

**MINNESOTA STATE BOARD  
OF INVESTMENT  
MEETING  
December 14, 1994  
&  
INVESTMENT ADVISORY  
COUNCIL MEETING  
December 13, 1994**

**AGENDA  
STATE BOARD OF INVESTMENT  
MEETING**

**Wednesday, December 14, 1994**

**8:30 A.M. - Room 125**

**State Capitol - Saint Paul**

- |  |            |
|--|------------|
|  | <b>TAB</b> |
| <b>1. Approval of Minutes of September 20, 1994</b>                                  |            |
| <b>2. Report from the Executive Director (H. Bicker)</b>                             |            |
| A. Quarterly Investment Review (July 1 - September 30, 1994)                         | <b>A</b>   |
| B. Portfolio Statistics (September 30, 1994)   | <b>B</b>   |
| C. Administrative Report   | <b>C</b>   |
| 1. Budget Reports  |            |
| 2. Travel Report   |            |
| 3. Annual Report   |            |
| 4. Board Meeting Dates   |            |
| 5. Comparison of the SBI to Other Public Funds                                       |            |
| 6. Review of Derivatives   |            |
| <b>3. Appointment of IAC Members (P. Sausen)</b>                                     |            |
| <b>4. Report from the Semi-Passive Stock Manager Search Committee (P. Sausen)</b>    | <b>D</b>   |
| <b>5. Report from the Deferred Compensation Review Committee (P. Sausen)</b>         | <b>E</b>   |
| <b>6. Reports from the Investment Advisory Council (J. Yeomans)</b>                  |            |
| <b>A. Stock and Bond Manager Committee</b>   | <b>F</b>   |
| 1. Review of Manager Performance   |            |
| <b>B. Alternative Investment Committee</b>   | <b>G</b>   |
| 1. Results of Review Sessions  |            |
| 2. Commitment reduction to Alternative Investment Manager<br>(Irwin Jacobs IMR Fund) |            |

## **STATE BOARD OF INVESTMENT**

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### **Minutes State Board of Investment September 20, 1994**

The State Board of Investment (SBI) met at 8:30 a.m. on Wednesday, September 20, 1994 in Room 125, State Capitol, St. Paul, Minnesota. Governor Arne H. Carlson, Chair; State Auditor Mark B. Dayton; State Treasurer Michael A. McGrath; Secretary of State Joan Anderson Growe and Attorney General Humphrey III were present.

Mr. Carlson called the meeting to order and the minutes of the June 8, 1994 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 and Basic Funds had outperformed their respective return objectives over the period ending June 30, 1994. He added that the Post Fund had matched its composite index for the year ending June 30, 1994. He reminded members that the Post Fund's new asset allocation had been in place only since July 1, 1993.

In response to a question from Mr. Carlson, Mr. Bicker confirmed that the performance of the Combined Funds was in the second quartile of the Trust Universe Comparison Service (TUCS). In response to a question from Mr. Dayton, Mr. Bicker stated that the median fund comparison reflects a universe of public and corporate funds with varying asset allocations, while the composite index comparison represents returns generated using weightings that match the long-term asset allocation chosen by the SBI for a given fund.

Mr. Bicker reported that the Basic Funds' asset growth was flat for the quarter ending June 30, 1994 and that the asset mix is basically in-line with policy targets. He noted, however, that the bond segment is slightly overweighted since the allocation to alternative assets are invested in bonds until they are needed. Mr. Bicker said that the Basic Funds had slightly underperformed their composite index for the year (Basics 2.1% vs. Composite 2.4%) but had outperformed for the three year (Basics 10.1% vs. Composite 9.4%) and five year periods (Basics 9.6% vs. Composite 9.1%).

Mr. Bicker reported that the Post Retirement Fund had experienced a slight increase in value due to positive net contributions and that the asset mix for the Fund is basically in-line with policy targets given the early stage of investments in alternative assets. He said the total fund had matched its composite index at 1.6% for the year.

Mr. Bicker stated that the domestic stock manager group had slightly underperformed for the year (Domestic Stocks 0.7% vs. Wilshire 5000 0.9%) but had outperformed for the three year period (Domestic Stocks 10.2% vs. Wilshire 5000 10.0%). He said that the international stock manager group had outperformed its target for the year (International

Stocks 17.3% vs. EAFE 17.0%) and that the domestic bond manager group had slightly outperformed its target for the year (Domestic Bonds -1.1% vs. Salomon BIG -1.2%).

Mr. Bicker reported that the Assigned Risk Plan (ARP) had matched its composite for the year at 0.6%. He stated that the equity segment had underperformed its target for the year (Equity Segment -1.2% vs. Benchmark 0.4%) and he reminded members that the Board had approved a move to passive stock management for the ARP effective July 1, 1994. He said that as of June 30, 1994 the SBI was responsible for over \$23 billion in assets.

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

Mr. Bicker referred members to Tab C of the meeting materials for the current budget and travel reports and he noted that the SBI had come in \$38,000 under budget for the fiscal year. He also informed the Board that Ms. Lehman will be taking a three month developmental leave to attend the London School of Economics and will be returning around the first of the new calendar year.

#### **SBI Administrative Committee Report**

Mr. McGrath reported that the SBI Administrative Committee met on August 30, 1994 prior to the International Round Table meeting. He referred members to the four information items in the Committee report and then moved to the one action item before the Board. He said that the Committee is recommending that the Board approve the proposed rule changes for the Deferred Compensation Plan, as outlined in the materials distributed to members prior to the meeting (see Exhibit A). In response to a question from Mr. Carlson, Mr. Bicker confirmed that the MSRS Board, along with legal counsel, had already approved these changes. Mr. McGrath moved approval of the proposed changes, as described in the materials. The motion passed.

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

Mr. Bicker stated that the Deferred Compensation Review Committee had conducted a search during the quarter for a "Stable Asset Manager" to manage a portfolio of guaranteed investment contracts (GIC's) for the Fixed Interest Account of the Supplemental Investment Fund. He noted that currently the Account is invested in discrete, three year GIC's. He said that if the recommendation is approved, this manager would manage a portfolio of GIC's and synthetic GIC's, which would allow participants greater flexibility in making transfers in and out of the Account. He reported that the Committee was recommending that the SBI retain Norwest Investment Management as the manager for the account. Mr. Dayton moved approval of the Committee's recommendation as stated in the Committee Report. Mr. Humphrey seconded the motion. The motion passed.

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

Ms. Yeomans referred members to Tab F of the meeting materials and reported that the Committee is recommending a proposal to add a semi-passively managed component to

the domestic stock program. She explained that this investment approach offers the potential to increase returns with only a marginal increase in risk. She said this approach also offers the opportunity to recoup fees and transactions costs through low-risk value added strategies not available through passive management. She stated that the proposed structure reduces the passively managed segment from 50% to 25% and adds a maximum of 25% of the domestic stock segment to be semi-passively managed. She said that the Committee is also recommending that the SBI retain 2-4 semi-passive managers and fund them with portfolios of \$500-600 million each. She said that this funding level would represent about 15% of the domestic stock program and would move the SBI toward the 25% target for semi-passive management. She then referred members to the staff position paper for more detail on the background and rationale for the proposal. She said it was felt that the risk-return trade-off for this approach is good because while the risk of deviating from the passive benchmark is small, the possibility of recouping at least transactions costs was fairly high. Ms. Yeomans reminded members that the trading costs of the passively managed segment causes that segment to underperform by approximately 10 basis points.

Mr. Carlson commented that he believes the addition of semi-passive management creates an exact duplicate of the index. Ms. Yeomans clarified that differences occur when the active and semi-passive managers deviate from the index by making active bets. Mr. Carlson stated that he believes it is important for the Board to understand that the SBI is setting a course that will result in rankings between the 50th and 40th percentile, and not much higher. Mr. Bicker stated that by taking a portion of the passive component, which will underperform due to trading costs, and investing it semi-passively, which has the potential to add incremental value, the SBI would be making a change that could significantly improve the SBI's performance rankings. He noted that over 5 or 10 year periods, the difference between the 30th percentile and the 50th percentile is often only 0.1 or 0.2%. Mr. Carlson said he did not have any problem with the proposal since it is designed to add value but that it means only basis points of improvement in overall returns. He added that this is a desirable result, but he said he did not believe that it would ever be sufficient to put the SBI in the top quartile of universe comparisons and that he felt it was important for the Board to recognize this. Mr. Bicker responded that he felt that the strategy had the potential for achieving close to top quartile returns but that attempting to achieve returns in the top five or ten percent would entail inappropriate levels of risk for the SBI.

Mr. Humphrey stated that he disagrees with the statement that the passive portfolio will underperform due to transaction costs since transaction costs are a part of any portfolio's cost. He asked Mr. Bicker and Ms. Yeomans to comment on the additional risk that the Board would be taking if adopted this proposal. Ms. Yeomans and Mr. Bicker confirmed that there is some additional risk in adding semi-passive management, but that the expectation is that the increased risk will pay off over a reasonable period of time. Mr. Humphrey commented that the potential to add 15 to 30 basis points was targeted over the long term and that he understood that there may be some periods of negative returns relative to the benchmark. Mr. Bicker and Ms. Yeomans confirmed Mr. Humphrey's

observation and said they believe that the additional risk will pay off over the long term. In response to a question from Mr. Dayton, Mr. Bicker stated that by hiring multiple managers who utilize various investment styles, the semi-passive segment would be well diversified. In response to a question from Ms. Growe, Mr. Bicker said the semi-passive managers will be evaluated much the same way as the active managers.

Mr. Dayton asked why the SBI did not put all assets into active management and cover all areas of the market with active managers rather than attempting to balance the active manager group with the tilted index fund. Mr. Bicker stated that one problem with going completely to active management is the large size of the SBI's equity assets. He also noted previous debates by the Board regarding the percentage of assets actively and passively managed. Mr. Bicker reminded the Board that if the semi-passive recommendation is approved, the end result would be an additional \$2.5 billion being managed in a more active fashion.

Mr. Carlson requested staff to gather additional information on the asset mix strategies used by other large pension funds. He noted that he is not uncomfortable with the strategy being proposed, however, he reaffirmed his belief that a fund the size of the SBI has limited potential to reach first quartile performance. Mr. Bicker said that first quartile performance may not be likely, but that SBI would be well served if it stayed in the second quartile. Mr. Carlson agreed and said that assessment was fair. He reiterated his desire to take a look at the strategy of some other large funds so that the Board could gain some comfort that the SBI will match up well in terms of returns. Mr. Bicker agreed to Mr. Carlson's request.

In response to a question from Mr. Humphrey, Ms. Yeomans confirmed that the semi-passive recommendation involves a maximum of 25% of the total domestic equity portfolio. Mr. McGrath moved approval of the Committee's recommendation to add a semi-passive component to the domestic stock program, as stated in the Committee Report. Ms. Growe seconded the motion. The motion passed.

Ms. Yeomans stated that the second recommendation from the Committee involves approval for a semi-passive manager search and she referred members to the Committee Report for a listing of the nine managers on the finalist list. She noted that GE Capital Management is only being recommended as a finalist for the Assigned Risk Plan. Mr. McGrath moved approval of the Committee's recommendation to convene the Manager Search Committee to select semi-passive stock managers, as stated in the Committee Report. Ms. Growe seconded the motion. The motion passed.

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

Ms. Yeomans referred members to Tab G of the meeting materials and stated that the Committee is recommending four new alternative investments. She said that the first recommendation is for an investment in Colony Advisers II, an opportunistic real estate fund. She noted that the recommendation designates 50% of the commitment for the Basic Fund and 50% for the Post Fund. Mr. McGrath moved approval of the Committee's

recommendation, as stated in the meeting materials. Mr. Carlson seconded the motion. The motion passed.

Ms. Yeomans stated that the Committee is recommending an investment for the Post Fund with a new private equity manager, Kleinwort Benson, in Kleinwort Benson Mezzanine Fund II. In response to a question from Mr. Carlson, Ms. Yeomans and Mr. Bicker stated that the fund does not invest in a narrow market area. Mr. McGrath moved approval of the Committee's recommendation, as stated in the meeting materials. Mr. Dayton seconded the motion. The motion passed.

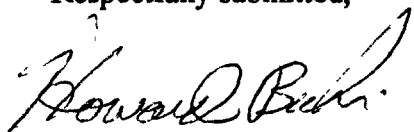
Ms. Yeomans stated that the Committee is also recommending an investment with another new private equity manager, Citicorp, in Citicorp Mezzanine Partners, L.P. Fund II, for the Post Fund. Mr. Dayton moved approval of the Committee's recommendation, as stated in the Committee Report. Ms. Grove second the motion. The motion passed.

Ms. Yeomans reported that the Committee's final recommendation is for the Basic Retirement Funds, with a new private equity manager, E.M. Warburg Pincus & Co., in Warburg Pincus Ventures, L.P. Ms. Grove moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. Humphrey seconded the motion. The motion passed.

Mr. Humphrey stated that he would like to thank Mr. Bicker for responding to his information requests during the quarter concerning derivatives and said he will continue to examine this area and report back to the Board in December 1994. Mr. Bicker added that he also intends to make a short educational presentation on derivatives to the Board in December.

The meeting adjourned at 9:06 a.m.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Howard J. Bicker".

Howard J. Bicker  
Executive Director

**OFFICE MEMORANDUM**

MINNESOTA STATE RETIREMENT SYSTEM

175 W. Lafayette Frontage Road  
St. Paul, MN 55107-1425

DATE: August 16, 1994

FROM: Dave Bergstrom

Tel. (612) 296-2761

Toll Free 800-657-5757

Fax (612) 297-5238

SUBJECT: Proposed Deferred Compensation Rule Changes

TO: Howard Bicker

At their July 22, 1994 meeting, the MSRS Board approved the enclosed State of Minnesota Deferred Compensation Plan rule changes. It is my understanding that the rule changes need approval by the SBI, and I request approval before submitting them through the rulemaking process.

The State of Minnesota Deferred Compensation Plan (DCP) is primarily governed by Minnesota Statutes §352.96 and Section 457 of the Internal Revenue Code (IRC). In addition, there are rules governing the DCP. Recent changes to the Minnesota Mutual and Great-West contracts and administrative modifications made over the last few years require us to update the rules.

In many places, the rules are simply repetition of Section 457 of the Internal Revenue Code. In certain instances, I have deleted language and replaced it with a general reference to the 457 Codes, which will eliminate the need to modify the rules if the federal law changes. Several federal law changes to Section 457 are currently under consideration.

Below is a summary of the proposed changes.

**7905.0100**

- Subpart 12. Removes specific definition of "includable compensation" and references IRC Section 457.
- Subpart 22. Removes the specific definition of "Unforeseeable emergency" and replaces with reference to IRC Section 457.
- Subpart 23. Adds "Board of Directors" as definition to mean Minnesota State Retirement System Board of Directors.
- Subpart 24. Adds "Product Providers" as definition to mean Great-West, Minnesota Mutual, and the Supplemental Investment Fund.



**7905.0200**

Clarifies that the Plan is established according to Section 457 of the IRC.

**7905.0300**

Changes references from "Director" which is MSRS Executive Director to "Board of Directors". This puts into rules the changes made in Minnesota Statutes §352.96 giving the MSRS Board official authority over the DCP.

**7905.0400**

Adds reference to IRC Section 457 as applicable law.

**7905.0600**

Grants overall administrative authority to the MSRS Board of Directors.

**7905.0700**

Adds language granting authority to the MSRS Board of Directors.

**7905.0800**

Adds language to codify current practice of mailing participant statements at least semiannually.

**7905.1000**

Adds language referring to IRC Section 457, and striking specific language regarding the timing of transactions that does not always apply.

**7905.1100**

Requires contributions of at least \$10 per product provider. This is the same as current practice.

**7905.1200**

Removes specific language on maximum deferrals and replaces with reference to maximums under IRC Section 457.

**7905.1300**

Current rules allow participants to change deferral amounts only twice in a calendar year. We are proposing that this restriction be removed to allow more frequent changes. This restriction has been loosely administered and is difficult to monitor.

**7905.1400**

Removes language regarding the timing required to stop deferrals. We are more flexible than current language, allowing us to stop deductions more quickly than allowed under the existing rule.

**7905.1700**

Subpart 1. Removes obsolete language referring to the front-end charge which was eliminated in July 1992.

Subpart 4. Removes obsolete language defining the front-end fees that are no longer charged.

**7905.1900**

Subpart 2. Removes the specific references to the various funds offered through the Supplemental Fund administered by the State Board of Investment. By referencing the statutes establishing the funds, changes can be made without having to modify the rules. For example, this year we will be adding an international fund.

Also removes restriction that a participant can only contribute to one insurance company at a time. Under the terms of the new contract, money can be invested with Great West, Minnesota Mutual, and the Supplemental Fund.

- Subpart 3. Removes language regarding the timing of transactions which does not represent current, more flexible administration.
- Subpart 4. Removes restriction that assets cannot be transferred from the two insurance companies. Transfers are now allowed under the new contracts.

**7905.2100**

- Subpart 1 Removes language that is governed by already referenced Section 457 of the IRC.
- Subpart 2 Changes the name "guaranteed return" account to "fixed interest" account to coincide with the name change in Minnesota Statutes §11A.17. Also, removes language regarding the timing of transactions which does not represent current, more flexible administration.  
  
Requires MSRS to pay interest if processing of a lump sum payment is delayed by ten or more working days because of MSRS error.
- Subpart 3 Removes language regarding the timing of transactions which does not represent current, more flexible administration. Also, replaces "monthly" with "periodic" to allow for both monthly and annual payments as allowed under current practice, and allows systematic withdrawals rather than requiring participants to purchase an annuity.

**7905.2200**

- Subpart 1 Removes language regarding the timing of transactions which does not represent current, more flexible administration.
- Subpart 2 Removes specific language governing distributions and replaces with reference to same requirements in IRC Section 457.
- Subpart 6 Removes specific language and replaces with IRC Section 457 requirements.

Memo to Howard Bicker  
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**7905.2300**

Subpart 2 Adds reference to IRC Section 457.

Subpart 3 Allows for more timely processing of emergency withdrawals.

**7905.2400**

Current rules only allow a participant to name a single beneficiary. We are proposing that this restriction be dropped to allow the naming of multiple beneficiaries. Several participants have expressed displeasure about the current restriction.

**7905.2900**

Clarifies that the MSRS Board of Directors has the authority to amend the DCP. Also strikes language that could present a legal barrier to making future changes to the Plan.

**7905.3000**

Specifies the effective date of these changes.

1           7905.0100 DEFINITIONS.

2           Subpart 1. Scope. When used in the plan, the following terms have the  
3 meanings given unless otherwise provided.

4           Subp. 2. Accounting date. "Accounting date" means the date on which an  
5 investment fund is valued and earnings or losses are allocated to participants' deferred  
6 compensation accounts. There shall be an accounting date at least once a month on  
7 the last business day of the month and if practical more frequent accounting dates to  
8 reflect as closely as possible the earnings or losses with respect to a deferred  
9 compensation account from the time compensation is deferred and invested in various  
10 investment funds until it is eventually distributed according to the plan.

11           Subp. 3. Beneficiary. "Beneficiary" means the person or legal entity provided  
12 for by the plan or designated by the participant to receive any undistributed deferred  
13 compensation that becomes payable in the event of the participant's death.

14           Subp. 4. Board. "Board" means the Minnesota State Board of Investment.

15           Subp. 5. Compensation. "Compensation" means any remuneration payable to  
16 an individual who performs service for the employer which is reportable as federal  
17 gross income.

18           Subp. 6. Deferred compensation. "Deferred compensation" means the part of  
19 the participant's compensation that the participant and employer mutually agree to  
20 defer under the plan.

21           Subp. 7. Deferred compensation account. "Deferred compensation account"  
22 means the account established for the investment of deferred compensation. It

1 includes the supplemental investment account and the fixed and variable annuity  
2 account.

3 Subp. 8. Director. "Director" means the executive director of the Minnesota  
4 State Retirement System.

5 Subp. 9. Employee. "Employee" means:

6 A. an individual receiving compensation for services from the state of Minnesota  
7 including any elected official, appointed official, or employee of the state of Minnesota,  
8 including employees of departments, agencies, and instrumentalities, wherein the state  
9 legislature has specifically held the employees to be "state employees" for any one or  
10 more specific purposes such as, but not limited to, membership in the Minnesota State  
11 Retirement System, employee group insurance program, or unemployment  
12 compensation plan for state employees; or

13 B. an individual receiving compensation for services performed for a political  
14 subdivision of the state including any elected official, appointed official, or employee of  
15 a political subdivision of the state, including any employee of the political subdivision or  
16 other employing unit entitled to membership in a public retirement plan listed in  
17 Minnesota Statutes, section 356.20, subdivision 2.

18 Subp. 10. Employer. "Employer" means the state of Minnesota, or a political  
19 subdivision of the state of Minnesota, or an agency or instrumentality of the state of  
20 Minnesota or its political subdivisions.

1           Subp. 11. Fixed or variable annuity account. "Fixed or variable annuity  
2 account" means the investment accounts of the companies approved by the board  
3 under Minnesota Statutes, section 352.96, subdivision 2.

4           Subp. 12. Includable compensation. "Includable compensation" means the  
5 ~~compensation remaining after any deferrals through the plan and any amount of~~  
6 ~~compensation excluded from federal gross income as a result of contributions made for~~  
7 ~~the benefit of an employee under a tax sheltered annuity under section 403(b);~~  
8 ~~expense account authorized under section 125, employee contributions to a retirement~~  
9 ~~plan excluded under section 414(h)(2), or employee deferrals as defined under section~~  
10 ~~401(k) or 408(k)(6) of the Internal Revenue Code of 1986~~ as defined in section 457 of  
11 the Internal Revenue Code.

12           Subp. 13. Normal retirement age. "Normal retirement age" means:

13           A. an age not earlier than that for attainment of eligibility by the participant to  
14 begin receiving normal, or unreduced, retirement benefits from one of the retirement  
15 systems listed in Minnesota Statutes, section 356.20, subdivision 2, or other Minnesota  
16 public employee pension plan of which the participant is a member, nor later than age  
17 70-1/2; or

18           B. if the participant is not a member of one of the retirement systems, not later  
19 than age 70-1/2.

20           Subp. 14. Participant. "Participant" means an individual who has enrolled in the  
21 plan as provided in parts 7905.0900 to 7905.1600 and has not had a complete  
22 distribution of the deferred compensation account.

1           Subp. 15. Pay period. "Pay period" means a regular accounting period  
2 established by the employer for measuring and paying compensation earned by  
3 employees.

4           Subp. 16. Pay date. "Pay date" means the date the participant receives  
5 payment of compensation.

6           Subp. 17. Plan. "Plan" means the Minnesota ~~public-employee's~~ State deferred  
7 compensation plan as set forth in this chapter and as it may be amended from time to  
8 time.

9           Subp. 18. Prior plan. "Prior plan" means the Minnesota deferred compensation  
10 plan approved by the attorney general and filed with the secretary of state and the  
11 commissioner of administration November 24, 1975, and any plans established under  
12 authority of the plan by political subdivisions of the state of Minnesota.

13           Subp. 19. Supplemental investment account. "Supplemental investment  
14 account" means the Minnesota supplemental investment fund as established by  
15 Minnesota Statutes, section 11A.17, and managed by the board.

16           Subp. 20. Separation from service. "Separation from service" means the  
17 permanent severance of the participant's employment relationship with the employer by  
18 means of: retirement; discharge, provided all appellate processes have been  
19 exhausted or tolled; resignation, provided seniority or continuous service is interrupted;  
20 permanent layoff; expiration or nonrenewal of appointment or term of office;  
21 nonreelection; death; or other form of permanent severance as may be provided by



1 appropriate law, contract, or rules. For purposes of this definition, a break in  
2 employment for less than 30 days shall not be considered a separation from service.

3 Subp. 21. Taxable year. "Taxable year" means the calendar year beginning  
4 January 1 and ending December 31.

5 Subp. 22. Unforeseeable emergency. "Unforeseeable emergency" means a  
6 severe financial hardship to the participant ~~resulting from a sudden and unexpected~~  
7 ~~illness or accident of the participant or of a dependent of the participant, loss of the~~  
8 ~~participant's property due to casualty, or other similar extraordinary and unforeseeable~~  
9 ~~circumstances arising as a result of events beyond the control of the participant. as~~  
10 defined in section 457 of the Internal Revenue Code. The circumstances that will  
11 constitute an unforeseeable emergency will depend upon the facts of each case, but in  
12 any case payment will not be made to the extent that the hardship is, or may be  
13 relieved, through reimbursement or compensation by insurance or otherwise by  
14 liquidation of the participant's assets to the extent the liquidation of the assets would  
15 not itself cause severe financial hardship or by cessation of deferrals under the plan.

16 Subp. 23. Board of Directors. "Board of Directors" means the Minnesota State  
17 Retirement System Board of Directors.

18 Subp. 24. Product Providers. "Product Providers" means any company that has  
19 a contract with the State Board of Investment to offer an investment product under the  
20 plan or the supplemental investment fund.

21 7905.0200 ESTABLISHMENT OF PLAN.

1           The plan shall be known as the "Minnesota ~~public employees'~~ State deferred  
2 compensation plan" ("plan") and is created according to Minnesota Statutes, section  
3 352.96 and section 457 of the Internal Revenue Code. The plan shall constitute a  
4 continuation of the Minnesota deferred compensation plan, approved by the attorney  
5 general and filed with the secretary of state and the commissioner of administration,  
6 November 24, 1975.

7           7905.0300 PURPOSE OF PLAN.

8           The purpose of the plan is to allow employees to designate a portion of their  
9 compensation to be withheld each pay period by the employer and invested at the  
10 discretion of and in a manner approved by the ~~director~~ Board of Directors for the  
11 employer until separation from service, financial hardship, or death of the employee.  
12 Any compensation deferred by employees may be invested by the ~~director~~ Board of  
13 Directors, but there is no requirement for the ~~director~~ Board of Directors or employer to  
14 do so. Participation in the plan shall not be construed to establish or create an  
15 employment contract between the employee and the ;  
16 employer.

17           7905.0400 APPLICABLE LAW.

18           The plan shall be construed, administered, and governed in all respects under  
19 and by the laws of the state of Minnesota, Minnesota Statutes, section 352.96 and  
20 section 457 of the Internal Revenue Code.

21           7905.0500 TERMS: GENDER AND NUMBER.

1 Except when otherwise indicated by the context, any masculine terminology  
2 herein shall also include the feminine and neuter and vice versa, and the definition of  
3 any terms in part 7905.0400 in the singular may also include the plural.

4 7905.0600 ADMINISTRATION OF PLAN.

5 The ~~director~~ Board of Directors has the full power and authority to administer the  
6 plan and promulgate, adopt, amend, or revoke internal management procedures which  
7 are consistent with, and necessary to implement and maintain, the plan.

8 7905.0700 WRITTEN AGREEMENT.

9 The employer or the director on behalf of the Board of Directors and the  
10 employer shall enter into a written agreement with each participant. The written  
11 agreement and other application forms shall be in a form and manner as prescribed by  
12 the director and shall set forth the obligations contained in the plan, the amounts of  
13 compensation to be deferred, and other information the director considers necessary to  
14 administer the plan.

15 7905.0800 COPIES OF PLAN, PAMPHLETS, AND ACCOUNT STATEMENTS.

16 Pamphlets describing the plan and outlining the options and opportunities  
17 available shall be prepared under the direction of the director and made available to  
18 eligible employees. Copies of the plan will be made available upon request. Individual  
19 account statements shall be made available to each participant at least semiannually.

20 7905.0900 ELIGIBILITY.

21 All employees who are receiving compensation who have not received a  
22 distribution based on an unforeseeable emergency as provided in part 7905.2300

1 within the last 12 months shall be eligible to become participants in accordance with  
2 part 7905.1000. If an employee received a distribution based on an unforeseeable  
3 emergency in the last 12 months and is eligible for an employer matching contribution  
4 under Minnesota Statutes, section 356.24, employee contributions can be made only  
5 up to the amount matched by employer contributions.

6 7905.1000 ENROLLMENT.

7 Any employee eligible to participate according to part 7905.0900 may become a  
8 participant by agreeing with the employer in writing, on a form approved by the director,  
9 to a deferment of the participant's compensation according to parts 7905.1100 and  
10 7905.1200. The deferment will begin with the first pay date following 30 days from the  
11 date the application is properly completed by the employee and accepted by the  
12 employer or director acting for the employer shall be made in compliance with section  
13 457 of the Internal Revenue Code. The application shall also specify an investment  
14 preference for the deferred compensation.

15 7905.1100 MINIMUM DEFERRAL.

16 The minimum amount which may be deferred is \$10 per pay period per product  
17 provider. The amounts to be deferred must be stated in whole dollars. If the application  
18 indicates an amount including cents, the cents will be disregarded.

19 7905.1200 MAXIMUM DEFERRAL.

20 The total amount of deferred compensation during any taxable year shall not  
21 exceed the limits provided in items A and B established under section 457 of the  
22 Internal Revenue Code.

1 ~~A. 33 1/3 percent of includable compensation or \$7,500, whichever is less; or~~

2 ~~B. for each of three taxable years preceding the year in which the participant will~~  
3 ~~attain normal retirement age, the participant may defer an amount equal to the limits in~~  
4 ~~item A plus an additional amount equal to the difference between the amount of~~  
5 ~~compensation that could have been deferred under the plan, and the amount that was~~  
6 ~~deferred for years after December 31, 1978. In no event, however, can the deferral~~  
7 ~~exceed \$15,000 for any taxable year.~~

8 ~~The participant may designate and use this catch-up provision only once~~  
9 ~~whether or not it is used in less than all of the three taxable years ending before~~  
10 ~~attaining normal retirement age and whether or not the participant or former participant~~  
11 ~~rejoins the plan. The participant may not use this catch-up provision in another eligible~~  
12 ~~plan.~~

13 ~~If a participant also participates in or has amounts contributed by the employer~~  
14 ~~for the purchase of a tax sheltered annuity, a section 401(k) plan, or a salary reduction~~  
15 ~~simplified employee pension plan, and part or all of the contributions are excludable~~  
16 ~~from taxable income under section 403(b), 402(a)(8), or 402(h)(1)(B) of the Internal~~  
17 ~~Revenue Code, the contributions reduce the maximums established in items A and B.~~

18 ~~In no event can deferrals exceed an employee's compensation less deductions~~  
19 ~~for FICA, any other taxes, pension contributions, and other mandatory deductions.~~

20 **7905.1300 MODIFICATIONS TO AMOUNT DEFERRED.**

21 ~~The employer shall adjust the participant's total annual compensation, on a pay~~  
22 ~~period basis, by the deferred compensation amount indicated on the participant's~~

1 application. That amount, subject to the limits of part 7905.1200, may be increased or  
2 decreased only by proper application to the employer or to the director acting for the  
3 employer. ~~The change shall take effect the first pay date following 30 days from receipt~~  
4 ~~and approval of the application. Only two modifications, other than a revocation of~~  
5 ~~participation as provided in part 7905.1400, may be made each taxable year.~~

#### 6 7905.1400 REVOCATION OF DEFERRAL.

7 A participant may revoke an election to have compensation deferred by notifying  
8 the employer or the director acting for the employer ~~in writing~~ on a form prescribed by  
9 the director. ~~The participant's full compensation on a nondeferred basis will then be~~  
10 ~~restored beginning with the first pay date following 30 days from the date notification~~  
11 ~~was received; however, the participant's deferred compensation account shall be paid~~  
12 ~~only as provided in parts 7905.1700 to 7905.2400.~~

#### 13 7905.1500 DURATION OF ELECTION TO DEFER COMPENSATION.

14 Once an election to have compensation deferred has been made by the  
15 participant, the election shall continue in effect until the participant's separation from  
16 service, unless the participant modifies the amount according to part 7905.1300, or  
17 revokes the deferred compensation according to part 7905.1400 or receives a  
18 distribution under part 7905.2300.

#### 19 7905.1600 DEFERRAL ADJUSTMENTS.

20 Subpart 1. Deduction exceeds pay period salary. If for any reason the deferred  
21 compensation deduction for any pay period exceeds the amount remaining after  
22 provision is made for retirement deductions, social security tax contributions, state and

1 federal income taxes, and any other deductions required by law, then no deduction for  
2 the plan will be made for the participant for that pay period.

3 Subp. 2. Missed deductions; overdeductions. If a deferred compensation  
4 deduction is missed for any reason, no adjustment shall be made on any future pay  
5 period for the missed deduction. However, if for any reason an amount is deducted  
6 from a pay period greater than that indicated by the participant on the application, the  
7 amount overdeducted will be refunded.

8 Subp. 3. Change in pay period length. In the employee's application for  
9 participation in the plan, the employee must state the amount the employee wishes  
10 withheld each pay period. If for any reason the length of the period for which the  
11 employee is paid is changed from that in effect as of the date of the application, the  
12 employer or the director acting for the employer shall compute and have withheld from  
13 the employee's salary an equivalent whole dollar amount to be withheld corresponding  
14 to the new pay period length that will result in approximately the same annual amount  
15 being withheld.

16 Subp. 4. Maximum deduction. The employer shall attempt to ensure  
17 compliance with the maximum deferral in part 7905.1200. If the amount deducted  
18 exceeds the maximum deferral in part 7905.1200, the amount of subsequent  
19 deductions for the remainder of the taxable year shall be adjusted to conform to the  
20 maximum deferral allowed for the year. If it is not possible to correct the total  
21 deduction by year end, the overage shall be refunded. A participant is responsible for

1 any tax consequences to the participant that may arise as a result of the participant's  
2 deferrals under the plan that exceed the maximum amounts allowable.

3 7905.1700 DEFERRED COMPENSATION ACCOUNTS AND VALUATION.

4 Subpart 1. Participants' accounts. An investment account shall be established  
5 for each participant which shall be the basis for any distributions payable to the  
6 participants under parts 7905.2000 to 7905.2400. Each participant's account shall be  
7 credited with the amount of any compensation deferred and received, ~~less the~~  
8 ~~administrative charge in subpart 4~~, and shall be further credited or debited, as  
9 applicable, with any increase or decrease resulting from investments under part  
10 7905.1900, credited or debited with any investment expenses, if applicable, debited for  
11 the amount of any distribution, and credited initially with the value on December 19,  
12 1983, of any bookkeeping account maintained under the prior plan

13 Subp. 2. Financial responsibility of employer. The funds and assets paid into  
14 the deferred compensation account may be invested in approved investments as  
15 provided by Minnesota Statutes, section 352.96, subdivision 2, until distributed  
16 according to parts 7905.2000 to 7905.2400.

17 The employer shall not be responsible for any loss due to the investment or  
18 failure of investment of funds and assets in the deferred compensation account, nor  
19 shall the employer be required to replace any loss which may result from the  
20 investments.

21 Subp. 3. Account and fund valuation. The supplemental investment account is  
22 to be valued by the board as of each accounting date according to Minnesota Statutes,



1 section 11A.17. Any withdrawals or distributions shall be based upon the account's  
2 value as of the accounting date.

3 The fixed and variable annuity account is to be valued at current market value as  
4 of each accounting date on a reasonable and consistent basis and according to the  
5 terms of the contract as approved by the board under Minnesota Statutes, section  
6 352.96.

7 Subp. 4. Administrative expense. The administrative expenses of the plan will  
8 be paid under Minnesota Statutes, section 11A.17. ~~If amounts generated by Minnesota  
9 Statutes, section 11A.17, are insufficient to pay all necessary administrative expenses,  
10 up to one-half percent shall be deducted each pay period from the first \$3,000 deferred  
11 compensation invested in the supplemental investment account each calendar year to  
12 pay administrative costs. The director shall review the charge levied annually and if  
13 the levy proves to be excessive or insufficient to pay all necessary costs of  
14 administration, the director shall adjust the charges accordingly after review of the  
15 necessity for the charge by the legislative auditor.~~

16 Administrative costs for the fixed and variable annuity account shall be  
17 established by the contract as approved by the board under Minnesota Statutes,  
18 section 352.96.

#### 19 7905.1800 UNSECURED GENERAL CREDITOR

20 Title to and beneficial ownership of any assets, whether in cash or investment  
21 which the employer may earmark to pay or measure any deferred compensation under  
22 this chapter, shall at all times remain as a part of the general assets of the employer.

1 The participant and the participant's beneficiary shall not have any property interest in  
2 any specific asset of the employer on account of the participant's election to defer any  
3 compensation under the plan. To the extent that any person acquires a right to receive  
4 payments from the employer under the terms of the plan, the right shall be no greater  
5 than the right of any unsecured general creditor of the employer.

6 7905.1900 INVESTMENT OF FUNDS.

7 Subpart 1. Investment allowed. Any compensation deferred by employees may  
8 be invested by the director for the employer, but there is no requirement to do so.

9 Subp. 2. Investment options. The participant may select an investment  
10 preference from among the options provided in the deferred compensation account.

11 The supplemental investment account shall provide the options ~~of the income~~  
12 ~~share account, growth share account, or, common stock index account, money market~~  
13 ~~account, bond market account, or fixed interest account~~ available under Minnesota  
14 Statutes, section 11A.

15 The fixed or variable annuity account shall provide the options of a fixed annuity  
16 or a variable annuity as provided in the contract approved by the board under  
17 Minnesota Statutes, section 352.96.

18 A participant may select a combination of these five investment account  
19 preferences by specifying on the application the amount to be deferred under each  
20 investment preference. ~~A participant may select the account options of only one of the~~  
21 ~~companies approved by the board at any one time.~~ The amount to be deferred cannot  
22 be less than \$10 per pay period per account selected product provider.

1 Subp. 3. Investment preference requests for future compensation. A participant  
2 shall, at the time of enrollment, make an investment preference request on an  
3 application provided for that purpose. Once made, an investment request shall  
4 continue for any deferments unless later changed by the participant.

5 A participant may change an investment preference request for future amounts  
6 of deferred compensation. ~~A change in investment request shall be effective with  
7 respect to compensation to be deferred for the first pay date following 30 days from  
8 receipt of the request.~~

9 Subp. 4. Investment preference requests for past deferred compensation. A  
10 participant may also change an investment preference request with respect to all or  
11 part of previously deferred compensation. Changes are limited to a change within the  
12 fixed or variable annuity account according to the terms of the annuity contracts or  
13 within the supplemental investment account, ~~but not between the annuity accounts and  
14 the supplemental investment account, nor between companies approved by the board.~~  
15 Changes are also permitted between the fixed or variable annuity accounts according  
16 to the terms of the contract and the supplemental investment account. These changes  
17 in investment preference shall be effected as soon as practical as cash flow to an  
18 account permits, but not later than six months after the requested change.

19 7905.2000 DISTRIBUTION EVENTS.

20 A participant's deferred compensation account may begin to be distributed  
21 according to part 7905.2100 following the occurrence of one of the following events:

1 separation from service; death; unforeseeable emergency; distribution date as provided  
2 in part 7905.2200; or attainment of age 70-1/2.

3 7905.2100 METHODS OF DISTRIBUTION.

4 Subpart 1. Election in general. Distribution of a participant's deferred  
5 compensation account shall be made in one of the following ways, with the date of  
6 distribution determined according to part 7905.2200. Benefits shall be paid ~~at least~~  
7 ~~annually and in nonincreasing amounts~~ as provided in section 457(d)(2)(C) of the  
8 Internal Revenue Code. Elections by a participant as authorized in this chapter shall  
9 be made on forms approved by the director.

10 Subp. 2. Supplemental investment account. A participant in the supplemental  
11 investment account will have deferred compensation distributed over a period of 60  
12 months, ~~unless at least 30 days before distribution~~ the participant elects to have  
13 distribution made in one of the following methods:

14 A. in a lump sum;

15 B. in a lump sum purchase by the director of a fixed or variable annuity contract  
16 with one of the companies approved by the board under Minnesota Statutes, section  
17 352 96, subdivision 2, including the availability of the options in subpart 3; or

18 C. for distribution beginning before the death of the participant, in monthly  
19 installments over a period of months specified by the participant; provided, however,  
20 that the amounts payable to the participant will be paid at times that are not later than  
21 the time determined under section 401(a)(9)(G) of the Internal Revenue Code relating  
22 to incidental death benefits as prescribed by the federal tax regulations. Any amount

1 not distributed to the participant during the participant's lifetime will continue to the  
2 beneficiary at least as rapidly as was made to the participant before death.

