

MINNESOTA STATE BOARD  
OF INVESTMENT  
MEETING  
**December 3, 2003**

&

INVESTMENT ADVISORY  
COUNCIL MEETING  
**December 2, 2003**

**STATE BOARD OF INVESTMENT**

**AGENDA AND MINUTES**

**December 3, 2003**

**AGENDA**  
**STATE BOARD OF INVESTMENT MEETING**  
**Wednesday, December 3, 2003**  
**9:00 A.M. - Room 125**  
**State Capitol - Saint Paul**

- |  |            |
|--|------------|
|  | <b>TAB</b> |
| <b>1. Approval of Minutes of September 3, 2003</b>   |            |
| <b>2. Report from the Executive Director (Howard Bicker)</b>   | <b>A</b>   |
| A. Quarterly Investment Review<br>(July 1, 2003 – September 30, 2003)                                    |            |
| B. Administrative Report   | <b>B</b>   |
| 1. Reports on budget and travel.   |            |
| 2. Post Retirement Benefit Increase for FY03.  |            |
| 3. Litigation Update.  |            |
| 4. Results of FY03 Audit.  |            |
| 5. Draft of FY03 Annual Report.  |            |
| 6. Tentative Meeting Dates for Calendar 2004.  |            |
| <b>3. Report from Deferred Compensation Committee (Peter Sausen)</b>                                     | <b>C</b>   |
| 1. Recommendation to replace the Morgan Stanley Mid Cap Fund in<br>the State Deferred Compensation Plan. |            |
| <b>4. Domestic Equity Small-Capitalization Search Committee (Peter Sausen)</b>                           | <b>D</b>   |
| 1. Recommendation to hire small capitalization growth and value managers.                                |            |
| <b>5. Reports from the Investment Advisory Council (Mike Troutman)</b>                                   |            |
| <b>A. Stock and Bond Manager Committee</b>   | <b>E</b>   |
| 1. Review of manager performance.  |            |
| 2. Update on the domestic equity small-capitalization manager search.                                    |            |
| 3. Recommendation to terminate Lincoln Equity Management, LLC<br>in the Domestic Equity Program.         |            |
| 4. Recommendation to terminate GeoCapital Corporation in the<br>Domestic Equity Program.                 |            |
| 5. Recommendation to terminate Artemis Asset Management LLC<br>in the Domestic Equity Program.           |            |
| <b>B. Alternative Investment Committee</b>   | <b>F</b>   |
| 1. Review of current strategy.   |            |
| 2. Review of Alternative Investment Asset Allocation.  |            |
| 3. Recommendation for an investment with an existing resource<br>manager, First Reserve.                 |            |
| 4. Recommendation for an investment with an existing yield<br>oriented resource manager, Merit Energy.   |            |
| 5. Recommendation for an investment with a new private<br>equity manager, Silver Lake.                   |            |

# **STATE BOARD OF INVESTMENT**

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## **Minutes State Board of Investment September 3, 2003**

The State Board of Investment (SBI) met at 9:00 A.M. Wednesday, September 3, 2003 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 June 4, 2003 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 its Composite Index over the ten year period ending June 30, 2003 (Combined Fund 8.2% vs. Composite 8.0%), and had provided a real rate of return over the latest 20 year period of 10.1%. He stated that the Basic Funds have slightly outperformed its composite index (Basic Funds 8.4% vs. Composite 8.2%) over the last five years and reported that the Post Fund has also outperformed its composite over the last five years period (Post Fund 8.0% vs. Composite 7.7%).

Mr. Bicker reported that the Basic Fund's assets increased 10.0% for the quarter ending June 30, 2003 due 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 11.3% vs. Composite 11.6%) and for the year (Basic Funds 1.9% vs. Composite 2.4%).

Mr. Bicker reported that the market value of the Post Fund's assets increased 10.8% for the quarter ending June 30, 2003 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 11.6% vs. Composite 11.7%) and for the year (Post Fund 2.8% vs. Composite 3.3%).

Mr. Bicker reported that the domestic stock manager group underperformed its target for the quarter (Domestic Stock 15.8% vs. Wilshire 5000 Investable 16.1%) and for the year (Domestic Stocks 0.4% vs. Wilshire 5000 Investable 0.8%). He said the International Stock manager group underperformed its composite index for the quarter (International Stocks 19.1% vs. Int'l Composite 19.6%) and for the year (International Stocks -6.2% vs. Int'l Composite -5.4%). Mr. Bicker stated that the bond segment outperformed its target for the quarter (Bonds 2.9% vs. Lehman Aggregate 2.5%) and for the year (Bonds 10.7% vs. Lehman Aggregate 10.4%). He concluded his report with the comment that as of June 30, 2003, the SBI was responsible for over \$43 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 asked Christie Eller, Assistant Attorney General, to update members on the status of litigation. She noted that the SBI is the plaintiff in four different securities actions. She stated that the case against McKesson HBOC is being brought in state court in California with pension plans from Colorado, Utah and Oregon. She said that a settlement conference had been scheduled but was cancelled. She said that the federal judge ruled in favor of the plaintiff in a cross claim and said that shareholders should not be held liable for profits made when shareholders were not part of the fraud. Ms. Eller reported that the Broadcom litigation is proceeding and that the class certification motion will be argued on September 22, 2003. She reported that the discovery cutoff is March 4, 2004 and that the trial date is set in July 2004. She said that the class action against AOL Time Warner is in the early stages and that the State is preparing responses to the motion to dismiss. Ms. Eller stated that the case involving WorldCom bonds 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 other pension funds have also filed similar actions and that they have been consolidated with the bankruptcy. She said the next hearing will be on September 8, 2003.

Mr. Bicker stated that SBI staff prepared a resolution that would not require seconds to motions made at Board meetings. Mr. Hatch moved approval of the resolution, as stated in Attachment A. Ms. Awada seconded the motion. The motion passed.

### **Administrative Committee Report**

Mr. Bicker referred members to Tab C of the meeting materials and stated that the SBI currently reviews international countries regarding their worker and human rights records. He said the countries are categorized into three groups. He said that Group I countries have legal protections in place for both worker and human rights; Group II countries have legal protections in place but have documented violations; and, Group III countries lack protections for basic worker and human rights. He explained that in the past, staff has prepared extensive write-ups on all the countries in all three groups. He said that the Committee's recommendation is to do only the reviews for countries included in the asset class target that fall in Group II or Group III. Ms. Awada moved approval of the Committee's recommendation, as stated in the Committee Report, which reads: **"The SBI Administrative Committee recommends that the SBI approve an amendment to the International Investing Guidelines that requires a review of only those countries found in the International Equity Program asset class target, that detailed reports be prepared for countries falling into Group II and III, and that the review be conducted every four years or at a Board Member's request."** The motion passed.

### **Deferred Compensation Review Committee**

Mr. Bergstrom, Executive Director of the Minnesota State Retirement System (MSRS) referred members to Tab D of the meeting materials and noted that the Committee has two recommendations for the Board's consideration. He reported that the Committee is recommending that the INVESCO Total Return Fund be replaced by the Dodge & Cox Balanced Fund. He noted that INVESCO has underperformed and has had several management changes. Ms. Kiffmeyer moved approval of the Committee's recommendation, as stated in the Committee Report, which reads: **"The Committee recommends that the SBI terminate the relationship with INVESCO Total Return Fund in the State Deferred Compensation Plan. The Committee further recommends that the SBI authorize the executive director, with assistance from legal counsel, to negotiate a contract with Dodge & Cox, Inc. in order to offer the Dodge & Cox Balanced Fund to participants in the State Deferred Compensation Plan at a date agreeable to Minnesota State Retirement System."** The motion passed.

Mr. Bergstrom stated that the Committee's second recommendation is to adopt daily pricing for all investment options in the State Deferred Compensation Plan, and he briefly reviewed the changes that would be made to move out of the monthly-valued Supplemental Investment Fund accounts and into the proposed mutual fund accounts. Ms. Awada moved approval of the Committee's recommendation, as stated in the Committee Report, which reads: **"The Committee recommends that the State Deferred Compensation Plan be converted so that all investments are daily priced. The Committee recommends that the Board replace the Growth Share Account, Income Share Account, Bond Market Account and International Share Account with low cost daily valued mutual funds. The Committee further recommends that the SBI retain the Money Market Account which is daily valued for the Plan, eliminate the Common Stock Index Account because the Plan will retain its existing passively managed equity mutual fund offering, and convert the Fixed Interest Account to a daily valued offering. The new active/passive structure will be implemented at a date agreeable to the SBI and the Minnesota State Retirement System."** The Committee further recommends that the Board authorize the executive director, with assistance from legal counsel, to negotiate contracts with the following companies for the mutual funds identified in order to offer these funds to participants of the State Deferred Compensation Plan.

**Smith Barney Group**

**Smith Barney Appreciation Y**

**The Vanguard Group, Inc.**

**Vanguard Balanced Index**

**Vanguard Developed Markets Index**

**Vanguard Total Bond Market Index**

The motion passed.

### **Asset Allocation Committee Report**

Mr. Troutman referred members to Tab E of the meeting materials and reminded members that at the June 2003 meeting, the Asset Allocation decision was tabled until the September 2003 meeting. He said that after further analysis and review, the IAC is

unanimously re-affirming the proposed long-term asset allocations for the Basic and Post Retirement Funds. He reviewed the proposed asset allocation recommendations, noting that the Committee had amended the recommendation from the prior meeting to include language that the Basic Funds would remain at their current target of 15% in alternative investments until the proposed allocation of 12% for alternative investments in the Post Fund is reached.

Mr. Hatch stated that he had asked staff for asset allocation information from other pension funds for comparison. Mr. Hatch expressed his concern about moving to a 20% allocation in alternative investments. He noted that the information shows that the proposed 20% allocation is in the range for nongovernmental plans and that the allocations for governmental plans were lower. In response to questions from Mr. Hatch and Governor Pawlenty, Mr. Troutman and Mr. Bicker discussed the various definitions of alternative investments and stated that the SBI's definition is very broad and diversified and includes asset categories that some other funds may separate out. Mr. Bicker added that the SBI's definition makes the portfolio more conservative than some others because real estate and mezzanine debt are also included. Mr. Bicker also noted that the SBI does not make individual investments in alternative assets, which makes the SBI's level of risk lower.

In response to a question from Ms. Kiffmeyer, Mr. Bicker stated that over the last 10 years, the private equity portion of the alternative asset segment returned 14% net of all costs. In response to questions from Mr. Hatch, Mr. Bicker confirmed that he expects it will take two to three years to attain the increased level of 12% alternatives in the Post Fund. Mr. Hatch suggested that the Board consider only doing the increased allocation for the Post Fund at this time and to postpone making the decision to increase the allocation for the Basic Funds. A discussion followed regarding the choices of increasing one or both of the funds now or later. Mr. Hatch moved approval of the second bullet of the Committee's recommendation, as stated in the Committee Report, which reads: **"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 motion passed.

Ms. Awada moved approval of the remainder of the Committee's recommendation, as stated in the Committee Report, which reads: **"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%. The allocation to alternative investments not exceed the current target of 15% in the Basic Retirement Funds until the proposed target allocation of 12% for alternative investments in the Post Retirement Fund is reached. At that time, staff will notify the Board of the status of the respective alternative investment allocations before the allocation target for Basic Retirement Funds alternative investments would be raised from the current 15% level to the proposed 20% allocation. 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.”** She commented that she is comfortable with the increased allocation. Mr. Hatch stated his intention to vote against the motion. He stated that the increase in the Basics would not occur for two or three years and that the Board could revisit the issue at that time. The motion passed.

Mr. Troutman discussed several proposed changes that are being recommended to the asset class targets and asset class structure. He said that there are no changes being proposed for the fixed income or alternative investment programs. He stated that the Committee is recommending that the international program use the MSCI All Country World Index Free as its asset class target and the benchmark for developed markets managers. He noted that the new target includes Canada in the SBI’s benchmark. Mr. Troutman reported that the Committee is also recommending an allocation to semi-passive management. In response to questions from Mr. Hatch, Mr. Bicker confirmed that these changes will be footnoted when reporting on performance.

Mr. Troutman stated that the major changes to the domestic equity program include changing the asset class target to the Russell 3000 Index, using the Russell sub-indices to measure active managers, using the Russell 1000 to measure semi-passive managers, using the Russell 3000 to measure the passive index fund, and to use ranges in the allocation among active, semi-passive and passive management. Ms. Awada moved approval of the Committee’s recommendation, as stated in the Committee Report, which reads: **“The Committee recommends that the Board approve the following:**

- **For the Fixed Income Program:**
  - **continue to use the Lehman Aggregate Bond Index as the asset class target; continue to use a 50% active and 50% semi-passive management allocation; continue to use the asset class target as the benchmark for all managers; and continue the current opportunistic approach to invest in high yield and non-dollar sectors.**
- **For the Alternative Investment Program:**
  - **continue to measure Alternative Investments against themselves using actual portfolio returns for composite fund performance evaluation; and continue the current structure of investing in private equity, real estate, resource, and mezzanine investments.**
- **For the International Equity Program:**
  - **continue to use Morgan Stanley Capital International as the asset class target provider; change the asset class target to the MSCI All Country World Index Free ex. U.S. (net of taxes on dividends); continue to measure the asset class target on an unhedged basis; change the benchmark for developed markets managers to the MSCI World Index ex. U.S. (net of taxes on dividends);**



continue to use the MSCI Emerging Market Free Index (net) as the benchmark for emerging markets managers; allow up to 10% of the Program to be allocated to semi-passive management and at least 25% to be allocated to passive management with at least 33% of the Program being allocated, in aggregate, to passive and semi-passive management; and continue to allocate at least 33% of the Program to active management.

- **For the Domestic Equity Program:**

- change the asset class target to the Russell 3000 Index; use published Russell sub-indices to measure and monitor the active domestic equity managers; use the Russell 1000 to measure the semi-passive domestic equity managers; use the Russell 3000 for the passive index fund; control misfit risk or style bias by allocating assets across active managers and reducing reliance on the DCF, use the DCF to correct residual style bias, when necessary; continue to use custom benchmarks where appropriate as an additional analytical tool to evaluate managers; and use ranges in stating the allocation among active, semi-passive, and passive management for the Domestic Equity Program. The proposed ranges are 25%-40% for active, 25%-40% for semi-passive, and 25%-40% for passive.

Further, the Committee recommends that the SBI adopt the position paper which begins on page 27 of this section regarding the asset class targets and asset class management structure for the investment programs of the Basic and Post Retirement Funds.” The motion passed.

Mr. Bicker referred members to page 65 of Tab E of the meeting materials concerning the appropriateness of the 8.5% actuarial rate of return. He reported that staff and the Committee concluded that the 8.5% assumption used by the Minnesota statewide pension systems is reasonable and in line with other public and corporate plans. In response to a question from Ms. Kiffmeyer, Mr. Bicker stated that the SBI has generated a return of 10.2% for the last 22 ½ years. Ms. Kiffmeyer said she believes the 8.5% return assumption is reasonable. In response to comments from Mr. Hatch, Mr. Bicker confirmed that the returns for the last 10 years were 8.2% for the Basic Funds and 8% for the Post Fund, both of which are lower than the 8.5% required rate of return. A discussion followed with members agreeing that the situation should continue to be closely monitored and that no changes were being recommended at this time.

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

Mr. Troutman referred members to Tab F of the meeting materials and stated that the Committee is recommending the termination of Forstmann-Leff, due to changes in management, and Valenzuela Capital due to poor performance. Ms. Awada moved approval of the Committee’s recommendation, as stated in the Committee Report, which reads: **“The Committee recommends that the SBI terminate its relationship with Forstmann-Leff Asset Management, LLC and Valenzuela Capital Partners, LLC for investment management services in the Domestic Equity Program.”** The motion passed.

**Alternative Investment Committee Report**

Mr. Troutman referred members to Tab G of the meeting materials and stated that the Committee has no action items for Board approval this quarter.

The meeting adjourned at 9:52 A.M.

Respectfully submitted,

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

Howard J. Bicker  
Executive Director

**INVESTMENT ADVISORY COUNCIL**

**AGENDA AND MINUTES**

**December 2, 2003**

**AGENDA**  
**INVESTMENT ADVISORY COUNCIL MEETING**  
**Tuesday, December 2, 2003**  
**9:00 A.M. - Board Room – First Floor**  
**60 Empire Drive**  
**St. Paul, MN**

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|--|------------|
|  | <b>TAB</b> |
| <b>1. Approval of Minutes of September 2, 2003</b>   |            |
| <b>2. Report from the Executive Director (Howard Bicker)</b>   | <b>A</b>   |
| A. Quarterly Investment Review<br>(July 1, 2003 – September 30, 2003)                                    |            |
| B. Administrative Report   | <b>B</b>   |
| 1. Reports on budget and travel.   |            |
| 2. Post Retirement Benefit Increase for FY03.  |            |
| 3. Litigation Update.  |            |
| 4. Results of FY03 Audit.  |            |
| 5. Draft of FY03 Annual Report.  |            |
| 6. Tentative Meeting Dates for Calendar 2004.  |            |
| <b>3. Report from Deferred Compensation Committee (Peter Sausen)</b>                                     | <b>C</b>   |
| 1. Recommendation to replace the Morgan Stanley Mid Cap Fund in<br>the State Deferred Compensation Plan. |            |
| <b>4. Domestic Equity Small-Capitalization Search Committee (Peter Sausen)</b>                           | <b>D</b>   |
| 1. Recommendation to hire small capitalization growth and value managers.                                |            |
| <b>5. Reports from the Investment Advisory Council</b>   |            |
| <b>A. Stock and Bond Manager Committee (Gary Norstrom)</b>   | <b>E</b>   |
| 1. Review of manager performance.  |            |
| 2. Update on the domestic equity small-capitalization manager search.                                    |            |
| 3. Recommendation to terminate Lincoln Equity Management, LLC<br>in the Domestic Equity Program.         |            |
| 4. Recommendation to terminate GeoCapital Corporation in the<br>Domestic Equity Program.                 |            |
| 5. Recommendation to terminate Artemis Asset Management LLC<br>in the Domestic Equity Program.           |            |
| <b>B. Alternative Investment Committee (Judy Mares)</b>  | <b>F</b>   |
| 1. Review of current strategy.   |            |
| 2. Review of Alternative Investment Asset Allocation.  |            |
| 3. Recommendation for an investment with an existing resource<br>manager, First Reserve.                 |            |
| 4. Recommendation for an investment with an existing yield<br>oriented resource manager, Merit Energy.   |            |
| 5. Recommendation for an investment with a new private<br>equity manager, Silver Lake.                   |            |

**Minutes  
Investment Advisory Council  
September 2, 2003**

**MEMBERS PRESENT:** Frank Ahrens; Gary Austin; John Bohan; Dave Bergstrom; Kerry Brick; Ken Gudorf; Heather Johnston; P. Jay Kiedrowski; Hon. Ken Maas; Malcolm McDonald; Dan McElroy; Gary Norstrem; Mike Troutman; and Mary Vanek.

**MEMBERS ABSENT:** Doug Gorence; Judy Mares; and Daralyn Peifer.

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

**OTHERS ATTENDING:** Ann Posey, Richards & Tierney; Christie Eller; Carla Heyl; Elaine Voss; Robert Heimerl, Jerry Irsfeld, REAM; Ed Rapp, Education Minnesota; and Conrad DeFiebre, Star Tribune.

The minutes of the June 3, 2003 meeting were approved. Mr. Troutman and Mr. Bicker introduced and welcomed the three new gubernatorial appointees, Hon. Ken Maas, Heather Johnston and Frank Ahrens, to the IAC. Mr. Bicker announced that the December 2, 2003 IAC meeting will take place at 9:00 A.M. rather than 2:00 P.M.

**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 its Composite Index over the ten year period ending June 30, 2003 (Combined Fund 8.2% vs. Composite 8.0%), and had provided a real rate of return over the latest 20 year period of 10.1%. He stated that the Basic Funds have slightly outperformed its composite index (Basic Funds 8.4% vs. Composite 8.2%) over the last five years and reported that the Post Fund has also outperformed its composite over the last five years period (Post Fund 8.0% vs. Composite 7.7%).

Mr. Bicker reported that the Basic Fund's assets increased 10.0% for the quarter ending June 30, 2003 due 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 11.3% vs. Composite 11.6%) and for the year (Basic Funds 1.9% vs. Composite 2.4%).

Mr. Bicker reported that the market value of the Post Fund's assets increased 10.8% for the quarter ending June 30, 2003 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 11.6% vs. Composite 11.7%) and for the year (Post Fund 2.8% vs. Composite 3.3%).

Mr. Bicker reported that the domestic stock manager group underperformed its target for the quarter (Domestic Stock 15.8% vs. Wilshire 5000 Investable 16.1%) and for the year (Domestic Stocks 0.4% vs. Wilshire 5000 Investable 0.8%). He said the International Stock manager group underperformed its composite index for the quarter (International Stocks 19.1% vs. Int'l Composite 19.6%) and for the year (International Stocks -6.2% vs. Int'l Composite -5.4%). Mr. Bicker stated that the bond segment outperformed its target for the quarter (Bonds 2.9% vs. Lehman Aggregate 2.5%) and for the year (Bonds 10.7% vs. Lehman Aggregate 10.4%). He concluded his report with the comment that as of June 30, 2003, the SBI was responsible for over \$43 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 asked Christie Eller, Assistant Attorney General, to update members on the status of litigation. She noted that the SBI is the plaintiff in four different securities actions. She stated that the case against McKesson HBOC is being brought in state court in California with pension plans from Colorado, Utah and Oregon. She said that the federal judge ruled in favor of the plaintiff in a cross claim and said that shareholders should not be held liable for profits they made when they were not part of the fraud. Ms. Eller reported that the Broadcom litigation is proceeding and that the class certification motion will be argued on September 22, 2003. She reported that the discovery cutoff is March 4, 2004 and that the trial date is set in July 2004. She said that the class action against AOL Time Warner is in the early stages and that the State is preparing responses to the motion to dismiss. Ms. Eller stated that the case involving WorldCom bonds is an action against the investment banks and not against the company. She added that other pension funds have also filed similar actions and that they have been consolidated with the bankruptcy. She said the next hearing will be September 8, 2003.

Mr. Bicker stated that SBI staff prepared a resolution for the Board's consideration that would not require seconds to motions made at Board meetings.

#### **Administrative Committee Report**

Mr. Bicker referred members to Tab C of the meeting materials and stated that the SBI currently reviews international countries regarding their worker and human rights records. He said the countries are categorized into three groups. He said that Group I countries have legal protections in place for both worker and human rights; Group II countries have legal protections in place but have documented violations; and, Group III countries lack protections for basic worker and human rights. He explained that in the past, staff has prepared extensive write-ups on all the countries in all three groups. He

said that the Committee's recommendation is to do only the reviews for countries included in the asset class target that fall in Group II or Group III. Mr. Bohan moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. McDonald seconded the motion. The motion passed.

#### **Deferred Compensation Review Committee**

Mr. Bergstrom, Executive Director of the Minnesota State Retirement System (MSRS) referred members to Tab D of the meeting materials and reported that the Committee has two recommendations for consideration. He stated that the Committee is recommending that the INVESCO Total Return Fund be replaced by the Dodge & Cox Balanced Fund. He noted that INVESCO has underperformed and has had several management changes. In response to questions from Commissioner McElroy, Mr. Bicker confirmed that Dodge & Cox is currently a fixed income manager for the SBI and that they are a medium sized fund. Mr. Norstrom moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. McDonald seconded the motion. The motion passed.

Mr. Bergstrom stated that the Committee's second recommendation is to adopt daily pricing for all investment options in the State Deferred Compensation Plan (Plan), and he briefly reviewed the changes that would be made to move out of the monthly-valued Supplemental Investment Fund (SIF) accounts and into the proposed mutual fund accounts. He noted that daily pricing will allow prompt transfers between options and faster payments to participants. In response to a question from Ms. Johnston, Mr. Bergstrom stated that monthly valued accounts were very common at the time the SIF accounts were created. He added that the industry norm is now daily pricing.

Mr. Bergstrom stated that the Committee had reviewed and is recommending mutual fund replacements as follows: The Growth Share Account will be replaced by the Smith Barney Appreciation Y Fund. The Income Share Account will be replaced by the Vanguard Balanced Index Fund. The Bond Market Account will be replaced with the Vanguard Total Bond Market Index and the International Share Account will be replaced by the Vanguard Developed Markets Index. Mr. Bicker added that the addition of daily pricing will not cause a significant increase in costs to the Plan due to the way it is being set up and other cost savings that have taken place recently in the Plan.

In response to a question from Mr. Brick, Mr. Bergstrom stated that of the two balanced fund options being recommended, Dodge & Cox is actively managed and the Vanguard option is passively managed. In response to questions from Mr. Bohan, Mr. Bicker confirmed that the benchmarks used will be the Lehman Aggregate and the S&P 500. Ms. Vanek moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. McDonald seconded the motion. The motion passed.

In response to a question from Mr. Norstrom, Mr. Bicker confirmed that these changes only affect the Deferred Compensation Plan and that the SIF investment options will remain for the fire relief associations and participants in the Unclassified Retirement Plan and the other plans using the SIF.

### **Asset Allocation Committee Report**

Mr. Bicker referred members to Tab E of the meeting materials and reminded members that at the June 2003 meeting, the Asset Allocation decision was tabled until the September 2003 meeting. He said that after further analysis and review, the Committee is re-affirming the proposed long-term asset allocations for the Basic and Post Retirement Funds. He reviewed the proposed asset allocation recommendations, noting that the Committee had amended the recommendation from the prior meeting to include language that the Basic Funds would remain at their current target of 15% in alternative investments until the proposed allocation of 12% for alternative investments in the Post Fund is reached. Mr. Gudorf moved approval of the Committee's recommendation as stated in the Committee Report. Mr. Bohan seconded the motion. The motion passed.

Mr. Troutman stated that he would like to confirm that the Committee believes that the recommendation is not motivated by the IAC's discussion of the 8.5% required rate of return and that the Committee believes it is an appropriate long term proposal for the Basics and Post given the long-term nature and time horizons of the funds. Mr. Bohan confirmed that was the Committee's sentiment.

Mr. Bicker discussed several proposed changes that are being recommended to the asset class targets and asset class structure. He said that there are no changes being proposed for the fixed income or alternative investment programs. He stated that the Committee is recommending that the international program use the MSCI All Country World ex. U.S. Index as its asset class target. He noted that the new target includes Canada. In response to a question from Mr. Gudorf, Ms. Posey stated that the All Country World Index includes all developed countries and emerging markets by market capitalization. Mr. Troutman reported that the Committee is also recommending an allocation to semi-passive management.

Mr. Bicker stated that the major changes to the domestic equity program include changing the asset class target to the Russell 3000 Index, using the Russell sub-indices to measure active managers, using the Russell 1000 to measure semi-passive managers, using the Russell 3000 to measure the passive index fund, and to use ranges in the allocation among active, semi-passive and passive management.

In response to a question from Mr. Gudorf, Mr. Bicker stated that one of the main advantages of using the Russell 3000 is that it is a published index and that it has sub-indexes that can be used to evaluate the active managers. In response to a question from Commissioner McElroy, Mr. Bicker stated that the changes would be effective October 1, 2003. In response to questions from Mr. Bohan, Mr. Bicker stated that the Committee will discuss reporting issues regarding these changes at its November 2003 meeting. Commissioner McElroy moved approval of the Committee's asset class target and structure recommendation, as stated in the Committee Report. Mr. Bohan seconded the motion. The motion passed. Mr. Troutman and Mr. Bicker thanked Committee members and staff for their hard work on the asset allocation review.



Mr. Bicker referred members to page 65 of Tab E of the meeting materials concerning the appropriateness of the 8.5% actuarial rate of return. He reported that staff and the Committee concluded that the 8.5% assumption used by the Minnesota statewide pension systems is reasonable and in line with other public and corporate plans. A discussion followed on the differences between corporate and public plans and about the fiscal impact a reduction in the required return would have on the retirement systems. Further discussion took place with members agreeing that the situation should continue to be monitored.

**Stock and Bond Manager Committee Report**

Mr. Bohan referred members to Tab F of the meeting materials and reviewed the performance of the stock and bond managers. He stated that the Committee is recommending the termination of Forstmann-Leff, due to changes in management, and Valenzuela Capital due to poor performance. Mr. Bohan moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. Bergstrom seconded the motion. The motion passed.

**Alternative Investment Committee Report**

Mr. Gudorf referred members to Tab G of the meeting materials, and stated that the Committee has no action items for Board approval this quarter. He noted that the Basic and Post alternative assets had been pooled and that there was sufficient allocation available to make the investments in the Piper and Goldman funds that had been approved by the Board at the June 2003 meeting.

The meeting adjourned at 3:32 P.M.

Respectfully submitted,



Howard J. Bicker  
Executive Director

# **Tab A**

**LONG TERM OBJECTIVES**  
**Period Ending 9/30/2003**

<b>COMBINED FUNDS: \$33.9 Billion</b>	<b>Result</b>	<b>Compared to Objective</b>
<p><b>Match or Exceed Composite Index (10 Yr.)</b></p> <p>Outperform a composite market index weighted in a manner that reflects the long-term asset allocation of the Combined Funds over the latest 10 year period.</p>	<b>8.1% (1)</b>	0.1 percentage point above target
<p><b>Provide Real Return (20 yr.)</b></p> <p>Provide returns that are 3-5 percentage points greater than inflation over the latest 20 year period.</p>	<b>10.3%</b>	7.2 percentage points above CPI

<b>BASIC RETIREMENT FUNDS: \$17.0 Billion</b>	<b>Result</b>	<b>Compared to Objective</b>
<p><b>Match or Exceed Composite Index (10 Yr.)</b></p> <p>Outperform a composite market index weighted in a manner that reflects the long-term asset allocation of the Basic Funds over the latest 10 year period.</p>	<b>8.3%</b>	0.1 percentage point above target

<b>POST RETIREMENT FUND: \$16.9 Billion</b>	<b>Result</b>	<b>Compared to Objective</b>
<p><b>Match or Exceed Composite Index (10 Yr.)</b></p> <p>Outperform a composite market index weighted in a manner that reflects the long-term asset allocation of the Post Fund over the latest 10 year period.</p>	<b>7.9%</b>	0.2 percentage point above target

(1) Performance is calculated net of fees.

## SUMMARY OF ACTUARIAL VALUATIONS

## MSRS, TRA, PERA General Plans

July 1, 2002

	Active (Basics)	Retired (Post)	Total (Combined)
<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

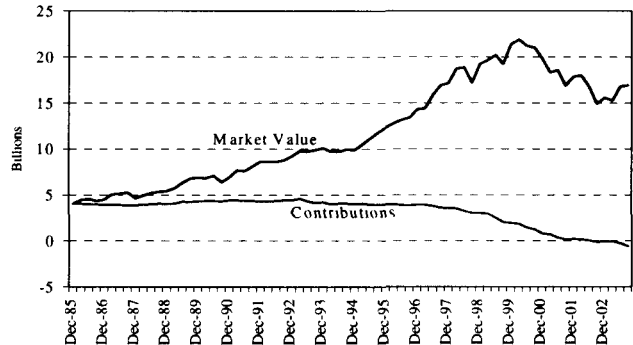
**EXECUTIVE SUMMARY**  
**Basic Retirement Funds (Net of Fees)**

**Asset Growth**

The market value of the Basic Funds increased 1.0% during the third quarter of 2003. Positive investment returns accounted for the increase.

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

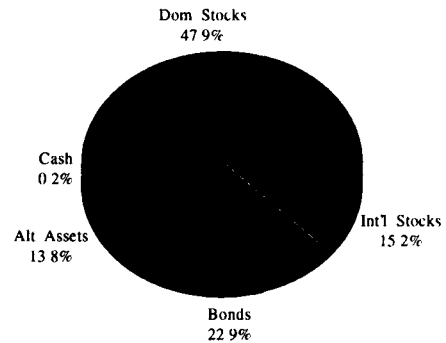
Beginning Value	\$ 16,781
Net Contributions	-324
Investment Return	495
Ending Value	\$ 16,952



**Asset Mix**

The allocation to domestic stocks and international stocks increased over the quarter due to their relative outperformance versus other asset classes.

	Policy Targets	Actual Mix 9/30/2003	Actual Market Value (Millions)
Domestic Stocks	45.0%	47.9%	\$8,112
Int'l. Stocks	15.0	15.2	2,576
Bonds	24.0	22.9	3,887
Alternative Assets*	15.0	13.8	2,345
Unallocated Cash	1.0	0.2	31
	100.0%	100.0%	\$16,951

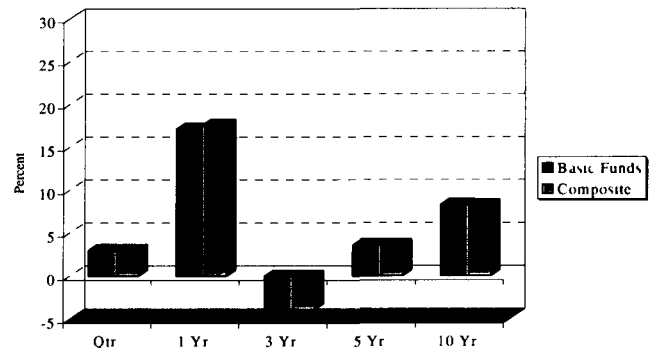


\* Any uninvested allocation is held in domestic stocks

**Fund Performance (Net of Fees)**

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

	Qtr.	Period Ending 9/30/2003			
		1 Yr.	3 Yr.	5 Yr.	10 Yr.
Basics	3.0%	17.1%	-3.7%	3.6%	8.3%
Composite	3.0	17.5	-3.9	3.6	8.2



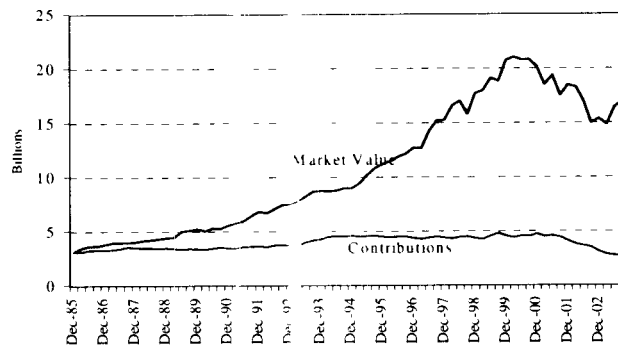
**EXECUTIVE SUMMARY**  
**Post Retirement Fund (Net of Fees)**

**Asset Growth**

The market value of the Post Fund increased by 2.8% during the third quarter of 2003. Positive investment returns accounted for the increase.

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

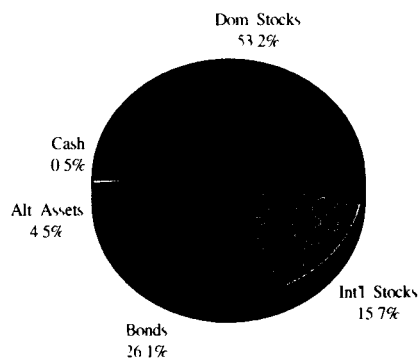
Beginning Value	\$16,458
Net Contributions	-50
Investment Return	514
Ending Value	\$16,922



**Asset Mix**

The domestic stock and international stock allocations increased this quarter due to the relative outperformance versus other asset classes.

	<b>Policy Targets</b>	<b>Actual Mix 9/30/2003</b>	<b>Actual Market Value (Millions)</b>
Domestic Stocks	<b>50.0%</b>	53.2%	\$9,003
Int'l Stocks	<b>15.0</b>	15.7	2,659
Bonds	<b>27.0</b>	26.1	4,413
Alternative Assets*	<b>5.0</b>	4.5	767
Unallocated Cash	<b>3.0</b>	0.5	80
	<b>100.0%</b>	100.0%	\$16,922

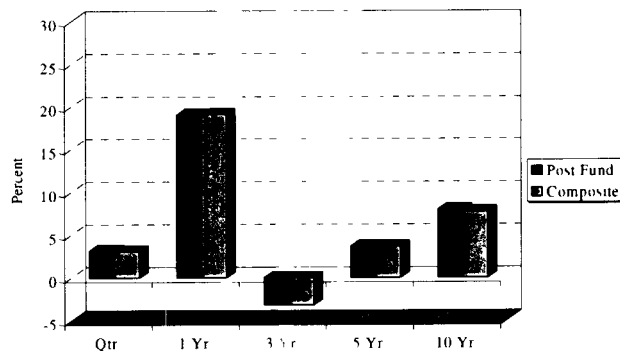


\* Any uninvested allocation is held in bonds

**Fund Performance (Net of Fees)**

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

	<b>Period Ending 9/30/2003</b>				
		<b>Annualized</b>			
	<b>Qtr</b>	<b>1 Yr</b>	<b>3 Yr.</b>	<b>5 Yr</b>	<b>10 Yr.</b>
<b>Post</b>	<b>3.2%</b>	<b>19.0%</b>	<b>-3.2%</b>	<b>3.7%</b>	<b>7.9%</b>
<b>Composite</b>	3.1	19.1	-3.2	3.6	7.7



## EXECUTIVE SUMMARY

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

#### Domestic Stocks

The domestic stock manager group (active, semi-passive and passive combined) matched its target for the quarter and underperformed for the one-year period.

	Period Ending 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Dom. Stocks</b>	<b>3.5%</b>	<b>25.4%</b>	<b>-10.3%</b>	<b>1.0%</b>	<b>8.9%</b>
W5000 Investable*	3.5	26.1	-10.2	1.4	9.2

\* 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 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Int'l. Stocks</b>	<b>8.5%</b>	<b>26.8%</b>	<b>-7.3%</b>	<b>2.1%</b>	<b>4.1%</b>
Composite Index*	8.7	27.7	-7.8	1.6	2.7

\* 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 semi-passive combined) outperformed its target for the quarter and one-year time periods.

	Period Ending 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Bonds</b>	<b>0.1%</b>	<b>6.9%</b>	<b>9.2%</b>	<b>6.8%</b>	<b>7.1%</b>
Lehman Agg.	-0.1	5.4	8.9	6.6	6.9

#### Alternative Investments

	Period Ending 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Alternatives</b>	<b>0.5%</b>	<b>3.9%</b>	<b>0.7%</b>	<b>6.3%</b>	<b>12.4%</b>

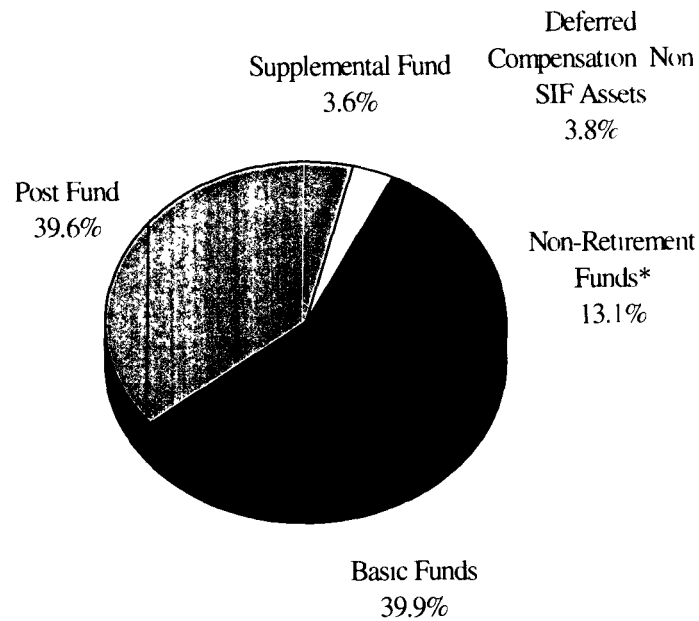
**Wilshire 5000 Investable:** The Wilshire 5000 Investable stock index reflects the performance of a broad range of publicly traded stocks of companies domiciled in the U.S. It does not include the smallest and least liquid securities in the W5000 that generally are not owned by large pension plans.

**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>9/30/2003 Market Value (Billions)</b>
<b>Retirement Funds</b>	
Basic Retirement Funds	\$17.0
Post Retirement Fund	16.9
Supplemental Investment Fund	1.5
State Deferred Compensation Plan Non-SIF Assets	1.6
<b>Non-Retirement Funds*</b>	
Assigned Risk Plan	0.2
Permanent School Fund	0.5
Environmental Trust Fund	0.3
State Cash Accounts	4.6
<b>Total</b>	<b>\$42.6</b>



# MINNESOTA STATE BOARD OF INVESTMENT

## QUARTERLY INVESTMENT REPORT

Third Quarter 2003

(July 1, 2003 - September 30, 2003)

### Table of Contents

	Page
<b>Capital Market Indices</b> .....	2
<b>Financial Markets Review</b> .....	3
<b>Combined Funds</b> .....	5
<b>Basic Retirement Funds</b> .....	9
<b>Post Retirement Fund</b> .....	12
<b>Stock and Bond Manager Pools</b> .....	15
<b>Alternative Investments</b> .....	16
<b>Supplemental Investment Fund</b> .....	17
Fund Description	
Income Share Account	
Growth Share Account	
Common Stock Index Account	
International Share Account	
Bond Market Account	
Money Market Account	
Fixed Interest Account	
<b>Assigned Risk Plan</b> .....	20
<b>Permanent School Fund</b> .....	21
<b>Environmental Trust Fund</b> .....	22
<b>Closed Landfill Investment Fund</b> .....	23
<b>State Cash Accounts</b> .....	24
<b>Composition of State Investment Portfolios</b> .....	25

## VARIOUS CAPITAL MARKET INDICES

	Period Ending 9/30/2003				
	Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Domestic Equity</b>					
Wilshire 5000	3.7%	26.3%	-9.5%	2.0%	9.5%
Dow Jones Industrials	3.8	25.1	-2.6	5.3	12.4
S&P 500	2.6	24.4	-10.1	1.0	10.0
Russell 3000 (broad market)	3.4	25.9	-9.7	1.9	9.7
Russell 1000 (large cap)	3.0	25.1	-10.3	1.5	9.9
Russell 2000 (small cap)	9.1	36.5	-0.8	7.5	8.3
<b>Domestic Fixed Income</b>					
Lehman Aggregate (1)	-0.1	5.4	8.9	6.6	6.9
Lehman Gov't./Corp.	-0.5	6.5	9.6	6.7	7.0
3 month U.S. Treasury Bills	0.2	1.2	2.6	3.6	4.3
<b>International</b>					
EAFE (2)	8.1	26.0	-8.7	0.6	2.9
Emerging Markets Free (3)	14.2	46.0	1.8	10.6	1.4
ACWI ex-U.S. (4)	8.7	29.0	-7.4	2.1	3.3
World ex-U.S. (5)	8.1	27.0	-8.7	1.0	3.2
Salomon Non U.S. Gov't. Bond	2.8	17.8	10.8	4.9	6.1
<b>Inflation Measure</b>					
Consumer Price Index (6)	0.8	2.3	2.2	2.5	2.5

(1) Lehman Brothers Aggregate Bond index. Includes governments, corporates and mortgages.

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

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

(4) Morgan Stanley Capital International All Country World Index Ex-U.S. (Gross index)

(5) Morgan Stanley Capital International World Ex-U.S. Index (Developed Markets) [Net index]

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

FINANCIAL MARKETS REVIEW

DOMESTIC STOCKS

The U.S. stock market, as measured by the W5000, advanced by 3.7% during the third quarter of 2003. The recovery in the U.S. is gradually improving, based on leading economic indicators, while the jobless rate remains high. The market reacted generally positively to the mixed data. So far this year, smaller, high P/E, low-yield stocks have outperformed larger, better-quality companies. The electronic technology sector was the best performing sector, while communications was the worst area of the market.

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

Large Value	2.5%
Small Value	8.6
Large Growth	3.2
Small Growth	9.6

The Wilshire 5000 returned 26.3% for the year ending September 30, 2003.

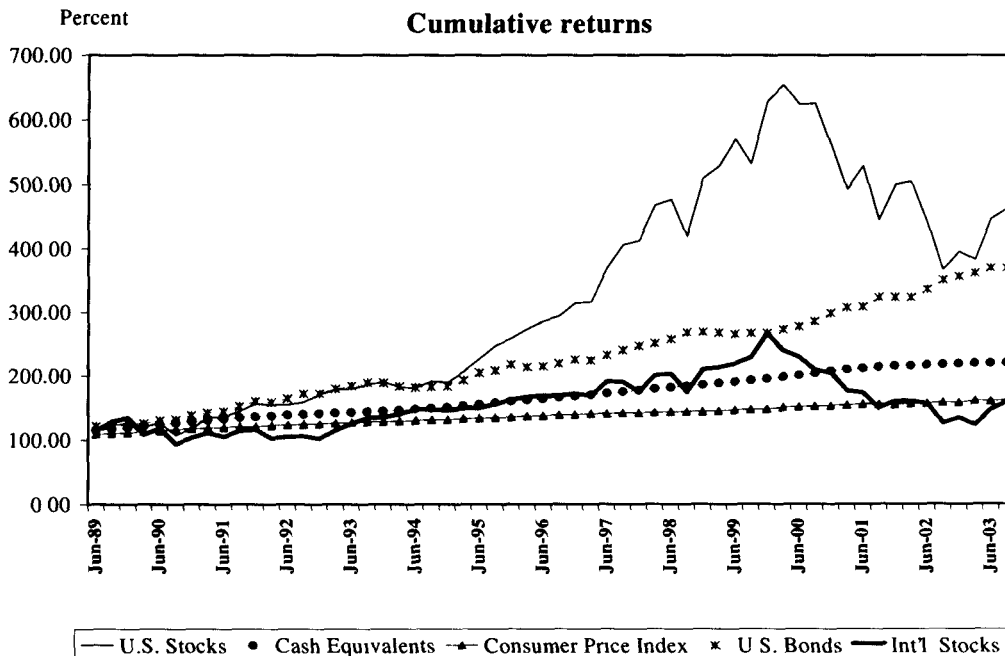
DOMESTIC BONDS

The bond market generated a negative return of 0.20% for the quarter and posted a gain of 5.4% for the year. The negative return for the quarter was the result of interest rates increasing by 0.8% in the month of July. The increase in rates was the result of faster economic growth than anticipated and indications that capital spending by corporations was starting to pick up. Mortgages suffered their worst month ever in July due to the significant increase in the 10 year treasury rate. The rate increase caused the mortgage duration and volatility to increase significantly. The mortgage market recovered some in September, but only about one third of what it lost relative to treasuries in July. Credit spreads continued their rally during the quarter as investors continued to buy corporates to add yield to their portfolios.

The major sector returns for the Lehman Aggregate for the quarter were:

Treasury/Agency	-0.8%
Credit	-0.1
Mortgages	0.5

PERFORMANCE OF CAPITAL MARKETS



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 8.1% for the quarter. The quarterly performance of the five largest stock markets is shown below:

United Kingdom	3.5%
Japan	21.8
France	3.0
Switzerland	7.5
Germany	3.4

The EAFE index decreased by 26.0% 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 14.2% for the quarter. The quarterly performance of the five largest stock markets in the index is shown below:

Korea	9.8%
Taiwan	23.2
South Africa	15.1
Mexico	4.6
Brazil	18.3

The Emerging Markets Free index increased by 46.0% 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 has contributed 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 look for a more restrained supply to lead to improving fundamentals in 2004.

### 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. The first three quarters of 2003 have seen \$18 billion raised.

### RESOURCE FUNDS

During the third quarter of 2003, crude oil averaged \$30.21 per barrel, slightly higher than an average price of \$28.91 during the second quarter of 2003. 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.

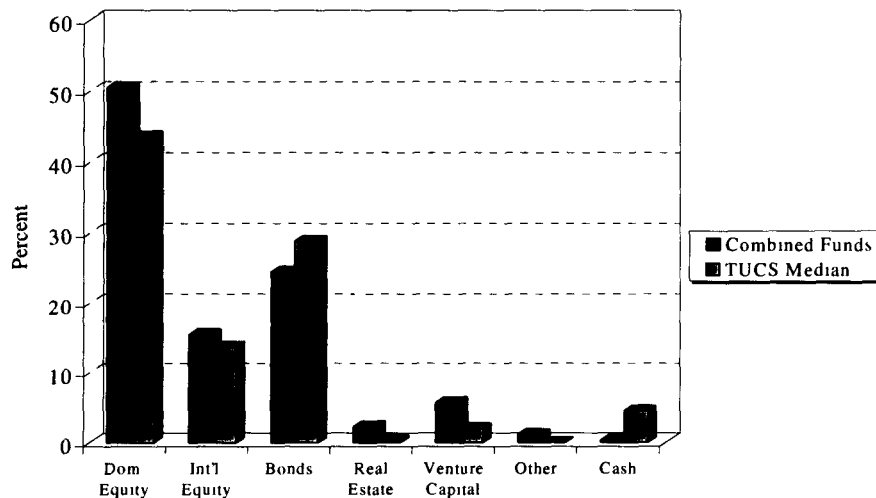
The comparison universe used by the SBI is the Trust Universe Comparison Service (TUCS). Only funds with assets over \$1 billion are included in the comparisons shown in this section.

Asset Mix Compared to Other Pension Funds

On September 30, 2003, the actual asset mix of the Combined Funds was:

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:

	\$ Millions	%
Domestic Stocks	\$17,115	50.5%
International Stocks	5,235	15.5
Bonds	8,300	24.5
Alternative Assets	3,112	9.2
Unallocated Cash	111	0.3
<b>Total</b>	<b>\$33,873</b>	<b>100.0%</b>



	Dom. Equity	Int'l Equity	Bonds	Real Estate	Venture Capital	Other	Cash
<b>Combined Funds</b>	<b>50.5%</b>	<b>15.5%</b>	<b>24.5%</b>	<b>2.3%</b>	<b>5.7%</b>	<b>1.2%</b>	<b>0.3%</b>
Median Allocation in TUCS*	43.6	13.7	28.9	0.3	2.0	0.0	4.5

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

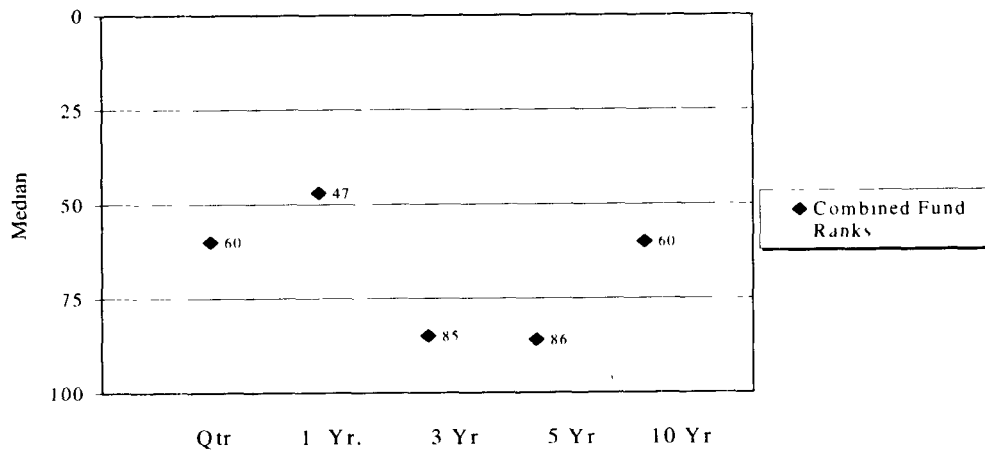
**COMBINED FUNDS  
Performance Compared to Other Pension Funds**

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.



