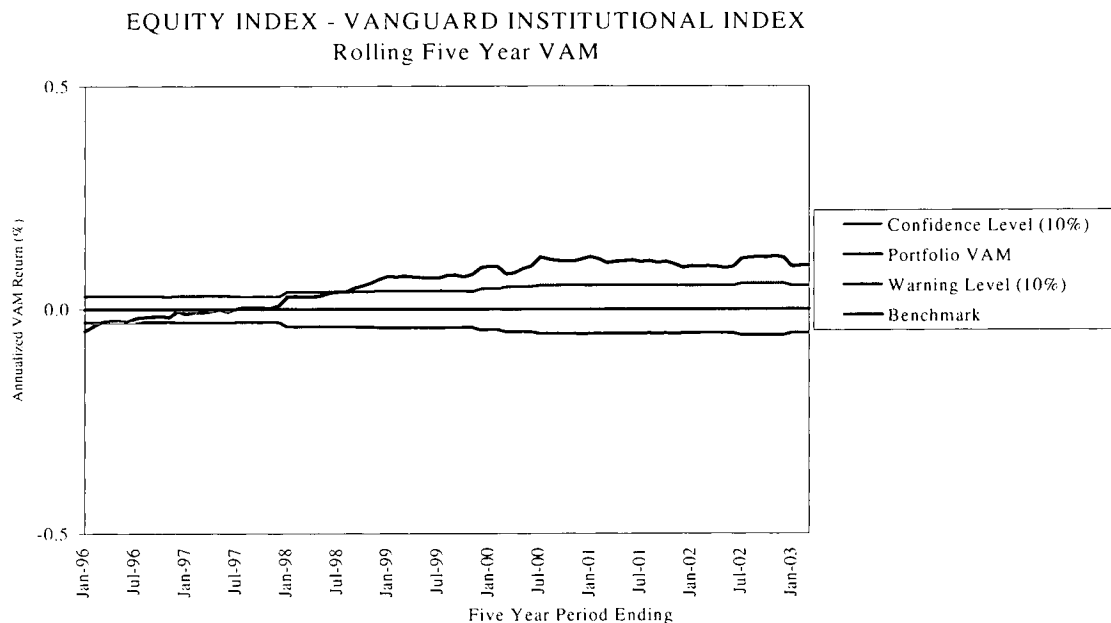
**Quantitative Evaluation**

	Actual	Benchmark*
Last Quarter	-3.1%	-3.1%
Last 1 year	-24.7	-24.8
Last 2 years	-13.1	-13.2
Last 3 years	-16.0	-16.1
Last 4 years	-8.6	-8.6
Last 5 years	-3.7	-3.8
Since Retention by SBI (7/99)	-10.7	-10.8

**Recommendation**

No action required.

\*Benchmark is the S&P 500.  
Numbers in black are returns since retention by SBI.  
Numbers in blue include returns prior to retention by SBI.



Note: Shaded area includes performance prior to managing SBI account.

**MN STATE 457 DEFERRED COMPENSATION PLAN  
BALANCED – INVESCO TOTAL RETURN  
Periods Ending March, 2003**

**Portfolio Manager: Charlie Mayer**

**State's Participation in Fund: \$77,230,029  
Total Assets in Fund: \$760,200,000**

**Investment Philosophy  
Invesco Total Return**

This fund is designed for investors who want to invest in a mix of stocks and bonds in the same fund. The fund seeks both capital appreciation and current income. The managers start from a 60% stock / 40% bond asset allocation and adjusts the mix based on the expected risks and returns of each asset class. The fund invests in mid- to large-cap value stocks and in high quality bonds with the bond portfolio having a duration somewhat less than the bond market as a whole.

**Staff Comments**

INVESCO trailed the quarterly and one-year benchmark. The fund's telecommunications services and basic materials stocks hurt the quarterly return. The one-year return was negatively impacted by the telecommunications and technology positions.

Staff continues to closely monitor the fund.

**Quantitative Evaluation**

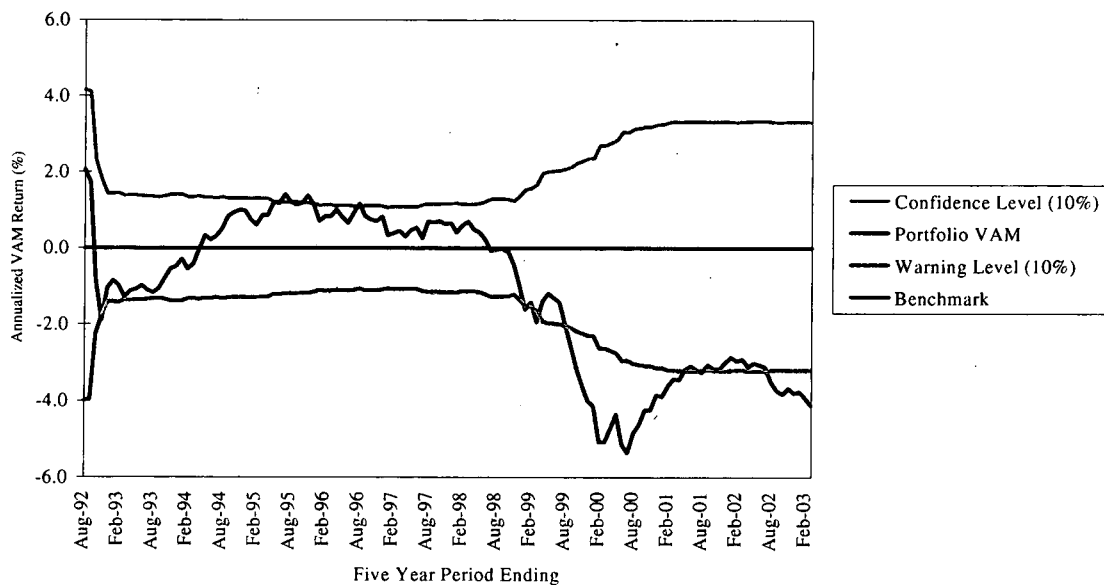
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	-3.3%	-1.3%
Last 1 year	-16.4	-11.3
Last 2 years	-6.7	-4.5
Last 3 years	-5.8	-6.9
Last 4 years	-5.1	-2.6
Last 5 years	-3.6	0.6
Since Retention by SBI (7/99)	-7.5	-3.7

**Recommendation**

No action required.

\*Benchmark is the 60% S&P 500/ 40% Lehman Gov-Corp.  
Numbers in black are returns since retention by SBI.  
Numbers in blue include returns prior to retention by SBI.

**BALANCED - INVESCO TOTAL RETURN  
Rolling Five Year VAM**



Note: Shaded area includes performance prior to managing SBI account.

**MN STATE 457 DEFERRED COMPENSATION PLAN  
BOND – DODGE & COX INCOME FUND  
Periods Ending March, 2003**

**Portfolio Manager: Dana Emery**

**State's Participation in Fund: \$74,105,782  
Total Assets in Fund: \$4,091,185,425**

**Investment Philosophy  
Dodge & Cox Income Fund**

The objective of this fund is a high and stable rate of current income with capital appreciation being a secondary consideration. This portfolio is invested primarily in intermediate term, investment-grade quality corporate and mortgage bonds and, to a lesser extent, government issues. While the fund invests primarily in the U. S. bond market, it may invest a small portion of assets in dollar-denominated foreign securities. The duration of the portfolio is kept near that of the bond market as a whole.