3 The monthly installment payment from the supplemental investment account  
4 shall be determined by dividing the number of shares held by the months to be paid  
5 according to the withdrawal period selected. If the computation results in a monthly  
6 payment of less than \$100, the number of shares that equal approximately \$100 shall  
7 be determined and shall be redeemed and distributed to the employee or beneficiary  
8 each month until the deferred compensation is depleted in its entirety. If the deferred  
9 compensation has been invested in shares of more than one investment account,  
10 shares will be redeemed in whole units proportionately to the extent possible. Money  
11 market and ~~guaranteed return~~ fixed interest account investment payments shall also  
12 include payment of annual interest on the invested balance. If the value of the  
13 participant's account is \$1,000 or less, distribution shall be made in a lump sum.

14 If an acceptable application for a lump sum withdrawal and the information  
15 necessary to process the withdrawal is received in the office of the System prior to  
16 month end, the lump sum payment should be processed within the first ten working  
17 days of the following month. If not processed within ten working days, the participant  
18 will be eligible for interest at the rate set by the Commissioner of Revenue in  
19 accordance with M. S. §270.75, subd. 5. Interest will be calculated from the day after  
20 the tenth working day to the date payment is processed.

21 Subp. 3. Fixed or variable annuity account. A participant in the fixed or variable  
22 annuity account will have deferred compensation distributed in the form of ~~monthly~~ an

1 annuity or systematic withdrawal payments unless, before distribution, the participant  
2 elects a lump sum distribution. The annuity or systematic withdrawal payments shall be  
3 based on one of the following methods, as selected by the participant ~~at least 30 days~~  
4 ~~before distribution begins~~:

- 5 A. the life of the participant;
- 6 B. the joint lifetime of the participant and spouse; or
- 7 C. a period certain in which the amounts payable to the participant will be paid  
8 at times not later than the time determined under section 401(a)(9)(G) of the Internal  
9 Revenue Code relating to incidental death benefits as prescribed by the federal tax  
10 regulations. Any amount not distributed to the participant during the participant's  
11 lifetime will continue to the beneficiary at least as rapidly as was made to the  
12 participant before death.

13 If no election is made, the participant's deferred compensation will be paid on  
14 the basis of a five-year period certain annuity.

15 Notwithstanding any other rule to the contrary, if a fixed or variable annuity  
16 account is equal to or less than \$1,000, the account shall be distributed in a lump sum  
17 within 60 days following the close of the taxable year during which the distribution  
18 event occurs.

19 Once payments have begun on an annuity or systematic withdrawal basis, any  
20 future payments to a beneficiary will depend on the terms of the annuity or systematic  
21 withdrawal payments agreed to by the participant and the employer. If a participant  
22 dies before the end of a period certain, any remaining distributions will be paid to the

1 beneficiary determined under part 7905.2500. If annuity payments have begun on a  
2 joint and last survivor basis, any payments due after the death of the participant will be  
3 due only to the other person on which the annuity payments have been based and not  
4 any other beneficiary.

5 If, in fact, an annuity contract is purchased, the owner and named beneficiary  
6 shall be the employer. Any rights of participants or beneficiaries are derived solely  
7 from the plan.

8 7905.2200 DATE OF DISTRIBUTION.

9 Subpart 1. Election in general. A participant may irrevocably elect, on a form  
10 approved by the director ~~at least 30 days before the time any amounts become~~  
11 ~~payable~~, to defer payment of some or all of the amounts to a fixed or determinable  
12 future time, subject to subparts 2 to 6.

13 Subp. 2. Electing distribution date. ~~At any time prior to 30 days following the~~  
14 ~~close of the taxable year in which separation from service occurs, a~~ A participant may  
15 designate a distribution date ~~not later than the latest of:~~ in accordance with section 457  
16 of the Internal Revenue Code.

17 ~~A. April 1 after the close of the taxable year in which the participant attains age~~  
18 ~~70-1/2; or~~

19 ~~B. 60 days after the close of the taxable year in which the participant separates~~  
20 ~~from service.~~

21 ~~Election of a date of distribution may be made only once and, once made, is~~  
22 ~~irrevocable.~~

1           Subp. 3. Death of participant. If a participant dies before the distribution date or  
2 date of separation from service, the death will be treated as an event of distribution. If  
3 the beneficiary is the participant's surviving spouse, the beneficiary shall have the right  
4 to elect the method and time of distribution as if the beneficiary was the participant.  
5 The distribution to the surviving spouse cannot exceed the life expectancy of the  
6 surviving spouse. If the beneficiary is other than the surviving spouse, payments to the  
7 beneficiary must be distributed over a period not to exceed 180 months from the date of  
8 death.

9           Subp. 4. After payment starts. Once payment has begun, the method of  
10 distribution may not be changed, except in the event of an unforeseeable emergency,  
11 subject to the restrictions of the payment option the participant or beneficiary has  
12 selected. If the participant dies before all benefits have been paid, payments must  
13 continue to a beneficiary under a schedule that is at least as rapid as the schedule  
14 under which the participant was being paid.

15           Subp. 5. When distribution begins. Distribution may not begin before  
16 separation from service or death, except for unforeseeable emergency distributions as  
17 provided in part 7905.2300.

18           Subp. 6. No election. If no distribution date is elected, payment shall begin 60  
19 ~~days after the close of the taxable year in which separation from service occurs~~ in  
20 accordance with section 457 of the Internal Revenue Code.

21           7905.2300 UNFORESEEABLE EMERGENCY.



1           Subpart 1. Conditions permitting distribution. A distribution of all or a part of a  
2 participant's deferred compensation account or a change in method of distribution to a  
3 participant notwithstanding the fact that distribution has begun, unless the distribution  
4 is in the form of an annuity, shall be permitted if the participant is faced with an  
5 unforeseeable emergency. Deferrals under the plan shall cease as soon as possible  
6 for one year for any participant granted a distribution because of an unforeseeable  
7 emergency except for the minimum employee deferral to allow an employer match as  
8 specified under part 7905.0900.

9           Subp. 2. Showing of an emergency. Any participant desiring a distribution by  
10 reason of an unforeseeable emergency must demonstrate that the circumstances being  
11 experienced were not under the participant's control and constitute a real emergency  
12 that is likely to cause the participant great financial hardship and qualifies under  
13 section 457 of the Internal Revenue Code. The employer or director acting for the  
14 employer shall have the authority to require medical or other evidence as may be  
15 needed to determine the necessity for the participant's withdrawal request.

16           Subp. 3. Amount and method of distribution. The distribution shall be limited to  
17 an amount sufficient only to meet the emergency and shall not exceed the amount of  
18 the deferred compensation account.

19           The allowed distribution shall be payable by a method determined by the  
20 employer or the director acting for the employer and begin as soon as possible after  
21 notice to the participant of approval. An approved unforeseeable emergency payment

1 from the supplemental investment account may be based on the values determined on  
2 the prior month's accounting date if the application is received by the 20th of the month.

3 7905.2400 DESIGNATION OF BENEFICIARY.

4 A participant may designate a beneficiary or beneficiaries to receive payment of  
5 the participant's deferred compensation in the event of the participant's death. ~~With~~  
6 ~~respect to deferred compensation in the supplemental investment account, only a~~  
7 ~~singular beneficiary may be designated.~~ If the designated beneficiary predeceases the  
8 employee and a new beneficiary has not been named or the designated beneficiary  
9 dies before receiving payment, a lump sum payment shall be made to the participant's  
10 estate. The beneficiary designation shall be in writing and must be filed with the  
11 director or company approved by the board under Minnesota Statutes, section 352.96,  
12 subdivision 2, as the case may be, before the death of the participant. If no  
13 designation of beneficiary is filed with the director, the beneficiary shall be the surviving  
14 spouse, or if none, a lump sum payment shall be made to the participant's estate.

15 7905.2500 LEAVE OF ABSENCE.

16 A participant who is granted a leave of absence by the employer may continue to  
17 be a participant in the plan as long as the leave of absence is approved by the  
18 employer. If an approved leave of absence is terminated by the employer or employee  
19 without the resumption of the employment relationship, the participant shall be treated  
20 as having a separation from service under the plan.

21 7905.2600 NONASSIGNABILITY OF CONTRACT.

1           The contract entered into between the employer and a participant through the  
2 plan and the benefits, proceeds, or payments under the plan cannot be sold, assigned,  
3 pledged, commuted, transferred, or otherwise conveyed by an employee, participant, or  
4 beneficiary. An attempt to assign or transfer shall not be recognized and shall impose  
5 no liability on the employer.

6           Except as otherwise required by law, deferred compensation money withheld  
7 under the plan shall not be subject to attachment, garnishment, or execution, or to  
8 transfer by operation of law in the event of bankruptcy or insolvency of the participant  
9 or otherwise.

10           7905.2700 HEADINGS AND SUBHEADINGS.

11           The headings and subheadings in the plan are inserted for convenience of  
12 reference only and are to be ignored in any construction of the provisions of this  
13 chapter.

14           7905.2800 CONFLICTS.

15           If any form or other document used in administering the plan conflicts with the  
16 terms of the plan, the terms of the plan shall prevail.

17           7905.2900 AMENDMENT OF PLAN.

18           The ~~director~~ Board of Directors acting for the employer shall have the authority  
19 to propose amendments to the plan consistent with Minnesota Statutes, section 352.96.

20           ~~No amendment or modification shall adversely affect the rights of participants or their~~  
21 ~~beneficiaries to the receipt of compensation deferred before the amendment or~~

1 ~~modification unless required by state or federal law to maintain the tax status of the~~  
2 ~~plan and any compensation previously deferred.~~

3 7905.3000 PRIOR PLAN.

4 The plan constitutes a continuation of the Minnesota deferred compensation  
5 plan approved by the attorney general and filed with the secretary of state and the  
6 commissioner of administration, November 24, 1975. All participants and any  
7 compensation deferred under the prior plan are, after January 1, 1981, governed by the  
8 terms of the plan subject to items A to D.

9 A. All deferrals elected under the prior plan shall continue without further action  
10 as long as they do not exceed the limits in part 7905.1200.

11 B. Any investment requests made under the prior plan shall continue to apply to  
12 any deferrals made under the plan according to part 7905.1900.

13 C. Any election of the method of distribution of benefits made under the prior  
14 plan shall be void, and a participant or beneficiary may elect the form of distribution  
15 according to parts 7905.2100 and 7905.2200.

16 D. The revised plan is effective ~~July 1, 1991~~ September 1, 1994.

**AGENDA**  
**INVESTMENT ADVISORY COUNCIL**  
**MEETING**  
**Tuesday, December 13, 1994**  
**2:00 P.M. - SBI Conference Room**  
**Room 105, MEA Building - Saint Paul**

**TAB**

- 1. Approval of Minutes of September 19, 1994**
  
- 2. Report from the Executive Director (H. Bicker)**
  - A. Quarterly Investment Review (July 1 - September 30, 1994)** **A**
  - B. Portfolio Statistics (September 30, 1994)** **B**
  - C. Administrative Report** **C**
    - 1. Budget Reports**
    - 2. Travel Report**
    - 3. Annual Report**
    - 4. Board Meeting Dates**
    - 5. Comparison of the SBI to Other Public Funds**
    - 6. Review of Derivatives**
  
- 3. Appointment of IAC Members (P. Sausen)**
  
- 4. Report from the Semi-Passive Stock Manager Search Committee (P. Sausen)** **D**
  
- 5. Report from the Deferred Compensation Review Committee (P. Sausen)** **E**
  
- 6. Reports from the Investment Advisory Council**
  - A. Stock and Bond Manager Committee (John Bohan)** **F**
    - 1. Review of Manager Performance**
  
  - B. Alternative Investment Committee (Debbie Veverka)** **G**
    - 1. Results of Review Sessions**
    - 2. Commitment reduction to Alternative Investment Manager (Irwin Jacobs IMR Fund)**

# **STATE BOARD OF INVESTMENT**

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## **Minutes Investment Advisory Council September 19, 1994**

The Investment Advisory Council met on Monday, September 19, 1994 at 2:00 P.M. in the State Board of Investment (SBI) Conference Room, 55 Sherburne Avenue, St. Paul.

**MEMBERS PRESENT:** Dave Bergstrom; John Bohan; Ken Gudorf; Laurie Fiori Hacking; Keith Johnson; Peter Kiedrowski; Malcolm McDonald; Gary Norstrem; Debbie Veverka and Jan Yeomans.

**MEMBERS ABSENT:** Gary Austin; Jim Eckmann; John Gunyou; Han Chin Liu; and Barbara Schnoor.

**SBI STAFF:** Howard Bicker; Beth Lehman; Jim Heidelberg; John Griebenow; Debbie Griebenow; Charlene Olson and Linda Nadeau.

**OTHERS ATTENDING:** Ann Posey, Richards & Tierney; John Wicklund, Teachers Retirement Association; Christie Eller; Elaine Voss; Julie Bleyhl, AFSCME; Richard Shager, Equitable; Robert Whitaker; Mike Ousdigian; John Hagman and Ed Stuart.

Ms. Yeomans called the meeting to order and the minutes of the June 7, 1994 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 and Basic Funds had outperformed their respective return objectives over the period ending June 30, 1994. He added that the Post Fund had matched its composite index for the year ending June 30, 1994 and he noted that the Post Fund's new asset allocation had only been in place since July 1, 1993.

Mr. Bicker reported that the Basic Funds' asset growth was flat for the quarter ending June 30, 1994 and that the asset mix is basically in-line with policy targets. He noted, however, that the bond segment is slightly overweighted since funds allocated to alternative assets are invested in bonds until they are needed. Mr. Bicker said that the Basic Funds had slightly underperformed their composite index for the quarter (Basics - 0.6% vs. Composite -0.3%) but had outperformed for the three year (Basics 10.1% vs. Composite 9.4%) and five year periods (Basics 9.6% vs. Composite 9.1%).

Mr. Bicker reported that the Post Retirement Fund had experienced a slight increase in value due to net contributions and that the asset mix for the Fund is basically in-line with policy targets, with the same exception noted above for the alternative asset and bond segments. He said the total fund had matched its composite index at 1.6% for the year.

Mr. Bicker stated that the domestic stock manager group had slightly underperformed for the year (Domestic Stocks 0.7% vs. Wilshire 5000 0.9%) but had outperformed its target for the three year period (Domestic Stocks 10.2% vs. Wilshire 5000 10.0%). He said that the international stock manager group had outperformed its target for the year (International Stocks 17.3% vs. EAFE 17.0%) and slightly underperformed its target since inception (International Stocks 19.5% vs. EAFE 20.5%) and that the domestic bond manager group had slightly outperformed its target for the one year (Domestic Bonds -1.1% vs. Salomon BIG -1.2%), three year (Domestic Bonds 8.7% vs. Salomon BIG 8.1%), and five year periods (Domestic Bonds 8.9% vs. Salomon BIG 8.6%).

Mr. Bicker reported that the Assigned risk Plan (ARP) had underperformed its composite index for the quarter (ARP -0.6% vs. Composite -0.1%) and had matched its composite for the year at 0.6%. He stated that the equity segment had underperformed its target for the year (Equity Segment -1.2% vs. Benchmark 0.4%) and he reminded members that the Board had approved a change to passive management effective July 1, 1994. He said that as of June 30, 1994 the SBI was responsible for over \$23 billion in assets.

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

Mr. Bicker stated that the Deferred Compensation Review Committee had conducted a search during the quarter for a "Stable Asset Manager" to manage a portfolio of guaranteed investment contracts (GIC's) for the Fixed Interest Account of the Supplemental Investment Fund. He noted that currently the Account is invested in discrete, three year GIC's. He said that if the Committee recommendation is approved, Norwest Investment Management would manage a portfolio of GIC's and synthetic GIC's, which would allow participants greater flexibility in making transfers in and out of the Account. Mr. Bicker noted that Mr. Kiedrowski would not be voting on the recommendation due to his affiliation with Norwest.

A discussion followed about how the Account will be managed and several members wondered if a GIC investment option is still an appropriate investment vehicle to offer participants. Ms. Lehman and Mr. Bicker both responded that the Fixed Interest Account continues to be a popular option for participants. In response to questions from Ms. Hacking and Mr. Bohan, Mr. Bicker stated that staff is in the process of developing an appropriate benchmark for the Account and that maturity and quality guidelines are also being established. Mr. Bicker said he believes that the existing quality criteria will be maintained and that the manager will be allowed to invest in GIC's with maturities of 5 years or less. He noted that the goal of the new structure is to add further diversification to the Account.

Ms. Yeomans, Ms. Veverka and Mr. Bohan restated their belief that the popularity of GIC options is declining as concerns about the viability of GIC's themselves is increasing and they questioned whether the SBI should be offering a GIC option in the Supplemental Fund. In response to questions from Mr. Bicker, all three members acknowledged that their own plans still offer participants investment options that use GIC's and synthetic GIC's. Ms. Yeomans said that as her fund went out and educated participants as to why they are saving their money, employee directed amounts going into that type of investment option has declined from 80% of total contributions to less than 50%. Mr. Bicker observed that a 50% rate is still very high and underscores that participants are generally risk averse and very much want a GIC-type option. Ms. Yeomans suggested that staff consider other fixed income alternatives for the Account in the near future and Mr. Bicker said staff will continue to evaluate other approaches. Mr. Bergstrom noted that since the Fixed Interest Account remains in demand by participants, the new structure of the Account was set up to further diversify the GIC options offered by the other vendors in the Deferred Compensation Plan. Mr. Bergstrom noted that he believes the recent drop in participation levels in the Fixed Interest Account is due primarily to low interest rates and he said he feels the number of participants utilizing the Account will increase again when interest rates rise to higher levels.

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

Mr. Bohan referred members to Tab F of the meeting materials and he reviewed the managers' performance for the quarter ending June 30, 1994. He reported that a review of manager benchmarks had been conducted during the quarter and that the conclusion was that the current benchmarks were satisfactory with the exceptions of those for Waddell and IAI. Mr. Bicker added that the benchmarks for those two managers have now been revised and are in place.

Mr. Bohan reported that staff has been researching the effects of adding a semi-passive stock segment to the domestic stock program. He said that the proposed structure would be applied to no more than 25% of the domestic stock program. He stated that the Committee's reasons for support of the semi-passive strategy are: it offers the potential to increase returns with only a marginal increase in risk; it offers the opportunity to recoup fees and transaction costs; and it has a lower manager fee structure than active management which increases the likelihood that semi-passive managers will be able to provide the expected value-added, net of fees to the fund.

Mr. Norstrom moved approval of the Committee's recommendation as stated in the Committee Report. Mr. Johnson seconded the motion. Ms. Yeomans then asked for discussion of the concept. In response to a question from Mr. Gudorf, Mr. Bicker stated that the recommendation affects stock segments of both the Basic and Post Retirement Funds since they now have the same managers. In response to further questions from Mr. Gudorf, Mr. Bicker said that the benchmark for the semi-passive managers would be the same as used for the tilted index fund. In response to questions from Ms. Hacking, Mr. Bicker said that there are firms that are implementing semi-passive management



approaches at this time. He reported that staff has been analyzing data from a universe of semi-passive managers and he added that all interview candidates will be asked to complete a hypothetical analysis of what their returns would have been vs. the tilted index benchmark. He said that if the concept is approved, the Search Committee would need to determine which managers they feel would be able to add value as well as to define the risk parameters under which the managers would operate. Mr. Bicker restated that the goal for the semi-passive managers is to add small incremental amounts of returns to cover their costs and the cost of the passive component.

Ms. Posey stated that there is only a small universe of semi-passive managers who can manage against a tilted index fund benchmark that is based on an extended market index. As a result, she said that trading costs and a manager's ability to track the benchmark will be a significant factor in the search and evaluation process. Ms. Yeomans observed that it appeared that the task of the Search Committee would be more complicated than some of the past searches given the need to define the risk control issues that had been raised during this discussion. Mr. Sausen said that as the likely chair of the Search Committee, he would welcome volunteers for the task and that the expertise of the IAC is very much needed for this search. Ms. Yeomans then asked for a vote on the previous motion. The motion passed.

Mr. Bohan referred members to the Committee Report for a list of nine finalists to be included in the semi-passive manager search. He noted that GE Capital is only being considered as a potential manager for the Assigned Risk Plan. Mr. Bergstrom moved approval of the Committee's recommendation, as stated in the Committee Report. Ms. Yeomans seconded the motion. Mr. Bicker clarified that the recommendation includes conducting a search for a semi-passive manager for the Assigned Risk Plan and he reminded members that this Plan must remain totally separate from retirement assets since it is a taxable entity. In response to a question from Mr. Bohan, Mr. Bicker confirmed that the Assigned Risk Plan will not use the tilted index fund as a benchmark since the Plan has a much smaller pool of money to work with. In response to a question from Mr. Gudorf, Mr. Bicker said that the intent is to retain 2-4 managers for the Basic and Post Funds with between \$500-600 million in assets each and 1 manager for the Assigned Risk Plan with \$75-80 million in assets. Mr. Gudorf stated his preference for hiring four managers for use by the Basic and Post Funds as a way to further diversify the pool. Further discussion followed regarding the need for the Search committee to determine how individual managers are able ensure the level of risk they are taking is compatible with the SBI's goals for the semi-passive program. Mr. Bicker commented that most of the SBI's active stock managers have standard deviations of value added in the area of 3-4 percentage points per year and that it was expected that a semi-passive manager would be in the range of 1-1.5 percentage points per year. He reiterated that the particular risk control methods of each manager would need to be evaluated through the search process. Ms. Yeomans asked for a vote on the previous motion regarding the finalists for the search. The motion passed.

### **Alternative Investment Committee Report**

Ms. Veverka referred members to Tab G of the meeting materials and she summarized the four investments that the Committee is recommending. She said the Committee is recommending an investment for both the Basic and Post Retirement Funds with a new real estate manager, Colony Advisors, in Colony Investors II. She said the Committee felt that fund as a bit different from other distressed real estate funds in that they provide internal property management with their own staff rather than hire a third party. Ms. Veverka said the next recommendation was for an investment in Kleinwort Benson Mezzanine Fund II for the Post Retirement Fund. She commented that the Committee felt the fund has an attractive strategy and the amount invested could be larger, given the large size of the fund. However, she said, the Committee did not want to make too many commitments to straightforward mezzanine funds. She then reported that the Committee was recommending an investment in Citicorp Mezzanine Partners Fund II for the Post Fund. She observed that this fund is somewhat unique in that it plays off the investments Citicorp is making for itself and therefore has a substantially different and lower fee structure. Finally, Ms. Veverka reported a recommendation for an investment in Warburg Pincus Ventures for the Basic Funds. She said the Committee found the large and deep organization of Warburg particularly attractive. In total, she said that \$90 million was being recommended for the Basic Funds and \$105 was being suggested for the Post Fund.

In response to questions from Mr. Bohan, Mr. Griebenow stated that Warburg Pincus had reduced its carried interest from 20% to 15%. He added that the 7% preferred return for Kleinwort Benson is in-line with current hurdle rates of other managers. Mr. Bohan commented that he is in favor of preferred returns and that he feels they should be a minimum of 10%. Mr. McDonald moved approval of all four of the Committee's recommendations, as stated in the Committee Report. Mr. Gudorf seconded the motion. In response to a question from Ms. Hacking, Ms. Veverka explained the characteristics of the two Post Fund investments and how they meet the Fund's yield oriented objective for alternative assets. The motion passed.

Mr. Bicker announced to members that Ms. Lehman will be taking a developmental leave to study at the London School of Economics and that she will return at year-end. Members of the IAC congratulated her and the meeting adjourned at 2:50 P.M.

Respectively submitted,



Howard J. Bicker  
Executive Director

# **Tab A**

## RETURN OBJECTIVES

### Period Ending 9/30/94

COMBINED FUNDS: \$ Billion	Return	Compared to Objective
<p><b>Provide Real Return (10 yr.)</b></p> <p>Provide returns that are 3-5 percentage points greater than inflation over moving 10 year periods.</p>	12.3% (1)	8.7 percentage points above target
<p><b>Exceed Median Fund (5 yr.)</b></p> <p>Outperform the median fund from a universe of public and corporate funds with a balanced asset mix over moving 5 year periods.</p>	8.7% (1)	0.1 percentage points below target Rank: 53 percentile (2)
<p><b>Exceed Composite Index (5 yr.)</b></p> <p>Outperform a composite market index weighted in a manner that reflects the actual asset mix of the Combined Funds over moving 5 year periods.</p>	8.7% (1)	0.3 percentage points above target

BASIC RETIREMENT FUNDS: \$ Billion	Return	Compared to Objective
<p><b>Exceed Composite Index (5 Yr.)</b></p> <p>Outperform a composite index weighted in a manner that reflects the long-term asset allocation of the Basic Funds over moving 5 year periods.</p>	8.7%	0.3 percentage points above target

POST RETIREMENT FUND: \$ Billion	Return	Compared to Objective
<p><b>Exceed Composite Index</b></p> <p>Outperform a composite index weighted in a manner that reflects the long-term asset allocation of the Post Fund over moving 5 year periods.</p>	3.7% (3)	0.0 percentage points above target (3)

(1) Reflects performance of Basic Funds only through 6/30/93, Combined Funds thereafter.

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

(3) Since asset allocation transition was completed, 7/1/93, annualized.

## ACTUARIAL VALUATIONS

### MSRS, TRA, PERA General Plans June 30, 1993

	Active (Basics)	Retired (Post)	Total (Basics & Post)
<b>Liability Measures</b>			
1. Current and Future Benefit Obligation	\$15.8 billion	\$6.4 billion	\$22.2 billion
2. Accrued Liabilities	11.2	6.4	17.6
<b>Asset Measures</b>			
3. Current and Future Actuarial Value	\$15.2 billion	\$6.4 billion	\$21.6 billion
4. Current Actuarial Value	7.9	6.4	14.3
<b>Funding Ratios</b>			
Future Obligations vs. Future Assets (3 ÷ 1)	96%	100%	97%
Accrued Liabilities vs. Current Actuarial Value (4 ÷ 2)	71%	100%	81%*

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

The funding ratio required by **Governmental Standard Accounting Board Statement No. 5** compares Cost Value of assets to the Current Benefit Obligation. This calculation provides funded ratios of **78%** for the Basics, **100%** for the Post and **86%** for the Total, respectively.

#### 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. Cost plus one-third of the difference between cost and market value for Basics.

#### Actuarial Assumptions:

Salary Growth: 6.5%

Interest//Discount Rate: 8.5% Basics, 5.0% Post

Full Funding Target Date: 2020

**EXECUTIVE SUMMARY**

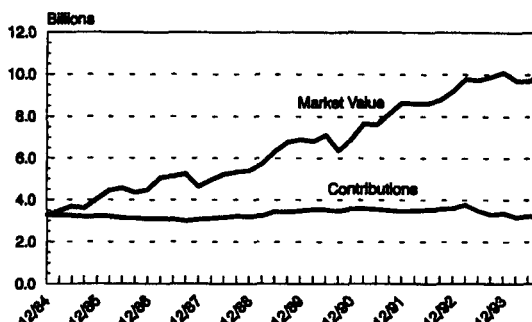
**Basic Retirement Funds**

**Asset Growth**

The market value of the Basic Funds increased 2.9% during the third quarter of 1994. Positive investment returns accounted for the increase during the period.

**Asset Growth  
During Third Quarter 1994  
(Millions)**

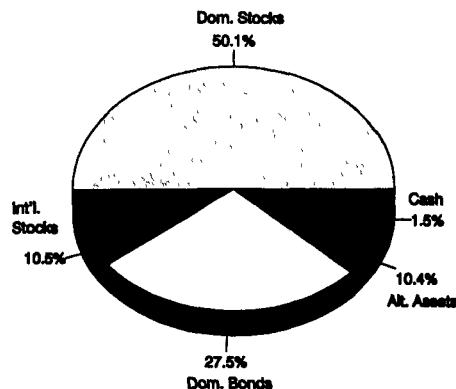
Beginning Value	\$9,688
Net Contributions	-5
Investment Return	285
Ending Value	\$9,968



**Asset Mix**

Domestic stocks are slightly over the policy target while cash and international stocks are slightly over. Bonds will exceed their target until alternative assets increase.

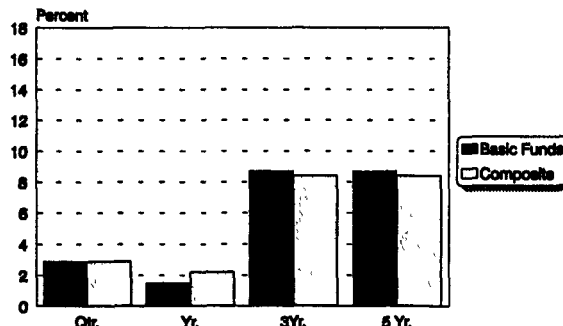
	Policy Asset Mix	Actual Mix 9/30/94	Actual Market Value (Millions)
Domestic Stocks	50.0%	50.1%	\$4,993
Int'l. Stocks	10.0	10.5	1,047
Bonds	24.0	27.5	2,737
Alternative Assets	15.0	10.4	1,035
Unallocated Cash	1.0	1.5	156
	100.0%	100.0%	\$9,968



**Fund Performance**

The Basic Funds matched its composite market index for the quarter and trailed its composite for the year.

	Qtr.	1 Yr.	3 Yr.	5 Yr.
Basics	2.9%	1.5%	8.7%	8.7%
Composite	2.9	2.2	8.4	8.4



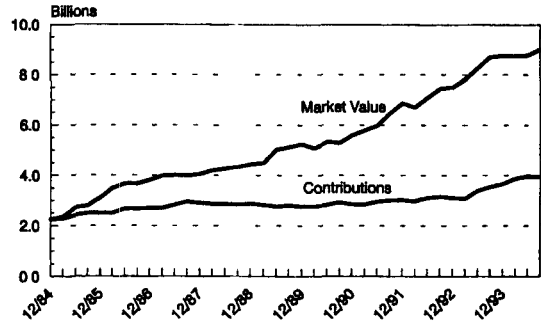
**EXECUTIVE SUMMARY**  
**Post Retirement Fund**

**Asset Growth**

The market value of the Post Fund increased 2.7% during the third quarter of 1994. The increase resulted from positive investment returns.

**Asset Growth**  
**During Third Quarter 1994**  
**(Millions)**

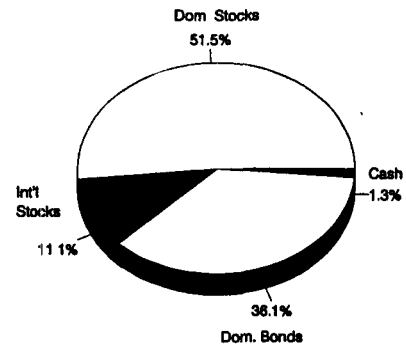
Beginning Value	\$8,772
Net Contributions	-27
Investment Return	267
Ending Value	\$9,012



**Asset Mix**

Domestic stocks and international stocks are slightly over the policy target while cash is slightly under. Domestic bonds will exceed its target until alternative assets increase.

	Policy Asset Mix	Actual Mix 9/30/94	Actual Market Value (Millions)
Domestic Stocks	50.0%	51.5%	\$4,638
Int'l. Stocks	10.0	11.1	1,005
Domestic Bonds	32.0	36.1	3,249
Alternative Assets	5.0	0.0*	3
Unallocated Cash	3.0	1.3	117
	100.0%	100.0%	\$9,012

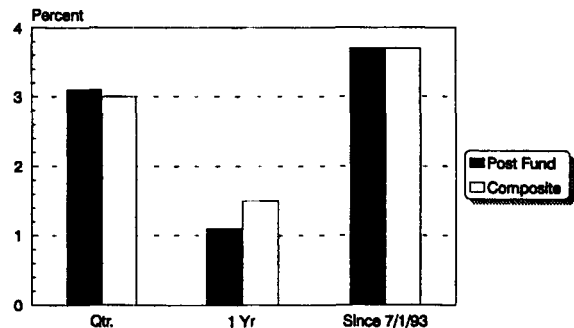


\* less than 0.1%

**Fund Performance**

The Post Fund exceeded its composite market index for the quarter and trailed the composite for the year.

	Qtr.	1 Yr.	Since 7/1/93*
Post Fund	3.1%	1.1%	3.7%
Composite	3.0	1.5	3.7



\* Date asset allocation transition to 50% domestic common stocks was completed.

**EXECUTIVE SUMMARY**  
**Stock and Bond Manager Performance**

**Domestic Stocks**

The domestic stock manager group (active and passive combined) trailed its target for the quarter and year.

	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Dom. Stocks</b>	<b>5.1%</b>	<b>1.7%</b>	<b>9.6%</b>	<b>8.5%</b>
Wilshire 5000*	5.4	2.6	9.8	8.9

\* Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

**International Stocks**

The international stock manager group (active and passive combined) exceeded its target for the quarter and for the year.

	Qtr.	1 Yr.	Since Incept.*
<b>Int'l. Stocks</b>	<b>1.9%</b>	<b>11.9%</b>	<b>18.0%</b>
EAFE	0.1	9.8	17.8

\* since 10/1/92.

**Domestic Bonds**

The domestic bond manager group (active and semi-passive combined) exceeded its target for the quarter and trailed its target for the year.

	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Bonds</b>	<b>0.7%</b>	<b>-3.5%</b>	<b>6.9%</b>	<b>8.8%</b>
Shearson Agg.	0.6	-3.2	6.3	8.5

**Note:** The above returns reflect the performance of the Basic Funds' managers through 6/30/93 and of the Combined Funds (Basic and Post) since 7/1/93.

**Wilshire 5000:** The Wilshire 5000 stock index reflects the performance of all publicly traded stocks of companies domiciled in the U.S.

**EAFE:** The Morgan Stanley Capital International index of 20 stock markets in Europe, Australia and the Far East.

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



**EXECUTIVE SUMMARY**  
**Assigned Risk Plan**

**Investment Objective**

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 balanced portfolio of common stocks and bonds. The actual asset mix will fluctuate in response to changes in the Plan's liability stream.

	9/30/94 Target	9/30/94 Actual
Stocks	20.0%	21.0%
Bonds	80.0	77.6
Unallocated Cash	0.0	1.4
Total	100.0%	100.0%

**Investment Management**

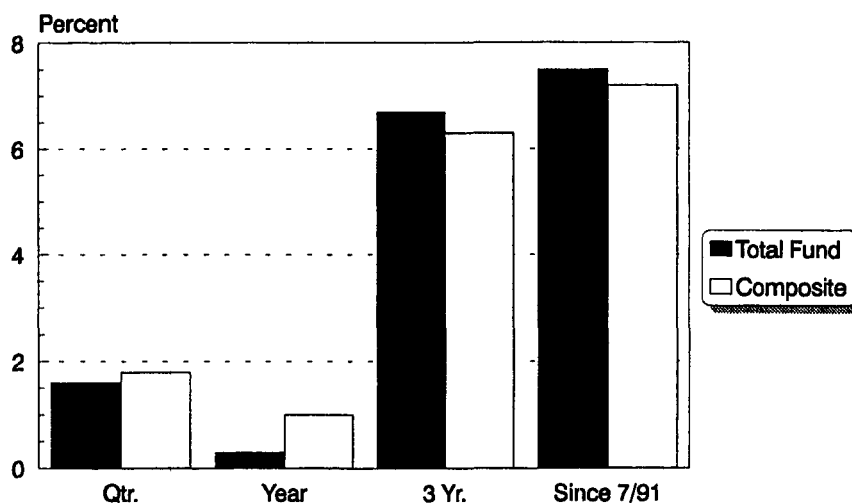
Voyageur Asset Management manages the bond segment of the Fund and SBI staff manage the bond segment through June 30, 1994. The portfolio was transferred from the Department of Commerce to the SBI on May 1, 1991.

**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. The equity benchmark is the S&P 500 as of July 1, 1994. Prior to that, it was a custom benchmark. The total fund benchmark is a combination of the fixed income and equity benchmarks, weighted according to the asset allocation target.

**Market Value**

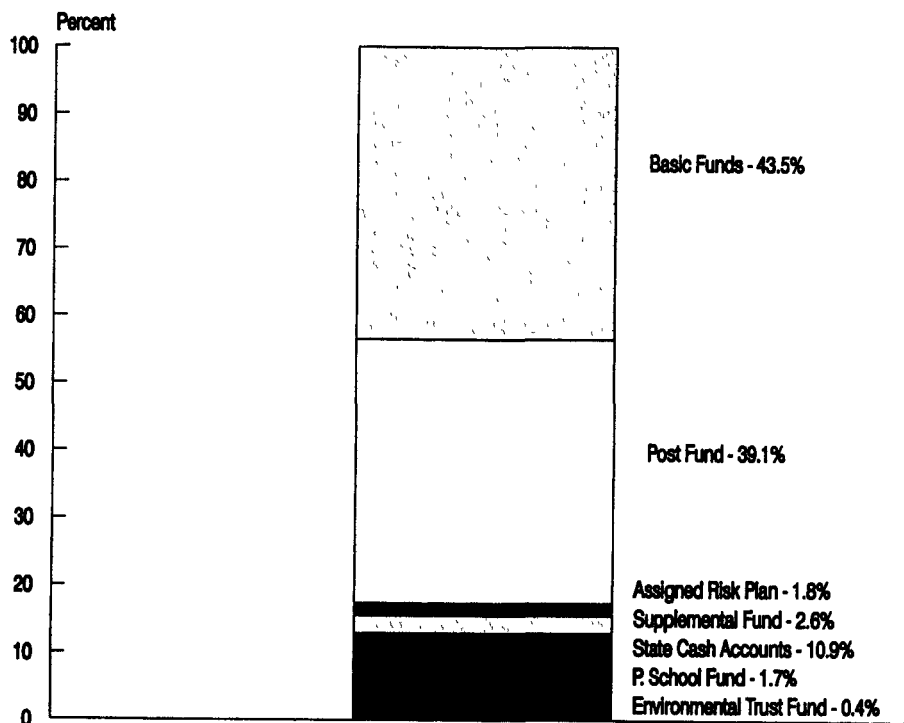
On September 30, 1994 the market value of the Assigned Risk Plan was \$451 million.