	Period Ending 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
Combined Funds Percentile Rank in TUCS*	60th	47th	85th	86th	60th

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

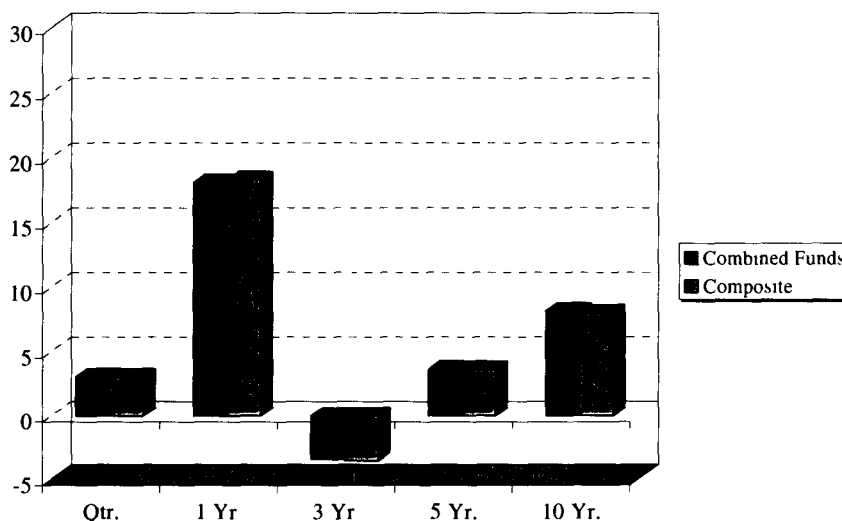
**COMBINED FUNDS  
Performance Compared to Composite Index**

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* 3Q03</b>
Domestic Stocks	Wilshire 5000 Investable	48.1%*
Int'l. Stocks	Int'l. Composite	15.0
Bonds	Lehman Aggregate	25.7*
Alternative Investments	Alternative Investments	9.2*
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 9/30/2003**

	<b>Qtr.</b>	<b>1 Yr.</b>	<b>3 Yr.</b>	<b>Annualized 5 Yr.</b>	<b>10 Yr.</b>
<b>Combined Funds**</b>	<b>3.1%</b>	<b>18.1%</b>	<b>-3.4%</b>	<b>3.6%</b>	<b>8.1%</b>
<b>Composite Index</b>	<b>3.0</b>	<b>18.3</b>	<b>-3.5</b>	<b>3.6</b>	<b>8.0</b>

\*\*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

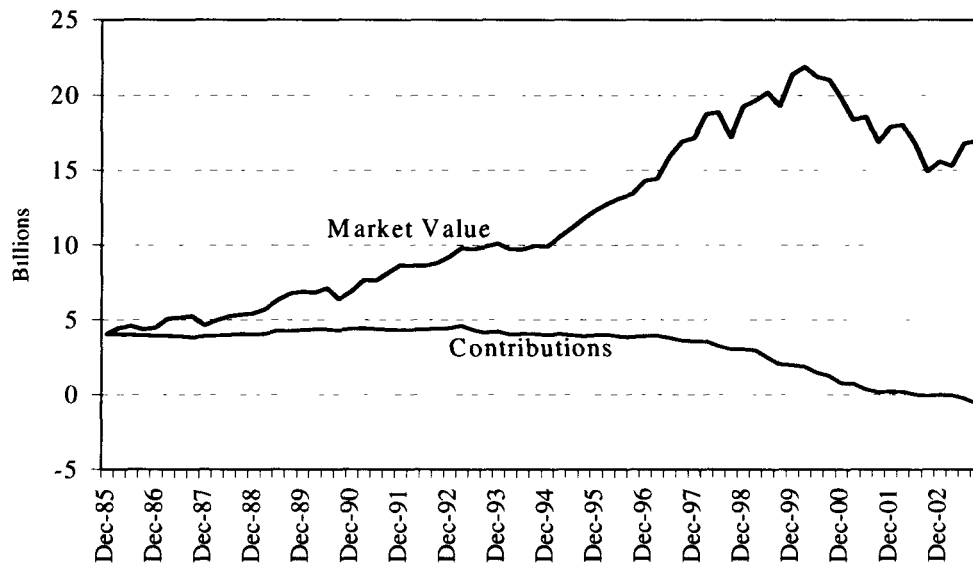
projected pension costs, the Basic Retirement Funds must generate investment returns of at least 8.5% on an annualized basis, over time.

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 increased 1.0% during the third quarter of 2003.

Positive investment returns accounted for the increase.



	Last Five Years							Latest Qtr.
	In Millions							
	12/98	12/99	12/00	12/01	12/02	3/03	6/03	9/03
Beginning Value	\$17,146	\$19,244	\$21,365	\$19,807	\$17,874	\$15,561	\$15,257	\$16,781
Net Contributions	-539	-1,065	-1,186	-572	-247	-19	-201	-324
Investment Return	2,637	3,186	-372	-1,361	-2,066	-285	1,725	495
Ending Value	\$19,244	\$21,365	\$19,807	\$17,874	\$15,561	\$15,257	\$16,781	\$16,952

**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

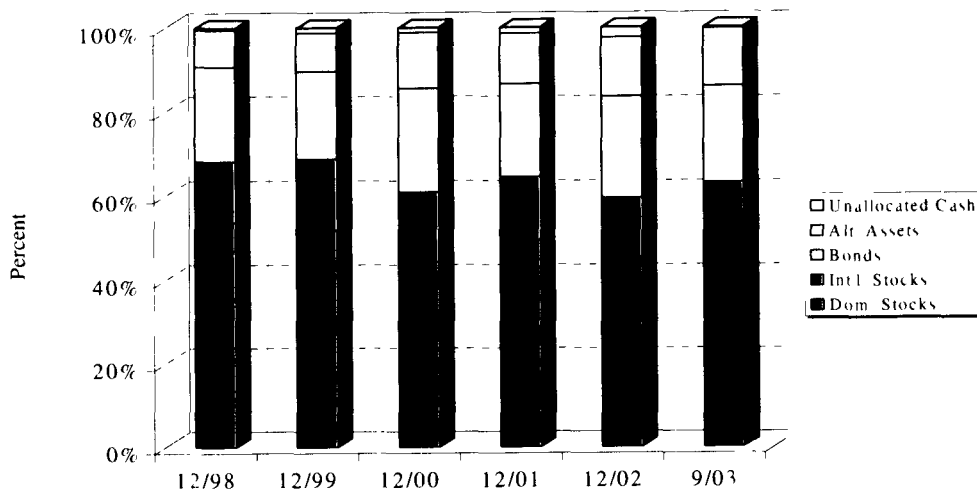
In October 1995, the Board revised its long term asset allocation targets for the Basic Funds, increasing international stocks from 10% to 15% and decreasing domestic stocks from 50% to 45%. The change was implemented over several quarters.

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

The domestic stock and international stock allocations increased over the quarter due to their relative outperformance versus other asset classes

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

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



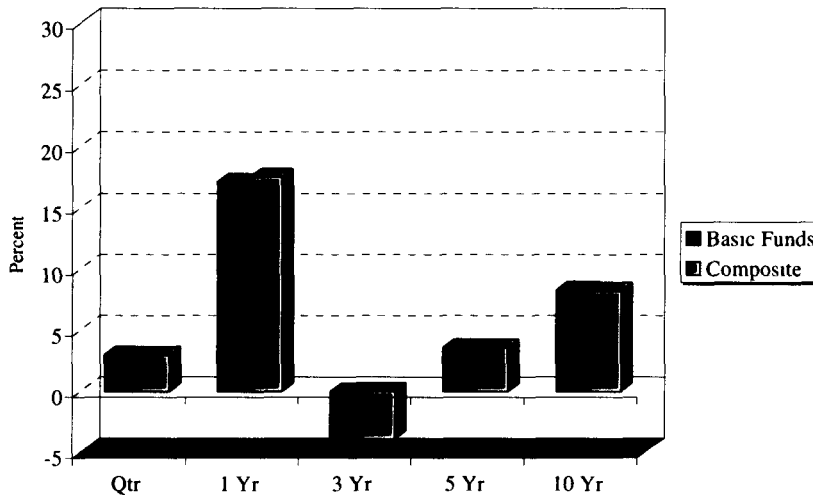
	Last Five Years							Latest Qtr.	
	12/98	12/99	12/00	12/01	12/02	3/03	6/03	9/30	
Domestic Stocks	53.8%	51.9%	44.3%	49.5%	45.3%	45.0%	47.7%	47.9%	
Int'l. Stocks	14.4	16.8	16.6	15.0	14.1	13.4	14.4	15.2	
Bonds	22.6	21.0	24.7	22.1	24.2	25.3	23.5	22.9	
Alternative Assets	8.8	9.1	13.3	12.1	14.1	14.7	13.9	13.8	
Unallocated Cash	0.4	1.2	1.1	1.3	2.3	1.6	0.5	0.2	
Total	100.0%	100.0%	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:

	<b>Basics Target</b>	<b>Market Index</b>	<b>Basics Composite* 3Q03</b>
Domestic Stocks	45.0%	Wilshire 5000 Investable	46.2%*
Int'l. Stocks	15.0	Int'l Composite	15.0
Bonds	24.0	Lehman Aggregate	24.0
Alternative Investments	15.0	Alternative Investments	13.8*
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 9/30/2003**

	<b>Qtr.</b>	<b>1 Yr.</b>	<b>3 Yr.</b>	<b>Annualized 5 Yr.</b>	<b>10 Yr.</b>
<b>Basic Funds**</b>	<b>3.0%</b>	<b>17.1%</b>	<b>-3.7%</b>	<b>3.6%</b>	<b>8.3%</b>
<b>Composite Index</b>	<b>3.0</b>	<b>17.5</b>	<b>-3.9</b>	<b>3.6</b>	<b>8.2</b>

\*\*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.

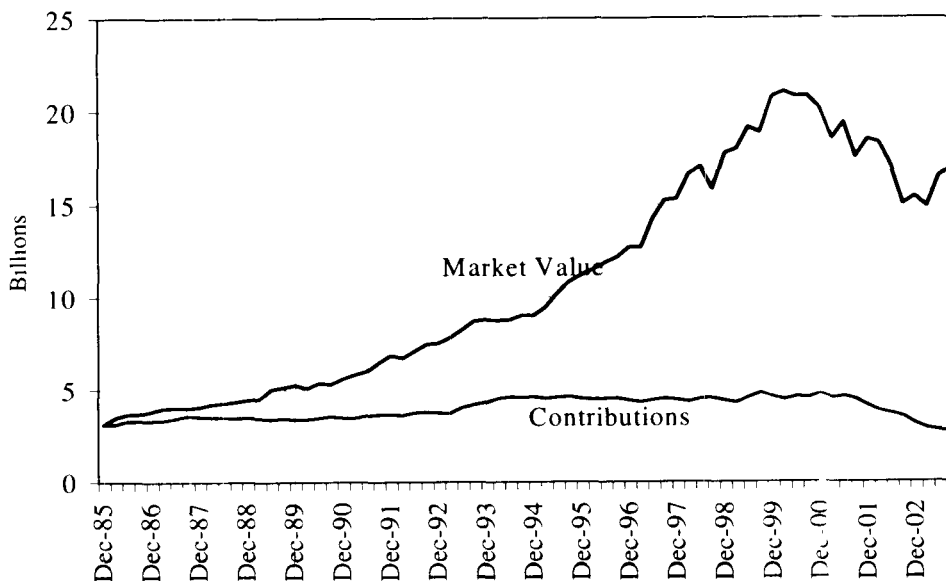
The post retirement benefit increase formula is based on the total return of the Fund. As a result, the Board maintains a long-term asset allocation strategy for the Post Fund which incorporates a substantial commitment to common stocks.

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 increased by 2.8% during the third quarter of 2003.

Positive investment returns accounted for the increase.



	Last Five Years							Latest Qtr.
	In Millions							
	12/98	12/99	12/00	12/01	12/02	3/03	6/03	9/03
Beginning Value	\$15,273	17,743	\$20,768	\$20,153	\$18,475	\$15,403	\$14,853	\$16,458
Net Contributions	-45	211	167	-647	-1,000	-266	-95	-50
Investment Return	2,515	2,814	-782	-1,031	-2,072	-284	1,700	514
Ending Value	\$17,743	20,768	\$20,153	\$18,475	\$15,403	\$14,853	\$16,458	\$16,922

**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%.

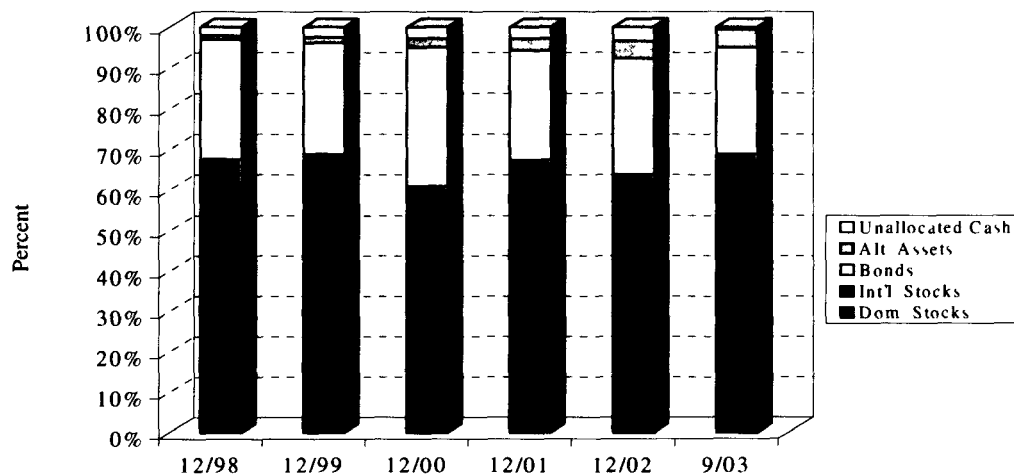
During the quarter, the domestic stock and international stock allocations increased due to the relative outperformance versus other asset classes.

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

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.



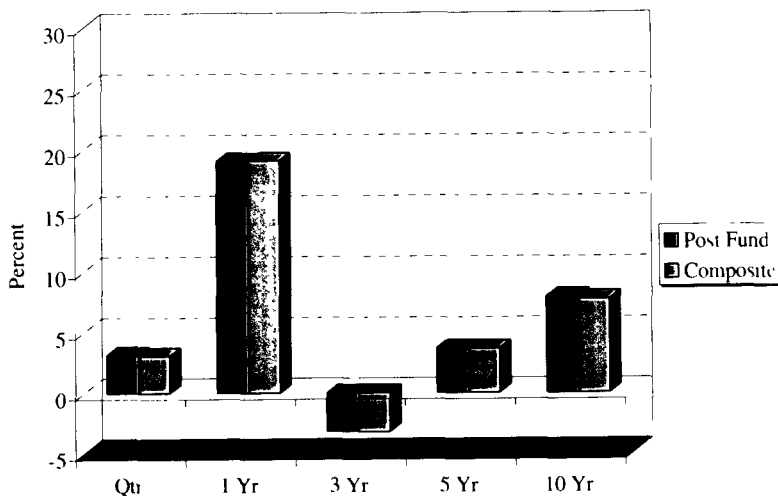
	Last Five years						Latest Qtr.	
	12/98	12/99	12/00	12/01	12/02	3/03	6/03	9/03
Dom. Stocks	53.2	52.0%	47.5%	52.4%	49.6%	50.1%	51.9%	53.2%
Int'l. Stocks	14.5	16.9	13.5	15.1	14.4	13.5	14.7	15.7
Bonds	29.2	27.2	34.0	26.7	28.3	29.1	27.2	26.1
Alt. Assets	1.1	1.5	2.3	3.1	4.5	4.9	4.6	4.5
Unallocated Cash	2.0	2.4	2.7	2.7	3.2	2.5	1.6	0.5
Total	100.0%	100.0%	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* 3Q03
Domestic Stocks	50.0%	Wilshire 5000 Investable	50.0%
Int'l Stocks	15.0	Int'l. Composite	15.0
Bonds	27.0	Lehman Aggregate	27.4*
Alternative Investments	5.0	Alternative Investments	4.6*
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 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	Annualized 5 Yr.	10 Yr.
<b>Post Fund**</b>	<b>3.2%</b>	<b>19.0%</b>	<b>-3.2%</b>	<b>3.7%</b>	<b>7.9%</b>
Composite Index	3.1	19.1	-3.2	3.6	7.7

\*\* 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)

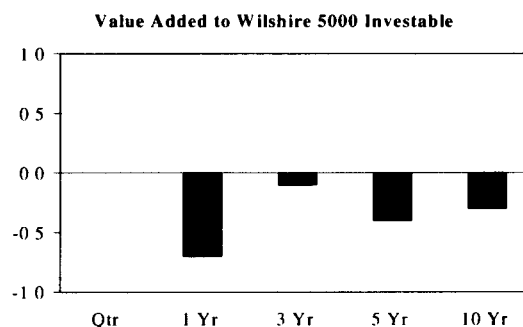
#### Domestic Stocks

**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 9/30/2003				
		Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
Domestic Stocks	3.5%	25.4%	-10.3%	1.0%	8.9%
W5000 Investable*	3.5	26.1	-10.2	1.4	9.2

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



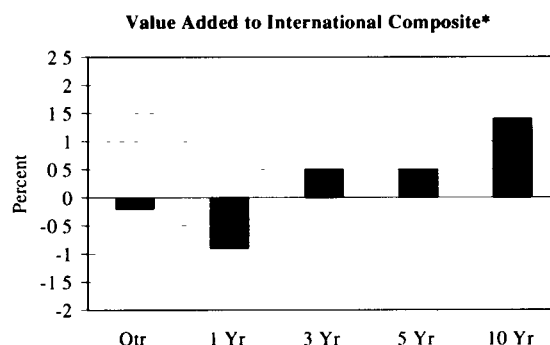
#### International Stocks

**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 9/30/2003				
		Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
Int'l. Stocks	8.5%	26.8%	-7.3%	2.1%	4.1%
Composite Index*	8.7	27.7	-7.8	1.6	2.7

\* 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.

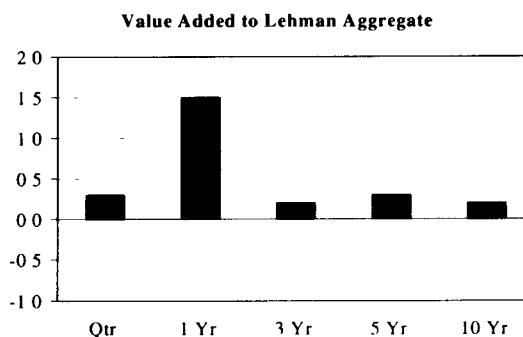


#### Bonds

**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 9/30/2003				
		Annualized			
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
Bonds	0.1%	6.9%	9.2%	6.8%	7.1%
Lehman Agg.	-0.1	5.4	8.9	6.6	6.9



## ALTERNATIVE INVESTMENTS

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

#### Alternative Investments

**Expectation:** The alternative investments are measured against themselves using actual portfolio returns

Period Ending 9/30/2003				
Annualized				
Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
0.5%	3.9%	0.7%	6.3%	12.4%

#### Real Estate Investments (Equity emphasis)

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

Period Ending 9/30/2003				
Annualized				
Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
1.4%	9.1%	7.1%	9.0%	9.6%

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

**Real Estate**      1.4%    9.1%    7.1%    9.0%    9.6%

#### Private Equity Investments (Equity emphasis)

**Expectation:** Private equity investments are expected to exceed the rate of inflation by 10% annualized, over the life of the investment.

Period Ending 9/30/2003				
Annualized				
Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
-0.1%	-1.1%	-5.8%	3.3%	14.7%

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

**Private Equity**    -0.1%   -1.1%   -5.8%   3.3%   14.7%

#### Resource Investments (Equity emphasis)

**Expectation:** Resource investments are expected to exceed the rate of inflation by 5% annualized, over the life of the investment

Period Ending 9/30/2003				
Annualized				
Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
-0.3%	5.6%	4.1%	6.2%	10.8%

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

**Resource**            -0.3%   5.6%   4.1%   6.2%   10.8%

#### Yield Oriented Investments (Debt emphasis)

**Expectation:** Yield oriented investments are expected to exceed the rate of inflation by 5.5% annualized, over the life of the investment

Period Ending 9/30/2003				
Annualized				
Qtr.	Yr.	3 Yr.	5 Yr.	Since 3/1/94
1.3%	9.5%	7.5%	10.0%	11.6%

The SBI began its yield oriented program in 1994. Some of the existing investments are relatively immature and returns may not be indicative of future returns.

**Yield Oriented**    1.3%    9.5%    7.5%    10.0%   11.6%

Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
0.8%	2.3%	2.2%	2.5%	2.5%

**Inflation**            0.8%    2.3%    2.2%    2.5%    2.5%



## 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 September 30, 2003 the market value of the entire Fund was \$1.5 billion.**

## Investment Options

	<b>9/30/2003 Market Value (In Millions)</b>
<b>Income Share Account</b> – a balanced portfolio utilizing both common stocks and bonds.	\$578
<b>Growth Share Account</b> – an actively managed, all common stock portfolio.	\$209
<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.	\$293
<b>International Share Account</b> – a portfolio of non U.S. stocks that incorporates both active and passive management.	\$54
<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.	\$101
<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.	\$142

## 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%	59.6%
Bonds	35.0	34.7
Unallocated Cash	5.0	5.7
	100.0%	100.0%

## Period Ending 9/30/2003

	Annualized				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Total Account</b>	<b>2.2%</b>	<b>17.5%</b>	<b>-3.2%</b>	<b>3.7%</b>	<b>8.6%</b>
Composite*	2.1	17.6	-2.7	3.9	8.6

\* 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 9/30/2003

	Annualized				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Total Account</b>	<b>3.5%</b>	<b>25.0%</b>	<b>-10.5%</b>	<b>0.6%</b>	<b>8.5%</b>
Composite*	3.5	26.1	-10.2	1.4	9.0

\* 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 9/30/2003

	Annualized				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Total Account</b>	<b>3.5%</b>	<b>25.9%</b>	<b>-10.1%</b>	<b>1.8%</b>	<b>9.5%</b>
Wilshire 5000 Investable*	3.5	26.1	-10.2	1.6	9.3

\* 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 9/30/2003

	Annualized				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	Since 9/1/94
<b>Total Account</b>	<b>8.5%</b>	<b>27.0%</b>	<b>-7.2%</b>	<b>2.2%</b>	<b>2.9%</b>
Composite*	8.7	27.7	-7.8	1.6	1.5

\* 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 9/30/2003

Annualized

	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Total Account</b>	<b>0.1%</b>	<b>7.0%</b>	<b>9.2%</b>	<b>6.9%</b>	<b>7.1%</b>
Lehman Agg.	-0.1	5.4	8.9	6.6	6.9

**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 9/30/2003

Annualized

	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Total Account</b>	<b>0.3%</b>	<b>1.4%</b>	<b>3.0%</b>	<b>4.1%</b>	<b>4.7%</b>
3 month T-Bills	0.2	1.2	2.6	3.6	4.3

**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 9/30/2003

Annualized

	Qtr.	1 Yr.	3 Yr.	5 Yr.	Since 11/1/94
<b>Total Account</b>	<b>1.1%</b>	<b>4.9%</b>	<b>5.7%</b>	<b>5.9%</b>	<b>6.3%</b>
Benchmark*	0.7	2.5	3.6	4.6	5.3

**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.

\* The Fixed Interest Benchmark is 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

	9/30/2003 Target	9/30/2003 Actual
Stocks	20.0%	24.1%
Bonds	80.0	75.9
Total	100.0%	100.0%

**Investment Management**

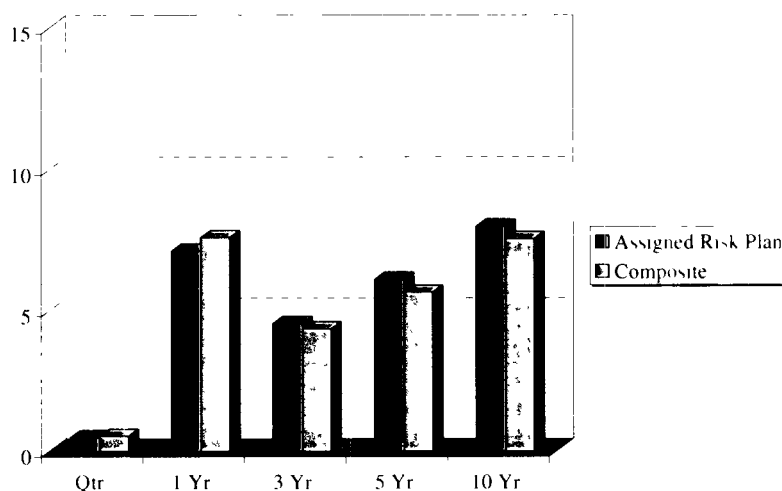
Voyageur Asset Management manages the bond segment of the Fund. GE Investment Management manages the equity segment

**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 September 30, 2003 the market value of the Assigned Risk Plan was \$235 million



**Period Ending 9/30/2003**

	Annualized					
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.	
<b>Total Fund*</b>	0.5%	7.1%	4.6%	6.1%	8.0%	* Actual returns are calculated net of fees.
Composite	0.5	7.6	4.4	5.7	7.6	
<b>Equity Segment*</b>	1.7	20.4	-7.0	3.5	11.1	
Benchmark	2.6	24.4	-10.1	1.0	10.0	
<b>Bond Segment*</b>	0.1	3.7	6.9	5.7	6.3	
Benchmark	0.0	3.5	7.9	6.5	6.6	

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.

	9/30/2003 Target	9/30/2003 Actual
Stocks	50.0%	51.8%
Bond	48.0	46.6
Unallocated Cash	2.0	1.6
Total	100.0%	100.0%

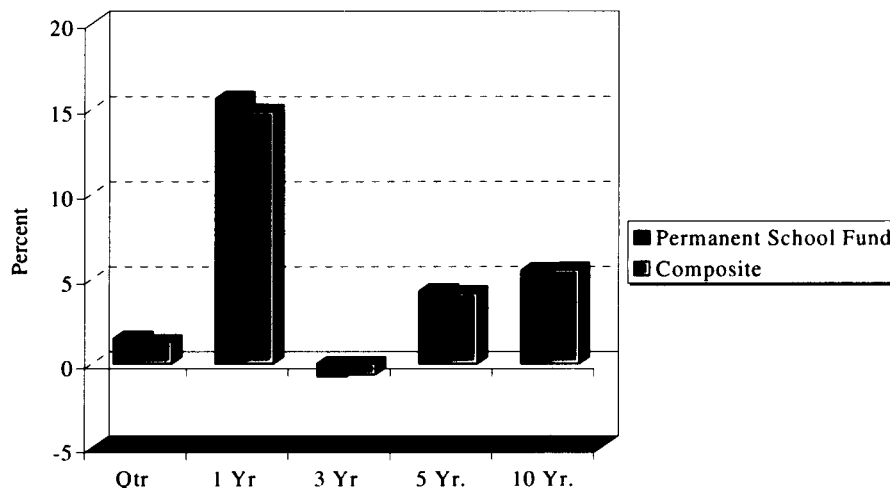
Prior to FY98, the Fund was invested entirely in fixed income securities in order to maximize current income. It is understood that the change in asset mix will reduce portfolio income in the short term, but will enhance the value of the fund, over time.

**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 September 30, 2003 the market value of the Permanent School Fund was \$536 million.



	Period Ending 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Total Fund (1) (2)</b>	1.5%	15.6%	-0.8%	4.3%	5.5%
Composite	1.3	14.8	-0.6	4.2	5.6
<b>Equity Segment (1) (2)</b>	2.7	24.5	-10.0	1.1	N/A
S&P 500	2.6	24.4	-10.1	1.0	N/A
<b>Bond Segment (1)</b>	0.2	7.4	9.0	6.8	7.1
Lehman Aggregate	-0.1	5.4	8.9	6.6	6.9

(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.

ENVIRONMENTAL TRUST FUND

**Investment Objective**

The objective of the Environmental Trust 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 Environmental Trust Fund 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. As of July 1, 1999, the asset

allocation changed from 50% stocks/50% fixed income to 70% stocks /30% fixed income.

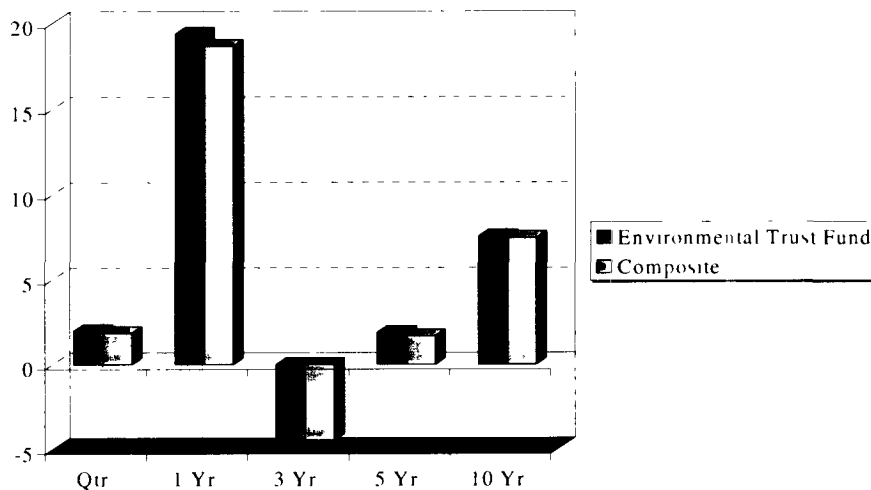
**Investment Management**

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

**Market Value**

On September 30, 2003 the market value of the Environmental Trust Fund was \$299 million.

	9/30/2003 Target	9/30/2003 Actual
Stocks	70.0%	70.4%
Bonds	28.0	29.0
Unallocated Cash	2.0	0.6
Total	100.0%	100.0%



	Period Ending 9/30/2003				
	Qtr.	1 Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Total Fund*</b>	2.0%	19.4%	-4.3%	1.9%	7.5%
Composite	1.9	18.6	-4.5	1.7	7.4
<b>Equity Segment*</b>	2.7	24.5	-10.0	1.1	10.2
S&P 500	2.6	24.4	-10.1	1.0	10.0
<b>Bond Segment*</b>	0.2	7.4	9.1	6.8	7.3
Lehman Agg	-0.1	5.4	8.9	6.6	6.9

\* 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**

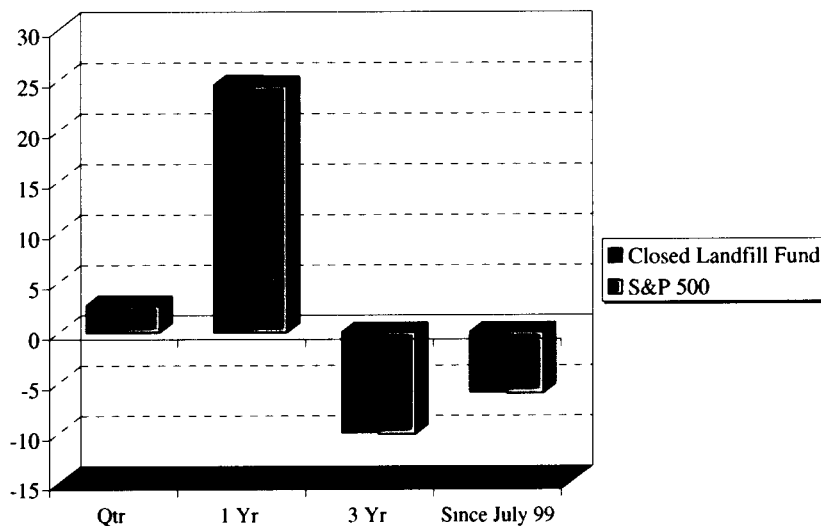
SBI staff manage all assets of the Closed Landfill Investment Fund. The assets are managed to passively track the performance of the S&P 500 index.

**Market Value**

On September 30, 2003, the market value of the Closed Landfill Investment Fund was \$17.2 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 9/30/2003			
	Qtr.	1 Yr.	3 Yr.	Since 7/1/99
<b>Total Fund (1)</b>	2.7%	24.5%	-9.9%	-5.9%
<b>S&amp;P 500 (2)</b>	2.6	24.4	-10.1	-6.1

- (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 9/30/2003				
		Qtr.	1 Yr.	3 Yr.	Annualized 5 Yr	10 Yr.
<b>Treasurer's Cash Pool*</b>	<b>\$3,559</b>	<b>0.3%</b>	<b>1.6%</b>	<b>3.5%</b>	<b>4.4%</b>	<b>4.8%</b>
Custom Benchmark**		0.1	0.9	3.0	3.8	4.5
<b>Trust Fund Cash Pool*</b>	<b>\$66</b>	<b>0.3</b>	<b>1.3</b>	<b>3.0</b>	<b>4.1</b>	<b>4.7</b>
Custom Benchmark***		0.1	0.8	2.3	3.4	4.3
3 month T-Bills		0.2	1.2	2.6	3.6	4.3

\* 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 September 30, 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	11,471 0.19%	0	1,431,573 22.94%	0	2,986,355 47.85%	949,183 15.21%	862,018 13.81%	6,240,600 100%
Public Employees Retirement Fund	6,395 0.15%	0	996,144 22.95%	0	2,079,861 47.91%	661,071 15.23%	597,471 13.76%	4,340,942 100%
State Employees Retirement Fund	5,579 0.15%	0	854,381 22.90%	0	1,784,214 47.82%	565,419 15.15%	521,676 13.98%	3,731,269 100%
Public Employees Police & Fire	3,155 0.15%	0	490,580 22.95%	0	1,024,349 47.92%	325,631 15.23%	293,963 13.75%	2,137,678 100%
Highway Patrol Retirement Fund	307 0.15%	0	45,999 22.86%	0	95,918 47.67%	30,268 15.05%	28,714 14.27%	201,206 100%
Judges Retirement Fund	39 0.15%	0	6,229 23.00%	0	12,998 47.99%	4,142 15.29%	3,676 13.57%	27,084 100%
Correctional Employees Retirement	331 0.15%	0	49,641 22.80%	0	103,962 47.76%	32,850 15.09%	30,911 14.20%	217,695 100%
Public Employees Correctional	3,376 6.18%	0	11,798 21.61%	0	24,617 45.09%	7,845 14.37%	6,964 12.75%	54,600 100%
<b>TOTAL BASIC FUNDS</b>	<b>30,653 0.18%</b>	<b>0</b>	<b>3,886,345 22.93%</b>	<b>0</b>	<b>8,112,274 47.86%</b>	<b>2,576,409 15.20%</b>	<b>2,345,393 13.83%</b>	<b>16,951,074 100%</b>
<b>POST RETIREMENT FUND</b>	<b>80,064 0.47%</b>	<b>0</b>	<b>4,413,119 26.08%</b>	<b>0</b>	<b>9,003,223 53.21%</b>	<b>2,658,763 15.71%</b>	<b>766,946 4.53%</b>	<b>16,922,115 100%</b>
<b>TOTAL BASIC AND POST</b>	<b>110,717 0.33%</b>	<b>0</b>	<b>8,299,464 24.50%</b>	<b>0</b>	<b>17,115,497 50.53%</b>	<b>5,235,172 15.45%</b>	<b>3,112,339 9.19%</b>	<b>33,873,189 100%</b>

	Cash and Short term Securities		Bonds Internal		Bonds External		Stocks Internal		Stocks External		External Int'l		Alternative Assets		Total	
<b>MINNESOTA SUPPLEMENTAL FUNDS:</b>																
Income Share Account	33,215	200,779	0	0	0	0	0	0	0	344,442	0	0	0	0	578,436	
	5 74%	34 71%								59 55%					100%	
Growth Share Account	0	0	0	0	0	0	0	0	0	209,448	0	0	0	0	209,448	
										100 00%					100%	
Money Market Account	39,047	0	0	0	0	0	0	0	0	0	0	0	0	0	39,047	
	100 00%														100%	
Common Stock Index	0	0	0	0	0	0	0	0	0	293,081	0	0	0	0	293,081	
										100 00%					100%	
Bond Market Account	0	0	0	0	157,162	0	0	0	0	0	0	0	0	0	157,162	
					100 00%										100%	
International Share Account	0	0	0	0	0	0	0	0	0	0	53,635	0	0	53,635		
											100 00%			100%		
Fixed Interest Account	2,184	0	0	0	140,076	0	0	0	0	0	0	0	0	142,260		
	1 54%				98 46%									100%		
Money Market Deferred Comp	61,820	0	0	0	0	0	0	0	0	0	0	0	0	61,820		
	100 00%													100%		
<b>TOTAL SUPPLEMENTAL FUNDS</b>	<b>136,266</b>	<b>200,779</b>	<b>297,238</b>	<b>0</b>	<b>297,238</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>846,971</b>	<b>53,635</b>	<b>0</b>	<b>0</b>	<b>1,534,889</b>		
	<b>8 88%</b>	<b>13 08%</b>	<b>19 37%</b>		<b>19 37%</b>					<b>55 18%</b>	<b>3 49%</b>			<b>100%</b>		
<b>MN DEFERRED COMP PLAN *</b>	<b>0</b>	<b>0</b>	<b>762,307</b>	<b>0</b>	<b>762,307</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>744,937</b>	<b>94,693</b>	<b>0</b>	<b>0</b>	<b>1,601,937</b>		
			<b>47 59%</b>		<b>47 59%</b>					<b>46 50%</b>	<b>5 91%</b>			<b>100%</b>		
<b>TOTAL RETIREMENT FUNDS</b>	<b>246,983</b>	<b>200,779</b>	<b>9,359,009</b>	<b>0</b>	<b>9,359,009</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>18,707,405</b>	<b>5,383,500</b>	<b>3,112,339</b>	<b>0</b>	<b>37,010,015</b>		
	<b>0 67%</b>	<b>0 54%</b>	<b>25 29%</b>		<b>25 29%</b>			<b>0 00%</b>		<b>50 55%</b>	<b>14 54%</b>	<b>8 41%</b>		<b>100%</b>		

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

	Cash and Short Term Securities		Bond		Bond		Stock		Stock		Alternative Assets		Total	
			Internal	External	Internal	External	Internal	External	Internal	External	Int'l			
<b>ASSIGNED RISK PLAN</b>	3,538	1.51%	0	175,132	0	175,132	0	55,931	0	0	0	0	234,601	100%
				74.65%				23.84%						
<b>ENVIRONMENTAL FUND</b>	1,935	0.65%	86,559	0	210,233	0	0	0	0	0	0	0	298,727	100%
			28.97%		70.38%									
<b>PERMANENT SCHOOL FUND</b>	8,454	1.58%	249,850	0	277,297	0	0	0	0	0	0	0	535,601	100%
			46.65%		51.77%									
<b>CLOSED LANDFILL INVESTMENT</b>	23	0.13%	0	0	17,208	0	0	0	0	0	0	0	17,231	100%
					99.87%									
<b>TREASURERS CASH</b>	3,556,647	100.00%	0	0	0	0	0	0	0	0	0	0	3,556,647	100%
<b>HOUSING FINANCE AGENCY</b>	73,438	28.86%	181,048	0	0	0	0	0	0	0	0	0	254,486	100%
			71.14%											
<b>MINNESOTA DEBT SERVICE FUND</b>	73,101	24.47%	225,607	0	0	0	0	0	0	0	0	0	298,708	100%
			75.53%											
<b>MISCELLANEOUS ACCOUNTS</b>	361,328	74.41%	94,399	0	29,886	0	0	0	0	0	0	0	485,613	100%
			19.44%		6.15%									
<b>GRAND TOTAL</b>	4,325,447	10.13%	1,038,242	9,534,141	534,624	18,763,336	5,383,500	3,112,339	42,691,629					
			2.43%	22.34%	1.25%	43.95%	12.61%	7.29%						

# **Tab B**

## EXECUTIVE DIRECTOR'S ADMINISTRATIVE REPORT

DATE: November 25, 2003

TO: Members, State Board of Investment

FROM: **Howard Bicker**

### **1. Reports on Budget and Travel**

A report on the SBI's administrative budget for the fiscal year to date through October 31, 2003 is included as **Attachment A**.

A report on travel for the period from August 16, 2003 - November 15, 2003 is included as **Attachment B**.

### **2. Post Retirement Benefit Increase for FY03**

The Post Retirement benefit increase for FY03 will be 2.103%. The increase will be payable to eligible retirees effective January 1, 2004.

For FY 1994-1997 the "inflation cap" in the benefit increase formula was 3.5%. Beginning FY 1999, the "inflation cap" is 2.5%. The following shows the benefit increases for the past ten years:

1994	4.0%
1995	6.4%
1996	8.0%
1997	10.1%
1998	9.8%
1999	11.1%
2000	9.5%
2001	4.5%
2002	0.7%
2003	2.1%

### **3. Litigation Update**

The SBI is involved in class action and securities litigation suits. SBI legal counsel will give the Board a verbal update on the status of the litigation at the Board meeting on December 3, 2003.

**4. Results of FY03 Audit**

The Legislative Auditor is nearly finished with its financial audit of SBI operations for FY03. I should be able to provide a verbal report of the audit findings at the Board meeting on December 3, 2003.

**5. Draft of FY03 Annual Report**

A draft of the SBI's annual report for FY03 will be sent to the Board members/designees and IAC members. The final report will be distributed in January 2004.

**6. Tentative Meeting Dates for Calendar 2004**

The quarterly meetings of the IAC/SBI are normally held on the first consecutive Tuesday and Wednesday of March, June, September and December. The dates for the calendar 2004 are:

<b>IAC</b>	<b>SBI</b>
<b>Tuesday, March 2, 2004</b>	<b>Wednesday, March 3, 2004</b>
<b>Tuesday, June 1, 2004</b>	<b>Wednesday, June 2, 2004</b>
<b>Tuesday, September 7, 2004</b>	<b>Wednesday, September 8, 2004</b>
<b>Tuesday, December 7, 2004</b>	<b>Wednesday, December 8, 2004</b>

SBI staff will confirm the availability of Board members for the above dates over the next few weeks.

**ATTACHMENT A**

**STATE BOARD OF INVESTMENT  
FISCAL YEAR 2004 ADMINISTRATIVE BUDGET REPORT  
GENERAL FUND APPROPRIATION  
FISCAL YEAR TO-DATE THROUGH OCTOBER 31, 2003**

<b>ITEM</b>	<b>FISCAL YEAR 2004 BUDGET</b>	<b>FISCAL YEAR 2004 EXPENDITURES</b>
<b>PERSONAL SERVICES</b>		
FULL TIME EMPLOYEES	\$ 1,900,000	\$ 518,007
SEVERENCE PAYOFF	22,000	37,514
WORKERS COMPENSATION INSURANCE	1,000	860
MISCELLANEOUS PAYROLL	2,000	148
<b>SUBTOTAL</b>	<b>\$ 1,925,000</b>	<b>\$ 556,529</b>
<b>STATE OPERATIONS</b>		
RENTS & LEASES	196,000	63,938
REPAIRS/ALTERATIONS/MAINTENANCE	15,000	5,037
PRINTING & BINDING	10,000	2,555
PROFESSIONAL/TECHNICAL SERVICES	0	0
COMPUTER SYSTEMS SERVICES	10,000	2,540
COMMUNICATIONS	20,000	4,273
TRAVEL, IN-STATE	3,000	50
TRAVEL, OUT-STATE	45,000	5,057
SUPPLIES	20,000	2,418
EQUIPMENT	0	0
EMPLOYEE DEVELOPMENT	15,000	350
OTHER OPERATING COSTS	15,000	5,234
<b>SUBTOTAL</b>	<b>\$ 349,000</b>	<b>\$ 91,452</b>
<b>ORIGINAL BUDGET</b>	<b>\$ 2,274,000</b>	<b>\$ 647,981</b>
<b>BUDGET REDUCTION (UNALLOTMENT)</b>	<b>\$ 39,000</b>	
<b>TOTAL GENERAL FUND</b>	<b>\$ 2,235,000</b>	<b>\$ 647,981</b>

**ATTACHMENT B**

**STATE BOARD OF INVESTMENT**

**Travel Summary by Date  
SBI Travel August 16, 2003 – November 15, 2003**

<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
<b>Manager Monitoring: Domestic Equity Manager:</b> UBS Global Asset Mgmt. <b>Cosultant:</b> Richards & Tierney	H. Bicker	Chicago, IL 8/19-8/20	\$442.60
<b>In State Travel:</b> Retired Educations Association of Minnesota	H. Bicker	St. Cloud, MN 9/23	\$49.80
<b>Manager Monitoring: Alternative Investment Manager:</b> TCW Crescent Mezzanine <b>Conference:</b> Institutional Ltd. Partners Assoc.	A. Christensen	Los Angeles, CA 10/1-10/3	\$1,275.00
<b>Manager Monitoring: Domestic Equity Managers:</b> GeoCapital Corp; New Amsterdam Partners; <b>Emerging Equity Manager:</b> Artemis Investment Mgmt. <b>Manager Search: Domestic Equity Managers:</b> Chartwell Investment Partners; David L. Babson & Co.; Gabelli Asset Mgmt. Co.; Goldman Sachs Asset Mgmt.; Grantham Mayo, Van Otterloo; Martingale Asset Mgmt.; State Street Research & Mgmt. Co.; Turner Investment Partners	Lois Buermann	Philadelphia, PA New York, NY Boston, MA 10/6-10/10	\$2,093.58
<b>Conference:</b> NASIO	Howard Bicker Mansco Perry	Lexington, KY 10/12-10/15	\$1,224.50



<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
<b>Manager Monitoring:</b> <b>Alternative Investment Managers:</b> Blum Capital; Crescendo Ventures; Fox Paine; Hellman & Friedman; KKR <b>Manager Search:</b> <b>Alternative Investment Managers:</b> Gold Hill Venture Lending; Silver Lake Partners	Andy Christensen	San Francisco, CA 10/27-10/29	\$1,442.00
<b>Manager Monitoring:</b> <b>Fixed Income Managers:</b> BlackRock; Deutsche Asset Mgmt.; Goldman Sachs; Morgan Stanley <b>Manager Search:</b> <b>Fixed Income Manager:</b> Delaware Investments	Mike Menssen Tammy Brusehaver	Philadelphia, PA 11/3-11/5	\$2,759.08
<b>Conference:</b> Short Term ABS Conference sponsored by Lehman Brothers <b>Manager Monitoring:</b> <b>Short-term:</b> Bank of America; HSBC Securities	Steve Kuettel	New York, NY 11/12-11/14	\$1,727.00

# Tab C

## **COMMITTEE REPORT**

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DATE: November 25, 2003

TO: Members, State Board of Investment

FROM: **Deferred Compensation Review Committee**

The Deferred Compensation Review Committee met on November 6, 2003 to consider a recommendation to replace the Morgan Stanley midcap fund in the Deferred Compensation Plan.

**Action is required by the SBI on this item.**

### **Recommendation to replace the Morgan Stanley midcap fund in the State Deferred Compensation Plan**

Morgan Stanley Investment Fund Trust US MidCap Core Portfolio Institutional was retained in January 2002 to provide a midcap equity option in the Plan. The Fund has experienced some performance difficulties. A copy of the Fund's VAM is on **page 3**.

The midcap team was part of the large equity presence in Philadelphia that Morgan Stanley purchased in January 1996. In early October 2003 Morgan Stanley terminated the entire equity presence in Philadelphia for "performance reasons," and transferred management of the Fund to a Van Kampen mutual fund team in Houston. Van Kampen funds are owned by Morgan Stanley. The Van Kampen team in Houston that is now managing the Fund specializes in large cap value management and has not managed a midcap discipline. In addition, the Fund objective has been changed from a midcap core approach to a midcap value orientation.

Due to performance issues, portfolio management changes and a change in the investment focus of the Fund, the Committee recommends the termination of the Morgan Stanley fund.

As the Fund is the only midcap equity offering in the Plan, a replacement fund must be selected so that assets can be transferred to a new manager to allow participants to remain fully invested. As a result of the difficulty in identifying an actively managed fund that is satisfactory, the Committee recommends replacing the existing fund with a passively managed option.

The Committee reviewed the enclosed information beginning on **page 4** relating to proposed replacements for Morgan Stanley.

- California Investment S&P Midcap Index
- Federated Mid-Cap Index
- Munder Institutional S&P MidCap Index Equity Y
- Nationwide Mid Cap Market Index Institutional
- Vanguard Mid Capitalization Index Institutional

**RECOMMENDATION:**

**The Committee recommends the Board terminate the relationship with the Morgan Stanley Fund in the State Deferred Compensation Plan. The Committee further recommends that the SBI authorize the Executive Director, with assistance from legal counsel, to negotiate a contract with The Vanguard Group in order to offer the Vanguard Mid Capitalization Index Institutional to participants in the State Deferred Compensation Plan at a date to be determined with the Minnesota State Retirement System.**

**MN STATE 457 DEFERRED COMPENSATION PLAN  
MORGAN STANLEY MID-CAP VALUE INSTITUTIONAL  
Periods Ending September, 2003**

**Portfolio Manager: James Gilligan**

**State's Participation in Fund: \$16,962,567  
Total Assets in Fund: \$542,400,000**

**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 outperformed the benchmark for the quarter and one-year periods. The portfolio was helped by stock selection within the technology, utilities, and financial services sectors.

Morgan Stanley announced on October 1<sup>st</sup> that the portfolio manager (William Gerlach) and his team were terminated on September 30<sup>th</sup>. The new portfolio manager is James Gilligan and the fund will now be managed against the Russell Midcap Value Index.

**Quantitative Evaluation**

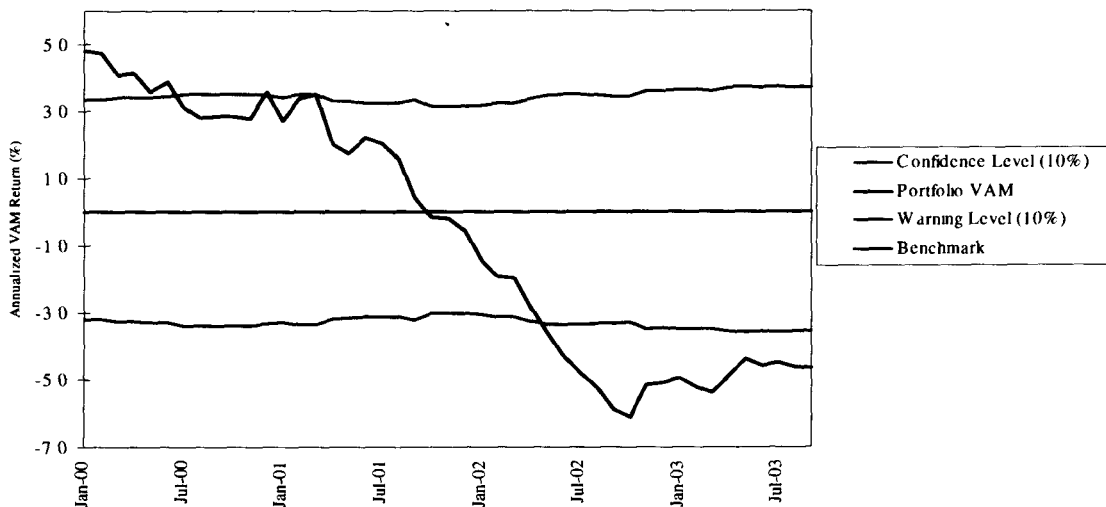
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	6.6%	6.5%
Last 1 year	33.9	26.7
Last 2 years	3.4	10.1
Last 3 years	-5.5	-0.2
Last 4 years	2.2	9.4
Last 5 years	7.1	12.4
Since Retention		
By SBI	-6.5	1.5
(1/02)		

**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**



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

**MIDCAP INDEX FUND DATA**

<b>Fund</b>	<b>Net Assets \$ million</b>	<b>Expense Ratio</b>	<b>Benchmark</b>	<b>Location</b>	<b>Manager</b>	<b>Fund Inception</b>	<b>Ticker</b>
California Investment S&P Midcap Index	\$ 102	0.40 %	S&P Midcap 400	San Francisco	CCM Partners	4/20/92	SPMIX
Federated Mid-Cap Index	515	0.50	S&P Midcap 400	Pittsburgh	Federated Invstmt Mgmt Co John W. Harris	11/05/92	FMDCX
Munder Institutional S&P Midcap Index Equity Y	14	0.18	S&P Midcap 400	Birmingham, MI	Munder Capital Mgmt management team	2/13/98	MIMIX
Nationwide Mid Cap Market Index Institutional	213	0.31	S&P Midcap 400	Columbus, OH	Gartmore Mutual Fund Capital Trust, mgmt team	12/29/99	NMXIX
Vanguard Mid Capitalization Index Institutional	880	0.10	MSCI U.S. Mid Cap 450*	Valley Forge, PA	The Vanguard Group George U. Sauter	5/21/98	VMCIX

Data is as of 9/30/03.

\* Vanguard changed its investment target from the S&P Midcap 400 to the MSCI U.S. Mid Cap 450 effective May 16, 2003.

**MIDCAP INDEX FUND**

**PERFORMANCE DATA**

	Annualized As Of June 30					Calendar Year			
	1 Yr.	3 Yr.	5 Yr.	1998	1999	2000	2001	2002	6-30-03
California Investment S&P Midcap Index	-1.25	1.35	7.51	18.49	14.71	19.49	0.33	-14.22	11.73
Federated Mid-Cap Index	-1.18	0.29	6.36	18.10	13.88	16.70	-1.30	-15.16	12.19
Munder Institutional S&P Midcap Index Equity Y	-1.11	0.65	6.91	--	14.69	17.74	-1.29	-14.85	12.18
Nationwide Mid Cap Market Index Institutional	-1.17	0.73	--	--	--	18.88	-1.16	-15.05	12.19
Vanguard Mid Capitalization Index Institutional	-1.75	0.84	7.39	--	15.52	18.39	-0.37	-14.45	11.21**
S&P Midcap 400	-0.64	1.50	7.63	18.65	14.86	19.67	-0.03	-14.35	12.38

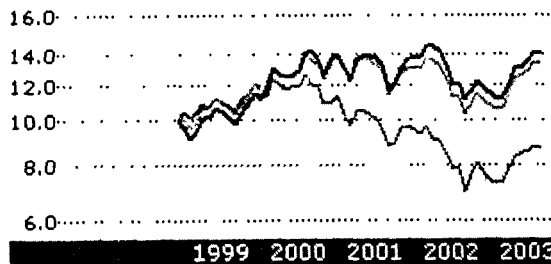
\*\* Vanguard changed its investment target from the S&P Midcap 400 to the MSCI U.S. Mid Cap 450 effective May 16, 2003.