**Staff Comments**

Dodge and Cox matched the benchmark for the quarter.

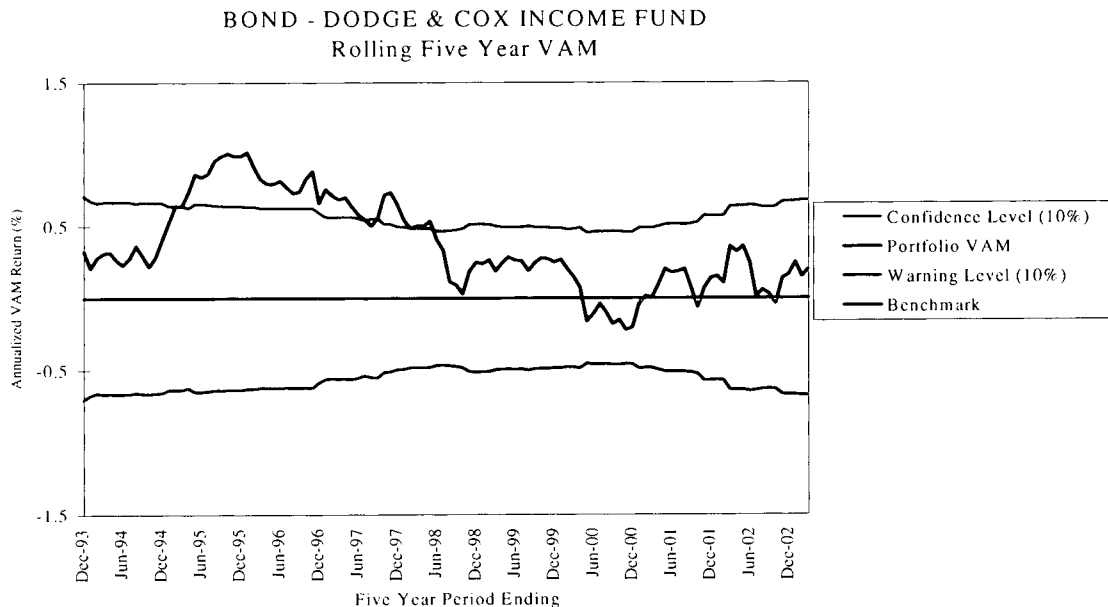
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	1.4%	1.4%
Last 1 year	11.2	11.7
Last 2 years	9.3	8.5
Last 3 years	10.3	9.8
Last 4 years	8.1	7.8
Last 5 years	7.7	7.5
Since Retention By SBI (7/99)	9.0	8.6

**Recommendation**

No action required.

\*Benchmark is the Lehman Aggregate.  
Numbers in black are returns since retention by SBI.  
Numbers in blue include returns prior to retention by SBI.



Note: Shaded area includes performance prior to managing SBI account.

**MN STATE 457 DEFERRED COMPENSATION PLAN  
INTERNATIONAL – FIDELITY DIVERSIFIED INTERNATIONAL  
Periods Ending March, 2003**

**Portfolio Manager: William Bower**

**State's Participation in Fund: \$68,410,562  
Total Assets in Fund: \$7,137,098,258**

**Investment Philosophy  
Fidelity Diversified International**

The goal of this fund is capital appreciation by investing in securities of companies located outside of the United States. While the fund invests primarily in stocks, it may also invest in bonds. Most investments are made in companies that have a market capitalization of \$100 million or more and which are located in developed countries. To select the securities, the fund utilizes a rigorous computer-aided quantitative analysis supplemented by relevant economic and regulatory factors. The manager rarely invests in currency to protect the account from exchange fluctuations.

**Staff Comments**

Fidelity exceeded the quarterly benchmark due to strong stock selection in the poorly performing financial sector. The one-year outperformance was due to the strong stock selection across all sectors, particularly the financial sector.

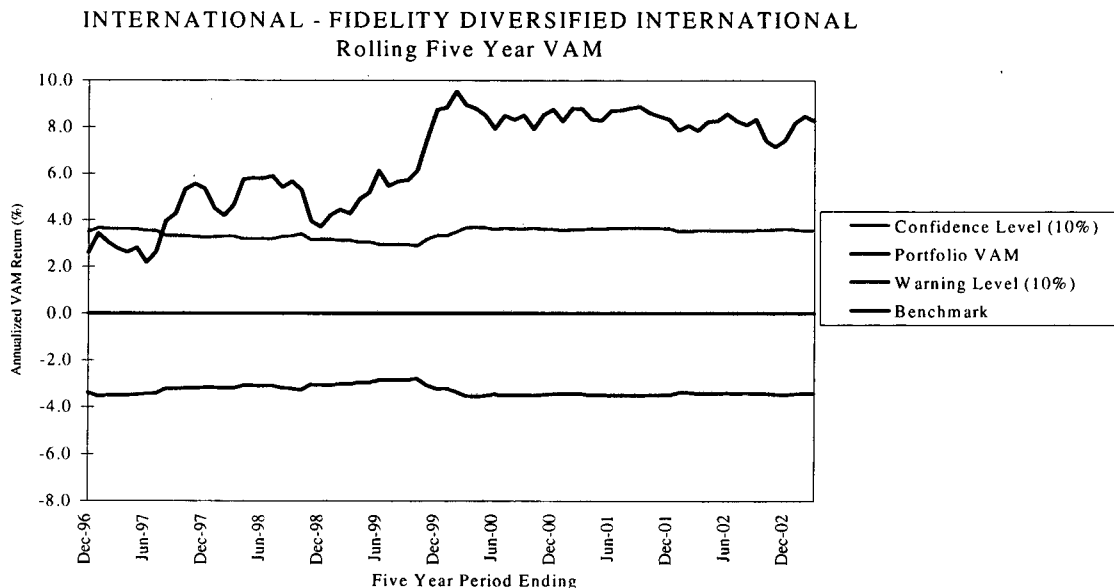
**Quantitative Evaluation**

	Actual	Benchmark*
Last Quarter	-5.8%	-8.2%
Last 1 year	-16.7	-23.0
Last 2 years	-8.3	-16.1
Last 3 years	-12.3	-19.5
Last 4 years	-0.2	-10.1
Last 5 years	0.6	-7.1
Since Retention By SBI (7/99)	-1.9	-11.4

**Recommendation**

No action required.

\*Benchmark is the MSCI EAFE-Free.  
Numbers in black are returns since retention by SBI.  
Numbers in blue include returns prior to retention by SBI.



**MN STATE 457 DEFERRED COMPENSATION PLAN  
MN FIXED FUND  
Periods Ending March, 2003**

**Total Assets in MN Fixed Fund: \$419,056,018 \***

**Total Assets in 457 Plan: \$636,648,982 \*\***

\*Includes \$14-18M in Liquidity Buffer Account

\*\*Includes all assets in new and old fixed options

**Principal Life**

**Investment Philosophy**

**Ratings:** Moody's            Aa2  
                 S&P                        AA  
                 A.M. Best                A+  
                 Duff & Phelps            AA+

The manager invests in fixed income securities, commercial mortgages, mortgage-backed securities and residential whole loans, with lesser amounts invested in stock, cash equivalents and direct real estate. The manager relies upon in-house analysis and prefers investments that offer more call protection. The manager strongly prefers private placements to corporate bonds in the belief that private placements offer higher yields and superior protective covenants compared to public bonds. A portion of the fixed income portfolio is invested in US dollar-denominated foreign corporate bonds. Mortgage-backed bonds are actively managed to prices at or below par to reduce prepayment risk. Conservative underwriting standards, small loan sizes and an emphasis on industrial properties minimizes commercial loan risk.