**Period Ending 9/30/94**

	Qtr.	Yr.	3 Yr.	Since 7/1/91
<b>Total Fund</b>	1.6%	0.3%	6.7%	7.5%
<b>Composite Index</b>	1.8	1.0	6.3	7.2
<b>Equity Segment</b>	5.0	2.9	6.4	6.6
<b>Benchmark</b>	4.9	5.2	6.2	7.5
<b>Bond Segment</b>	0.7	-0.4	6.7	7.7
<b>Benchmark</b>	1.0	0.1	6.2	7.1

**EXECUTIVE SUMMARY**  
**Funds Under Management**



**9/30/94**  
**Market Value**  
**(Billions)**

Basic Retirement Funds	\$10.0
Post Retirement Fund	9.0
Assigned Risk Plan	0.4
Supplemental Investment Fund	0.6
State Cash Accounts	2.5
Permanent School Fund	0.4
Environmental Trust Fund	0.1
<b>Total</b>	<b>\$23.0</b>

# MINNESOTA STATE BOARD OF INVESTMENT

## QUARTERLY INVESTMENT REPORT

Third Quarter 1994

(June 30, 1994 — September 30, 1994)

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## VARIOUS CAPITAL MARKET INDICES

	Period Ending 9/30/94				
	Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Domestic Equity</b>					
Wilshire 5000	5.4%	2.5%	9.9%	9.1%	14.1%
Dow Jones Industrials	6.7	11.1	11.6	10.8	16.4
S&P 500	4.9	3.8	9.2	9.2	14.5
Russell 2000	6.9	2.7	14.2	9.5	11.4
<b>Domestic Fixed Income</b>					
Lehman Aggregate	0.6	-3.2	6.2	8.4	10.7
Shearson Gov't./Corp.	0.5	-4.1	6.6	8.4	10.6
90 Day U.S. Treasury Bills	1.1	3.7	3.6	5.1	6.2
<b>International</b>					
EAFE**	0.1	9.8	8.8	2.6	18.2
Salomon Non U.S. Gov't. Bond	1.7	5.6	12.0	11.8	15.5
<b>Inflation Measure</b>					
Consumer Price Index***	1.0	2.9	2.9	3.6	3.6

\* Lehman Brothers Aggregate bond index

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

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

FINANCIAL MARKETS REVIEW

DOMESTIC STOCKS

For the quarter, the stock market generated positive returns. The increase was very broad based producing positive returns in almost every segment of the market. As shown below, all four of the Wilshire Style Indexes produced positive returns with growth stocks significantly outperforming value stocks. From a sector perspective, the technology, consumer non-durables, and material and services produced the largest positive returns while consumer durables and transportation produced the only negative returns. In general, the stock market advanced sharply in the first two months of the quarter due to strong corporate earnings. However the market gave up some of the increase in September due to the weakening of the dollar and increased fears of rising inflation.

The Wilshire 5000 provided a 5.4% return for the quarter. Performance among the different Wilshire Style Indexes for the quarter are shown below:

Large Value	1.2%
Small Value	3.2
Large Growth	6.7
Small Growth	12.0

The Wilshire 5000 increased 2.5% during the latest year.

DOMESTIC BONDS

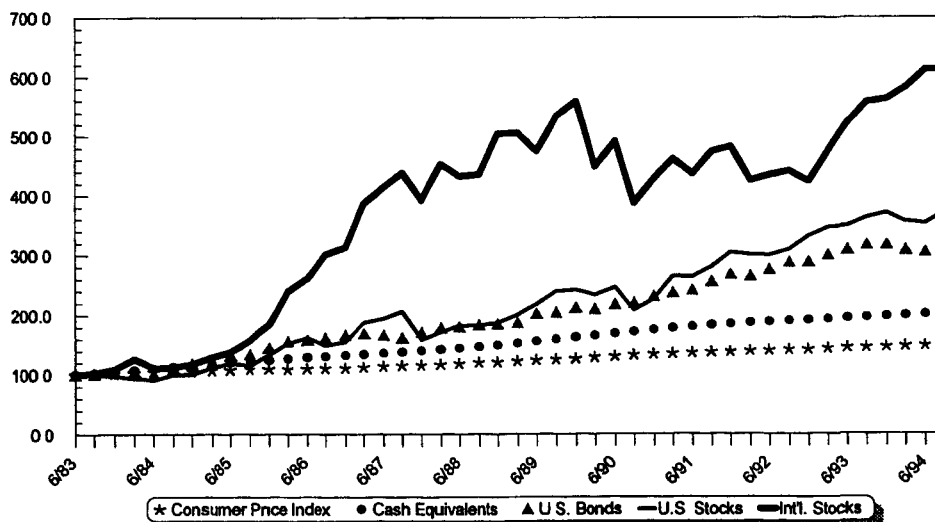
Returns were low because interest rates rose. The economy continues to strengthen forcing interest rates up as traders fear inflation. Two year rates increased 0.42% while long rates increased 0.21%. Mortgage securities had a shorter duration and therefore outperformed corporate and Treasury securities.

Overall, the Lehman Brothers Aggregate Bond Index increased 0.6% for the quarter. The Lehman Aggregate sector returns for the quarter were:

Treasury/Agency	0.43%
Corporates	0.73
Mortgages	0.87

The Lehman Aggregate declined 3.2% for the latest year.

PERFORMANCE OF CAPITAL MARKETS  
Cumulative Returns



Indices used are: Morgan Stanley's Index of Europe, Australia and the Far East (EAFE); Wilshire 5000 Index; Salomon Broad Investment Grade (BIG) Bond Index; 91 Day Treasury Bills; and the Consumer Price Index.

**FINANCIAL MARKETS REVIEW****INTERNATIONAL STOCKS**

In aggregate, the international stock markets (as measured by the EAFE index) provided a return of 0.1% for the quarter. As shown below, performance varied widely among the major markets:

Japan	-5.3%
United Kingdom	6.3
Germany	2.6
France	3.3

The EAFE index increased by 9.8% during the latest year. The index is compiled by Morgan Stanley Capital International and is a measure of 20 markets located in Europe, Australia and the Far East (EAFE). The major markets listed above comprise about 75% of the value of international markets.

**REAL ESTATE**

Nationally, many real estate markets are improving and currently, property types most favored by buyers include apartments, industrial parks and large regional shopping malls. Real estate investing by institutions is picking up after a long dry spell.

**PRIVATE EQUITY**

According to the *Venture Capital Journal*, "venture capital fundraising in the first half of 1994 surged to \$1.879 billion, up nearly 45% from last year, with venture capitalists favoring seed/early stage rather than later-stage strategies."

**RESOURCE FUNDS**

Crude oil prices averaged \$17.67 per barrel during the quarter compared to \$16.42 per barrel a year earlier. Natural gas prices were surprisingly weak during the quarter averaging \$1.70 per thousand cubic feet versus an unusually strong \$2.20 per thousand cubic feet a year earlier.

**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.

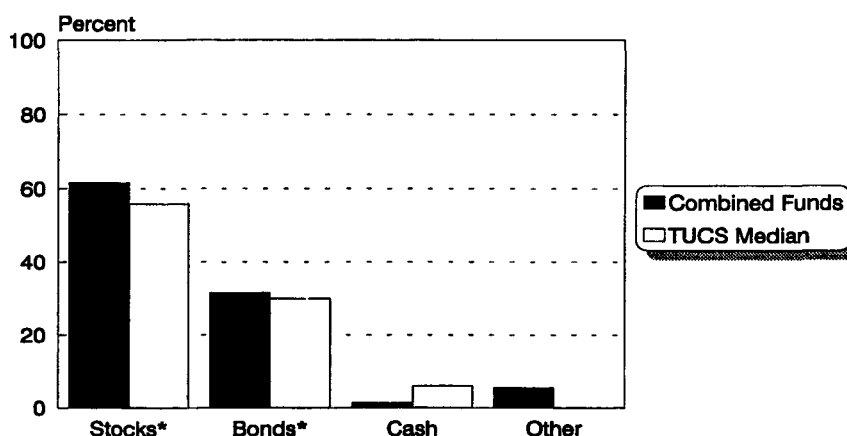
The comparison universe used by the SBI is the Master Trust portion of the Trust Universe Comparison Service (TUCS). This universe contains information on more than 200 public and corporate pension and trust funds with a balanced asset mix.

**Asset Mix Compared to Other Pension Funds**

On September 30, 1994, the actual asset mix of the Combined Funds was:

Comparisons of the Combined Funds' asset mix to the median allocation to stocks, bond and other assets of the public and corporate funds in TUCS on September 30, 1994 are shown below:

	\$ Millions	%
Domestic Stocks	\$9,631	50.8%
International Stocks	2,052	10.8
Bonds	5,985	31.5
Alternative Assets	1,038	5.5
Unallocated Cash	273	1.4
<b>Total</b>	<b>\$18,979</b>	<b>100.0%</b>



	Stocks*	Bonds*	Cash	Other
<b>Combined Funds</b>	<b>61.6%</b>	<b>31.5%</b>	<b>1.4%</b>	<b>5.5%</b>
Median Allocation in TUCS	55.9	29.9	6.0	0.0

\* Both domestic and international.

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

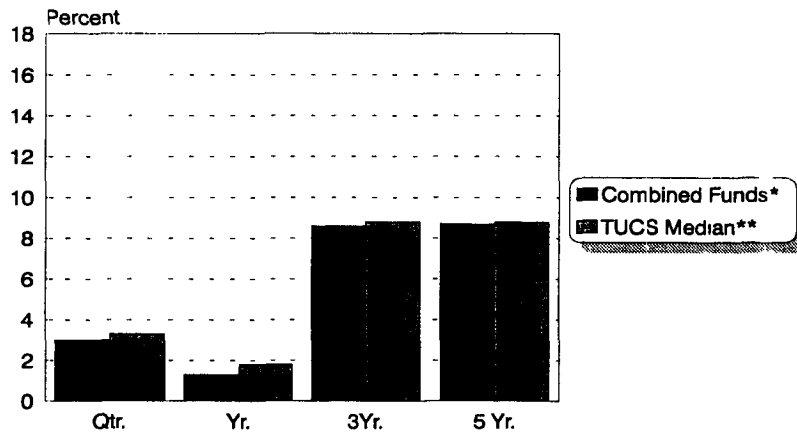
While the SBI is naturally concerned with how its returns compare to other pension investors, universe comparison data should be used with great care. There are several reasons why such comparisons will provide an "apples to oranges" look at performance:

- **Differing Treatment of Fees.** All SBI returns in this report are shown *after* all management fees while TUCS data is reported *before* fees. If the SBI reported returns before fees, its returns and rankings would be *higher* than those shown in this report.
- **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 TUCS are shown below:



	Period Ending 9/30/94			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Combined Funds Return*</b>	3.0%	1.3%	8.6%	8.7%
<b>TUCS Median Fund Return**</b>	3.3	1.8	8.8	8.8
<b>Percentile Rank in TUCS</b>	61st	59th	55th	53rd

\* After fees. Includes Basic Funds only through 6/30/93, Basic and Post thereafter.

\*\* Before fees

The SBI's stated performance objective is that the Combined Funds will rank in the top half of the universe (above the 50th percentile) over the most recent five year

period. The SBI will strive to achieve performance which ranks in the top third (above the 33rd percentile).



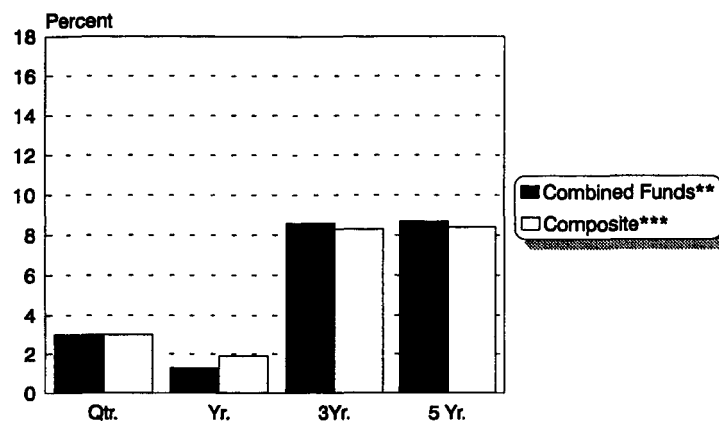
**COMBINED FUNDS**  
**Performance Compared to Composite Index**

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:

	Market Index	Combined Index Weights 7/1/94
Domestic Stocks	Wilshire 5000	50.0%
Int'l. Stocks	EAFE	10.0
Domestic Bonds	Lehman Aggregate	32.8*
Alternative Assets	Wilshire Real Estate	2.1*
	Venture Capital Funds	2.6*
	Resource Funds	0.5*
Unallocated Cash	91 Day T-Bills	2.0
		100.0%

\* Alternative asset and bond weights are reset in the composite each quarter to reflect the amount of unfunded commitments in alternative asset classes.



	Period Ending 9/30/94			
	Qtr.	Yr.	3 Yr.	5 Yr.
Combined Funds**	3.0%	1.3%	8.6%	8.7%
Composite Index***	3.0	1.9	8.3	8.4

\*\*Includes performance of Basic Funds through 6/30/93, Basic and Post Funds thereafter.

\*\*\*Adjusted to reflect the SBI's restrictions on liquor and tobacco stocks through 3/31/93 and AHP restriction through 10/31/93.

## 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 250,000 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,

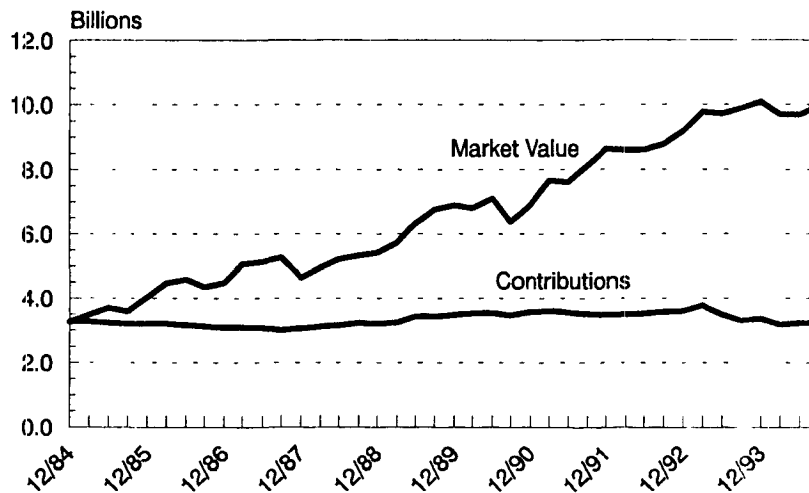
the Basic Retirement Funds must generate investment returns of at least 8.5% on an annualized basis, over time.

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 Retirement Funds' assets increased 2.9% during the third quarter of 1994.

Positive investment returns accounted for the increase.



	Last Five Years						Latest Qtr.
	In Millions						
	12/90	12/91	12/92	12/93	3/94	6/94	9/94
Beginning Value	\$6,875	\$6,919	\$8,639	\$9,191	\$10,086	\$9,697	\$9,688
Net Contributions	91	-92	-34	-239	-187	51	-5
Investment Return	-47	1,812	586	1,134	-202	-60	285
Ending Value	\$6,919	\$8,639	\$9,191	\$10,086	9,697	\$9,688	9,968

**BASIC RETIREMENT FUNDS**

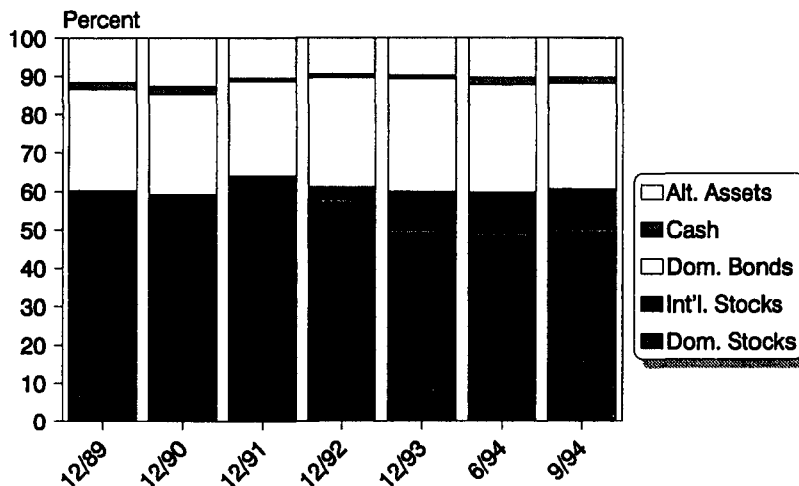
**Asset Mix**

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 targets are designed to add value to the Basic Funds over their long-term investment time horizon.

The actual asset mix changed only slightly from the prior quarter. This was due primarily to market movements.

Domestic Stocks	50.0%
Int'l. Stocks	10.0
Domestic Bonds	24.0
Alternative Assets*	15.0
Unallocated Cash	1.0

\*Alternative assets include real estate, venture capital and resource funds.



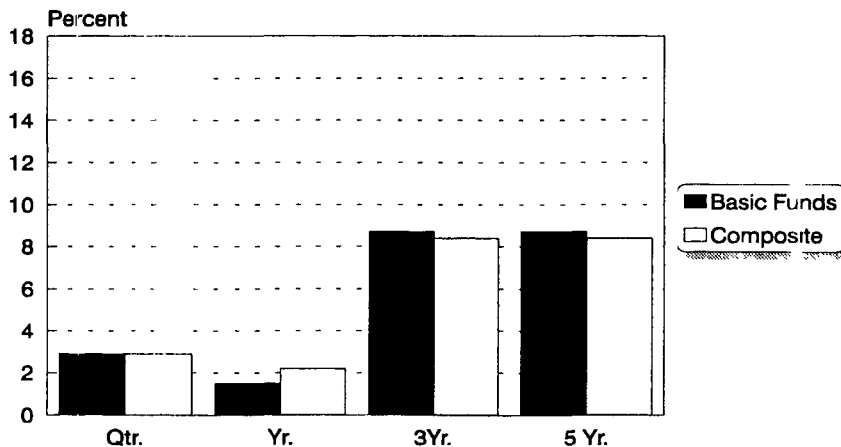
	Last Five Years					Latest Qtr.	
	12/90	12/91	12/92	12/93	3/94	6/94	9/94
Domestic Stocks	59.1%	63.9%	57.9%	49.9%	49.0%	49.1%	50.1%
Int'l. Stocks	0.0	0.0	3.2	10.0	10.3	10.6	10.5
Domestic Bonds	26.2	24.7	28.5	29.4	28.6	28.1	27.5
Real Estate	7.0	4.8	4.2	4.1	4.2	4.4	4.4
Private Equity	4.2	4.7	4.2	4.6	5.1	5.2	5.2
Resource Funds	1.5	1.1	1.2	1.1	1.0	0.8	0.8
Unallocated Cash	2.0	0.8	0.8	0.9	1.8	1.8	1.5
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

**BASIC RETIREMENT FUNDS**  
**Total Fund Performance**

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

	Basics Target	Market Index	Basics Composite 7/1/94
Domestic Stocks	50.0%	Wilshire 5000	50.0%
Int'l. Stocks	10.0	EAFE	10.0
Domestic Bonds	24.0	Lehman Aggregate	28.5*
Alternative Assets	15.0	Wilshire Real Estate	4.5*
		Private Equity Funds	5.0*
		Resource Funds	1.0*
Unallocated Cash	1.0	91 Day T-Bills	1.0
	100.0%		100.0%

\* Alternative asset and bond weights are reset in the composite each quarter to reflect the amount of unfunded commitments in alternative asset classes.



**Period Ending 6/30/94**

	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Basic Funds</b>	2.9%	1.5%	8.7%	8.7%
Composite Index**	2.9	2.2	8.4	8.4

\*\*Adjusted to reflect the SBI's restrictions on liquor and tobacco stocks through 3/31/93 and AHP restriction through 10/31/93

Effective July 1, 1993, the Basic and Post Funds share the same stock, domestic bond and international stock managers. See page 14 for the performance of these asset pools. Performance of the Basic Funds' alternative assets is on page 15.

**POST RETIREMENT FUND**

The Post Retirement Investment Fund contains the pension assets of retired public employees covered by statewide retirement plans. Approximately 60,000 retirees receive monthly annuities from the assets of the Fund.

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 5% 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.

Through fiscal year 1992, unrealized capital gains (or losses) were excluded from the statutory definition of

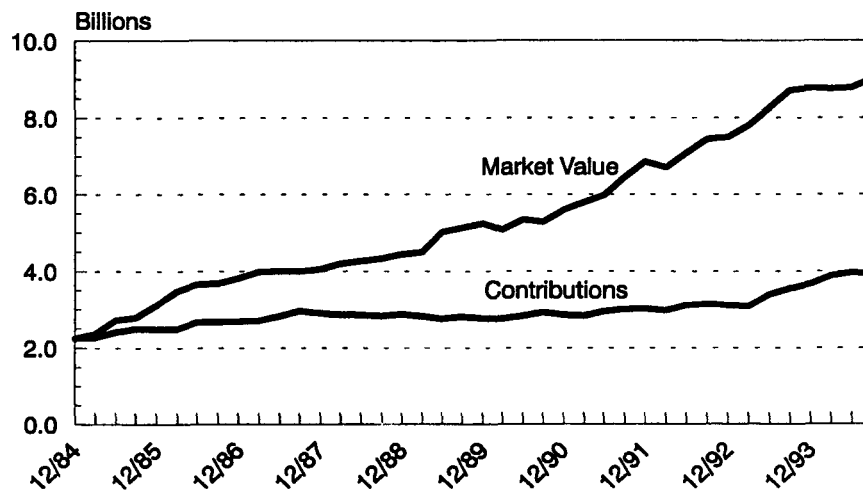
earnings. For this reason the Post Fund previously was not designed to maximize long-term total rates of return. Rather, the SBI attempted to generate a high, consistent stream of realized earnings for the Post Fund that maintained current benefits, as well as produced benefit increases over time.

Beginning in fiscal year 1993, the post retirement benefit increase formula is based on total return rather than realized earnings. As a result, the Board has adopted a new long-term asset allocation strategy for the Post Fund which incorporates a substantial commitment to common stocks. The transition to the new asset allocation strategy was completed by the start of fiscal year 1994 (7/1/93).

**Asset Growth**

The market value of the Post Retirement Fund increased by 2.7% during the third quarter of 1994.

The increase was due to positive investment returns.



	In Millions						
	12/90	12/91	12/92	12/93	3/94	6/94	Latest Qtr. 9/94
Beginning Value	\$5,238	\$5,590	\$6,855	\$7,500	\$8,766	\$8,742	\$8,772
Net Contributions	88	162	95	386	211	86	-27
Investment Return	264	1,103	550	880	-235	-56	267
Ending Value	\$5,590	\$6,855	\$7,500	\$8,766	\$8,742	\$8,772	9,012

POST RETIREMENT FUND

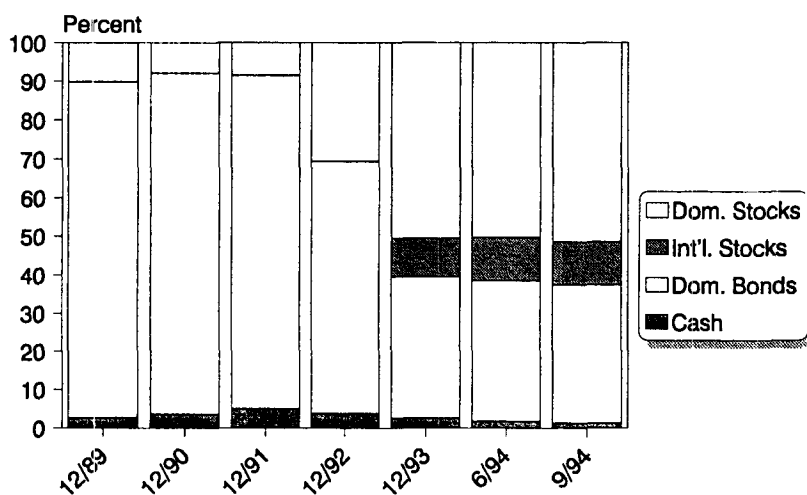
Asset Mix

The Board adopted a new asset allocation strategy for the Post Fund in fiscal year 1993 which reflects the new post retirement benefit increase formula recently 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 will allow 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.

Funding for alternative assets began first quarter 1994 with a small private equity investment. International stocks are slightly above the target allocation due to market movements.

Domestic Stocks	50.0%
Int'l. Stocks	10.0
Domestic Bonds	32.0
Alternative Assets	5.0
Unallocated Cash	3.0
<b>Total</b>	<b>100.0%</b>



	Last Five years				Latest Qtr		
	12/90	12/91	12/92	12/93	3/94	6/94	9/94
Dom. Stocks	7.9%	8.5%	30.6%	50.5%	50.1%	50.3%	51.5%
Int'l. Stocks	0.0	0.0	0.0	10.0	10.6	11.2	11.1
Dom. Bonds	88.5	80.0	65.6	36.9	36.8	36.7	36.1
Alt. Assets	0.0	0.0	0.0	0.0	0.0*	0.0*	0.0*
Unallocated Cash	3.6	5.0	3.8	2.6	2.5	1.8	1.3
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

\* less than 0.1%

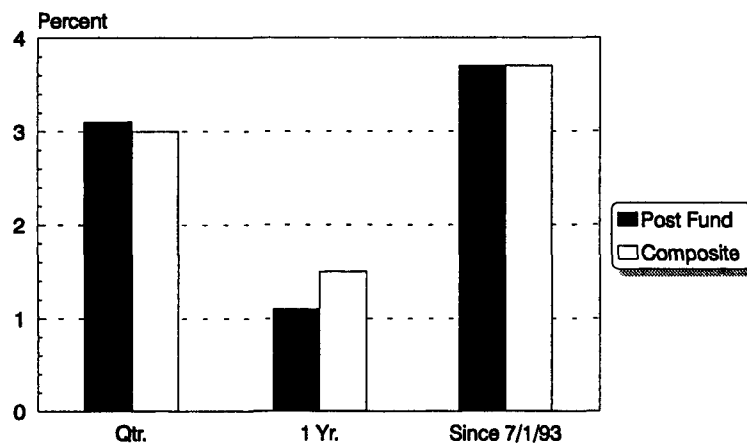
**POST RETIREMENT FUND**  
**Total Fund Performance**

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 7/1/94
Domestic Stocks	50%	Wilshire 5000	50.0%
Int'l. Stocks	10	EAFE	10.0
Domestic Bonds	32	Lehman Aggregate	37.0*
Alternative Assets	5	---	0.0*
Unallocated Cash	3	91 Day T-Bills	3.0
	100%		100.0%

\* Until the alternative asset allocation is fully funded, the composite will be overweighted in bonds.

The asset mix of the Post Fund was moved toward a 50% stock allocation during fiscal year 1993 and in fiscal year 1994, a 10% international stock allocation was added. The performance of the fund since the transition was completed is shown below.



	Qtr.	1 Yr.	Since 7/1/93
<b>Post Fund</b>	<b>3.1%</b>	<b>1.1%</b>	<b>3.7%</b>
Composite Index	3.0	1.5	3.7

Effective July 1, 1993, the Basic and Post Funds share the same domestic stock, domestic bond and international stock managers. See page 14 for the performance of these asset pools.

**STOCK AND BOND MANAGERS**  
**Performance of Asset Pools**

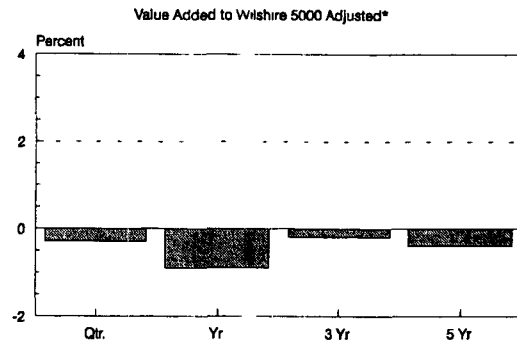
**Domestic Stock Pool**

**Target:** Wilshire 5000 Adjusted\*

**Expectation:** If half of the pool is actively managed and half is passively managed, the entire pool is expected to exceed the target by +.20-.45% annualized, over time.

	Qtr.	Yr.	Annualized	
			3 Yrs.	5 Yrs.
Stock Pool	5.1%	1.7%	9.6%	8.5%
Wilshire 5000*	5.4	2.6	9.8	8.9

\*Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

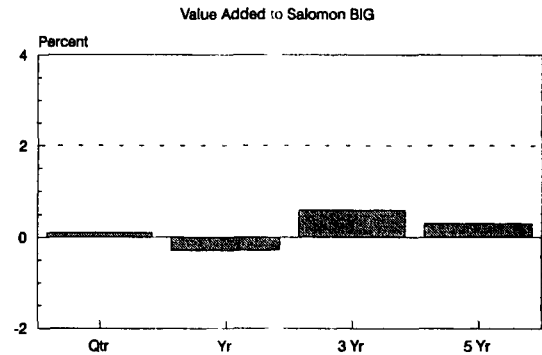


**Domestic Bond Pool**

**Target:** Salomon Broad Investment Grade (BIG) 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.

	Qtr.	Yr.	Annualized	
			3 Yrs.	5 Yrs.
Bond Pool	0.7%	-3.5%	6.9%	8.8%
Salomon BIG	0.6	-3.2	6.3	8.5

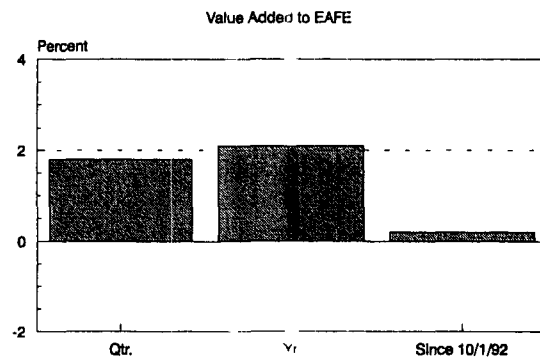


**International Stock Pool**

**Target:** EAFE

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

	Qtr.	Yr.	Since
			10/1/92
Int'l. Pool	1.9%	11.9%	18.0%
EAFE	0.1	9.8	17.8





**ALTERNATIVE ASSET MANAGERS**  
**Performance of Asset Pools**

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

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

The Wilshire Real Estate Index contains returns of 30 commingled funds. The index does not include returns from funds that are less than 3 years old or are not fully invested.

	Qtr.	Yr.	Annualized	
			3 Yrs.	5 Yrs.
Real Estate	1.5%	0.7%	-5.2%	-3.1%
Real Estate Index	1.5	1.5	-4.8	-4.1
Inflation	1.0	3.0	2.9	3.6

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

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

The SBI began its venture capital programs in the mid-1980's. Some of the investments, therefore, are relatively immature and returns may not be indicative of future results.

	Qtr.	Yr.	Annualized	
			3 Yrs.	5 Yrs.
Private Equity	-0.5%	15.4%	6.8%	15.5%

**Resource Pool (Basic Funds only)**

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

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

	Qtr.	Yr.	Annualized	
			3 Yrs.	5 Yrs.
Resource Funds	-1.4%	-2.3%	5.6%	5.9%

ASSIGNED RISK PLAN

**Investment Objective**

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 balanced portfolio of common stocks and bonds. The actual asset mix will fluctuate in response to changes in the Plan's liability stream.

	9/30/94 Target	9/30/94 Actual
Stocks	20.0%	21.0%
Bonds	80.0	77.6
Unallocated Cash	0.0	1.4
	100.0%	100.0%

**Investment Management**

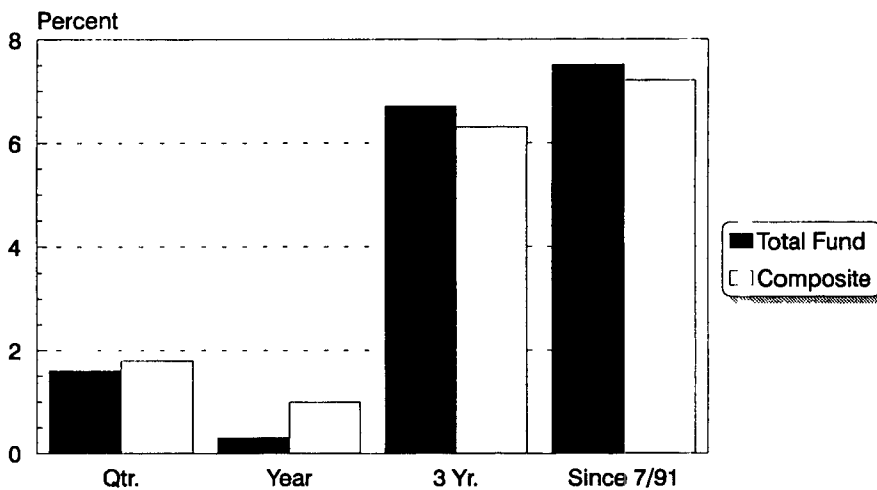
Voyageur Asset Management manages the bond segment of the Fund while SBI staff manage the equity segment. The portfolio was transferred from the Department of Commerce to the SBI on May 1, 1991.

**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. The equity benchmark is the S&P 500. The total fund benchmark is a combination of the fixed income and equity benchmarks, weighted according to the asset allocation target

**Market Value**

On September 30, 1994 the market value of the Assigned Risk Plan was \$451 million



	Period Ending 9/30/94			
	Qtr.	Yr.	1 Yr.	Since 7/1/91
<b>Total Account</b>	1.6%	0.3	6.7%	7.5%
Composite	1.8	1.0	6.3	7.2
<b>Equity Segment</b>	5.0	2.9	6.4	6.6
Benchmark	4.9	5.2	6.2	7.5
<b>Bond Segment</b>	0.7	-0.4	6.7	7.7
Benchmark	1.0	0.1	6.2	7.1

## 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. These returns may differ slightly from calculations based on share values, due to the movement of cash flows in and out of the accounts.

**On September 30, 1994 the market value of the entire fund was \$602 million.**

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## Investment Options

**Income Share Account** - a balanced portfolio utilizing both common stocks and bonds.

**Growth Share Account** - an actively managed, all common stock portfolio.

**Common Stock Index Account** - a passively managed, all common stock portfolio designed to track the performance of the entire stock market.

**International Share Account** - a portfolio of non U.S. stocks that incorporates both active and passive management and is designed to track the performance of the Morgan Stanley Capital International Index of Europe, Australia and the Far East (EAFE).

**Bond Market Account** - an actively managed, all bond portfolio.

**Money Market Account** - a portfolio utilizing short-term, liquid debt securities.

**Fixed Interest Account** - an option utilizing guaranteed investment contracts (GIC's), which offer a fixed rate of return for a specified period of time.

**SUPPLEMENTAL INVESTMENT FUND**  
**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.

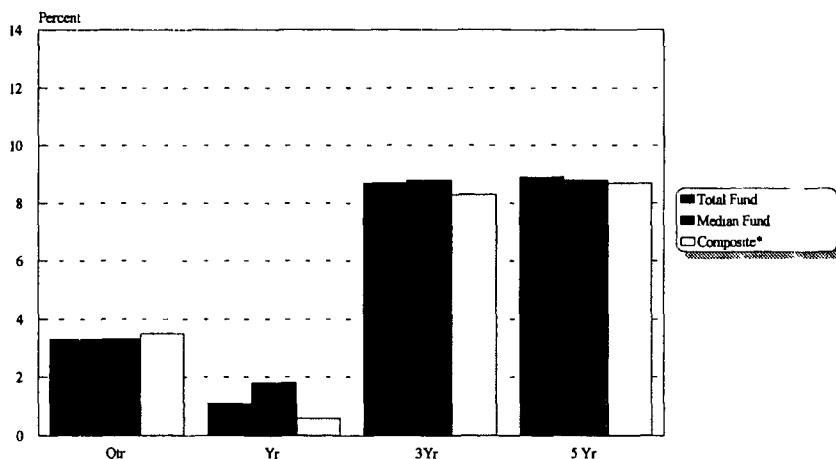
**Investment Management**

The Account combines internal and external management. Internal investment staff manage the entire fixed income segment. Throughout the period shown below, the entire stock segment has been managed by Wilshire Associates as part of a passively managed index fund designed to track the Wilshire 5000. Prior to April 1988, a significant portion of the stock segment was actively managed.

**Market Value**

On September 30, 1994 the market value of the Income Share Account was \$291 million.

	Target	Actual
Stocks	60.0%	61.1%
Bonds	35.0	33.9
Unallocated Cash	5.0	5.0
	100.0%	100.0%



	Period Ending 9/30/94			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Total Account%</b>	<b>3.3%</b>	<b>1.1%</b>	<b>8.7%</b>	<b>8.9%</b>
Median Fund*	3.3	1.8	8.8	8.8
Composite**	3.5	0.6	8.3	8.7
<b>Equity Segment</b>	<b>5.3</b>	<b>3.7</b>	<b>10.4</b>	<b>9.3</b>
Wilshire 5000***	5.4	2.6	9.8	8.9
<b>Bond Segment</b>	<b>0.1</b>	<b>-3.7</b>	<b>6.8</b>	<b>8.6</b>
Lehman Aggregate	0.6	-3.2	6.3	8.5

\*TUCS Median Master Trust

\*\*60% Wilshire 5000/35% Lehman Aggregate Bond Index/5% T-Bills Composite. Wilshire 5000 is adjusted as noted below.

\*\*\* Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

Note: Prior to 7/1/94 the Salomon BIG was the benchmark and a component of the Composite.

**SUPPLEMENTAL INVESTMENT FUND**  
**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 almost entirely in common stocks. Generally, the small cash equivalents component represents the normal cash reserves held by the Account as a result of net contributions not yet allocated to stocks or held in reserve to accommodate withdrawals.

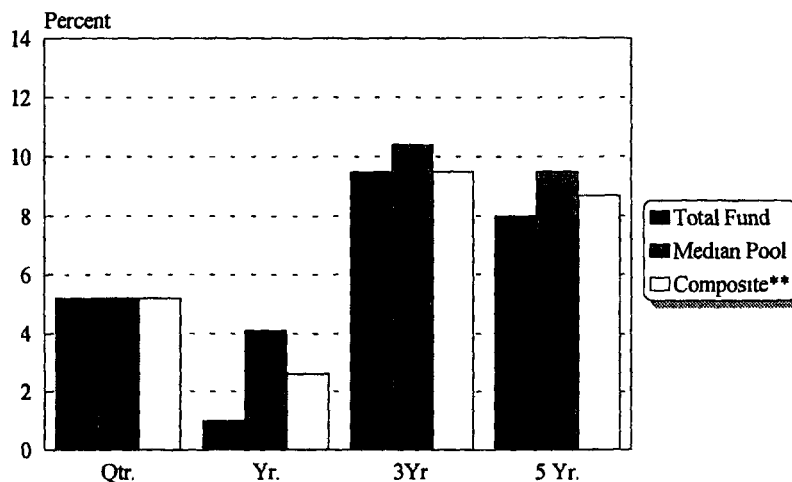
**Investment Management**

Throughout the period shown below, the entire Account has been managed by the same group of active external stock managers utilized by the Basic and Post Retirement Funds. Prior to April 1988, other active managers controlled a substantial portion of the account.

**Market Value**

On September 30, 1994 the market value of the Growth Share Account was \$108 million.

	Target	Actual
Stocks	95.0%	92.8%
Unallocated Cash	5.0	7.2
	100.0%	100.0%



**Period Ending 9/30/94**

	Annualized			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>5.2%</b>	<b>1.0%</b>	<b>9.5%</b>	<b>8.0%</b>
Median Pool*	5.2	4.1	10.4	9.5
Composite**	5.2	2.6	9.5	8.7

\* TUCS Median Equity Pool

\*\* 95% Wilshire 5000/5% T-Bills Composite. Wilshire 5000 buy/hold index is adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

**SUPPLEMENTAL INVESTMENT FUND**  
**Common Stock Index Account**

**Investment Objective and Asset Mix**

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

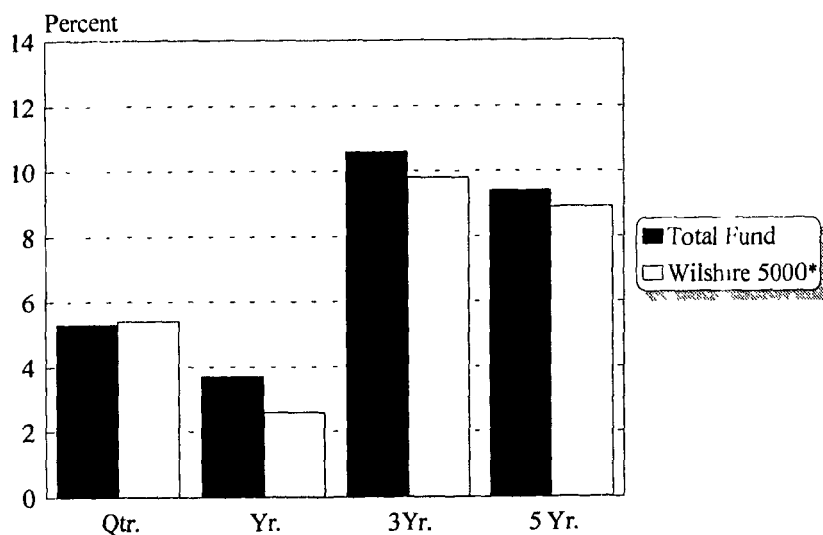
The Account is invested 100% in common stock.