California Investment S&P MidCap Idx SPMIX

[Snapshot](#) | 
 [Analyst Report](#) | 
 [Quote](#) | 
 [Total Returns](#) | 
 [Ratings & Risk](#) | 
 [Portfolio](#) | 
 [Nuts & Bolts](#)

Performance  09-30-2003

Growth of \$10,000



Quick Stats 

NAV ( 10-29-2003 ) \$17.93  
 Day Change \$0.08  
 YTD Return 27.47%  
 Morningstar Rating ★★★★★  
 Morningstar Category Mid-Cap Blend  
 Net Assets (\$Mil) 102

- Fund: California Investment S&P MidCap Idx
- Category: Mid-Cap Blend
- Index: Standard & Poor's 500

Annual Returns




	2000	2001	2002	09-03
Fund	19.49	0.33	-14.22	18.87
+/- Cat	10.04	0.37	2.41	-1.37
+/- Index	28.59	12.21	7.87	4.16

Portfolio 

09-30-2003

Top 5 Holdings

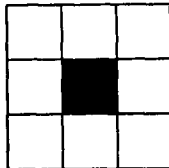
	% Net Assets
Gilead Sciences	1.21
M & T Bank	1.13
Mylan Laboratories	0.78
Affiliated Computer Services	0.71
Washington Post	0.69

 Increase 
  Decrease 
  New since last portfolio

Fund Details 

Fund Inception 04-20-1992  
 Sales Charge %  
 Front None  
 Deferred None  
 Expense Ratio 0.40

Current Investment Style

Equity	Size	Valuation
	Medium	Blend

Asset Allocation %

Cash	3.30
Stocks	93.79
Bonds	0.00
Other	2.91

Top 3 Stock Sectors %

Financial Services	19.52
Healthcare Services	14.00
Consumer Services	12.15



Federated Mid-Cap Index FMDCX

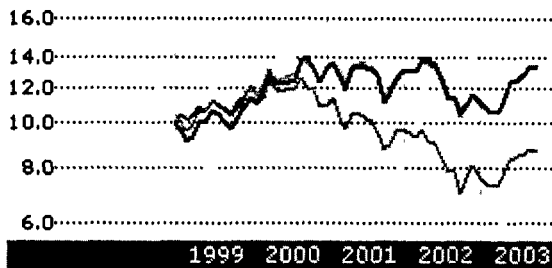
**Snapshot** | **Analyst Report** | **Quote** | **Total Returns** | **Ratings & Risk** | **Portfolio** | **Nuts & Bolts**

This fund seeks to fully replicate the S&P MidCap 400 Index. Though it may not be the cheapest index fund around, it's a solid offering nonetheless.

**Quick Stats**

NAV ( 10-29-2003 ) \$18.18  
 Day Change \$0.09  
 YTD Return 28.14%  
 Morningstar Rating ★★  
 Morningstar Category Mid-Cap Blend  
 Net Assets (\$Mil) 515

**Performance** 09-30-2003  
 Growth of \$10,000



- Fund: Federated Mid-Cap Index
- Category: Mid-Cap Blend
- Index: Standard & Poor's 500

**Annual Returns**

	2000	2001	2002	09-03
Fund	16.70	-1.30	-15.16	19.4
+/- Cat	7.25	-1.26	1.47	-0.85
+/- Index	25.80	10.58	6.93	4.69

**Fund Details**

Fund Inception 11-05-1992  
 Mngr Name John W. Harris  
 Mngr Start Date 01-31-2003

Sales Charge %  
 Front None  
 Deferred None  
 Expense Ratio 0.50

**Portfolio**

09-30-2003

Top 5 Holdings	% Net Assets
⊕ Gilead Sciences	1.22
⊕ M & T Bk	1.14
⊖ Mylan Laboratories	0.76
⊕ Affiliated Computer Services	0.72
⊕ Washington Post	0.69

⊕ Increase ⊖ Decrease ☆ New since last portfolio

**Current Investment Style**

Equity	Size	Valuation									
<table border="1"> <tr><td></td><td></td><td></td></tr> <tr><td></td><td style="background-color: black;"></td><td></td></tr> <tr><td></td><td></td><td></td></tr> </table>										Medium	Blend

**Asset Allocation %**

Cash	6.36
Stocks	93.64
Bonds	0.00
Other	0.00

**Top 3 Stock Sectors %**

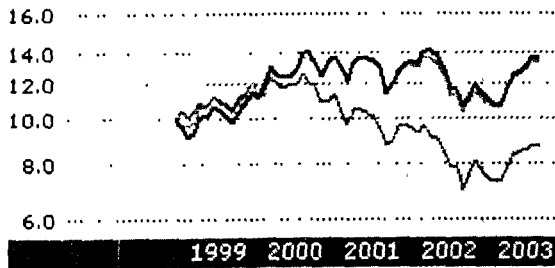
Financial Services	19.54
Healthcare Services	13.54
Consumer Services	13.03

Munder Instl S&P MidCap Index Eq Y MIMIX

[Snapshot](#) | 
 [Analyst Report](#) | 
 [Quote](#) | 
 [Total Returns](#) | 
 [Ratings & Risk](#) | 
 [Portfolio](#) | 
 [Nuts & Bolts](#)

Performance 09-30-2003

Growth of \$10,000



- Fund: Munder Instl S&P MidCap Index Eq Y
- Category: Mid-Cap Blend
- Index: Standard & Poor's 500

Annual Returns

	2000	2001	2002	09-03
Fund	17.74	-1.29	-14.85	19.29
+/- Cat	8.29	-1.25	1.78	-0.95
+/- Index	26.84	10.59	7.24	4.58

Fund Details

Fund Inception	02-13-1998
Mngr Name	Management Team
Mngr Start Date	---
Sales Charge %	
Front	None
Deferred	None
Expense Ratio	0.18

Quick Stats

NAV ( 10-29-2003 )	\$10.14
Day Change	\$0.05
YTD Return	28.00%
Morningstar Rating	★★★★
Morningstar Category	Mid-Cap Blend
Net Assets (\$Mil)	14

Portfolio

Top 5 Holdings	%
	Net Assets
⊕ Gilad Sciences	1.23
⊕ M & T Bank	1.14
⊕ Mylan Laboratories	0.75
⊕ Affiliated Computer Services	0.70
Washington Post	0.67

⊕ Increase ⊖ Decrease ✱ New since last portfolio

Current Investment Style

Equity	Size	Valuation
	Medium	Blend

Asset Allocation %

Cash	3.56
Stocks	92.98
Bonds	0.00
Other	3.46

Top 3 Stock Sectors %

Financial Services	19.48
Healthcare Services	13.48
Consumer Services	12.84

Nationwide Mid Cap Market Index Instl NMXIX

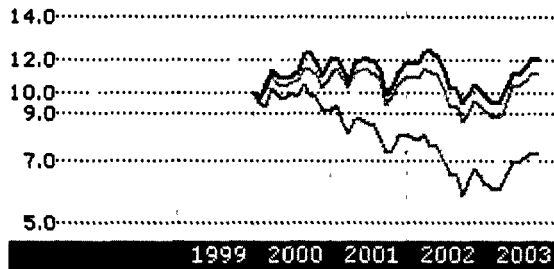
[Snapshot](#) | 
 [Analyst Report](#) | 
 [Quote](#) | 
 [Total Returns](#) | 
 [Ratings & Risk](#) | 
 [Portfolio](#) | 
 [Nuts & Bolts](#)

Performance

09-30-2003

Quick Stats

Growth of \$10,000



NAV ( 10-29-2003 )	\$11.92
Day Change	\$0.05
YTD Return	28.20%
Morningstar Rating	★★★
Morningstar Category	Mid-Cap Blend
Net Assets (\$Mil)	213

Portfolio

09-30-2003

- Fund: Nationwide Mid Cap Market Index Instl
- Category: Mid-Cap Blend
- Index: Standard & Poor's 500

Top 5 Holdings

	%
Gilead Sciences	1.09
M & T Bank	1.02
⊖ Mylan Laboratories	0.68
Affiliated Computer Services	0.64
Washington Post	0.61

Annual Returns

	2000	2001	2002	09-03
Fund	18.88	-1.16	-15.05	19.49
+/- Cat	9.43	-1.12	1.58	-0.76
+/- Index	27.98	10.72	7.04	4.78

⊕ Increase ⊖ Decrease ★ New since last portfolio

Fund Details

Fund Inception	12-29-1999
Mngr Name	--- Management Team
Mngr Start Date	---
Sales Charge %	
Front	None
Deferred	None
Expense Ratio	0.31

Current Investment Style

Equity	Size	Valuation
	Medium	Blend

Asset Allocation %

Cash	7.21
Stocks	83.84
Bonds	0.00
Other	8.95

Top 3 Stock Sectors %

Financial Services	19.57
Healthcare Services	13.51
Consumer Services	12.99

# Vanguard Mid Capitalization Index Ins VMCIX

[Snapshot](#) | 
 [Analyst Report](#) | 
 [Quote](#) | 
 [Total Returns](#) | 
 [Ratings & Risk](#) | 
 [Portfolio](#) | 
 [Nuts & Bolts](#)

This index fund recently ditched its old bogy, the S&P Midcap 400 Index, in favor of a newly minted--and unproven--MSCI benchmark. The S&P index had been a champ during its roughly five-year residence, topping most actively managed rivals. It'll be a tough act to follow. But the MSCI index also boasts appealing attributes.

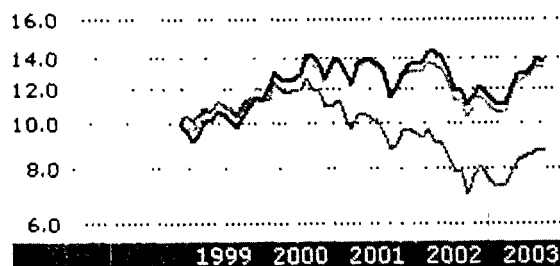
## Quick Stats

NAV ( 10-29-2003 )	\$12.55
Day Change	\$0.08
YTD Return	26.77%
Morningstar Rating	★★★★
Morningstar Category	Mid-Cap Blend
Net Assets (\$Mil)	880

## Performance

09-30-2003

Growth of \$10,000



Fund: Vanguard Mid Capitalization Index Ins

\* Category: Mid-Cap Blend

\* Index: Standard & Poor's 500

## Annual Returns

	2000	2001	2002	09-03
Fund	18.39	-0.37	-14.45	18.28
+/- Cat	8.94	-0.33	2.18	-1.96
+/- Index	27.49	11.51	7.64	3.57

## Fund Details

Fund Inception	05-21-1998
Mngr Name	George U. Sauter
Mngr Start Date	05-21-1998
Sales Charge %	
Front	None
Deferred	None
Expense Ratio	0.10

## Portfolio

06-30-2003

### Top 5 Holdings

	% Net Assets
★ PG & E	0.63
★ Xerox	0.61
★ AmerisourceBergen	0.56
★ PPL	0.55
★ Paccar	0.55

⊕ Increase ⊖ Decrease ★ New since last portfolio

## Current Investment Style

Equity


Size

Medium

Valuation

Blend

## Asset Allocation %

Cash	0.31
Stocks	99.69
Bonds	0.00
Other	0.00

## Top 3 Stock Sectors %

Financial Services	19.97
Consumer Services	11.74
Hardware	11.17

# **Tab D**

## **COMMITTEE REPORT**

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DATE: November 25, 2003

TO: Members, State Board of Investment

FROM: Domestic Equity Search Committee

**SUBJECT: Domestic Equity Small-Capitalization Search**

The SBI conducted a search for small capitalization value and growth managers to achieve the following two goals:

- To reallocate actively managed domestic equity assets so they more closely match the weight of the small-capitalization component of the R3000, asset class target, and
- To diversify and add capacity to the SBI's lineup of small cap managers.

The Search Committee met on October 30 and 31, 2003 to interview potential small-capitalization managers for the Domestic Equity Program.

The members of the Search Committee included:

<b><u>Name</u></b>	<b><u>Representing</u></b>
Peter Sausen, Chair	Governor Pawlenty
Christie Eller	State Attorney General Hatch
Carla Heyl	State Auditor Awada
Alberto Quintela	Secretary of State Kiffmeyer
Frank Ahrens	Investment Advisory Council
Kerry Brick	Investment Advisory Council
Mary Vanek	Investment Advisory Council

The Search Committee interviewed ten candidates. Based on the interviews, questionnaire responses, and other information provided, the Search Committee is recommending that seven (7) firms be retained by the SBI for inclusion in the Domestic Equity Program. Two of the firms will be part of the Emerging Manager Program. Information on each of the recommended firms is attached starting on page 3 of this tab.

**RECOMMENDATION:**

**The Domestic Equity Search Committee recommends that the following firms be retained for the Domestic Equity Program:**

**Small Capitalization Value Managers**

<b>Goldman Sachs Asset Management</b>	<b>New York, NY</b>
<b>Hotchkis &amp; Wiley Capital Management</b>	<b>Los Angeles, CA</b>
<b>Kenwood Capital Management (Emerging Manager)</b>	<b>Minneapolis, MN</b>
<b>Martingale Asset Management</b>	<b>Boston, MA</b>

**Small Capitalization Growth Managers**

<b>McKinley Capital Management</b>	<b>Anchorage, AK</b>
<b>Turner Investment Partners</b>	<b>Berwyn, PA</b>
<b>US Bancorp Asset Management (Emerging Manager)</b>	<b>Milwaukee, WI</b>

**and that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a contract with each firm.**

## **GOLDMAN SACHS ASSET MANAGEMENT (“GSAM”)**

**Name of Product:** Small Cap Value

**Investment Style:** Small Cap Value – Separate Account

### **Investment Philosophy:**

GSAM’s Value Equity philosophy is based on the belief that all successful investing begins with fundamental stock selection that should thoughtfully weigh two important attributes of a stock: **price and prospects**. While most value managers are keenly interested in stock price, they tend to underestimate the importance of prospects. At GSAM, we believe a company’s prospective ability to generate high cash flow returns on capital will strongly influence investment success. In our view, using a strong valuation discipline to purchase well-positioned, cash generating businesses run by shareholder-oriented management teams is the best formula for long-term portfolio performance.

**We recognize that uncertainty creates opportunity.** Some stock price declines truly reflect a permanently disadvantaged business model. These stocks are the “value traps” which mire price-oriented investors. Other stock price declines reflect a lack of near-term clarity, such as what occurs during a challenging economic environment, an interval of price competition or a period of temporarily rising costs. A well-managed company may thus sell below its true economic value. Through our extensive proprietary research, we confirm the business’s long-term competitive advantage and earnings power are intact. We then seek to purchase the stock at a price that encompasses a healthy margin of safety.

### **Investment Process:**

#### **STEP 1: PRIORITIZE RESEARCH**

Since we believe that applying a single valuation measure unilaterally across the investment universe can be misleading, we have identified key valuation measures for each industry to screen the initial investable universe and to help us prioritize our research. We use these metrics to categorize companies within each industry and eliminate companies with:

- Valuations in the top-tier of their peer group
- Known situations of faulty management governance

Additionally, we seek to identify:

- Early evidence of changing business trends
- A specific catalyst that may indicate an improving risk/reward profile.

This helps to create a “short list” for more intense research focus.



## **STEP 2: ANALYZE BUSINESS FUNDAMENTALS**

### **Decompose Historic Financial Reports**

Through intense scrutiny of companies' financial reports, including SEC filings and proxy statements, we assess the quality of the business using criteria such as:

- Return on invested capital
- Sustainability of free cash flow
- Capital intensity of its business
- Balance sheet strength

### **Evaluate Competitive Position Within the Industry**

By meeting face-to-face with company managements, we seek to gain insight into their competitive advantage and ability to acquire and/or sustain market share.

### **Evaluate relative attractiveness**

We evaluate each company's valuation attractiveness relative to other comparable companies within the sector using industry-specific valuation metrics.

### **Create "Short List" of Potential Investment Ideas**

Once we have thoroughly analyzed the fundamentals, we exclude companies with:

- Poor earnings quality
- Meaningful long-term increase in capital requirements
- Negative divergence of cash flow
- High valuations given long-term prospects

## **STEP 3: PORTFOLIO CONSTRUCTION**

### **Team Interaction**

Our experienced team of portfolio managers and research analysts are organized by industry, focusing on a particular area of expertise within the portfolio. Portfolio managers work along with the research analysts in conducting first-hand fundamental research. Portfolio managers meet on a regular basis to discuss portfolio ideas/positions and to solicit feedback from team members. The team manages all small cap value portfolios thereby eliminating dispersion in client portfolios. The portfolio manager responsible for that industry makes the final buy/sell decision.

### **Determine Portfolio Weightings**

Security allocations are determined by upside potential, downside risk, relative value and impact on sector and industry weightings. The largest weightings are given to companies with the most upside return potential relative to their contribution to overall portfolio risk.

### **Risk Management**

– **Ongoing monitoring:** We continually assess each holding's valuation relative to other companies in the industry. Regular meetings with company management also ensure the integrity of our original investment thesis. We also monitor the portfolio's characteristics to maintain style and market cap consistency.

– **Sector diversification:** While our bottom-up view influences portfolio construction, we also monitor sector exposures relative to the benchmark and generally target 4% over/under weight.

– **Small Cap-specific risks:** We manage liquidity and company-specific risks associated with this asset class by limiting our sector bets and investing in a large number of holdings.

– **Sell Discipline:** We look to sell a security when the attractiveness of the position has diminished relative to other securities within the respective sector and/or the marketcap increases beyond an acceptable level.

– **Risk Management Group:** Furthermore, GSAM has an independent and comprehensive risk management group - the Risk and Performance Analytics Group (RPAG). The primary role of this group is to monitor daily portfolio management risk, adherence to client guidelines and general portfolio strategy.

The portfolio risk management process includes an effort to monitor and manage risk, but should not be confused with and does not imply low risk.

**Ownership:**

Goldman Sachs Asset Management, L.P. is a Delaware limited partnership. The Goldman Sachs Group, Inc. is the general partner and Goldman Sachs Global Holdings, LLC is the limited partner. The Goldman Sachs Group, Inc. is a Delaware corporation.

<b>Firm's total assets under management:</b>	\$314,593.5 MM
<b>Assets under management in this product:</b>	\$1,263.9 MM
<b>Number of Accounts in this product:</b>	17 accounts
<b>Number of Portfolio Managers on this product:</b>	5* portfolio managers
<b>Number of Analysts on this product:</b>	4* research analysts

*All data above as of 6/30/03*

\*Please note: Subsequent to quarter end, David Berdon who had been a research analyst for the Technology portion of the portfolio was made a portfolio manager. Therefore the total number of portfolio managers is 6, and the total number of research analysts is 3.

**Largest Accounts:**

<u>Account Type</u>	<u>Small Cap Value Assets in MM as of 6/30/03</u>
Separate Account Foundation	\$35.1
Separate Account Corporate	\$67.0
Mutual Fund	\$91.3
Mutual Fund	\$240.4
Mutual Fund	\$781.3

Investment Manager:		GOLDMAN SACHS - REP 4					
Benchmark:		FRANK RUSSELL 2000 VALUE					
		---PORTFOLIO---		---BENCHMARK---		-----VAM-----	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
00	Q3	12.33		7.34		4.65	
	Q4	4.40	17.27	8.11	16.04	-3.43	1.06
01	Q1	3.27		0.97		2.28	
	Q2	12.36		11.64		0.65	
	Q3	-11.07		-13.33		2.61	
	Q4	16.92	20.65	16.72	14.03	0.17	5.81
02	Q1	9.15		9.58		-0.39	
	Q2	-1.12		-2.12		1.02	
	Q3	-17.31		-21.29		5.06	
	Q4	3.55	-7.58	4.92	-11.43	-1.31	4.34
03	Q1	-3.39		-5.08		1.78	
	Q2	19.97		22.72		-2.24	
Latest:							
1 yr			-0.76		-3.80		3.16
3 yr			14.87		10.94		3.54
5 yr			N/A		N/A		N/A
Cumulative 0007-0306			14.87		10.94		3.54
Std.Dev			17.59		19.19		5.54

## HOTCHKIS AND WILEY CAPITAL MANAGEMENT

**Name of Product:** Hotchkis and Wiley Small Cap Value

**Investment Style:** Small Cap Value

### **Investment Philosophy:**

Hotchkis and Wiley Capital Management "HWCM" is a disciplined equity investment manager with a commitment to the principles of value investing. The firm seeks to exploit mis-priced securities in the small cap market by investing in "undiscovered" or "out of favor" companies. We invest in stocks where, in our opinion, the present value of the company's future cash flows exceeds the current market price. This approach exploits equity market inefficiencies created by irrational investor behavior and lack of Wall Street research coverage of smaller capitalization stocks. We identify these investment opportunities by employing a disciplined, bottom-up investment process that emphasizes internally generated fundamental research. We believe that the consistent application of our research and process will produce superior long-term performance with below-market volatility.

### **Investment Process:**

The investment process begins with a quantitative screen based on market capitalization (between \$100 million and \$3 billion), trading liquidity (achieve a full position in 7 days) and enterprise value/normalized EBIT (bottom 40% in valuation), supplemented with ideas generated from the investment team. The qualifying screens are run weekly. The results contain a list of approximately 500 securities that represent a true small cap value universe. Our internal research is then utilized to identify the most attractive valuation opportunities within this value universe.

HWCM's investment process is driven by in-depth, internal fundamental research (90% internal, 10% external). Based in Los Angeles, our research is independent, time-intensive and solely focused on our clients' portfolios. Our investment staff is organized by industry coverage and supports all of the firm's products. Individual security analysis for small-cap companies consumes an average of 60 hours to complete depending on the complexity of the investment under review.

The primary focus of the research analyst is to determine a company's "normal" earnings power, which is the basis for security valuation. Normal earnings power is the sustainable cash earnings level of a company under equilibrium economic and competitive market conditions. Generally, reported earnings are adjusted to account for the impact of the economic cycle, return on capital reversion and non-operating accounting items such as pensions.

HWCM subscribes to a team-oriented investment process, where portfolios are constructed on a bottom-up basis by the investment team. Continual informal investment strategy sessions (weekly formal sessions are also scheduled) allow analysts and portfolio managers to promote current investment ideas within their assigned industries. The investment team, led by the small cap managers, debates the merits of each recommendation, taking into account the return potential and risk of the investment before determining the final portfolio weight. Each of the major steps in the research process is subject to peer review with the small cap portfolio managers final responsibility for the product.

**Ownership:**

HWCM, a limited liability company organized in Delaware, is majority-owned by its employees. Twenty-one active employees have an ownership interest in HWCM comprising 53.0%. Additional shareholders include Stephens Group Inc. and affiliates, 42.7%, George Wiley, 1.1%; John Hotchkis, 1.1%; and Nigel Hurst-Brown, 2.1%. Approximately 6% of the equity has been reserved for future allocation to employees to facilitate recruitment and retention of key individuals.

<b>Firm's total assets under management:</b>	\$ 5,951 mm
<b>Assets under management in this product:</b>	\$ 451
<b>Number of Accounts in this product:</b>	6
<b>Total Number of Portfolio Managers:</b>	8
<b>Number of Portfolio Managers on this product†:</b>	2
<b>Number of Analysts on this product†:</b>	7

†Jim Miles has been with the small cap product since 1995 and assumed responsibility for the small cap product in the second quarter of 1996. David Green joined in 1997 as co-manager of the small cap product. They are supported by the firm's research team, which is organized along industry coverage and supports all market capitalization ranges within the assigned industry group. Portfolios are managed on a team basis, with David and Jim having final responsibility for the product.

**Largest Accounts:**

<u>Account Name</u>	<u>Account Type</u>	<u>Market Value</u>
American AAdvantage Small Cap Fund	Sub-Advisory	\$ 132.7 mm
Froedtert & Community Health	Corporate	23.8 mm
American Airlines Fixed Benefit	Corporate	16.3 mm
Springfield Retirement System	Public	13.9 mm
Silver Growth Fund	Limited Partnership	5.2 mm

**Additional Small Cap Value institutional mandates funded during 3Q03:**

<u>Account Name</u>	<u>Account Type</u>	<u>Market Value</u>
Alaska Electrical Pension Fund	Taft-Hartley	\$ 43.0 mm
OK State Regents For Higher Education	Public	13.0 mm
Babson College	Endowment	8.5 mm

		Investment Manager: HOTCHKIS & WILEY - REP 2		Benchmark: FRANK RUSSELL 2000 VALUE			
		---PORTFOLIO---		---BENCHMARK---		-----VAM-----	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
99	Q1	-13.89		-9.69		-4.64	
	Q2	25.48		16.56		7.66	
	Q3	-14.74		-7.82		-7.50	
	Q4	-4.34	-11.86	1.53	-1.49	-5.78	-10.53
00	Q1	2.69		3.82		-1.09	
	Q2	-1.55		1.95		-3.44	
	Q3	16.12		7.34		8.18	
	Q4	10.01	29.14	8.11	22.83	1.76	5.14
01	Q1	6.04		0.97		5.01	
	Q2	16.34		11.64		4.21	
	Q3	-10.23		-13.33		3.58	
	Q4	22.16	35.28	16.72	14.03	4.66	18.64
02	Q1	10.47		9.58		0.82	
	Q2	0.67		-2.12		2.85	
	Q3	-17.78		-21.29		4.45	
	Q4	9.66	0.27	4.92	-11.43	4.52	13.20
03	Q1	-2.12		-5.08		3.12	
	Q2	24.73		22.72		1.64	
Latest:							
1 yr			10.07		-3.80		14.42
3 yr			28.37		10.94		15.72
5 yr			N/A		N/A		N/A
Cum 9901-0306			15.13		8.16		6.44
Std Dev			20.05		17.30		9.75

## MARTINGALE ASSET MANAGEMENT, L.P.

**Name of Product:** Small Cap Value

**Investment Style:** Small Cap Value

### **Investment Philosophy:**

Martingale's investment process is founded on a simple philosophy: *we exploit the long-term link between undervalued company fundamentals and current market prices to achieve superior investment returns.* Years of employing a research-driven, systematic process stand firmly behind this philosophy. Martingale has a long history of employing sound quantitative methods to managing assets. The firm has nearly two decades of hands-on experience using technology to analyze stocks and construct portfolios to add value for our clients. Our valuation process is comprised of a handful of well-researched valuation indicators that have stood the test of time, with improvements made only after careful evaluation, testing and analysis.

Our investment philosophy takes advantage of long-term inefficiencies in stock prices. The characteristics of our valuation process lead us to find undervalued stocks that typically take a year to appreciate in value. The average holding period of a SmallCap Value stock is typically one year. We approach every holding as an investment in the business and intend to hold it until either our objectives are reached, or it is apparent that there are better opportunities in other stocks.

### **Investment Process:**

Our Small Cap Value product seeks stocks with low P/E ratios and high cash flow to price versus their peers. "Value Traps" are avoided by favoring stocks with positive relative strength and earnings estimate revisions versus their peers. In addition, we measure the quality of company management by examining its commitment to R&D, its accounting practices with regard to earnings and cash flow from operations and its ability to manage inventory. The strategy selects from stocks included in the Russell 2000 Value index. There are approximately 1300 companies in this index, and 90% of them are closely followed.

Martingale evaluates all stocks in the selection universe by using a proprietary stock selection process. It examines multiple characteristics of quality, value and momentum. Each stock "earns" a composite score derived from our valuation process, and each is ranked from highest to lowest as a measure of its current level of attractiveness, or expected return. Using an optimization process, Martingale builds a portfolio of roughly the highest ranked stocks while minimizing unintended bets by controlling industry and sector weightings and average company size to resemble the benchmark. Ranges are also established for asset positions, tracking error, beta, number of assets held, turnover and other policy variables. At the end of the day, a typical portfolio should have above average value, momentum and management characteristics versus the Russell 2000 Value benchmark.

The goal of our portfolio rebalance process is to create a portfolio that has the highest expected return within the client's risk management guidelines. Accordingly, in the great majority of cases, we sell a stock to make room for a more attractive one with a higher expected return. Typically, we sell a stock when it has appreciated in value and is no longer as attractive relative to its industry peers.

Neither the firm nor the investment process has undergone any major philosophical changes since the firm began in 1987. Because market conditions are always changing, we recognize the need to preserve our model's performance. We continually research new characteristics that would enhance our process so that it emphasizes those investment characteristics that are relevant to adding value over a one to two year horizon. Martingale recently added management quality and cash earnings valuation indicators to our investment process. These variables were researched for more than a year and implemented in the third quarter of 2001.

**Ownership:**

There are twelve employee-partners, including the firm's four founding partners. Today, Martingale is 100% employee-owned: In 2002, employees completed the repurchase of German-based Commerzbank AG's 60% share of the firm, which the bank had owned since 1995.

<b>Firm's total assets under management:</b>	\$1,514M
<b>Assets under management in this product:</b>	\$239M
<b>Number of Accounts in this product:</b>	8
<b>Number of Portfolio Managers on this product:</b>	3
<b>Number of Analysts on this product:</b>	0

**Largest Accounts:**

Alaska Permanent Fund Corporation	\$92M
SEI Investments	\$65M
John D. and Catherine T. MacArthur Foundation	\$26M
Dartmouth College	\$24M
Texas Tech University	\$14M



Investment Manager: MARTINGALE ASSET MGMT - REP 1  
 Benchmark: FRANK RUSSELL 2000 VALUE

		---PORTFOLIO---		---BENCHMARK---		-----VAM-----	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
96	Q3	3.27		1.49		1.75	
	Q4	12.15	15.82	10.06	11.70	1.90	3.69
97	Q1	-0.99		-0.25		-0.75	
	Q2	17.04		15.09		1.69	
	Q3	15.00		12.89		1.87	
	Q4	4.67	39.48	1.68	31.79	2.94	5.84
98	Q1	11.93		8.35		3.30	
	Q2	-5.01		-3.61		-1.45	
	Q3	-19.24		-17.88		-1.66	
	Q4	10.53	-5.09	9.07	-6.45	1.34	1.46
99	Q1	-12.16		-9.69		-2.73	
	Q2	17.73		16.56		1.01	
	Q3	-7.48		-7.82		0.37	
	Q4	-0.14	-4.47	1.53	-1.49	-1.65	-3.02
00	Q1	0.10		3.82		-3.59	
	Q2	3.66		1.95		1.68	
	Q3	11.12		7.34		3.52	
	Q4	10.40	27.29	8.11	22.83	2.12	3.64
01	Q1	2.13		0.97		1.14	
	Q2	12.31		11.64		0.60	
	Q3	-10.58		-13.33		3.18	
	Q4	14.71	17.65	16.72	14.03	-1.72	3.18
02	Q1	12.94		9.58		3.07	
	Q2	1.26		-2.12		3.46	
	Q3	-17.15		-21.29		5.26	
	Q4	2.58	-2.80	4.92	-11.43	-2.23	9.74
03	Q1	-2.11		-5.08		3.13	
	Q2	25.25		22.72		2.06	
Latest:							
1 yr			4.20		-3.80		8.32
3 yr			19.82		10.94		8.01
5 yr			8.76		4.98		3.60
Cum 9607-0306			14.72		10.09		4.20
Std Dev			17.19		17.18		4.42

## McKINLEY CAPITAL MANAGEMENT, INC.

**Name of Product:** Small Cap Growth

**Investment Style:** Small Cap Growth

**Investment Philosophy:**

We believe that excess market returns can be achieved through the construction and management of a diversified, fundamentally sound portfolio of inefficiently priced securities whose earnings growth rates are accelerating above market expectations.

**Investment Process:**

Using proprietary quantitative models, we systematically search for and identify early signs of accelerating growth. Our initial universe consists of 10,500 publicly traded domestic stocks, including growth and value stocks from all capitalization categories. The primary model includes a linear regression model to identify common stocks that are inefficiently priced relative to the market while adjusting each security for standard deviation. The ratio of alpha to standard deviation (O/R) is the primary screening value; we use it to filter out all but the top 10% of stocks in our initial universe.

The remaining candidates then pass through liquidity and strength of earnings tests. The candidates are filtered and scrutinized for liquidity factors which include, but are not limited to: minimum market capitalization of \$100 million and buy-in positions not to exceed three times daily average stock volume. The result is approximately 400 stocks.

Our earnings test or model identifies securities with strong earnings acceleration. Positive earnings surprises are one of the strongest fuels of a security's price appreciation. We search for substantive reasons for continued growth in each stock by applying estimates of earnings growth models, earnings percent surprise, superior characteristics of earnings revisions and comparisons of estimates for next year's earnings growth rates to the expected price/earnings ratio. For the Small Cap Growth product, our portfolio team selects securities with a minimum market capitalization of \$100 million up to the largest market capitalization stock in the Russell 2000 Growth Index. And we will not exceed 120% of the average weighted market cap of the benchmark index. The result is approximately 150-200 stocks.

In the final portfolio construction process, we examine a variety of qualitative factors, which could ultimately impact earnings. These include qualitative data, economic factors, street research overview, and specific industry themes. Philosophically, we are looking to ensure that earnings estimates are reasonable and sustainable. The final portfolio holds between 35-50 stocks, providing diversification and risk control by issue and sector.

**Ownership:**

McKinley Capital is independently owned. Thirty-two professionals currently hold options to purchase approximately 25% of the firm's Class B Common Stock through the firm's ISO (Incentive Stock Option) Plan. Robert B. Gillam is the sole shareholder of class A shares through a revocable trust. The tax qualified ISO Plan was adopted in December 1998 to address succession planning, enhance the compensation structure, and allow key professionals to participate in the ownership of the firm.

<b>Firm's total assets under management as of 8/31/03:</b>	\$4.1 billion
<b>Assets under management in this product as of 8/31/03:</b>	\$341 million
<b>Number of Accounts in this product as of 8/31/03:</b>	6
<b>Number of Portfolio Managers on this product:</b>	7*
<b>Number of Analysts on this product:</b>	6**

\*Investment decisions are made on a team basis. Each product is assigned to a specified member of the portfolio team – the lead manager – who also serves as a primary client contact. Within this team framework, the lead manager for each product bears ultimate responsibility for the portfolio. All investment decisions are subject to the oversight of Robert B. Gillam, CIO, who oversees implementation of the investment process on a firm-wide basis.

\*\*Our quantitative research team plays an essential role in the portfolio management process. We do not carry out research in the traditional sense of site visits and meetings with company management. Instead, our dedicated quantitative research staff and systems support the portfolio team by providing them with meaningful investment data, linked and coordinated from a wide variety of sources.

**Largest Accounts:**

As of 8/31/03:

Corporate	\$130,993,334
Sub-Advisory	\$98,052,056
Sub-Advisory	\$62,802,741
Corporate	\$5,166,072
Corporate	\$5,144,990

Investment Manager: MCKINLEY CAPITAL MGMT - REP 3  
 Benchmark: FRANK RUSSELL 2000 GROWTH

	---PORTFOLIO---		---BENCHMARK---		-----VAM-----	
	Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
97 Q2	25.04		17.55		6.37	
Q3	40.18		16.92		19.89	
Q4	-25.04	31.39	-8.20	26.18	-18.35	4.13
98 Q1	14.23		11.88		2.10	
Q2	0.30		-5.74		6.41	
Q3	-19.18		-22.36		4.09	
Q4	31.90	22.14	23.64	1.23	6.69	20.65
99 Q1	-2.50		-1.68		-0.83	
Q2	23.94		14.75		8.01	
Q3	1.89		-4.92		7.16	
Q4	28.03	57.65	33.39	43.09	-4.02	10.18
00 Q1	15.18		9.28		5.40	
Q2	-8.27		-7.37		-0.97	
Q3	-7.64		-3.97		-3.82	
Q4	-15.04	-17.09	-20.20	-22.43	6.46	6.88
01 Q1	-20.50		-15.20		-6.24	
Q2	23.94		17.97		5.06	
Q3	-23.50		-28.08		6.37	
Q4	26.33	-4.78	26.16	-9.23	0.13	4.91
02 Q1	-5.77		-1.96		-3.89	
Q2	-12.01		-15.70		4.37	
Q3	-16.04		-21.52		6.98	
Q4	-0.01	-30.40	7.51	-30.26	-7.00	-0.19
03 Q1	-1.01		-3.88		2.98	
Q2	20.22		24.15		-3.16	
Latest:						
1 yr		-0.09		0.69		-0.78
3 yr		-14.78		-16.66		2.26
5 yr		1.91		-4.25		6.43
Cum 9704-0306		8.39		1.10		7.21
Std Dev		32.20		30.78		12.87

## TURNER INVESTMENT PARTNERS, INC.

**Name of Product:** Turner Small Cap GrowthPlus Equity

**Investment Style:** Small Cap Growth

### **Investment Philosophy:**

Turner's investment philosophy, that earnings expectations drive stock prices, has remained unchanged since the firm's inception in 1990. We implement our philosophy with a process that has dynamic elements that change with market conditions. We believe that investing in companies with strong earnings prospects is an effective long-term strategy; therefore, we do not deviate from our philosophy. We apply the same investment process to all of our equity portfolios to help provide clients a uniform and consistent approach to investing in growth stocks. Our objective is to significantly outperform the market with a level of risk commensurate with the market.

We add value primarily through stock selection. Turner pursues a bottom-up strategy that blends quantitative and qualitative analyses. In our view, ideal candidates for investment are growth companies that we believe may have above average earnings prospects, reasonable valuations, favorable trading volume, and price patterns. Each security is subjected to three separate evaluation criteria: fundamental analysis (approximately 80%), model screening (approximately 10%), and technical analysis (approximately 10%).

### **Investment Process:**

The heart of our stock selection process is fundamental analysis. We invest in companies whose fundamentals support:

- a rate of growth that exceeds their industry peers;
- earnings that meet or exceed market consensus estimates; and
- earnings estimates that are being revised upwards.

Fundamental analysis helps us determine if the companies we follow will exceed, meet or fall short of Wall Street analysts' consensus earning expectations. Our analysts meet with company management, talk to industry experts and competitors, and attend trade conferences in an effort to anticipate changes in the outlook for corporate earnings.

While our primary focus is on fundamental analysis, we use a proprietary computer model to assess a universe of approximately 5,000 companies of varying capitalizations based on multiple earnings growth and valuation factors. We screen securities within sector and market capitalization groups, using factors appropriate for each specific group. Once screened, companies are ranked from the first percentile (most attractive) to the 100th percentile (least attractive). Companies ranked in the top 35th percentile within their respective sector groupings qualify for further consideration. Current holdings that fall below the 50th percentile become candidates for sale. Our model ranking process is

used as a screening tool and does not automatically eliminate stocks from consideration. The process serves to focus our attention on those stocks that are likely to meet Turner's fundamental criteria.

Technical analysis is used to evaluate trends in trading volume and price patterns for individual stocks. This helps our investment team to identify attractive entry and exit points. For example, money flow (accumulation or distribution) may act as a leading or confirming indicator. Relative strength can provide an early alert and cause us to revisit fundamentals.

**Ownership:**

Turner Investment Partners, Inc., ("Turner" or "Turner Investment Partners"), is 100% employee owned.

<b>Firm's total assets under management:</b>	\$9,750.16 MM
<b>Assets under management in this product:</b>	\$477.25 MM
<b>Number of Accounts in this product:</b>	9
<b>Number of Portfolio Managers on this product:</b>	4
<b>Number of Analysts on this product:</b>	9

**Largest Accounts:**

The following table lists the five largest tax-exempt, institutional separate account client types and their corresponding dollar amounts in the Turner Small Cap GrowthPlus Equity strategy:

<b>Turner Small Cap GrowthPlus Equity Strategy</b>	
<u>Account Type</u>	<u>Dollar Amount</u>
Corporate	\$98.16 MM
Corporate	\$62.19 MM
Corporate	\$57.52 MM
Public	\$36.24 MM
Corporate	\$16.12 MM

		Investment Manager: TURNER INVESTMENT PARTNERS - REP 1		Benchmark: FRANK RUSSELL 2000 GROWTH			
		---PORTFOLIO---		---BENCHMARK---		-----VAM-----	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
94	Q1	-5.29 *		-6.14 *		0.90 *	
	Q2	-4.24		-6.28		2.17	
	Q3	13.62		9.32		3.93	
	Q4	4.47	7.65	-0.74	-4.54	5.25	12.77
95	Q1	7.38		5.48		1.79	
	Q2	16.03		9.92		5.56	
	Q3	17.91		11.37		5.87	
	Q4	14.47	68.16	1.48	31.04	12.80	28.33
96	Q1	10.54		5.74		4.53	
	Q2	17.29		5.84		10.82	
	Q3	2.71		-0.85		3.59	
	Q4	-3.24	28.85	0.26	11.26	-3.49	15.81
97	Q1	-16.83		-10.49		-7.09	
	Q2	24.09		17.55		5.56	
	Q3	16.80		16.92		-0.10	
	Q4	-4.80	14.75	-8.20	12.95	3.70	1.60
98	Q1	15.03		11.88		2.81	
	Q2	0.25		-5.74		6.36	
	Q3	-24.30		-22.36		-2.51	
	Q4	24.34	8.53	23.64	1.23	0.57	7.21
99	Q1	6.32		-1.68		8.14	
	Q2	16.40		14.75		1.44	
	Q3	3.42		-4.92		8.76	
	Q4	44.57	85.04	33.39	43.09	8.38	29.32
00	Q1	16.32		9.28		6.44	
	Q2	-4.54		-7.37		3.06	
	Q3	-2.78		-3.97		1.24	
	Q4	-20.69	-14.38	-20.20	-22.43	-0.62	10.37
01	Q1	-26.58		-15.20		-13.41	
	Q2	21.60		17.97		3.07	
	Q3	-28.44		-28.08		-0.50	
	Q4	28.65	-17.81	26.16	-9.23	1.97	-9.45
02	Q1	-3.28		-1.96		-1.35	
	Q2	-17.16		-15.70		-1.73	
	Q3	-20.78		-21.52		0.95	
	Q4	6.83	-32.19	7.51	-30.26	-0.63	-2.76
03	Q1	-2.75		-3.88		1.18	
	Q2	28.18		24.15		3.25	
Latest:							
1 yr			5.51		0.69		4.79
3 yr			-18.78		-16.66		-2.55
5 yr			0.71		-4.25		5.18
Cum 9403-0306			13.26		3.14		9.82
Std Dev			30.59		26.90		8.76

\*First Quarter 1994 includes one month of performance, March.

## KENWOOD CAPITAL MANAGEMENT

**Name of Product:** Kenwood Small Cap Value

**Investment Style:** Small Cap Value

**Investment Philosophy:**

We believe that active equity management with a *quantitative* approach is an effective way to identify and exploit investment opportunities in the small-cap segment of the US equity market. Our portfolio management team relies primarily on quantitative appraisal and risk management tools, but we also conduct fundamental analysis at the company level to supplement our model-based stock selection discipline. Our goal is to deliver superior risk-adjusted performance in both up and down markets.

Our strategy focuses on individual stock selection within a sector neutral framework. Our objective is to own a portfolio of stocks that represents the best opportunities in each sector based on valuation and indicators of improving cash flow and earnings. We look for higher quality stocks that are undervalued based on demonstrable fundamentals, rather than “distressed” value stocks.

For consistency of performance, we integrate risk management into all aspects of our investment process. We stress the importance of achieving a *risk-efficient* implementation of our strategy. We manage total portfolio risk relative to the strategy benchmark by adhering to a strict risk budget. By focusing on individual security mispricing and avoiding “top-down” rotational strategies, we take active risk where we believe that we have a proven information advantage.

**Investment Process:**

- **Quantitative Analysis**

The centerpiece of our stock selection process is a quantitative appraisal model that we have developed for the small cap universe. We employ this quantitative model to rank stocks on their “appraisal” premium, or potential excess return. This multifactor stock selection tool is *balanced* and comprehensive. It incorporates a number of different investment perspectives, including forward-looking elements:

- **Valuation**
  - On free cash flow
  - On earnings
- **Earnings**
  - Estimate diffusion (up versus down estimate revisions)
  - Trend of estimate revisions
  - Earnings surprise
- **Market Reaction**
  - Price momentum relative to sector (intermediate term)



- Price reversal relative to industry group (short term)

We use dynamic, sector-specified factor weights in our appraisal model. In effect, we have *12 sector models* driving stock selection. Within the context of each sector, we emphasize those stock attributes that are most important in determining relative performance. This process recognizes that the predictive power of different appraisal factors varies across economic sectors and through time, as investors react to changing market conditions.

By focusing on the intersection of a diverse set of signals, our appraisal model is designed to identify stocks within each economic sector that have attractive relative valuations and superior return potential. Our research indicates that these appraisal factors are relatively uncorrelated over time and serve as complementary indicators of relative stock performance.

- **Qualitative Analysis**

While quantitative discipline drives our investment process qualitative criteria also influence our buy and sell decisions. To ensure the accuracy of model-based appraisal rankings, we engage in a continuous review of company and industry fundamentals and monitor portfolios for exposure to event risks that cannot be modeled. We ask the following questions about all potential buy candidates:

- Does the stock offer adequate liquidity?
- Is a one-time event driving estimate revisions?
- Are there litigation / regulatory risks facing the company?
- Does the company face other unusual risks?

This activity is undertaken partly as a quality control function, to compensate for limited coverage by Wall Street analysts in the small cap value universe, and partly as a risk control function, dictated by the need to reflect a wide spectrum of purely company-specific factors in the appraisal process.

- **Buy and Sell Decisions**

Buy and sell decisions are based primarily on quantitative appraisal scores. Buy decisions focus on stocks in the top two quintiles of the selection universe that pass qualitative screens. Sell decisions are also generally the product of the quantitative appraisal process. In each sector, lower rated stocks are evaluated as swap candidates for top quintile stocks. Qualitative factors also influence sell decisions. For example, a sudden deterioration in company fundamentals or an unusual event risk or controversy, such as litigation or accounting irregularities, could trigger a sale.

When considering purchase and sale recommendations, we carefully review the potential impact on sector and industry diversification. We limit sector weights to +/- 2% of the index weight. The maximum active weight (portfolio weight - index weight) in any one

stock is 1% of the portfolio value. The resulting portfolios are *broadly diversified*, with 200 to 250 stock holdings.

**Ownership:**

Kenwood is a joint venture between American Express Asset Management (AEAM) and the firm's Principals, Jacob E. Hurwitz and Kent A. Kelley. AEAM owns 50.1% of Kenwood, and the Principals jointly and equally own the remaining 49.9%.

<b>Firm's total assets under management:</b>	\$759.5 million
<b>Assets under management in this product:</b>	\$38.0 million *
<b>Number of Accounts in this product:</b>	6
<b>Number of Portfolio Managers on this product:</b>	4
<b>Number of Analysts on this product:</b>	0

\* Additionally, Kenwood manages \$360 million in small cap value equities in two small cap core retail mutual funds.

**Largest Accounts:**

Type/Name	Inception Date	Market Value (9/30/03)
Collective Fund	5/31/2002	\$15.5 million
Foundation	4/13/2003	\$2.0 million
Foundation	3/1/2002	\$1.2 million
Public	4/10/2002	\$1.1 million

Investment Manager:		KENWOOD CAPITAL MANAGEMENT - REP					
Benchmark:		FRANK RUSSELL 2000 VALUE					
		---PORTFOLIO---		---BENCHMARK---		-----VAM-----	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
00	Q1	7.42		3.82		3.47	
	Q2	2.81		1.95		0.85	
	Q3	11.21		7.34		3.61	
	Q4	11.82	37.35	8.11	22.83	3.44	11.82
01	Q1	-3.21		0.97		-4.14	
	Q2	11.53		11.64		-0.10	
	Q3	-9.99		-13.33		3.86	
	Q4	16.09	12.80	16.72	14.03	-0.54	-1.07
02	Q1	11.49		9.58		1.74	
	Q2	0.21		-2.12		2.38	
	Q3	-16.97		-21.29		5.49	
	Q4	5.40	-2.23	4.92	-11.43	0.45	10.39
03	Q1	-5.07		-5.08		0.01	
	Q2	22.37		22.72		-0.29	
Latest:							
1 yr			1.66		-3.80		5.68
3 yr			16.80		10.94		5.28
5 yr			N/A		N/A		N/A
Cumulative 0001-0306			17.52		11.09		5.79
Std.Dev			17.14		18.12		4.11

## U.S. BANCORP ASSET MANAGEMENT

**Name of Product:** Small Cap Growth Equity

**Investment Style:** Small Cap Growth

**Investment Philosophy:**

U.S. Bancorp Asset Management investment philosophy is based on the belief that achieving superior long-term performance requires building consistent above-benchmark results over time.

U.S. Bancorp Asset Management's Small Cap Growth team utilizes a **bottom-up** fundamental valuation analysis in conjunction with **top-down** investment themes.

We believe as a result of the inherent inefficiencies within the Small Cap space, we can add value through our disciplined stock selection process. Our Small Cap Growth style is designed to uncover these inefficiencies by utilizing rigorous **fundamental analysis**.

**Investment Process:**

U.S. Bancorp Asset Management's Small Cap Growth team utilizes a bottom-up fundamental valuation analysis in conjunction with top-down investment themes.

The bottom-up approach concentrates on the company's management expertise, growth prospects, and competitive advantages, financial condition and attractiveness of valuation. The process is continuously overlaid with a top-down assessment of current and anticipated economic conditions and the subsequent impact on various industries.

The team looks for companies that are fundamentally superior growth companies, attractively priced at purchase with less than \$1 billion in market cap. The Small Cap Growth team process begins by generating ideas from an exhaustive database of Small Cap Stocks, investor conferences, and management and network contacts.

This initial universe of stocks is screen based on:

- Consistent historical and prospective growth in earnings
- Low financial leverage with strong cash flow
- High return on invested capital
- High management ownership
- Positive earnings surprises and upward earnings revisions

This screening process narrows the universe of small cap growth stocks and then the team performs in-depth fundamental and valuation analysis. The fundamental research consists of personal meetings with management, Wall Street research, in-depth company/market analysis, financial statement projections, and detailed financial statement analysis. All of these candidates must meet the overall investment themes established by the team. Superior fundamental companies will display the following characteristics:

- Above average historical and prospective revenue and earnings growth

- High levels of insider ownership
- Superior and defensible business model
- Above average returns on invested capital
- Income statement predictability and consistency
- Sustainable pricing power
- Self-funding growth capabilities
- Below average debt to equity ratio
- Executive compensation aligned with shareholder interests

Through this detailed fundamental analysis process companies that display compelling fundamentals become candidates for valuation analysis. Absolute and relative valuation metrics is computed on each of the surviving companies.

Absolute Valuation Analysis – Company characteristics compared to Russell 2000 Growth characteristic averages:

- Historical and prospective revenue growth rates
- Historical and prospective Return on Invested Capital
- Debt/Equity
- Enterprise Value/EBITDA

Relative Valuation Analysis – Comparison of current valuation with each of the following:

- P/E ratio compared to range over last 5 years
- P/E ratio relative to Russell Growth P/E ratio (5 year range of multiple)
- P/E ratio compared to other companies in industry
- Enterprise Value/EBITDA

If the company is attractively priced based on the above metrics it is added to the portfolio. If the company's valuation is too high, the company is added to the Small Cap Growth Team's watch list.

Sell decisions are driven by sector adjustments or if an individual security displays:

- Deteriorating fundamentals
- Overvaluation

### **Ownership:**

U.S. Bancorp Asset Management is the investment management division of U.S. Bank and headquartered in Minneapolis, MN.

The ownership structure of U.S. Bancorp Asset Management is constructed to exhibit the characteristics of an **independent firm**. These characteristics are defined as, direct firm ownership, the ability to **retain/attract** highly motivated and successful investment professionals. Our ownership structure has been designed with the ultimate goal of providing long-term superior investment performance and service for our client's.

Portfolio managers, senior analysts, and other senior professionals have indirect equity "Phantom" stock in U.S. Bancorp Asset Management. These units appreciate based on the

viability of the organization. Additionally, employees are awarded stock options in U.S. Bank stock.

<b>Firm's total assets under management:</b>	\$123.9 (mm)
<b>Assets under management in this product:</b>	\$428.4 (mm)
<b>Number of Accounts in this product:</b>	14
<b>Number of Portfolio Managers on this product:</b>	2
<b>Number of Analysts on this product:</b>	5

**Largest Accounts:**

Per the request of our clients we do not give out our client's names. The following is a list of our clients by client type and asset amount.

Public	\$31.9 million
Taft-Hartley	\$9.8 million
Taft-Hartley	\$7.0 million
Foundation	\$6.2 million
Foundation	\$5.7 million

		Investment Manager: US BANK - REP Y		Benchmark: FRANK RUSSELL 2000 GROWTH			
		----PORTFOLIO----		----BENCHMARK----		-----VAM-----	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
95	Q3	3.09 *		2.06 *		1 01 *	
	Q4	7.69	11.01	1.48	3.57	6 12	7.19
96	Q1	12.97		5.74		6 83	
	Q2	22.33		5.84		15 57	
	Q3	5.55		-0.85		6 46	
	Q4	9.56	59.80	0.26	11.26	9 27	43.63
97	Q1	-12.20		-10.49		-1 92	
	Q2	14.17		17.55		-2 88	
	Q3	21.79		16.92		4 17	
	Q4	-5.12	15.82	-8.20	12.95	3 34	2.54
98	Q1	19.10		11.88		6 46	
	Q2	-3.02		-5.74		2 89	
	Q3	-30.48		-22.36		-10 45	
	Q4	23.56	-0.77	23.64	1.23	-0 06	-1.98
99	Q1	-4.51		-1.68		-2 88	
	Q2	31.01		14.75		14 17	
	Q3	12.24		-4.92		18 05	
	Q4	71.41	140.69	33.39	43.09	28 50	68.20
00	Q1	34.74		9.28		23 29	
	Q2	-7.42		-7.37		-0 05	
	Q3	6.19		-3.97		10 59	
	Q4	-14.32	13.49	-20.20	-22.43	7 36	46.30
01	Q1	-7.20		-15.20		9 44	
	Q2	21.09		17.97		2 64	
	Q3	-25.03		-28.08		4 24	
	Q4	27.23	7.18	26.16	-9.23	0 84	18.07
02	Q1	1.79		-1.96		3 82	
	Q2	-16.32		-15.70		-0 73	
	Q3	-22.68		-21.52		-1 48	
	Q4	14.93	-24.31	7.51	-30.26	6 90	8.54
03	Q1	-7.23		-3.88		-3 49	
	Q2	34.64		24.15		8 45	
Latest:							
1 yr			10.99		0.69		10.23
3 yr			-2.68		-16.66		16.78
5 yr			18.91		-4.25		24.19
Cum 9509-0306			24.72		1.28		23.14
Std Dev			34.58		28.78		12.69

\*Third Quarter 1995 includes one month of performance, September.