**Assets in MN Fixed Fund: \$103,195,639**

**Minnesota Life**

**Investment Philosophy**

**Ratings:** Moody's            Aa2  
                 S&P                        AA+  
                 A.M. Best                A++  
                 Duff & Phelps            AA+

Investment decisions support an asset/liability match for the company's many product lines. A conservative investment philosophy uses a number of active and passive investment strategies to manage general account assets and cash flow. Assets are primarily invested in a widely diversified portfolio of high quality fixed income investments that includes public and private corporate bonds, commercial mortgages, residential mortgage securities and other structured investment products, providing safety of principal and stable, predictable cash flow to meet liabilities and to invest in and produce consistent results in all phases of the economic cycle.

**Assets in MN Fixed Fund: \$115,255,822**

**Assets in Prior MN 457 Plan: \$89,798,546**

**Total Assets: \$205,054,368**

**Great-West Life**

**Investment Philosophy**

**Ratings:** Moody's            Aa2  
                 S&P                        AA+  
                 A.M. Best                A++  
                 Duff & Phelps            AAA

The Company observes strict asset/liability matching guidelines to ensure that the investment portfolio will meet the cash flow and income requirements of its liabilities. The manager invests in public and privately placed corporate bonds, government and international bonds, common stocks, mortgage loans, real estate, redeemable preferred stocks and short-term investments. To reduce portfolio risk, the manager invests primarily in investment grade fixed maturities rated by third-party rating agencies or by the manager if private placements. Mortgage loans reflect a broadly diversified portfolio of commercial and industrial mortgages subject to strict underwriting criteria.

**Assets in MN Fixed Fund: \$82,060,892**

**Assets in Prior MN 457 Plan: \$127,794,419**

**Total Assets: \$209,855,311**



**MN STATE 457 DEFERRED COMPENSATION PLAN  
MN FIXED FUND  
Periods Ending March, 2003**

**Current Quarter**

**Dollar Amount of Bid: \$34,500,000**

**Blended Rate: 5.56%**

**Bid Rates:**

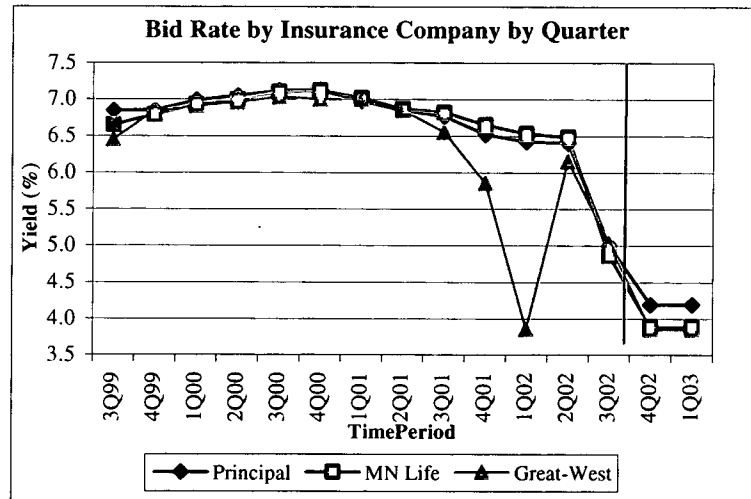
Principal Life	4.19%	Contracts were renewed in June 2002. Bid rates are now effective for five years on <u>new</u> cashflows. The bid rate bands were narrowed to 8 b.p. from 10 b.p. and additional scenarios were added. All changes were effective for 3Q 2002 bids.
Minnesota Life	3.88%	
Great-West Life	3.85%	

**Dollar Amount in existing**

**Minnesota Life portfolio: \$89,798,546**

**Rate on existing**

**Minnesota Life portfolio: 5.56 %**



**Staff Comments on Bid Rates**

The line on the graph indicates when the contracts were renewed and the bid rates for the new cash flows became effective for five year periods. Prior to that, the bids were effective for a quarter for the total portfolio.

**Staff Comments**

	<b>2Q02</b>	<b>3Q02</b>	<b>4Q02</b>	<b>1Q03</b>	
Principal Life	40.0%	40.0%	40.0%	100.0%	For the first quarter, Principal received all of the bid dollars since their bid was 25 b.p. higher than Minnesota Life's bid and Great West Life's bid.
Minnesota Life	40.0%	30.0%	30.0%	0.0%	
Great-West Life	20.0%	30.0%	30.0%	0.0%	

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## COMMITTEE REPORT

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DATE: May 27, 2003

TO: Members, State Board of Investment  
Members, Investment Advisory Council

FROM: **Alternative Investment Committee**

The Alternative Investment Committee met on May 15, 2003 to review the following information and action agenda items:

- Review of current strategy
- Discussion related to recommendations from the Asset Allocation Committee
- New investments with two existing private equity managers, Goldman Sachs and Piper Jaffray.

**Board/IAC action is required on the last item.**

### INFORMATION ITEMS:

#### 1) Review of Current Strategy.

To increase overall portfolio diversification, 15% of the Basic Retirement Funds and 5% of the Post Retirement Fund are allocated to alternative investments. Alternative investments include real estate, private equity and resource investments where Minnesota State Board of Investment (SBI) participation is limited to commingled funds or other pooled vehicles. Charts summarizing the Board's current commitments are attached (see **Attachments A and B**).

#### **Basic Funds**

- The real estate investment strategy calls for the establishment and maintenance of a broadly diversified real estate portfolio comprised of investments that provide overall diversification by property type and location. The main component of this portfolio consists of investments in diversified Real Estate Investment Trusts (REITs), open-end commingled funds and closed-end commingled funds. The remaining portion of the portfolio can include investments in less diversified, more focused (specialty) commingled funds and REITs.

- The private equity investment strategy is to establish and maintain a broadly diversified private equity portfolio comprised of investments that provide diversification by industry type, stage of corporate development and location.
- The strategy for resource investment is to establish and maintain a portfolio of resource investment vehicles that are specifically designed for institutional investors to provide an inflation hedge and additional diversification. Individual resource investments will include proved producing oil and gas properties, royalties and other investments that are diversified geographically and by type.

### **Post Fund**

- The Post Fund assets allocated to alternative investments will be invested separately from the Basic Funds' alternative investments to assure that returns are accounted for appropriately. Since the Post Fund invests the retired employees' pension assets, an allocation to yield oriented alternative investments will be emphasized. The Basic Retirement Funds' invest the active employees' pension assets and have less concern regarding the current yield for their alternative investments.

## **2) Discussion related to recommendations from the Asset Allocation Committee**

The Committee discussed the Asset Allocation Review Paper on **page 7 of Tab E**. There was a review and discussion regarding the pooling of alternative investments for the Basic and Post Retirement Funds. The Committee supported the recommendations of the Asset Allocation Committee as presented in the Asset Allocation Review Paper.