**Investment Management**

The entire Account is managed by Wilshire Associates as part of a passively managed index fund.

**Market Value**

On September 30, 1994 the market value of the Common Stock Index Account was \$13 million.



	Period Ending 9/30/94			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>5.3%</b>	<b>3.7%</b>	<b>10.6%</b>	<b>9.4%</b>
<b>Wilshire 5000*</b>	<b>5.4</b>	<b>2.6</b>	<b>9.8</b>	<b>8.9</b>

\*Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

**SUPPLEMENTAL INVESTMENT FUND  
International Share Account**

**Investment Objective and Asset Mix**

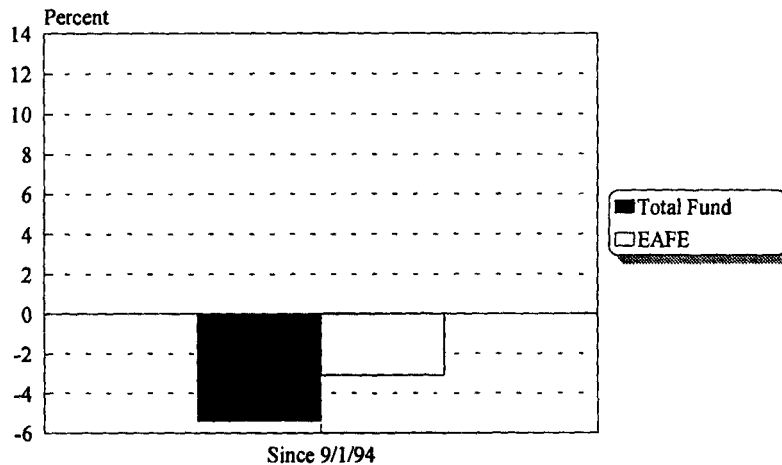
The investment objective of the International Share Account is to earn a high rate of return by investing in the stock of companies outside the U.S. Approximately half of the Account is "passively managed" and is designed to track the return of 20 markets included in the Morgan Capital International index of Europe, Australia and the Far East (EAFE). The remainder of the Account is "actively managed" by several international managers who buy and sell stocks in an attempt to maximize market value.

**Investment Management**

The Account was opened for contributions on September 1, 1994. Beginning October 1, 1994, the Account will use the same group of international active and passive managers as the Basic and Post Retirement Funds.

**Market Value**

On September 30, 1994 the market value of the International Share Account was \$41 thousand.



**Period Ending 9/30/94  
Since  
9/1/94**

<b>Total Account*</b>	<b>-5.4%</b>
<b>EAFE</b>	<b>-3.1</b>

\* Account established on September 1, 1994.

**SUPPLEMENTAL INVESTMENT FUND**  
**Bond Market Account**

**Investment Objective**

The investment objective of the Bond Market Account is to earn a high rate of return by investing in fixed income securities.

**Asset Mix**

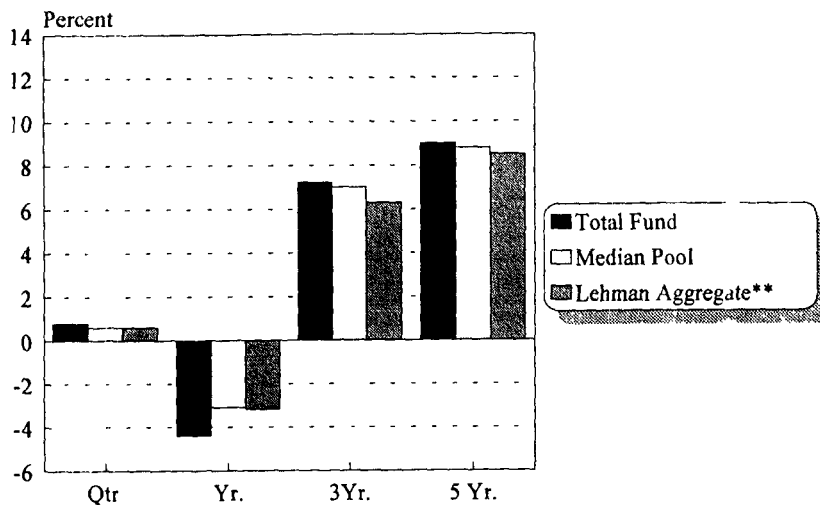
The Bond Market Account invests primarily in high-quality, government and corporate bonds that have intermediate to long-term maturities, usually 3 to 20 years.

**Investment Management**

The entire Account is managed by the same group of active external bond managers utilized by the Basic and Post Retirement Funds.

**Market Value**

On September 30, 1994 the market value of the Bond Market Account was \$20 million.



	Period Ending 9/30/94			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>0.8%</b>	<b>-4.4%</b>	<b>7.2%</b>	<b>9.0%</b>
Median Pool*	0.6	-3.1	7.0	8.8
Lehman Aggregate**	0.6	-3.2	6.3	8.5

\* TUCS Median Fixed Income Pool

\*\* Prior to July 1, 1994, the Salomon Broad Investment Grade Index was used.



**SUPPLEMENTAL INVESTMENT FUND  
Money Market Account**

**Investment Objective**

The investment objective of the Money Market Account is to purchase short-term, liquid fixed income investments that pay interest at rates competitive with those available in the money markets.

**Asset Mix**

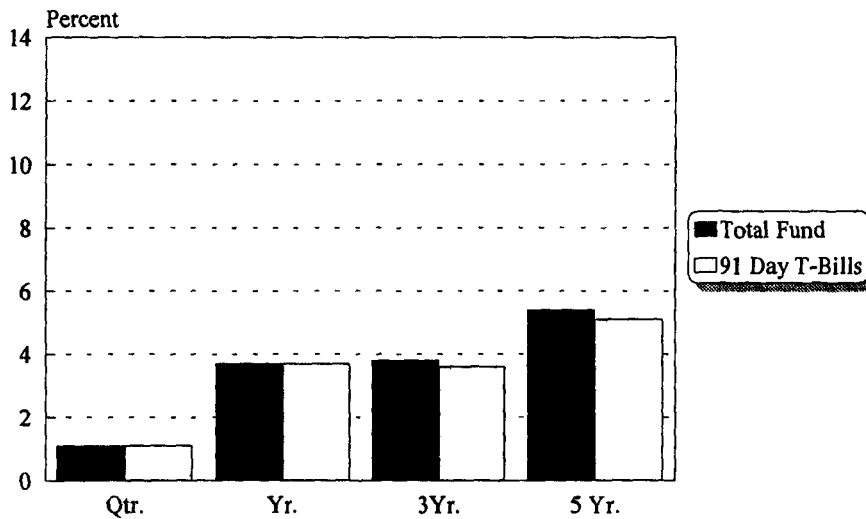
The Money Market Account is invested entirely in high quality short-term investments such as U.S. Treasury Bills, bank certificates of deposit, repurchase agreements, and high grade commercial paper. The average maturity of these investments is 30 to 60 days.

**Investment Management**

The Money Market Account is managed solely by State Street Bank and Trust Company. State Street manages a major portion of the Board's cash reserves.

**Market Value**

On September 30, 1994 the market value of the Money Market Account was \$61 million.



**Period Ending 9/30/94**

**Annualized**

**Qtr. Yr. 3 Yr. 5 Yr.**

<b>Total Account</b>	<b>1.1%</b>	<b>3.7%</b>	<b>3.8%</b>	<b>5.4%</b>
<b>91 Day T-Bills</b>	<b>1.1</b>	<b>3.7</b>	<b>3.6</b>	<b>5.0</b>

## SUPPLEMENTAL INVESTMENT FUND

### Fixed Interest Account

#### Investment Objectives

The investment objectives of the Fixed Interest Account are to protect investors from any loss of their original investment and to provide a fixed rate of return over a three year period.

#### Asset Mix

The Fixed Interest Account is invested in guaranteed investment contracts (GIC's) offered by major U.S. insurance companies and banks.

#### Investment Management

Annually, the Board accepts bids from banks and insurance companies that meet the financial quality criteria defined by State statute. Generally, the insurance company or bank offering the highest three year GIC interest rate is awarded the contract. That interest rate is then offered to participants who make contributions to the Fixed Interest Account over the following twelve months.

#### Market Value

On September 30, 1994 the market value of the Fixed Interest Account was \$68 million.

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Contract Period	Annual Effective Interest Rate	Manager
Nov. 1, 1991-Oct. 31, 1994	6.634%	Continental Assurance/Provident National (blended rate)
Nov. 1, 1992-Oct. 31, 1995	5.280%	Norwest Bank Minnesota
Nov. 1, 1993-Oct. 31, 1996	4.625%	Principal Mutual/Hartford Life (blended rate)

PERMANENT SCHOOL FUND

**Investment Objectives**

The SBI invests the Permanent School Fund to produce a high, consistent level of income that will assist in offsetting state expenditures on school aids.

The Permanent School Fund's investment objectives have been influenced by the legal provisions under which its investments must be managed. These provisions require that the Permanent School Fund's principal remain inviolate. Further, any net realized equity and fixed income capital gains must be added to principal. Moreover, if the Permanent School Fund realizes net capital losses, these losses must be offset against interest and dividend income before such income can be distributed. Finally, all interest and dividend income must be distributed in the year in which it is earned.

These legal provisions have limited the investment time horizon over which the Permanent School Fund is managed. Long-run growth in its assets is difficult to achieve without seriously reducing current spendable income and exposing the spendable income stream to unacceptable volatility. The SBI, therefore, has invested the Permanent School Fund's assets to produce the maximum amount of current income, within the constraint of maintaining adequate portfolio quality.

**Asset Mix**

The Permanent School Fund continues to hold only fixed income securities.

	Target	Actual
Bonds	95.0%	86.8%
Unallocated Cash	5.0	13.2
Total	100.0%	100.0%

**Investment Management**

The entire fund is managed by the SBI investment staff.

**Asset Growth**

The market value of the Permanent School Fund's assets increased 1.1% during the third quarter due to positive investment returns and net contributions.

**Asset Growth  
During Third Quarter 1994  
(Millions)**

Beginning Value	\$415.6
Net Contributions	1.5
Investment Return	3.2
Ending Value	\$420.3

**Bond Segment Performance**

The composition of the Permanent School Fund's bond portfolio was essentially unchanged during the quarter. The bond portfolio is structured with a laddered distribution of maturities to minimize the Fund's exposure to re-investment rate risk. At the quarter's-end, the portfolio had a current yield of 7.99%, duration of 5.52 years, and a AAA quality rating. The portfolio remains concentrated in Treasury issues with the remainder primarily distributed among mortgages, industrials and utilities.

**Bond Portfolio Statistics  
9/30/94**

Value at Market	\$358,699,904
Value at Cost	358,668,637
Average Coupon	8.07%
Current Yield	7.99
Yield to Maturity	8.08
Current Yield at Cost	7.99
Average Time to Maturity	9.85
Duration	5.52
Average Quality Rating	AAA
Number of Issues	108
Treasury	57.9%
Agency	0.0
Corporate	21.1
Mortgages	21.0
Total	100.0%

**ENVIRONMENTAL TRUST FUND**

**Investment Objective**

The Environmental Trust Fund's objective is to produce a growing level of spendable income, within the constraints of maintaining adequate portfolio quality and liquidity.

**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.

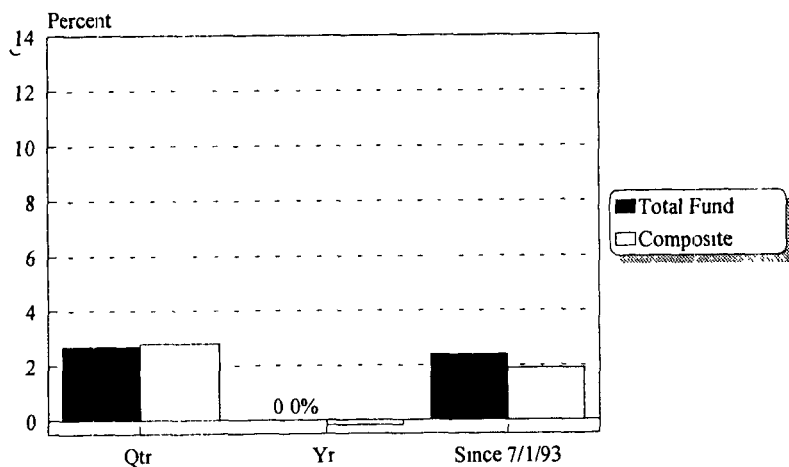
**Investment Management**

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, 1994 the market value of the Environmental Trust Fund was \$81 million.

	Target	Actual
Stocks	50.0%	49.7%
Bonds	50.0	50.3
Unallocated Cash	0.0	0.0
	100.0%	100.0%



	Period Ending 9/30/94		
	Qtr.	1 Yr.	Since 7/1/93
<b>Total Fund</b>	<b>2.7%</b>	<b>0.0%</b>	<b>2.4%</b>
Composite	2.8	-0.2	1.9
<b>Equity Segment</b>	<b>4.9</b>	<b>3.8</b>	<b>5.1</b>
Benchmark	4.9	3.8	5.2
<b>Bond Segment</b>	<b>0.6</b>	<b>-2.3</b>	<b>0.9</b>
Benchmark	0.6	-3.1	-0.5

STATE CASH ACCOUNTS

**Description**

State Cash Accounts represent the cash balances in more than 200 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 cash balances of retirement-related accounts managed internally and cash balances in the Permanent School Fund.
2. Treasurer's Cash Pool contains the cash balances of special or dedicated accounts necessary for the operation of certain State agencies and the balance of the Invested Treasurer's Cash.

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.

Period Ending 9/30/94

	Market Value (Millions)	Qtr.	Yr.	3 Yrs. Annualized
Treasurer's Cash Pool	\$2,074	1.1%	3.1%	4.6%
Trust Fund Cash Pool	82	1.2	3.9	4.6
Benchmark*		1.1	3.1	NA
91-Day T-Bills		1.1	3.7	3.6

\* 75% State Street Short Term Investment Fund/25% 1-3 Year Treasuries. This benchmark was established in April 1993. The Investment Advisory Council (IAC) intend to review the appropriateness of this benchmark in FY96. Until that time the IAC believe the pools should continue to be monitored against 91-Day T-Bills.

# **Tab B**

## **PORTFOLIO STATISTICS**

	<b>PAGE</b>
<b>I. Composition of State Investment Portfolios 9/30/94</b>	<b>1</b>
<b>II. Cash Flow Available for Investment 7/1/94 - 9/30/94</b>	<b>4</b>
<b>III. Monthly Transactions and Asset Summary - Retirement Funds</b>	<b>5</b>

**MINNESOTA STATE BOARD OF INVESTMENT**  
**Composition of State Investment Portfolios By Type of Investment**  
**Market Value September 30, 1994 (in Millions)**

	Cash And Short Term Securities	Bonds Internal	Bonds External	Stocks Internal	Stocks External	External Int'l.	Alternative Assets	Total
<b>BASIC RETIREMENT FUNDS:</b>								
Teachers Retirement Fund	\$64,510 1.51%	-0-	\$1,178,430 27.47%	-0-	\$2,150,351 50.13%	\$450,818 10.51%	\$445,339 10.38%	\$4,289,448 100%
Public Employees Retirement Fund	\$35,749 1.67%	-0-	\$588,754 27.43%	-0-	\$1,074,335 50.06%	\$225,232 10.49%	\$222,226 10.35%	\$2,146,296 100%
State Employees Retirement Fund	\$30,779 1.55%	-0-	\$544,412 27.46%	-0-	\$993,421 50.11%	\$208,269 10.51%	\$205,455 10.37%	\$1,982,336 100%
Public Employees Police & Fire Fund	\$18,151 1.85%	-0-	\$268,048 27.38%	-0-	\$489,122 49.96%	\$102,544 10.48%	\$101,162 10.33%	\$979,027 100%
Highway Patrol Retirement Fund	\$2,334 1.55%	-0-	\$41,289 27.46%	-0-	\$75,341 50.11%	\$15,795 10.51%	\$15,582 10.37%	\$150,341 100%
Judges Retirement Fund	\$167 1.57%	-0-	\$2,921 27.47%	-0-	\$5,330 50.12%	\$1,117 10.50%	\$1,100 10.34%	\$10,635 100%
Public Employees P.F. Consolidated	\$2,200 0.73%	\$258 0.09%	\$82,970 27.48%	\$2,263 0.75%	\$151,400 50.15%	\$31,742 10.51%	\$31,071 10.29%	\$301,904 100%
Correctional Employees Retirement	\$1,671 1.55%	-0-	\$29,562 27.46%	-0-	\$53,944 50.12%	\$11,309 10.51%	\$11,156 10.36%	\$107,642 100%
<b>POST RETIREMENT FUND</b>	\$117,258 1.30%	-0-	\$3,248,866 \$36.05%	-0-	\$4,637,730 51.46%	\$1,004,737 11.16%	\$3,014 0.03%	\$9,011,605 100%
<b>TOTAL BASIC &amp; POST</b>	\$272,819 1.44%	\$258 0.00%	\$5,985,252 31.54%	\$2,263 0.01%	\$9,630,974 50.74%	\$2,051,563 10.81%	\$1,036,105 5.46%	\$18,979,234 100%



	Cash And Short Term Securities		Bonds		Bonds		Stocks		Stocks		Alternative Assets		Total
			Internal	External	Internal	External	Internal	External	Internal	External	Int'l.		
<b>MINNESOTA SUPPLEMENTAL FUNDS:</b>													
Income Share Account	\$14,665 5.04%	\$98,709 33.90%	-0-	-0-	-0-	\$177,788 61.06%	-0-	-0-	-0-	-0-	-0-	\$291,162 100%	
Growth Share Account	\$7,761 7.16%	-0-	-0-	-0-	-0-	\$100,559 92.84%	-0-	-0-	-0-	-0-	-0-	\$108,320 100%	
Money Market Account	\$61,239 100%	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	\$61,239 100%	
Common Stock Index Account	-0-	-0-	-0-	-0-	-0-	\$53,346 100%	-0-	-0-	-0-	-0-	-0-	\$53,346 100%	
Bond Market Account	-0-	-0-	-0-	\$20,333 100%	-0-	-0-	-0-	-0-	-0-	-0-	-0-	\$20,333 100%	
International Share Account	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	\$41 100%	-0-	-0-	\$41 100%	
Fixed Interest Account	-0-	-0-	-0-	\$67,921 100%	-0-	-0-	-0-	-0-	-0-	-0-	-0-	\$67,921 100%	
<b>TOTAL SUPPLEMENTAL FUNDS</b>	\$83,665 13.89%	\$98,709 16.39%	-0-	\$88,254 14.65%	-0-	\$331,693 55.06%	-0-	-0-	\$41 0.01%	-0-	-0-	\$602,362 100%	
<b>TOTAL RETIREMENT FUNDS</b>	\$356,484 1.82%	\$98,967 0.51%	\$6,073,506 31.01%	\$2,263 0.01%	\$9,962,667 50.88%	\$2,051,604 10.48%	\$1,036,105 5.29%	\$19,581,596 100%					

	Cash And Short Term Securities	Bonds Internal	Bonds External	Stocks Internal	Stocks External	External Int'l.	Alternative Assets	Total
<b>ASSIGNED RISK PLAN</b>	\$6,245 1.38%	-0-	\$350,094 77.62%	-0-	\$94,702 21.00%	-0-	-0-	\$451,041 100%
<b>ENVIRONMENTAL FUND</b>	-0-	\$40,078 49.64%	-0-	\$40,653 50.36%	-0-	-0-	-0-	\$80,731 100%
<b>PERMANENT SCHOOL FUND</b>	\$55,437 13.19%	\$364,823 86.81%	-0-	-0-	-0-	-0-	-0-	\$420,260 100%
<b>TREASURERS CASH</b>	\$2,088,963 100%	-0-	-0-	-0-	-0-	-0-	-0-	\$2,088,963 100%
<b>HOUSING FINANCE AGENCY</b>	\$58,530 28.21%	\$148,971 71.79%	-0-	-0-	-0-	-0-	-0-	\$207,501 100%
<b>MINNESOTA DEBT SERVICE FUND</b>	\$12,159 48.66%	\$12,830 51.34%	-0-	-0-	-0-	-0-	-0-	\$24,989 100%
<b>MISCELLANEOUS ACCOUNTS</b>	\$38,998 23.43%	\$127,433 76.57%	-0-	-0-	-0-	-0-	-0-	\$166,431 100%
<b>GRAND TOTAL</b>	\$2,616,816 11.37%	\$793,102 3.44%	\$6,423,600 27.90%	\$42,916 0.19%	\$10,057,369 43.69%	\$2,051,604 8.91%	\$1,036,105 4.50%	\$23,021,512 100%

**STATE OF MINNESOTA  
STATE BOARD OF INVESTMENT**

**Net Cash Flow Available For Investment  
July 1, 1994 - September 30, 1994**

Teachers Retirement Fund	(\$15,700,000 00)
Public Employees Retirement Fund	(5,500,000.00)
State Employees Retirement Fund	9,300,000 00
Public Employees Police & Fire	6,000,000 00
Highway Patrol Retirement Fund	440,000 00
Judges Retirement Fund	1,069,000 00
Public Employees P&F Consolidated	(1,290,778 13)
Correctional Employees Retirement Fund	502,000 00
Post Retirement Fund	(26,935,509 82)
Supplemental Retirement Fund - Income	1,701,944.49
Supplemental Retirement Fund - Growth	1,184,251.77
Supplemental Retirement Fund - Money Market	773,750.88
Supplemental Retirement Fund - Index	3,309,821.75
Supplemental Retirement Fund - Bond Market	(544,811.71)
Supplemental Retirement Fund - Fixed Interest	(759,486.68)
Supplemental Retirement Fund - International	41,769.61
<b>Total Retirement Funds Net Cash Flow</b>	<b>(\$26,408,047.84)</b>
Assigned Risk Plan	(532,422.78)
Permanent School Fund	1,486,774.86
<b>Total Net Cash Flow</b>	<b>(\$25,453,695.76)</b>

**STATE OF MINNESOTA**  
**STATE BOARD OF INVESTMENT**  
**Transaction and Asset Summary**  
**Retirement Funds**

	<b>Net Transactions</b>			<b>Asset Summary (at Market Value)</b>				
	<b>Bonds (Millions)</b>	<b>Stocks (Millions)</b>	<b>Total (Millions)</b>	<b>Cash Flow (Millions)</b>	<b>Short-Term % of Fund</b>	<b>Bonds % of Fund</b>	<b>Equity % of Fund</b>	<b>Total Mkt. Value (Millions)</b>
January 1991	6	-2	4	47	3.6	52.3	44.1	13,356
February	-6	11	5	60	3.9	50.6	45.5	13,790
March	82	1	83	6	3.3	50.8	45.9	13,961
April	-24	-9	-33	9	3.6	50.9	45.5	14,045
May	33	1	34	66	3.8	49.8	46.4	14,308
June	25	2	27	115	4.4	50.5	45.1	14,106
July	124	0	124	48	3.8	50.4	45.8	14,527
August	85	21	106	55	3.3	50.8	45.9	14,891
September	22	1	23	5	3.1	51.4	45.5	15,105
October	21	1	22	14	3.1	51.2	45.7	15,285
November	81	-48	33	64	3.3	52.3	44.3	15,083
December	-4	9	5	25	3.2	51.2	45.6	16,065
January 1992	-42	-3	-45	11	3.6	50.3	46.1	15,878
February	-19	0	-19	57	4.1	49.4	46.5	16,086
March	292	-300	-8	2	4.2	51.6	44.2	15,870
April	-6	2	-4	4	4.2	51.5	44.3	15,905
May	-13	5	-8	72	4.7	51.3	44.0	16,127
June	-22	0	-22	150	5.7	51.5	42.8	16,264
July	389	152	541	123	3.0	53.3	43.7	16,726
August	-149	151	2	-11	3.0	53.1	43.9	16,627
September	-200	200	0	-10	2.9	52.0	45.1	16,809
October	-282	282	0	10	2.9	49.8	47.3	16,771
November	-248	270	22	-9	2.7	47.5	49.8	17,057
December	-500	518	18	4	2.6	44.7	52.7	17,305
January 1993	-138	158	20	40	2.6	44.0	53.4	17,617
February	-253	266	13	2	2.6	42.9	54.5	17,811
March	-272	335	63	70	2.6	40.7	56.7	18,180
April	-412	423	11	8	2.6	38.9	58.5	18,101
May	-206	200	-6	1	2.5	37.2	60.3	18,387
June	-250	210	-40	15	2.8	36.3	60.9	18,573
July	-17	-26	-43	20	3.1	36.4	60.5	18,649
August	0	10	10	-12	3.0	36.0	61.0	19,183
September	6	1	7	-15	2.8	36.2	61.0	19,216
October	-23	101	78	-21	2.3	35.8	61.9	19,433
November	-426	460	34	-22	2.0	34.0	64.0	19,032
December	-113	158	45	73	2.1	32.8	65.1	19,486
January 1994	-1	1	0	14	2.1	32.3	65.6	20,105
February	-26	-25	-51	10	2.5	32.1	65.4	19,735
March	-3	14	11	1	2.5	32.4	65.1	19,051
April	37	186	223	132	2.0	31.9	66.1	19,285
May	0	-24	-24	-11	2.1	31.8	66.1	19,349
June	-13	0	-13	-6	2.1	32.2	65.7	19,038
July	0	4	4	25	2.2	32.0	65.8	19,507
August	0	-1	-1	-18	2.1	31.3	66.6	19,982
September	0	25	25	-30	1.8	31.5	66.7	19,581

# Tab C

# **EXECUTIVE DIRECTOR'S ADMINISTRATIVE REPORT**

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**DATE:** December 6, 1994

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

**FROM:** Howard Bicker

## **1. Budget Report**

A final report on the SBI's administrative budget for the period ending September 30, 1994 is in **Attachment A**.

## **2. Travel Report**

A travel report for the period from August 16, 1994 - November 15, 1994 is included as **Attachment B**.

## **3. Annual Report**

A draft of the SBI's annual report was sent on November 21, 1994 to all Board members for their review. The final report will be distributed in January 1995.

## **4. Board Meeting Dates for Calendar 1995.**

The quarterly meetings of the SBI/IAC for calendar 1995 have been scheduled for:

<b>SBI</b>	<b>IAC</b>
Wednesday, March 8, 1995	Tuesday, March 7, 1995
Wednesday, June 7, 1995	Tuesday, June 6, 1995
Wednesday, September 6, 1995	Tuesday, September 5, 1995
Wednesday, December 6, 1995	Tuesday, December 5, 1995

## **5. Comparison of the SBI to Other Public Funds**

A report comparing the SBI's performance and asset allocation to that of other public funds is included as **Attachment C**.

## **6. Review of Derivatives**

A background report on derivatives is included as **Attachment D**.

**ATTACHMENT A**

**STATE BOARD OF INVESTMENT  
FISCAL YEAR 1995 ADMINISTRATIVE BUDGET REPORT  
GENERAL FUND APPROPRIATION  
FISCAL YEAR TO DATE THROUGH OCTOBER 31, 1994**

<b>ITEM</b>	<b>FISCAL YEAR 1995 BUDGET</b>	<b>FISCAL YEAR 1995 EXPENDITURES</b>
<b>PERSONAL SERVICES</b>		
CLASSIFIED EMPLOYEES	\$ 345,000	\$ 104,066
UNCLASSIFIED EMPLOYEES	1,160,000	332,345
SEVERENCE PAYOFF	0	0
WORKERS COMPENSATION INSURANCE	0	0
MISCELLANEOUS PAYROLL	7,686	1,949
<b>SUBTOTAL</b>	<b>\$ 1,512,686</b>	<b>\$ 438,360</b>
<b>EXPENSES &amp; CONTRACTUAL SERVICES</b>		
RENTS & LEASES	86,000	28,417
REPAIRS/ALTERATIONS/MAINTENANCE	10,000	2,023
BONDS AND INSURANCE	1,000	895
PRINTING & BINDING	8,000	6,156
PROFESSIONAL/TECHNICAL SERVICES	58,000	0
DATA PROCESSING & SYSTEM SERVICES	202,500	50,625
PURCHASED SERVICES	35,000	6,510
<b>SUBTOTAL</b>	<b>\$ 400,500</b>	<b>\$ 94,626</b>
<b>MISCELLANEOUS OPERATING EXPENSES</b>		
COMMUNICATIONS	27,000	6,607
TRAVEL, IN-STATE	2,000	6
TRAVEL, OUT-STATE	40,000	14,634
FEES & OTHER FIXED CHARGES	8,000	3,807
<b>SUBTOTAL</b>	<b>\$ 77,000</b>	<b>\$ 25,054</b>
<b>SUPPLIES/MATERIALS/PARTS</b>	<b>34,500</b>	<b>5,284</b>
<b>CAPITAL EQUIPMENT</b>	<b>54,000</b>	<b>17,769</b>
<b>TOTAL GENERAL FUND</b>	<b>\$ 2,078,686</b>	<b>\$ 581,093</b>

**ATTACHMENT B**

**STATE BOARD OF INVESTMENT**

**Travel Summary by Date  
August 16, 1994 - November 15, 1994**

<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
<b>Manager Monitoring Alternative Investments KKR, Blackstone Manager Search Alternative Investments Citicorp, Kleinwort Benson Staff Conference Mezzanine Finance Conference</b>	D. Egeland	New York, NY 9/17-9/21	\$1,190.18
<b>Staff Education State Street Bank Global Quest Client Conference</b>	D. Griebenow	Chicago, IL 9/20-9/22	\$182.00
<b>Staff Conference Investor Responsibility Research Center</b>	J. Heidelberg	Chicago, IL 9/28	\$467.50
<b>Board Member Travel Institutional Investors Semi-Annual Meeting</b>	M. McGrath	San Francisco, CA 10/1-10/4	\$964.28
<b>Manager Monitoring Stock Managers Fidelity, Forstmann, Franklin, GeoCapital, Independence, Lynch &amp; Mayer, Oppenheimer, Weiss Peck &amp; Greer Manager Search GE Capital, Martingale</b>	M. Menssen L. Buermann	Boston, MA Stamford, CT New York, NY 10/3-10/7	\$3,604.07
<b>Manager Monitoring Alternative Investments Colony Capital, CB Commercial, TCW Fund Termination</b>	J. Griebenow	Los Angeles, CA 10/18-10/23	\$873.00



<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
Staff Conference National Association of State Investment Officers	H. Bicker	Nashville, TN 10/30-11/1	\$1,343.27
Staff Conference Templeton Client Conference Global Investing	K. Vnuk	W. Palm Beach, FL 11/12-11/16	\$1,316.00

**Total Fund Rate of Return  
Public Fund Universe  
June 30, 1994**

	<b>1 Year</b>	<b>5 year</b>
Top Decile	4.1%	9.8%
Top Quartile	2.9	9.6
Median	1.6	9.3
Bottom Quartile	0.6	8.7
Bottom Decile	-0.3	8.1
SBI	1.8	9.5

(Universe: 60 Statewide public funds)

## Asset Allocation June 30, 1994

	Domestic Stocks	Int'l Stocks	Domestic Bonds	Int'l Bonds	Alternative Investment	Cash
SBI \$18.5 Billion	49.6%	10.9%	32.2%	0.0%	5.5%	1.8%
California(PERS) \$77.1 Billion	33.0	12.0	37.0	4.0	12.0	2.0
California (TRA) \$49.2 Billion	40.0	9.0	40.0	0.0	7.0	4.0
Florida \$36.2 Billion	62.0	4.0	31.0	0.0	2.0	1.0
Iowa \$7.2 Billion	34.4	6.7	39.0	3.2	15.0	1.7
New York \$59.4 Billion	45.5	6.4	37.0	0.0	7.9	3.2
Oregon \$17.5 Billion	43.0	16.0	23.0	0.0	15.0	3.0
Wisconsin \$25.6 Billion	47.0	9.6	28.0	4.9	7.3	3.2
<b>Average</b>	<u><b>44.3%</b></u>	<u><b>9.3%</b></u>	<u><b>33.4%</b></u>	<u><b>1.5%</b></u>	<u><b>8.9%</b></u>	<u><b>2.5%</b></u>

## **What are Derivatives?**

**Derivatives are securities whose price is linked to, or derived from, other assets such as stocks, bonds, currencies or commodities.**

## **Traditional Derivatives**

### **■ Futures, Options and Forwards**

- listed on exchanges or traded over-the-counter
- here have been actively traded for over 20 years

## **Other Derivatives Securities**

### **■ Generally associated with fixed income securities**

- mortgage-backed
- interest rate swaps

## **SBI's Exposure to the Derivatives Market**

- **\$12 million net position to traditional derivatives**
  - **Mostly in S&P futures . . .**
  
- **\$2 billion in other derivative securities**
  - **Most of this exposure is in mortgage backed securities that are rated by nationally recognized rating agencies and trade like traditional corporate or government bonds.**

## **How Derivatives Are Used in Portfolio Management**

- **To efficiently manage exposure to a class of securities**
  - **Provide short term liquidity**
  - **Reduce costs associated with trading underlying securities**
  
- **To lower/eliminate the risks associated with a particular security or class of securities**
  - **Hedge currency risk in international equity portfolio**
  - **Lock in a profit**
  
- **To lock in a profit of an existing investment**
  - **Forego further potential**  
**and**
  - **Avoid potential losses**
  
- **To enhance returns within the portfolio.**

# **How Derivatives Can be Misused in Portfolio Management**

## **■ Leverage**

- similar to buying securities "on margin"

## **■ Duration Mismatch**

- similar to lending long-term and borrowing short term like S&L's in the 1980's

## **■ Lack of accounting control at the investor level**

## **■ Lack of understanding the dynamics of derivatives**

- underestimating the volatility
- underestimating the liquidity



## **Safeguards Employed by SBI**

### **■ Leverage**

- **expressly prohibited in manager contracts**

### **■ Duration Control**

- **Total fund through appropriate asset allocation**
- **Investment manager guidelines specify duration ranges**

## **Reforms Being Sought Regarding Derivatives**

- Accelerate FASB accounting standards setting process, both for derivative products and for disclosure by derivative brokers.**
- Clarify current suitability rules for derivatives brokers, dealers and investment managers to increase investor protection.**
- Close regulatory gaps related to securities firms and insurance companies that are dealers of derivative products.**
- Examine and set reasonable capital requirements for brokers and dealers.**

**There has been no call for a ban on  
the use of any type of derivative.**

# Tab D

## **COMMITTEE REPORT**

---

**DATE:** December 6, 1994

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

**FROM:** Semi-Passive Domestic Stock Manager Search Committee

During the last quarter, a Manager Search Committee conducted a search for semi-passive domestic stock managers. The members of the Committee were:

<b>Name</b>	<b>Title</b>	<b>Representing</b>
Peter Sausen, Chair	Deputy Commissioner of Finance	Governor Carlson
Christie Eller	Deputy Attorney General	State Attorney General Humphrey
Jake Manahan	Deputy State Treasurer	State Treasurer McGrath
Elaine Voss	Deputy Secretary of State	Secretary of State Growe
John Bohan	IAC Representative	Investment Advisory Council

### **BACKGROUND:**

At its September 1994 meeting the SBI approved the implementation of a semi-passive domestic stock manager program. The Board approved an allocation of up to 25% of the total domestic equity assets with a commensurate reduction in the allocation to the passive domestic equity manager program. Several reasons were cited for the implementation of the semi-passive manager program.

- Adding semi-passive management with a commensurate reduction in passive management offers the potential to increase returns with only a marginal increase in risk.
- Semi-passive management offers the opportunity to recoup fees and transaction costs through low-risk value added strategies that are not available through passive management.
- The lower fee structures of semi-passive managers relative to active managers increases the likelihood that semi-passive managers will be able to provide the expected value added, net of fees, to the fund.

### **MANAGER SELECTION:**

The Committee interviewed nine (9) firms on November 15-16, 1994. All finalists had been approved by the SBI and IAC at their September 1994 meetings.

**Firm:**

Fidelity Management Trust  
Franklin Portfolio Associates  
GE Capital Management  
Goldman Sachs Asset Management  
J.P. Morgan  
Parametric Portfolio Associates  
Martingale Asset Management  
T Rowe Price  
Wells Fargo Nikko Investment Advisors

While the primary purpose of the semi-passive manager search was to select managers for the retirement funds, the same managers are appropriate for the stock segment of the Assigned Risk Plan. As a result the search Committee selected semi-passive managers for both the retirements funds and the Assigned Risk Plan.

Based on the interviews, questionnaire responses and supporting information gathered by staff and the SBI's consultant, Richards & Tierney, the Committee recommended, subject to successful negotiation of fee structures, that:

- 1) three (3) firms be retained by the SBI for the retirement funds and be funded with \$750 million each from the SBI's passive portfolio, and
- 2) one (1) firm be retained by the SBI for the entire equity portfolio of the Assigned Risk Plan.

The Committee initially recommended Franklin Portfolio Associates, Wells Fargo Nikko Investment Advisors, and Fidelity Management Trust. After an unsuccessful discussion of fees with Fidelity, the consensus of the Committee is to replace Fidelity with J.P. Morgan. A profile of each firm is attached.

**RECOMMENDATION:**

The Committee recommends that the SBI authorize the executive director, with assistance from SBI legal counsel, to negotiate and execute contracts with the following semi-passive domestic equity managers:

<b>Franklin Portfolio Associates</b>	<b>Boston, MA</b>	<b>Retirement Funds</b>
<b>J.P. Morgan</b>	<b>New York, NY</b>	<b>Retirement Funds</b>
<b>Wells Fargo Nikko Investment Advisors</b>	<b>San Francisco, CA</b>	<b>Retirement Funds</b>
<b>GE Capital Management</b>	<b>Stamford, CT</b>	<b>Assigned Risk Plan</b>

## MANAGER FACT SHEET

**Manager:** Franklin Portfolio Associates

### **Investment Philosophy and Process**

Franklin believes the financial community creates an overabundance of information, and that rigorous and consistent application of fundamentally based valuation criteria will produce value added investment returns. They use the BARRA E.2 risk model to maintain the portfolio's systematic risk and industry weightings close to the selected benchmark resulting in a residual risk of 1.5% to 2.0% for semi-passive portfolios. The composition of the residual risk is monitored to insure that it is 70% to 80% stock specific risk. This is a "quality" check that keeps the residual risk focused on the stock picking strength of the valuation system.

Franklin builds a portfolio with the use of a series of more than 30 integrated computer models that value a universe of 3500 stocks. Each model is based on fundamental, financial, or behavioral principles. The value-added derives from the proprietary manner in which the models are integrated to provide one list of securities. Their models rank each security based on fundamental momentum, relative value, future cash flow, and supplementary models. The individual models rank each security, and then a composite ranking provides one ranked list of securities reflecting the relative attractiveness compared to other stocks. Stocks that fall below the median ranking are sold and proceeds reinvested in stocks from the top deciles in the ranking system. Franklin believes this sell discipline is one of the strengths of their process, since it does not allow emotions to interfere with a properly executed sell decision.

### **Research**

Franklin Portfolio's research focuses on quantitative technology to search out new inputs that will provide incremental information in the valuation process. Franklin back-tests their models monthly. Non-performing or inaccurate models are diminished in weight and occasionally eliminated.

### **Trading**

Franklin uses traditional trading methods as well as Instinet, Posit, and Arizona electronic matching networks. They sometimes use package trades, and occasionally, these are structured to utilize guaranteed prices through a blind-bidding process. Franklin employs Plexus to monitor trading costs. They also examine execution based on intraday market impact, ex-post performance of traded stocks, and ex-post of non-traded stocks.