# Tab E



## COMMITTEE REPORT

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DATE: November 25, 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, November 13, 2003 to consider the following agenda items:

- Review the manager performance for the period ending September 30, 2003.
- Update on the domestic equity small-capitalization search.
- Review of Lincoln Equity Management in the Domestic Equity Program
- Review of GeoCapital Corporation in the Domestic Equity Program.
- Recommendation to terminate Artemis Asset Management from the Domestic Equity Program

**Action is required by the SBI / IAC on the last three items.**

### INFORMATION ITEMS:

#### 1. Review of manager performance for the period ending September 30, 2003.

- *Domestic Equity Managers*

For the period ending September 30, 2003, the **Domestic Equity Manager Program** matched the W5000 Investable for the quarter, but under-performed during the one, three, and five-year time periods. The **current managers** matched the Aggregate Benchmark for the quarter and the five-year periods, but under-performed the Aggregate Benchmark during the one and three-year time periods.

Time period	Total Program	Wilshire 5000 Investable	Current Mgrs. Only	Aggregate Benchmark
Quarter	3.5%	3.5%	3.5%	3.5%
1 Year	25.4	26.1	25.4	26.9
3 Years	-10.3	-10.2	-10.2	-9.6
5 Years	1.0	1.4	1.9	1.9

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 September 30, 2003, the **Fixed Income Manager Program** out-performed the Lehman Aggregate over all time periods. The **current managers** also out-performed the Aggregate Benchmark over all time periods.

Time period	Total Program	Lehman Aggregate
Quarter	0.1%	-0.1%
1 Year	6.9	5.4
3 Years	9.2	8.9
5 Years	6.8	6.6

Current Mgrs. Only	Aggregate Benchmark
0.1%	-.01%
7.0	5.4
9.3	8.9
7.0	6.6

The performance evaluation reports for the fixed income managers start on the **blue page A-51** of this Tab.

- **International Equity Managers**

For the period ending September 30, 2003, the **International Equity Program** and the **equity managers** (excluding the currency overlay) under-performed the composite index over the quarter and the year and outperformed over the three and five-year time periods.

Time Period	Total* Program	Composite Index**
Quarter	8.5	8.7
1 Year	26.8	27.7
3 Year	-7.3	-7.8
5 Year	2.1	1.6

Equity*** Mgrs. Only
8.5
26.8
-7.3
2.1

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

\*\* The international benchmark is EAFE-Free plus Emerging Markets Free. 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% Emerging Markets Free. On 5/1/96, the portfolio began transitioning from 100% EAFE-Free to the 12/31/96 fixed weights. Prior to 5/1/96, the benchmark was 100% EAFE-Free.

\*\*\* 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-63** of this Tab.

## **2. Update on the domestic equity small-capitalization search.**

The SBI conducted a search for small capitalization value and growth managers to achieve the following two goals:

- To reallocate actively managed domestic equity assets so they more closely match the weight of the small-capitalization component of the R3000, asset class target, and
- To diversify and add capacity to the SBI's lineup of small cap managers.

The Search Committee met on October 30 and 31, 2003, and interviewed ten potential small-capitalization managers for the Domestic Equity Program. The Search Committee is recommending that five (5) firms be retained by the SBI for inclusion in the Domestic Equity Program. The Committee is also recommending two (2) additional firms be retained as Emerging Managers within the Domestic Equity Program. These two firms would be responsible for a smaller portfolio. The results and recommendations from the Search Committee appear in **Tab D**.

### **ACTION ITEMS:**

#### **1. Review of Lincoln Equity Management in the Domestic Equity Program.**

Lincoln met with the Stock and Bond Manager Committee to discuss the company's restructuring, staffing changes, and poor relative performance over the last several years. During the past year, the firm sold its fixed income business and reorganized its ownership and management staff. Lincoln has also experienced a high level of turnover in their investment staff. The Committee questioned Lincoln about its technology research capabilities, which is a sector that continues to under-perform relative to the benchmark. As a result of the significant changes at Lincoln and the Committee's doubts about the capabilities of the investment team to improve relative performance going forward, the Committee recommends the SBI end its relationship with Lincoln.

### **RECOMMENDATION:**

**The Committee recommends that the SBI terminate its relationship with Lincoln Equity Management, LLC for investment management services in the Domestic Equity Program.**

**2. Review of GeoCapital Corporation in the Domestic Equity Program.**

GeoCapital met with the Stock and Bond Manager Committee to discuss their performance over the past few years. GeoCapital discussed their investment process and some of the reasons for underperformance during 2000 through 2002 with the Committee. The Committee was concerned by a lack of a transition plan, other organizational issues, and the performance shortfall relative to the custom and published benchmarks.

**RECOMMENDATION:**

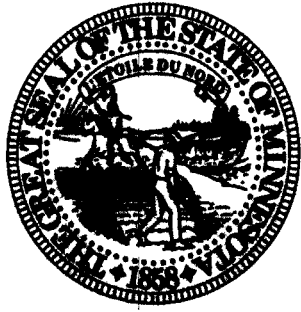
**The Committee recommends that the SBI terminate its relationship with GeoCapital Corporation for investment management services in the Domestic Equity Program.**

**3. Recommendation to terminate Artemis Asset Management LLC from the Domestic Equity Program.**

A recommendation was made by Staff to terminate Artemis as an Emerging Manager within the Domestic Equity Program due to concerns about performance and organizational change. Artemis was hired in July 2000, after a period of good performance. Since then performance has been disappointing due to the portfolio managers' stock selection decisions. Staff met with Artemis on several occasions to discuss portfolio holdings and the resulting performance, and has little confidence in the ability of the portfolio management team to add value in the future. The Stock and Bond Manager Committee concurred with the Staff recommendation.

**RECOMMENDATION:**

**The Committee recommends that the SBI terminate its relationship with Artemis Asset Management LLC for investment management services in the Domestic Equity Program.**



# STATE BOARD OF INVESTMENT

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## Domestic Equity Manager Evaluation Reports

Third Quarter, 2003

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**COMBINED RETIREMENT FUNDS  
DOMESTIC STOCK MANAGERS  
Periods Ending September, 2003  
Versus Custom Benchmarks**

	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	1.6	3.4	15.5	23.9	-13.9	-13.4	1.6	1.6	15.2	11.2	\$879.0	4.9%
Cohen, Klingenstein & Marks	6.0	5.0	42.5	41.0	-16.1	-10.2	-1.7	4.4	9.8	11.3	\$542.8	3.0%
Forstmann-Leff	9.7	5.9	28.7	35.1	-13.2	1.0	3.0	11.3	11.6	11.9	\$554.5	3.1%
Franklin Portfolio	4.9	4.0	21.2	34.5	-8.0	-3.8	3.8	5.3	11.4	11.4	\$663.2	3.7%
GeoCapital	8.2	8.6	48.7	51.4	-16.5	-6.4	0.4	6.1	8.1	10.1	\$293.7	1.6%
Lincoln	4.4	4.0	22.8	28.7	-23.6	-17.9	-6.4	-2.3	7.1	9.3	\$490.4	2.7%
New Amsterdam Partners	7.2	6.0	28.1	30.5	-3.0	-2.3	9.3	10.6	13.8	13.5	\$341.1	1.9%
Oppenheimer	3.3	1.8	24.4	25.3	-1.0	-5.7	5.7	4.9	12.7	11.3	\$778.4	4.3%
UBS Global	1.7	3.1	26.7	26.9	2.5	-9.5	2.6	3.7	10.3	10.0	\$790.6	4.4%
<b>Emerging Managers</b>												
Artemis	2.4	9.2	21.0	36.0	-8.6	1.6			-9.3	1.8	\$36.6	0.2%
Bay Isle Financial	0.6	2.9	12.5	24.7	-7.7	-3.3			-6.3	-0.8	\$40.5	0.2%
Earnest Partners	3.5	5.4	25.8	36.7	-3.0	8.9			-3.4	10.7	\$45.0	0.3%
Holt-Smith & Yates	-0.1	5.4	18.8	28.7	-10.2	-0.2			-9.3	-0.5	\$36.8	0.2%
Next Century Growth	15.4	9.6	37.0	44.9	-17.8	-9.3			-16.3	-9.5	\$28.3	0.2%
Peregrine Capital	10.7	8.1	38.1	31.8	13.8	15.7			15.6	16.9	\$146.3	0.8%
Valenzuela Capital	6.4	4.4	20.5	25.8	-0.8	3.9	4.3	7.6	9.8	11.3	\$72.8	0.4%
Voyageur-Chicago Equity	2.8	3.0	17.1	20.4	-10.7	-7.8			-7.9	-8.8	\$38.8	0.2%
Winslow-Small Cap	7.0	10.4	38.2	45.5	-9.9	-4.5			-7.4	-5.4	\$137.1	0.8%
Zevenbergen Capital	4.8	4.9	39.3	29.2	-25.1	-12.2	-0.4	8.3	9.3	13.0	\$111.9	0.6%
<b>Semi-Passive Managers</b>												
Barclays Global Investors	3.0	2.5	26.0	23.5	-9.2	-10.8	0.2	-0.9	10.5	9.6	\$2,473.7	13.8%
Franklin Portfolio	2.2	2.5	21.2	23.5	-10.8	-10.8	-1.5	-0.9	9.2	9.6	\$1,538.9	8.6%
JP Morgan	1.8	2.5	22.7	23.5	-10.5	-10.8	-0.9	-0.9	9.6	9.6	\$2,138.4	11.9%
<b>Passive Manager</b>												
Barclays Global Investors	3.5	3.5	25.8	26.1	-10.1	-10.2	1.7	1.6	8.9	8.7	\$5,783.7	32.2%
Current Aggregate	3.5	3.5	25.4	26.9	-10.2	-9.6	1.9	1.9	13.0	10.9	\$17,962.5	100.0%
Historical Aggregate (2)	3.5	3.5	25.4	26.9	-10.3	-9.6	1.0	1.9	11.3	11.7		
Wilshire 5000 Investable (3)	3.5		26.1		-10.2		1.4		11.5			
Wilshire 5000	3.7		26.3		-9.5		2.0		11.9			

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

(2) Includes the performance of terminated managers.

(3) 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.

**COMBINED RETIREMENT FUNDS**  
**ACTIVE DOMESTIC STOCK MANAGERS**  
**Periods Ending September, 2003**  
**Performance versus Published Style Benchmarks**

	Quarter		1 Year		3 Years		5 Years		Since Inception (1)		Market Value (in millions)	Active Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>LARGE CAP</b>												
<b>Russell 1000 Core</b>												
Forstmann-Leff	9.7	3.0	28.7	25.1	-13.2	-10.3	3.0	1.5	11.6	12.3	\$554.5	9.2%
Franklin Portfolio	4.9	3.0	21.2	25.1	-8.0	-10.3	3.8	1.5	11.4	11.3	\$663.2	11.0%
New Amsterdam Partners	7.2	6.4	28.1	32.6	-3.0	-2.1	9.3	8.1	13.8	11.7	\$341.1	5.7%
UBS Global	1.7	3.0	26.7	25.1	2.5	-10.3	2.6	1.5	10.3	10.0	\$790.6	13.1%
Voyageur-Chicago Equity	2.8	3.0	17.1	25.1	-10.7	-10.3			-7.9	-9.4	\$38.8	0.6%
<b>Russell 1000 Growth</b>												
Alliance Capital	1.6	3.9	15.5	25.9	-13.9	-19.1	1.6	-2.5	15.2	11.1	\$879.0	14.6%
Cohen, Klingenstein & Marks	6.0	3.9	42.5	25.9	-16.1	-19.1	-1.7	-2.5	9.8	9.1	\$542.8	9.0%
Holt-Smith & Yates	-0.1	3.9	18.8	25.9	-10.2	-19.1			-9.3	-19.1	\$36.8	0.6%
Lincoln	4.4	3.9	22.8	25.9	-23.6	-19.1	-6.4	-2.5	7.1	8.5	\$490.4	8.1%
Zevenbergen Capital	4.8	3.9	39.3	25.9	-25.1	-19.1	-0.4	-2.5	9.3	9.1	\$111.9	1.9%
<b>Russell 1000 Value</b>												
Bay Isle Financial	0.6	2.1	12.5	24.4	-7.7	-2.0			-6.3	0.5	\$40.5	0.7%
Earnest Partners	3.5	2.1	25.8	24.4	-3.0	-2.0			-3.4	0.5	\$45.0	0.7%
Oppenheimer	3.3	2.1	24.4	24.4	-1.0	-2.0	5.7	4.0	12.7	10.6	\$778.4	12.9%
Valenzuela Capital	6.4	5.9	20.5	28.3	-0.8	6.6	3.6	8.4	9.8	12.4	\$72.8	1.2%
<b>SMALL CAP</b>												
<b>Russell 2000 Core</b>												
Artemis	2.4	9.1	21.0	36.5	-8.6	-0.8			-9.3	-0.4	\$36.6	0.6%
<b>Russell 2000 Growth</b>												
GeoCapital	8.2	10.5	48.7	41.7	-16.5	-12.7	0.4	2.7	8.1	6.6	\$293.7	4.9%
Next Century Growth	15.4	10.5	37.0	41.7	-17.8	-12.7			-16.3	-12.9	\$28.3	0.5%
Winslow-Small Cap	7.0	10.5	38.2	41.7	-9.9	-12.7			-7.4	-12.9	\$137.1	2.3%
<b>Russell 2000 Value</b>												
Peregrine Capital	10.7	7.7	38.1	31.7	13.8	11.1			15.6	12.6	\$146.3	2.4%
									<b>Since 1/184</b>			
Russell 3000	3.4		25.9		-9.7		1.9		12.0			
Historical Aggregate (2)	3.5		25.4		-10.3		1.0		11.3			

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

(2) Includes the performance of terminated managers.



**COMBINED RETIREMENT FUNDS  
DOMESTIC STOCK MANAGERS  
Calendar Year Returns Versus  
Custom Benchmarks**

	YTD 9/30/03		2002		2001		2000		1999		1998	
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %
<b>Active Managers</b>												
Alliance Capital	12.3	14.4	-26.8	-24.0	-13.7	-15.3	-13.7	-11.4	38.0	30.3	49.6	38.6
Cohen, Klingenstein & Marks	29.6	26.2	-35.0	-23.8	-25.0	-11.2	-6.0	-12.1	24.8	28.6	38.2	31.3
Forstmann-Leff	28.8	26.0	-36.0	-21.0	-10.3	-2.5	-12.3	18.1	38.3	20.5	30.3	9.7
Franklin Portfolio	18.2	21.9	-25.4	-19.8	-6.6	-5.4	-1.6	0.3	26.2	16.3	10.7	18.3
GeoCapital	35.5	31.0	-31.5	-23.2	-24.1	-1.8	-27.8	-13.0	59.8	25.9	6.9	-1.3
Lincoln	14.1	17.8	-26.3	-26.3	-30.4	-18.1	-22.4	-24.5	26.7	29.2	42.3	44.5
New Amsterdam Partners	19.6	22.1	-17.5	-22.2	-3.3	3.7	15.0	3.1	15.0	32.1	26.2	18.5
Oppenheimer	13.9	15.1	-15.5	-20.7	-7.0	-9.5	11.2	10.3	10.7	14.9	21.5	24.4
UBS Global	15.2	16.5	-14.7	-20.6	5.2	-11.0	3.6	-1.0	-8.5	21.6	17.3	18.8
<b>Emerging Managers</b>												
Artemis	13.3	30.1	-21.5	-20.5	5.8	11.9						
Bay Isle Financial	9.2	15.7	-26.1	-17.2	-1.6	-5.9						
Earnest Partners	16.9	24.1	-18.1	-11.6	-0.4	11.5						
Holt-Smith & Yates	10.2	18.9	-28.0	-19.0	-1.7	4.6						
Next Century Growth	38.3	31.8	-33.3	-27.8	-22.8	-5.5						
Peregrine Capital	25.7	23.9	-8.1	-6.9	12.6	22.9						
Valenzuela Capital	20.1	16.7	-17.6	-11.2	-7.7	4.5	18.9	14.9	-6.7	3.7	-0.2	2.6
Voyageur-Chicago Equity	12.6	14.8	-20.6	-20.7	-19.4	-12.0						
Winslow-Small Cap	23.8	34.2	-25.0	-26.7	-6.1	4.6						
Zevenbergen Capital	32.1	18.9	-36.2	-24.2	-29.0	-3.2	-38.2	-16.6	94.3	56.6	54.5	30.7
<b>Semi-Passive Managers</b>												
Franklin Portfolio	12.9	13.9	-20.2	-19.7	-9.0	-9.7	-15.9	-16.3	12.9	16.3	22.4	23.7
JP Morgan	13.7	13.9	-21.8	-19.7	-8.7	-9.7	-13.6	-16.3	14.0	16.3	24.6	23.7
Barclays Global Investors	15.6	13.9	-19.1	-19.7	-7.8	-9.7	-13.8	-16.3	14.1	16.3	21.4	23.7
<b>Passive Manager</b>												
Barclays Global Investors	16.4	16.7	-21.4	-21.5	-11.8	-11.7	-9.8	-11.0	23.3	23.6	23.4	23.4
Current Aggregate	16.7	16.8	-22.4	-21.1	-10.9	-9.7	-10.5	-10.7	25.2	21.7	25.1	23.9
<b>Historical Aggregate (1)</b>	<b>16.7</b>	<b>16.8</b>	<b>-22.4</b>	<b>-21.1</b>	<b>-11.1</b>	<b>-9.9</b>	<b>-11.0</b>	<b>-10.7</b>	<b>21.0</b>	<b>21.3</b>	<b>23.5</b>	<b>23.4</b>
Wilshire 5000 Investable (2)	16.7		-21.5		-11.7		-10.8		22.2		23.4	
Wilshire 5000	17.1		-20.9		-11.0		-10.9		23.6		23.4	

(1) Includes the performance of terminated managers

(2) 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

Includes full-year returns only. Performance of managers hired during a calendar year are reported beginning with the following calendar year.

**COMBINED RETIREMENT FUNDS  
ACTIVE DOMESTIC STOCK MANAGERS  
Calendar Year Returns Versus  
Published Style Benchmarks**

	YTD 9/30/03		2002		2001		2000		1999		1998	
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %
<b>LARGE CAP</b>												
<b>Russell 1000 Core</b>												
Forstmann-Leff	28.8	15.7	-36.0	-21.7	-10.3	-12.5	-12.3	-7.8	38.3	20.9	30.3	27.0
Franklin Portfolio	18.2	15.7	-25.4	-21.7	-6.6	-12.5	-1.6	-7.8	26.2	20.9	10.7	27.0
New Amsterdam Partners	19.6	22.9	-17.5	-16.2	-3.3	-5.6	15.0	8.2	15.0	18.2	26.2	10.1
UBS Global	15.2	15.7	-14.7	-21.7	5.2	-12.5	3.6	-7.8	-8.5	20.9	17.3	27.0
Voyageur-Chicago Equity	12.6	15.7	-20.6	-21.7	-19.4	-12.5						
<b>Russell 1000 Growth</b>												
Alliance Capital	12.3	17.5	-26.8	-27.9	-13.7	-20.4	-13.7	-22.4	38.0	33.2	49.6	38.7
Cohen, Klingenstein & Marks	29.6	17.5	-35.0	-27.9	-25.0	-20.4	-6.0	-22.4	24.8	33.2	38.2	38.7
Holt-Smith & Yates	10.2	17.5	-28.0	-27.9	-1.7	-20.4						
Lincoln	14.1	17.5	-26.3	-27.9	-30.4	-20.4	-22.4	-22.4	26.7	33.2	42.3	38.7
Zevenbergen Capital	32.1	17.5	-36.2	-27.9	-29.0	-20.4	-38.2	-22.4	94.3	33.2	54.5	38.7
<b>Russell 1000 Value</b>												
Bay Isle Financial	9.2	13.9	-26.1	-15.5	-1.6	-5.6						
Earnest Partners	16.9	13.9	-18.1	-15.5	-0.4	-5.6						
Oppenheimer	13.9	13.9	-15.5	-15.5	-7.0	-5.6	11.2	7.0	10.7	7.3	21.5	15.6
Valenzuela Capital	20.1	19.8	-17.6	-9.6	-7.7	2.3	18.9	19.2	-6.7	-0.1	-0.2	5.1
<b>SMALL CAP</b>												
<b>Russell 2000 Core</b>												
Artemis	13.3	28.6	-21.5	-20.5	5.8	2.5						
<b>Russell 2000 Growth</b>												
GeoCapital	35.5	31.8	-31.5	-30.3	-24.1	-9.2	-27.8	-22.4	59.8	43.1	6.9	1.2
Next Century Growth	38.3	31.8	-33.3	-30.3	-22.8	-9.2						
Winslow-Small Cap	23.8	31.8	-25.0	-30.3	-6.1	-9.2						
<b>Russell 2000 Value</b>												
Peregrine Capital	25.7	25.5	-8.1	-11.4	12.6	14.0						

Includes full-year returns only. Performance of managers hired during a calendar year are reported beginning with the following calendar year.

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

**Portfolio Manager: Jack Koltes**

**Assets Under Management: \$878,951,729**

**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**

Alliance underperformed during the quarter due to their holdings in the media and cable industries. Their one-year performance lagged the custom benchmark as a result of stock selection in health technology and retail. Not owning Genentech hurt relative performance, as did owning Tenent Healthcare, Cardinal Healthcare, Pfizer, and Kohl, which underperformed during the year.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
Last Quarter	1.6%	3.4%	3.9%
Last 1 year	15.5	23.9	25.9
Last 2 years	-3.3	-2.2	-1.2
Last 3 years	-13.9	-13.4	-19.1
Last 4 years	-6.6	-5.8	-10.0
Last 5 years	1.6	1.6	-2.5
Since Inception (1/84)	15.2	11.2	11.1

**Calendar Year Returns**

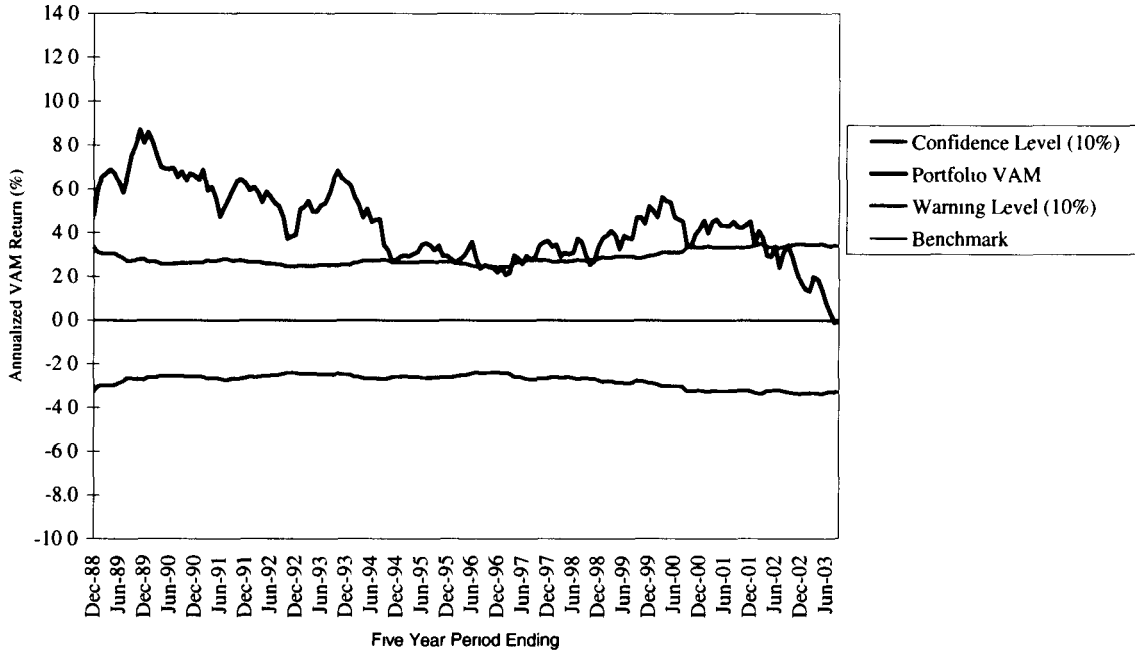
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
YTD 6/30/2003	12.3%	14.4%	17.5%
2002	-26.8	-24.0	-27.9
2001	-13.7	-15.3	-20.4
2000	-13.7	-11.4	-22.4
1999	38.0	30.3	33.2
1998	49.6	38.6	38.7

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

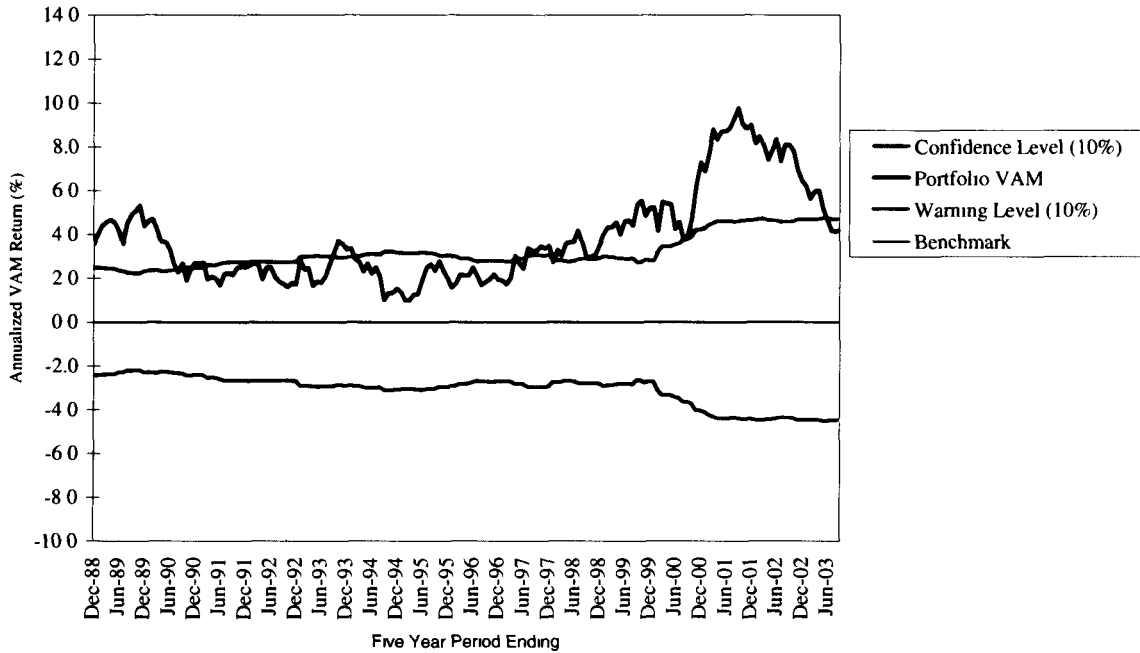
**Portfolio Manager: Jack Koltes**

**Assets Under Management: \$878,951,729**

**ALLIANCE CAPITAL MANAGEMENT**  
**Rolling Five Year VAM vs. Custom Benchmark**



**ALLIANCE CAPITAL MANAGEMENT**  
**Rolling Five Year VAM vs. Russell 1000 Growth**



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

**Portfolio Manager: George Cohen**

**Assets Under Management: \$542,797,097**

**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**

Cohen outperformed the custom benchmark by 1.0% for the quarter due to a higher weighting and good stock selection in technology and the consumer areas. Over the one-year period, the portfolio has outperformed the custom benchmark by 1.5% due to an overweight in electronic technology and an under weight in consumer services. Echo Star Communications, Adobe Systems, and EMC Corp. were the largest contributors to positive performance.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
Last Quarter	6.0%	5.0%	3.9%
Last 1 year	42.5	41.0	25.9
Last 2 years	-4.0	6.9	-1.2
Last 3 years	-16.1	-10.2	-19.1
Last 4 years	-8.7	-2.1	-10.0
Last 5 years	-1.7	4.4	-2.5
Since Inception (4/94)	9.8	11.3	9.1

**Calendar Year Returns**

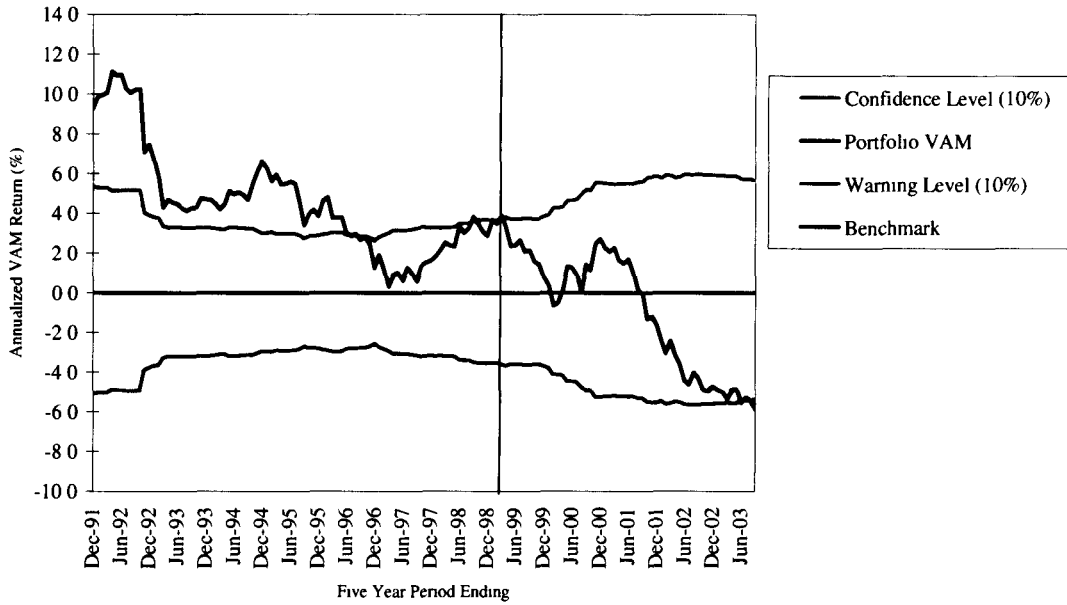
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
YTD 6/30/2003	29.6%	26.2%	17.5%
2002	-35.0	-23.8	-27.9
2001	-25.0	-11.2	-20.4
2000	-6.0	-12.1	-22.4
1999	24.8	28.6	33.2
1998	38.2	31.3	38.7

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

**Portfolio Manager: George Cohen**

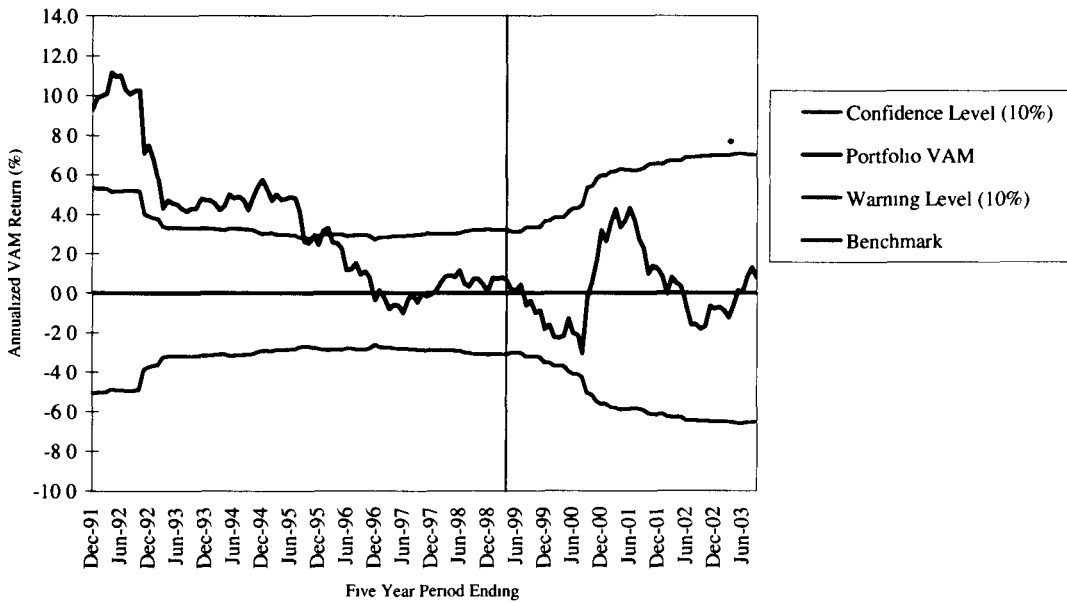
**Assets Under Management: \$542,797,097**

**COHEN KLINGENSTEIN & MARKS**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**COHEN KLINGENSTEIN & MARKS**  
**Rolling Five Year VAM vs. Russell 1000 Growth**



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

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

**Portfolio Manager: John Cone**

**Assets Under Management: \$663,155,242**

**Investment Philosophy – Active Style**

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 outperformed the benchmark by 0.9% due to stock selection and slight overweights to Energy and Utilities.

For the past year, Franklin underperformed the custom benchmark by 13.3% and the R1000 by 3.9%. This was a result of several holdings that performed poorly during the year including Tenet Healthcare, UnumProvident, and Amerada Hess.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Core</b>
Last Quarter	4.9%	4.0%	3.0%
Last 1 year	21.2	34.5	25.1
Last 2 years	1.4	6.7	0.4
Last 3 years	-8.0	-3.8	-10.3
Last 4 years	-1.0	0.9	-4.0
Last 5 years	3.8	5.3	1.5
Since Inception (4/89)	11.4	11.4	11.3

**Calendar Year Returns**

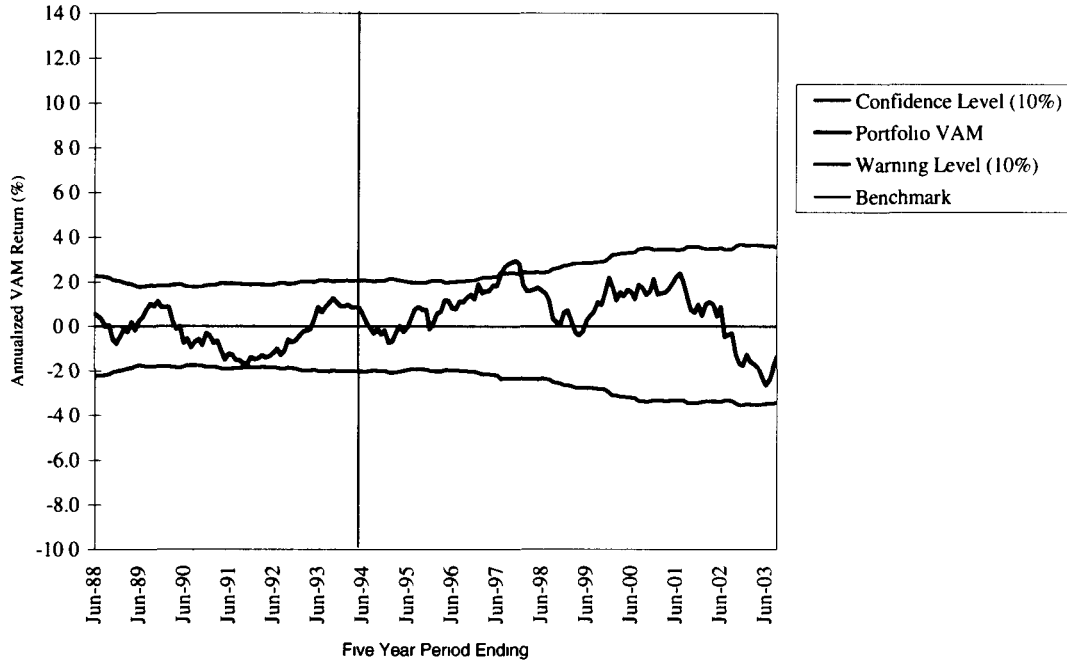
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Core</b>
YTD 6/30/2003	18.2%	21.9%	15.7%
2002	-25.4	-19.8	-21.7
2001	-6.6	-5.4	-12.5
2000	-1.6	0.3	-7.8
1999	26.2	16.3	20.9
1998	10.7	18.3	27.0

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

**Portfolio Manager: John Cone**

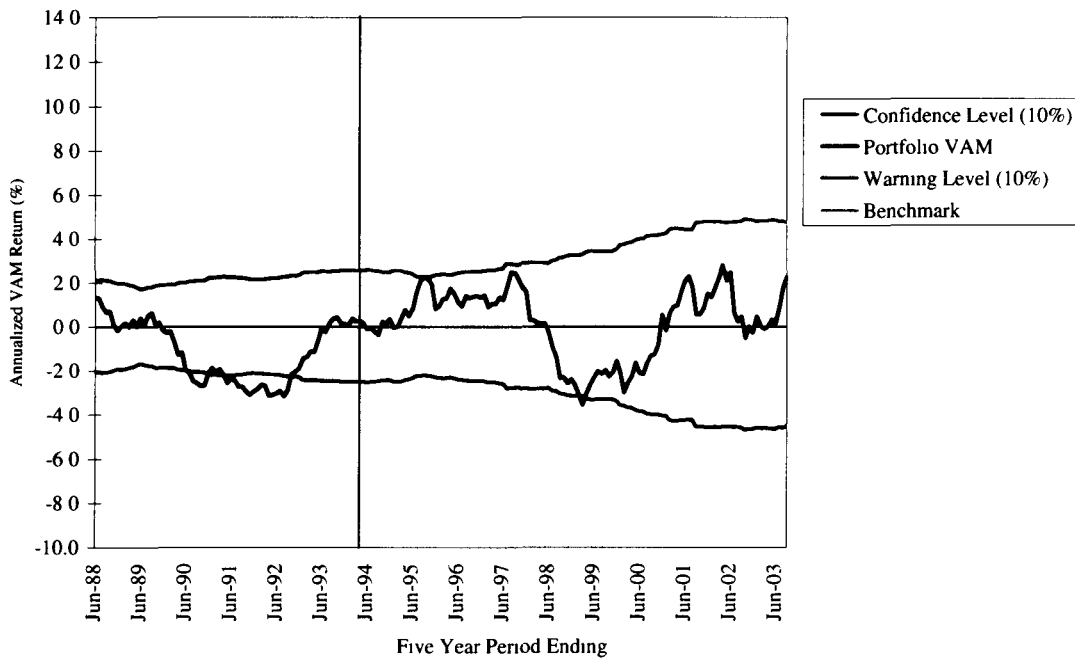
**Assets Under Management: \$663,155,242**

**FRANKLIN PORTFOLIO ASSOCIATES - Active**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**FRANKLIN PORTFOLIO ASSOCIATES - Active**  
**Rolling Five Year VAM vs. Russell 1000 Core**



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



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

**Portfolio Manager: Barry Fingerhut**

**Assets Under Management: \$293,659,507**

**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 lagged the custom benchmark for the quarter by 0.4%. The largest detractor came from stock selection and an underweight in the electronic technology area and an overweight to industrial services. Over the past year, GeoCapital trailed the custom benchmark by 2.7% primarily in the Energy sector. They were also hurt by an underweight to the technology sector where they are increasing their exposure. Staff met with GeoCapital in October in their office. The firm has made no change to the investment process. There are six investment professionals. Assets under management total \$1.1 billion. In the small cap product they have \$636 million under management.

**Recommendation**

The Stock and Bond Manager Committee will conduct a formal review of the manager during the Committee meeting this quarter.

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Growth</b>
Last Quarter	8.2%	8.6%	10.5%
Last 1 year	48.7	51.4	41.7
Last 2 years	8.6	16.9	7.7
Last 3 years	-16.5	-6.4	-12.7
Last 4 years	-6.0	2.4	-3.6
Last 5 years	0.4	6.1	2.7
Since Inception (4/90)	8.1	10.1	6.6

**Calendar Year Returns**

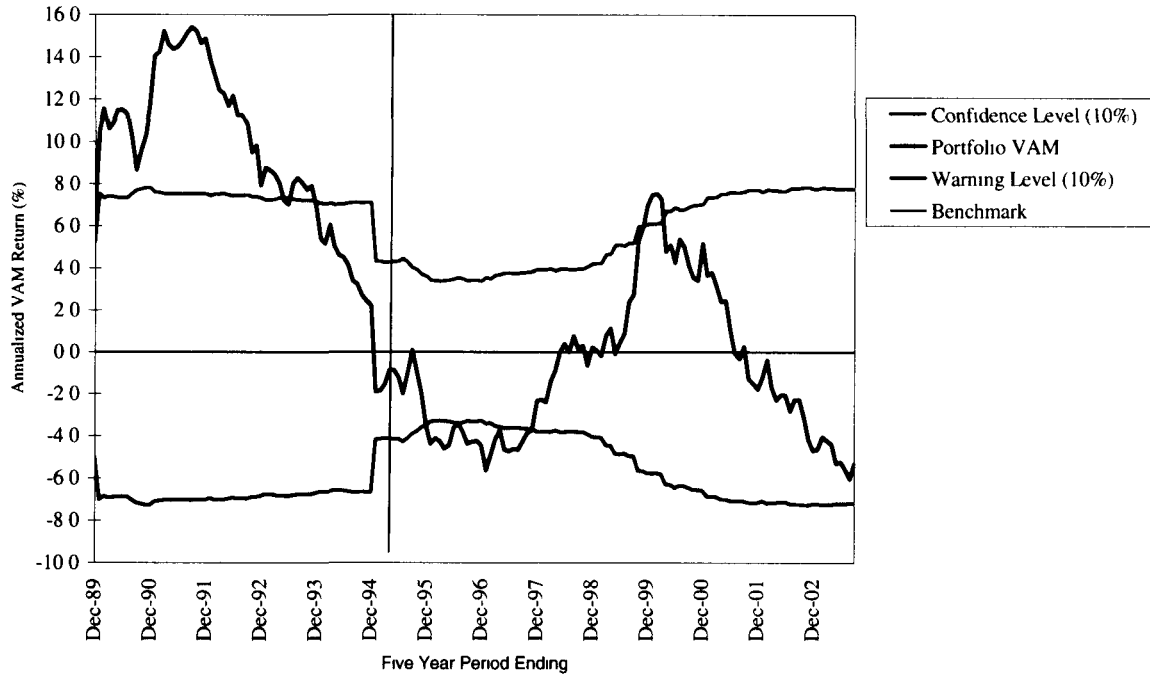
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Growth</b>
YTD 6/30/2003	35.5%	31.0%	31.8%
2002	-31.5	-23.2	-30.3
2001	-24.1	-1.8	-9.2
2000	-27.8	-13.0	-22.4
1999	59.8	25.9	43.1
1998	6.9	-1.3	1.2

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

**Portfolio Manager: Barry Fingerhut**

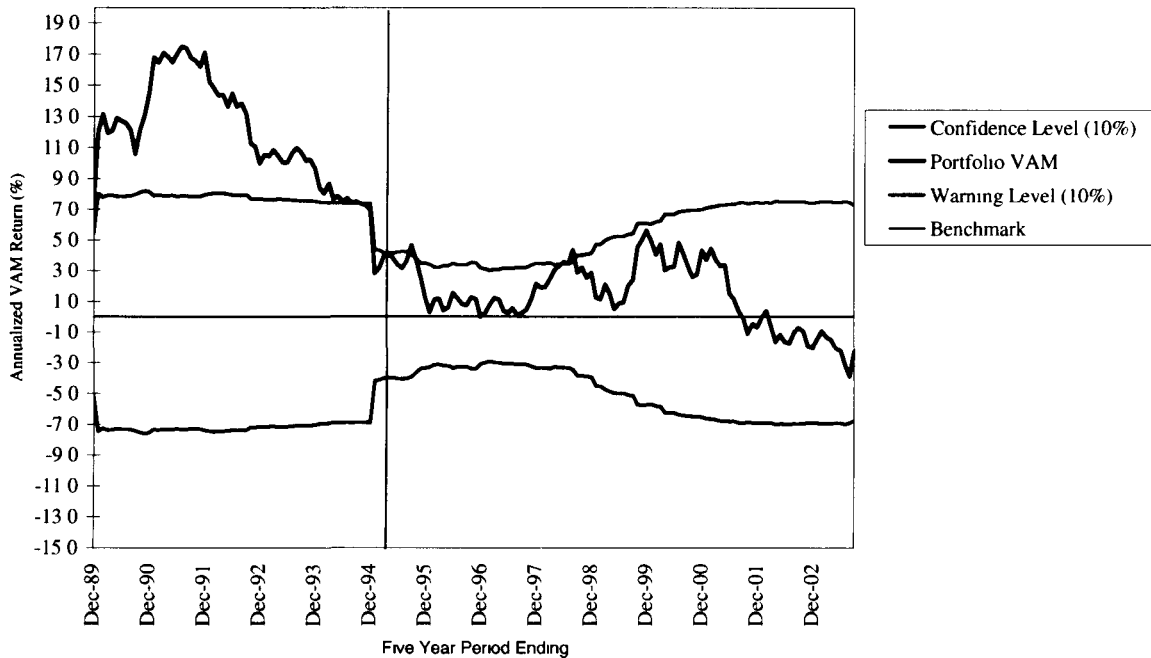
**Assets Under Management: \$293,659,507**

**GEOCAPITAL CORP.**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**GEOCAPITAL CORP.**  
**Rolling Five Year VAM vs. Russell 2000 Growth**



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

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

**Portfolio Manager: Barney Wilson**

**Assets Under Management: \$490,424,447**

**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 0.4% for the quarter due to stock selection in health technology and retail. Stocks that performed well included Lowe's, AutoZone, Zimmer Holdings, and Jabil Circuits. Offsetting the positive performance was stock selection in the electronic technology and consumer services sectors. For the year, Lincoln lagged by 5.9% due to companies held in the technology services and distribution services industry. Oracle, Microsoft, and AmerisourceBergen Corp. (a pharmaceutical distributor) were the biggest detractors from performance. The firm lost three accounts valued at \$261.5 million during the last quarter.

**Recommendation**

The Stock and Bond Manager Committee will conduct a formal review of the manager during the Committee meeting this quarter.

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
Last Quarter	4.4%	4.0%	3.9%
Last 1 year	22.8	28.7	25.9
Last 2 years	-1.3	1.3	-1.2
Last 3 years	-23.6	-17.9	-19.1
Last 4 years	-14.1	-10.1	-10.0
Last 5 years	-6.4	-2.3	-2.5
Since Inception (7/93)	7.1	9.3	8.5

**Calendar Year Returns**

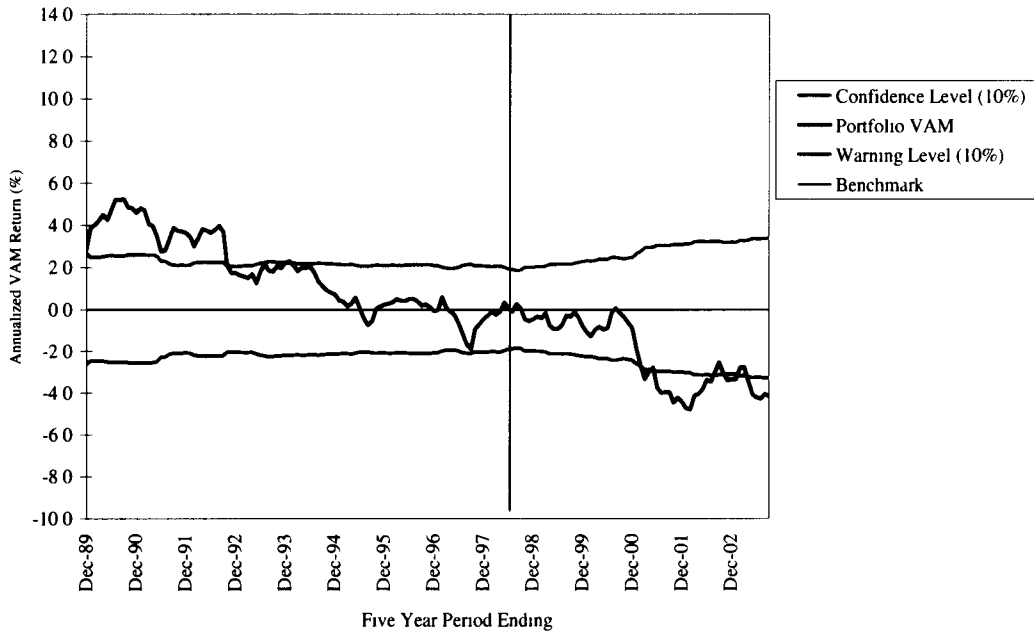
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
YTD 6/30/2003	14.1%	17.8%	17.5%
2002	-26.3	-26.3	-27.9
2001	-30.4	-18.1	-20.4
2000	-22.4	-24.5	-22.4
1999	26.7	29.2	33.2
1998	42.3	44.5	38.7

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

**Portfolio Manager: Barney Wilson**

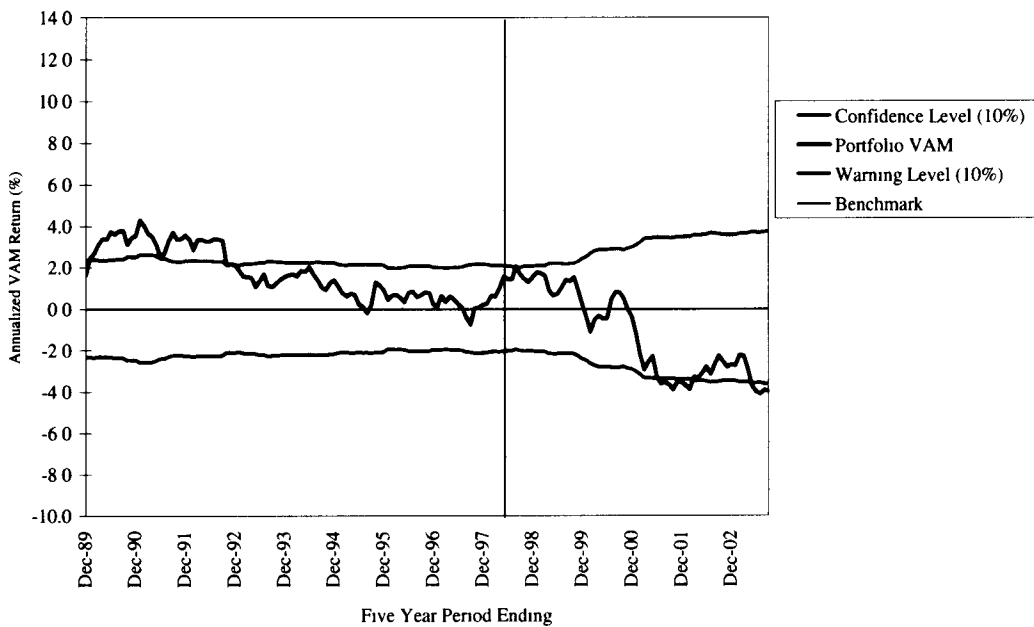
**Assets Under Management: \$490,424,447**

**LINCOLN EQUITY MANAGEMENT - Domestic Equity**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**LINCOLN EQUITY MANAGEMENT - Domestic Equity**  
**Rolling Five Year VAM vs. Russell 1000 Growth**



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

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

**Portfolio Manager: Michelle Clayman**

**Assets Under Management: \$341,114,915**

**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**

New Amsterdam outperformed for the quarter and slightly lagged the custom benchmark for the year. The portfolio is overweight in consumer stocks and underweight in utility, technology, and distribution services stocks.