## **ACTION ITEMS**

### **1) Investment with an existing private equity manager, Goldman Sachs, in GS Mezzanine Partners III, L.P.**

Goldman Sachs is seeking investors for a new \$1 billion mezzanine debt fund. This fund is a successor to other similar mezzanine debt funds managed by Goldman Sachs. The SBI has invested in a prior Goldman Sachs mezzanine debt fund. This fund, like the prior fund, will seek to earn attractive returns through investments in mezzanine securities.

More information on GS Mezzanine Partners III, L.P., is included as **Attachment C**.

**RECOMMENDATION:**

The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$75 million or 20%, whichever is less, in GS Mezzanine Partners III, L.P. This commitment is contingent upon changes to the asset allocation parameters for the Basic and Post Retirement Funds. These changes are expected to be recommended to the SBI for approval at its June 2003 meeting. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment nor its Executive Director have any liability for reliance by Goldman Sachs upon this approval. Until a formal agreement is executed by the Executive Director on behalf of the SBI, further due diligence and negotiations may result in the imposition of additional terms and conditions on Goldman Sachs or reduction or termination of the commitment.

**2) Investment with an existing private equity manager, Piper Jaffray, in Piper Jaffray Healthcare Fund IV, L.P.**

Piper Jaffray is seeking investors for a new \$30 to \$50 million healthcare private equity fund. This fund is a successor to other similar healthcare private equity funds managed by Piper Jaffray. The SBI has invested in prior Piper Jaffray healthcare private equity funds. This fund, like the prior funds, will seek to earn attractive returns through investments in healthcare companies.

More information on Piper Jaffray Healthcare Fund IV, L.P. is included as **Attachment D**.

**RECOMMENDATION:**

The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$10 million or 20%, whichever is less, in Piper Jaffray Healthcare Fund IV, L.P. This commitment is contingent upon changes to the asset allocation parameters for the Basic and Post Retirement Funds. These changes are expected to be recommended to the SBI for approval at its June 2003 meeting. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment nor its Executive Director have any liability for reliance by Piper Jaffray upon this approval. Until a formal agreement is executed by the Executive Director on behalf of the SBI, further due diligence and negotiations may result in the imposition of additional terms and conditions on Piper Jaffray or reduction or termination of the commitment.

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**ATTACHMENT A**

**Minnesota State Board of Investment**  
*Alternative Investments*  
*Basic Retirement Funds*  
*March 31, 2003*

Market Value of Basic Retirement Funds	\$15,256,573,668
Amount Available for Investment	<b>\$0</b>

	Current Level	Target Level	Difference
Market Value	\$2,231,809,654	\$2,288,486,050	\$56,676,397
MV +Unfunded	\$3,333,282,521	\$3,051,314,734	(\$281,967,787)

Asset Class	Market Value	Unfunded Commitment	Total
Real Estate	\$594,539,938	\$36,614,435	\$631,154,373
Private Equity	\$1,386,281,185	\$991,228,644	\$2,377,509,829
Resource	\$250,988,530	\$73,629,789	\$324,618,319
<b>Total</b>	\$2,231,809,654	\$1,101,472,867	\$3,333,282,521

**Minnesota State Board of Investment**  
*Alternative Investments*  
*Post Retirement Funds*  
*March 31, 2003*

Market Value of Post Retirement Funds	\$14,852,595,733
Amount Available for Investment	<b>\$22,457,006</b>

	Current Level	Target Level	Difference
Market Value	\$720,172,781	\$742,629,787	\$22,457,006
MV +Unfunded	\$1,183,784,772	\$1,485,259,573	\$301,474,801

Asset Class	Market Value	Unfunded Commitment	Total
Real Estate	\$183,647,176	\$95,727,540	\$279,374,716
Private Equity	\$422,168,745	\$303,316,889	\$725,485,634
Resource	\$114,356,860	\$64,567,562	\$178,924,422
<b>Total</b>	<b>\$720,172,781</b>	<b>\$463,611,991</b>	<b>\$1,183,784,772</b>



# ATTACHMENT B

## Minnesota State Board of Investment - Alternative Investment -

As of March 31, 2003

Investment	Total Commitment	Funded Commitment	Market Value	Distributions	Unfunded Commitment	IRR %	Period Years
<b>Real Estate-Basic</b>							
<b>Colony Capital</b>							
Colony Investors II	40,000,000	39,241,164	2,747,505	40,407,900	758,836	3.57	8.00
Colony Investors III	100,000,000	100,000,000	52,264,095	70,819,470	0	8.72	5.25
Equity Office Properties Trust	140,388,854	140,388,854	50,224,149	273,089,979	0	15.51	11.34
Heitman Fund V	20,000,000	20,000,000	7,882,154	24,621,419	0	7.64	11.32
Lasalle Income Parking Fund	15,000,000	14,644,401	6,044,749	22,320,922	355,599	11.35	11.53
Lend Lease Real Estate Investments	40,000,000	40,000,000	141,998,899	5,060,882	0	6.41	21.47
<b>T.A. Associates Realty</b>							
Realty Associates Fund III	40,000,000	40,000,000	47,140,998	36,905,136	0	12.32	8.83
Realty Associates Fund IV	50,000,000	50,000,000	54,742,191	29,620,347	0	12.21	6.16
Realty Associates Fund V	50,000,000	50,000,000	52,846,933	11,533,433	0	9.37	3.85
Realty Associates Fund VI	50,000,000	14,500,000	14,535,409	172,548	35,500,000	N/A	0.76
UBS Realty	42,376,529	42,376,529	163,692,955	0	0	7.22	20.92
Funds in Liquidation (AEW III & V, First Asset Realty Fund, Heitman I, II & III, RREEF III)	180,916,185	180,916,185	419,902	260,282,429	0	N/A	N/A
<b>Real Estate-Basic Total</b>	<b>768,681,568</b>	<b>732,067,133</b>	<b>594,539,938</b>	<b>774,834,465</b>	<b>36,614,435</b>		
<b>Real Estate-Post</b>							
Carbon Capital	50,000,000	17,323,730	17,479,781	1,041,553	32,676,270	N/A	0.88
Colony Investors II	40,000,000	39,241,164	2,747,505	40,407,900	758,836	3.57	8.00
CT Mezzanine Partners	100,000,000	38,035,013	38,804,233	6,485,714	61,964,987	19.97	1.52
Equity Office Properties Trust	117,673,360	117,673,360	50,224,149	78,533,883	0	9.26	1.99
<b>GMAC Institutional Advisors</b>							
Institutional Commercial Mortgage Fund II	13,500,000	13,397,500	4,769,309	16,299,335	102,500	9.84	7.68
Institutional Commercial Mortgage Fund III	21,500,000	21,275,052	19,643,567	11,458,640	224,948	8.50	6.33
Institutional Commercial Mortgage Fund IV	14,300,000	14,300,000	13,416,259	5,887,301	0	8.37	5.25
Institutional Commercial Mortgage Fund V	37,200,000	37,200,000	36,562,372	8,460,878	0	9.02	3.66
<b>Real Estate-Post Total</b>	<b>394,173,360</b>	<b>298,445,820</b>	<b>183,647,176</b>	<b>168,575,203</b>	<b>95,727,540</b>		
<b>Real Estate Total</b>	<b>1,162,854,928</b>	<b>1,030,512,953</b>	<b>778,187,114</b>	<b>943,409,669</b>	<b>132,341,975</b>		