## Franklin (con't)

### Ownership

Franklin Portfolio is an independently managed wholly owned subsidiary of MBC Investor Corporation. MBCIC is a wholly-owned subsidiary of Mellon Bank Corporation.

Total Number of Semi-Passive Equity Portfolio Managers / Analysts: 3

Total Number of Semi-Passive Equity Traders: 2

Total Tax-exempt Equity Assets Managed: \$ 4,653 MM

Total tax-exempt Domestic Semi-Passive Equity Assets Managed: \$ 3,674 MM

Total number of tax-exempt Domestic Semi-Passive Equity Accounts: 28

### Three Largest Tax-exempt Semi-Passive Domestic Equity Accounts:

Corporate Pension	\$518 MM
Corporate Pension	\$342 MM
Corporate Pension	\$324 MM

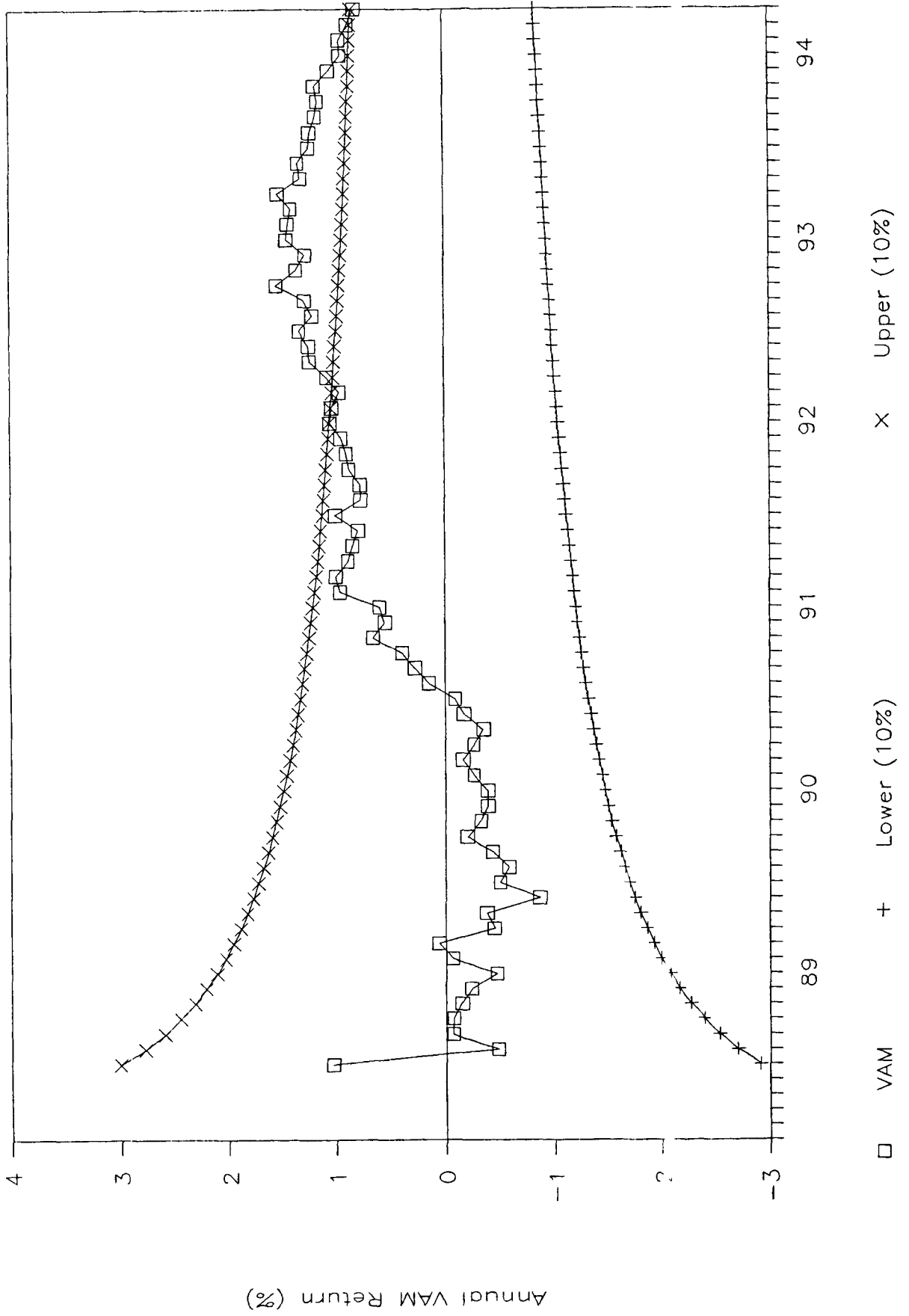
**Investment Manager: FRANKLIN PORTFOLIO**  
**Benchmark: CUSTOM**

	—PORTFOLIO—		—BENCHMARK—		—VAM—	
	Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
88	Q1					
	Q2					
	Q3	1.95%	1.83%	0.11%		
	Q4	4.08%	3.66%	0.40%		
89	Q1	7.26%	7.87%	-0.57%		
	Q2	9.17%	9.62%	-0.41%		
	Q3	9.24%	9.34%	-0.09%		
	Q4	6.18%	6.38%	-0.19%		
		35.82%	37.54%	-1.25%		
90	Q1	-3.63%	-4.01%	0.39%		
	Q2	3.55%	3.98%	-0.42%		
	Q3	-6.95%	-7.12%	0.18%		
	Q4	7.39%	7.01%	0.36%		
		-0.28%	-0.79%	0.52%		
91	Q1	8.94%	7.53%	1.32%		
	Q2	0.26%	-0.44%	0.71%		
	Q3	7.59%	6.42%	1.10%		
	Q4	7.13%	6.48%	0.61%		
		25.90%	21.31%	3.79%		
92	Q1	-4.30%	-4.10%	-0.21%		
	Q2	5.94%	5.01%	0.88%		
	Q3	4.24%	3.83%	0.39%		
	Q4	2.73%	1.29%	1.43%		
		8.57%	5.91%	2.51%		
93	Q1	8.67%	7.26%	1.31%		
	Q2	1.72%	1.79%	-0.07%		
	Q3	4.95%	4.17%	0.75%		
	Q4	2.92%	-1.75%	-1.18%		
		12.63%	11.74%	0.80%		
94	Q1	-5.88%	-5.71%	-0.18%		
	Q2	-1.68%	-0.74%	-0.94%		
	Q3	2.73%	3.33%	-0.58%		
Latest:						
1 yr		-7.70%	-4.99%	-2.86%		
3 yr		7.59%	6.81%	0.73%		
5 yr		9.16%	7.94%	1.13%		
Cum 88Q3-94Q3		12.64%	11.73%	0.81%		
Std Dev		10.11%	9.71%	1.62%		



# FRANKLIN PORTFOLIO (DCF)

Value Active Mgmt (1988-07 1994-09)



## MANAGER FACT SHEET

**Manager:** J.P. Morgan Investment Management, Inc.

### **Investment Philosophy and Process**

J.P. Morgan believes that superior stock selection is necessary to achieve excellent investment results and that market timing, industry, and factor bets can and should be eliminated as much as possible. They also believe security prices do not always reflect the long term earnings and dividend potential. J.P. Morgan therefore uses a proprietary fundamental research and a systematic valuation model to rank the attractiveness of the individual securities in their research universe. Portfolio managers then use these rankings to construct their portfolios.

To begin the stock selection process for their investment strategy, analysts at J.P. Morgan forecast the earnings and dividends for the 650 stocks in their universe. The earnings and dividend forecast and the stock's price are entered into a stock valuation model to calculate an expected return for each security. The stocks are ranked according to their attractiveness within their economic sector based on their expected return. Stocks most undervalued are placed in the first quintile and are most attractive. The portfolio includes stocks from the first four quintiles always favoring the highest ranked stocks whenever possible and sells those in the fifth quintile. In addition, the portfolio will closely approximate the sector, style, and security weightings of the index chosen by the plan sponsor.

### **Research**

J.P. Morgan generates about 90% of its research internally. They employ 21 analysts to follow 650 securities performing original research and projecting earnings and dividend growth rates. J.P. Morgan also has an in-house economist who works closely with their portfolio managers and research analysts to provide a common macroeconomic framework.

### **Trading**

J.P. Morgan uses Instinet to cross as many trades as possible, historically 15 - 20%. They cross an additional 20% at the previous night's closing price. Seven internal traders handle the remaining trades.

## J.P. Morgan (con't)

### Ownership

J.P. Morgan Investment Management, Inc. is a wholly owned subsidiary of J.P. Morgan & Co. Incorporated whose other holdings include J.P. Morgan Securities Inc., J.P. Morgan Futures Inc., and Morgan Guaranty Trust Company.

Total Number of Semi-Passive Equity Portfolio Managers / Analysts 24

Total Number of Semi-Passive Equity Traders: 7

Total Tax-exempt Equity Assets Managed: \$ 38,720 MM

Total tax-exempt Domestic Semi-Passive Equity Assets Managed: \$ 5,752 MM

Total number of tax-exempt Domestic Semi-Passive Equity Accounts: 31

### Three Largest Tax-exempt Semi-Passive Domestic Equity Accounts:

Foreign Corporate	\$1,488 MM
Commingled fund	\$327 MM
Corporate Pension	\$321 MM

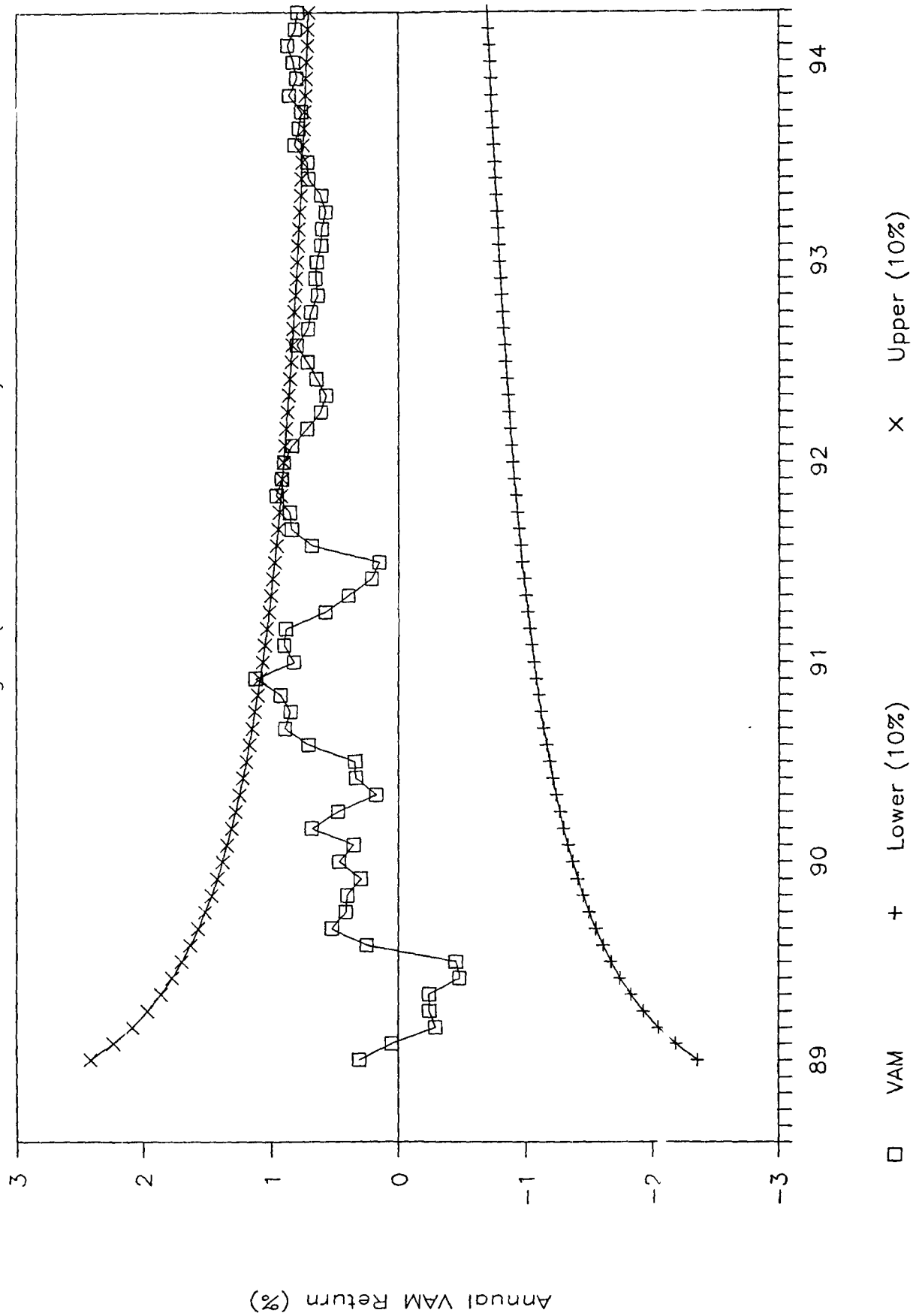
**Investment Manager: J. P. MORGAN (RESEARCH ENHANCED)**

**Benchmark: S&P 500**

		—PORTFOLIO—		—BENCHMARK—		—VAM—	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
89	Q1	6.95%		7.00%		-0.05%	
	Q2	9.00%		8.77%		0.20%	
	Q3	10.23%		10.60%		-0.34%	
	Q4	1.71%	30.69%	1.99%	31.28%	-0.27%	-0.45%
90	Q1	-2.07%		-3.01%		0.97%	
	Q2	6.48%		6.28%		0.19%	
	Q3	-13.66%		-13.77%		0.14%	
	Q4	8.78%	2.06%	8.95%	3.17%	-0.15%	1.14%
91	Q1	15.96%		14.55%		1.23%	
	Q2	-0.07%		-0.22%		0.15%	
	Q3	4.87%		5.37%		-0.48%	
	Q4	7.15%	30.21%	8.36%	30.51%	-1.12%	-0.23%
92	Q1	-0.23%		-2.53%		2.36%	
	Q2	2.34%		1.97%		0.36%	
	Q3	2.24%		3.11%		-0.85%	
	Q4	5.69%	10.33%	5.10%	7.71%	0.57%	2.44%
93	Q1	4.37%		4.30%		0.06%	
	Q2	0.46%		0.49%		-0.03%	
	Q3	2.37%		2.56%		-0.18%	
	Q4	1.27%	10.84%	2.38%	10.05%	0.87%	0.72%
94	Q1	-3.40%		-3.81%		0.43%	
	Q2	1.00%		0.46%		0.53%	
	Q3	4.93%		4.94%		0.00%	
Latest:							
1 yr			5.73%		3.82%		1.84%
3 yr			10.29%		9.21%		0.99%
5 yr			10.18%		9.15%		0.95%
Cum 89Q1-94Q3			13.65%		12.75%		0.79%
Std Dev			12.63%		12.51%		1.30%

# JP MORGAN RESEARCH ENHANCED

Value Active Mgmt (1989-01 1994-09)



## **MANAGER FACT SHEET**

**Manager:** Wells Fargo Nikko Investment Advisors (WFNIA)

### **Investment Philosophy and Process**

WFNIA's philosophy in the management of enhanced equity portfolios encompasses three key objectives: the delivery of consistent, superior performance; the maximum control of all investment and operational risks; and the minimization of trading costs.

WFNIA proposes the Alpha Tilts Strategy, a semi-passive enhanced equity index strategy that tightly controls the actual portfolio relative to the selected benchmark. In managing the fund, the optimization objective is to maximize the overall alpha (after trading costs) of the portfolio subject to the level of residual risk selected by the plan sponsor. A variety of portfolio constraints are used in the optimization process to control the portfolio's tracking error. These risk controls include: 1) matching the benchmark weightings across 55 industries; 2) limiting the active position in any individual security; 3) constraining the predicted beta of the portfolio to be close to 1.0; and 4) achieving an overall predicted active risk level that is within client guidelines. The result is a portfolio that closely matches the benchmark in terms of systematic risk characteristics and industry/sector diversification, and is also very diversified at the individual security level.

The Alpha Tilts Fund uses a quantitative model, the Core Alpha Model, that desegregates individual equity returns into their important components (fundamental, expectational, and technical). This model allows them to understand and quantify pricing relationships across the equity market, and to identify which sources or factors of equity returns are slightly mispriced by the market.

The fundamental factors look at measures of underlying company value including earnings, book value, cash flow, and sales. These factors help identify securities that may be trading at attractive prices relative to their true economic value. The fundamental factors work by capturing small misvaluations caused by the average investor. By evaluating a broad universe of companies on a consistent, rigorous basis, the Alpha Tilts Fund is able to identify and capture these misvaluations.

The expectational factors incorporate future earnings and growth rate information for each company. The Core Alpha Model is able to monitor and evaluate the individual earnings forecasts made by over 2500 security analysts. The model is able to track and evaluate the true information content of their forecasts and thereby obtain a superior measure of the future growth rates for each company.

The technical factors provide a measure of recent changes in company fundamentals, consensus expectations, and performance. These factors include measures of relative returns, earnings momentum, short-term alpha, and liquidity measures. These factors play a role by helping to determine the optimal timing for rebalancing trades which are driven by the expectational and fundamental factors.

## Wells Fargo Nikko (con't)

The investment process starts with a universe of the largest 3500 U.S. equities. The expectational data is updated daily, while the fundamental and technical factors are updated as necessary on each of these securities. An alpha or estimated mispricing, is then calculated based on a systematic assessment of the company's measures on the fundamental, expectational and technical characteristics. The estimated alphas are then used in a portfolio optimization algorithm, which also incorporates other inputs, such as estimated trading costs and a variety of risk constraints, to identify the optimal portfolio.

### Research

WFNIA's Advanced Strategies and Research Group has 12 professionals and extensive computing, database and academic/technical resources. Data sources that are used in the ongoing management of the strategy include Compustat, CRSP (University of Chicago), IBES, First Call, BARRA, Zacks, and Reuters. As part of ongoing research commitment to this strategy, WFNIA continues to explore ideas that may be incorporated as enhancements to the strategy in the future.

### Trading

The main objective of WFNIA's trading approach is to provide their clients with excellent execution at low total trading costs. Their strategies include crossing within their "internal marketplace" of index funds and separate accounts; "private" crossing between their funds and other institutions; "public" crossing through networks such as POSIT and Instinet; and open market trades. They believe that their large trading volume has created important advantages in the marketplace for its clients.

### Ownership

Wells Fargo Nikko Investment Advisors is a global joint venture partnership owned by Wells Fargo & Company and the Nikko Securities Co., Ltd. Prior to the formation of the joint venture in April of 1990, Wells Fargo Investment Advisors was a wholly-owned subsidiary of Wells Fargo & Company. WFIA became a subsidiary in January, 1985. Previously WFIA was a division of Wells Fargo Bank, N.A.

Total Number of Semi-Passive Equity Portfolio Managers / Analysts: 12

Total Number of Semi-Passive Equity Traders: 5 (all equity classes)

Total Tax-exempt Equity Assets Managed: \$92,739 MM

Total tax-exempt Domestic Semi-Passive Equity Assets Managed: \$2,282 MM

Total number of tax-exempt Domestic Semi-Passive Equity Accounts: 19

### Three Largest Tax-exempt Semi-Passive Domestic Equity Accounts:

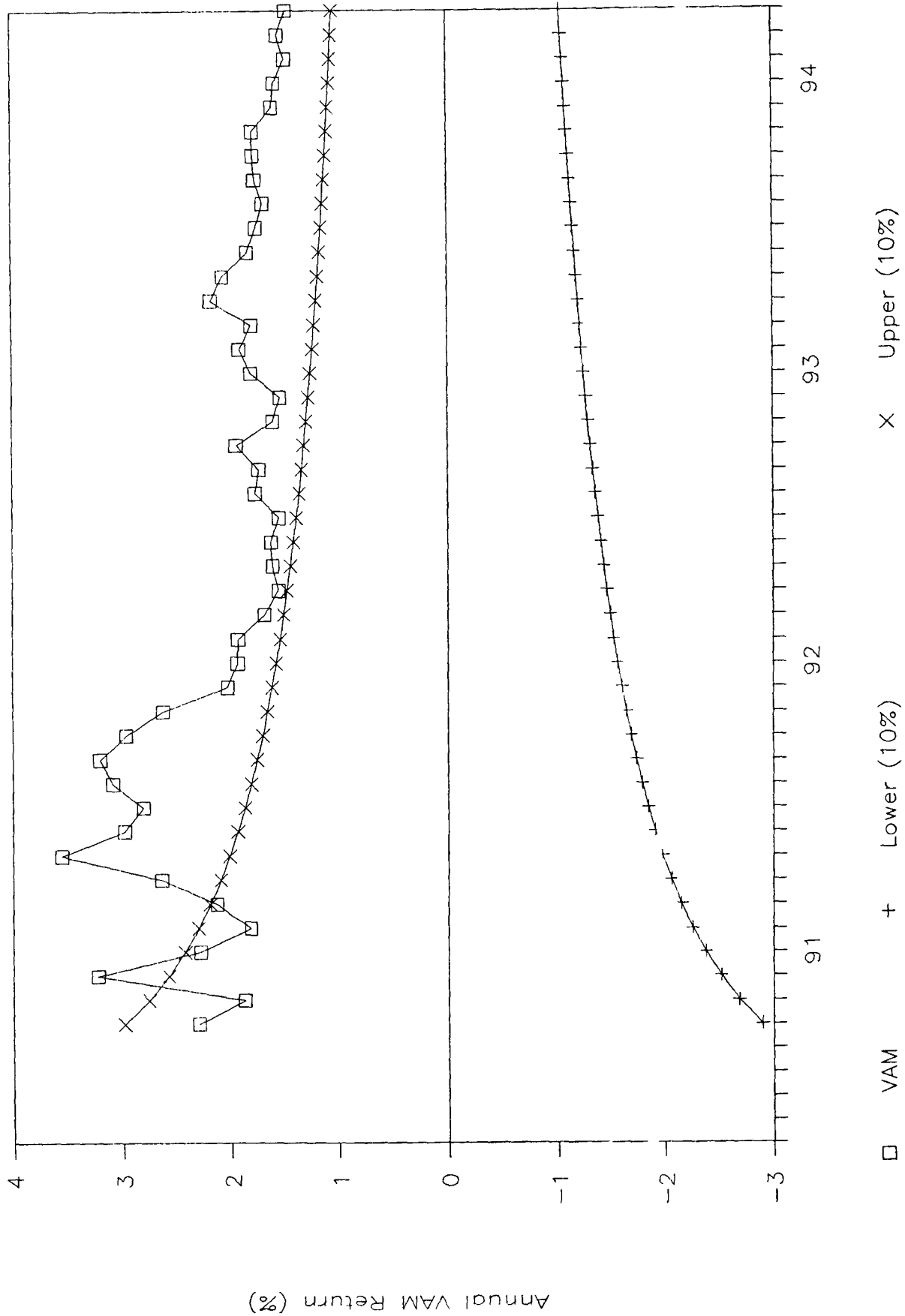
General Motors  
Southwestern Bell  
Texas Instruments

Investment Manager: WELLS FARGO NIKKO						
Benchmark: FRANK RUSSELL 3000						
	—PORTFOLIO—		—BENCHMARK—		—VAM—	
	Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
90	Q1					
	Q2					
	Q3					
	Q4	9.29%	9.29%	9.30%	9.30%	-0.01%
91	Q1	17.57%		16.23%		1.16%
	Q2	0.05%		-0.51%		0.56%
	Q3	7.27%		6.30%		0.92%
	Q4	9.68%	38.41%	8.75%	33.67%	0.86%
92	Q1	-0.67%		-1.58%		0.93%
	Q2	-0.17%		0.85%		-1.02%
	Q3	2.97%		3.25%		-0.27%
	Q4	7.44%	9.70%	7.03%	9.69%	0.38%
93	Q1	5.60%		4.17%		1.37%
	Q2	0.91%		0.80%		0.10%
	Q3	5.31%		3.70%		1.55%
	Q4	1.01%	13.34%	1.82%	10.87%	-0.80%
94	Q1	-3.32%		-3.83%		0.53%
	Q2	-0.84%		-0.54%		-0.30%
	Q3	5.27%		5.30%		-0.03%
Latest:						
1 yr			1.93%		2.55%	-0.61%
3 yr			11.23%		10.03%	1.09%
Cum 90Q3-94Q3			17.37%		15.66%	1.48%
Std Dev			11.06%		10.70%	1.60%



# WELLS FARGO NIKKO

Value Active Mgmt (1990-10 1994-09)



## MANAGER FACT SHEET

**Manager:** GE Investment Management Inc.

### Investment Philosophy and Process

The investment philosophy for GE's Multi-Style Equity program is to outperform the benchmark consistently while controlling overall portfolio risk through use of a unique investment process. This is accomplished by combining the expertise of five experienced portfolio managers, encompassing different styles ranging from value to growth, supported by a staff of ten industry analysts. The five portfolios are combined to create a well diversified equity portfolio while maintaining low relative volatility and a style-neutral position between value and growth.

GE encourages teamwork in order to develop an environment where professionals openly compare views and debate the future prospects of a given stock. They have weekly meetings, but their "committee without consensus" approach means that managers are free to make their own investment decisions. Portfolio managers are empowered to move quickly, but usually engage in careful analysis and discussion with peers before major decisions are made.

GE focuses on stock selection from a bottom-up perspective. They monitor GE's economic forecasts along with selected Wall Street forecasts, but tend to pay more attention to GE's short-cycle order patterns to get a sense for trends in the economy. GE runs a broadly diversified portfolio investing in seventy-eight of the eighty-seven S&P 500 industry categories. They also have a large number of stocks in the portfolio which tends to dampen volatility. GE follows approximately 700 companies. This includes all S&P 500 companies with a market capitalization greater than \$300MM, as well as several hundred companies not in the S&P 500. The average number of companies represented in the aggregate portfolio is approximately 350. Finally, by using five portfolio managers with differing styles, they carefully balance the portfolio between value and growth. GE monitors the value/growth mix, and rebalance the portfolio through the use of various analytics. The result is a portfolio with low residual risk to the benchmark and a high Information Ratio.

GE's five portfolio managers have different investment styles, so their buy/sell disciplines also tend to be somewhat different. The growth-oriented managers look to buy stocks with above average growth rates at reasonable P/E ratios and tend to hold them until their growth prospects diminish or they become overvalued versus alternatives. The value-oriented managers look for stocks that have low P/E's, high yields, sell for less than intrinsic value or appear attractive on a dividend discount model. They generally sell when prices approach targeted levels and tend to have a somewhat higher turnover rate than the growth managers.

### Research

GE has extensive research capabilities, generating approximately 70% of research internally. A team of ten global analysts works together to provide analytical coverage across the full spectrum of industries. Each analyst is responsible for one or more industries and coverage includes major non-US companies in those industries that compete globally.

## GE Investment Management (con't)

GE Investments feels a unique strength is access to the entire GE Company which buys from or sells to almost the entire economic spectrum worldwide. They have access to top management as well as analysts and participants throughout the system. They also have an Investment Advisory Board, a non-fiduciary group that meets quarterly to share insights and review trends in business and the economy.

The investment staff has an information center that uses optical imaging system for efficiently storing and retrieving brokerage reports. Up-to-the-minute information can be retrieved from over 2,500 global databases providing news coverage, current events, and company financials.

Another critical research avenue is the face-to-face meeting with company management. During the past year, GE analysts and portfolio managers attended numerous conferences and company-sponsored analyst meetings. About 60 company meetings took place in Stamford, and they visited about 140 companies at their headquarters. These visits include companies GE owns in their portfolio as well as those under consideration.

### Trading

GE has four full time traders. Portfolio managers and traders discuss the portfolio manager's objective and the trader's view of the market when an order is placed on the trading desk. The trader determines the best way to execute the trade and keeps the portfolio manager informed as the order is completed.

GE traders use electronic equipment such as Bridge, Autex, Insync, Instinet, and Merrin. They implemented the Merrin Financial Trading System which has allowed them to monitor, on a real time basis, actual costs (commissions and market impact) by broker, portfolio manager and trader.

### Ownership

GE Investments is a wholly-owned, direct subsidiary of General Electric Company.

Total Number of Semi-Passive Equity Portfolio Managers / Analysts: 16

Total Number of Semi-Passive Equity Traders: 6

Total Tax-exempt Equity Assets Managed: \$ 8,368 MM

Total tax-exempt Domestic Semi-Passive Equity Assets Managed: \$ 6053MM

Total number of tax-exempt Domestic Semi-Passive Equity Accounts: 18

### Three Largest Tax-exempt Semi-Passive Domestic Equity Accounts:

General Electric Pension Trust	\$5,024MM
U S West	176MM
Province of Alberta Treasury	104MM

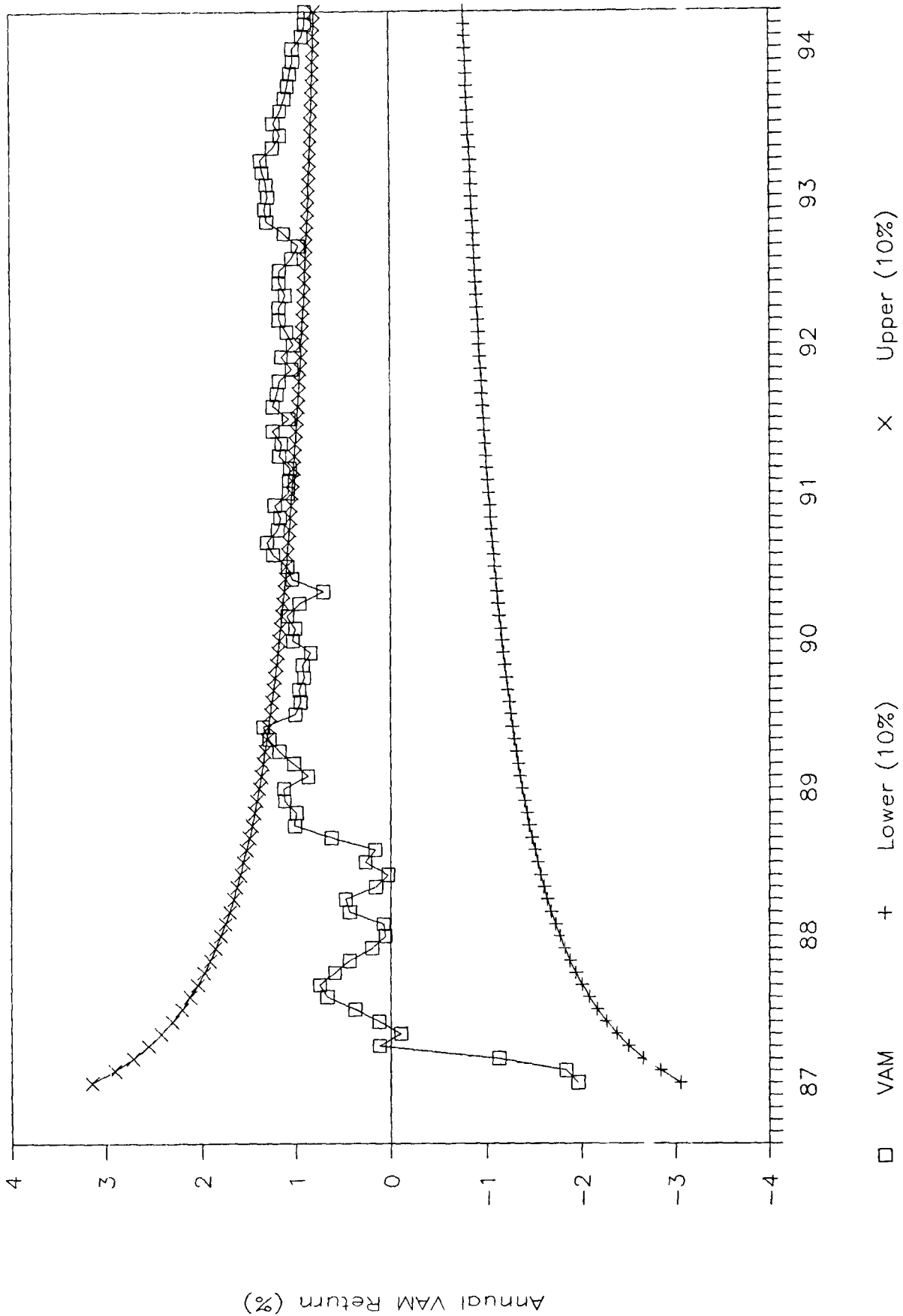
**Investment Manager: GE INVESTMENTS**

**Benchmark: S&P 500**

		—PORTFOLIO—		—BENCHMARK—		—VAM—	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
87	Q1	20.87%		21.32%		-0.37%	
	Q2	4.48%		5.12%		-0.61%	
	Q3	7.77%		6.61%		1.08%	
	Q4	22.39%	5.62%	22.62%	5.21%	0.29%	0.38%
88	Q1	6.21%		5.82%		0.37%	
	Q2	5.81%		6.51%		-0.66%	
	Q3	1.15%		0.39%		0.76%	
	Q4	2.79%	16.85%	3.10%	16.66%	-0.30%	0.16%
89	Q1	8.86%		7.00%		1.74%	
	Q2	9.37%		8.77%		0.54%	
	Q3	11.05%		10.60%		0.41%	
	Q4	1.77%	31.55%	1.99%	31.28%	-0.21%	2.49%
90	Q1	-3.06%		-3.01%		-0.04%	
	Q2	6.96%		6.28%		0.64%	
	Q3	-13.78%		-13.77%		0.00%	
	Q4	9.75%	-1.88%	8.95%	-3.17%	0.74%	1.33%
91	Q1	15.35%		14.55%		0.70%	
	Q2	-0.43%		-0.22%		-0.21%	
	Q3	6.13%		5.37%		0.72%	
	Q4	8.14%	31.81%	8.36%	30.51%	-0.21%	1.00%
92	Q1	-1.76%		-2.53%		0.80%	
	Q2	1.44%		1.97%		-0.52%	
	Q3	4.27%		3.11%		1.12%	
	Q4	5.38%	9.50%	5.10%	7.71%	0.26%	1.66%
93	Q1	4.29%		4.30%		-0.01%	
	Q2	1.87%		0.49%		1.37%	
	Q3	3.41%		2.56%		0.83%	
	Q4	1.75%	11.79%	2.38%	10.05%	-0.61%	1.58%
94	Q1	-4.56%		-3.81%		-0.78%	
	Q2	0.31%		0.46%		-0.15%	
	Q3	4.12%		4.94%		-0.78%	
Latest:							
1 yr			1.42%		3.82%		-2.31%
3 yr			9.68%		9.21%		0.43%
5 yr			9.94%		9.15%		0.72%
Cum 87Q1-94Q3			13.24%		12.24%		0.88%
Std Dev			15.85%		15.92%		1.70%

# GE INVESTMENTS

Value Active Mgmt (1987 01 1994-09)



# Tab E

## **COMMITTEE REPORT**

**DATE:** December 6, 1994

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

**FROM:** **Deferred Compensation Review Committee**

*Minnesota Statutes* section 354B.05, subdivision 3 requires the SBI to select up to 5 financial institutions to provide annuity options and to periodically review the product providers for the Individual Retirement Account Plan (IRAP) and College Supplemental Retirement Plan (Supplemental Plan).

At its June 7, 1994 meeting the SBI authorized the Deferred Compensation Review Committee to review the structure of the IRAP and Supplemental Plans, to issue a request for proposal (RFP) to select vendors to provide annuity products for the Plans, and to bring recommendations to the Board. The members of the Committee are:

Peter Sausen	Governor's Designee
Christie Eller	Attorney General's Designee
Jake Manahan	Treasurer's Designee
Elaine Voss	Secretary of State's Designee
Gary Austin	IAC Representative, TRA
David Bergstrom	IAC Representative, MSRS
Laurie Fiori Hacking	IAC Representative, PERA

The Auditor's office did not name a designee.

The Committee was assisted by the SBI's deferred compensation programs consultant, The Wyatt Company. The Wyatt Company has subcontracted with PRIMCO Capital Management to provide the consulting services.

### **Background Regarding the Higher Education Plans**

The Plans are currently administered by the Minnesota State Universities System and the Community College System. The State Universities and Community Colleges will be merged into a single system to be administered by a single board, the Higher Education Board, effective July 1, 1995. At that time, the Technical Colleges will also become part of the new Higher Education Board.

Until 1989, the Minnesota Teachers Retirement Association was the administrator for the Supplemental Plan and the Supplemental Investment Fund (SIF) was the only investment vehicle available. During the 1988 and 1989 legislative sessions, the IRAP plan was created and the Systems were given the authority to administer both plans and to choose

additional outside product providers. In 1993 and 1994, the Legislature assigned the responsibility of selecting and reviewing product providers to the SBI and stipulated that the SBI may select up to 5 "financial institutions that provide annuity products." The SBI has determined that "financial institutions that provide annuity products" are insurance companies.

### **Insurance Company Selection Process**

The Deferred Compensation Review Committee and its consultant, Kim McCarrel of PRIMCO Capital Management, developed an insurance company RFP during August 1994. The RFP was formally announced in the State Register on September 6, 1994 and sent to approximately two dozen firms. Seven companies responded by the September 30, 1994 deadline. A copy of the RFP document begins on page 5.

The Review Committee established the following minimum requirements:

- The product provider must currently have at least two ratings within the top two ratings classifications of the nationally recognized credit rating agencies: Moody's, Standard & Poor's and Duff & Phelps.
- The product provider must offer one product in these asset categories: fixed (general account, GIC), equity, balanced, bond, international/global, and money market.
- The product provider must offer participants, without charge, the opportunity to transfer to other product providers at least 10 percent of fixed fund balances each year and 100 percent of variable fund balances each year.
- The product provider must provide a written analysis of the provider's willingness to comply with proposed contract terms.
- The product provider must agree to reimburse the SBI for selection and monitoring costs as provided in *Minnesota Statutes* section 354B.05, subd. 3.

Each insurance company response was evaluated according to the following criteria:

- Credit Ratings 25 points
  - based on the two lowest credit ratings (including PRIMCO rating)
- Investment Products 35 points
  - core products 32
  - additional products (up to 4) 3
    - based on risk adjusted performance, net of fees, for each option and length of its track record



- **Payout Options** 5 points
  - based on range of payout options and competitiveness of rates
- **Portability/Transferability** 20 points
  - based on level of portability/transferability within own products, with other providers' products, and to other states' higher education plans
- **Service** 10 points
  - based on quality and availability of communication materials, participant statements and employer statements
- **Fees** 5 points
  - based on level of fees assessed to participants in addition to those deducted before returns are calculated or credited
- **Total** 100 points

A "financial strength multiplier" was then applied to the total points of the provider based on the two highest credit ratings from among Moody's, Standard & Poor's and Duff & Phelps. The multiplier was as follows:

- 1.2 Both ratings are in the highest category
- 1.1 One rating in the highest category and one in the second highest
- 1.0 Both ratings in the second highest category

On November 17, 1994 the Committee met to discuss the responses to the RFP and the consultant's analysis. The Committee eliminated from consideration three companies because they did not meet the minimum criteria:

AUSA	did not offer required portability
Nationwide	did not offer required portability
Prudential	did not meet minimum credit ratings

The rankings of the remaining four responders were as follows:

<u>Provider</u>	<u>Final Score</u>	<u>Credit Multiplier</u>	<u>Total Raw Score</u>
TIAA-CREF	89.70	1.2	74.75
VALIC	83.10	1.2	69.25
Great-West	82.21	1.2	68.51
Minnesota Mutual	75.85	1.1	68.95

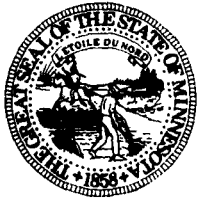
The law provides for the selection of up to five product providers. Based on the rankings and the responses to the RFP, the Committee is recommending all four companies. The Committee also agreed to recommend that the State Universities and Community College Systems use the contract terms set forth in the RFP as the basis for contracts the Systems will sign with the four firms. As provided in statute, such contracts would come before the SBI for approval before execution.