Staff met with New Amsterdam in their office in October. New Amsterdam has gained \$260 million in assets in 2003. They have added 2 analysts, and are expanding their office space. There are currently eight investment professionals. The analysts are responsible for all stocks in their industries for the mid cap and large cap products.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell Mid Cap</b>
Last Quarter	7.2%	6.0%	6.4%
Last 1 year	28.1	30.5	32.6
Last 2 years	6.4	8.9	9.9
Last 3 years	-3.0	-2.3	-2.1
Last 4 years	6.5	5.4	5.4
Last 5 years	9.3	10.6	8.1
Since Inception (4/94)	13.8	13.5	11.7

**Calendar Year Returns**

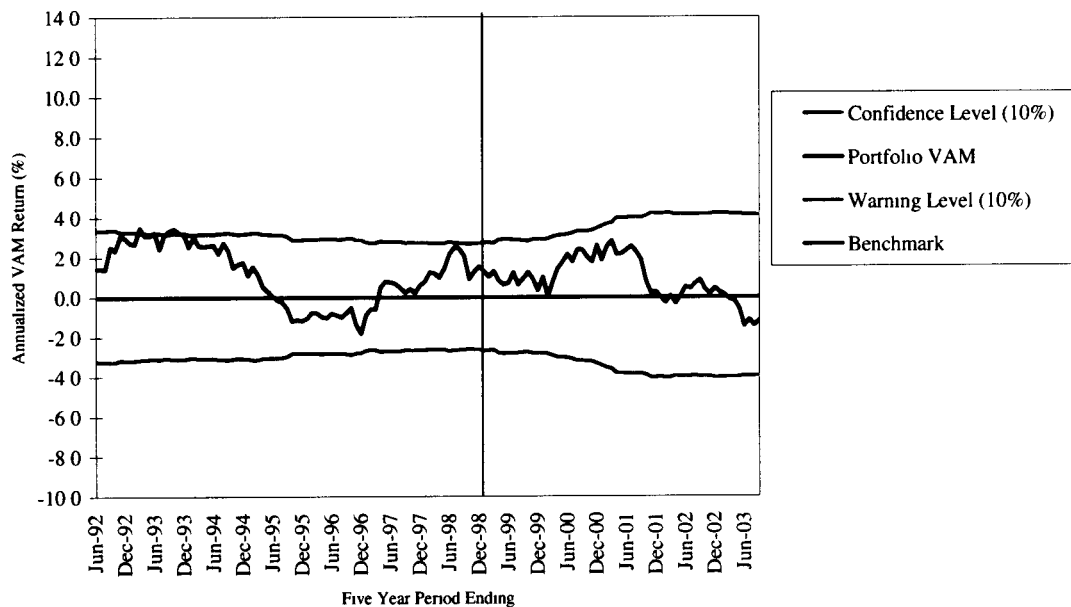
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell Mid Cap</b>
YTD 6/30/2003	19.6%	22.1%	22.9%
2002	-17.5	-22.2	-16.2
2001	-3.3	3.7	-5.6
2000	15.0	3.1	8.2
1999	15.0	32.1	18.2
1998	26.2	18.5	10.1

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

**Portfolio Manager: Michelle Clayman**

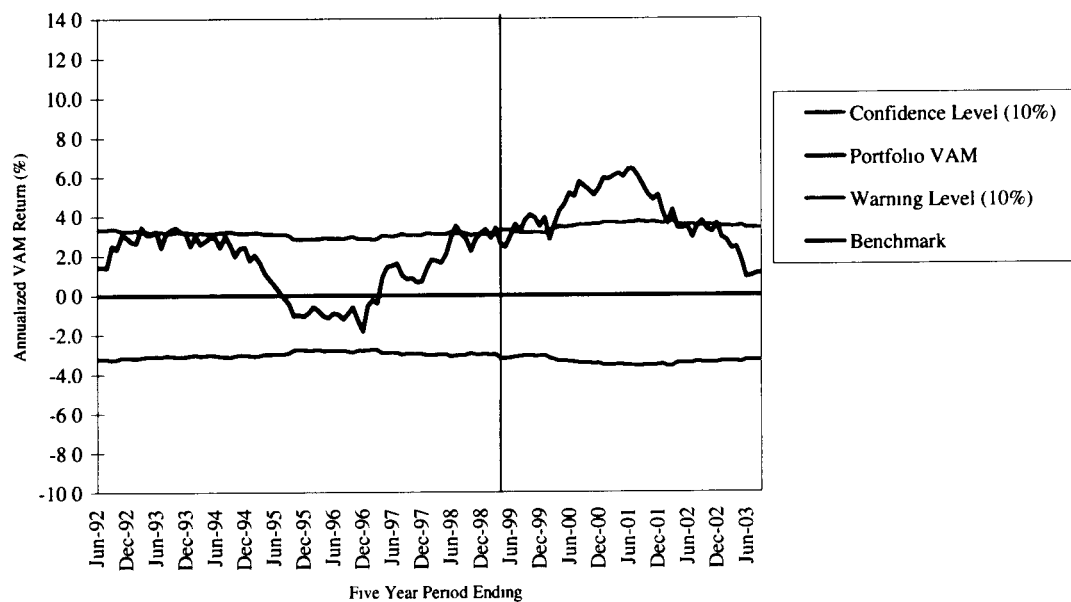
**Assets Under Management: \$341,114,915**

**NEW AMSTERDAM PARTNERS**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**NEW AMSTERDAM PARTNERS**  
**Rolling Five Year VAM vs. Russell Midcap Core**



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

**OPPENHEIMER CAPITAL**  
**Periods Ending September, 2003**

**Portfolio Manager: John Lindenthal**

**Assets Under Management: \$778,364,980**

**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**

No comments at this time

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Value</b>
Last Quarter	3.3%	1.8%	2.1%
Last 1 year	24.4	25.3	24.4
Last 2 years	2.0	1.0	1.6
Last 3 years	-1.0	-5.7	-2.0
Last 4 years	2.9	0.5	0.6
Last 5 years	5.7	4.9	4.0
Since Inception (7/93)	12.7	11.3	10.6

**Calendar Year Returns**

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Value</b>
YTD 6/30/2003	13.9%	15.1%	13.9%
2002	-15.5	-20.7	-15.5
2001	-7.0	-9.5	-5.6
2000	11.2	10.3	7.0
1999	10.7	14.9	7.3
1998	21.5	24.4	15.6

**OPPENHEIMER CAPITAL**  
**Periods Ending September, 2003**

**Portfolio Manager: John Lindenthal**

**Assets Under Management: \$778,364,980**

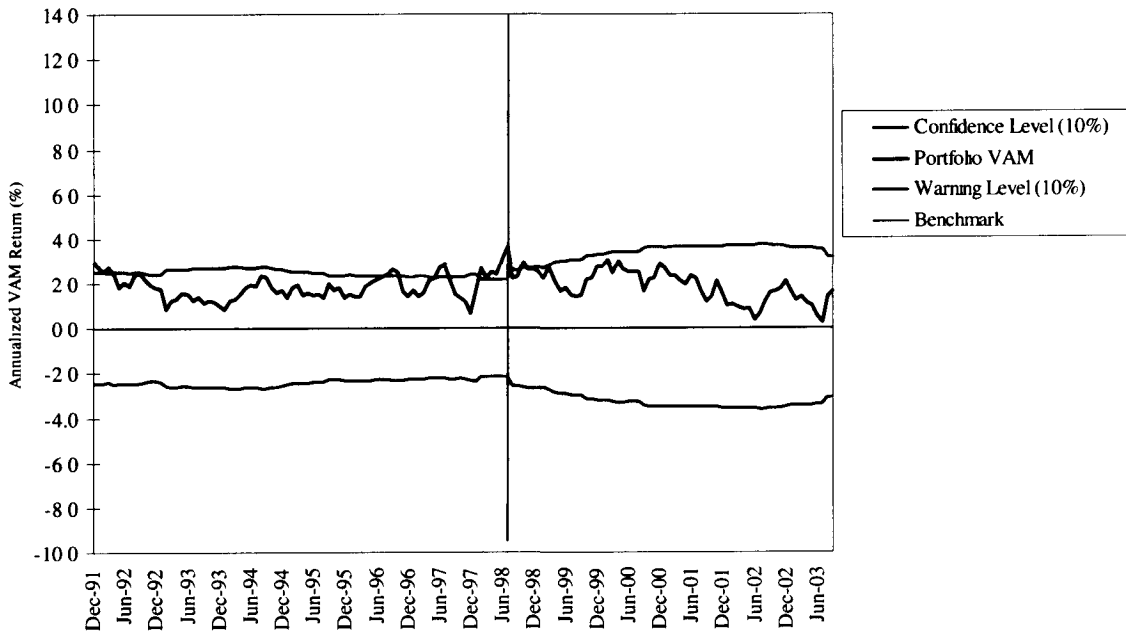
**OPPENHEIMER CAPITAL**  
**Rolling Five Year VAM vs. Custom Benchmark**



Five Year Period Ending

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

**OPPENHEIMER CAPITAL**  
**Rolling Five Year VAM vs. Russell 1000 Value**



Five 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 September, 2003**

**Portfolio Manager: John Leonard**

**Assets Under Management: \$790,626,403**

**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**

UBS underperformed the custom benchmark by 1.4% for the quarter and trailed slightly for the year. Their underweight and stock selection in the electronic technology sector was the largest detractor from performance. They were also hurt by stock selection in utilities and consumer durables.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Core</b>
Last Quarter	1.7%	3.1%	3.0%
Last 1 year	26.7	26.9	25.1
Last 2 years	6.3	2.6	0.4
Last 3 years	2.5	-9.5	-10.3
Last 4 years	0.7	-1.5	-4.0
Last 5 years	2.6	3.7	1.5
Since Inception (7/93)	10.3	10.0	10.0

**Calendar Year Returns**

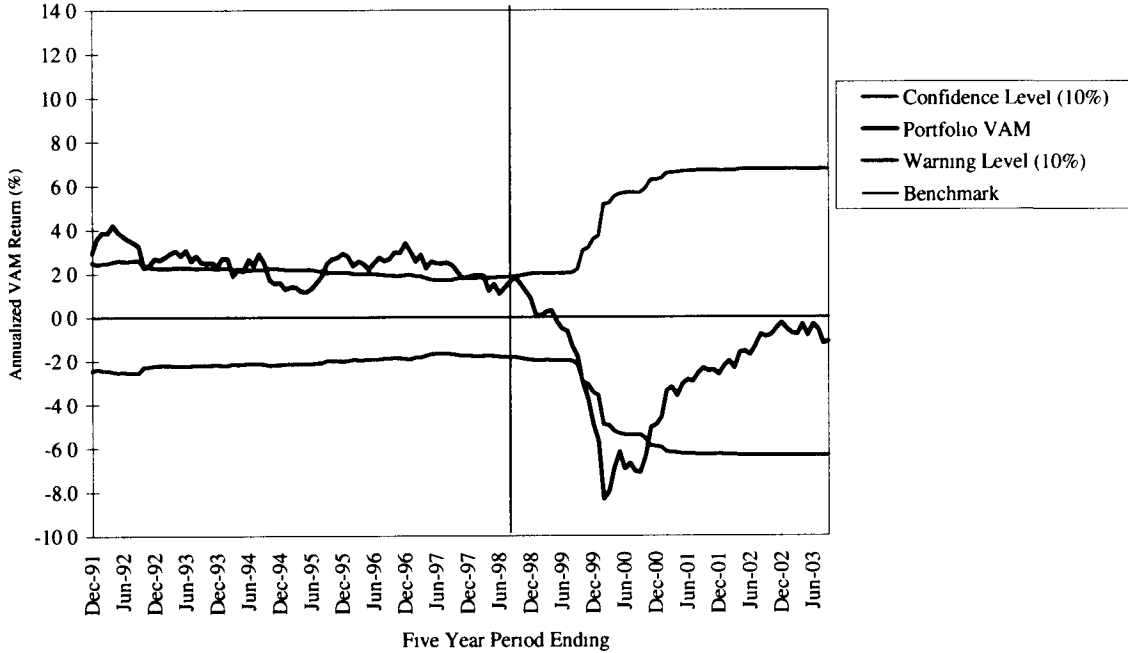
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Core</b>
YTD 6/30/2003	15.2%	16.5%	15.7%
2002	-14.7	-20.6	-21.7
2001	5.2	-11.0	-12.5
2000	3.6	-1.0	-7.8
1999	-8.5	21.6	20.9
1998	17.3	18.8	27.0

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

**Portfolio Manager: John Leonard**

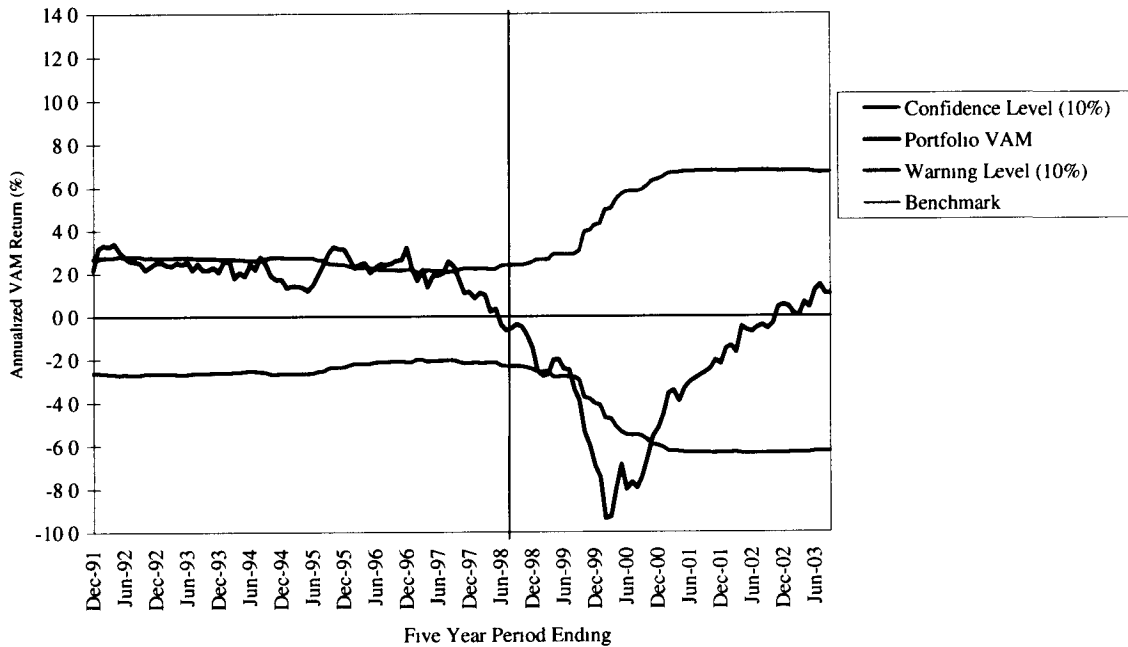
**Assets Under Management: \$790,626,403**

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



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

**UBS GLOBAL ASSET MANAGEMENT, INC.**  
**Rolling Five Year VAM vs. Russell 1000 Core**



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

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

**Portfolio Manager: Joyce Capuano**

**Assets Under Management: \$36,632,086**

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**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**

Artemis underperformed the quarterly benchmark by 6.8% primarily as a result of stock selection in the health care and consumer discretionary sectors. For the past 12 months, Artemis lagged the benchmark by 15%. The healthcare and materials/processing names were the most disappointing stocks. Staff met with the firm in their New York office. They have added a second analyst to work with the two portfolio managers. Artemis believes that the companies they own, those with favorable earnings growth prospects and attractive relative valuation, have not participated to the same extent in this market rally as those of generally lower quality and less liquidity. They believe the market will broaden and their stocks will begin to outperform

**Recommendation**

No action required.

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Core</b>
Last Quarter	2.4%	9.2%	9.1%
Last 1 year	21.0	36.0	36.5
Last 2 years	3.2	13.6	11.3
Last 3 years	-8.6	1.6	-0.8
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	-9.3	1.8	-0.4

**Calendar Year Returns**

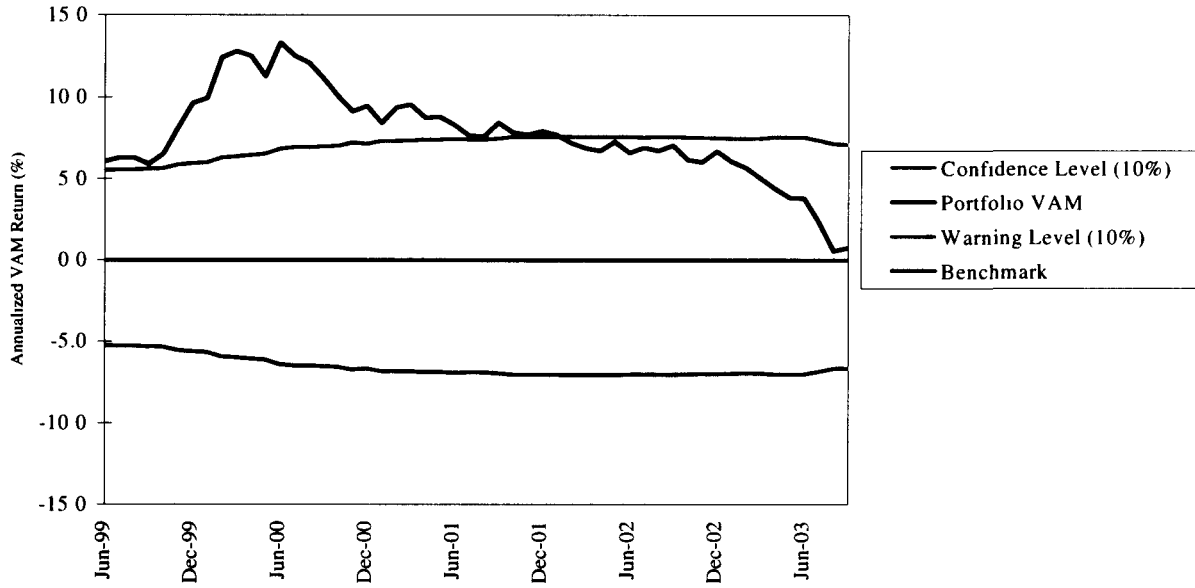
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Core</b>
YTD 6/30/2003	13.3%	30.1%	28.6%
2002	-21.5	-20.5	-20.5
2001	5.8	11.9	2.5
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

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

**Portfolio Manager: Joyce Capuano**

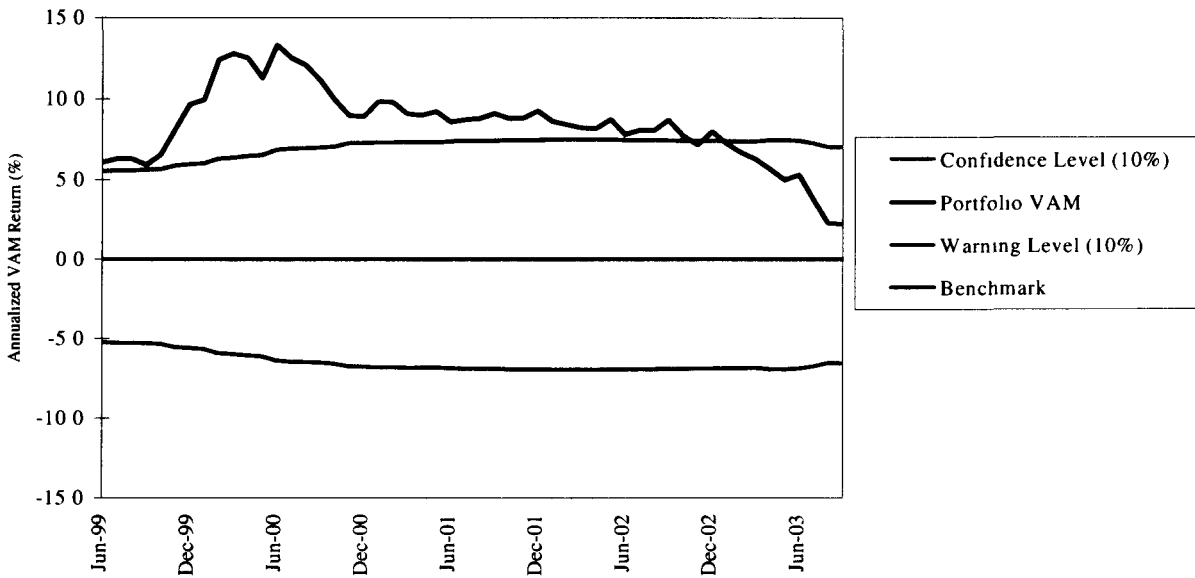
**Assets Under Management: \$36,632,086**

**Artemis Investment Management  
Rolling Five Year VAM vs. Custom Benchmark**



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

**Artemis Investment Management  
Rolling Five Year VAM vs. Russell 2000 Core**



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

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

**Portfolio Manager: William Schaff**

**Assets Under Management: \$40,469,356**

**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**

Bay Isle underperformed its benchmark for the quarter and year with weakness attributed to the portfolio's relatively small weighting in the more highly cyclical sectors of investment banking, semiconductors, networking equipment, and lodging.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Value</b>
Last Quarter	0.6%	2.9%	2.1%
Last 1 year	12.5	24.7	24.4
Last 2 years	-4.9	3.6	1.6
Last 3 years	-7.7	-3.3	-2.0
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	-6.3	-0.8	0.5

**Calendar Year Returns**

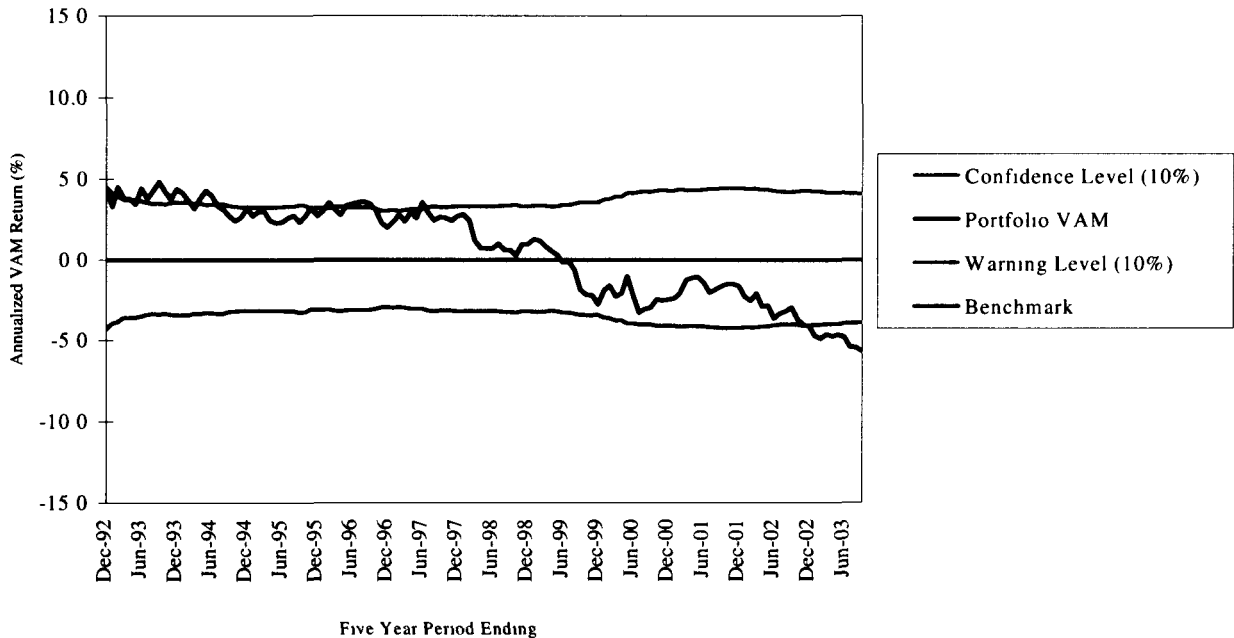
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Value</b>
YTD 6/30/2003	9.2%	15.7%	13.9%
2002	-26.1	-17.2	-15.5
2001	-1.6	-5.9	-5.6
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

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

**Portfolio Manager: William Schaff**

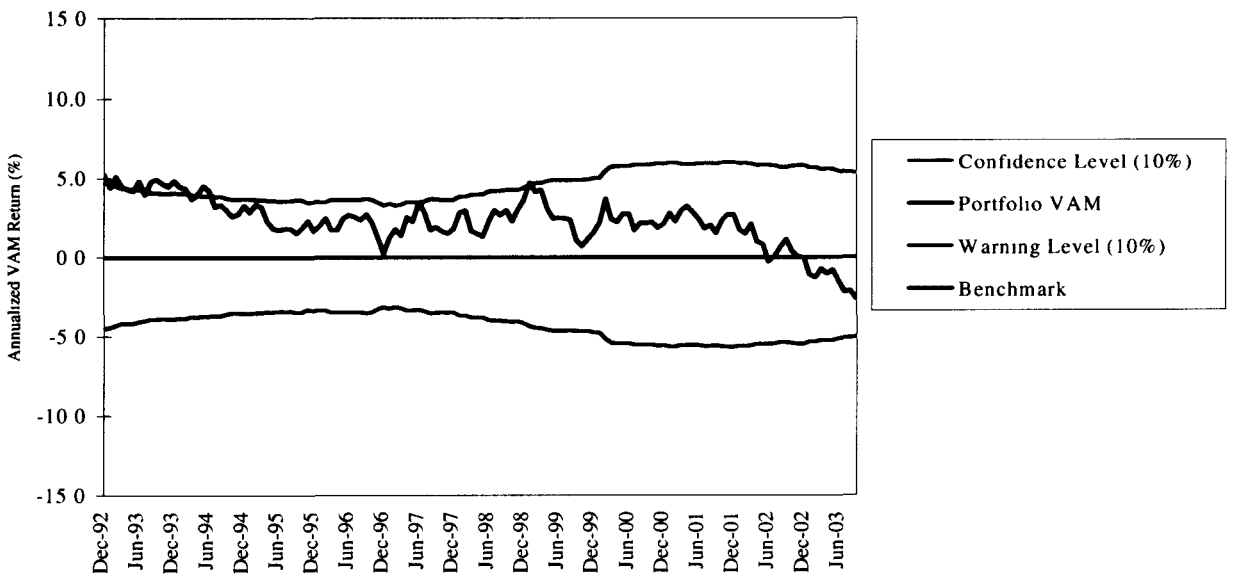
**Assets Under Management: \$40,469,356**

**Bay Isle Financial Management**  
 Rolling Five Year VAM vs. Custom Benchmark



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

**Bay Isle Financial Management**  
 Rolling Five Year VAM vs. Russell 1000 Value



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

**EARNEST PARTNERS, LLC**  
**Periods Ending September, 2003**

**Portfolio Manager: Paul Viera**

**Assets Under Management: \$44,993,844**

**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**

Earnest Partners lagged the benchmark by 1.9% during the quarter and 10.9% over the past year. As a result of their bottom up stock selection process, Earnest Partners held a substantial overweight in health services and health technology, which hurt performance. Stock selection in consumer services also contributed to the shortfall particularly the holding Yum! Brands Inc, which underperformed other restaurant stocks in the benchmark.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Value</b>
Last Quarter	3.5%	5.4%	2.1%
Last 1 year	25.8	36.7	24.4
Last 2 years	0.1	15.4	1.6
Last 3 years	-3	8.9	-2
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	-3.4	10.7	0.5

**Calendar Year Returns**

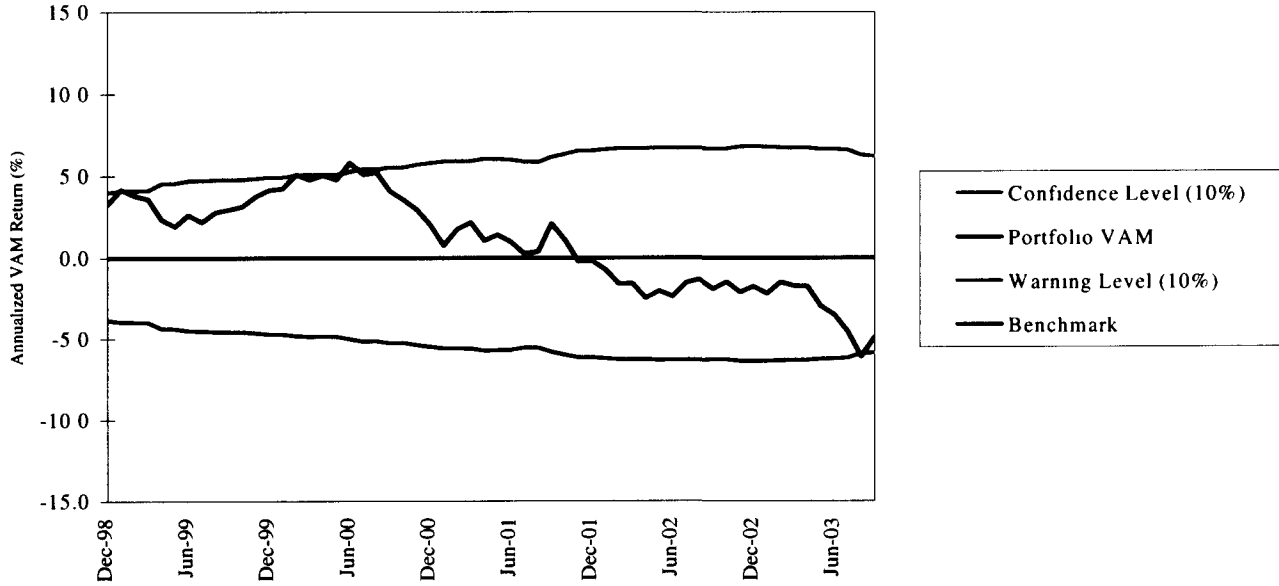
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Value</b>
YTD 6/30/2003	16.9%	24.1%	13.9%
2002	-18.1	-11.6	-15.5
2001	-0.4	11.5	-5.6
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

**EARNEST PARTNERS, LLC**  
**Periods Ending September, 2003**

**Portfolio Manager: Paul Viera**

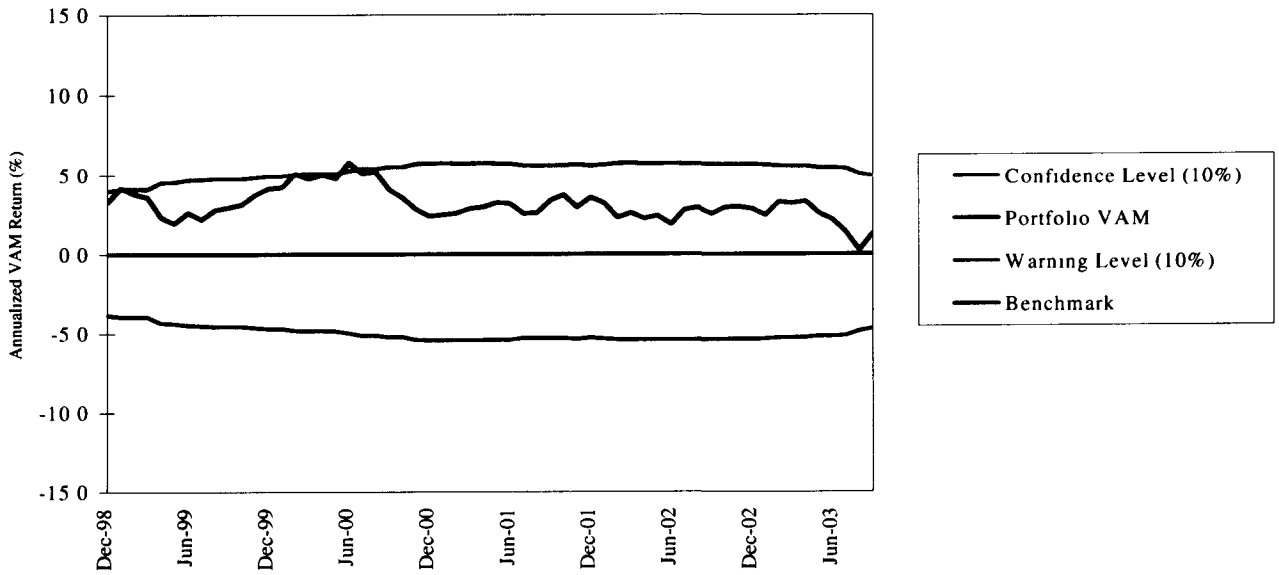
**Assets Under Management: \$44,993,844**

**Earnest Partners**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**Earnest Partners**  
**Rolling Five Year VAM vs. Russell 1000 Value**



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



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

**Portfolio Manager: Kristin Yates**

**Assets Under Management: \$36,830,656**

**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**

Holt-Smith Yates underperformed the custom benchmark by 5.5% for the quarter and 9.9% for the year. Stock selection in the technology and financial sectors were primarily the source. An overweight to medical distributors also hurt performance. Cardinal health, Pfizer, Quest Diagnostics, and WellPoint Health Networks were all in negative territory.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
Last Quarter	-0.1%	5.4%	3.9%
Last 1 year	18.8	28.7	25.9
Last 2 years	-2.6	8.3	-1.2
Last 3 years	-10.2	-0.2	-19.1
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	-9.3	-0.5	-19.1

**Calendar Year Returns**

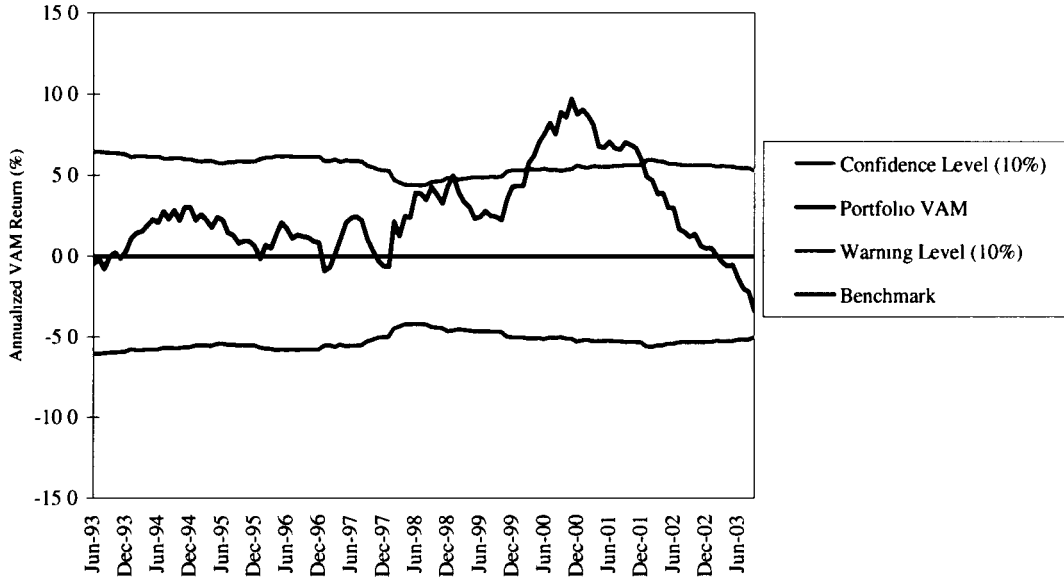
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
YTD 6/30/2003	10.2%	18.9%	17.5%
2002	-28	-19	-27.9
2001	-1.7	4.6	-20.4
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

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

**Portfolio Manager: Kristin Yates**

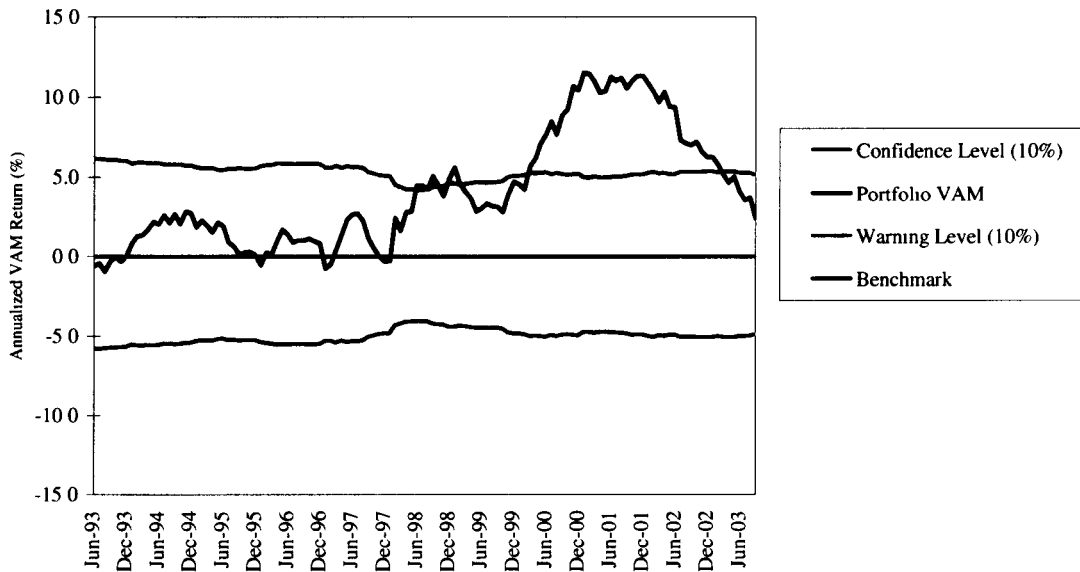
**Assets Under Management: \$36,830,656**

**Holt-Smith & Yates**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**Holt-Smith & Yates**  
**Rolling Five Year VAM vs. Russell 1000 Growth**



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

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

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

**Assets Under Management: \$28,343,298**

**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

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Growth</b>
Last Quarter	15.4%	9.6%	10.5%
Last 1 year	37.0	44.9	41.7
Last 2 years	8.5	10.2	7.7
Last 3 years	-17.8	-9.3	-12.7
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	-16.3	-9.5	-12.9

**Calendar Year Returns**

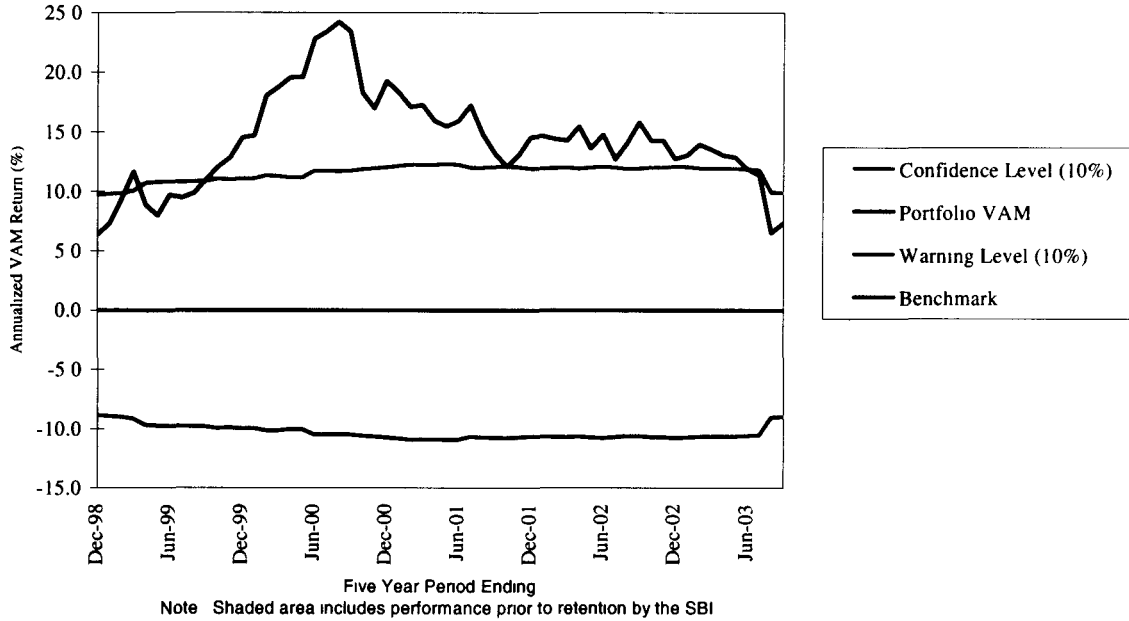
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Growth</b>
YTD 6/30/2003	38.3%	31.8%	31.8%
2002	-33.3	-27.8	-30.3
2001	-22.8	-5.5	-9.2
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

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

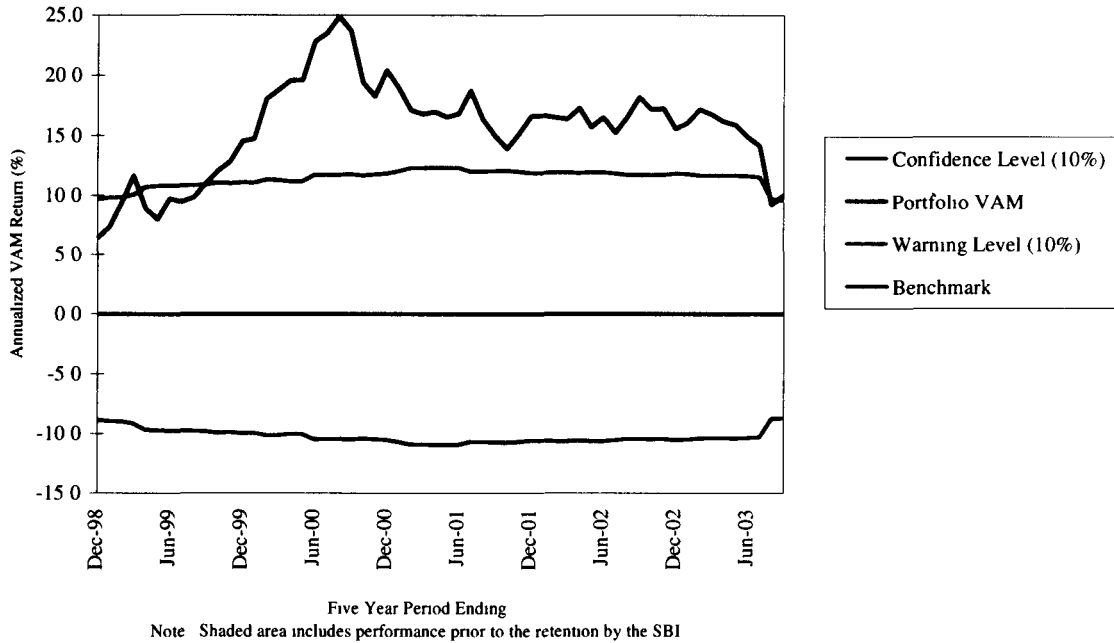
**Portfolio Manager: Thomas Press and Don Longlet**

**Assets Under Management: \$28,343,298**

Next Century Growth Investors  
Rolling Five Year VAM vs. Custom Benchmark



Next Century Growth Investors  
Rolling Five Year VAM vs. Russell 2000 Growth



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

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

**Assets Under Management: \$146,280,269**

**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

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Value</b>
Last Quarter	10.7%	8.1%	7.7%
Last 1 year	38.1	31.8	31.7
Last 2 years	15.4	17.1	13.9
Last 3 years	13.8	15.7	11.1
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	15.6	16.9	12.6

**Calendar Year Returns**

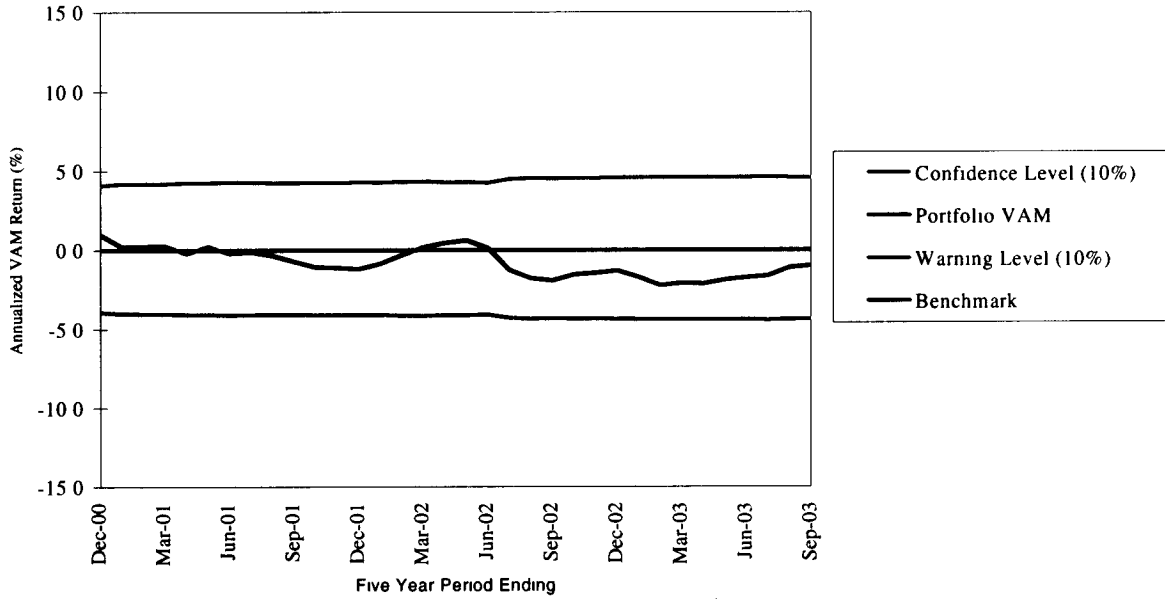
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Value</b>
YTD 6/30/2003	25.7%	23.9%	25.5%
2002	-8.1	-6.9	-11.4
2001	12.6	22.9	14
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

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

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

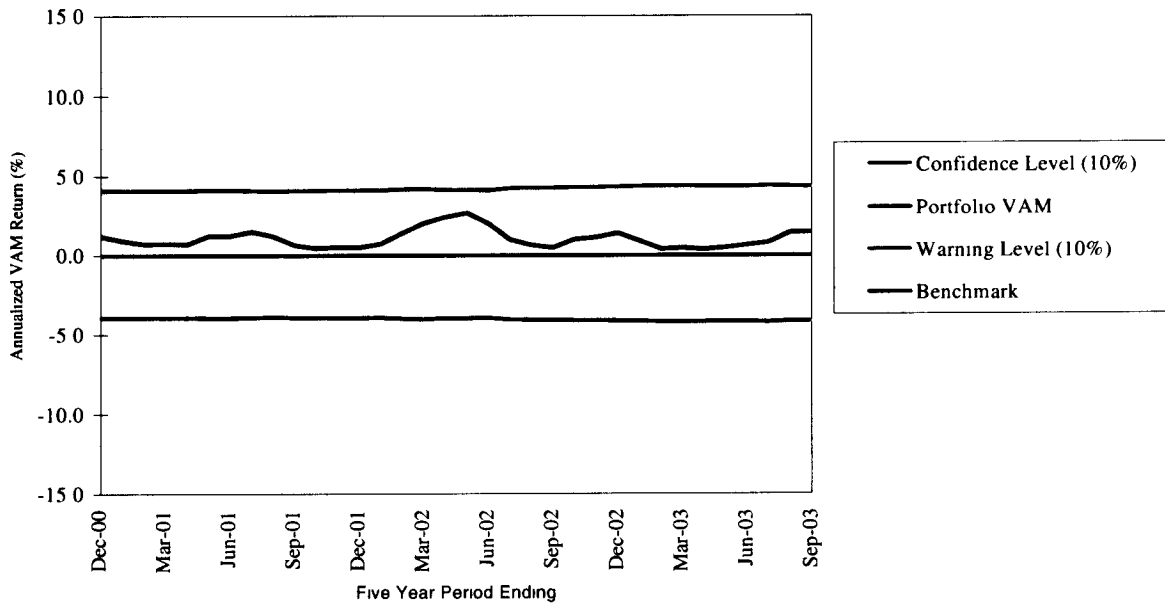
**Assets Under Management: \$146,280,269**

**Peregrine Capital Management**  
**Rolling Five Year VAM vs. Custom Benchmark**



Note Shaded area includes performance prior to retention by the SBI

**Peregrine Capital Management**  
**Rolling Five Year VAM vs. Russell 2000 Value**



Note Shaded area includes performance prior to retention by the SBI

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

**Portfolio Manager: Charles Henderson**

**Assets Under Management: \$38,846,654**

**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

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Core</b>
Last Quarter	2.8%	3.0%	3.0%
Last 1 year	17.1	20.4	25.1
Last 2 years	1.5	4.0	0.4
Last 3 years	-10.7	-7.8	-10.3
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	-7.9	-8.8	-9.4

**Calendar Year Returns**

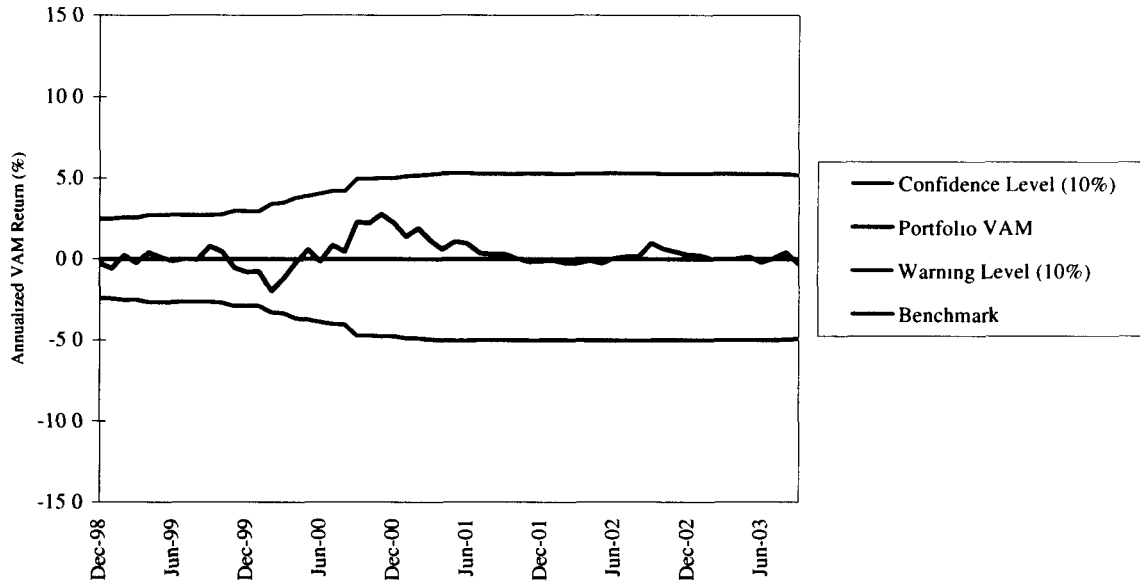
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Core</b>
YTD 6/30/2003	12.6%	14.8%	15.7%
2002	-20.6	-20.7	-21.7
2001	-19.4	-12.0	-12.5
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

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

**Portfolio Manager: Charles Henderson**

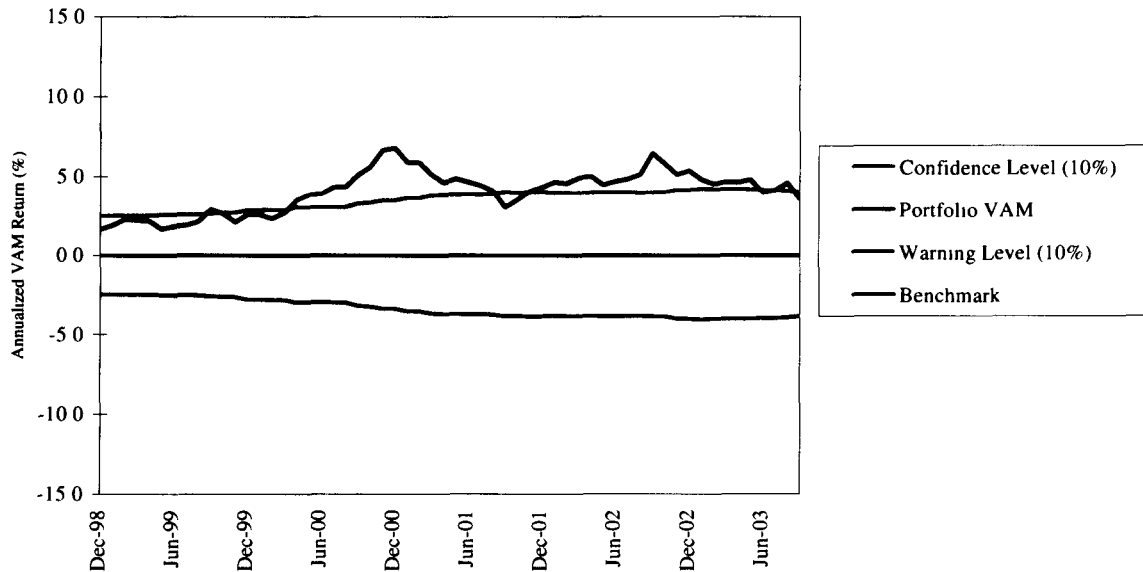
**Assets Under Management: \$38,846,654**

**Voyageur Asset Management**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**Voyageur Asset Management**  
**Rolling Five Year VAM vs. Russell 1000 Core**



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



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

**Portfolio Manager: Joseph Docter**

**Assets Under Management: \$137,095,030**

**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**

Winslow trailed the custom benchmark for the quarter and year, as stock selection in healthcare, technology, and industrial services hurt performance. In those sectors the best performing stocks were those with the higher P/E and smallest market caps. For the year, most of the underperformance came from the healthcare sector where the benchmark's small early stage medical device stocks more than doubled in price and steadier growth names did not keep up.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Growth</b>
Last Quarter	7%	10.4%	10.5%
Last 1 year	38.2	45.5	41.7
Last 2 years	7.8	11.8	7.7
Last 3 years	-9.9	-4.5	-12.7
Last 4 years	N/A	N/A	N/A
Last 5 years	N/A	N/A	N/A
Since Inception (7/00)	-7.4	-5.4	-12.9

**Calendar Year Returns**

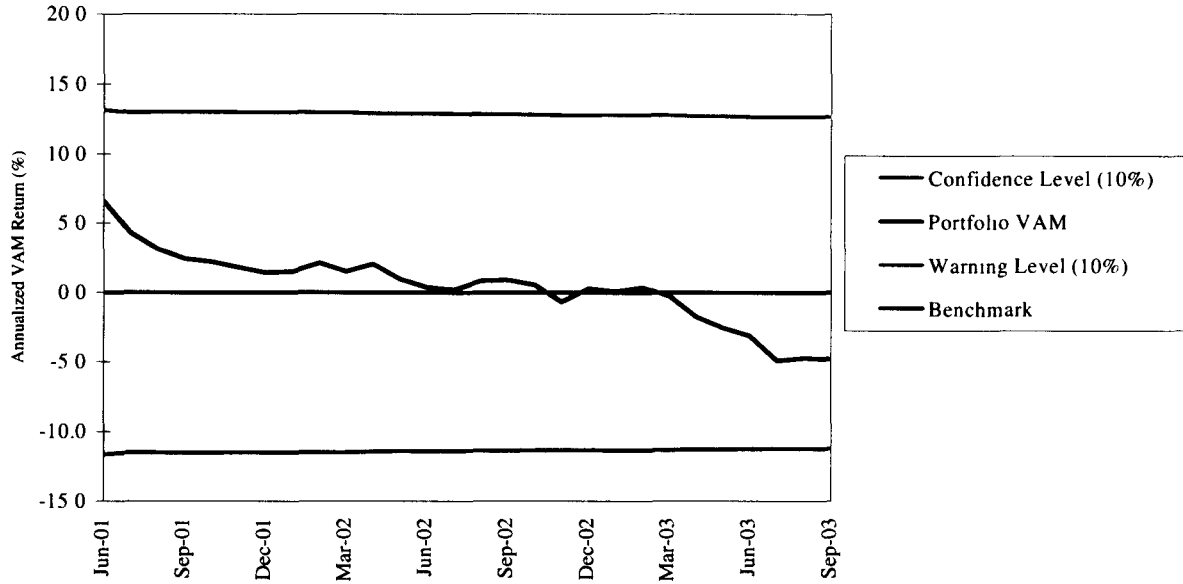
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 2000 Growth</b>
YTD 6/30/2003	23.8%	34.2%	31.8%
2002	-25	-26.7	-30.3
2001	-6.1	4.6	-9.2
2000	N/A	N/A	N/A
1999	N/A	N/A	N/A
1998	N/A	N/A	N/A

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

**Portfolio Manager: Joseph Docter**

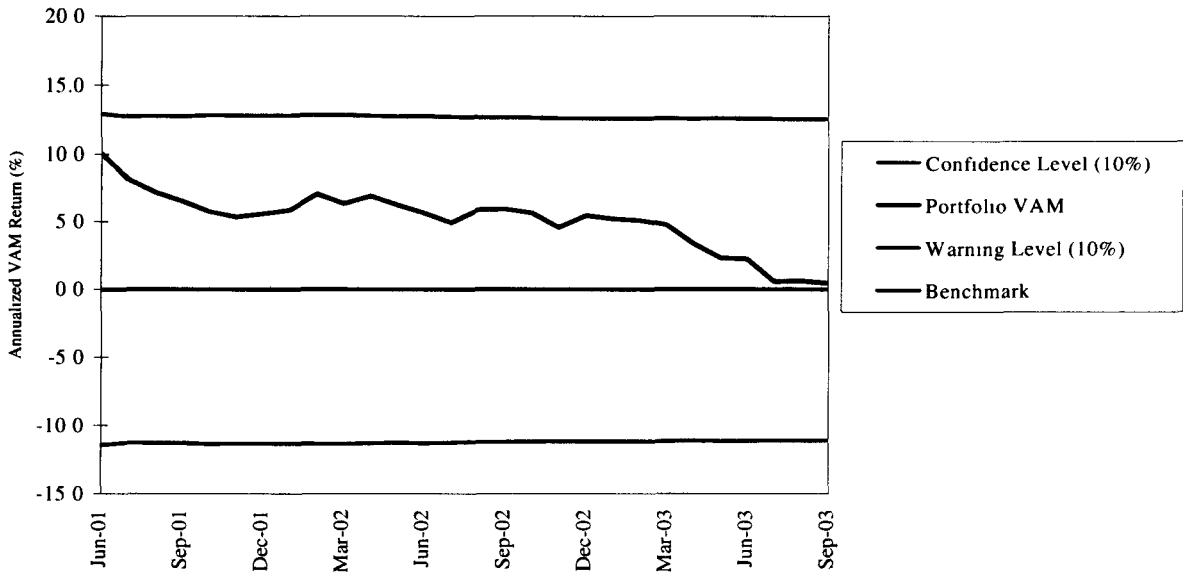
**Assets Under Management: \$137,095,030**

**Winslow Capital Management**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**Winslow Capital Management**  
**Rolling Five Year VAM vs. Russell 2000 Growth**



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

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

**Portfolio Manager: Nancy Zevenbergen**

**Assets Under Management: \$111,932,984**

**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**

No comments at this time.