Minnesota State Board of Investment  
- Alternative Investment -

As of March 31, 2003

Investment	Total Commitment	Funded Commitment	Market Value	Distributions	Unfunded Commitment	IRR %	Period Years
<b>Private Equity-Basic</b>							
<b>Bank Fund</b>							
<i>Banc Fund IV</i>	25,000,000	25,000,000	30,644,025	13,889,766	0	12.46	7.12
<i>Banc Fund V</i>	48,000,000	48,000,000	55,776,576	6,417,818	0	10.04	4.71
<b>Blackstone Capital Partners</b>							
<i>Blackstone Capital Partners II</i>	50,000,000	47,271,190	22,878,665	71,655,149	2,728,810	34.67	9.35
<i>Blackstone Capital Partners IV</i>	70,000,000	4,655,228	4,655,228	0	65,344,772	N/A	0.72
<b>BLUM Capital Partners</b>							
<i>Blum Strategic Partners I</i>	50,000,000	49,635,460	37,241,130	21,190,374	364,540	3.79	4.27
<i>Blum Strategic Partners II</i>	50,000,000	20,150,724	19,203,203	828,951	29,849,276	-0.43	1.70
<b>Churchill Capital Partners II</b>	20,000,000	20,000,000	3,740,582	23,475,376	0	10.29	10.42
<b>Citigroup Venture Capital Equity Partners</b>	100,000,000	27,549,074	25,521,352	226,356	72,450,926	-6.84	1.30
<b>Contrarian Capital Fund II</b>	37,000,000	33,244,395	27,961,677	5,553,178	3,755,605	0.12	5.83
<b>Coral Partners</b>							
<i>Coral Partners Fund II</i>	10,000,000	8,069,315	599,041	36,117,047	1,930,685	24.92	12.68
<i>Coral Partners Fund IV</i>	15,000,000	15,000,000	6,745,941	10,744,034	0	4.16	8.69
<i>Coral Partners Fund V</i>	15,000,000	14,250,000	8,129,278	152,481	750,000	-17.12	4.79
<b>Crescendo</b>							
<i>Crescendo II</i>	15,000,000	15,000,000	2,448,898	20,347,039	0	24.11	6.24
<i>Crescendo III</i>	25,000,000	25,000,000	4,680,308	8,084,795	0	-27.92	4.40
<i>Crescendo IV</i>	101,500,000	68,512,500	21,285,258	292,567	32,987,500	-41.34	3.06
<b>DLJ</b>							
<i>DLJ Merchant Banking Partners III</i>	125,000,000	63,488,738	53,950,462	10,109,468	61,511,262	-5.00	2.50
<i>DLJ Strategic Partners</i>	100,000,000	57,586,543	50,458,154	13,768,892	42,413,457	8.81	2.19
<b>DSV Partners IV</b>	10,000,000	10,000,000	1,262,297	27,596,934	0	9.52	17.97
<b>First Century Partners III</b>	10,000,000	10,000,000	1,122,223	14,955,832	0	8.09	18.29
<b>Fox Paine Capital Fund</b>							
<i>Fox Paine Capital Fund</i>	40,000,000	40,000,000	38,513,720	0	0	-1.11	4.94
<i>Fox Paine Capital Fund II</i>	50,000,000	11,177,538	8,455,617	0	38,822,462	-24.90	2.75
<b>Golder, Thoma, Cressey, Rauner</b>							
<i>Golder, Thoma, Cressey Fund III</i>	14,000,000	14,000,000	4,364,253	55,950,902	0	30.16	15.42
<i>Golder, Thoma, Cressey &amp; Rauner Fund IV</i>	20,000,000	20,000,000	608,500	40,757,528	0	24.94	9.16
<i>Golder, Thoma, Cressey &amp; Rauner Fund V</i>	30,000,000	30,000,000	22,200,166	19,459,194	0	8.37	6.75
<b>GTCR Golder Rauner</b>							
<i>GTCR VI</i>	90,000,000	89,137,778	41,170,058	49,263,209	862,222	0.79	4.75
<i>GTCR Fund VII</i>	175,000,000	121,734,375	101,699,330	34,299,153	53,265,625	8.13	3.14
<b>GS Capital Partners 2000</b>	50,000,000	26,512,162	23,645,375	0	23,487,838	-9.93	2.58
<b>GHJM Marathon Fund IV</b>	40,000,000	29,881,000	27,146,022	0	10,119,000	-7.04	3.96
<b>Hellman &amp; Friedman</b>							
<i>Hellman &amp; Friedman Capital Partners III</i>	40,000,000	32,113,684	6,785,657	55,563,011	7,886,316	33.37	8.53
<i>Hellman &amp; Friedman Capital Partners IV</i>	150,000,000	75,688,639	49,528,694	36,659,565	74,311,361	14.35	3.24
<b>Kohlberg Kravis Roberts</b>							
<i>KKR 1986 Fund</i>	18,365,339	18,365,339	13,807,253	202,833,867	0	28.09	16.96
<i>KKR 1987 Fund</i>	145,950,000	145,373,652	61,432,003	333,688,629	576,348	8.83	15.35
<i>KKR 1993 Fund</i>	150,000,000	150,000,000	30,543,219	261,374,656	0	16.26	9.28
<i>KKR 1996 Fund</i>	200,000,000	199,999,988	188,007,437	99,681,129	12	9.31	6.58
<i>KKR Millenium Fund</i>	200,000,000	14,942,000	13,963,000	0	185,058,000	N/A	0.31
<b>Lumina Ventures</b>	30,000,000	2,250,000	1,961,546	0	27,750,000	N/A	0.40
<b>Piper Jaffray Healthcare</b>							
<i>Piper Jaffray Healthcare Fund II</i>	10,000,000	9,900,000	8,201,067	1,648,415	100,000	-0.13	6.08
<i>Piper Jaffray Healthcare Fund III</i>	20,000,000	17,600,002	12,549,909	1,894,843	2,399,998	-8.05	4.19
<b>Summit Ventures V</b>	25,000,000	20,625,000	10,105,783	9,124,562	4,375,000	-2.69	5.00
<b>T. Rowe Price</b>	534,871,465	534,871,465	28,893,360	503,587,447	0	-1.75	N/A
<b>Thoma Cressey</b>							
<i>Thoma Cressey Fund VI</i>	35,000,000	33,565,000	21,748,138	2,948,483	1,435,000	-10.70	4.61
<i>Thoma Cressey Fund VII</i>	50,000,000	11,000,000	11,456,280	0	39,000,000	3.76	2.60
<b>Vestar Capital Partners IV</b>	55,000,000	20,057,371	17,861,631	10,821	34,942,629	-6.38	3.29
<b>Warburg Pincus</b>							
<i>Warburg, Pincus Equity Partners</i>	100,000,000	100,000,000	64,467,094	26,695,040	0	-3.81	4.76
<i>Warburg, Pincus Ventures</i>	50,000,000	50,000,000	50,170,871	183,111,548	0	50.35	8.25
<i>Warburg Pincus Private Equity VIII</i>	100,000,000	24,000,000	23,441,128	2,679,500	76,000,000	N/A	0.96
<b>Welsh, Carson, Anderson &amp; Stowe</b>							
<i>Welsh, Carson, Anderson &amp; Stowe VIII</i>	100,000,000	97,000,000	51,490,413	0	3,000,000	-17.31	4.68
<i>Welsh, Carson, Anderson &amp; Stowe IX</i>	125,000,000	67,500,000	55,416,353	0	57,500,000	-15.22	2.76
<b>William Blair Capital Partners</b>	50,000,000	16,450,000	15,604,042	0	33,550,000	-4.73	2.06
Funds in Liquidation (Brinson I & II, Coral I, Matrix II & III, Summit I & II, and Zell/Chilmark)							
	122,011,923	119,311,923	2,738,968	345,688,194	2,700,000		
<b>Private Equity-Basic Total</b>	3,696,698,727	2,705,470,083	1,386,281,185	2,552,325,753	991,228,644		