**RECOMMENDATION:**

**The Committee recommends that the SBI recommend to the State Universities and Community College Systems the selection of TIAA-CREF, VALIC, Great-West, and Minnesota Mutual as product providers for the Higher Education Plans, and that the SBI recommend the contract terms set forth in the request for proposal as the basis for contracts the State Universities and Community College Systems will sign with the companies.**

Attachment: RFP Document

**MINNESOTA  
STATE  
BOARD OF  
INVESTMENT**



**Board Members:**

Governor  
Arne H. Carlson

State Auditor  
Mark B. Dayton

State Treasurer  
Michael A. McGrath

Secretary of State  
Joan Anderson Growe

Attorney General  
Hubert H. Humphrey III

**Executive Director:**

Howard J. Bicker

*Suite 105, MEA Bldg.  
55 Sherburne Avenue  
St. Paul, MN 55155  
(612)296-3328  
FAX (612)296-9572*

*An Equal Opportunity  
Employer*

September 6, 1994

To Whom It May Concern:

The Minnesota State Board of Investment (SBI) is soliciting proposals for insurance company product providers through the attached Request For Proposal (RFP).

This RFP is designed to obtain insurance company product providers for investment of mandatory employee and employer contributions into two 401(a) retirement plans for higher education faculty and administrators. These plans are referred to as the Individual Retirement Account Plan (IRAP) and College Supplemental Retirement Plan (Supplemental Plan).

**No proposal received after 3:00 P.M. Central Time on Friday, September 30, 1994 will be considered.**

**401(a) HIGHER EDUCATION PLANS  
RFP  
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**EXHIBITS**

- A- Minnesota Statutes 354B.05
- B- Minnesota Statutes Chapters 11A and 356A
- C- Background on IRAP and College Supplemental Plans
- D- Minnesota Statutes 16B.17
- E- Certificate of Compliance Information
- F- Principal Proposed Contract Terms
- G- Questionnaire
- H- Fixed Option Data
- I- Variable/Mutual Fund Data

## **REQUEST FOR PROPOSAL (RFP)**

### **REGARDING THE SELECTION OF INSURANCE COMPANY PRODUCT PROVIDERS FOR 401(a) HIGHER EDUCATION PLANS BY THE MINNESOTA STATE BOARD OF INVESTMENT (SBI).**

This RFP does not obligate the SBI to complete the project and the SBI reserves the right to cancel the solicitation if the SBI considers it to be in its best interest.

#### **I. INTRODUCTION**

The Minnesota State Board of Investment ("SBI") is charged with the investment of approximately \$22 billion for the State and related constituents. Of this amount, about \$19 billion represents retirement funds which the SBI invests on behalf of various State and local governmental employees.

The SBI is seeking insurance company product providers for investment of mandatory employee and employer contributions into two 401(a) plans, the Individual Retirement Account Plan and the College Supplemental Retirement Plan ("Higher Education Plans" or "Plans").

*Minnesota Statutes* Section 354B.05, subdivision 3 authorizes the SBI to select up to 5 "financial institutions to provide annuity products" and to periodically review the product providers selected. A copy of the law is attached in **Exhibit A**. The SBI has determined that "financial institutions that provide annuity products" means insurance companies.

Currently, the Plans are administered jointly by the Minnesota State University System and the Minnesota Community College System ("Systems"). The selected product providers will sign contracts with the two Systems. The SBI will select product providers and will participate in negotiating contract terms.

The SBI has established a Deferred Compensation Review Committee to prepare and distribute a RFP to evaluate insurance company product providers. The Review Committee is comprised of a designee of each of the five Board members and three members of the Board's Investment Advisory Council. The Committee will review all responses and will recommend candidates to the SBI for approval.

In carrying out its responsibilities, the SBI's deferred compensation programs consultant, The Wyatt Company, will work closely with the Review Committee, SBI staff, and the SBI's Investment Advisory Council. Please note that The Wyatt Company subcontracts with PRIMCO Capital Management for provision of these consultant services.

## II. PURPOSE

The law (see **Exhibit A**) requires the SBI to select up to 5 financial institutions to provide annuity options and to periodically review the product providers. The current product providers have been in place since 1989. The SBI is formally reviewing the investment providers for the Plans through this RFP process. The SBI anticipates selecting product providers and will participate in negotiating contract terms by December 1994. The contracts are expected to be effective July 1, 1995.

The goals of the SBI for this selection are:

- to assure the product providers are financially secure
- to offer a range of competitive investment options
- to provide a high level of service to participants
- to maintain the lowest possible administrative costs

## III. BACKGROUND REGARDING THE SBI

### A. Legal Authorization

The SBI was created pursuant to Article XI, Section 8, of the Minnesota Constitution for the purpose of "administering and directing the investment of all state funds." Statutory provisions relating to fiduciary responsibility, portfolio composition, and the types of securities in which the SBI may legally invest are set forth in *Minnesota Statutes* Chapters 11A and 356A, copies of which are attached as **Exhibit B**.

### B. Composition

By constitutional requirement, the SBI is composed of five (5) elected officials: Governor, State Auditor, State Treasurer, Secretary of State, and State Attorney General.

The Deferred Compensation Review Committee is composed of a designee of each member of the SBI and three (3) members of the SBI's Investment Advisory Council.

### C. Investments and Managers

Currently, the SBI invests in a variety of asset classes including stocks, bonds, real estate, venture capital, resource funds (oil and gas), guaranteed investment contracts and derivative securities.

The SBI's responsibility for the Higher Education plans is limited to the provisions of *Minnesota Statutes* Section 354B.05, subdivision 3 (see **Exhibit A**).

#### **D. Staffing and Support Services**

The SBI has a staff of twenty-five (25) persons supervised by an Executive Director. This group manages the day-to-day investment and monitors responsibilities. The Executive Director reports investment developments to the SBI at its quarterly and special meetings. In order to carry out its duties effectively, the SBI staff maintain close contact with the Board members and their staffs, the State Legislature, the state-wide and local retirement systems with assets managed by the SBI, and the many firms providing various forms of investment services.

The SBI also receives investment assistance from its 17-member Investment Advisory Council (IAC), whose duties are set forth in *Minnesota Statutes* Section 11A.08 (see **Exhibit B**). The IAC is composed of the State Commissioner of Finance, the Executive Directors of the three statewide retirement systems whose funds are invested by the SBI, a retiree representative, two active employee representatives and ten persons knowledgeable in general investment matters. The IAC's duties are to advise the SBI on general investment policy matters and perform other advisory tasks as the SBI requests.

#### **E. Deferred Compensation Programs Consultant and Review Committee**

The SBI's deferred compensation programs consultant, The Wyatt Company, will provide a variety of services related to the SBI's statutory mandate concerning the Higher Education Plans. The Wyatt Company has subcontracted with PRIMCO Capital Management to provide the consulting services. These services include, but are not limited to analysis, advice and recommendations on:

- vendor identification
- vendor evaluation and selection
- program design and related administrative issues
- methodology for on-going monitoring and review

The SBI has established a Deferred Compensation Review Committee to prepare and distribute this RFP to evaluate insurance company providers for the Plans. The Review Committee is comprised of a designee of each of the five Board members and three members of the SBI's investment Advisory Council.

The Review Committee will review all responses and will recommend up to five candidates to the SBI for approval.

#### **IV. BACKGROUND REGARDING THE HIGHER EDUCATION PLANS**

##### **A. History of the Plans**

Until 1988, the primary retirement plan for faculty and administrators at the State Universities and Community Colleges was a defined benefit plan administered by the Teachers Retirement Association (TRA). In 1988, the Minnesota Legislature created the Individual Retirement Account Plan (IRAP), a 401(a) qualified defined contribution plan, to serve as the primary retirement plan for these personnel and many participants elected to move from the defined benefit to defined contribution structure at that time. In 1988, the Legislature also transferred plan administration responsibilities from TRA to the two Systems.

Since the 1960's, faculty and administrators of the Systems have also been required to contribute to the College Supplemental Retirement Plan (Supplemental Plan). As the name implies, it is designed to supplement the primary retirement plan for faculty and administrators. Since its inception, this Plan has been a defined contribution program and is a 401(a) qualified plan. In 1991, the Legislature transferred administration of this Plan from TRA to the two Systems.

The State Universities and Community Colleges will be merged into a single system which will be administered by a single board, the Higher Education Board, effective July 1, 1995. At that time, Minnesota's Technical Colleges will also be part of the Higher Education Board and their faculty and administrators will be eligible to participate in the Plans for the first time.

##### **B. Product Providers**

Until 1989, the Supplemental Investment Fund (SIF) administered by the SBI was the only investment vehicle available to the Plans. When the Systems assumed responsibility to administer the Plans, the Systems were given authority to choose outside product providers to provide investment options in addition to those provided in the SIF. In 1989, the State University System selected TIAA-CREF and Great-West Life & Annuity (GW), and the Community College System selected TIAA-CREF and Prudential Asset Management (PRU).

In 1993 and 1994, the Legislature assigned the responsibility of selecting and reviewing product providers to the SBI and stipulated that the SBI may select



up to five (5) product providers for the Plans in addition to the SIF. The SBI has determined that "financial institutions that provide annuity products" are insurance companies.

The SBI is undertaking a complete review of the outside product providers through this RFP process and expects to choose product providers and arrange contract terms by December 1994. The new contracts are expected to be effective July 1, 1995.

**C. Participants and Assets by Plan and Product Provider**

**IRAP**

	<b>Participants</b>	<b>Assets</b>
SIF	150	\$ 6.0 million
GW	200	1.3
PRU	340	1.2
TIAA-CREF	1,560	17.5
<b>Total</b>	<b>2,250</b>	<b>\$26.0 million</b>

**SUPPLEMENTAL PLAN**

	<b>Participants</b>	<b>Assets</b>
SIF	2,550	\$145.1 million
GW	250	1.6
PRU	100	1.3
TIAA-CREF	810	12.4
<b>Total</b>	<b>3,710</b>	<b>\$160.4 million</b>

**COMBINED PLANS**

	<b>Participants</b>	<b>Assets</b>
SIF	2,700	\$151.1 million
GW	450	2.9
PRU	440	2.5
TIAA-CREF	2,370	29.9
<b>Total</b>	<b>5,960</b>	<b>\$186.4 million</b>

A more detailed description of each plan is provided in **Exhibit C**.

Contributions to the Plans in fiscal year 1994 totalled \$17 million, of which \$9 million flowed to the IRAP and \$8 million to the Supplemental Plan. Please note that the merger of the Technical Colleges beginning July 1, 1995 will add roughly 4,000 participants to the Supplemental Plan and some portion of these to the IRAP. Additional annual contribution flow from the Technical College personnel is expected to be in excess of \$2 million to the two plans combined during the year beginning July 1, 1995 and is very likely to increase substantially in subsequent years.

#### **D. Third Party Administrator**

After the merger of the State Universities, Community Colleges, and Technical Colleges effective July 1, 1995, the new Higher Education Board will administer the Plans using external resources. Accordingly, the Higher Education Systems will select a third party administrator (TPA) to perform certain functions for both Plans. At present, the Systems expect the TPA to perform the following functions:

- collect and disburse contributions to all vendors
- verify and/or produce plan information for all vendors/options in the Plans
- enroll participants
- provide on-going education to participants regarding their options under the Plans
- coordinate information flow to participant work sites (campuses of the Systems). This will include arranging vendor visits for group presentations and providing materials to campus personnel offices for distribution
- maintain a 1-800 telephone line for participant questions concerning general plan information and issues involving more than one vendor, such as portability
- perform participant recordkeeping functions for contributions to the SIF

The providers will provide investment and administrative services only, not enrollment. Enrollment and education activities of the TPA will be funded by an existing 2 percent "front-end load" on new contributions made to insurance company product providers and an asset-based charge on assets in SIF accounts. It is not anticipated that product providers will compensate the TPA for enrollment and education services. Product providers will be expected to assist the TPA in developing and producing product and plan communication materials.

Please note that participants will continue to contact the providers directly for provider specific information such as account balances, and each provider will issue statements to participants. Production of centralized account statements by the TPA is not considered a necessary item at this time.

## V. DUTIES OF THE INSURANCE COMPANY PRODUCT PROVIDERS

Up to five (5) insurance company product providers will be selected by the SBI to provide high quality and competitive annuity products to eligible employees in the Plans in addition to the SIF. If selected, an insurance company will agree to contract terms approved by the SBI and will be expected to enter into an agreement with the Systems that specifies the products and services that will be offered to employees.

Product providers currently in the Plans (TIAA-CREF, Great-West Life & Annuity, Prudential Asset Management) who choose to respond to this RFP will be expected to comply with the minimum portability provisions outlined in Section VI of this RFP for all dollars contributed to the Plans before the new contracts take effect (expected to be on or about July 1, 1995). These providers must state to what extent they are able to provide this portability in their responses to this RFP.

All product providers must comply with all provisions set forth in this RFP for all dollars contributed under the new contracts (expected to be effective on or about July 1, 1995).

## VI. MINIMUM REQUIREMENTS FOR PROPOSALS

The Review Committee has established the following minimum requirements:

### A. Financial Strength

The product providers selected by the SBI must have a current rating from two (2) or more of the following rating agencies within the highest two rating categories used by that agency:

Rating Agency	Rating Categories	
	<u>Highest</u>	<u>Second Highest</u>
Moody's Investor Services	Aaa	Aa1
Standard & Poor's	AAA	AA+
Duff & Phelps	AAA	AA+

## **B. Investment Options**

Each product provider must offer one (1) product in each of the following six (6) categories. These 6 options will be considered the provider's "core product group" for the purposes of the response.

Fixed Fund (general account, certificates, GIC's)  
Equity Fund (primarily domestic stock)  
Balanced Fund (may include tactical asset allocation)  
Bond Fund (primarily domestic bonds)  
International/Global Equity Fund  
Money Market Fund

The SBI prefers to select providers that offer multiple investment choices, but the providers will receive no additional credit for options in excess of ten; i.e. a core product group of 6 options and up to 4 additional options.

## **C. Portability Requirements**

Each product provider must offer at least the following level of portability to be considered:

- Each participant must be allowed to transfer, without charge, at least 10 percent of fixed fund balances each year to variable products of any provider in the Plan.
- Each participant must be allowed to transfer, without charge, 100 percent of variable balances to other variable or fixed products of any provider in the Plan.

Additional points will be awarded to providers who offer greater portability than the minimum specified above.

In addition, each product provider must fully explain how, and to what extent, its products are portable outside the Plan for those participants who may leave employment with the Minnesota Higher Education Systems for similar positions in other public and private higher education institutions across the country. (See Exhibit G, Item 18).

## **D. Contract Terms**

Each responder must provide a written analysis of the provider's willingness to comply with the proposed contract provisions as provided in **Exhibit F**. The analysis must state which provisions are not acceptable in their present form and provide alternate language that is acceptable to the provider. The proposed

terms outlined in Exhibit F are not all inclusive and the SBI reserves the right to add or modify terms, as necessary.

Please note that the proposed contract terms in Exhibit F reflect those that the SBI has recently negotiated with insurance companies for Minnesota's Deferred Compensation (457) Plan. The SBI believes that these contract provisions are highly desirable and therefore may eliminate from consideration any insurance company that will not agree to comply with all, or substantially all, the provisions specified in Exhibit F.

#### **E. Payment of Contract Costs**

Each provider must state that it will reimburse the SBI for selection and monitoring costs as provided in *Minnesota Statutes* Section 354B.05, subdivision 3. (See Section XIII and Exhibit F, Item 8.)

### **VII. PROPOSAL SELECTION**

#### **A. Nature of Procurement.**

This selection for procurement is undertaken by the SBI pursuant to the provisions of *Minnesota Statutes* 16B.17, a copy of which is attached as **Exhibit D**. As such, it is not governed by strict competitive bidding requirements frequently associated with the purchase of supplies and materials by the State, and selection will not be based exclusively on the concept of lowest responsible bidder. The SBI reserves the right to waive minor informalities.

Accordingly, the SBI will select the product provider(s) whose proposals and oral presentation(s), if requested, demonstrate, in SBI's sole opinion, clear capability to best fulfill the purposes of the RFP in a cost effective manner. The SBI reserves the right to accept or reject proposals, in whole or in part, and to negotiate separately as necessary to serve the best interest of the State of Minnesota.

#### **B. Evaluation Process.**

*Minnesota Statutes* Section 354B.05 Subd. 3 (see **Exhibit A**) requires the SBI to consider at least the following criteria in making its selections:

- the experience and ability of the financial institution to provide retirement and death benefits suited to the needs of the covered employees
- the relationship of the benefits to their cost

- the financial strength and stability of the institution.

These criteria are reflected in the evaluation process specified below. The Review Committee's evaluation process will consist of:

**1. Determination as to whether the minimum requirements set forth in Section VI of this RFP are met.**

- Responders will note that the SBI has established high minimum requirements regarding financial strength, portability and contract terms. Responders who do not meet the minimum criteria will be rejected from further consideration.
- Responders who meet the minimum requirements will be assigned a "financial strength multiplier" based on their *two highest* credit ratings from Moody's, Standard & Poors and Duff & Phelps.

**Multiplier**

- 1.2 Both ratings are in the highest category available from the respective rating organizations.
- 1.1 One rating is in the highest category and one rating is in the second highest category available from the respective rating organizations.
- 1.0 Both ratings are in the second highest category available from the respective rating organizations.

The multiplier will be applied to the total point score from the scoring system in #2, below.

**2. Further evaluation based on the following scoring system:**

**a) Credit Analysis maximum: 25 points**

Points will be awarded based on the *two lowest* credit ratings from Moody's, Standard & Poors, Duff & Phelps and PRIMCO. (E.g., if a company's two lowest ratings were both AAA, the company would receive the maximum point score.)

- b) Investment Products** **maximum: 35 points**
- Core Product Group 32
  - Additional Products 3

Points will be awarded based on the risk-adjusted performance, net of all fees, for each option and the length of its track record.

- c) Payout Options** **maximum: 5 points**

Points will be awarded based on the range and flexibility of the payout options available as well as the competitiveness of annuity rates.

- d) Portability/Transferability** **maximum: 20 points**

Points will be awarded based on the level of portability/transferability offered:

- among the provider's options
- between the provider and other providers in the Minnesota Plans
- from the Minnesota Plans to other plans (i.e., for those participants who may leave employment with Minnesota Higher Education Systems for similar positions with either public or private institutions across the country).

- e) Service** **maximum: 10 points**

Points will be awarded based on quality/availability of:

- communication materials
- participant statements
- employer/TPA statements

- f) Fees** **maximum: 5 points**

Points will be awarded based on the level of fees, if any, assessed to participants in addition to those that are deducted before returns are calculated or credited (e.g., additional fees would include withdrawal, surrender, contract maintenance etc.). The lower the level of fees, the higher the number of points that will be awarded.

### **3. Calculation of final score.**

Points awarded in #2 will be totaled. The assigned multiplier will then be applied to reach a final score. For example, a maximum score of 100 from

#2 combined with the highest multiplier of 1.2 from #1 would result in a final score of 120 points.

## **VIII. CERTIFICATE OF COMPLIANCE**

Each insurance company responding to this RFP must provide a Certificate of Compliance from the State of Minnesota Department of Human Rights as an attachment to its response.

A copy of an explanatory brochure and *Minnesota Statutes* Section 363.073 are in **Exhibit E**.

Questions regarding the certification process should be addressed to:

Minnesota Department of Human Rights  
Contract Compliance  
500 Bremer Tower  
7th Place and Minnesota Street  
St. Paul, MN 55101  
(612) 296-5663

## **IX. PREPARATION OF PROPOSAL**

A provider's response to this RFP shall be organized in the following manner:

**Section 1:** A written response to the questionnaire in **Exhibit G**

**Section 2:** A written analysis of the proposed contract terms in **Exhibit F**. This analysis must include agreement to reimburse the SBI for expenses (see Section XIII and Exhibit F, Item 8) or identify any law or laws which prohibit the provider from making such an agreement. The analysis must specify any contract provision that is unacceptable to the provider and provide alternate language that is acceptable on the point(s) in question.

**Section 3:** Fixed and Variable product data (see **Exhibit H** and **Exhibit I**).

**Section 4:** Attachments



**X. SUBMISSION OF RESPONSE**

The company shall submit its RFP response to the SBI and its consultant at the following addresses:

One (1) copy to:

Kim McCarrel  
Consultant  
PRIMCO Capital Management, Inc.  
Suite 1510  
1000 SW Broadway  
Portland, OR 97205

(503) 241-6515

Fifteen (15) copies to:

James E. Heidelberg  
Manager, Public Programs  
Minnesota State Board of Investment  
Room 105, MEA Building  
55 Sherburne Avenue  
St. Paul, MN 55155

(612) 296-3328

- **No proposal received by the SBI after 3:00 P.M. Central Time on September 30, 1994 will be considered.**
- **One (1) copy of the response sent to James E. Heidelberg at the SBI must be unbound and signed in ink by an authorized officer of the responding firm.**
- **Each copy of the response must be sealed in a mailing envelope or package with the insurance company vendor's name and address clearly written on the outside. Please identify the unbound copy on the outside of its envelope as well.**

**XI. INFORMATION CONTACTS**

The SBI's exclusive agents for the purposes of responding to vendor's inquiries on RFP requirements are:

Kim McCarrel                      or  
Consultant

PRIMCO Capital Management, Inc.  
Suite 1510  
1000 SW Broadway  
Portland, OR 97205  
Telephone: (503) 241-6515

James E. Heidelberg  
Manager, Public Programs

Minnesota State Board of Investment  
Room 105, MEA Building  
55 Sherburne Avenue  
St. Paul, MN 55155  
Telephone: (612) 206-3328

Other persons are not authorized to discuss RFP requirements with product providers before the proposal submission deadline.

The SBI shall not be bound by and product providers may not rely on information regarding RFP requirements obtained from non-authorized persons.

## **XII. RFP TIMETABLE AND RELATED REQUIREMENTS**

<b><u>RFP Issued.</u></b>	<b>Sep. 6, 1994</b>
<b><u>Vendor proposals due.</u></b>	<b>Sep. 30, 1994</b>
<b>NO PROPOSALS RECEIVED BY THE SBI AFTER 3:00 P.M. CENTRAL TIME ON FRIDAY, SEPTEMBER 30, 1994 WILL BE CONSIDERED.</b>	
<b><u>Proposals evaluated by the Deferred Compensation Review Committee and the SBI consultant.</u></b>	<b>Oct./Nov. 1994*</b>
<b><u>Vendor interviews (if necessary)</u></b>	<b>Oct./Nov. 1994*</b>
<p>The Review Committee may require that a vendor submitting a proposal make an oral presentation to the Committee during the evaluation process. Individual product providers will be notified if a presentation is required.</p>	
<b><u>Contract terms negotiated by providers and SBI staff.</u></b>	<b>Oct./Nov. 1994*</b>
<b><u>Product providers selected and contract terms approved by the SBI.</u></b>	<b>Dec. 1994*</b>
<b><u>Contracts' effective date</u></b>	<b>Jul. 1, 1995*</b>

**\* Approximate dates, subject to change.**

## **XIII. REIMBURSEMENT TO THE SBI**

*Minnesota Statutes* Section 354B.05 provide that the SBI "may establish a budget for its costs in the determination process" and "may charge a proportional share of that budget to each financial institution selected." Each provider selected must

reimburse the SBI a proportional share of the SBI's costs. Assuming 3 to 5 insurance companies are selected by the SBI, the cost to each insurance company over the life of a five year contract is expected to be in the range of \$20,000 to \$40,000.

To be considered, a product provider must state that it will agree to reimburse the SBI for these costs or must identify the law or laws which prohibit the provider from making such an agreement. The statement must be included in the written analysis of the proposed contract terms in Exhibit F, Item 8.

#### **XIV. PERIOD OF CONTRACT**

The contract shall be for a five (5) year period from on or about July 1, 1995 to on or about June 30, 2000. The SBI presently anticipates that the contracts will contain a 60 day cancellation clause (see Exhibit F, Item 10) and will be reviewed on an annual basis with regard, primarily, to credit quality and range of products offered. The SBI reserves the right to solicit additional proposals from time to time and presently plans to comprehensively review the approved product providers in approximately five years.

#### **XV. PUBLIC STATUS OF PROPOSALS SUBMITTED.**

Pursuant to Minnesota law, all proposals submitted in response to this RFP shall become the property of the State of Minnesota. Such proposals shall also constitute public records and shall be available for viewing and reproduction by any person.

Issue Date: September 6, 1994

# **Tab F**

## **COMMITTEE REPORT**

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**DATE:** December 6, 1994

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

**FROM:** Stock and Bond Manager Committee

The Stock and Bond Manager Committee met on November 28, 1994 to discuss the following agenda:

- Review of manager performance for the quarter ending September 30, 1994
- Discussion of report from the Semi-Passive Domestic Equity Search Committee

### **INFORMATION ITEMS:**

#### **1. Review of Manager Performance**

- Domestic Stock Managers

For the quarter ended September 30, 1994, the domestic stock manager program underperformed the Wilshire 5000 by 0.3 percentage points and underperformed the aggregate benchmark by 0.7 percentage points. For the latest year the **current** managers underperformed the benchmark and the Wilshire 5000. For the latest three and five year periods, the **current** manager group outperformed the Wilshire 5000 but underperformed the benchmark for the three year period and matched the benchmark for the five year period.

Time period	Actual	Wilshire 5000*	Benchmark
Quarter	5.1%	5.4%	5.8%
1 Year	1.8	2.6	3.6
3 Years	10.0	9.8	10.1
5 years	9.1	8.9	9.1

\* Adjusted for SBI's restrictions, as appropriate

The active managers' decisions to hold interest rate sensitive stocks in the consumer durables, banking and finance industries accounts for the under performance for the current quarter.

The performance evaluation reports for the domestic stock managers start on page 5 of this Tab. Manager Commentaries are in Tab H.

- **Bond Managers**

For the quarter ended September 30, 1994, the bond manager program outperformed the Lehman Aggregate by 0.2 percentage point and the aggregate benchmark. For the latest one, three and five year periods, the **current** manager group generally outperformed both the aggregate benchmark and the index.

Time period	Actual	Lehman Aggregate*	Benchmark
Quarter	0.8%	0.6%	0.6%
1 Year	-3.4	-3.2	-3.1
3 Years	7.0	6.3	6.4
5 years	8.9	8.5	8.5

\* Includes the Salomon BIG prior to July 1, 1994

An overweighting in mortgages and corporates as spreads narrowed accounts for the outperformance during the current quarter.

The performance evaluation reports for the bond managers start on page 29 of this Tab. Manager Commentaries are in Tab H.

- **International Stock Managers**

For the quarter ended September 30, 1994, the international stock manager program outperformed the EAFE index by 1.8 percentage points. For the latest year, the managers outperformed the index by 2.1 percentage points. Since inception in October 1992, the program has outperformed the index by 0.2 percentage point.

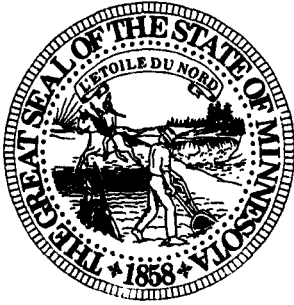
Time period	Actual	EAFE
Quarter	1.9%	0.1%
1 Year	11.9	9.8
Since inception	18.0	17.8

The active managers' decisions to underweight Japan relative to the EAFE index accounts for the outperformance in the current quarter.

The performance evaluation reports for the international stock managers start on page 43 of this Tab. Manager Commentaries are in Tab H.

**2. Discussion of Report from the Manager Search Committee Concerning the Semi-Passive Domestic Equity Search**

Staff updated the Stock and Bond Manager Committee on the recommendation from the Manager Search Committee concerning the retention of several domestic stock managers for the Domestic Equity Program (see full report under Tab E). The Committee reviewed the report from the Manager Search Committee and concurs with the report.



# STATE BOARD OF INVESTMENT

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## Stock Manager Evaluation Reports

Third Quarter, 1994



**DOMESTIC STOCK MANAGERS**  
**Period Ending 9/30/94**

Current Managers	Quarter		1 Year		3 years		5 Years		Since (1) 1/1/92		Since (2) Inception		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
Alliance	4.0	5.2	-0.7	4.3	11.2	7.1	10.8	7.2	6.8	3.9	16.2	10.9	\$696.35	7.2%
Brinson	5.4	5.5	6.9	2.9							7.7	5.6	\$272.46	2.8%
Forstmann-Leff	4.6	8.8	-0.4	4.9	5.7	9.3	7.3	8.4	3.8	7.8	11.7	11.2	\$350.68	3.6%
Franklin Portfolio	4.4	5.5	-0.4	2.7	12.9	11.5	8.9	9.3	10.7	9.6	12.0	11.4	\$373.08	3.8%
GeoCapital	8.0	14.0	2.0	7.9	10.3	15.8			5.2	12.6	14.6	15.4	\$260.08	2.7%
IAI	7.0	6.2	0.2	3.8							7.8	7.7	\$114.75	1.2%
IDS	3.0	5.0	2.9	3.7	11.5	12.2	9.4	9.6	8.5	10.2	13.7	13.3	\$369.97	3.8%
Independence	3.1	4.9	1.3	3.3							8.9	8.6	\$367.40	3.8%
Jundt Associates	15.9	8.5	6.5	5.7							7.4	8.1	\$222.96	2.3%
Lincoln	4.9	6.4	5.6	6.5							5.0	5.6	\$257.19	2.6%
Lynch & Mayer	5.7	6.6	-3.2	3.5							5.6	8.8	\$314.12	3.2%
Oppenheimer	4.2	4.2	2.6	2.6							5.7	4.9	\$265.76	2.7%
Waddell & Reed	5.3	7.9	1.4	7.4	12.0	12.7	8.7	9.8	11.1	11.7	11.6	11.4	\$392.64	4.0%
Weiss Peck & Greer	12.1	10.6	-6.2	1.1							1.6	7.4	\$205.86	2.1%
Emerging Managers (3)	6.0	7.8									3.7	4.3	293.65	3.0%
Wilshire Associates (4)	4.6	4.7	2.2	2.8	9.5	9.8	8.6	8.9	7.2	7.7	12.9	13.1	\$4,957.10	51.0%
													\$9,714.06	100.0%
											Since 1/1/84			
Current Aggregate	5.1	5.8	1.8	3.6	10.0	10.1	9.1	9.1	7.5	7.9	13.3	13.0		
Historical Aggregate (5)	5.1	5.8	1.7	3.5	9.6	10.1	8.5	9.0	7.2	8.0	12.7	12.9		
Wilshire Adjusted (6)		5.4		2.6		9.8		8.9		7.5		12.9		
Wilshire 5000		5.4		2.5		9.9		9.1		7.5		13.2		

(1) Since tilted index fund was fully implemented.

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

(3) Aggregate of emerging manager group.

(4) Passive manager. Tilted index fund began 10/90. Fully implemented 1/92.

(5) Includes performance of terminated managers.

(6) Buy hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

**EMERGING EQUITY MANAGERS**  
**Period Ending 9/30/94**

<b>Current Managers</b>	<b>Quarter</b>		<b>1 Year</b>		<b>3 years</b>		<b>5 Years</b>		<b>Since</b>		<b>Market Value</b> <b>(in millions)</b>	<b>Pool</b> <b>%</b>
	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>		
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>		
CIC Assets (1)	1.5	4.9							1.4	5.4	\$30.42	9.8%
Cohen, Davis & Marks (1)	6.9	4.9							9.0	5.4	32.69	10.5%
Compass Capital (2)	5.5	5.9							3.8	5.3	31.12	10.0%
First Capital (1)	2.4	4.9							1.9	5.4	30.56	9.8%
Kennedy Capital (3)	7.3	6.9							3.9	2.8	31.17	10.0%
New Amsterdam (4)	3.8	5.1							-1.0	4.9	29.71	9.6%
Valenzuela Capital (1)	3.3	4.9							4.7	5.4	31.40	10.1%
Wilke/Thompson (5)	12.1	7.2							4.7	3.4	31.42	10.1%
Winslow Capital (6)	10.7	7.7							7.6	6.6	32.28	10.4%
Zevenberger Capital (6)	6.6	7.7							1.1	6.6	\$30.34	9.8%
<b>Current Aggregate</b>	<b>6.0</b>	<b>6.0 *</b>							<b>3.7</b>	<b>5.2 *</b>	<b>\$311.12</b>	<b>100.0%</b>

Benchmarks currently used are:

- (1) S&P500
- (2) S&P500 (Equal-Weight)
- (3) Russell 2000
- (4) Russell 1000
- (5) Russell 2500
- (6) Russell 1000 Growth

\* weighted aggregate of above benchmarks

Inception date for all managers is 4/1/94.

**ALLIANCE CAPITAL MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Jack Koltes**

**Assets Under Management: \$696,348,995**

**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 wide range of growth opportunities from small, emerging growth to large, 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.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

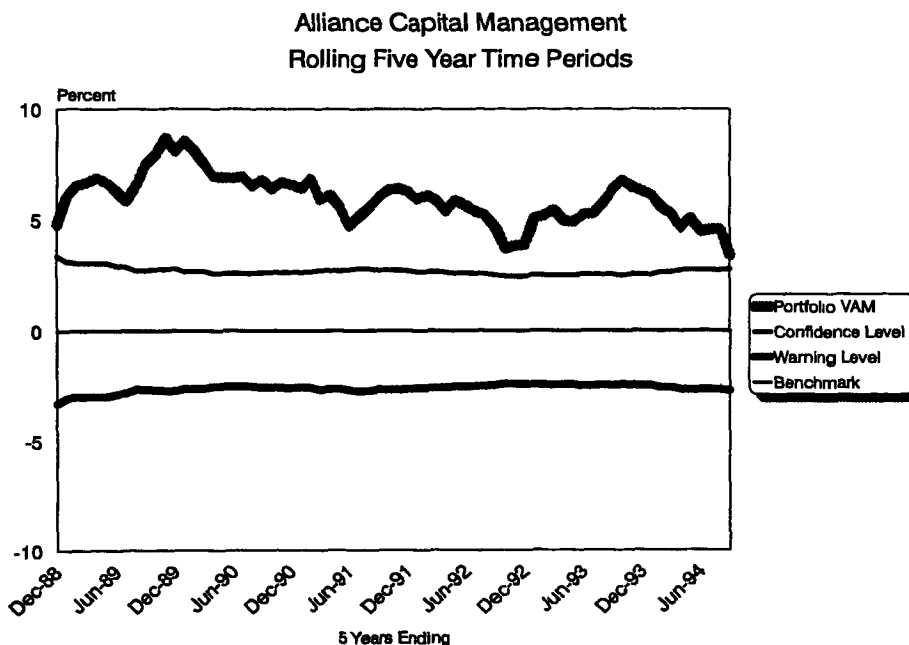
- Highly successful and experienced professionals.
- Organizational continuity and strong leadership.
- Well-acquainted with needs of large clients.
- Investment style consistently and successfully applied over a variety of market environments.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.0%	5.2%
Last 1 year	-0.7	4.3
Last 2 years	8.6	6.1
Last 3 years	11.2	7.1
Last 4 years	16.9	13.7
Last 5 years	10.8	7.2
Since Inception (1/84)	16.2	10.9

**Recommendations**

No action recommended.



Note: Graph uses 80/20 confidence interval.

**BRINSON PARTNERS**  
**Period Ending 9/30/94**

**Portfolio Manager: Jeff Diermeier**

**Assets Under Management: \$272,457,461**

**Investment Philosophy**

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

**Qualitative Evaluation**  
**(reported by exception)**

**Exceptional strengths are:**

- Familiar with the needs of large institutional clients.
- Highly successful and experienced professionals.
- Investment style consistently and successfully applied over a variety of market environments.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.4%	5.5%
Last 1 year	6.9	2.9
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	7.7	5.6

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

**FORSTMANN LEFF ASSOCIATES**  
**Period Ending 9/30/94**

**Portfolio Manager: Joel Leff**

**Assets Under Management: \$350,681,204**

**Investment Philosophy**

Forstmann Leff is a classic example of a "rotational" manager. The firm focuses almost exclusively on asset mix and sector weighting decisions. Based upon its macroeconomic outlook, the firm will move aggressively into and out of equity sectors over the course of a market cycle. The firm tends to purchase liquid, large capitalization stocks. In the past, Forstmann Leff has made sizable market timing moves at any point during a market cycle.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced leadership.
- Investment style consistently and successfully applied over a variety of market environments.
- Well acquainted with needs of large clients.

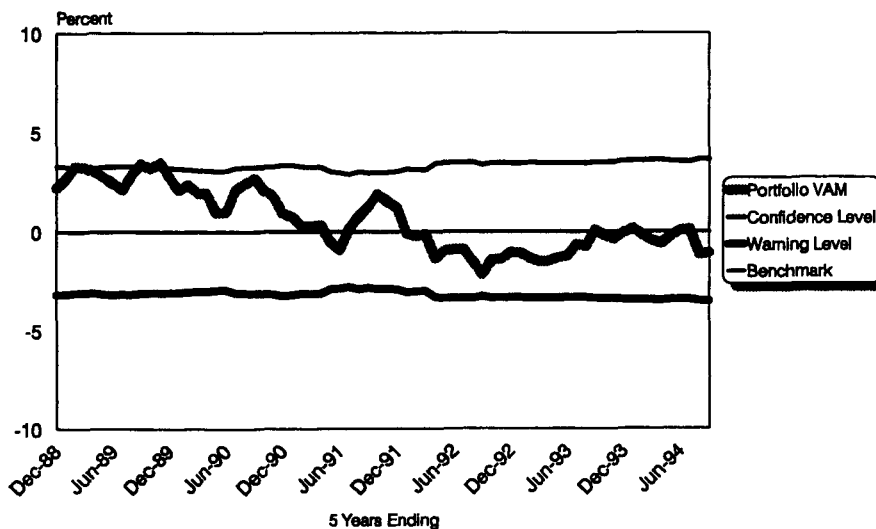
**Recommendations**

No action recommended.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.6%	8.8%
Last 1 year	-0.4	4.9
Last 2 years	9.4	9.5
Last 3 years	5.7	9.3
Last 4 years	12.2	14.4
Last 5 years	7.3	8.4
Since Inception (1/84)	11.7	11.2

**FORSTMANN-LEFF ASSOCIATES**  
**Rolling Five Year Time Periods**



Note: Graph uses 80/20 confidence interval

**FRANKLIN PORTFOLIO ASSOCIATES**  
**Period Ending 9/30/94**

**Portfolio Manager: John Nagorniak**

**Assets Under Management: \$373,084,405**

**Investment Philosophy**

Franklin's investment decisions are quantitatively driven and controlled. The firm's stock selection model uses 30 valuation measures covering the following factors: fundamental momentum, relative value, future cash flow, and economic cycle analysis. The firm believes that a multi-dimensional approach to stock selection provides greater consistency than reliance on a limited number of valuation criteria. Franklin's portfolio management process focuses on buying and selling the right stock rather than attempting to time the market or to pick the right sector or industry groups. The firm remains fully invested at all times.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

- Familiar with the needs of large institutional clients.
- Firm's investment approach has been consistently applied over a number of market cycles.