**Recommendation**

No action required.

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
Last Quarter	4.8%	4.9%	3.9%
Last 1 year	39.3	29.2	25.9
Last 2 years	-2.2	6.5	-1.2
Last 3 years	-25.1	-12.2	-19.1
Last 4 years	-13.4	0.1	-10
Last 5 years	-0.4	8.3	-2.5
Since Inception (4/94)	9.3	13	9.1

**Calendar Year Returns**

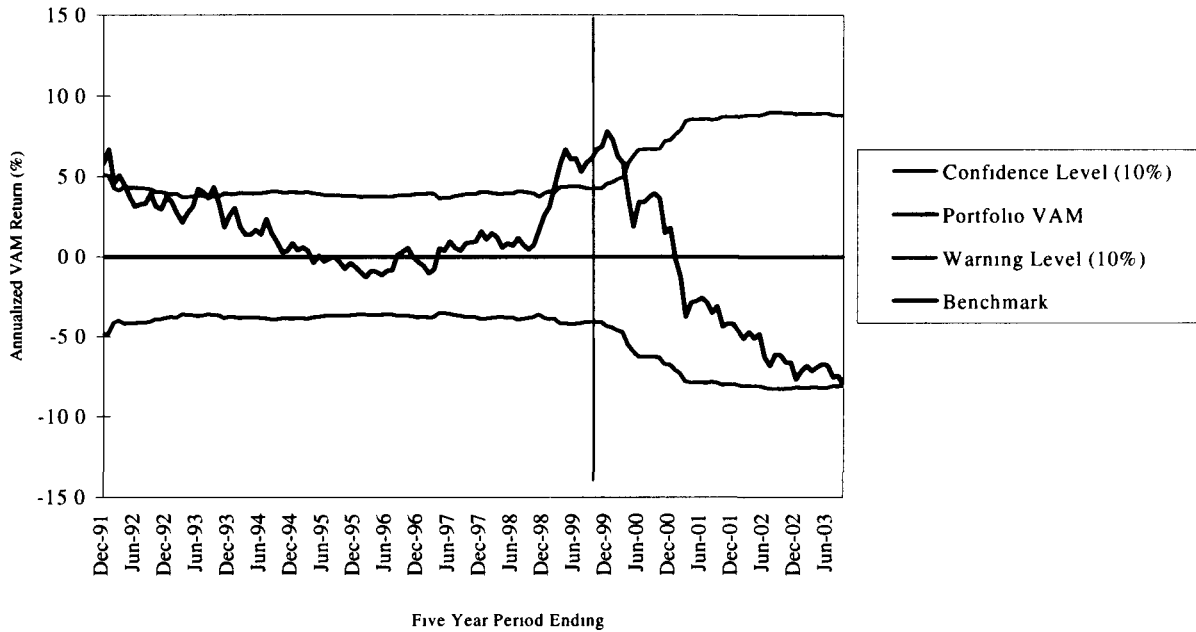
	<b>Actual</b>	<b>Custom Benchmark</b>	<b>Russell 1000 Growth</b>
YTD 6/30/2003	32.1%	18.9%	17.5%
2002	-36.2	-24.2	-27.9
2001	-29	-3.2	-20.4
2000	-38.2	-16.6	-22.4
1999	94.3	56.6	33.2
1998	54.5	30.7	38.7

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

**Portfolio Manager: Nancy Zevenbergen**

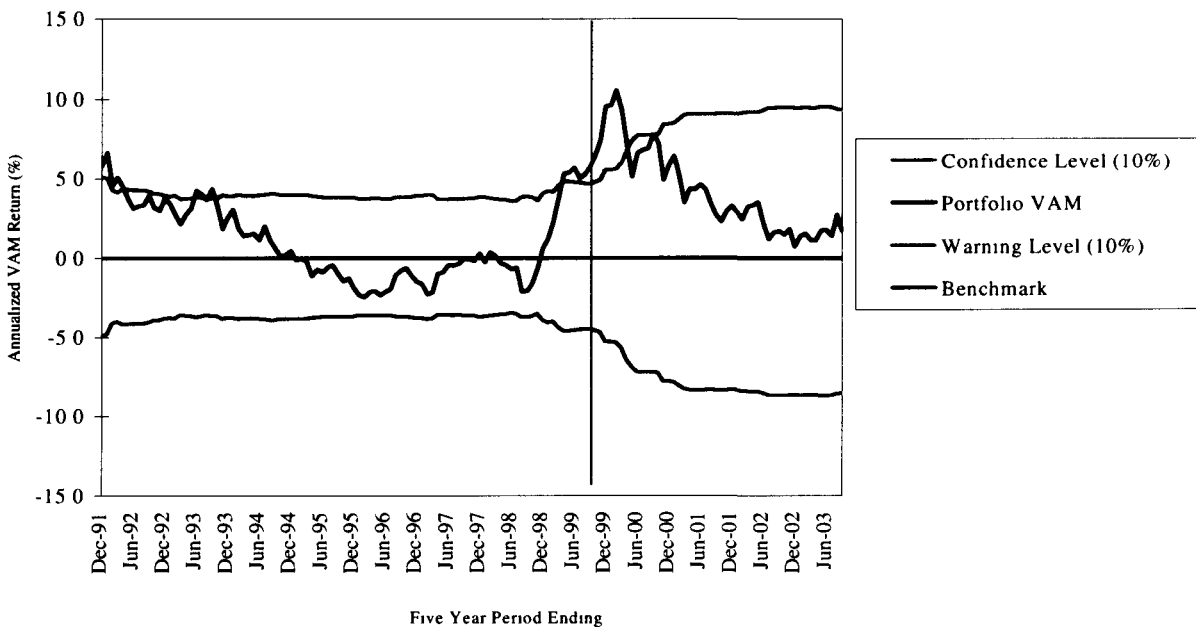
**Assets Under Management: \$111,932,984**

**Zevenbergen Capital Management**  
**Rolling Five Year VAM vs. Custom Benchmark**



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

**Zevenbergen Capital Management**  
**Rolling Five Year VAM vs. Russell 1000 Growth**



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

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

**Portfolio Manager: Rhonda Vitanye**

**Assets Under Management: \$2,473,673,358**

**Investment Philosophy – Semi-Passive Style**

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**

BGI outperformed for the quarter and year due to their earnings quality insights. They were able to identify companies with improving cash flow trends, which helped during both periods. Their relative valuation work also contributed positively during the quarter.

**Recommendation**

No action required.

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark*</b>
Last Quarter	3.0%	2.5%
Last 1 year	26.0	23.5
Last 2 years	1.7	0.9
Last 3 years	-9.2	-10.8
Last 4 years	-4.3	-5.9
Last 5 years	0.2	-0.9
Since Inception (1/95)	10.5	9.6

**Calendar Year Returns**

	<b>Actual</b>	<b>Custom Benchmark*</b>
YTD 6/30/2003	15.6%	13.9%
2002	-19.1	-19.7
2001	-7.8	-9.7
2000	-13.8	-16.3
1999	14.1	16.3
1998	21.4	23.7

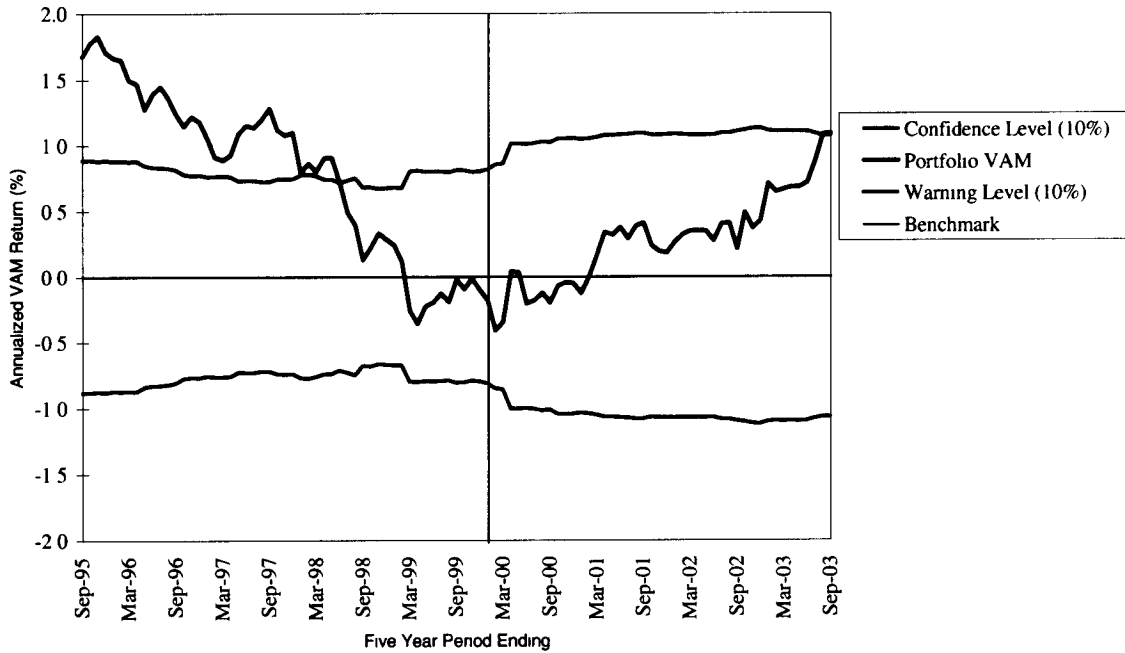
\* Completeness Fund.

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

**Portfolio Manager: Rhonda Vitanye**

**Assets Under Management: \$2,473,673,358**

**BARCLAYS GLOBAL INVESTORS - SEMI-PASSIVE**  
**Rolling Five Year VAM vs. Custom Benchmark (Completeness Fund)**



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

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

**Portfolio Manager: John Cone**

**Assets Under Management: \$1,538,883,460**

**Investment Philosophy – Semi-Passive Style**

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**

Franklin trailed the DCI benchmark for the quarter by 0.3% due to stock selection. Their earnings yield and momentum risk factors both behaved contrary to long-term expectations. For the past year, underperformance of 2.3% was a result of poor stock selection and unsuccessful sector tilts. Risk factor contributions were mixed. The worst performing stocks were Tenet Healthcare, Enzon Pharmaceuticals, Activision, and UnumProvident.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark*</b>
Last Quarter	2.2%	2.5%
Last 1 year	21.2	23.5
Last 2 years	-0.3	0.9
Last 3 years	-10.8	-10.8
Last 4 years	-6.1	-5.9
Last 5 years	-1.5	-0.9
Since Inception (1/95)	9.2	9.6

**Calendar Year Returns**

	<b>Actual</b>	<b>Custom Benchmark*</b>
YTD 6/30/2003	12.9%	13.9%
2002	-20.2	-19.7
2001	-9.0	-9.7
2000	-15.9	-16.3
1999	12.9	16.3
1998	22.4	23.7

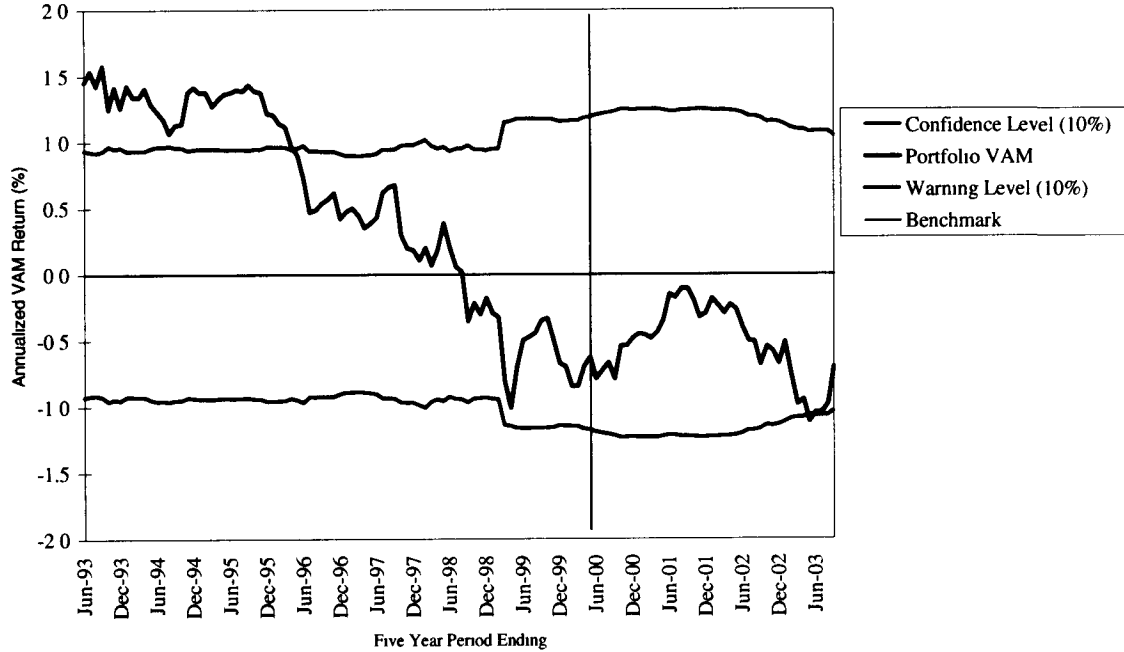
\* Completeness Fund

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

**Portfolio Manager: John Cone**

**Assets Under Management: \$1,538,883,460**

**FRANKLIN PORTFOLIO ASSOCIATES - SEMI-PASSIVE**  
**Rolling Five Year VAM vs. Custom Benchmark (Completeness Fund)**



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



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

**Portfolio Manager: Tim Devlin**

**Assets Under Management: \$2,138,433,777**

**Investment Philosophy – Semi-Passive Style**

JP 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**

JP Morgan underperformed the DCF benchmark by 0.7% during the quarter due to difficulties in the industrial cyclicals, semiconductors, and insurance sectors. Weak short-term earnings news from Viacom hurt performance, and a position in Raytheon detracted as it fell in tandem with other defense contractors given an expectation that defense spending would fall.

For the year, the portfolio trailed by 0.8% due to poor stock selection within the systems hardware, insurance and energy sectors. The portfolio did benefit from positive stock selection within utilities, health services and systems, and finance.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark*</b>
Last Quarter	1.8%	2.5%
Last 1 year	22.7	23.5
Last 2 years	-0.7	0.9
Last 3 years	-10.5	-10.8
Last 4 years	-6.0	-5.9
Last 5 years	-0.9	-0.9
Since Inception (1/95)	9.6	9.6

**Calendar Year Returns**

	<b>Actual</b>	<b>Custom Benchmark*</b>
YTD 6/30/2003	13.7%	13.9%
2002	-21.8	-19.7
2001	-8.7	-9.7
2000	-13.6	-16.3
1999	14.0	16.3
1998	24.6	23.7

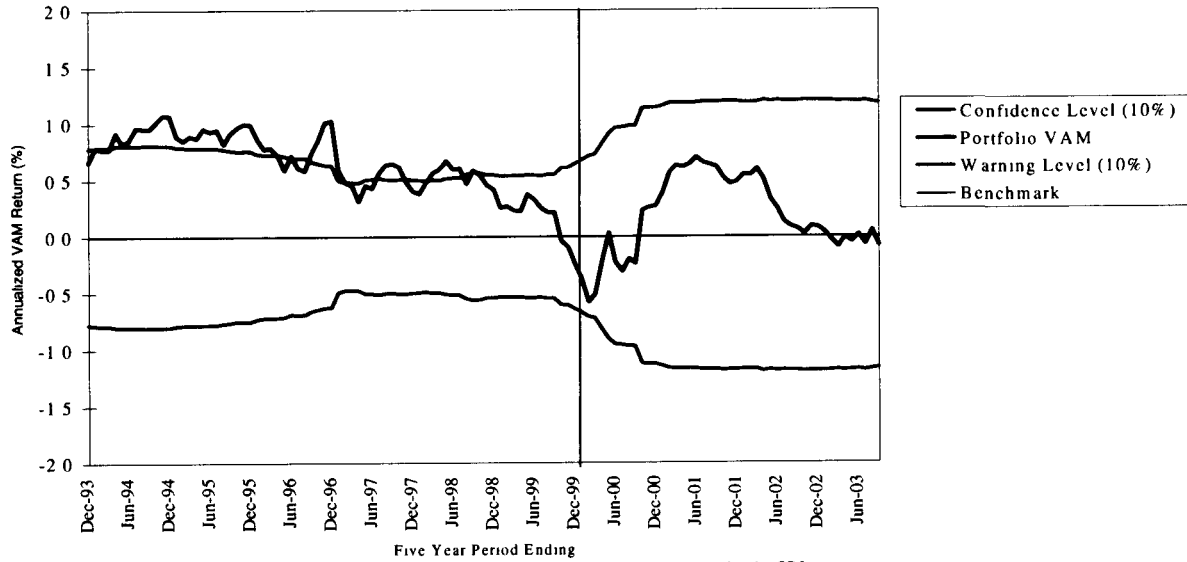
\* Completeness Fund

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

**Portfolio Manager: Tim Devlin**

**Assets Under Management: \$2,138,433,777**

**JP MORGAN - SEMI-PASSIVE**  
**Rolling Five Year VAM vs. Custom Benchmark (Completeness Fund)**



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

**Portfolio Manager: Amy Schioldager**

**Assets Under Management: \$5,783,690,036**

**Investment Philosophy – Passive Style**

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**

The passive portfolio matched the W5000 Investable target during the quarter and trailed by 0.3% for the year. The underperformance is attributed to the relative out performance of small and micro cap stocks over the broader market. The fund is generally underweight small and micro cap stocks due to low liquidity and higher transaction costs.

On September 29, 2003, BGI began to transition the portfolio to the R3000 target as directed by the SBI. The transition was accomplished with about 31% of the assets crossed at low commission and no market impact. The executions outperformed the September 30 closing prices by \$468,561.

**Recommendation**

No action required

**Quantitative Evaluation**

**Period Returns**

*(Annualized for multi-year periods)*

	<b>Actual</b>	<b>Custom Benchmark*</b>
Last Quarter	3.5%	3.5%
Last 1 year	25.8	26.1
Last 2 years	1.3	1.6
Last 3 years	-10.1	-10.2
Last 4 years	-3.8	-3.9
Last 5 years	1.7	1.6
Since Inception (7/95)	8.9	8.7

**Calendar Year Returns**

	<b>Actual</b>	<b>Custom Benchmark*</b>
YTD 6/30/2003	16.4%	16.7%
2002	-21.4	-21.5
2001	-11.8	-11.7
2000	-9.8	-11.0
1999	23.3	23.6
1998	23.4	23.4

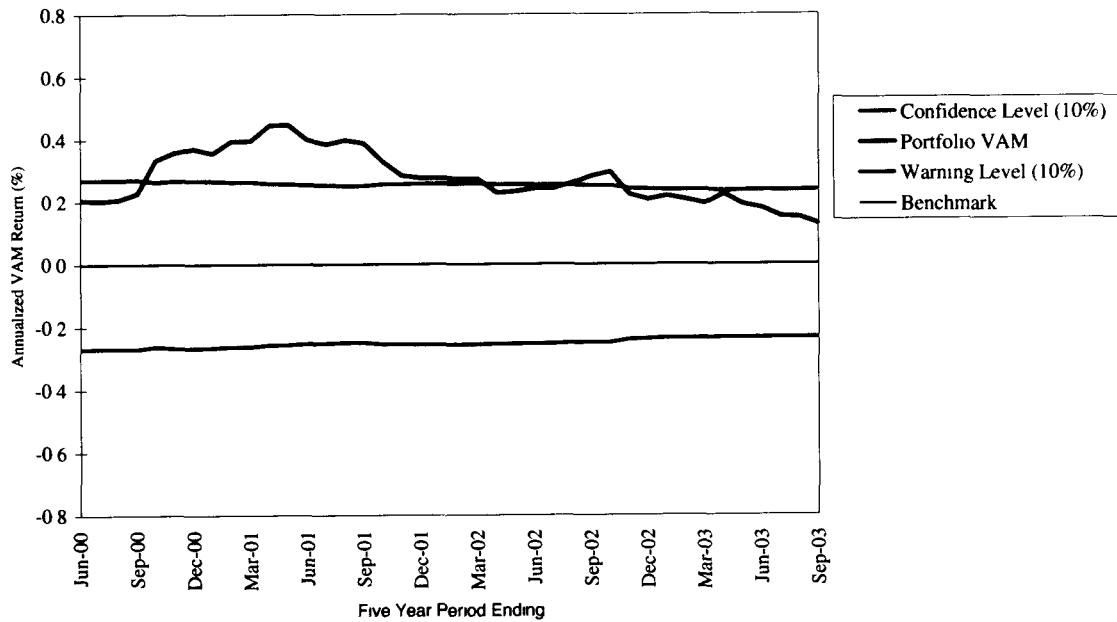
\* Domestic Equity Target (Currently Wilshire 5000 Investable)

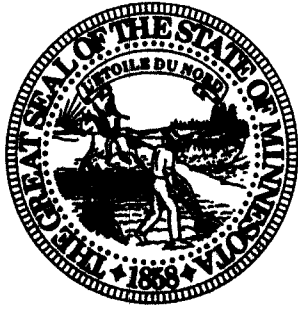
**BARCLAYS GLOBAL INVESTORS**  
**Periods Ending September, 2003**

**Portfolio Manager: Amy Schioldager**

**Assets Under Management: \$5,783,690,036**

**BARCLAYS GLOBAL INVESTORS - PASSIVE**  
**Rolling Five Year VAM vs. Domestic Equity Target**  
**(currently Wilshire 5000 Investable)**





# STATE BOARD OF INVESTMENT

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## **Bond Manager Evaluation Reports**

**Third Quarter, 2003**

**COMBINED RETIREMENT FUNDS  
BOND MANAGERS  
Periods Ending September, 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)	-0.3	-0.1	5.9	5.4	7.4	8.9	5.8	6.6	6.7	7.1	\$776.8	9.2%
Deutsche	-0.1	-0.1	5.6	5.4	9.6	8.9			9.8	9.2	\$628.0	7.4%
Dodge & Cox	0.6	-0.1	8.5	5.4	10.7	8.9			10.7	9.2	\$787.0	9.3%
Morgan Stanley	0.7	-0.1	6.1	5.4	9.0	8.9	6.8	6.6	10.1	9.9	\$747.3	8.8%
Western	0.4	-0.1	10.3	5.4	10.6	8.9	7.8	6.6	11.1	9.8	\$1,236.5	14.6%
<b>Semi-Passive Managers</b>												
BlackRock	-0.4	-0.1	6.1	5.4	9.1	8.9	6.9	6.6	7.8	7.6	\$1,433.2	16.9%
Goldman	0.2	-0.1	7.3	5.4	9.2	8.9	6.8	6.6	7.3	7.0	\$1,413.4	16.7%
Lincoln	0.0	-0.1	5.7	5.4	9.2	8.9	6.8	6.6	8.5	8.4	\$1,434.4	17.0%
											<b>\$8,456.7</b>	<b>100.0%</b>
									<b>Since 7/1/84</b>			
Current Aggregate	0.1	-0.1	7.0	5.4	9.3	8.9	7.0	6.6	10.3	9.8		
<b>Historical Aggregate (2)</b>	<b>0.1</b>	<b>-0.1</b>	<b>6.9</b>	<b>5.4</b>	<b>9.2</b>	<b>8.9</b>	<b>6.8</b>	<b>6.6</b>	<b>9.9</b>	<b>9.8</b>		
Lehman Aggregate (3)		-0.1		5.4		8.9		6.6		9.9		

(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 September, 2003**

**Portfolio Manager: Colin Lundgren**

**Assets Under Management: \$776,824,180**

**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 underperformed for the quarter due to an overweight and a higher coupon rate bias in their mortgage portfolio, especially in July, when interest rates backed up significantly. For the year, they outperformed as a result of good issue selection in investment grade corporate bonds as well as their allocation to high yield corporate bonds.

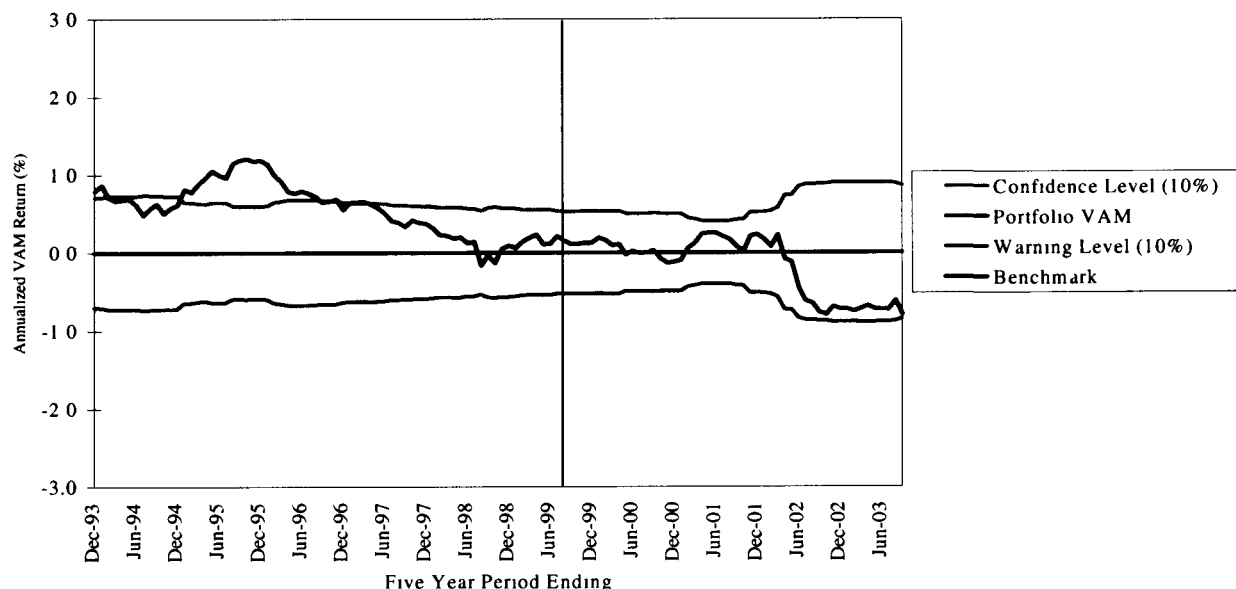
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.3%	-0.1%
Last 1 year	5.9	5.4
Last 2 years	5.2	7.0
Last 3 years	7.4	8.9
Last 4 years	7.4	8.5
Last 5 years	5.8	6.6
Since Inception (7/93)	6.7	7.1

**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 September, 2003**

**Portfolio Manager: Warren Davis**

**Assets Under Management: \$628,044,820**

**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 Asset outperformed for the quarter and year because of their overweighting to the corporate sector. In addition within corporates they overweighted the BBB sector which was the best performing portion of the corporate sector

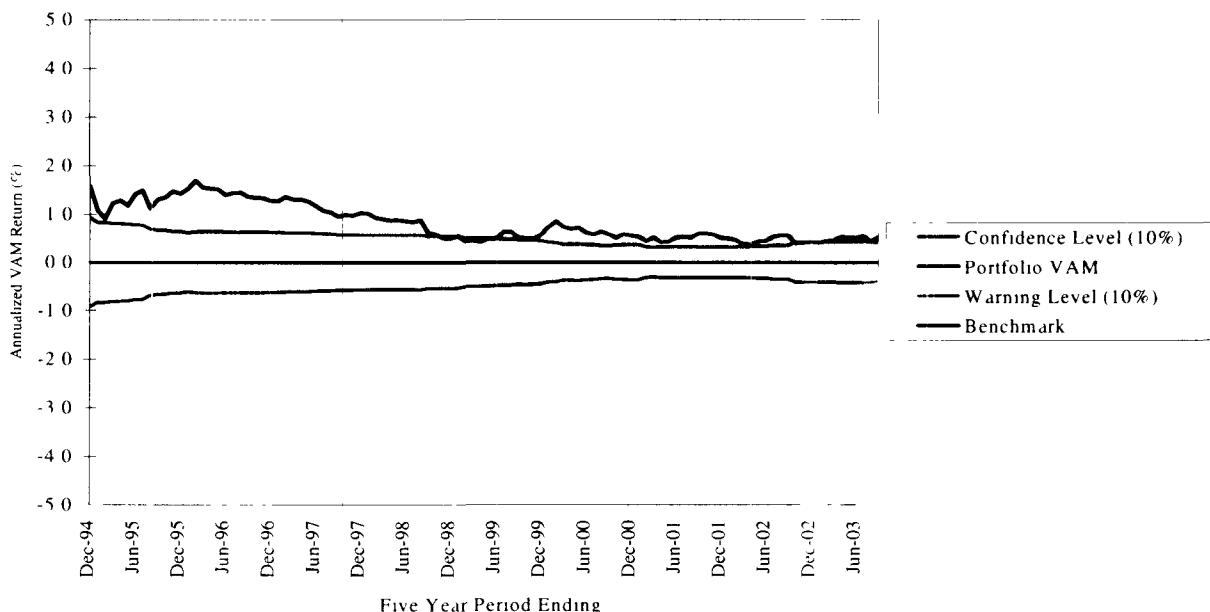
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.1%	-0.1%
Last 1 year	5.6	5.4
Last 2 years	7.4	7.0
Last 3 years	9.6	8.9
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (2/00)	9.8	9.2

**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 September, 2003**

**Portfolio Manager: Dana Emery**

**Assets Under Management: \$787,031,254**

**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 and Cox's outperformance for the quarter was due to a shorter than benchmark duration position and an overweighting to the corporate sector. For the year, they outperformed because of their overweighting to the spread sectors, especially corporate bonds. In addition, issue selection within the corporate sector also contributed to their positive excess return.

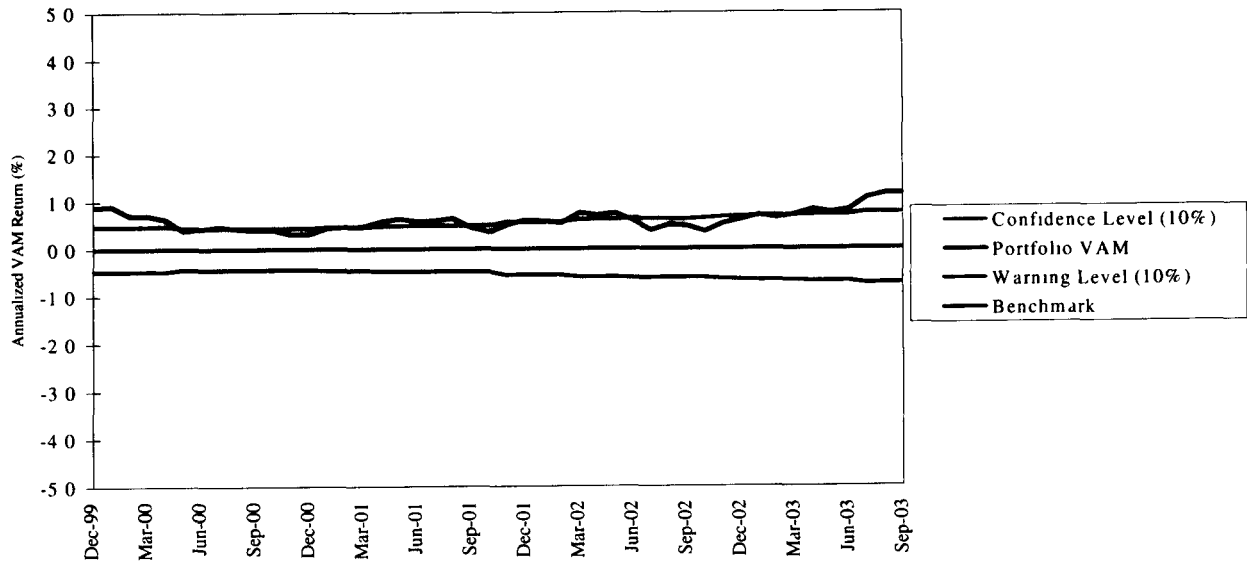
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.6%	-0.1%
Last 1 year	8.5	5.4
Last 2 years	9.1	7.0
Last 3 years	10.7	8.9
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (2/00)	10.7	9.2

**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 September, 2003**

**Portfolio Manager: David Horowitz**

**Assets Under Management: \$747,305,117**

**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**

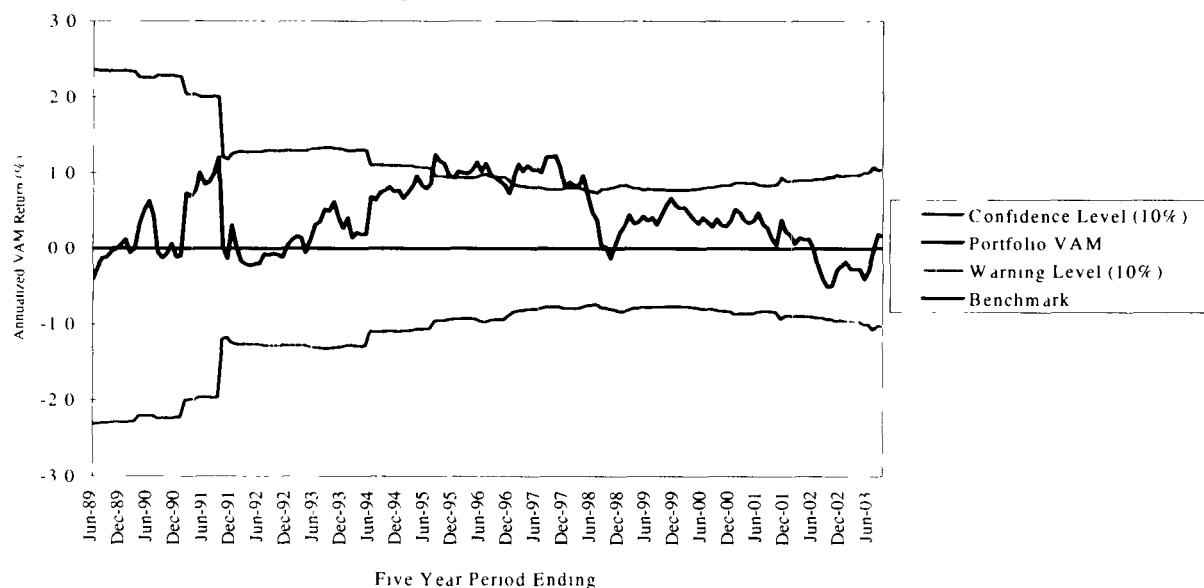
Morgan Stanley outperformed for the third quarter due to a shorter than benchmark duration bet and their overweighting to corporate bonds. For the year, their outperformance was primarily due to their corporate overweight.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	0.7%	-0.1%	No action required
Last 1 year	6.1	5.4	
Last 2 years	6.8	7.0	
Last 3 years	9.0	8.9	
Last 4 years	8.6	8.7	
Last 5 years	6.8	6.6	
Since Inception (7/84)	10.1	9.9	

**Recommendations**

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



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

**Portfolio Manager: Ken Leech**

**Assets Under Management: \$1,236,515,812**

**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 during the quarter because of their overweight to corporate bonds – in particular longer maturity, BBB rated bonds generated significant returns as spreads tightened and interest rates fell. Also the portfolio benefited from exposure to high yield bonds. For the year, overweights to the spread sectors, especially corporates, and an overweight duration position for the first six months of the year added value over the benchmark.

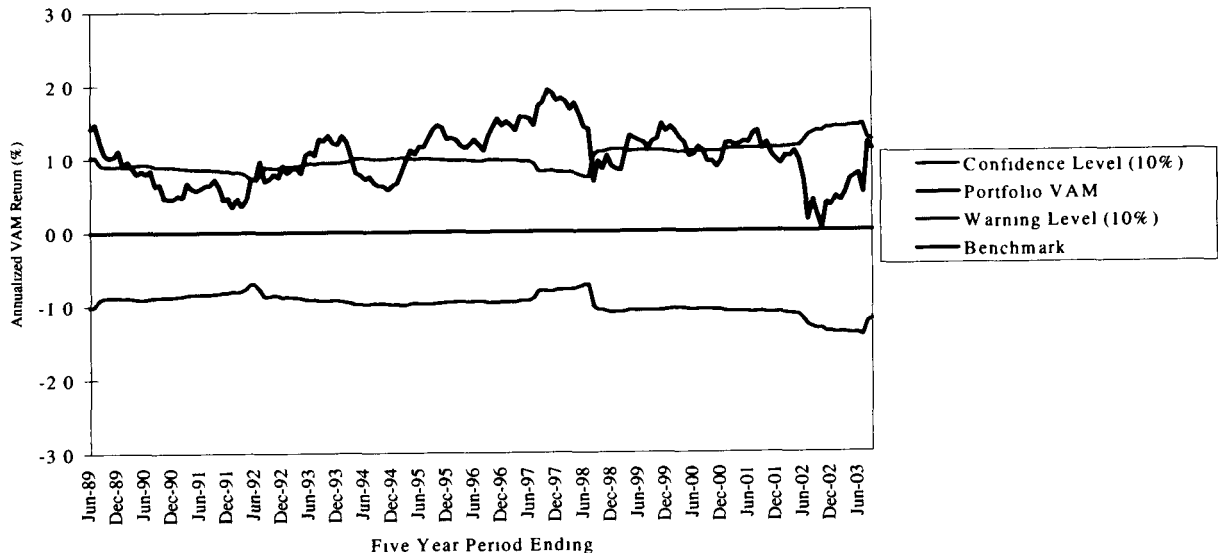
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.4%	-0.1%
Last 1 year	10.3	5.4
Last 2 years	8.5	7.0
Last 3 years	10.6	8.9
Last 4 years	9.8	8.5
Last 5 years	7.8	6.6
Since Inception (7/84)	11.1	9.8

**Recommendations**

No action required.

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



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

**Portfolio Manager: Keith Anderson**

**Assets Under Management: \$1,433,206,484**

**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 underperformed their quarterly benchmark primarily due to a yield curve flattening bet while the yield curve steepened 26 basis points during the quarter and an underweight to the corporate sector. The one-year outperformance was due to their issue selection within the spread sectors, and active sector rotation between the Government, Mortgage, and Corporate sectors.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	-0.4%	-0.1%	No action required
Last 1 year	6.1	5.4	
Last 2 years	7.0	7.0	
Last 3 years	9.1	8.9	
Last 4 years	8.6	8.5	
Last 5 years	6.9	6.6	
Since Inception (4/96)	7.8	7.6	

**Recommendation**

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



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

**Portfolio Manager: Jonathon Beinrer**

**Assets Under Management: \$1,413,351,156**

**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 exceeded the benchmark for the quarter and the year primarily due to issue selection in the mortgage sector of the market and their overweighting to the corporate sector.

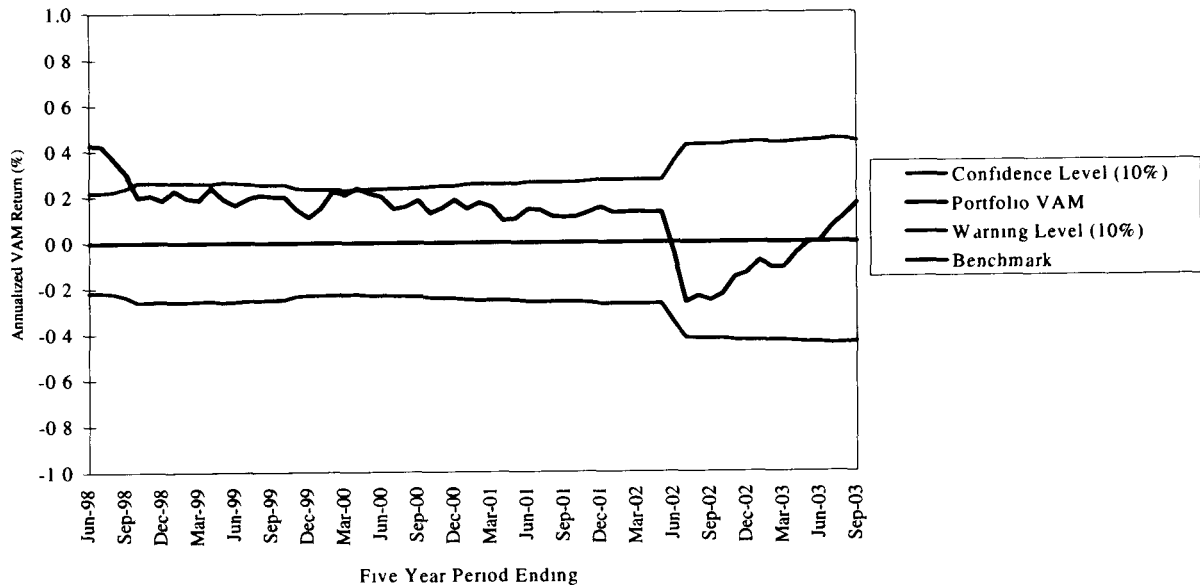
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.2%	-0.1%
Last 1 year	7.3	5.4
Last 2 years	7.3	7.0
Last 3 years	9.2	8.9
Last 4 years	8.7	8.5
Last 5 years	6.8	6.6
Since Inception (7/93)	7.3	7.0

**Recommendations**

No action required.

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



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

**Portfolio Manager: Andrew Johnson**

**Assets Under Management: \$1,434,412,755**

**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 outperformed for the quarter and year due to good security selection in the mortgage and corporate sectors. The outperformance for the year was partially offset by negative security selection in the asset back sector.

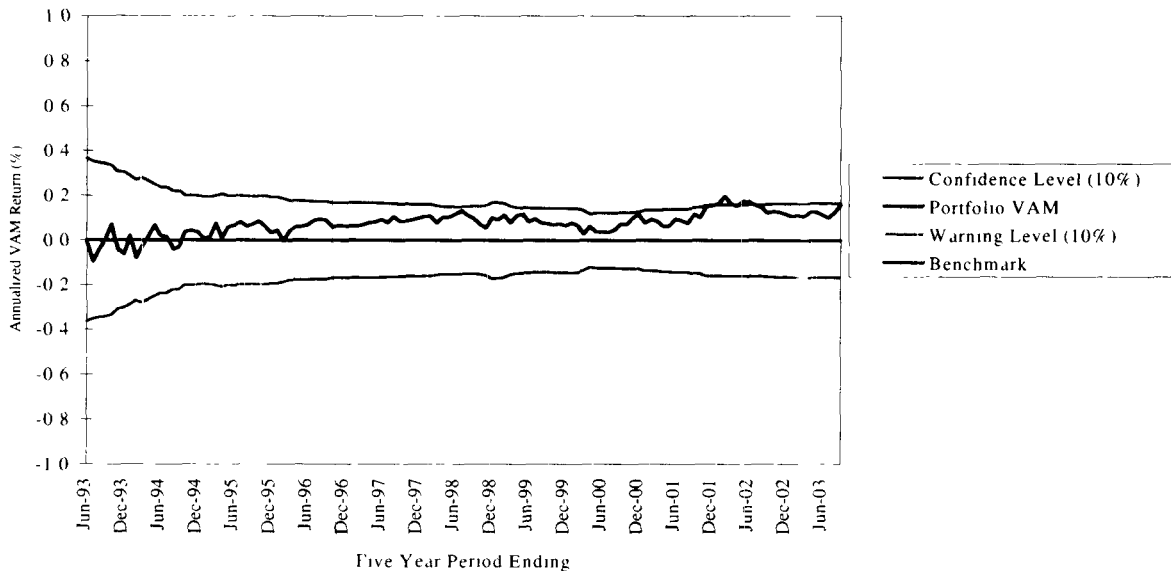
**Quantitative Evaluation**

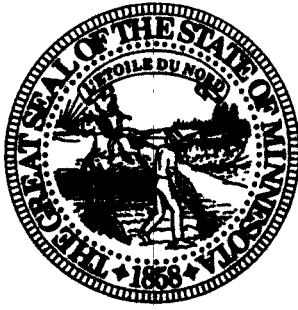
	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.0%	-0.1%
Last 1 year	5.7	5.4
Last 2 years	7.2	7.0
Last 3 years	9.2	8.9
Last 4 years	8.7	8.5
Last 5 years	6.8	6.6
Since Inception (7/88)	8.5	8.4

**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

Third Quarter, 2003

**COMBINED RETIREMENT FUNDS  
INTERNATIONAL STOCK MANAGERS  
Periods Ending September, 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	6.8	8.1	20.0	26.0	-14.0	-8.7			-14.3	-9.5	\$441.6	8.4%
Britannic (Blairlogie)	8.3	8.1	24.3	26.0	-10.0	-8.7			-10.7	-9.5	\$280.5	5.3%
Invesco	5.7	8.1	21.2	26.0	-4.7	-8.7			-4.6	-9.5	\$533.1	10.1%
Marathon (5)	14.0	10.8	32.9	32.5	0.2	-4.4	8.6	3.5	6.4	3.4	\$601.4	11.4%
T. Rowe Price	4.9	8.1	22.9	26.0	-11.3	-8.7	0.0	0.6	3.5	2.6	\$460.9	8.7%
UBS Global	5.7	8.1	23.5	26.0	-4.6	-8.7	3.9	0.6	6.2	4.4	\$561.2	10.6%
<b>Active Emerging Markets</b>												
Alliance Capital	14.3	14.2	43.5	45.6					2.7	3.2	\$142.8	2.7%
Capital International	14.4	14.2	47.9	45.6					-1.7	3.2	\$127.4	2.4%
Morgan Stanley	15.0	14.2	44.1	45.6					3.0	3.2	\$133.5	2.5%
Schroders	16.8	14.2	46.5	45.6					0.3	3.2	\$135.9	2.6%
<b>Passive EAFE</b>												
State Street	8.1	8.1	26.1	26.0	-8.6	-8.7	0.8	0.6	5.1	4.9	\$1,870.4	35.4%
									<b>Since 10/1/92</b>			
Equity Only (2) (4)	8.5	8.7	26.8	27.7	-7.3	-7.8	2.1	1.6	5.4	4.6	\$5,288.8	100.0%
<b>Total Program (3) (4)</b>	<b>8.5</b>	<b>8.7</b>	<b>26.8</b>	<b>27.7</b>	<b>-7.3</b>	<b>-7.8</b>	<b>2.1</b>	<b>1.6</b>	<b>5.8</b>	<b>4.6</b>	<b>\$5,288.8</b>	
EAFE Free (net)		8.1	26.0		-8.7		0.5		4.8			
Emerging Markets Free (net)		14.2	45.6		1.6		10.5		4.4			

(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% Citigroup EMI EPAC and 45% Citigroup PMI EPAC.



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

**Portfolio Manager: Mark Burgess**

**Assets Under Management: \$441,647,740**

**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**

Underperformance for the quarter was due primarily to financial holdings in Europe and Japan. The portfolio's underweight position in Japan, one of the best performing markets, also detracted from performance. Over the year, stock selection in Europe did not add value.

Staff met with AmEx to discuss recent changes to the organization. Following the acquisition of Threadneedle Asset Management, Threadneedle staff as of the end of 4Q03 will assume investment management responsibility for AmEx's international equity product. Ed Gaunt, AmEx's current portfolio manager for Japan, will join the Threadneedle team.