Minnesota State Board of Investment  
- Alternative Investment -

As of March 31, 2003

Investment	Total Commitment	Funded Commitment	Market Value	Distributions	Unfunded Commitment	IRR %	Period Years
<b>Private Equity-Post</b>							
<b>Citicorp Mezzanine</b>							
<i>Citicorp Mezzanine Partners</i>	40,000,000	40,000,000	16,163,735	38,092,853	0	10.75	8.25
<i>Citicorp Mezzanine III</i>	100,000,000	36,372,850	24,467,495	23,874,442	63,627,150	14.74	3.41
<b>DLJ Investment Partners II</b>	50,000,000	18,296,951	27,371,604	2,790,251	31,703,049	17.36	3.24
<b>GS Mezzanine Partners II</b>	100,000,000	91,429,405	78,748,293	11,517,309	8,570,595	-1.95	3.08
<b>GTCR Capital Partners</b>	80,000,000	69,867,147	56,692,079	26,160,007	10,132,853	8.31	3.38
<b>KB Mezzanine Partners Fund II</b>	25,000,000	24,999,999	6,001,035	7,151,873	1	-17.20	7.50
<b>Prudential Capital Partners</b>	100,000,000	41,753,523	39,936,284	4,393,379	58,246,477	4.19	1.95
<b>Summit Partners</b>							
<i>Summit Sub. Debt Fund I</i>	20,000,000	18,000,000	383,067	30,985,377	2,000,000	30.56	9.00
<i>Summit Sub. Debt Fund II</i>	45,000,000	29,250,000	14,542,138	57,201,346	15,750,000	60.31	5.66
<b>T. Rowe Price</b>	52,990,378	52,990,378	114,000	51,844,812	0	-12.32	N/A
<b>TCW/Crescent Mezzanine</b>							
<i>TCW/Crescent Mezzanine Partners</i>	40,000,000	36,756,265	19,796,220	36,047,302	3,243,735	15.80	7.00
<i>TCW/Crescent Mezzanine Partners II</i>	100,000,000	87,479,046	38,819,105	72,188,055	12,520,954	10.25	4.35
<i>TCW/Crescent Mezzanine Partners III</i>	75,000,000	37,227,114	34,167,416	4,388,406	37,772,886	2.05	2.00
<b>William Blair Mezz. Fund III</b>	60,000,000	38,961,600	38,022,720	3,740,400	21,038,400	3.19	3.24
<b>Windjammer Mezz. &amp; Equity Fund II</b>	66,708,861	27,998,072	26,943,553	2,435,859	38,710,789	3.48	3.00
<b>Private Equity-Post Total</b>	954,699,239	651,382,350	422,168,745	372,811,672	303,316,889		
<b>Private Equity Total</b>	4,651,397,966	3,356,852,433	1,808,449,930	2,925,137,425	1,294,545,533		

Minnesota State Board of Investment  
- Alternative Investment -

As of March 31, 2003

Investment	Total Commitment	Funded Commitment	Market Value	Distributions	Unfunded Commitment	IRR %	Period Years
<b>Resource-Basic</b>							
Apache Corp III	30,000,000	30,000,000	3,190,500	47,515,848	0	11.59	16.25
<b>First Reserve</b>							
First Reserve VII	40,000,000	40,000,000	23,994,010	30,397,909	0	9.46	6.75
First Reserve VIII	100,000,000	100,000,000	97,071,617	37,339,203	0	10.78	4.92
First Reserve IX	100,000,000	46,364,431	45,907,370	0	53,635,569	-0.91	1.97
<b>Simmons</b>							
Simmons - SCF Fund II	17,000,000	14,847,529	6,243,832	27,807,132	2,152,471	10.39	11.65
Simmons - SCF Fund III	25,000,000	21,999,242	33,152,688	28,112,283	3,000,758	20.52	7.75
Simmons - SCF Fund IV	50,000,000	35,159,009	34,107,322	16,449,877	14,840,991	9.32	5.00
T. Rowe Price	21,888,430	21,888,430	6,927,500	9,858,468	0	-21.41	N/A
Funds in Liquidation (First Reserve I, II, & V)	53,800,000	53,800,000	393,690	104,708,362	0	N/A	N/A
<b>Resource-Basic Total</b>	<b>437,688,430</b>	<b>364,058,641</b>	<b>250,988,530</b>	<b>302,189,083</b>	<b>73,629,789</b>		
<b>Resource-Post</b>							
<b>Merit Energy Partners</b>							
Merit Energy Partners B	24,000,000	24,000,000	26,711,641	17,405,297	0	15.58	6.75
Merit Energy Partners C	50,000,000	36,155,565	50,699,431	6,455,320	13,844,435	18.55	4.42
Merit Energy Partners D	88,000,000	37,276,873	36,945,788	1,477,056	50,723,127	3.32	1.85
<b>Resource-Post Total</b>	<b>162,000,000</b>	<b>97,432,438</b>	<b>114,356,860</b>	<b>25,337,673</b>	<b>64,567,562</b>		
<b>Resource Total</b>	<b>599,688,430</b>	<b>461,491,079</b>	<b>365,345,390</b>	<b>327,526,756</b>	<b>138,197,351</b>		

<b>MEZZANINE DEBT MANAGER SUMMARY PROFILE</b>
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**I. Background Data**

<b>Name of Fund:</b>	GS Mezzanine Partners II, L.P.
<b>Type of Fund:</b>	Limited Partnership
<b>Total Fund Size:</b>	\$1.0 billion
<b>Fund Manager:</b>	GS Mezzanine Advisors II, L.L.C.
<b>Manager Contact:</b>	Muneer A. Satter Goldman Sachs & Co. 85 Broad Street New York, New York 10004 Phone: (212) 902-9645 Fax: (212) 357-5505

**II. Organization and Staff**

Goldman Sachs, a leading international investment banking firm, is establishing GS Mezzanine Partners III, L.P. (the "Fund," the "Partnership," or "GSMP III") as a vehicle for investors seeking both long-term capital appreciation as well as current returns through investments in mezzanine securities. The Fund will be the successor to GS Mezzanine Partners, L.P. ("GSMP I"), formed in 1996 with \$800 million in committed capital and GS Mezzanine Partners II, L.P. ("GSMP II"), formed in 2000 with \$1.0 billion in committed capital.