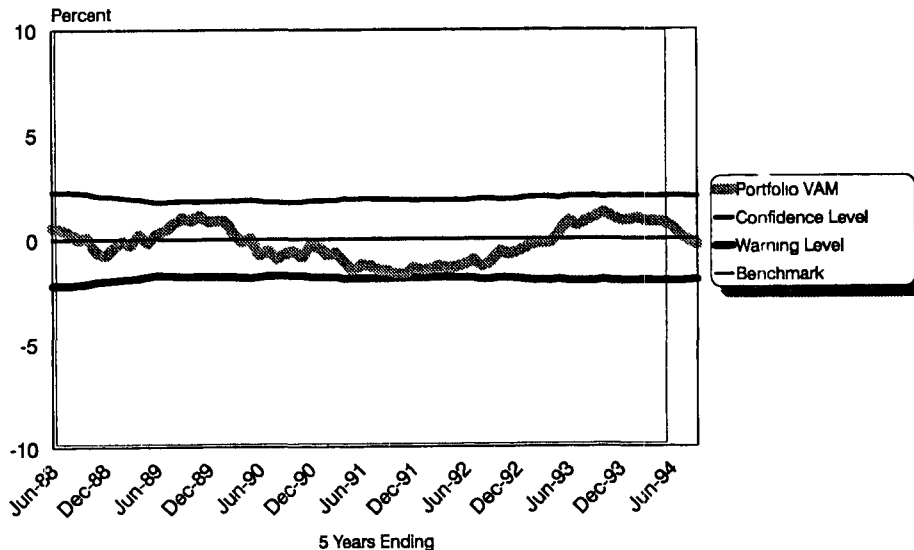
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.4%	5.5%
Last 1 year	-0.4	2.7
Last 2 years	13.6	11.3
Last 3 years	12.9	11.5
Last 4 years	18.1	17.6
Last 5 years	8.9	9.3
Since Inception (4/89)	12.0	11.4

**Recommendations**

No action recommended.

**FRANKLIN PORTFOLIO**  
**Rolling Five Year Time Periods**



Note: Shaded area includes performance prior to managing SBI account. Graph uses 80/20 confidence interval.

**GEOCAPITAL CORP.**  
**Period Ending 9/30/94**

**Portfolio Manager: Barry Fingerhut**

**Assets Under Management: \$260,076,681**

**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 an individual stock selection analysis to invest in the growth/technology and intrinsic value areas of the market. In the growth/technology area, GeoCapital looks for companies that will have above average growth due to a good product development program and limited competition. In the intrinsic value area, the key factors in this analysis 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 the lack of attractive investment opportunities.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

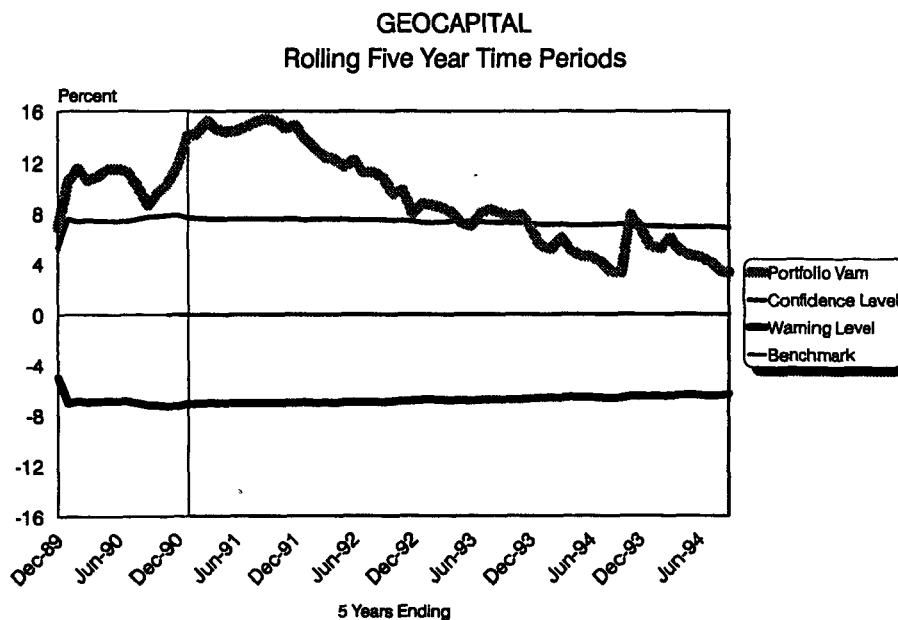
- Investment style consistently and successfully applied over a variety of market environments.
- Attractive, unique investment approach.
- Highly successful and experienced professionals.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	8.0%	14.0%
Last 1 year	2.0	7.9
Last 2 years	14.5	22.7
Last 3 years	10.3	15.8
Last 4 years	25.6	23.3
Last 5 years	N/A	N/A
Since Inception (4/90)	14.6	15.4

**Recommendations**

No action recommended.



Note: Shaded area includes performance prior to managing SBI account.  
 Scale differs from other manager VAM graphs. Graph uses 80/20 confidence interval.

**INVESTMENT ADVISERS INC.**

**Period Ending 9/30/94**

**Portfolio Manager: Julian (Bing) Carlin**

**Assets Under Management: \$114,750,199**

**Investment Philosophy**

IAI's investment philosophy is to own the highest quality companies which demonstrate sustainable growth and the objective of this discipline is capital appreciation. IAI tries to achieve this objective by investing at least 80% of the portfolio in companies which have their headquarters in Minnesota, Wisconsin, Illinois, Iowa, Nebraska, Montana, North Dakota and South Dakota. Twenty percent of the portfolio can be used to purchase large capitalization stocks that display the same quality and growth characteristics but have headquarters outside this region.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are**

- Attractive, unique investment approach.
- Investment style successfully applied over a number of market cycles.

**Current concerns are:**

- Current benchmark does not meet benchmark quality tests. IAI has been working with a consultant on the issue since 1Q94.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	7.0%	6.2%
Last 1 year	0.2	3.8
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	7.8	7.7

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 6/30/95.**



**IDS ADVISORY**  
**Period Ending 9/30/94**

**Portfolio Manager: Pete Anderson**

**Assets Under Management: \$369,965,386**

**Investment Philosophy**

IDS employs a "rotational" style of management, shifting among industry sectors based upon its outlook for the economy and the financial markets. The firm emphasizes primarily sector weighting decisions. Moderate market timing is also used. Over a market cycle, IDS will invest in a wide range of industries. It tends to buy liquid, large capitalization stocks. While IDS will make occasional significant asset mix shifts over a market cycle, the firm is a less aggressive market timer than most rotational managers.

**Qualitative Evaluation**  
**(reported by exception)**

**Exceptional strengths are:**

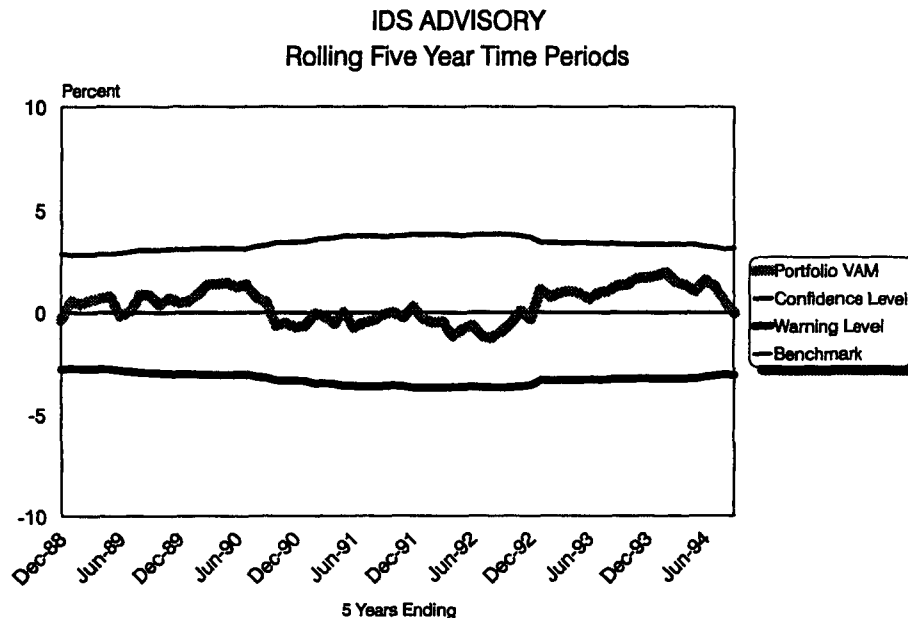
- Investment style consistently and successfully applied over a variety of market environments.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	3.0%	5.0%
Last 1 year	2.9	3.7
Last 2 years	11.1	11.1
Last 3 years	11.5	12.2
Last 4 years	16.0	16.0
Last 5 years	9.4	9.6
Since Inception (1/84)	13.7	13.3

**Recommendations**

No action recommended.



Note: Graph uses 80/20 confidence interval.

**INDEPENDENCE INVESTMENT ASSOCIATES**  
**Period Ending 9/30/94**

**Portfolio Manager: Bill Fletcher**

**Assets Under Management: \$367,401,942**

**Investment Philosophy**

Independence believes that individual stocks which outperform the market always have two characteristics: they are intrinsically cheap and their business is in the process of improving. Independence ranks their universe using a multifactor model. Based on input primarily generated by their internal analysts, the model ranks each stock based on 10 discreet criteria. Independence constricts their portfolio to the top 60% of their ranked universe. The portfolio is optimized relative to the benchmark selected by the client to minimize the market and industry risks. Independence maintains a fully invested portfolio and rarely holds more than a 1% cash position.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

- Investment style consistently and successfully applied over a variety of market environments.
- Attractive, unique investment approach.
- Highly successful and experienced professionals.

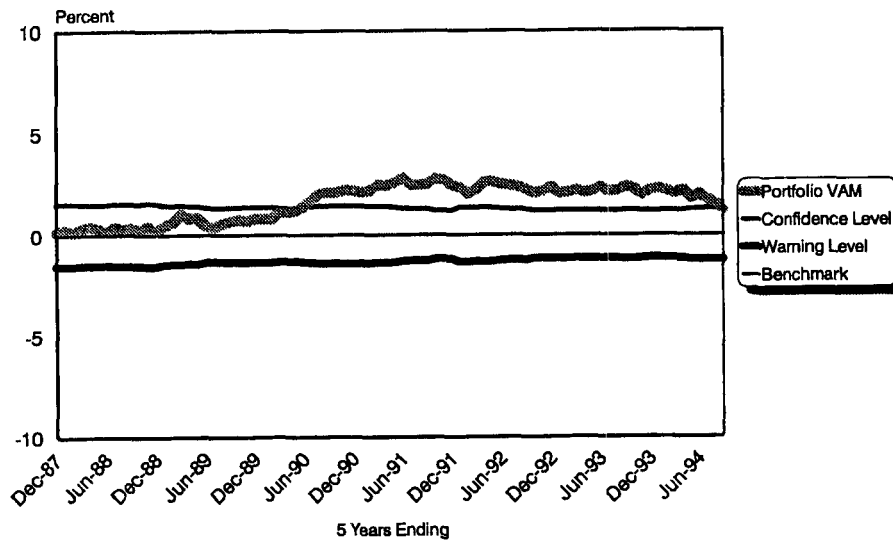
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	3.1%	4.9%
Last 1 year	1.3	3.3
Last 2 years	9.5	8.7
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (2/92)	8.9	8.6

**Recommendations**

No action recommended.

**INDEPENDENCE INVESTMENT ASSOCIATES**  
**Rolling Five Year Time Periods**



Note: Shaded area includes performance prior to managing SBI account. Graph uses 80/20 confidence interval.

**JUNDT ASSOCIATES**  
**Period Ending 9/30/94**

**Portfolio Manager: James Jundt**

**Assets Under Management: \$222,962,124**

**Investment Philosophy**

Jundt Associates' investment philosophy is growth oriented with a focus on companies generating significant revenue increases. They concentrate on larger-capitalization companies, with at least half the equity securities consisting of companies with annual revenues over \$750 million. Within these parameters, the firm's mission is to establish equity positions in 30 to 50 of the fastest growing corporations in America. Particular emphasis is placed on companies the firm believes will achieve annual revenue growth of 15% or greater. Jundt utilizes a bottom-up stock selection process combined with a top-down theme overlay. The firm attempts to identify five to seven investment themes and typically invests three to five stocks in each theme.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Attractive, unique investment approach.
- Investment style has been consistently applied over a number of market cycles.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	15.9%	8.5%
Last 1 year	6.5	5.7
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	7.4	8.1

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

**LINCOLN CAPITAL MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Parker Hall**

**Assets Under Management: \$257,192,903**

**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.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are**

- Organizational continuity and strong leadership.
- Familiar with the needs of large clients.
- Investment style has been consistently applied over a number of market cycles.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.9%	6.4%
Last 1 year	5.6	6.5
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	5.0	5.6

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

**LYNCH & MAYER**  
**Period Ending 9/30/94**

**Portfolio Manager: Eldon Mayer**

**Assets Under Management: \$314,121,131**

**Investment Philosophy**

Lynch & Mayer invest primarily in high-quality, large capitalization growth stocks. They believe that outstanding investments are a function of corporate earnings growth that is considerably above historical trends or consensus expectations. Lynch & Mayer are bottom up stock pickers and rely on very little economic analysis in their selection process. The firm screens out stocks below a certain market capitalization and liquidity level and then eliminates additional stocks based on various fundamental criteria. After the screening process they look for at least one of the following four factors: 1) acceleration of growth; 2) improving industry environment; 3) corporate restructuring; or 4) turnaround. The firm generally stays fully invested, with any cash due to lack of attractive investment opportunities.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

- Organizational continuity and strong leadership.
- Highly successful and experienced professionals.

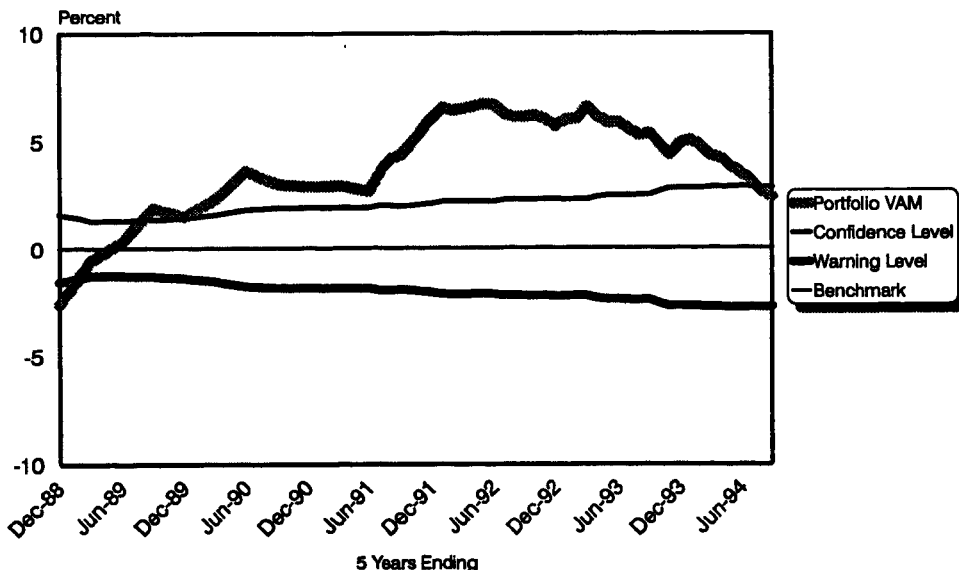
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.7%	6.6%
Last 1 year	-3.2	3.5
Last 2 years	6.8	11.6
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (2/92)	5.6	8.8

**Recommendations**

No action recommended.

**LYNCH & MAYER**  
**Rolling Five Year Time Periods**



Note: Shaded area includes performance prior to managing SBI account. Graph uses 80/20 confidence interval.

**OPPENHEIMER CAPITAL**  
**Period Ending 9/30/94**

**Portfolio Manager: John Lindenthal**

**Assets Under Management: \$265,761,313**

**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. Based on its outlook on the market and the economy, Oppenheimer will make moderate shifts between cash and equities. Oppenheimer focuses on five key variables when evaluating companies: management, financial strength, profitability, industry position and valuation.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Familiar with the needs of large institutional clients.
- Investment style has been consistently applied over a number of market cycles.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.2%	4.2%
Last 1 year	2.6	2.6
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	5.7	4.9

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

**WADDELL & REED ASSET MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Henry Herrmann**

**Assets Under Management: \$392,642,076**

**Investment Philosophy**

Waddell & Reed focuses its attention primarily on smaller capitalization growth stocks. However, the firm has demonstrated a willingness to make significant bets against this investment approach for extended periods of time and has been very eclectic in its choice of stocks in recent years. The firm is an active market timer and will raise cash to extreme levels at various points in the market cycle.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

—Highly successful and experienced professionals.

**Current concerns are:**

—Staff has some concerns about Waddell & Reed's benchmark. The firm is analyzing their benchmark and will have all enhancements implemented by the end of 1994.

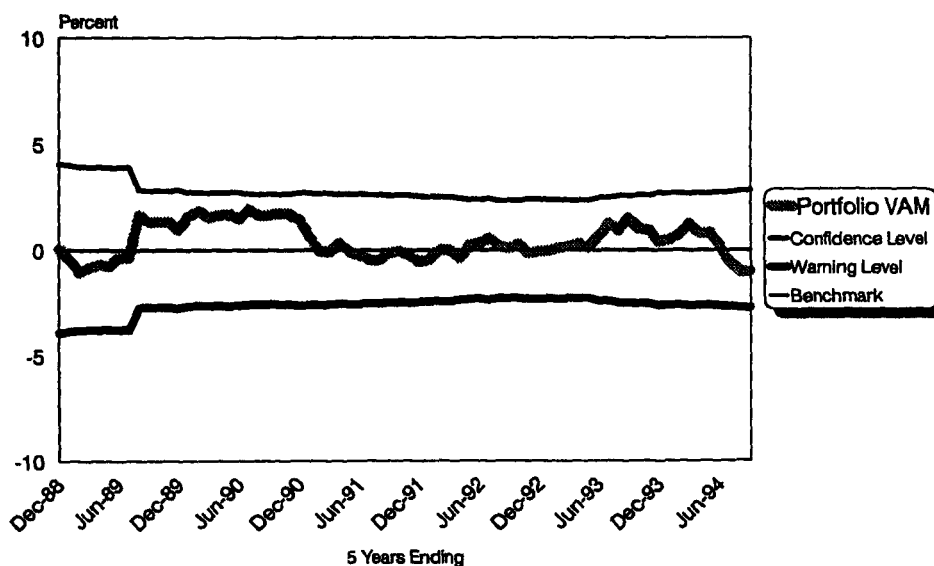
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.3%	7.9%
Last 1 year	1.4	7.4
Last 2 years	12.9	15.1
Last 3 years	12.0	12.7
Last 4 years	15.0	17.6
Last 5 years	8.7	9.8
Since Inception (1/84)	11.6	11.4

**Recommendations**

No action recommended.

**WADDELL & REED**  
**Rolling Five Year Time Periods**



Note: Graph uses 80/20 confidence interval.

**WEISS, PECK & GREER**  
**Period Ending 9/30/94**

**Portfolio Manager: Melville Straus**

**Assets Under Management: \$205,860,564**

**Investment Philosophy**

Weiss, Peck & Greer's dynamic growth process concentrates on small to medium size growth companies that have demonstrated consistent superior earnings growth rates. The process emphasizes companies in new or dynamic, rapidly growing industries where there is a potential for a major acceleration in earnings growth. The firm also believes that superior stock selection can be achieved through in-depth fundamental company research.

**Qualitative Evaluation**  
**(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Investment style has been consistently applied over a number of market cycles

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	12.1%	10.6%
Last 1 year	-6.2	1.1
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	1.6	7.4

**Recommendations**

No action recommended

**VAM graph will be created for period ending 6/30/95.**



**CIC ASSET MANAGEMENT**  
Period Ending 9/30/94

**Portfolio Manager: Jorge Castro**

**Assets Under Management: \$30,420,462**

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**Investment Philosophy**

CIC Asset Management (CIC) uses a disciplined relative value approach to managing equities. CIC believes that purchasing companies at attractive prices provides superior long-term performance with lower volatility. This investment process is designed for clients who desire equity market exposure with both incremental value added and downside protection due to reasonable dividend yields, moderate price to book values and low normalized price to earnings ratios. Finally, the process provides a synergy between quantitative valuation techniques and "Graham & Dodd" fundamental analyses.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.5%	4.9%
Since Inception (4/94)	1.4	5.4

**COHEN DAVIS & MARKS INCORPORATED**  
Period Ending 9/30/94

**Portfolio Manager: George Cohen**

**Assets Under Management: \$32,691,711**

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**Investment Philosophy**

Cohen Davis & Marks Inc. (CDM) 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. CDM exploits short run inefficiencies through an unbiased process that relates the price of a stock to the consensus earnings expectations.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	6.9%	4.9%
Since Inception (4/94)	9.0	5.4

**COMPASS CAPITAL MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Charles Kelley**

**Assets Under Management: \$31,124,742**

**Investment Philosophy**

Compass Capital Management (CCM) combines aspects of growth and value investing to achieve the proper blend of return (growth) and risk (value). They use a computer based data network to screen for large, well established companies whose earnings grow in spite of a weak economy and companies whose earnings have grown well over long time periods, but which may experience earnings pressure with downturns in the economy. Particular focus is given to growth in sales, earnings, dividends, book value and the underlying industry. Due to their "growing company" orientation, their portfolios generally hold no utility, bank, deep cyclical (auto companies for example), or oil and gas stocks.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.5%	5.9%
Since Inception (4/94)	3.8	5.3

**FIRST CAPITAL ADVISORS, INC.**  
**Period Ending 9/30/94**

**Portfolio Manager: Phil Orlando**

**Assets Under Management: \$30,558,469**

**Investment Philosophy**

First Capital Advisers believes that cash flow, "true" earnings, tangible asset values, and inherent growth are measures of potential relative performance that are often superior to measures based simply on "reported earnings". First Capital Advisers bases its valuations primarily on these "value-related" factors. They employ a sector-rotational equity strategy, which combines elements of both top-down and bottom-up analysis. Their primary investment focus is on large capitalization companies with strong balance sheets and are highly liquid. First Capital combines fundamental and technical analyses to identify superior longer-term investment opportunities and to endeavor to maximize short-term trading strategies.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.4%	4.9%
Since Inception (4/94)	1.9	5.4

**KENNEDY CAPITAL MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Richard Sinise**

**Assets Under Management: \$31,168,941**

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**Investment Philosophy**

Kennedy Capital Management (KCM) is dedicated to exploiting pricing inefficiencies in under-followed and misunderstood small capitalization stocks. They believe that stocks are efficiently priced where there is a proper distribution of information. However, many emerging growth companies suffer from lack of analytical coverage and information flow, and therefore, are "invisible" to institutional investors. KCM believes it is this lack of information which creates pricing inefficiencies. They anticipate that by closing this information gap they can transform these holdings into attractive institutional candidates. This, in turn, will increase the price of the stock.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	7.3%	6.9%
Since Inception (4/94)	3.9	2.8

**NEW AMSTERDAM PARTNERS**  
**Period Ending 9/30/94**

**Portfolio Manager: Michelle Clayman**

**Assets Under Management: \$29,713,851**

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**Investment Philosophy**

New Amsterdam Partners believe 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.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	3.8%	5.1%
Since Inception (4/94)	-1.0	4.9

**VALENZUELA CAPITAL MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Mariko Gordon**

**Assets Under Management: \$31,402,881**

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**Investment Philosophy**

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

**Quantitative Evaluation**

	Actual	Benchmark
Last Quarter	3.3%	4.9%
Since Inception (4/94)	4.7	5.4

**WILKE/THOMPSON CAPITAL MANAGEMENT INC.**  
**Period Ending 9/30/94**

**Portfolio Manager: Mark Thompson**

**Assets Under Management: \$31,419,022**

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**Investment Philosophy**

The investment philosophy of Wilke/Thompson (W/T) is to invest in high quality growth companies that demonstrate the ability to sustain strong secular earnings growth, notwithstanding overall economic conditions. W/T's investment approach involves a bottom-up fundamental process. The stock selection process favors companies with strong earnings, high unit growth, a proprietary market niche, minimum debt, conservative accounting and strong management practices. They formulate investment ideas by networking with the corporate managers of their current and prospective holdings, as well as with regional brokers, venture capitalists, and other buy-side portfolio managers.

**Quantitative Evaluation**

	Actual	Benchmark
Last Quarter	12.1%	7.2%
Since Inception (4/94)	4.7	3.4

## WINSLOW CAPITAL MANAGEMENT

Period Ending 9/30/94

Portfolio Manager: Clark Winslow

Assets Under Management: \$32,282,011

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### Investment Philosophy

Winslow Capital Management (WCM) believes that investing in companies with above average earnings growth provide the best opportunities for superior portfolio returns over time. WCM believes that a high rate of earnings growth is often found in medium capitalization growth companies of \$1 to \$10 billion market capitalization. Thus, to seek superior portfolio returns while maintaining good liquidity, Winslow Capital emphasizes a growth strategy buying securities of both medium and large cap companies. The objective is to achieve a weighted average annual earnings growth rate of 15-20% over a 2-3 year time horizon.

### Quantitative Evaluation

	Actual	Benchmark
Last Quarter	10.7%	7.7%
Since Inception (4/94)	7.6	6.6

## ZEVENBERGEN CAPITAL INC

Period Ending 9/30/94

Portfolio Manager: Nancy Zevenbergen

Assets Under Management: \$30,339,306

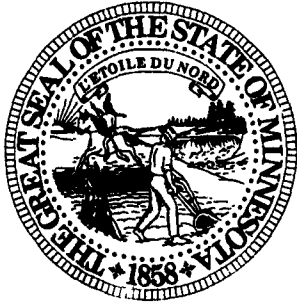
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### Investment Philosophy

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 to potential diversification. The firm emphasizes that they are not market timers.

### Quantitative Evaluation

	Actual	Benchmark
Last Quarter	6.6%	7.7%
Since Inception (4/94)	1.1	6.6



# STATE BOARD OF INVESTMENT

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## Bond Manager Evaluation Reports

Third Quarter, 1994

**DOMESTIC BOND MANAGERS**  
**Period Ending 9/30/94**

<b>Current Managers</b>	<b>Quarter</b>		<b>1 Year</b>		<b>3 years</b>		<b>5 Years</b>		<b>Since (1)</b>		<b>Market Value</b> (in millions)	<b>Pool %</b>
	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>		
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>		
BEA	-0.3	0.6	-4.4	-3.1					-1.2	-0.5	\$274.93	4.6%
IAI	0.1	0.6	-5.6	-3.1	6.9	6.3	8.7	8.4	11.7	11.4	453.54	7.6%
Miller	0.4	0.6	-4.6	-3.1	7.2	6.3	9.3	8.5	11.5	11.4	502.00	8.4%
Standish	0.2	0.6	-4.2	-3.1					-1.1	-0.5	453.77	7.6%
Western	0.9	0.6	-4.1	-3.1	7.6	6.3	9.3	8.6	12.5	11.3	845.75	14.1%
IDS (2)	0.3	0.5	-5.0	-4.1					-0.7	-0.7	236.49	3.9%
TCW (3)	5.2	0.9	-2.4	-0.9					0.3	0.0	239.27	4.0%
Goldman (4)	0.5	0.6	-2.7	-3.1					0.0	-0.5	1,003.01	16.7%
Fidelity (4)	1.1	0.6	-2.0	-3.1	7.0	6.3	9.0	8.5	9.3	8.9	1,005.04	16.7%
Lincoln (4)	0.6	0.6	-3.0	-3.1	6.5	6.3	8.5	8.5	8.9	8.9	991.81	16.5%
											\$6,005.61	100.0%
									<b>Since 7/1/84</b>			
<b>Current Aggregate</b>	<b>0.8</b>	<b>0.6</b>	<b>-3.4</b>	<b>-3.1</b>	<b>7.0</b>	<b>6.4</b>	<b>8.9</b>	<b>8.5</b>	<b>11.9</b>	<b>11.4</b>		
<b>Historical Aggregate (5)</b>	<b>0.7</b>	<b>0.6</b>	<b>-3.5</b>	<b>-3.1</b>	<b>6.9</b>	<b>6.4</b>	<b>8.8</b>	<b>8.5</b>	<b>11.2</b>	<b>11.2</b>		
<b>Lehman Aggregate (6)</b>		<b>0.6</b>		<b>-3.2</b>		<b>6.3</b>		<b>8.5</b>		<b>10.7</b>		

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

(2) Govt./Corp. only.

(3) Mortgages only.

(4) Semi- passive manager.

(5) Includes performance of terminated managers.

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

**BEA ASSOCIATES**  
**Period Ending 9/30/94**

**Portfolio Manager: Bob Moore**

**Assets Under Management: \$274,925,078**

**Investment Philosophy**

BEA's investment approach focuses on individual bond selection and on sector selection rather than short term interest rate forecasting. BEA keeps the duration close to the benchmark but may be slightly longer or shorter depending on their long-term economic outlook. BEA's approach is distinguished by 1) a quantitative approach which avoids market timing; 2) contrarian weightings of bond sectors; and 3) rigorous call and credit analysis rather than yield driven management.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Extensive option analysis capabilities.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.3%	0.6%
Last 1 year	-4.4	-3.1
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	-1.2	-0.5

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**



**INVESTMENT ADVISERS**  
**Period Ending 9/30/94**

**Portfolio Manager: Larry Hill**

**Assets Under Management: \$453,535,152**

**Investment Philosophy**

Investment Advisers is a traditional top down bond manager. The firm's approach is oriented toward correct identification of the economy's position in the credit cycle. This analysis leads the firm to its interest rate forecast and maturity decisions, from which the firm derives most of its value-added. Investment Advisers is an active asset allocator, willing to make rapid, significant moves between cash and long maturity investments over the course of an interest rate cycle. Quality and sector choices are made through yield spread analyses consistent with the interest rate forecasts. Individual security selection receives very limited emphasis and focuses largely on specific bond characteristics such as call provisions.

**Qualitative Evaluation  
 (reported by exception)**

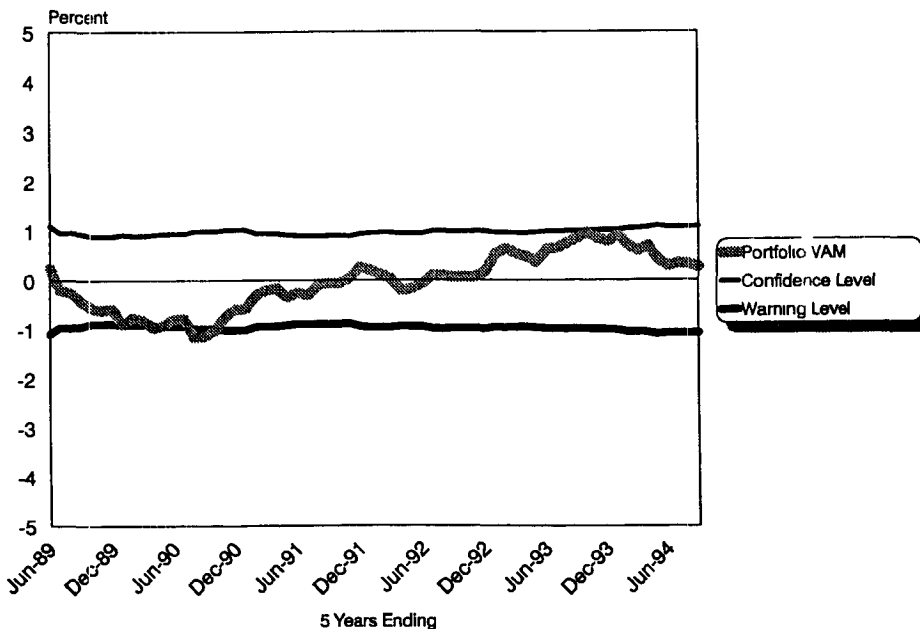
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.1%	0.6%
Last 1 year	-5.6	-3.1
Last 2 years	3.6	3.3
Last 3 years	6.9	6.3
Last 4 years	9.7	8.7
Last 5 years	8.7	8.4
Since Inception (7/84)	11.7	11.4

**Recommendations**

No action recommended.

**Investment Advisers  
 Rolling Five Year Time Periods**



Note. Graph uses 80/20 confidence interval.

**MILLER ANDERSON & SHERRERD**  
**Period Ending 9/30/94**

**Portfolio Manager: Tom Bennett**

**Assets Under Management: \$501,997,507**

**Investment Philosophy**

Miller Anderson focuses its investments in misunderstood or under-researched classes of securities. Over the years this approach has led the firm to emphasize mortgage-backed and specialized corporate securities in its portfolios. Based on its economic and interest rate outlook, the firm establishes a desired maturity level for its portfolios. Changes are made gradually over an interest rate cycle and extremely high cash positions are never taken. Total portfolio maturity is always kept within an intermediate three-to-seven year duration band. Unlike other firms that invest in mortgage securities, Miller Anderson intensively researches and, in some cases, manages the mortgage pools in which it invests.

**Qualitative Evaluation  
 (reported by exception)**

The firms strengths continue to be:  
 —Highly successful and experienced professionals.  
 —Extensive securities research process.

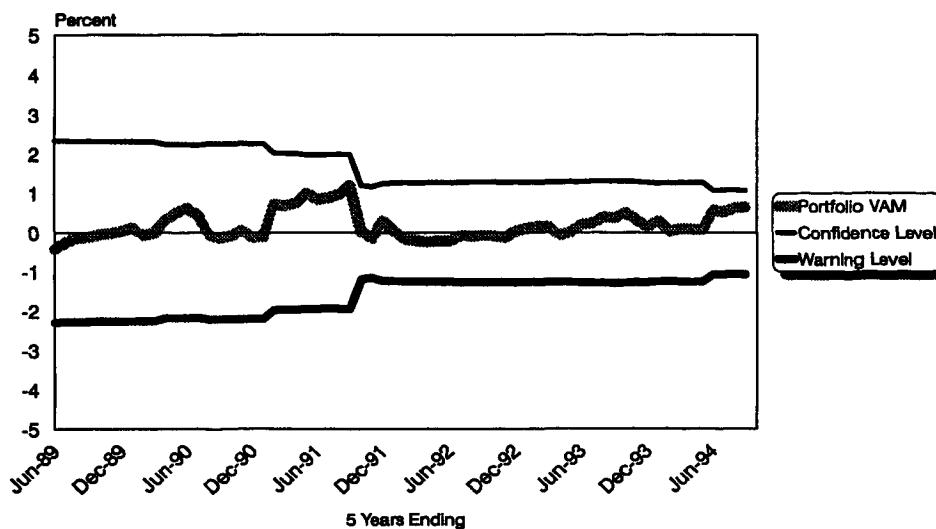
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.4%	0.6%
Last 1 year	-4.6	-3.1
Last 2 years	4.2	3.3
Last 3 years	7.2	6.3
Last 4 years	10.2	8.7
Last 5 years	9.3	8.5
Since Inception (7/84)	11.5	11.4

**Recommendations**

No action recommended.

**MILLER ANDERSON**  
**Rolling Five Year Time Periods**



Note: Graph uses 80/20 confidence interval.

**STANDISH, AYER & WOOD**  
**Period Ending 9/30/94**

**Portfolio Manager: Austin Smith**

**Assets Under Management: \$453,767,265**

**Investment Philosophy**

Standish adds value by capitalizing on market inefficiencies and trading actively through intra and inter-sector swapping. The firm does not forecast interest rates but adds value to the portfolio by buying non-Treasury issues. Key to the approach is active sector trading and relative spread analysis of both sectors and individual issues. In addition to sector spreads, the firm also analyzes how secular trends affect bond pricing. The firm believes that 65% of its value added comes from inter-sector swapping in non-government sectors.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals
- Extensive corporate research capabilities.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.2%	0.6%
Last 1 year	-4.2	-3.1
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	-1.1	-0.5

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95**

**WESTERN ASSET MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Kent Engel**

**Assets Under Management: \$845,748,346**

**Investment Philosophy**

Western recognizes the importance of interest rate changes on fixed income portfolio returns. However, the firm believes that successful interest rate forecasting, particularly short run forecasting, is extremely difficult to accomplish consistently. Thus, the firm attempts to keep portfolio maturity in a narrow band near that of the market, making only relatively small, gradual shifts over an interest rate cycle. It prefers to add value primarily through appropriate sector decisions. Based on its economic analysis, Western will significantly overweight particular sectors, shifting these weights as economic expectations warrant. Issue selection, like maturity decisions, are of secondary importance to the firm.

**Qualitative Evaluation  
 (reported by exception)**

- The firm's exceptional strengths continue to be:**
- Highly successful and experienced professionals.
  - Extensive securities research process.

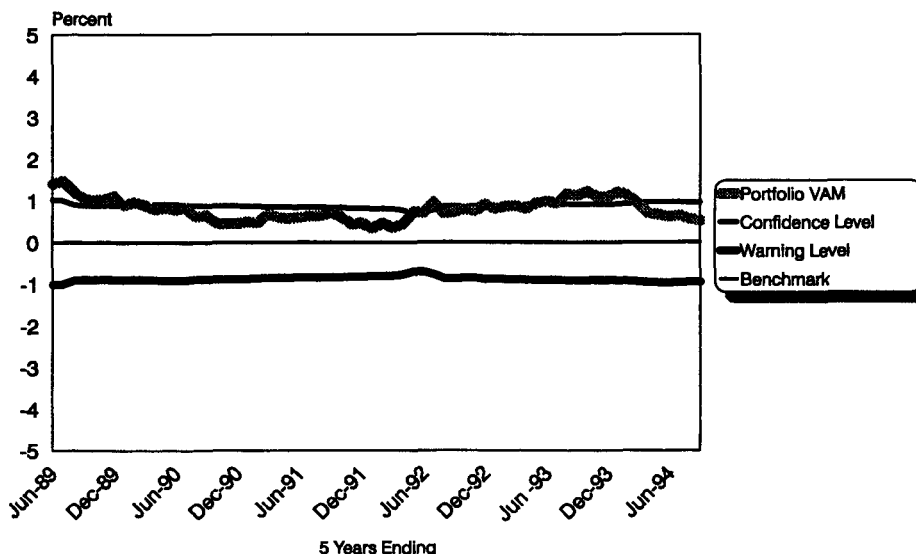
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.9%	0.6%
Last 1 year	-4.1	-3.1
Last 2 years	5.0	3.3
Last 3 years	7.6	6.3
Last 4 years	10.1	8.8
Last 5 years	9.3	8.6
Since Inception (7/84)	12.5	11.3

**Recommendations**

No action recommended.

**Western Asset Management  
 Rolling Five Year Time Periods**



Note: Graph uses 80/20 confidence interval.

**IDS ADVISORY GROUP**  
**Period Ending 9/30/94**

**Portfolio Manager: Ed Labenski**

**Assets Under Management: \$236,487,805**

**Investment Philosophy**

IDS manages a corporate and treasury portfolio for the SBI. The firm uses duration management combined with in-depth fundamental analysis of the corporate sector to add value to the portfolio. Active duration management begins with an economic overview and interest rate outlook. These factors help IDS determine the direction of both short and long-term interest rates which leads to the portfolio duration decisions. After IDS determines duration, they use their extensive corporate research capabilities to determine corporate sector allocation and to select individual issues.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Extensive corporate research capabilities.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.3%	0.5%
Last 1 year	-5.0	-4.1
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	-0.7	-0.7

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

**TCW**  
**Period Ending 9/30/94**

**Portfolio Manager: Philip Barach**

**Assets Under Management: \$239,268,579**

**Investment Philosophy**

TCW manages a mortgage only portfolio for the SBI. TCW is a mortgage manager that emphasizes security selection. TCW invests a significant portion of the portfolio in collateralized mortgage obligations (CMO's). The staff analyzes various Wall Street models used to evaluate CMO's and determines the validity of their underlying assumptions. Historically, they have added significant value by understanding the strengths and weaknesses of these models. This helps them purchase undervalued securities and avoid those that are overpriced.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Extensive CMO investment experience.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.2%	0.9 %
Last 1 year	-2.4	-0.9
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (7/93)	0.3	0.0

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

**GOLDMAN SACHS**  
**Period Ending 9/30/94**

**Portfolio Manager: Sharmin Mossavar Rahmani**

**Assets Under Management: \$1,003,009,399**

**Investment Philosophy**

Goldman is an enhanced index manager who focuses on security selection. When analyzing treasuries, the firm models Treasury coupons with an arbitrage based pricing model. This model determines the spread between actual and intrinsic market yields and determines whether the security is rich or cheap. Goldman takes a highly quantitative and analytical approach to value mortgage securities as well. Goldman uncovers undervalued securities using proprietary research and internally developed models. In the corporate sector, Goldman performs its own credit review of each issue. Goldman adds value to the corporate sector with extensive research, market knowledge, and trading skill.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Quantitative capabilities

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.5%	0.6%
Last 1 year	-2.7	-3.1
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception	0.0	-0.5

**Recommendations**

No action recommended.