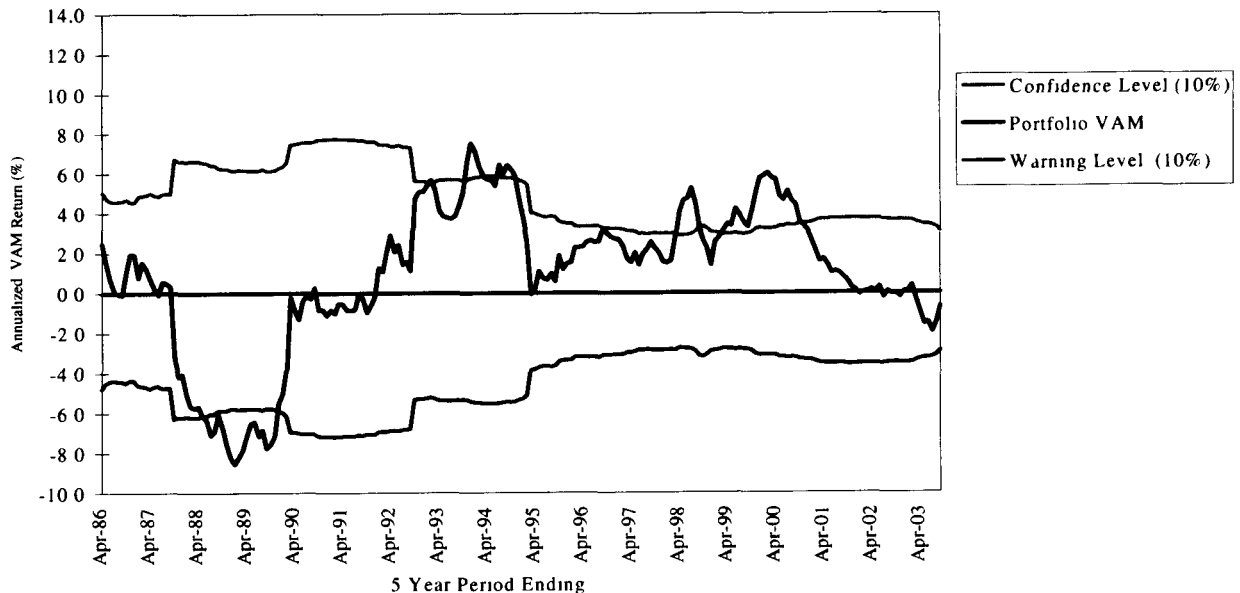
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	6.8%	8.1%
Last 1 year	20.0	26.0
Last 2 years	0.9	3.3
Last 3 years	-14.0	-8.7
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/00)	-14.3	-9.5

**Recommendations**

Staff is closely monitoring the firm due to organizational change and performance concerns.

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



Note: Shaded area includes performance prior to managing SBI account

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

**Portfolio Manager: James Smith**

**Assets Under Management: \$280,495,057**

**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**

Staff met with Britannic during the quarter to discuss the investment process and organization. Recent portfolio performance narrowly exceeded the benchmark due to strong stock selection, especially in the UK and Japan.

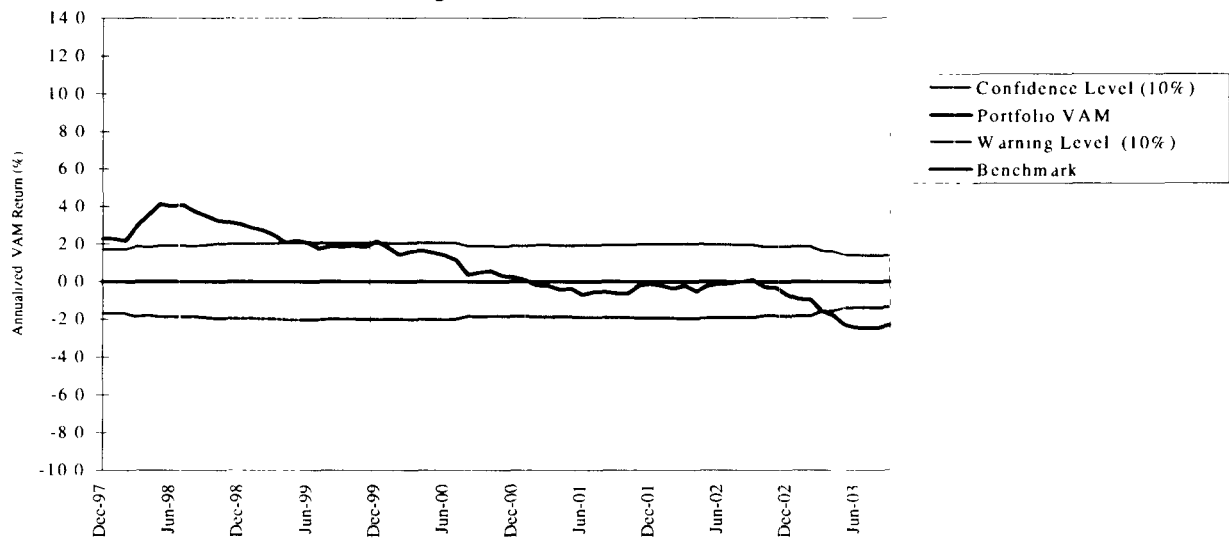
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	8.3%	8.1%
Last 1 year	24.3	26.0
Last 2 years	3.7	3.3
Last 3 years	-10.0	-8.7
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (3/00)	-10.7	-9.5

**Recommendations**

Staff is monitoring the firm due to performance concerns.

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



Note: Shaded area includes performance prior to managing SBI account

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

**Portfolio Manager: Erik Granade**

**Assets Under Management: \$533,084,994**

**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**

Japanese financial and consumer discretionary holdings detracted from performance during the quarter. In addition, the portfolio's large cap and quality biases were out of favor with the market, as small cap companies with lesser quality earnings outperformed.

For the year, the market's shift from defensive sectors to more momentum driven areas, which tend to benefit from improving economic conditions, detracted from performance.

**Quantitative Evaluation**

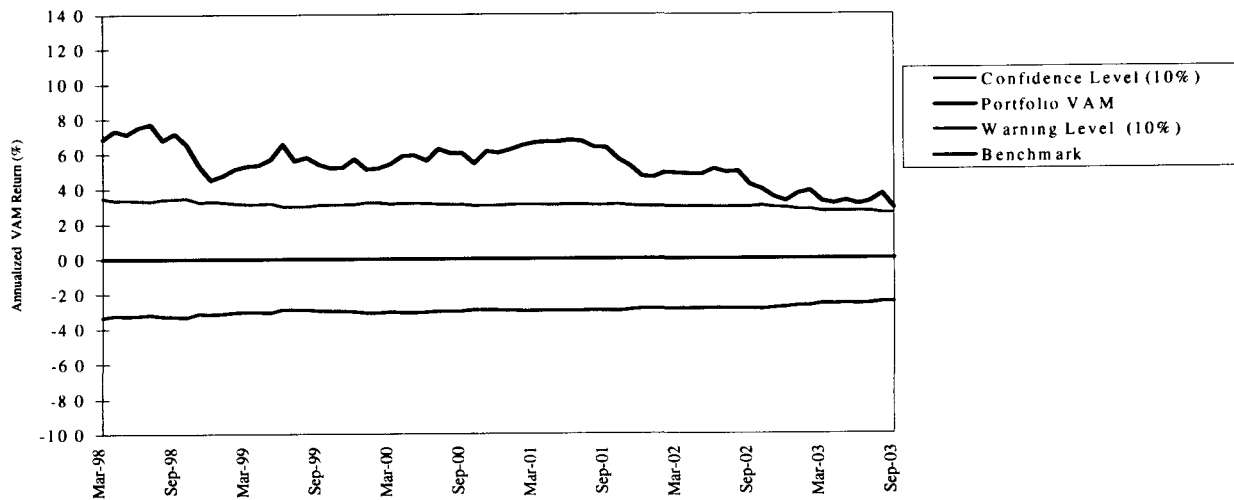
	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.7%	8.1%
Last 1 year	21.2	26.0
Last 2 years	4.2	3.3
Last 3 years	-4.7	-8.7
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception	-4.6	-9.5

(3/00)

**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 September, 2003**

**Portfolio Manager: William Arah**

**Assets Under Management: \$601,405,901**

**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**

The portfolio significantly outperformed during the quarter due to strong stock selection in the UK and Japan and a mid cap bias. An underweight position in Europe and an overweight position in Asia, in particular Hong Kong, also added value.

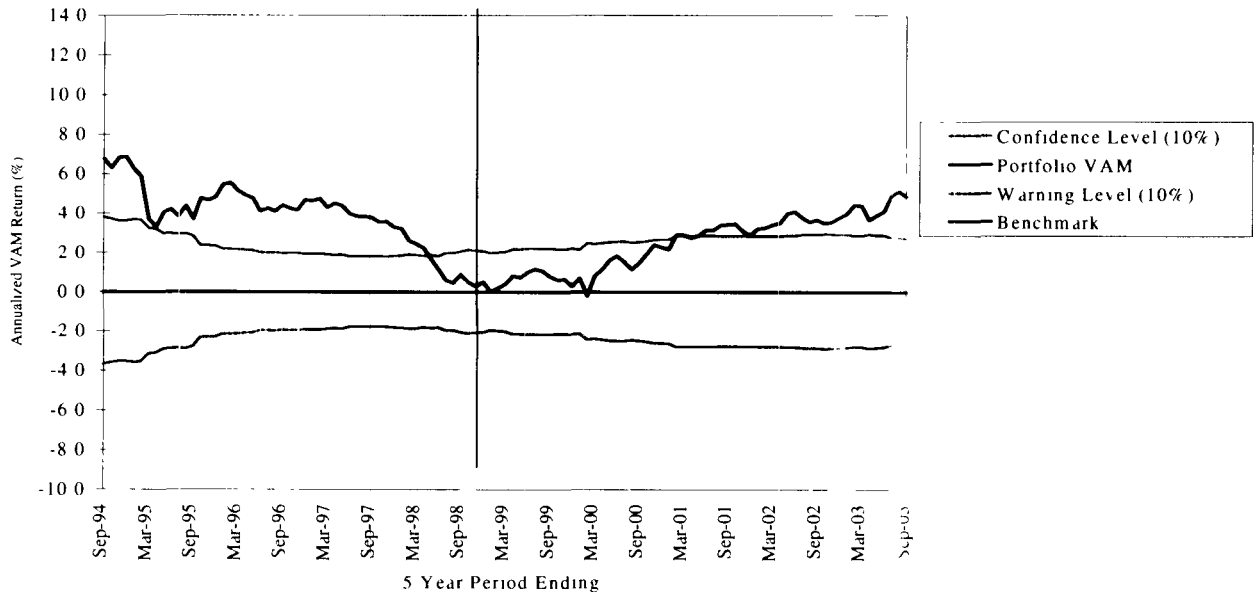
**Quantitative Evaluation**

	<b>Actual</b>	<b>Custom Benchmark</b>
Last Quarter	14.0%	10.8%
Last 1 year	32.9	32.5
Last 2 years	11.6	9.7
Last 3 years	0.2	-4.4
Last 4 years	2.0	-2.4
Last 5 years	8.6	3.5
Since Inception (11/93)	6.4	3.4

**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 September, 2003**

**Portfolio Manager: David Warren**

**Assets Under Management: \$460,912,133**

**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**

Underperformance for the quarter was due primarily to financial holdings in Japan and Europe, followed by stock selection in the information technology sector.

Stock selection in Japan also contributed to the portfolio's underperformance for the one-year period.

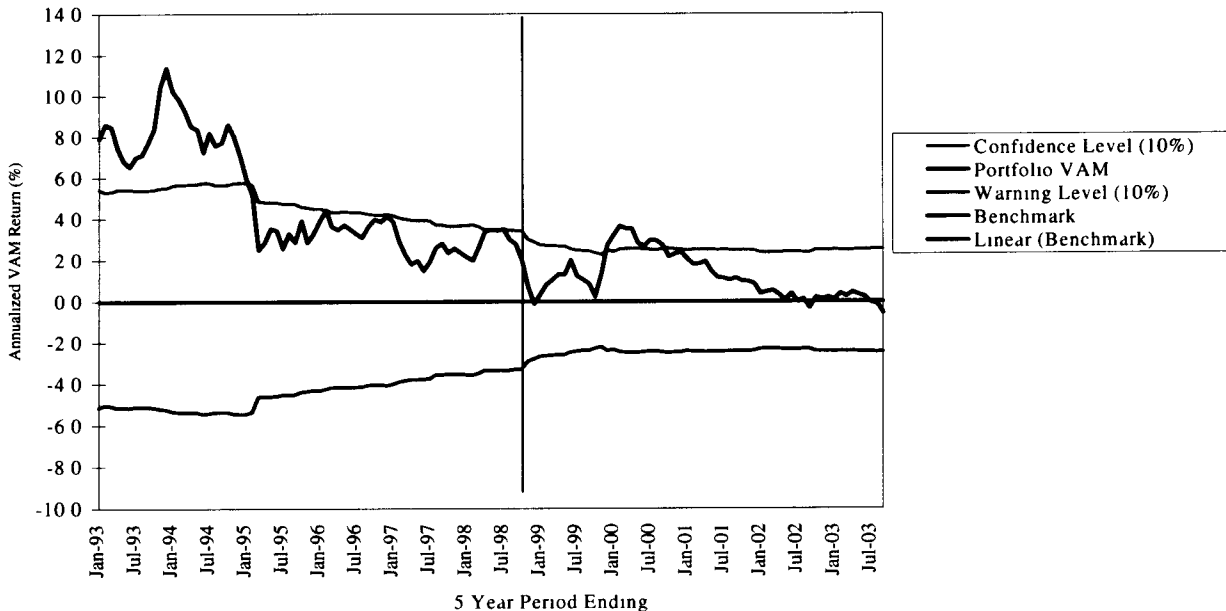
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.9%	8.1%
Last 1 year	22.9	26.0
Last 2 years	0.6	3.3
Last 3 years	-11.3	-8.7
Last 4 years	-5.9	-5.8
Last 5 years	0.0	0.6
Since Inception (11/93)	3.5	2.6

**Recommendations**

No action required.

**T. ROWE PRICE INTERNATIONAL**  
**Rolling Five Year VAM**



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

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

**Portfolio Manager: Thomas Madsen**

**Assets Under Management: \$561,229,535**

**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, stock selection within Japan and in consumer discretionary and financial stocks, accounted for the majority of the portfolio's underperformance. UBS's Japanese positions are in high quality, large cap exporters that have lagged smaller, highly indebted domestic companies in recent months. Overweight positions in France and the UK, which underperformed relative to Asian markets, also detracted from returns.

Japanese stock selection was the largest contributor to underperformance for the year.

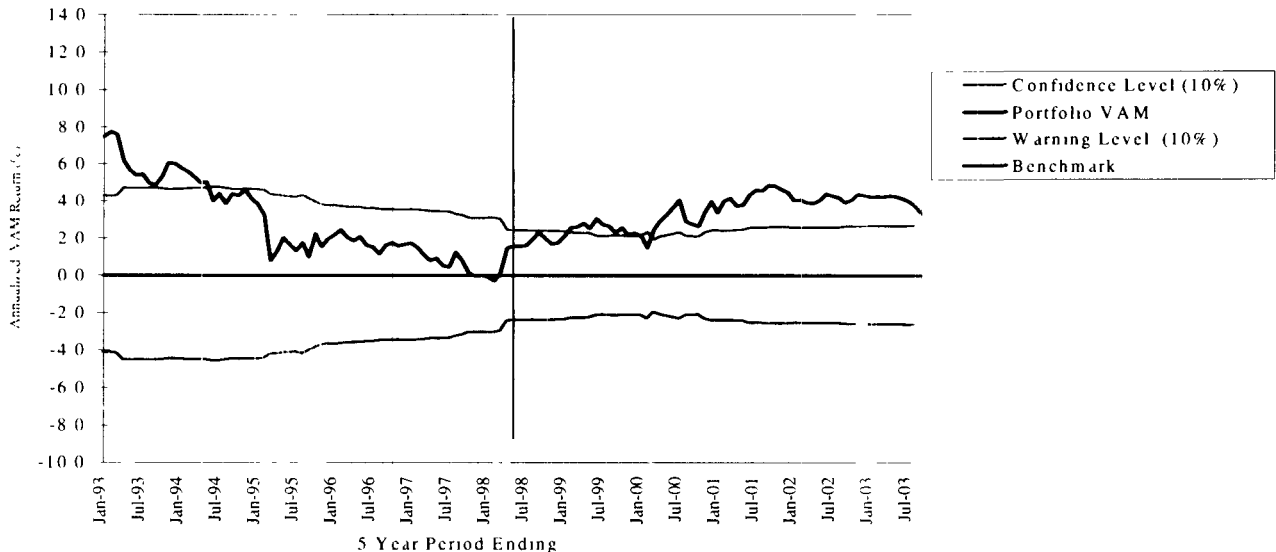
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.7%	8.1%
Last 1 year	23.5	26.0
Last 2 years	2.1	3.3
Last 3 years	-4.6	-8.7
Last 4 years	-1.4	-5.8
Last 5 years	3.9	0.6
Since Inception (4/93)	6.2	4.4

**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 September, 2003**

**Portfolio Manager: Edward Baker**

**Assets Under Management: \$142,783,247**

**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**

Staff met with Alliance during the quarter to discuss recent changes to the investment management team. The portfolio manager for the Asian region resigned as of the beginning of August to pursue a business venture. Alliance's Asia telecoms analyst who has been working as a back-up portfolio manager for several years has replaced him. Staff is monitoring performance to ensure there is no disruption to the management of the SBI's account.

The portfolio tracked the benchmark for the quarter due to strong stock selection in Taiwan and an overweight to India. For the year, stock selection in Asia and Latin America, detracted from performance.

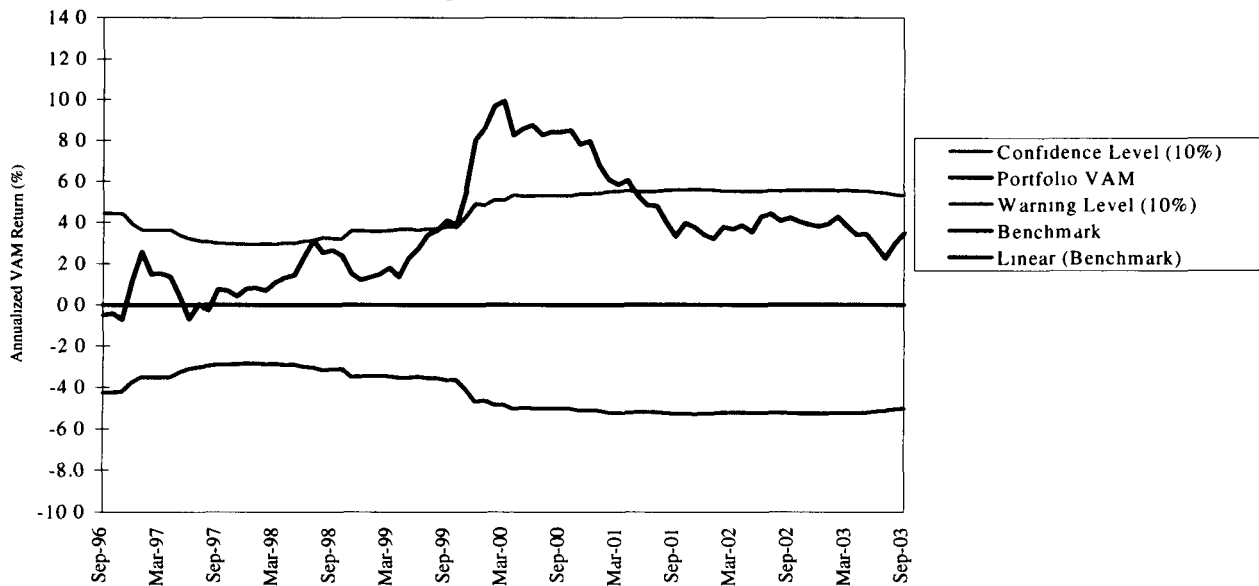
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	14.3	14.2
Last 1 year	43.5	45.6
Last 2 years	30.3	26.7
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)	2.7	3.2

**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 September, 2003**

**Portfolio Manager: Victor Kohn**

**Assets Under Management: \$127,442,498**

**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**

Staff met with Capital during the quarter to review performance. The portfolio outperformed during the quarter due to information technology holdings. Stock selection in India, Korea, Taiwan, and Malaysia was particularly strong.

For the year, the portfolio benefited substantially from an overweight position in Brazil, which posted a 122% return for the 12 month period.

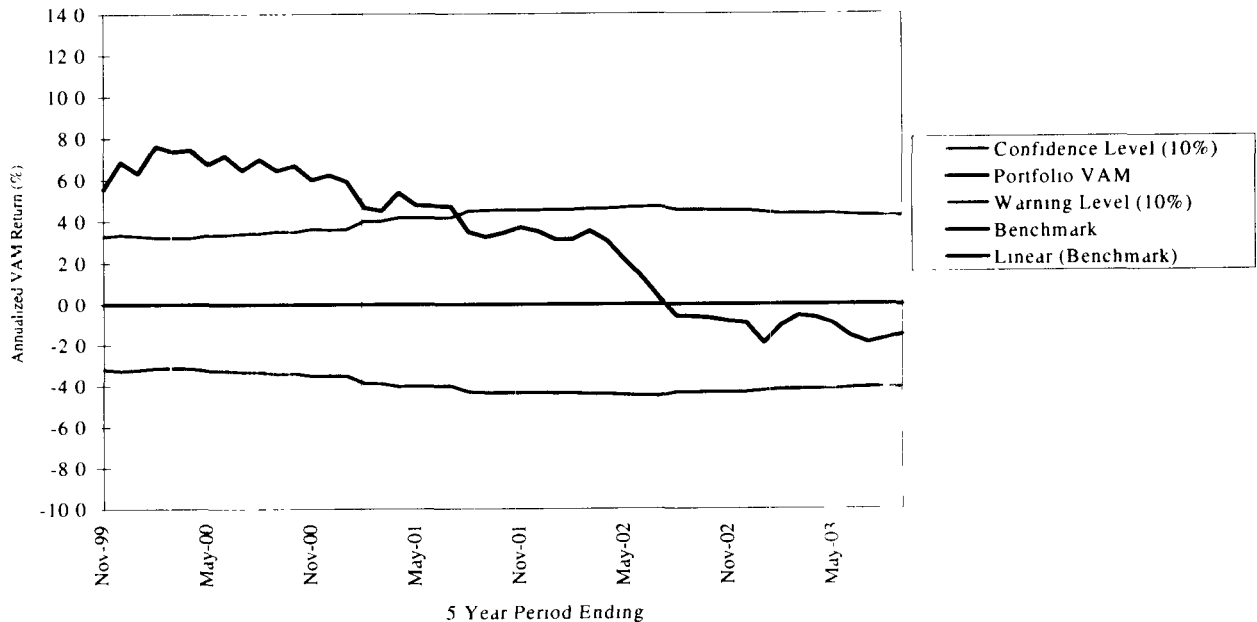
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	14.4	14.2
Last 1 year	47.9	45.6
Last 2 years	24.9	26.7
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)	-1.7	3.2

**Recommendations**

No action required.

**CAPITAL INTERNATIONAL, INC.**  
**Rolling Five Year VAM**



Note: Shaded area includes performance prior to managing SBI account



**MORGAN STANLEY INVESTMENT MANAGEMENT**  
**Periods Ending September, 2003**

**Portfolio Manager: Narayan Ramachandran**

**Assets Under Management: \$133,468,307**

**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**

During the quarter, the portfolio gained equally from both country and stock selection decisions. Stock selection was particularly strong in Thailand, Russia, and Taiwan. Underweight positions in Israel and Malaysia were beneficial.

Country allocations detracted from performance for the year, primarily due to the portfolio's underweight to Brazil.

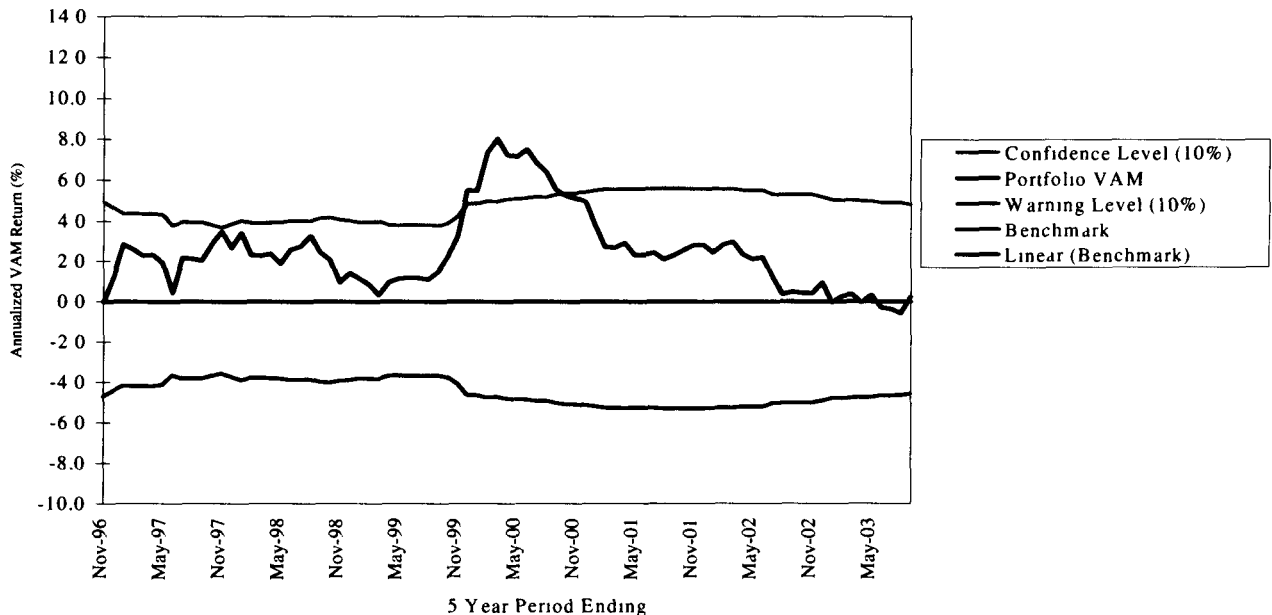
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	15.0%	14.2%
Last 1 year	44.1	45.6
Last 2 years	28.2	26.7
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)	3.0	3.2

**Recommendations**

No action required.

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



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

**SCHRODERS INVESTMENT MANAGEMENT NORTH AMERICA INC.**  
**Periods Ending September, 2003**

**Portfolio Manager: Peter Clark**

**Assets Under Management: \$135,885,191**

**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**

Staff met with Schroders during the quarter to discuss performance and the organization. We reviewed changes that were made to management responsibilities at the firm level. No changes were made to the emerging markets equity team.

Performance for the quarter exceeded the benchmark due to stock selection in Korea and Taiwan where cyclical stocks had a strong recovery. For the year, stock selection was strong in these markets as well as in Mexico, Russia and South Africa.

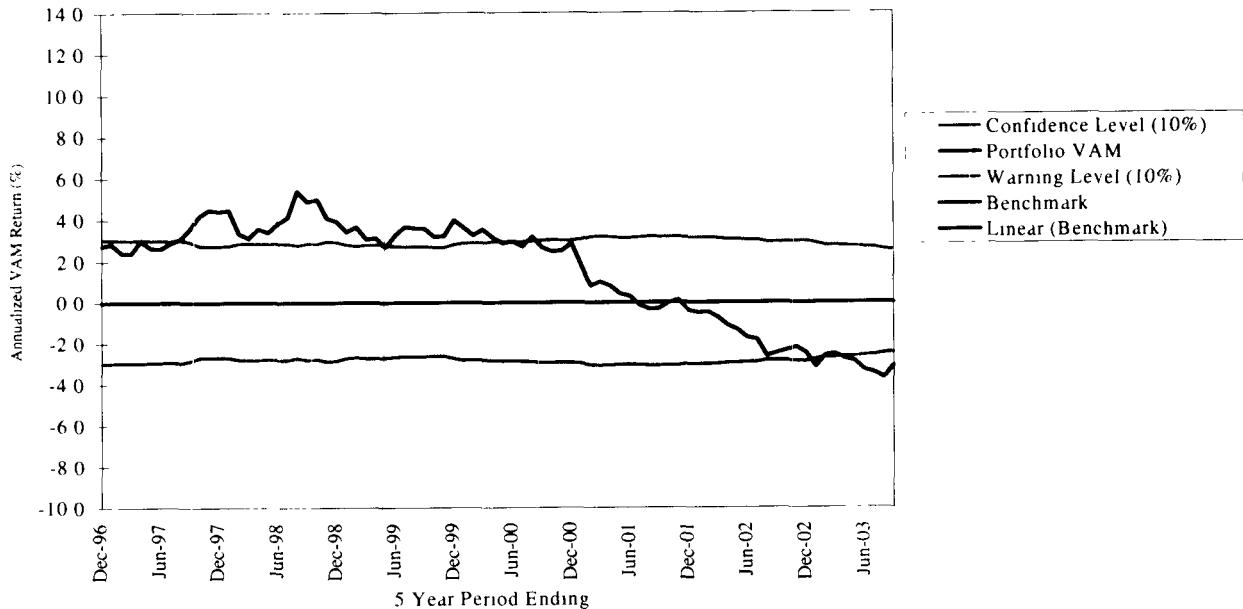
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	16.8	14.2
Last 1 year	46.5	45.6
Last 2 years	25.7	26.7
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)	0.3	3.2

**Recommendations**

Staff continues to closely monitor 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 September, 2003**

**Portfolio Manager: Lynn Blake**

**Assets Under Management: \$1,870,445,316**

**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 index both for the quarter and the year. Performance is within expectation over all time periods.

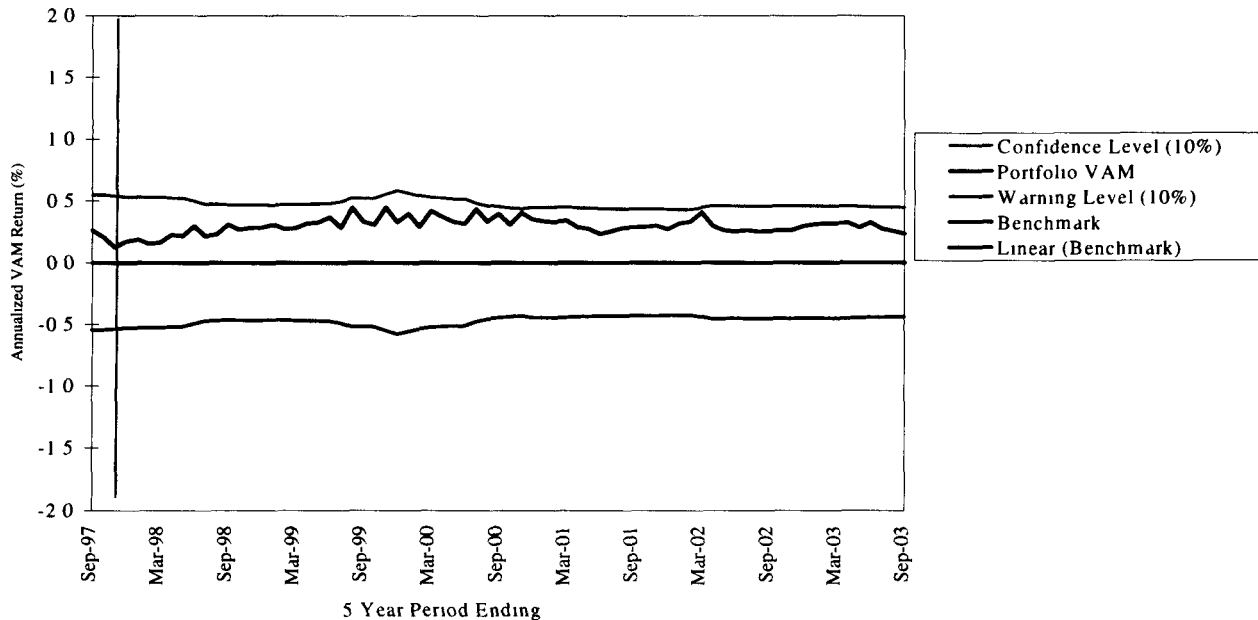
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	8.1%	8.1%
Last 1 year	26.1	26.0
Last 2 years	3.4	3.3
Last 3 years	-8.6	-8.7
Last 4 years	-5.7	-5.8
Last 5 years	0.8	0.6
Since Inception (10/92)	5.1	4.9

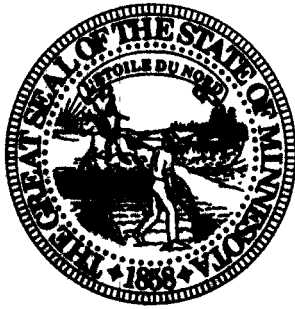
**Recommendation**

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



# STATE BOARD OF INVESTMENT

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## **Non-Retirement Manager Evaluation Reports**

**Third Quarter, 2003**

**NON - RETIREMENT MANAGERS**  
**Periods Ending September, 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)*	1.7	2.6	20.4	24.4	-7.0	-10.1	3.5	1.0	12.4	11.1	\$56.5
Voyageur Asset Management (Custom Benchmark)*	0.1	0.0	3.7	3.5	6.9	7.9	5.7	6.5	7.2	7.3	\$178.1
Galliard Capital Management (3 yr. Constant Maturity Treasury + 45 bp)*	1.1	0.7	4.9	2.5	5.7	3.6	5.9	4.6	6.3	5.3	\$142.3
Internal Stock Pool (S&P 500 Index)*	2.7	2.6	24.5	24.4	-10.0	-10.1	1.1	1.0	10.2	10.1	\$534.6
Internal Bond Pool - Income Share (Lehman Aggregate)*(2)	0.6	-0.1	7.5	5.4	8.9	8.9	6.6	6.6	8.6	8.3	\$200.8
Internal Bond Pool - Trust (Lehman Aggregate)*	0.2	-0.1	7.4	5.4	9.1	8.9	6.8	6.6	8.3	8.0	\$367.3

\* 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 September, 2003**

**Portfolio Manager: Gene Bolton**

**Assets Under Management: \$56,503,359**

**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 trailed the benchmark for the quarter, primarily due to stock selection in the consumer discretionary, information technology, energy and healthcare sectors. The portfolio underperformed the one-year benchmark due to positions in technology, healthcare and telecommunication services.

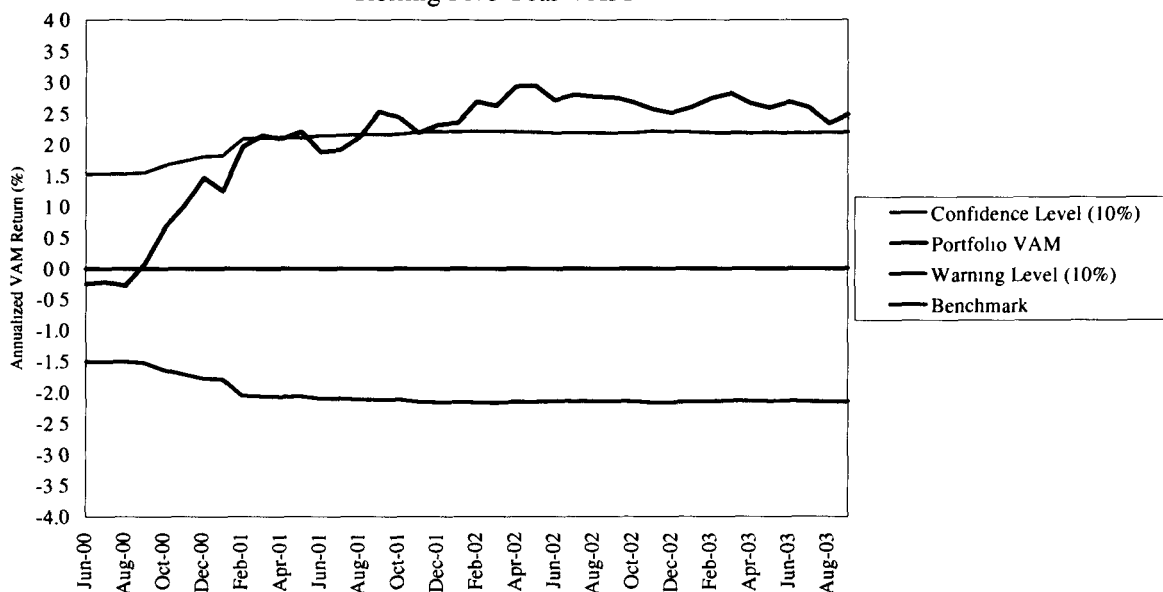
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.7%	2.6%
Last 1 year	20.4	24.4
Last 2 years	-0.9	-0.5
Last 3 years	-7.0	-10.1
Last 4 years	-2.1	-4.8
Last 5 years	3.5	1.0
Since Inception (1/95)	12.4	11.1

**Recommendation**

No recommendation at this time.

**GE INVESTMENT MANAGEMENT**  
**Rolling Five Year VAM**



5 Year Period Ending

**VOYAGEUR ASSET MANAGEMENT - Assigned Risk Plan**  
**Periods Ending September, 2003**

**Portfolio Manager: Tom McGlinch**

**Assets Under Management: \$178,080,515**

**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 outperformed for the quarter and the year. The quarterly performance was helped by the portfolio duration being shorter than the benchmark.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	0.1%	0.0%
Last 1 year	3.7	3.5
Last 2 years	5.1	5.8
Last 3 years	6.9	7.9
Last 4 years	6.6	7.6
Last 5 years	5.7	6.5
Since Inception (7/91)	7.2	7.3

**Recommendation**

No action required

\*Custom benchmark since inception date

**VAM Graph will be drawn for period ending 3/31/04.**

**GALLIARD CAPITAL MANAGEMENT**  
**Periods Ending September, 2003**

**Portfolio Manager: Karl Tourville**

**Assets Under Management: \$142,259,290**

**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.

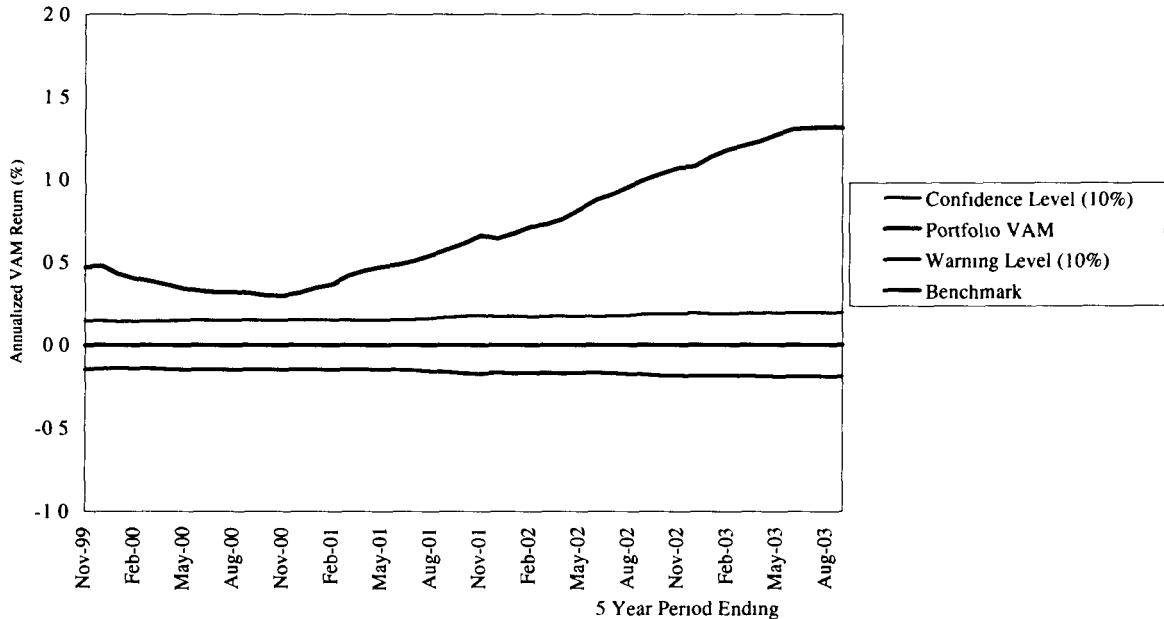
No comments at this time.

**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	1.1%	0.7%	No action required.
Last 1 year	4.9	2.5	
Last 2 years	5.5	3.0	
Last 3 years	5.7	3.6	
Last 4 years	5.9	4.4	
Last 5 years	5.9	4.6	
Since Inception (11/94)	6.3	5.3	

**GALLIARD CAPITAL MANAGEMENT**  
**Rolling Five Year VAM**





**INTERNAL STOCK POOL - Trust/Non-Retirement Assets**  
**Periods Ending September, 2003**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$534,623,803**

**Investment Philosophy**  
**Environmental Trust Fund**  
**Permanent School Fund**

**Staff Comments**

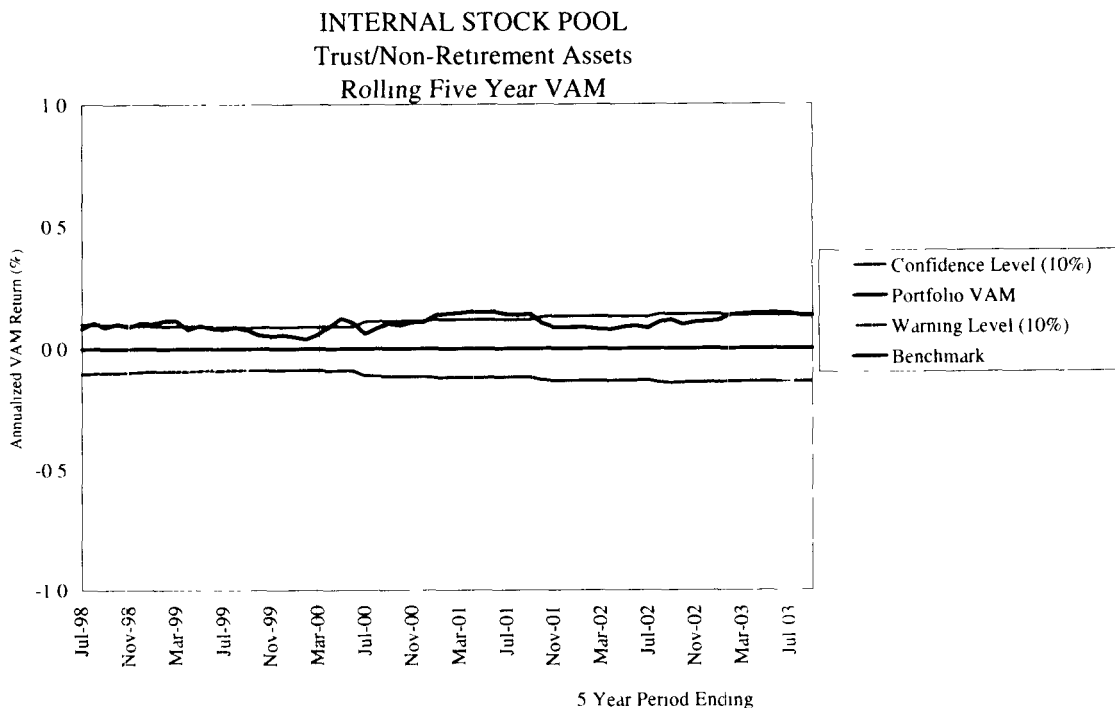
The Internal Equity Pool is managed to closely track the S&P 500 Index. The strategy replicates the S&P 500 by owning all of the names in the index at weightings similar to those of the index. The optimization model's estimate of tracking error with this strategy is approximately 10 basis points per year

The portfolio had positive tracking error for the quarter and 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	2.7%	2.6%	No action required
Last 1 year	24.5	24.4	
Last 2 years	-0.4	-0.5	
Last 3 years	-10.0	-10.1	
Last 4 years	-4.7	-4.8	
Last 5 years	1.1	1.0	
Since Inception (7/93)	10.2	10.1	



**INTERNAL BOND POOL - Income Share Account**  
**Periods Ending September, 2003**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$200,780,211**

**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 BBB portion of the corporate sector and an overweight to mortgages helped the one-year outperformance.

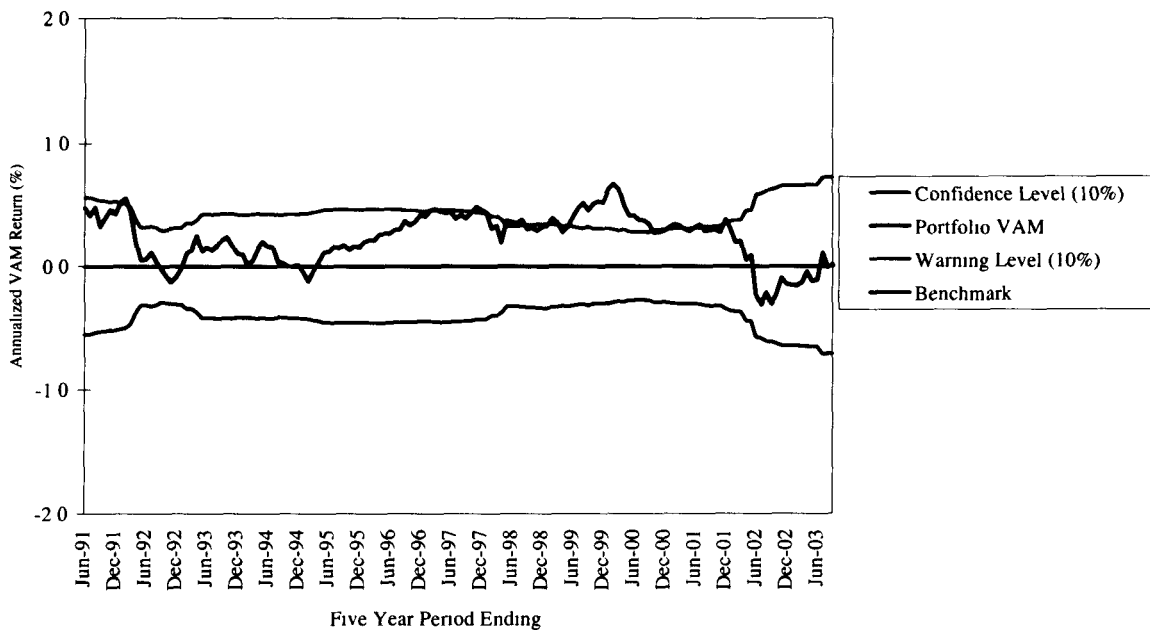
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.6%	-0.1%
Last 1 year	7.5	5.4
Last 2 years	6.8	7.0
Last 3 years	8.9	8.9
Last 4 years	8.4	8.5
Last 5 years	6.6	6.6
Since Inception (7/86)	8.6	8.3

**Recommendation**

No action required.

**INTERNAL BOND POOL - INCOME SHARE ACCOUNT**  
**Rolling Five Year VAM**



**INTERNAL BOND POOL - Trust/Non-Retirement Assets**  
**Periods Ending September, 2003**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$367,349,264**

**Investment Philosophy**  
**Environmental Trust Fund**  
**Permanent School Trust Fund**

**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 BBB portion of the corporate sector and an overweight to mortgages helped the one-year outperformance

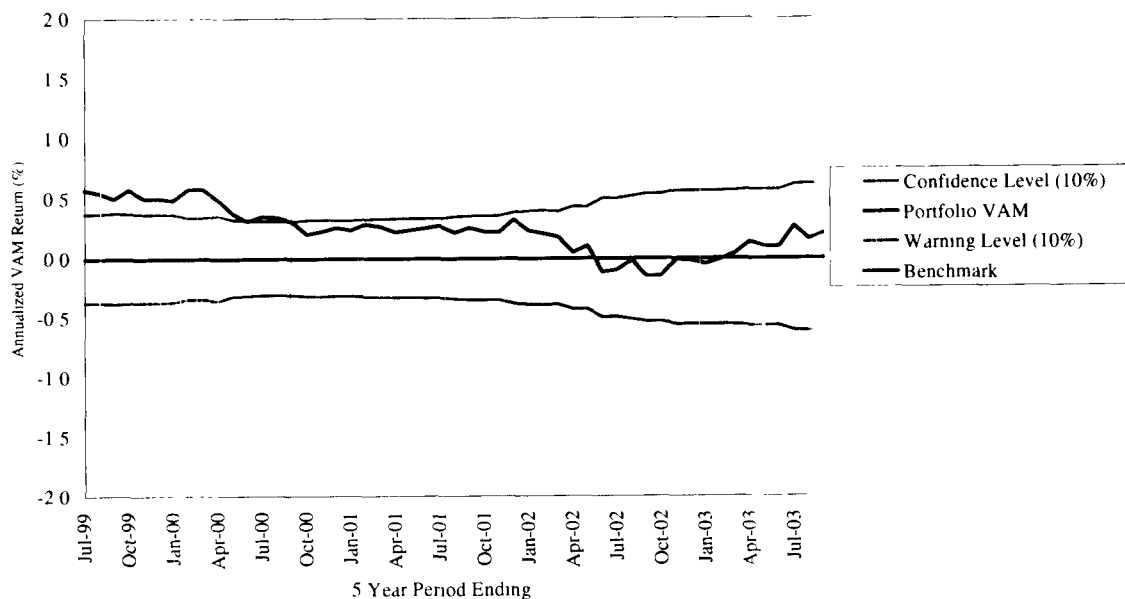
**Quantitative Evaluation**

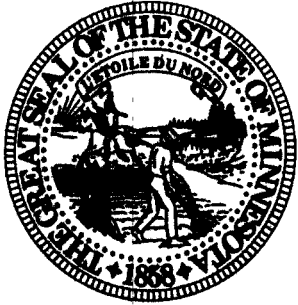
**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	0.2%	-0.1%	No action required
Last 1 year	7.4	5.4	
Last 2 years	7.1	7.0	
Last 3 years	9.1	8.9	
Last 4 years	8.6	8.5	
Last 5 years	6.8	6.6	
Since Inception (7/94)*	8.3	8.0	

\* Date started managing the Permanent School Fund against the Lehman Aggregate

**INTERNAL BOND POOL - TRUST/NON-RETIREMENT ASSETS**  
**Rolling Five Year VAM**





# STATE BOARD OF INVESTMENT

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## Deferred Compensation Plan Evaluation Reports

Third Quarter, 2003

**MN STATE 457 DEFERRED COMPENSATION PLAN**  
**MUTUAL FUND MANAGERS**  
**Periods Ending September, 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)**	1.2	2.6	17.2	24.4	-23.0	-10.1	-2.5	1.0	-12.1	-5.9	\$224.8
<b>Mid Cap Equity:</b>											
Morgan Stanley Mid-Cap Value Instl. (S&P Mid-Cap 400)	6.6	6.5	33.9	26.7	-5.5	-0.2	7.1	12.4	-6.5	1.5	\$16.96
<b>Small Cap Equity:</b>											
T. Rowe Price Small-Cap Stock (Russell 2000)**	4.9	9.1	24.7	36.5	2.3	-0.8	10.5	7.5	7.8	2.9	\$266.2
<b>Equity Index:</b>											
Vanguard Institutional Index Plus (S&P 500)**	2.6	2.6	24.4	24.4	-10.1	-10.1	1.1	1.0	-5.9	-5.9	\$182.3
<b>Balanced:</b>											
INVESCO Total Return (60% S&P 500/40% Lehman Gov-Corp)**	1.4	1.6	14.6	16.8	-1.6	-2.4	-0.3	3.1	-4.0	-0.7	\$89.0
<b>Bond:</b>											
Dodge & Cox Income Fund (Lehman Aggregate)**	0.5	-0.1	7.4	5.4	10.1	8.9	7.3	6.6	8.7	8.1	\$76.0
<b>International:</b>											
Fidelity Diversified International (MSCI EAFE-Free)**	9.6	8.1	31.1	26.0	-1.6	-8.7	9.0	0.6	4.8	-4.5	\$94.7

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***	5.3
Bid Rates for current quarter:	
Great West Life	2.7
Minnesota Life	2.6
Principal Life	2.9

\*\*\*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 September, 2003**

**Portfolio Manager: Scott W. Schoelzel**

**State's Participation in Fund: \$224,793,405  
Total Assets in Fund: \$9,762,800,000**

**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 underperformed the quarterly and one-year benchmark. The portfolio was hurt by its holdings in the financial and energy sectors.

**Quantitative Evaluation**

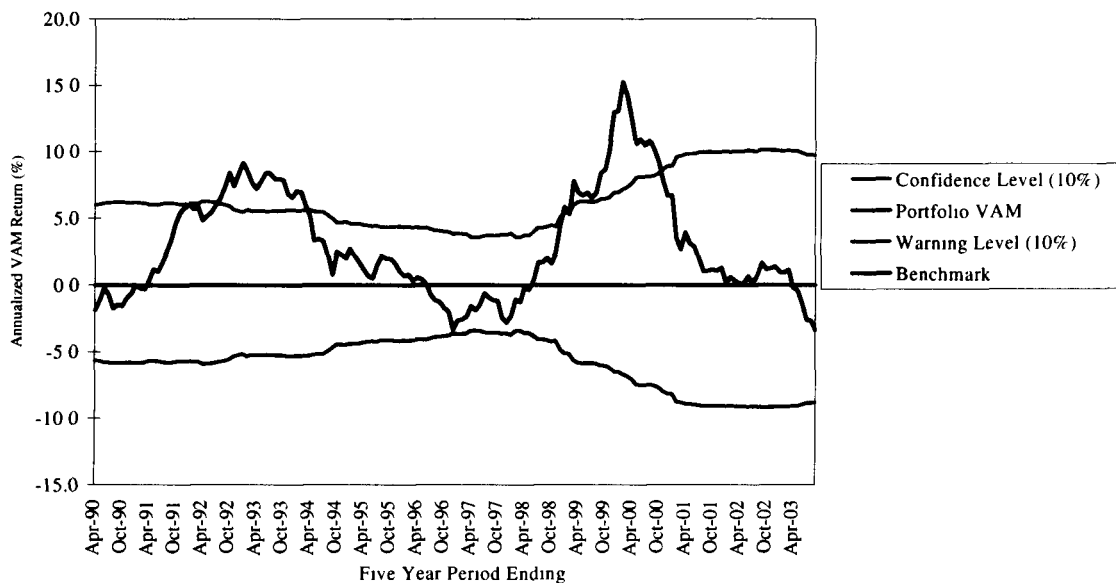
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	1.2%	2.6%
Last 1 year	17.2	24.4
Last 2 years	-2.8	-0.5
Last 3 years	-23.0	-10.1
Last 4 years	-13.1	-4.8
Last 5 years	-2.5	1.0
Since Retention by SBI (7/99)	-12.1	-5.9

**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 September, 2003**

**Portfolio Manager: James Gilligan**

**State's Participation in Fund: \$16,962,567  
Total Assets in Fund: \$542,400,000**

**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 outperformed the benchmark for the quarter and one-year periods. The portfolio was helped by stock selection within the technology, utilities, and financial services sectors.