The Principal Investment Area of Goldman Sachs' Merchant Banking Division (the "PIA"), which has achieved seventeen years of successful results in its private investments, will evaluate, structure, monitor, manage, and harvest the Fund's investments. The PIA currently consists of 90 employees based in New York, Menlo Park, London, Hong Kong, and Tokyo.

All investment decisions are made by the Investment Committee of Goldman Sachs which currently consists of nine managing directors, one senior director and one advisory director of Goldman Sachs.

**III. Investment Strategy**

The Fund's investment objective is to achieve long-term capital appreciation as well as current returns through investments in mezzanine securities. These securities will principally include fixed income securities such as debt and preferred stock, often with an equity component, such as warrants, options, or common stock. The

Partnership will consider a broad array of investment opportunities, generally in North America and Western Europe, including leveraged buyout and other private equity sponsored transactions, recapitalizations, refinancings, restructurings, acquisitions, and structured transactions. The General Partner will seek to create a global portfolio of mezzanine investments and to use leverage on an appropriate basis to seek to enhance the return to investors in the Fund.

#### **IV. Investment Performance**

Previous fund performance as of December 31, 2002 for GS Mezzanine Partners Fund I and II and the SBI's investments with previous funds, where applicable, is shown below:

<b>Fund</b>	<b>Inception Date</b>	<b>Total Equity Commitments</b>	<b>SBI Investment</b>	<b>Net IRR from Inception</b>
Fund I	1996	\$800 million		8%
Fund II	2000	\$1 billion	\$100 million	-2%

Previous Fund investments may be relatively immature and therefore, returns may not be indicative of future results.

#### **V. General Partner's Investment**

Goldman Sachs will commit a minimum of \$200 million of the capital of the Partnerships. Goldman Sachs will commit an amount equal to 1% of each partnership's total capitalization for its general partnership interest and will invest the balance of its contribution as a limited partner (the "GSLP").

#### **VI. Takedown Schedule**

It is anticipated that the Commitments will generally be drawn down pro rata during the Commitment Period on an "as needed" basis. The General Partner will give 15 calendar days notice prior to each takedown of funds.

#### **VII. Fees**

The Investment Manager will be paid an annual management fee, which will be payable semi-annually in arrears by Limited Partners.

Each such Limited Partner will be charged an annual management fee on invested capital (including any leverage but reduced by the cost of harvested investments) at a fixed rate, to be determined at closing with respect to a Limited Partner, based on the amount of capital committed by the Limited Partner to the Partnership. In this

regard, the applicable rate of the management fee with respect to a Limited Partner will be determined as follows: (i) 1.50%, if the amount of capital committed by the Limited Partner to the Partnership is less than \$15 million, (ii) 1.25%, if the amount of capital committed by the Limited Partner to the Partnership is between \$15 and \$35 million, and (iii) 1.00%, if the amount of capital committed by the Limited Partner to the Partnership is greater than \$35 million.

Goldman Sachs will bear all expenses of organizing the Partnership and offering the LP Interests. The Partnership will bear its ongoing expenses including, without limitation, (i) expenses relating to investment accounting, information technology, and legal and tax advice, in each case, whether performed by internal staff of Goldman Sachs or third parties, and (ii) expenses relating to abandoned transactions.

Deal fees from portfolio companies payable upon the consummation of the Partnership's investment in those companies will be paid to the Partnership.

Goldman Sachs will seek to perform investment banking and other services for, and will expect to receive customary investment banking compensation from, portfolio companies and the Partnership. Such compensation may include financial advisory fees or fees in connection with restructurings and mergers and acquisitions, underwriting or placement fees, financing or commitment fees, and brokerage fees. Such investment banking and other compensation will not be shared with the Partnership or its Limited Partners.

Goldman Sachs employees may receive fees and options customarily paid and granted to directors on the boards of portfolio companies, and these fees and options are not required to be shared with the Partnership. Goldman Sachs' policy is that the fees and options received by its employees and consultants (but not its former officers or employees, or the former limited partners of The Goldman Sachs Group, L.P.) must be paid over to Goldman Sachs.

### ***VIII. Allocations and Distributions***

The GSLP, the GS Insiders and the Employee GSMP Fund (collectively, the "holders of SLP interests") will receive an override (the "Override") if the Partnership achieves certain returns, such Override not to exceed 20% of total profits, based on the following formula: Net Gain (the excess of short-term and long-term capital gains, cash flow from dividends, interest and fees, over expenses (other than withholding taxes imposed on income payable to the Partnership) and capital losses, computed by marking remaining positions to market and calculating unrealized gains and losses) will be allocated to the General and Limited Partners (including the holders of SLP interests) in proportion to their capital contributions (subject to adjustment in the event of a Default by any Limited Partner in making any capital contribution), until the Partners have achieved a return of 8% per annum on capital contributed by investors less distributions on an annually compounded

basis (the "Preferred Return"). Net Gain in excess of the Preferred Return will be allocated to the holders of SLP interests until they have, in the aggregate, achieved an override equal to 20% of the aggregate net gain. Thereafter, any additional net gain will be allocated 20% to the holders of SLP interests and 80% to the General and Limited Partners (including the holders of SLP interests) in proportion to their capital contributions. Losses will be allocated in a manner designed appropriately to reverse on a cumulative basis allocations made. No Override will be allocated if the Preferred Return is not achieved. Distributions may be made in the sole discretion of the General Partner.

#### ***IX. Investment Period and Term***

The Partnership may draw upon committed capital until December 31, 2006, with an ability to extend this period for three one-year periods at the sole discretion of the General Partner (such period, including extensions, the "Commitment Period"). After the Commitment Period, a Limited Partner will not be required to make any further capital contributions to the Partnership, except that the General Partner may, at any time and from time to time, require the Limited Partners to contribute up to an aggregate amount equal to their respective uncalled committed capital in order to permit the Partnership to (i) fulfill commitments made prior to the expiration of the Commitment Period, including, but not limited to, making investments approved by the Investment Committee prior to the expiration of the Commitment Period, (ii) pay expenses of the Partnership (including the management fee payable by the Limited Partners), (iii) repay indebtedness of the Partnership (including under credit facilities) whether incurred before or after the expiration of the Commitment Period, or (iv) make additional investments in existing portfolio companies.

The Fund will terminate at the end of ten years, unless extended at the option of the General Partner for up to three one-year periods. Additional extensions of the term of the Fund will require the approval of a majority-in-interest of the Partners other than the GSLP.



<b>PRIVATE EQUITY MANAGER SUMMARY PROFILE</b>
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**I. Background Data**

<b>Name of Fund:</b>	Piper Jaffray Healthcare Fund IV ("The Fund"), L.P.
<b>Type of Fund:</b>	Private Equity
<b>Total Fund Size:</b>	\$30-50 million
<b>Fund Manager:</b>	Piper Jaffray Ventures
<b>Manager Contact:</b>	Buzz Benson 800 Nicollet Mall Minneapolis MN 55402-7020 Ph: 612-303-5686 Fax: 612-303-1350

**II. Organization and Staff**

Piper Jaffray Ventures (PJV) is the venture capital affiliate of US Bancorp Piper Jaffray, a leading investment bank.