Morgan Stanley announced on October 1<sup>st</sup> that the portfolio manager (William Gerlach) and his team were terminated on September 30<sup>th</sup>. The new portfolio manager is James Gilligan and the fund will now be managed against the Russell Midcap Value Index.

**Quantitative Evaluation**

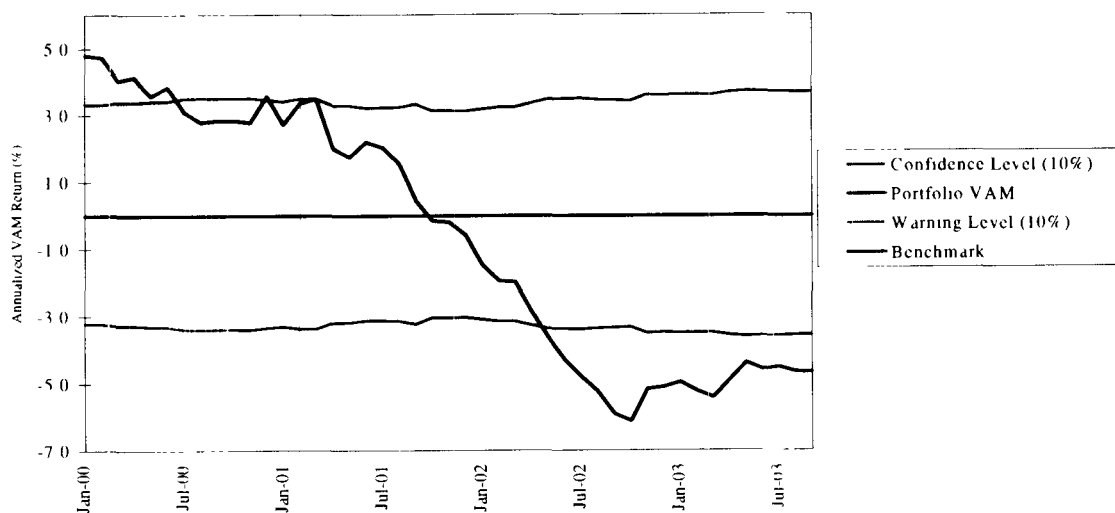
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	6.6%	6.5%
Last 1 year	33.9	26.7
Last 2 years	3.4	10.1
Last 3 years	-5.5	-0.2
Last 4 years	2.2	9.4
Last 5 years	7.1	12.4
Since Retention		
By SBI	-6.5	1.5
(1/02)		

**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**



Five Year Period Ending  
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 September, 2003**

**Portfolio Manager: Gregory A. McCrickard**

**State's Participation in Fund: \$266,160,207  
Total Assets in Fund: \$4,437,830,000**

**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 underweighting the telecom sector and overweighting energy, materials and industrials sectors. The one-year underperformance was due to stock selection.

**Quantitative Evaluation**

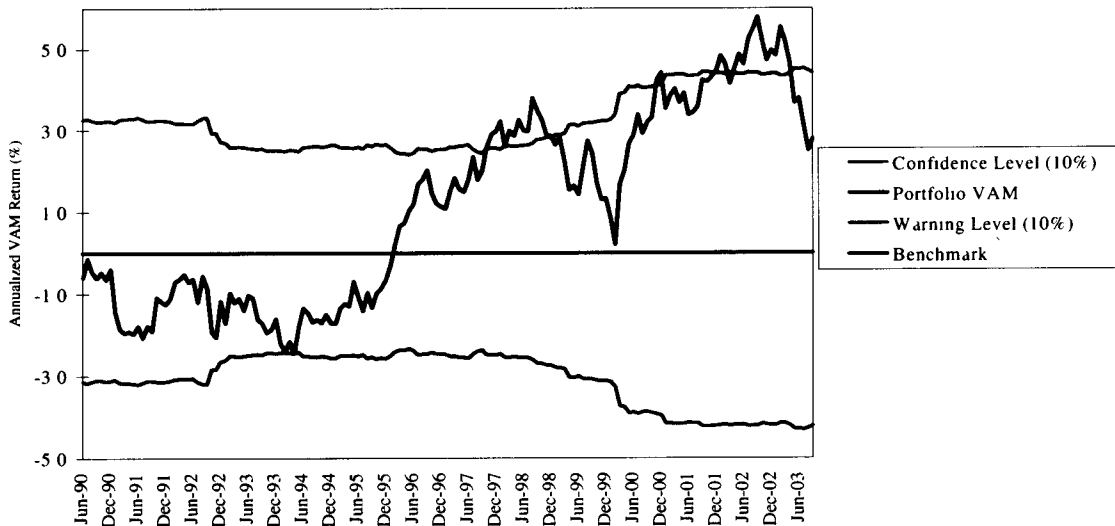
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	4.9%	9.1%
Last 1 year	24.7	36.5
Last 2 years	9.2	11.3
Last 3 years	2.3	-0.8
Last 4 years	9.0	4.8
Last 5 years	10.5	7.5
Since Retention by SBI (7/99)	7.8	2.9

**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**



Note Shaded area includes performance prior to managing SBI account



**MN STATE 457 DEFERRED COMPENSATION PLAN  
EQUITY INDEX – VANGUARD INSTITUTIONAL INDEX PLUS  
Periods Ending September, 2003**

**Portfolio Manager: George U. Sauter**

**State's Participation in Fund: \$182,330,701  
Total Assets in Fund: \$9,837,000,000**

**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 comments at this time

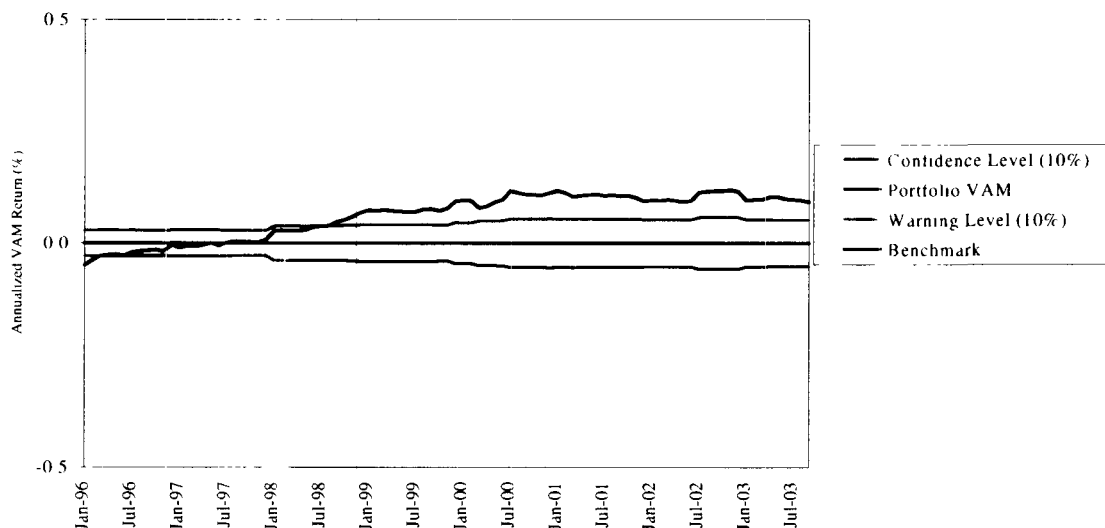
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>	
Last Quarter	2.6%	2.6%	No action required
Last 1 year	24.4	24.4	
Last 2 years	-0.5	-0.5	
Last 3 years	-10.1	-10.1	
Last 4 years	-4.7	-4.8	
Last 5 years	1.1	1.0	
Since Retention by SBI (7/99)	-5.9	-5.9	

**Recommendation**

\*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.

**EQUITY INDEX - VANGUARD INSTITUTIONAL INDEX  
Rolling Five Year VAM**



Note: Shaded area includes performance prior to managing SBI account

**MN STATE 457 DEFERRED COMPENSATION PLAN  
BALANCED – INVESCO TOTAL RETURN  
Periods Ending September, 2003**

**Portfolio Manager: Charlie Mayer**

**State's Participation in Fund: \$89,042,767  
Total Assets in Fund: \$768,584,878**

**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 holdings in the healthcare sector were the largest detractor to fund performance.

The Board approved the termination of INVESCO at its September 3<sup>rd</sup>, 2003 meeting. Dodge and Cox Balanced Fund will replace INVESCO on November 20, 2003.

**Quantitative Evaluation**

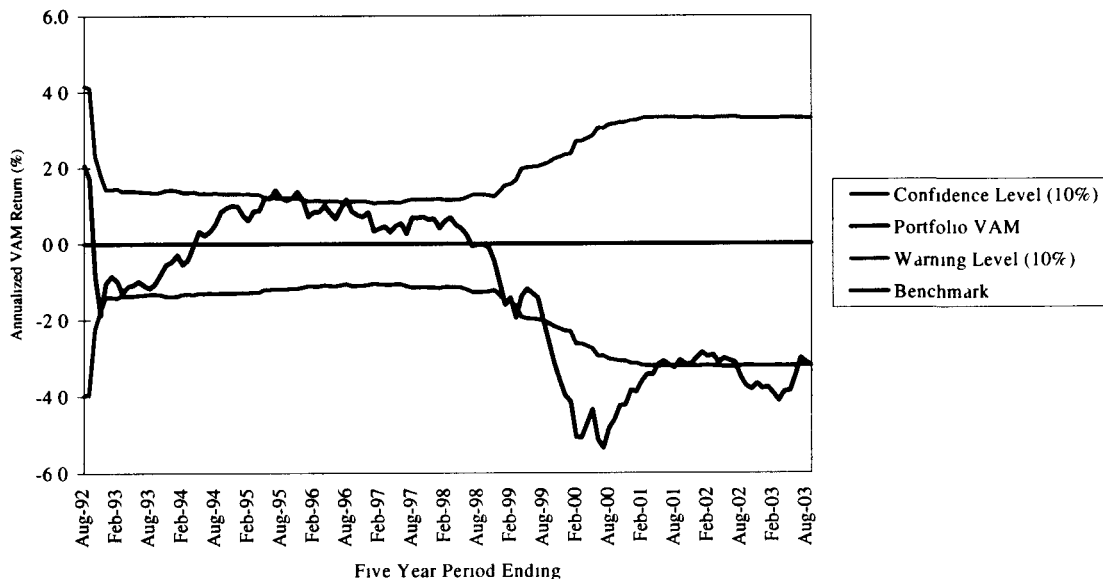
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	1.4%	1.6%
Last 1 year	14.6	16.8
Last 2 years	0.7	2.9
Last 3 years	-1.6	-2.4
Last 4 years	-2.1	0.2
Last 5 years	-0.3	3.1
Since Retention by SBI (7/99)	-4.0	-0.7

**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 September, 2003**

**Portfolio Manager: Dana Emery**

**State's Participation in Fund: \$75,993,194  
Total Assets in Fund: \$5,125,456,017**

**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**

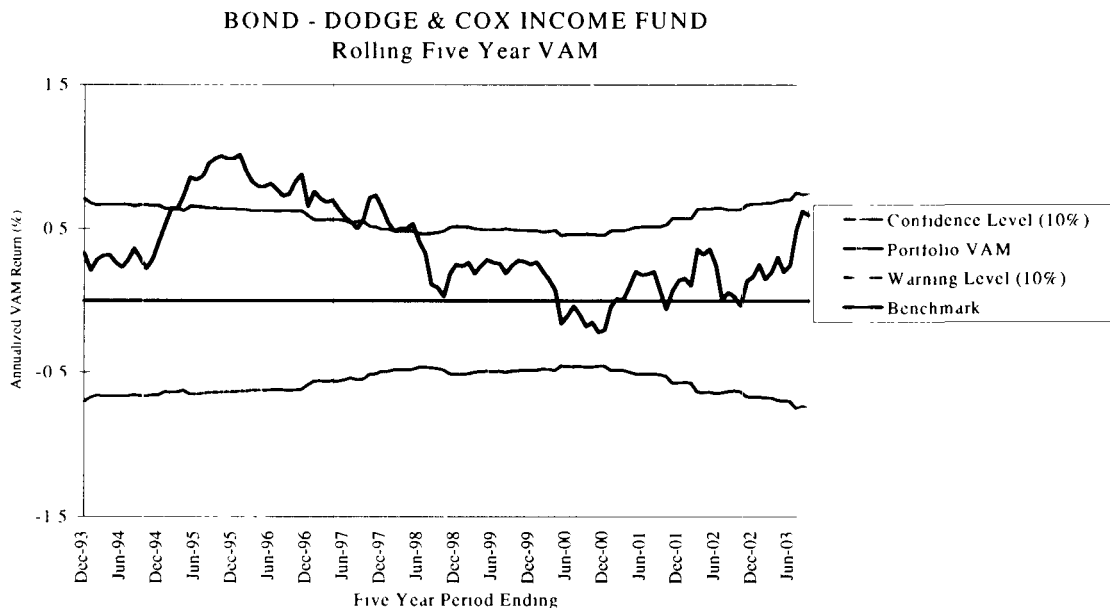
Dodge and Cox outperformed the benchmark for the quarter and the year. The outperformance for both periods was helped by the portfolio's shorter-than-benchmark duration position as well as an overweight position in corporate securities.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>	
Last Quarter	0.5%	-0.1%	No action required
Last 1 year	7.4	5.4	
Last 2 years	8.1	7.0	
Last 3 years	10.1	8.9	
Last 4 years	9.2	8.5	
Last 5 years	7.3	6.6	
Since Retention By SBI (7/99)	8.7	8.1	

**Recommendation**

\*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 September, 2003**

**Portfolio Manager: William Bower**

**State's Participation in Fund: \$94,693,359  
Total Assets in Fund: \$10,513,910,000**

**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 information technology sector. The one-year outperformance was due to the strong stock selection in the consumer discretionary stocks.

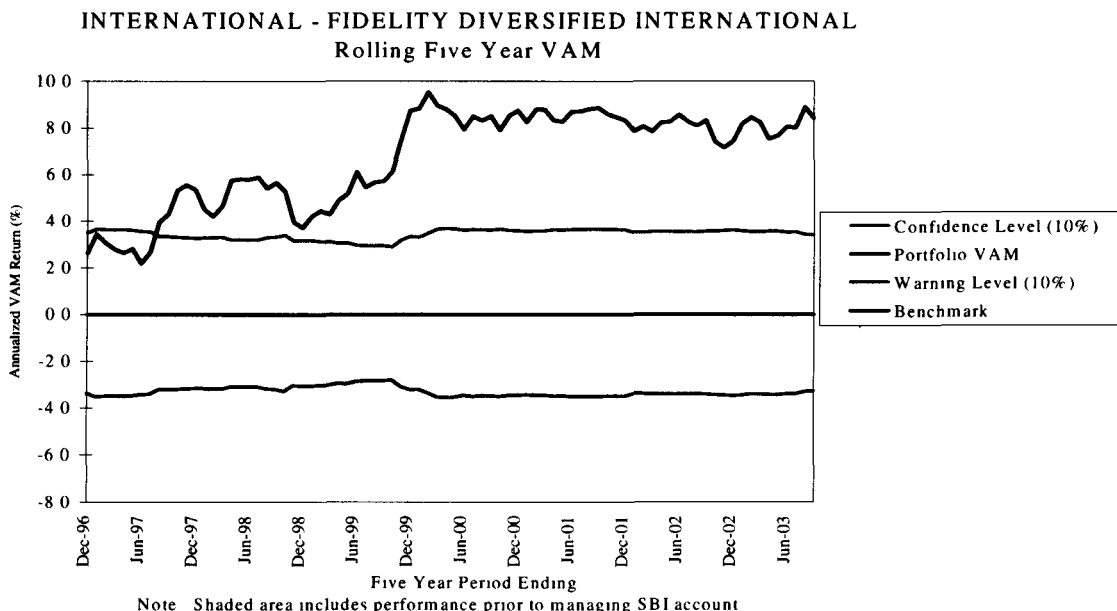
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	9.6%	8.1%
Last 1 year	31.1	26.0
Last 2 years	10.6	3.3
Last 3 years	-1.6	-8.7
Last 4 years	3.7	-5.8
Last 5 years	9.0	0.6
Since Retention		
By SBI	4.8	-4.5
(7/99)		

**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 September, 2003**

**Total Assets in MN Fixed Fund: \$483,359,143 \***  
\*Includes \$14-18M in Liquidity Buffer Account

**Total Assets in 457 Plan: \$651,960,843 \*\***  
\*\*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+

**Assets in MN Fixed Fund: \$106,460,779**

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.

**Minnesota Life**

**Investment Philosophy**

**Ratings:** Moody's           Aa2  
              S&P                 AA  
              A.M. Best           A++  
              Duff & Phelps       AA+

**Assets in MN Fixed Fund: \$118,941,729**

**Assets in Prior MN 457 Plan: \$61,656,316**

**Total Assets: \$180,598,045**

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.

**Great-West Life**

**Investment Philosophy**

**Ratings:** Moody's           Aa2  
              S&P                 AA+  
              A.M. Best           A++  
              Duff & Phelps       AAA

**Assets in MN Fixed Fund: \$84,164,654**

**Assets in Prior MN 457 Plan: \$106,945,383**

**Total Assets: \$191,110,037**

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.

**MN STATE 457 DEFERRED COMPENSATION PLAN  
MN FIXED FUND  
Periods Ending September, 2003**

**Current Quarter**

**Dollar Amount of Bid: \$31,400,000**

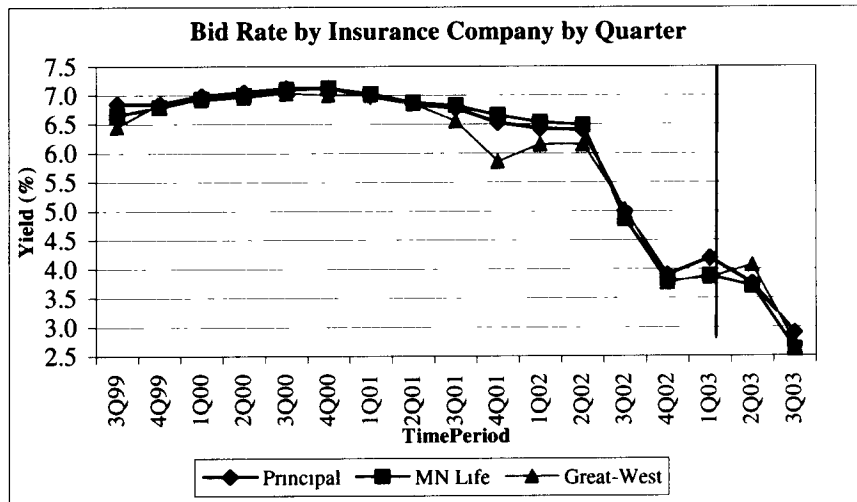
**Blended Rate: 5.30%**

**Bid Rates:**

Principal Life	2.90%	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	2.61%	
Great-West Life	2.70%	

**Dollar Amount in existing  
Minnesota Life portfolio: \$61,656,316**

**Rate on existing  
Minnesota Life portfolio: 5.30 %**



**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>4Q02</b>	<b>1Q03</b>	<b>2Q03</b>	<b>3Q03</b>	For the third quarter, Principal received 75% of the bid dollars and Great-West received 25%.
Principal Life	40.0%	100.0%	0.0%	75.0%	
Minnesota Life	30.0%	0.0%	0.0%	0.0%	
Great-West Life	30.0%	0.0%	100.0%	25.0%	

# Tab F

## **COMMITTEE REPORT**

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DATE: November 25, 2003

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

FROM: **Alternative Investment Committee**

The Alternative Investment Committee met on November 14, 2003 to review the following information and action agenda items:

- Review of current strategy
- Alternative investment asset allocation
- New investments with two existing managers, Merit Energy and First Reserve and a new manager, Silver Lake.

**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 12% of the Post Retirement Fund are allocated to alternative investments. Alternative investments include real estate, resource, yield-oriented and private equity 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**).

- 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, which includes leveraged buyouts and venture capital, 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 investments is to establish and maintain a portfolio of resource investment vehicles that provide an inflation hedge and additional diversification. Resource investments will include oil and gas investments, energy service industry investments and other investments that are diversified geographically and by type.
- The strategy for yield-oriented investments will target funds that typically provide a current return and may have an equity component such as subordinated debt or mezzanine investments. Yield-oriented investments will provide diversification by including investments in the private equity, resource and real estate categories.

## 2) **Alternative Investment Asset Allocation**

The Committee discussed the recently approved asset allocation study and the impact on the alternative investment portfolio. The review included anticipated deal flow from current and potential managers, level of commitments over the next 4-5 years, and distributions from current managers.

## **ACTION ITEMS**

### 1) **Investment with an existing resource manager, First Reserve, in First Reserve Fund X, L.P.**

First Reserve is seeking investors for a new \$2 billion resource fund. This fund is a successor to other similar resource funds managed by First Reserve. The SBI has invested in seven prior First Reserve funds. This fund, like the prior funds, will seek to earn attractive returns through investments in broadly diversified resource investments.

More information on First Reserve Fund X 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 \$100 million or 20%, whichever is less, in First Reserve Fund X L.P. 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 First Reserve 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 First Reserve or reduction or termination of the commitment.**

**2) Investment with an existing yield-oriented resource manager, Merit Energy, in Merit Energy Fund E, L.P.**

Merit Energy is seeking investors for a new \$750 million yield-oriented resource fund. This fund is a successor to other similar yield-oriented resource funds managed by Merit Energy. The SBI has invested in three prior Merit Energy funds. This fund, like the prior funds, will seek to earn attractive returns through investments in producing oil and gas properties.

More information on Merit Energy Fund E, 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 \$100 million or 20%, whichever is less, in Merit Energy Fund E, L.P. 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 Merit Energy 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 Merit Energy or reduction or termination of the commitment.**

**2) Investment with a new private equity manager, Silver Lake, in Silver Lake Partners II, L.P.**

Silver Lake is seeking investors for a new \$3.0 billion private equity fund. This fund is a successor to the other private equity fund managed by Silver Lake. This fund, like the prior fund, will seek to earn attractive returns through private equity investments in technology companies.

More information on Silver Lake Partners II, L.P. is included as **Attachment E**.

**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 \$100 million or 20%, whichever is less, in Silver Lake Partners II, L.P. 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 Silver Lake 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 Silver Lake or reduction or termination of the commitment.**

**ATTACHMENT A**

**Minnesota State Board of Investment**  
*Pooled Alternative Investments*  
*Combined Retirement Funds*  
*September 30, 2003*

Basic Retirement Funds Market Value	\$16,951,399,364
Post Retirement Fund Market Value	\$16,922,484,175
 Amount Available for Investment	 <b>\$1,483,539,001</b>

	<b>Current Level</b>	<b>Target Level*</b>	<b>Difference</b>
Market Value (MV)	\$3,089,869,005	\$4,573,408,006	\$1,483,539,001
MV +Unfunded	\$4,609,897,763	\$6,860,112,008	\$2,250,214,246

\* Target Level reflects the asset allocation approved by the Board at the Sep. 3, 2003 meeting.

<b>Asset Class</b>	<b>Market Value</b>	<b>Unfunded Commitment</b>	<b>Total</b>
Private Equity	\$1,472,516,949	\$954,963,328	\$2,427,480,277
Real Estate	\$649,497,855	\$37,373,271	\$686,871,126
Resource	\$256,667,597	\$58,526,768	\$315,194,366
Yield-Oriented	\$711,186,604	\$469,165,390	\$1,180,351,994
<b>Total</b>	\$3,089,869,005	\$1,520,028,757	\$4,609,897,763

# ATTACHMENT B

## Minnesota State Board of Investment - Alternative Investments -

As of September 30, 2003

Investment	Total Commitment	Funded Commitment	Market Value	Distributions	Unfunded Commitment	IRR %	Period Years
<b>Real Estate</b>							
<b>Colony Capital</b>							
<i>Colony Investors II</i>	80,000,000	78,482,328	3,736,798	82,262,200	1,517,672	3.42	8.50
<i>Colony Investors III</i>	100,000,000	100,000,000	48,299,916	78,039,470	0	9.02	5.75
<b>Equity Office Properties Trust</b>	140,388,854	140,388,854	108,499,646	237,822,602	0	15.30	11.84
<b>Heltman Advisory Fund V</b>	20,000,000	20,000,000	1,128,586	34,333,873	0	8.57	11.82
<b>Lasalle Income Parking Fund</b>	15,000,000	14,644,401	4,605,585	24,123,687	355,599	11.37	12.03
<b>Lend Lease Real Estate Investments</b>	40,000,000	40,000,000	148,939,082	5,673,901	0	6.50	21.97
<b>T.A. Associates Realty</b>							
<i>Realty Associates Fund III</i>	40,000,000	40,000,000	41,760,111	43,497,869	0	12.10	9.33
<i>Realty Associates Fund IV</i>	50,000,000	50,000,000	54,765,592	31,913,201	0	12.00	6.66
<i>Realty Associates Fund V</i>	50,000,000	50,000,000	52,725,815	13,527,616	0	9.12	4.35
<i>Realty Associates Fund VI</i>	50,000,000	14,500,000	14,667,519	543,123	35,500,000	8.80	1.26
<b>UBS Realty</b>	42,376,529	42,376,529	170,061,896	0	0	7.24	21.42
<b>Funds in Liquidation (Heltman I &amp; II, REEF III)</b>	125,000,000	125,000,000	307,311	187,402,827	0		
<b>Real Estate Total</b>	752,765,383	715,392,112	649,497,855	739,140,370	37,373,271		
<b>Resource</b>							
<b>Apache Corp III</b>	30,000,000	30,000,000	6,517,110	48,143,396	0	12.14	16.75
<b>First Reserve</b>							
<i>First Reserve VII</i>	40,000,000	40,000,000	26,896,986	30,397,909	0	10.28	7.25
<i>First Reserve VIII</i>	100,000,000	100,000,000	98,053,109	52,022,105	0	13.54	5.42
<i>First Reserve IX</i>	100,000,000	56,109,885	55,128,916	0	43,890,115	-1.32	2.48
<b>Simmons</b>							
<i>Simmons - SCF Fund II</i>	17,000,000	14,706,629	5,067,795	29,659,989	2,293,371	10.42	12.15
<i>Simmons - SCF Fund III</i>	25,000,000	23,301,636	27,443,441	32,246,680	1,698,364	19.10	8.25
<i>Simmons - SCF Fund IV</i>	50,000,000	39,355,082	31,725,074	24,311,714	10,644,918	8.78	5.50
<b>T Rowe Price</b>	21,888,430	21,888,430	5,442,000	10,154,374	0	-23.33	N/A
<b>Funds in Liquidation (First Reserve I, II &amp; V)</b>	38,800,000	38,800,000	393,166	79,693,851	0		
<b>Resource Total</b>	422,688,430	364,161,662	256,667,597	306,630,019	58,526,768		
<b>Yield Oriented</b>							
<b>Carbon Capital</b>	50,000,000	22,828,744	23,039,513	2,205,080	27,171,256	13.23	1.38
<b>CT Mezzanine Partners II</b>	100,000,000	37,119,363	25,622,675	21,483,702	62,880,637	19.15	2.02
<b>Churchill Capital Partners II</b>	20,000,000	20,000,000	2,801,642	24,772,705	0	10.43	10.92
<b>Citicorp Mezzanine</b>							
<i>Citicorp Mezzanine Partners</i>	40,000,000	40,000,000	10,671,241	44,176,104	0	10.73	8.75
<i>Citicorp Mezzanine III</i>	100,000,000	55,231,560	41,969,097	26,022,094	44,768,440	13.66	3.91
<b>DLJ Investment Partners II</b>	50,000,000	17,220,640	12,508,084	11,920,584	32,779,360	9.35	3.75
<b>GS Mezzanine Partners II</b>							
<i>GS Mezzanine Partners II</i>	100,000,000	91,429,405	82,954,422	11,517,309	8,570,595	2.64	3.58
<i>GS Mezzanine Partners III</i>	75,000,000	6,455,083	6,455,083	0	68,544,917	N/A	0.22
<b>GTCR Capital Partners</b>	80,000,000	69,589,422	51,523,608	27,816,141	10,410,578	5.51	3.88
<b>GMAC Institutional Advisors</b>							
<i>Institutional Commercial Mortgage Fd II</i>	13,500,000	13,397,500	4,638,501	16,577,058	102,500	9.76	8.18
<i>Institutional Commercial Mortgage Fd III</i>	21,500,000	21,275,052	19,483,719	12,793,438	224,948	8.73	6.83
<i>Institutional Commercial Mortgage Fd IV</i>	14,300,000	14,300,000	13,279,689	6,513,138	0	8.26	5.75
<i>Institutional Commercial Mortgage Fd V</i>	37,200,000	37,200,000	36,304,699	10,030,145	0	8.72	4.16
<b>KB Mezzanine Partners Fund II</b>	25,000,000	24,999,999	5,326,133	7,151,873	1	-17.52	8.00
<b>Merit Energy Partners</b>							
<i>Ment Energy Partners B</i>	24,000,000	24,000,000	29,765,321	17,405,297	0	16.11	7.25
<i>Ment Energy Partners C</i>	50,000,000	38,582,111	61,226,638	6,455,320	11,417,889	20.47	4.92
<i>Ment Energy Partners D</i>	88,000,000	51,667,581	54,836,910	1,477,056	36,332,419	8.12	2.35
<b>Prudential Capital Partners</b>	100,000,000	48,164,760	46,517,573	6,285,910	51,835,240	5.76	2.45
<b>Summit Partners</b>							
<i>Summit Sub Debt Fund I</i>	20,000,000	18,000,000	396,794	30,985,377	2,000,000	30.54	9.50
<i>Summit Sub Debt Fund II</i>	45,000,000	29,250,000	15,057,467	57,201,346	15,750,000	59.46	6.16
<b>T Rowe Price</b>	52,990,378	52,990,378	144,000	51,844,812	0	-11.65	N/A
<b>TCW/Crescent Mezzanine</b>							
<i>TCW/Crescent Mezzanine Partners</i>	40,000,000	36,756,265	14,358,476	39,796,200	3,243,735	14.20	7.50
<i>TCW/Crescent Mezzanine Partners II</i>	100,000,000	87,479,046	35,237,396	78,279,171	12,520,954	10.48	4.85
<i>TCW/Crescent Mezzanine Partners III</i>	75,000,000	36,291,645	36,041,032	8,622,760	38,708,355	17.73	2.50
<b>William Blair Mezz Fund III</b>	60,000,000	49,101,600	47,754,442	5,270,400	10,898,400	3.62	3.75
<b>Windjammer Mezz &amp; Equity Fund II</b>	66,708,861	35,703,695	33,272,451	3,141,730	31,005,167	1.32	3.50
<b>Yield Oriented Total</b>	1,448,199,239	979,033,849	711,186,604	529,744,751	469,165,390		

Minnesota State Board of Investment  
- Alternative Investments -

As of September 30, 2003

Investment	Total Commitment	Funded Commitment	Market Value	Distributions	Unfunded Commitment	IRR %	Period Years
<b>Private Equity</b>							
<b>Bank Fund</b>							
Banc Fund IV	25,000,000	25,000,000	21,425,715	26,861,110	0	13.36	7.62
Banc Fund V	48,000,000	48,000,000	59,405,328	8,864,743	0	11.77	5.21
<b>Blackstone Capital Partners</b>							
Blackstone Capital Partners II	50,000,000	47,271,190	18,239,473	75,404,281	2,728,810	33.88	9.85
Blackstone Capital Partners IV	70,000,000	4,637,068	4,636,998	205	65,362,932	-3.66	1.22
<b>BLUM Capital Partners</b>							
Blum Strategic Partners I	50,000,000	48,772,544	37,035,922	25,628,479	1,227,456	3.49	4.77
Blum Strategic Partners II	50,000,000	28,481,540	20,884,344	6,130,749	21,518,460	-3.87	2.20
Citigroup Venture Capital Partners	100,000,000	41,945,829	41,755,665	9,560,469	58,054,171	16.87	1.80
Contrarian Capital Fund II	37,000,000	33,244,395	28,834,431	9,247,000	3,755,605	2.42	6.33
<b>Coral Partners</b>							
Coral Partners Fund II	10,000,000	8,069,315	557,711	36,355,746	1,930,685	24.94	13.18
Coral Partners Fund IV	15,000,000	15,000,000	5,545,470	10,744,034	0	2.19	9.19
Coral Partners Fund V	15,000,000	14,250,000	7,673,806	152,481	750,000	-16.21	5.29
<b>Crescendo</b>							
Crescendo II	15,000,000	15,000,000	2,360,367	20,347,039	0	23.62	6.74
Crescendo III	25,000,000	25,000,000	3,848,450	8,084,795	0	-28.42	4.90
Crescendo IV	101,500,000	73,587,500	23,452,704	292,567	27,912,500	-37.60	3.56
<b>DLJ/CSFB</b>							
DLJ Merchant Banking Partners III	125,000,000	77,942,983	72,288,980	12,760,247	47,057,017	0.89	3.00
DLJ Strategic Partners	100,000,000	67,713,566	52,700,552	23,660,909	32,286,434	8.47	2.69
CSFB Strategic Partners II	100,000,000	20,000,000	20,000,000	0	80,000,000	N/A	0.20
DSV Partners IV	10,000,000	10,000,000	1,262,211	27,596,934	0	9.51	18.47
First Century Partners III	10,000,000	10,000,000	1,124,312	14,955,832	0	8.06	18.79
<b>Fox Paine Capital Fund</b>							
Fox Paine Capital Fund	40,000,000	40,000,000	40,557,360	0	0	0.36	5.44
Fox Paine Capital Fund II	50,000,000	30,264,520	27,005,365	0	19,735,480	-18.59	3.25
<b>Golder, Thoma, Cressey, Rauner</b>							
Golder, Thoma, Cressey Fund III	14,000,000	14,000,000	4,362,194	55,950,902	0	30.13	15.92
Golder, Thoma, Cressey & Rauner Fund V	30,000,000	30,000,000	17,035,761	25,515,734	0	8.40	7.25
<b>GTCR Golder Rauner</b>							
GTCR Fund VI	90,000,000	89,137,778	39,914,838	49,263,209	862,222	0.02	5.25
GTCR Fund VII	175,000,000	122,718,750	99,130,879	34,299,153	52,281,250	4.89	3.64
GS Capital Partners 2000	50,000,000	29,332,741	26,162,778	1,311,795	20,667,259	-4.77	3.08
<b>Hellman &amp; Friedman</b>							
Hellman & Friedman Capital Partners III	40,000,000	32,113,684	4,649,987	58,909,871	7,886,316	33.48	9.03
Hellman & Friedman Capital Partners IV	150,000,000	85,555,064	61,770,080	36,659,565	64,444,936	13.12	3.75
<b>Kohlberg Kravis Roberts</b>							
KKR 1986 Fund	18,365,339	18,365,339	13,336,700	202,833,867	0	28.06	17.46
KKR 1987 Fund	145,950,000	145,373,652	63,604,889	333,688,629	576,348	8.82	15.85
KKR 1993 Fund	150,000,000	150,000,000	28,119,290	267,383,941	0	16.35	9.78
KKR 1996 Fund	200,000,000	200,000,000	157,541,852	125,962,434	0	9.48	7.08
KKR Millennium Fund	200,000,000	13,368,000	12,608,000	774,670	186,632,000	N/A	0.81
GHJM Marathon Fund IV	40,000,000	32,481,000	23,299,651	10,640,000	7,519,000	-1.38	4.46
<b>Piper Jaffray Healthcare</b>							
Piper Jaffray Healthcare Fund II	10,000,000	9,900,000	7,109,716	1,648,415	100,000	-2.77	6.58
Piper Jaffray Healthcare Fund III	20,000,000	18,400,000	11,277,948	1,894,843	1,599,998	-11.77	4.69
Piper Jaffray Healthcare Fund IV	10,000,000	1,414,366	1,414,366	0	8,585,634	N/A	0.01
<b>Summit Partners</b>							
Summit Ventures V	25,000,000	21,625,000	10,013,220	9,895,886	3,375,000	-3.02	5.50
T Rowe Price	559,695,631	559,695,631	48,001,897	522,610,022	0	4.63	N/A
<b>Thoma Cressey</b>							
Thoma Cressey Fund VI	35,000,000	33,915,000	19,448,663	6,017,637	1,085,000	-8.46	5.11
Thoma Cressey Fund VII	50,000,000	18,250,000	18,461,554	0	31,750,000	1.14	3.10
Thomas, Mc Nerney & Partners	30,000,000	3,900,000	3,241,419	0	26,100,000	N/A	0.90
Vestar Capital Partners IV	55,000,000	24,621,184	23,326,150	869,359	30,378,816	-0.94	3.79
<b>Warburg Pincus</b>							
Warburg Pincus Ventures	50,000,000	50,000,000	46,665,101	185,250,249	0	49.80	8.75
Warburg Pincus Private Equity VIII	100,000,000	33,000,000	30,678,825	3,446,150	67,000,000	2.05	1.46
Warburg, Pincus Equity Partners	100,000,000	100,000,000	65,468,557	35,026,455	0	0.18	5.26
<b>Welsh, Carson, Anderson &amp; Stowe</b>							
Welsh, Carson, Anderson & Stowe VIII	100,000,000	99,000,000	63,348,615	0	1,000,000	-11.18	5.19
Welsh, Carson, Anderson & Stowe IX	125,000,000	75,000,000	60,066,483	9,667,834	50,000,000	-4.51	3.26
William Blair Capital Partners	50,000,000	21,900,000	19,944,418	0	28,100,000	-7.15	2.56
Funds in Liquidation (Bnnsor I & II, GTCR IV, Matrx III, Summit I & II, Zell/Chillmark)	125,000,000	122,300,000	1,917,952	336,030,462	2,700,000	N/A	N/A
<b>Private Equity Total</b>	<b>3,794,510,970</b>	<b>2,839,547,641</b>	<b>1,472,516,949</b>	<b>2,632,218,701</b>	<b>954,963,328</b>		

## ATTACHMENT C

### RESOURCE MANAGER SUMMARY PROFILE

#### I. Background Data

<b>Name of Fund:</b>	First Reserve Fund X, L.P.
<b>Type of Fund:</b>	Resource Limited Partnership
<b>Total Fund Size:</b>	\$2 billion
<b>Fund Manager:</b>	First Reserve Corporation
<b>Manager Contact:</b>	Bill Macaulay One Lafayette Place Greenwich, CT 06830 (203) 661-6601

#### II. Organization and Staff

First Reserve Corporation ("First Reserve" or the "Firm") is forming First Reserve Fund X, L.P. ("Fund X" or the "Partnership") to make privately negotiated equity and equity-related investments in a diversified portfolio of energy companies. Throughout its 20-year history, First Reserve has focused exclusively on the energy industry in order to capitalize on its broad base of specialized industry knowledge. In nine previous Funds, First Reserve has made investments in over 80 entities, more than 40 of which were platform companies for further acquisitions. First Reserve has also funded more than 200 add-on acquisitions for these portfolio companies.

First Reserve is one of the oldest resource private equity firms in the country. The Firm, which has raised approximately \$3.0 billion in capital for investment in the energy industry, is led by William E. Macaulay as Chairman and Chief Executive Officer. Mr. Macaulay and 4 other Principals lead the Firm's 18 member investment team.

#### III. Investment Strategy

Fund X will pursue the same investment strategy the Principals employed to achieve the investment success of First Reserve's prior Equity Funds.

Fund X will target investments of \$50 million to \$200 million in middle-market energy companies with enterprise values of \$100 million to \$2 billion. The companies will generally have proven management teams, significant growth potential, strong market positions and multiple exit opportunities. The investments will also be focused on companies in which First Reserve will have significant influence through the Fund's ownership position, board representation and the Firm's industry and strategic expertise.

Fund X will focus on the energy industry and include investments in a broad range of segments within the energy industry including: (i) Oilfield Services, such as drilling service providers and wellhead equipment manufacturers; (ii) Energy Infrastructure and Power, such as firms that engineer liquefied natural gas and natural gas processing facilities or install and repair electric transmission systems; and (iii) Energy Reserves, such as natural gas and coal producers

#### **IV. Investment Performance**

Previous fund performance as of September 30, 2003 for the First Reserve funds, 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>
AmGo I	1981	\$144 million	\$15 million	0%
AmGo II	1983	\$36 million	\$7 million	6%
AmGo III	1986	\$17 million	0	7%
First Reserve SEA Fund	1988	\$63 million	\$12 million	14%
First Reserve Fund V	1990	\$84 million	\$17 million	16%
First Reserve Fund V-2	1990	\$34 million	0	15%
First Reserve Fund VI	1992	\$184 million	0	26%
First Reserve Fund VII	1996	\$244 million	\$40 million	10%
First Reserve Fund VIII	1998	\$812 million	\$100 million	14%
First Reserve Fund IX	2000	\$1.4 billion	\$100 million	-1%

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 and its affiliates will make a cash commitment of \$30 million.

#### **VI. Takedown Schedule**

Commitments are expected to be drawn down as needed during the Commitment Period, generally with not less than ten business days' prior written notice.

#### **VII. Fees**

Commencing on the date of the first investment, 1.36% of Committed Capital until the earlier of the end of the Commitment Period or the commencement of payment of a management fee on a Competing Fund, thereafter, the fee will be 1.25% of Invested Capital.

After offsetting expenses associated with transactions, the Partnership's allocable share of transaction and break-up fees will be credited 80% against the management fee.

The Partnership's allocable share of Directors' and Advisory Fees will be credited 100% against the management fee.

The Partnership will bear up to \$2 million of organizational expenses.

### ***VIII. Allocations and Distributions***

In general, investors will receive distributions in the following order of priority:

- a return of all investment costs, net of management fees and other expenses attributable to realized investments and write-downs; plus
- an 8% preferred return on the above amounts;

After which distributions will be made:

- 80% to the General Partner and 20% to the Limited Partners in proportion to funded Commitments as a "catch-up" until the General Partner has received its 20% carried interest; and thereafter
- 80% to Limited Partners in proportion to funded Commitments and 20% to the General Partner.

### ***IX. Investment Period and Term***

Generally, the Commitment period will be six years from the closing date of the first investment.

The term will be ten years from date of initial investment, subject to two consecutive one-year extensions.



<b>RESOURCE MANAGER SUMMARY PROFILE</b>
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**I. Background Data**

<b><i>Name of Funds:</i></b>	Merit Energy Partners E (EI, EII and EIII), L.P.
<b><i>Type of Funds:</i></b>	Resource Limited Partnerships
<b><i>Total Fund Size:</i></b>	\$750 million (EI, EII and EIII combined)
<b><i>Fund Manager:</i></b>	Merit Energy Company
<b><i>Manager Contact:</i></b>	William K. Gayden 13727 Noel Road, Suite 500 Dallas, TX 75240 Phone: (972) 701-8377 Fax: (972) 960-1252

**II. Organization & Staff**

Merit Energy Company was founded in 1989 by Bill Gayden as a private firm specializing in direct investments in oil and gas assets. Merit currently employs over 400 people, with operations in 13 states, the Gulf of Mexico and Canada, with net production of approximately 74,000 barrels of oil equivalent per day. Merit's proved reserves at June 30, 2003 amounted to approximately 301 million barrels of oil equivalent.

Currently, Merit manages eighteen oil and gas investment limited partnerships. These partnerships are long term in nature, emphasizing a focus on preservation of capital and the reinvestment of cash flow into property development, or additional acquisitions. Six partnerships are currently being liquidated by distributing all discretionary cash flow to the limited partners. Since inception, two other limited partnerships have been successfully liquidated.

**III. Investment Strategy**

Merit's investment focus is to acquire properties with proved developed reserves that provide acceptable rates of return in the twelve to fourteen percent range, assuming flat prices for oil and gas. To maintain a relatively low risk profile, Merit seeks to recover the majority of the value from the proved developed reserves while also allowing investors to benefit from any future development or higher commodity prices.

Merit operates a substantial percentage of its properties. By placing an emphasis on control of physical operations, Merit is able to use its engineering and geological expertise to control costs and be a low cost producer.

Merit Energy Fund E will actually be comprised of three funds (EI, EII and EIII). Funds I and II, will be structured for institutional investors and are essentially the same except for the potential use of leverage in Fund EII up to 35% of Fund EII assets. Fund III will be a small fund holding its assets as direct working interests suitable primarily for taxable investors and individuals.

#### **IV. Investment Performance**

Previous fund performance as of June 30, 2003 for Merit Energy Partners Funds with SBI participation 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>
Merit B	1996	\$130 million	\$24 million	16%
Merit C	1998	\$300 million	\$50 million	20%
Merit D	2000	\$465 million	\$88 million	8%

Previous Fund investments may be relatively immature and therefore, returns may not be indicative of future results.

#### **V. General Partners Investment**

3% of the Partnership's total program size will be provided by the General Partner.

#### **VI. Takedown Schedule**

Capital will be called as needed on 16 days' notice.

#### **VII. Fees**

The General Partner will receive an annual management fee of 1.25% on the greater of invested capital or book value up to the committed capital amount, and 1% on additional amounts (due to retained earnings). There will be a first year minimum amount due (0.5% of committed capital). In addition, the General Partner will be reimbursed at cost for its general and administrative expenses associated with managing the oil and gas properties and partnerships, allocated equitably among all of the partnerships the General Partner manages

### ***VIII. Allocations and Distributions***

Cash distributions are made annually for each fiscal year during the investment period (i) first, in an amount equal to 6% of the lesser of called capital commitments or actual capital account, and (ii) second, in an amount equal to the General Partner's carried interest (13% of annual profits). After the expiration of the investment period, beginning in year ten, 100% of available cash flow will be distributed to partners quarterly.

Allocations of profit will be made annually, generally as follows: (i) 100% to the capital contributing partners until they receive accumulative 8%, then (ii) 100% to the General Partner as a carried interest until it has received 13% of cumulative profits (after depletion) as a carried interest, then (iii) 87% to the capital contributing partners and 13% to the General Partner as a carried interest.

Working Interest Allocation: In addition to the 13% carried interest at the partnership level the General Partner will also be allocated a 2% carry at the working interest ownership level, which will bring the total carried interests to 15%. The majority of the General Partner's investment will also be at this level (2% of the total 3% General Partner investment).

### ***IX. Investment Period and Term***

Capital may be called for the first six years of the partnership, with a capital call notice of not less than 16 days. Reinvestment of cash flow is permitted for an additional three years. The term of each limited partnership is fifteen years from inception.

## ATTACHMENT E

### PRIVATE EQUITY MANAGER SUMMARY PROFILE

#### **I. Background Data**

<b><i>Name of Fund:</i></b>	Silver Lake Partners II, L.P. ("Fund II" or "the Partnership")
<b><i>Type of Fund:</i></b>	Private Equity Limited Partnership
<b><i>Total Fund Size:</i></b>	\$3.0 Billion
<b><i>Fund Manager:</i></b>	Silver Lake Technology Associates II, LLC
<b><i>Manager Contact:</i></b>	David Roux 2725 Sand Hill Road, Ste. 150 Menlo Park, CA 94025 Phone: (650) 233-8121

#### **II. Organization and Staff**

With the introduction of their first fund, Silver Lake Partners, L.P. ("SLP I"), a \$2.3 billion investment partnership formed in 1999, Silver Lake created the first private equity firm focused primarily on large-scale private equity investing in technology companies. Silver Lake employs 21 investment professionals and has offices in New York, NY and Menlo Park, CA.

#### **III. Investment Strategy**

As has been the case for SLP I, the Partnership's investments will target large-scale private equity investments in technology companies which will vary with respect to size and structure. The partnership expects to continue to focus on companies with enterprise values from approximately \$200 million to \$10 billion or greater. Silver Lake expects to invest typically between \$100 million and \$500 million per transaction, supplemented by equity and debt from third parties as appropriate.

The ideal target company for Silver Lake has an established position in its industry, a sustainable and profitable business model, a strong management team, and proprietary core technology and business processes. Silver Lake believes that within the technology sector there are several strategies that can lead to investment success. These include investing in: (i) market leaders, (ii) companies vying for market leadership, (iii) companies undergoing financial distress, and (iv) companies experiencing significant operational challenges that are in need of turnarounds. The relative attractiveness of each strategy may vary with changes in market valuations and economic environments.

#### **IV. Investment Performance**

Previous fund performance as of September 30, 2003 for Silver Lake Partners 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>
Silver Lake Partners Fund I	1999	\$2.3 billion	--	30.0%

Previous Fund investments may be relatively immature and therefore, returns may not be indicative of future results.

#### **V. General Partner's Investment**

The General Partners will commit to invest a minimum of \$60 million in the aggregate in all Portfolio Investments. In addition, prior to March 1 of each year, the General Partner may also commit to co-invest additional amount up to 5% of the amount of equity otherwise available to the Partnership in all Portfolio Investments for the next four succeeding quarters.

#### **VI. Takedown Schedule**

Commitments generally will be drawn down proportionately to Limited Partners' Unfunded Commitments on an as-needed basis, with a minimum of 10 day's prior notice to the Limited Partners.

#### **VII. Fees**

The Partnership will pay a management fee to the Investment Advisor quarterly in advance:

*During the Commitment Period:* 1.5% per annum of the Commitments of the Limited Partners.

*After the end of the Commitment Period (or, if earlier, the commencement of operations of a Competing Fund):* 1.0% per annum of the cost basis of Portfolio Investments remaining in the Partnership.

### **VIII. Allocations and Distributions**

Net cash proceeds from the sale of investments or any portion of an investment or marketable securities available for distribution and to be distributed (“Disposition Proceeds”) will be distributed as soon as practicable after receipt thereof (except as otherwise provided herein). Current cash receipts from dividends, interest and other similar distributions from Portfolio Investments net of current expenses (“Current Income”) will be distributed at least annually. The General Partners will be entitled to withhold from any distribution amounts necessary to create, in its discretion, appropriate reserves for expenses and liabilities of the Partnership as well as for any required tax withholdings. Amounts of tax credits received by the Partnership and amounts withheld for taxes will be treated as distributions for purposes of the calculations described below.

Distributions of Disposition Proceeds and Current Income (together, “Investment Proceeds” in respect of each Portfolio Investment will generally be made in the first instance to the Limited Partners and the General Partner pro rata in proportion to each of their percentage interests with respect to such Portfolio Investment. Each Limited Partner’s share of Investment Proceeds otherwise distributable to such Limited Partners will be distributed to such Limited Partner and the General Partner in the following amounts and order of priority:

- a. Return of Capital and Costs: First, 100% to such Limited Partner until such Limited Partner has received distributions of Investment Proceeds from such Portfolio Investment and all Portfolio Investments that have been disposed of (“Realized Investments”) equal to (i) such Limited Partner’s capital contributions for all Realized Investments; (ii) such Limited Partner’s direct payments or capital contributions for Organization Expenses, Management Fees and Partnership Expenses allocable to the Realized Investments; and (iii) such Limited Partner’s pro rata share of any net unrealized losses on writedowns of the Partnership’s other Portfolio Investments (taken in the aggregate); and
- b. 8% Preferred Return: Second, 100% to such Limited Partner until the cumulative distributions of the Investment Proceeds to such Limited Partner represent an 8% annual rate of return on the cumulative distributions made pursuant to clause a. above; and
- c. General Partner Catch-up: Third, 100% to the General Partner until the cumulative distributions to the General Partner from Realized Investments with respect to such Limited Partner pursuant to the clause c. equal 20% of the total amounts distributed to all Partners pursuant to clause b. and this clause c.; and
- d. 80/20 Split: Thereafter, 80% to such Limited Partner and 20% to the General Partner (the distributions to the General Partner described in clause c. and this clause d. being referred to collectively as “Carried Interest”).

## **IX. Investment Period and Term**

Capital calls may be required from time to time for a period of six years from the Initial Closing of the Partnership (the "Commitment Period"). Thereafter, the Limited Partners will be released from any further obligation with respect to their undrawn Commitments (the "Unfunded Commitments"), except to the extent necessary to: (i) cover the expenses of the Partnership, including Management Fees; (ii) complete investments by the Partnership in respect of transactions committed to by the Partnership prior to the end of the Commitment Period; and (iii) make follow-on investments in Portfolio Companies in an amount not to exceed 15% of the aggregate amount of the Commitments (excluding commitments and reserves made therefore during the Commitment Period).

The Partnership will terminate upon the later of ten years from the Initial Closing and five years after the end of the Commitment Period, but may be extended at the discretion of the General Partner for up to two consecutive one-year periods; provided, that the General Partner will provide prior notice of such extension to the LP Advisory Committee and the term of the Partnership will not be so extended if a majority of the members of the LP Advisory Committee object to such extension within 30 days of receiving such notice.