In February of 2003, US Bancorp announced plans to spin-off the Piper Jaffray business, including Piper Jaffray Ventures, with an anticipated closing date of October 2003. This spinoff is not expected to adversely affect Piper Jaffray Ventures. After the spinoff, PJV will maintain their independence and their relationship with the healthcare team at Piper Jaffray.

All Fund IV investment and operating decisions will be made by consensus of the Fund's four managing directors: Buzz Benson, Ken Higgins, Ned Scheetz and Heath Lukatch. The managing directors and the Fund's CFO, Maureen Harder, have worked together for many years across multiple funds, and collectively have over 50 years of healthcare specific investment and operating experience. PJV's managing directors are supported by a group of investment professionals who assist in healthcare industry research, financial modeling, due diligence, strategic intelligence and other activities related to portfolio investments.

As of May 2003, PJV is considering converting The Fund to an SBIC (Small Business Investment Companies) Program using SBA (Small Business Administration) leverage. The existing Fund partnership agreement would remain intact, with a separate partnership agreement between The Fund and the SBA that consists of an SBA standard partnership agreement. This is similar to how PJV structured Fund I (included in the Predecessor Funds), with SBIC activity consolidated for reporting purposes to Limited Partners (LPs) in a seamless fashion.

### **III. Investment Strategy**

PJV will continue to pursue the investment strategy that they have successfully executed over the last 11 years in the previous funds:

#### Exclusive Healthcare Focus

Investing activities are focused exclusively on biotechnology, medical technology, and healthcare services. Within these focus areas, PJV seeks investments with attractive risk/return profiles across all stages of company development.

#### Active Top-Down Approach

PJV targets attractive healthcare segments, identifies potential portfolio companies early in their fundraising efforts, acts as a lead investor in a majority of investor syndicates and takes an active role post-investment to provide value to the portfolio companies and the Fund's LPs.

#### Synergies with US Bancorp Piper Jaffray

PJV will leverage the relationship with the 40-plus healthcare professionals at US Bancorp Piper Jaffray to enhance all aspects of the business. Specifically, a portion of The Fund's carried interest will be used to incent US Bancorp Piper Jaffray investment bankers and research analysts to assist PJV in:

- Identifying and targeting healthcare sectors of growth and change;
- Finding promising companies early in their fundraising efforts;
- Selecting the best investment opportunities;
- Earning an investment position in highly competitive financings, and;
- Providing ongoing value-added support to the companies post-investment.

These relationships will be unaffected by the spinoff from US Bancorp expected in October 2003.

### **IV. Investment Performance**

Previous fund performance as of December 31, 2002 for Piper Jaffray Healthcare Ventures and the SBI's investments with previous funds, where applicable, is shown below:

<b>Fund</b>	<b>Inception Date</b>	<b>Total Equity Commitments</b>	<b>SBI Investment</b>	<b>Net IRR from Inception</b>
Piper Jaffray Healthcare Ventures III	1999	\$108 million	\$20 million	-8%
Piper Jaffray Healthcare Ventures II	1997	\$50 million	\$10 million	0%
Piper Jaffray Predecessor Funds	1990	\$27 million	-	22%

Previous Fund investments may be relatively immature and therefore, returns may not be indicative of future results.

## **V. General Partner's Investment**

The General Partner will contribute 1% of the Fund's capital. In lieu of cash contributions, the General Partner will make up to 75% of its capital contributions by reducing a corresponding amount of management fees payable to it by the Partnership.

## **VI. Takedown Schedule**

Each Limited Partner will contribute capital in installments as requested by the General Partner upon fifteen days' prior written notice.

## **VII. Fees**

The General Partner will receive an annual management fee, payable quarterly in advance, based solely on the committed capital of the Partnership. Until December 31, 2006, the annual management fee will equal 2.5% of the Partnership's committed capital (as such management fee is adjusted for the Partnership's first fiscal quarter based upon the number of days in such fiscal quarter). The annual management fee will equal 2.25% of committed capital from January 1, 2007 until December 31, 2008, 2% of committed capital for the calendar year of 2009, 1.75% of committed capital for the calendar year of 2010 and 1.5% of committed capital from January 1, 2011 until the scheduled expiration of the Partnership's term (as such management fee is adjusted for the Partnership's last scheduled fiscal quarter based upon the number of days in such fiscal quarter).

In the event of more than one closing, an additional management fee will be payable to the General Partner to reflect the increase in capital commitments. Such additional management fee will be calculated as if the Limited Partners admitted in later closings (or allowed to increase their capital commitments to the Partnership) were admitted (or had such increased commitments) upon the Formation Date.

The management fee payable by the Partnership will be reduced by all previous Fee Reductions, to the extent that such Fee Reductions have not already reduced management fees.

The management fee payable in subsequent quarters will also be reduced by the Partnership's share of any cash compensation paid to the General Partner, PJV, Piper Ventures Capital, Inc. ("PVC"), any of their employees, any Principal or any natural person who is a member or manager of the General Partner by portfolio companies or companies in which the Partnership is contemplating making an investment. If such cash compensation reduces the next quarterly management fee payment to zero, future management fees will be reduced by the remaining compensation, until exhausted. The Partnership's share of the economic benefit of stock awards and options granted by portfolio companies or companies in which the Partnership is contemplating making an investment to the General Partner, PJV, PVC, any of their employees, any Principal or any natural person who is a member

or manager of the General Partner will also offset the management fee in a similar manner.

From the management fee, the General Partner will pay all normal operating expenses of the Partnership, including salaries, wages, rent, travel and all normal expenses incurred in the investigation of investment opportunities and monitoring of portfolio companies (other than expenses borne by the Partnership as provided in this Section).

The Partnership will bear all expenses incident to the organization of the Partnership and the General Partner in an aggregate amount not to exceed \$525,000. The Partnership will also bear all extraordinary expenses of the Partnership including, but not limited to, the Partnership's indemnification obligation, and all costs and expenses related to the purchase, holding, sale or exchange of portfolio securities, including, but not limited to, legal, audit, accounting and banking expenses and any placement fees, finder's fees or real or personal property taxes. The Partnership will also bear all costs and expenses related to the liquidation of the Partnership's assets upon termination of the Partnership.

#### ***VIII. Allocations and Distributions***

At the end of each fiscal year or other accounting period, the net portfolio profit and loss of the Partnership for such period will be allocated 80% to the Partners (General and Limited), pro rata in proportion to their contributed capital, and 20% to the General Partner; provided, however, that, except as necessary to fund the General Partner's lookback obligation described in the placement memorandum, to the extent that an allocation of net loss would cause the General Partner's capital account to be less than 1% of all capital accounts, an amount of such loss (a "Contingent Loss") will be reallocated to all Partners in proportion to their contributed capital as necessary to maintain a 1% capital account balance for the General Partner (assuming that the General Partner made all of its capital contributions in cash and not by way of Fee Reduction). To the extent Partners have been allocated Contingent Losses, subsequent net profits will be allocated first to all Partners in proportion to and until such Contingent Losses have been restored and then in accordance with the first sentence of this paragraph.

#### ***IX. Investment Period and Term***

The Partnership anticipates an investment period of up to six years and a term of ten years, subject to a two-year extension at the General Partner's discretion. An additional one-year extension is possible with at least two-thirds in interest Limited Partners consent.