**Tracking graph will be drawn for the period ending 9/30/95.**

**FIDELITY MANAGEMENT TRUST**  
**Period Ending 9/30/94**

**Portfolio Manager: Tom Steffanci**

**Assets Under Management: \$1,005,035,254**

**Investment Philosophy**

Fidelity is an enhanced index manager who builds an index portfolio using stratified sampling and a risk factor model. Using stratified sampling, Fidelity divides the Salomon BIG into subsectors based on characteristics like maturity, coupon, sector and quality and chooses securities to represent each cell. The portfolio is then compared to the Salomon BIG using a risk factor model. Fidelity adds value to the portfolio through sector selection, issue selection, credit research and yield curve strategies. Fidelity weights sectors based on their relative value and attempts to buy stable credits or credits likely to be upgraded. Finally, Fidelity changes the maturity distribution of the portfolio securities to take advantage of non-parallel shifts in the yield curve.

**Qualitative Evaluation  
 (reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Extensive securities research process.
- Quantitative capabilities.

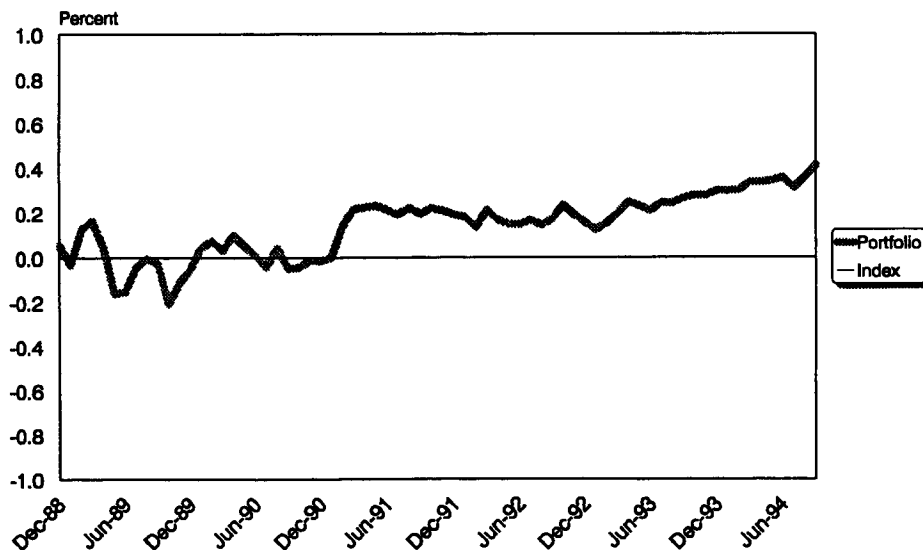
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.1%	0.6%
Last 1 year	-2.0	-3.1
Last 2 years	4.3	3.3
Last 3 years	7.0	6.3
Last 4 years	9.4	8.7
Last 5 years	9.0	8.5
Since Inception (7/88)	9.3	8.9

**Recommendations**

No action recommended.

**Fidelity Management Trust  
 Cumulative Annualized Tracking Report**





**LINCOLN CAPITAL MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: Brian Johnson**

**Assets Under Management: \$991,809,673**

**Investment Philosophy**

Lincoln is an enhanced index manager that uses a quantitative approach to managing the portfolio. Lincoln calculates the index's expected return for changes in 54 variables. These variables include interest rates, yield curve shape, call features and sector spreads. Lincoln then constructs a portfolio to match the expected returns for a given change in any of the variables. Lincoln relaxes the return tolerances, defined as the difference between the portfolio's expected returns and that for the index, for an enhanced index fund. The portfolio's securities are selected from a universe of 250 liquid issues using a proprietary risk-valuation model. A linear program or portfolio optimizer then constructs the most undervalued portfolio that still matches the return characteristics of the index.

**Qualitative Evaluation  
(reported by exception)**

**The firm's strengths are:**

- Highly successful and experienced professionals.
- Extensive quantitative capabilities.

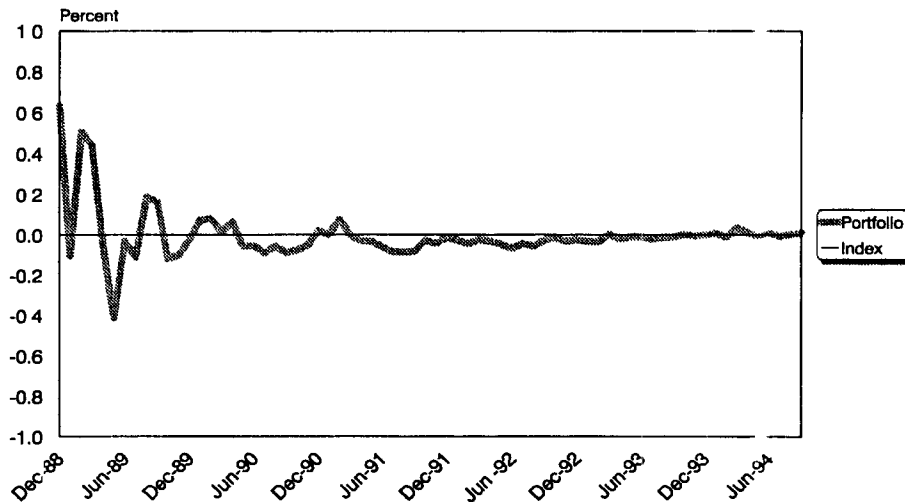
**Quantitative Evaluation**

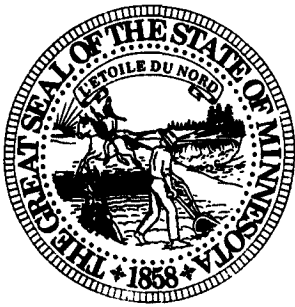
	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.6%	0.6%
Last 1 year	-3.0	-3.1
Last 2 years	3.4	3.3
Last 3 years	6.5	6.3
Last 4 years	8.8	8.7
Last 5 years	8.5	8.5
Since Inception (7/88)	8.9	8.9

**Recommendations**

No action recommended.

**LINCOLN CAPITAL MANAGEMENT**  
**Cumulative Annualized Tracking Report**





# STATE BOARD OF INVESTMENT

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## **International Manager Evaluation Reports**

**Third Quarter, 1994**

**INTERNATIONAL STOCK MANAGERS**  
**Period Ending 9/30/94**

<b>Current Managers</b>	<b>Quarter</b>		<b>1 Year</b>		<b>3 years</b>		<b>5 Years</b>		<b>Since Inception</b>		<b>Market Value</b> <b>(in millions)</b>	<b>Pool</b> <b>%</b>
	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>	<b>Actual</b>	<b>Bmk</b>		
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>		
Baring (1)	4.3	0.1	18.5	9.8					20.8	18.4	\$191.97	9.3%
Brinson (1)	2.0	0.1	7.6	9.8					10.2	18.4	169.49	8.3%
Marathon (2)	1.5	0.1							18.8	7.2	175.59	8.6%
Rowe Price (2)	5.2	0.1							12.3	7.2 #	166.52	8.1%
Scudder (2)	2.3	0.1							6.0	7.2	161.59	7.9%
Templeton (2)	5.4	0.1							9.5	7.2	166.34	8.1%
State Street (3)	0.4	0.1 #	10.3	9.8					18.0	17.8	1,020.11	49.7%
<b>Current Aggregate</b>	<b>1.9</b>	<b>0.1</b>	<b>11.9</b>	<b>9.8</b>					<b>18.0</b>	<b>17.8</b>	<b>\$2,051.61</b>	<b>100.0%</b>

(1) Active country/passive stock. Retained April 1, 1993

(2) Fully active. Retained November 1, 1993

(3) Index. Retained October 1, 1992

**BARING INTERNATIONAL INVESTMENT LTD.**  
**Period Ending 9/30/94**

**Portfolio Manager: Philip Bullen**

**Assets Under Management: \$191,966,372**

**Investment Philosophy**

Barings manages an active country/passive stock portfolio for the SBI. Barings' strategic policy team is responsible for the country and currency decisions. Country allocation decisions are made using a macroeconomic framework which seeks to identify growing economies as evidenced by positive changes in GDP and interest rates. The team uses multiple inputs including regional specialists, local market valuations and a computer model that functions as an audit of the qualitative valuation process. Currency specialists within Barings provide assessments on flow of funds, currency rates, monetary policy, inflation and interest rates. Barings uses country index funds managed by State Street Global Advisors to implement their country allocations. At Barings' direction, State Street also implements currency/hedging strategies for the portfolio.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Familiar with the needs of large institutional clients.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.3%	0.1%
Last 1 year	18.5	9.8
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (4/93)	20.8%	18.4%

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 6/30/95.**

**BRINSON PARTNERS**  
**Period Ending 9/30/94**

**Portfolio Manager: Richard Carr**

**Assets Under Management: \$169,487,637**

**Investment Philosophy**

Brinson manages an active country/passive stock portfolio for the SBI. The firm uses a proprietary valuation model to rank the relative attractiveness of individual markets based on fundamental considerations. Inputs include forecasts for growth, inflation, 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 country allocations. Brinson establishes an allocation range around the target index to define the limits of their exposure to individual countries and to assure diversification. Brinson constructs its country index funds using a proprietary optimization system.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Highly successful and experienced professionals.
- Familiar with the needs of large institutional clients.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.0%	0.1%
Last 1 year	7.6	9.8
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (4/93)	10.2%	18.4%

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

**MARATHON ASSET MANAGEMENT**  
**Period Ending 9/30/94**

**Portfolio Manager: William Arah**

**Assets Under Management: \$175,585,074**

**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.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

—Attractive, unique investment approach.

**Current concerns are:**

—The firm has experienced a fair amount of client growth over the last year.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.5%	0.1%
Last 1 year	N/A	N/A
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (11/93)	18.8%	7.2%

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

**ROWE PRICE-FLEMING INTERNATIONAL, INC.**  
**Period Ending 9/30/94**

**Portfolio Manager: Martin Wade**

**Assets Under Management: \$166,522,907**

**Investment Philosophy**

Rowe Price-Fleming (RPF) 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. RPF 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.

**Qualitative Evaluation  
(reported by exception)**

The firms strengths continue to be:

- Extensive securities research process.
- Successful investment approach which has been consistently applied over a number of market cycles.
- Familiarity with the needs of large institutional clients.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.2%	0.1%
Last 1 year	N/A	N/A
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (11/93)	12.3%	7.2%

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 3/31/96.**

**SCUDDER, STEVEN & CLARK**  
**Period Ending 9/30/94**

**Portfolio Manager: Nicholas Bratt**

**Assets Under Management: \$161,592,042**

**Investment Philosophy**

Scudder believes that successful international investing requires knowledge of each country's economy, political environment and financial market obtained through continuous and thorough research of individual markets and securities. The investment process focuses on three areas: country analysis, global themes and unique situations. Ideas from all three areas are integrated into Scudder's research universe. Using their own internal research, the firm seeks companies with potential for earnings and dividend growth, strong or improving balance sheets, superior management, conservative accounting practices and dominant position in growing industries.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Strong leadership.
- Extensive securities research capabilities.
- Successful investment approach which has been consistently applied over a number of market cycles.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.3%	0.1%
Last 1 year	N/A	N/A
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (11/93)	6.0%	7.2%

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**



**TEMPLETON INVESTMENT COUNSEL, INC.**  
**Period Ending 9/30/94**

**Portfolio Manager: Harry Ehrlich**

**Assets Under Management: \$166,342,560**

**Investment Philosophy**

Templeton's goal is to identify those companies selling at the greatest discount to future intrinsic value. The firm takes a long-term approach to investing and believes that, over time, markets are efficient and patience will reward those who have identified undervalued stocks. Stock selection dominates Templeton's investment approach; country, sector and industry weightings are a residual of the stock selection process. Stock ideas are obtained from a worldwide network of research sources and screens of their own global database. From this preliminary list, analysts conduct fundamental analysis to distinguish a "cheap" stock from a "bargain." Templeton seeks stocks that are cheap relative to their own price history, their global industry and their domestic market. Each stock on the resulting "bargain list" has established buy and sell price targets and is purchased and sold accordingly.

**Qualitative Evaluation  
(reported by exception)**

**Exceptional strengths are:**

- Extensive securities research process.
- Successful investment approach which has been consistently applied over a number of market cycles.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	5.4%	0.1%
Last 1 year	N/A	N/A
Last 2 years	N/A	N/A
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (11/93)	9.5%	7.2%

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

# Tab G

## **COMMITTEE REPORT**

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**DATE:** December 6, 1994

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

**FROM:** **Alternative Investment Committee**

The Alternative Investment Committee met during the quarter to review the following information and action items:

- Review of current strategy.
- Results of review session with one of the SBI's private equity managers, Matrix Partners.
- Commitment reduction to Irwin Jacobs' IMR Fund.

Board action is requested on the commitment reduction to the IMR Fund.

### **INFORMATION ITEMS:**

#### **1) Review of Current Strategy.**

To increase overall portfolio diversification, 15% of the Basic Retirement Funds and 5% of the Post Retirement Fund are allocated to alternative investments. Alternative investments include real estate, private equity and resource investments where Minnesota State Board of Investment (SBI) participation is limited to commingled funds or other pooled vehicles. A chart summarizing the Board's current commitments is attached (see **Attachment 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 open-end and closed-end commingled funds. The remaining portion of the portfolio can include investments in less diversified, more focused (specialty) commingled funds. Currently, the SBI has committed \$536 million to twenty-one (21) commingled real estate funds.

The private equity investment strategy is to establish and maintain a broadly diversified private equity portfolio comprised of investments that provide diversification by industry type, stage of corporate development and location. To date, the SBI has committed to thirty (30) commingled private equity funds for a total commitment of \$781 million.

The strategy for resource investment requires that investment be made in resource investment vehicles that are specifically designed for institutional investors to provide an inflation hedge and additional diversification. Individual resource investments will include proved producing oil and gas properties, royalties and other investments that are diversified geographically and by type. Currently, the SBI has committed \$113 million to seven (7) commingled oil and gas funds.

The Post Fund assets allocated to alternative investments will be invested separately from the Basic Funds' alternative investments to assure that returns are accounted for appropriately. Because the Post Fund invests the retired employee's pension assets, an allocation to yield oriented alternative investments will be emphasized. The Basic Retirement Funds' invest the active employees' pension assets and have less concern regarding the current yield for their alternative investments.

## **2) Results of Review Sessions with Existing Managers.**

During the quarter, the Alternative Investment Committee and staff attended a review session with one of the SBI's private equity managers, Matrix Partners. Overall, the meeting went well and produced no major surprises.

A summary of the review session is included as **Attachment C** of this Committee Report.

## **ACTION ITEMS:**

### **1) Commitment reduction to Irwin Jacobs IMR Fund.**

Effective on the third anniversary date of the IMR Fund, which is February 22, 1995, Limited Partners of the IMR Fund have the contractual right to halve their commitment to the Fund. In anticipation of this milestone, the general partner of the IMR Fund has recommended a 50% reduction, from \$500 million to \$250 million, in the financial commitments to the Fund by limited partners.

Over the last two and a half years, the IMR Fund has pursued a significant number of investments and has not been able to complete investments of the size and number that meet the Funds' objectives. The general partner of the IMR Fund now feels that the reduction in fund size will allow the Fund to more effectively meet Fund objectives and return expectations.

**RECOMMENDATION:**

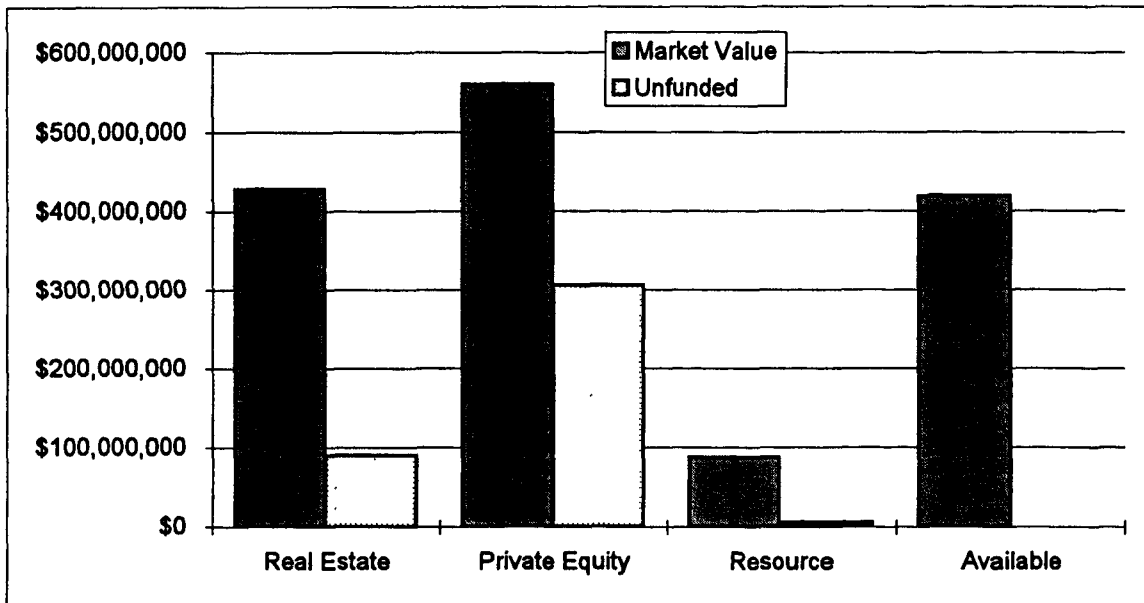
**The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to execute a commitment reduction of one half of the SBI's commitment to the IMR Fund, from \$30 million to \$15 million.**

**ATTACHMENT A**  
**Minnesota State Board of Investment**  
*Alternative Investments Basic Retirement Fund*  
 September 30, 1994

Market Value of Basic Retirement Fund (Basic)                      \$9,967,628,102  
 Amount Available For Investment    \$419,566,309

	<i>Current Level</i>	<i>Target Level</i>	<i>Difference</i>
Market Value	\$1,075,577,906	\$1,495,144,215	\$419,566,309
MV + Unfunded	\$1,478,137,080	\$1,993,525,620	\$515,388,540

<b>Asset Class</b>	<b>Market Value</b>	<b>Unfunded Commitment</b>	<b>Total</b>
Real estate	\$428,116,589 4.3%	\$90,418,636 0.9%	\$518,535,224 5.2%
Private Equity	\$559,912,077 5.6%	\$306,076,965 3.1%	\$865,989,042 8.7%
Resource	\$87,549,241 0.9%	\$6,063,573 0.1%	\$93,612,814 0.9%
<b>Total</b>	<b>\$1,075,577,906</b> <b>10.8%</b>	<b>\$402,559,174</b> <b>4.0%</b>	<b>\$1,478,137,080</b> <b>14.8%</b>



## ATTACHMENT A (con't)

### STATE OF MINNESOTA ALTERNATIVE EQUITY INVESTMENTS September 30, 1994

	INCEPTION DATE	TOTAL COMMITMENT	FUNDED COMMITMENT	MARKET VALUE	DISTRIBUTIONS	UNFUNDED COMMITMENT	IRR (%)	PERIOD (YEARS)
<b>REAL ESTATE</b>								
AETNA 13354 *	Jun-93	2,376,529	2,376,529	2,527,108	0	0	5.03	13
AETNA	Apr-82	40,000,000	40,000,000	56,783,837	0	0	3.16	12.5
AEW III	Sep-85	20,000,000	20,000,000	17,314,691	3,348,482	0	0.37	9.1
AEW IV	Sep-86	17,400,000	15,000,000	4,461,903	829	2,400,000	-14.39	8.1
AEW V	Dec-87	15,000,000	15,000,000	10,679,647	250,209	0	-4.80	6.8
AMERICAN REPUBLIC *	Feb-90	1	1	1	0	0	0.00	4.7
ARCH STREET CORP. **	Jul-93	10,000,000	10,000,000	4,300,000	0	0	-49.11	1.2
EQUITABLE	Oct-81	40,000,000	40,000,000	71,157,161	0	0	4.97	13.0
FIRST ASSET REALTY *	Apr-94	907,097	907,097	916,185	0	0	N/M	0.4
HEITMAN I	Aug-84	20,000,000	20,000,000	11,781,778	11,842,633	0	2.68	10.2
HEITMAN II	Nov-85	30,000,000	30,000,000	26,464,550	12,816,942	0	4.03	8.9
HEITMAN III	Jan-87	20,000,000	20,000,000	14,210,344	5,940,718	0	0.13	7.8
HEITMAN V	Dec-91	20,000,000	20,000,000	21,763,396	1,697,597	0	7.74	2.8
LASALLE	Sep-91	15,000,000	7,398,818	7,133,111	542,822	7,601,182	1.85	3.1
PAINE WEBBER *	Feb-90	500,000	500,000	313,665	97,902	0	-4.51	4.7
REALTY ASSOCIATES FUND III	Jun-94	40,000,000	11,800,000	11,800,000	0	28,200,000	N/M	0.3
RREEF	May-84	75,000,000	75,000,000	68,210,741	22,158,637	0	2.50	10.4
TCW III	Aug-85	40,000,000	40,000,000	27,628,436	10,900,073	0	-0.52	9.2
TCW IV	Nov-86	30,000,000	30,000,000	21,301,935	2,399,405	0	-3.53	7.9
ZELL/MERRILL LYNCH II	Nov-91	50,000,000	37,482,546	38,804,400	260,134	12,517,454	2.64	2.9
ZELL/MERRILL LYNCH III	Jan-94	50,000,000	10,300,000	10,563,700	0	39,700,000	N/M	0.7
<b>TOTAL REAL ESTATE</b>		<b>536,183,627</b>	<b>445,764,991</b>	<b>428,116,589</b>	<b>72,256,383</b>	<b>90,418,636</b>		
<b>PRIVATE EQUITY</b>								
ALLIED	Sep-85	5,000,000	5,000,000	2,887,046	3,544,838	0	5.73	9.1
BANK FUND III	Oct-92	20,000,000	13,000,000	13,262,116	8,372	7,000,000	1.06	2.0
BLACKSTONE II	Nov-93	50,000,000	4,817,985	4,333,420	169,993	45,182,015	N/M	0.9
BRINSON	May-88	5,000,000	5,000,000	3,091,423	3,997,965	0	9.21	6.4
BRINSON II	Nov-90	20,000,000	15,800,000	12,326,917	10,886,280	4,200,000	24.80	3.9
CHURHILL II	Oct-92	20,000,000	9,400,000	8,298,530	1,691,996	10,600,000	5.34	2.0
CORAL I (FORMERLY SUPERIOR)	Jun-86	6,645,000	6,645,000	4,541,865	2,707,667	0	1.79	8.3
CORAL I (FORMERLY SUPERIOR)*	Apr-94	515,972	515,972	510,910	0	0	N/M	0.4
CORAL II (FORMERLY IAI II)	Jul-90	10,000,000	7,500,000	6,672,448	1,443,401	2,500,000	-2.80	4.3
CORAL IV	Jul-94	15,000,000	1,519,110	1,519,110	0	13,480,890	N/M	0.2
DSV	Apr-85	10,000,000	10,000,000	9,816,089	2,528,197	0	2.52	9.5
FIRST CENTURY	Dec-84	10,000,000	10,000,000	8,066,179	5,808,419	0	7.81	9.8
GOLDER THOMA III	Oct-87	14,000,000	13,025,000	15,139,079	8,433,087	975,000	18.38	7.0
GOLDER THOMA IV	Jan-94	20,000,000	5,600,000	5,448,364	0	14,400,000	N/M	0.7
HELLMAN FRIEDMAN III	Sep-94	40,000,000	0	0	0	40,000,000	N/M	0.1
IAI VENTURES I *	Mar-91	500,000	500,000	314,053	284,080	0	5.73	3.6
IAI VENTURES I *	Apr-94	722,828	722,828	628,101	0	0	N/M	0.4
IMR PARTNERSHIP	Aug-92	30,000,000	1,176,900	1,165,602	38,997	28,823,100	1.72	2.2
INMAN BOWMAN	Jun-85	7,500,000	7,500,000	6,758,858	1,494,818	0	1.53	9.3
KKR I	Jun-84	25,000,000	25,000,000	43,110,000	70,809,719	0	29.32	10.3
KKR II	Apr-86	18,365,339	18,365,339	48,730,000	44,325,404	0	23.67	8.5
KKR III	Nov-87	145,950,000	145,950,000	242,740,000	104,652,928	0	12.63	6.9
KKR IV	Dec-93	150,000,000	14,102,000	14,070,000	28,441	135,898,000	N/M	0.8
MATRIX II	Aug-85	10,000,000	10,000,000	3,993,154	14,928,031	0	12.61	9.2
MATRIX III	May-90	10,000,000	8,750,000	18,714,436	497,220	1,250,000	40.36	4.4
NORTHWEST	Jan-84	10,000,000	10,000,000	1,690,484	10,411,651	0	2.77	10.8
SUMMIT I	Dec-84	10,000,000	10,000,000	2,069,950	16,571,891	0	12.24	9.8
SUMMIT II	May-88	30,000,000	28,865,455	13,710,680	34,734,817	1,134,545	21.22	6.4
T. ROWE PRICE	Nov-87	57,600,274	57,600,274	33,295,096	25,543,259	0	1.67	6.9
ZELL/CHILMARK	Jul-90	30,000,000	29,366,585	33,008,167	2,757,024	633,415	11.00	4.3
<b>TOTAL VENTURE CAPITAL</b>		<b>781,799,413</b>	<b>475,722,448</b>	<b>559,912,077</b>	<b>368,298,495</b>	<b>306,076,965</b>		
<b>RESOURCES</b>								
AMGO I	Sep-81	15,000,000	15,000,000	7,166,010	3,614,536	0	-3.22	13.1
AMGO II	Feb-83	7,000,000	7,000,000	8,239,465	2,325,453	0	4.74	11.7
AMGO IV	May-88	12,300,000	12,300,000	12,637,358	1,508,552	0	2.89	6.4
AMGO V	May-90	16,800,000	15,925,203	19,166,202	3,403,869	874,797	11.46	4.4
APACHE III	Dec-86	30,000,000	30,000,000	7,855,872	36,156,533	0	11.08	7.8
MORGAN OIL&GAS	Aug-88	15,000,000	13,799,697	18,935,960	1,517,481	1,200,303	9.06	6.2
SIMMONS OFS	Aug-91	17,000,000	13,011,527	13,548,374	530,186	3,988,473	6.15	3.2
<b>TOTAL RESOURCES</b>		<b>113,100,000</b>	<b>107,036,427</b>	<b>87,549,241</b>	<b>49,056,610</b>	<b>6,083,573</b>		
<b>TOTAL PORTFOLIO</b>		<b>1,431,083,040</b>	<b>1,028,523,866</b>	<b>1,075,577,906</b>	<b>489,611,488</b>	<b>402,559,174</b>		

\* - Acquired in local police and fire fund consolidation with PERA

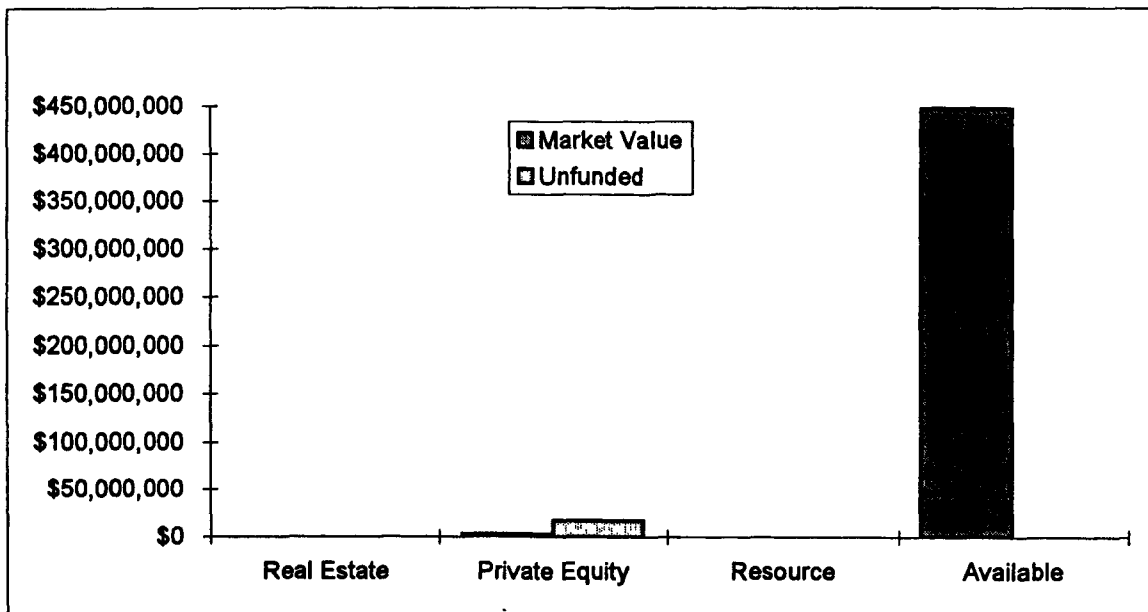
\*\* - Acquired from Post Retirement Fund as part of asset allocation transition during FY93

**ATTACHMENT B**  
**Minnesota State Board of Investment**  
*Alternative Investments Post Retirement Fund*  
 September 30, 1994

Market Value of Post Retirement Fund (Post)                      \$9,011,604,664  
 Amount Available For Investment                                      \$447,569,217

	<i>Current Level</i>	<i>Target Level</i>	<i>Difference</i>
Market Value	\$3,011,016	\$450,580,233	\$447,569,217
MV + Unfunded	\$20,011,016	\$901,160,466	\$881,149,450

Asset Class	Market Value	Unfunded Commitment	Total
Real estate	\$0 0.0%	\$0 0.0%	\$0 0.0%
Private Equity	\$3,011,016 0.0%	\$17,000,000 0.2%	\$20,011,016 0.2%
Resource	\$0 0.0%	\$0 0.0%	\$0 0.0%
Total	\$3,011,016 0.0%	\$17,000,000 0.2%	\$20,011,016 0.2%





**ATTACHMENT B (con't)**  
**STATE OF MINNESOTA**  
**ALTERNATIVE EQUITY INVESTMENTS**  
September 30, 1994

	INCEPTION DATE	TOTAL COMMITMENT	FUNDED COMMITMENT	MARKET VALUE	DISTRIBUTIONS	UNFUNDED COMMITMENT	IRR (%)	PERIOD (YEARS)
<b>REAL ESTATE</b>								
<i>TOTAL REAL ESTATE</i>		0	0	0	0	0		
<b>PRIVATE EQUITY</b>								
SUMMIT SUBORDINATED DEBT	Mar-94	20,000,000	3,000,000	3,011,016	0	17,000,000	NM	0.6
<i>TOTAL VENTURE CAPITAL</i>		20,000,000	3,000,000	3,011,016	0	17,000,000		
<b>RESOURCES</b>								
<i>TOTAL RESOURCES</i>		0	0	0	0	0		
<i>TOTAL PORTFOLIO</i>		20,000,000	3,000,000	3,011,016	0	17,000,000		

## ATTACHMENT C

### REVIEW SUMMARY MATRIX II AND III October 11, 1994

<b>MANAGER REPRESENTATIVES:</b>	Mike Humphreys
<b>SBI ASSETS UNDER MANAGEMENT:</b>	Matrix II      \$3,999,154
	Matrix III <u>\$18,714,436</u>
	Total          \$22,707,590

#### BACKGROUND AND DESCRIPTION:

Matrix Partners II (\$70 million in total investor commitments) and III (\$80 million in total investor commitments) were formed in August 1985 and March 1990, respectively. The SBI committed \$10 million to each fund. Each fund has a term of ten years. The Funds' investment emphasis is on high-technology firms in the early and expansion stages of corporate development. However, for diversification, the Fund's portfolio includes a sizable component of non-technology firms. The portfolio may include several small leveraged buyout investments as well. The partners have offices in Boston, and Menlo Park, CA.

#### QUALITATIVE EVALUATION:

Matrix II is fully invested with 14 companies remaining in the portfolio. Currently, the SBI's prorata share of the portfolio has a cost of \$10 million, a market value of \$4 million and has, since inception, distributed to the SBI \$15 million in cash and securities. To date, the SBI has achieved a net internal rate of return from inception of 12.61%. During the next two years Matrix II will be in a liquidation mode as the fund is approaching the end of its ten year term.

Matrix III is approximately 81% invested with investments in twenty nine portfolio companies. Currently, the SBI's prorata share of the portfolio has a cost of \$8.75 million, a market value of \$18.7 million and has, since inception, distributed to the SBI \$0.5 million in cash and securities. To date, the SBI has achieved a net internal rate of return from inception of 40.36%.

The Matrix General Partners are currently raising capital for their next fund, Matrix Fund IV. The projected size and strategy for the new fund will be very similar to the prior fund. Two of the Matrix California-based General Partners will not be involved with the new fund as Matrix continues to emphasize investing on the East Coast.

**ATTACHMENT C (con't)**

**MATRIX QUANTITATIVE EVALUATION**

	<b>Matrix II</b>	<b>Matrix III</b>
<b>COMMITMENT:</b>	\$10,000,000	\$10,000,000
<b>FUNDED COMMITMENT:</b>	\$10,000,000	\$8,750,000
<b>MARKET VALUE OF FUNDED COMMITMENT:</b>	\$3,993,154	\$18,714,436
<b>CASH DISTRIBUTIONS:</b>	\$14,928,031	\$497,220
<b>INCEPTION DATE(S):</b>	August 1985	May 1990
<b>INTERNAL RATE OF RETURN (IRR):</b> (annualized, since inception)	12.61%	40.36%

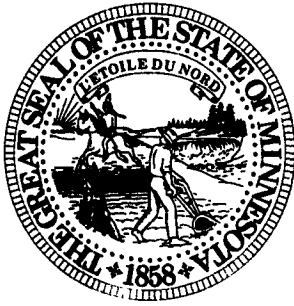
**MATRIX II  
DIVERSIFICATION PROFILE**

<b>LOCATION</b>		<b>INVESTMENT STAGE</b>		<b>INDUSTRY</b>	
West	62%	Established	38%	Technology	54%
East	<u>38%</u>	Early Stage	<u>62%</u>	Non-Technology	<u>46%</u>
	100%		100%		100%

**MATRIX III  
DIVERSIFICATION PROFILE**

West	42%	Established	26%	Technology	85%
East	<u>58%</u>	Early Stage	<u>74%</u>	Non-Technology	<u>15%</u>
	100%		100%		100%

# Tab H



# STATE BOARD OF INVESTMENT

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## Manager Commentaries

**Period Ending September 30, 1994**

<b>Domestic Stock Managers</b>	<b>1</b>
<b>Emerging Stock Managers</b>	<b>33</b>
<b>Domestic Bond Managers</b>	<b>53</b>
<b>International Stock Managers</b>	<b>73</b>

**Manager Commentary**  
**Alliance Capital Management L.P.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$125 billion	Actual	4.0%	-0.7%
Total Firm Assets Managed in this Discipline	\$ 11 billion	Benchmark	5.2%	4.3%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

During the quarter we underperformed the benchmark. A primary reason was the underweighting in the consumer staple area. Our holdings of Gillette and Coke performed well but this sector of the market was particularly strong after a lengthy period of underperformance. Also, our underweighting in healthcare, particularly drugs, contributed to the underperformance. United Healthcare, which is one of the largest holdings in the portfolio, continues to be an excellent performer along with Amgen but many of the traditional drug stocks which also had underperformed for a lengthy period did well in the second quarter. As interest rates rose investors began to anticipate a slowing in the economy which would make the relative earnings of many companies in these sectors more attractive. While we were only slightly overweighted in technology, Motorola, our largest position in the portfolio, and Lin Broadcasting performed well as both are participating in the explosive growth in the cellular industry.

For the past year the underperformance was somewhat stock specific i.e., in the auto sector General Motors was +12% while Chrysler was -6.5%; in technology Microsoft was +36% while Intel was -13%; in retail Home Depot +9% while Wal-Mart was -5%. However, our overweighting in the financial and cable sectors was also a factor in the negative performance of the portfolio versus the benchmark during the past year.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We continue to overweight the portfolio in the financial sector because many of these high quality companies are reporting earnings growth in the 12-14% range and sell at a 10 P/E and we feel this is the most attractive part of the market. Given our view that the market will begin to recognize the strong corporate profit growth over the next several years, brokerage stocks i.e., Merrill Lynch and Morgan Stanley should respond to a strong stock market. Cable stocks have recently begun to show positive performance as the regulatory environment is clearly becoming less burdensome and as a result we will continue to overweight that sector. Our retail overweight should benefit as consumer spending buoyed by a strong economy and good income growth should portend a good holiday selling season. We will continue to overweight the cellular area, thus our recent purchase of Airtouch. Finally, we believe that Intel, which is the second largest holding in the portfolio, will begin to benefit as the transition from the 486 PC chip to the Pentium chip gathers momentum over the next several quarters.

## **Alliance (Con't)**

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Accounts Lost: Metropolitan Healthcare Council

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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## **Staff Comments**

No additional comments.

**Manager Commentary**  
**Brinson Partners, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
<b>Total Firm Assets Under Management</b>	<b>\$35.8 Billion</b>	<b>Actual</b>	<b>5.4%</b>	<b>6.9%</b>
<b>Total Firm Assets Managed in this Discipline</b>	<b>\$ 6.9 Billion</b>	<b>Benchmark</b>	<b>5.5%</b>	<b>2.9%</b>

1. *Past Performance.* Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?

Strong corporate profits and cash flows and an increase in market volatility are among the factors which affected the level of the U.S. equity market during the third quarter. Active factor exposures added meaningfully to portfolio performance during both the third quarter and twelve months ending September 30, 1994 although to a lesser degree than during 1993. Stocks with a high level of economic sensitivity contributed modestly to performance for the 3 and 12 month periods. The portfolio is overweighted with respect to stocks that are more financially levered than the market. For the year ending September 30, these stocks have contributed materially to portfolio total return, consistent with the rise in interest rates during the first nine months of the 1994. The portfolio remains underweighted with respect to stocks that exhibit a high degree of relative strength or momentum and overweighted to stocks that rank high in terms of price/book. These exposures contributed modestly to performance for both the third quarter and year ending September 30, 1994 while the relative overweight in stocks that rank high in terms of foreign earnings exposure contributed materially to performance in both periods.

Industry weightings added the largest increment to portfolio performance during the third quarter of 1994. Positive returns from relative overweights in a number of industries including the drug, paper, electronics and tobacco sectors more than offset negative contributions to performance from our relative overweights in bank, airline and oil service stocks. Drug stock prices rebounded during the third quarter reflecting diminished concerns over the potential effect of health care reform legislation and government controls on drug prices. Paper stocks benefited from strong price gains across a variety of paper grades including linerboard, uncoated free sheet, bleached board and newsprint. Due in part to strong industry effects, stock selection during the third quarter and for the year ending in September has detracted from portfolio performance.

2. *Future Strategy.* What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.

Our process remains focused on identifying those stocks that are most attractive in price/value terms through intensive individual company analysis, which incorporates strategic themes and industry research. The portfolio remains overweighted in stocks that possess a high degree of economic sensitivity, although recent portfolio changes have resulted in a measured shift away from economically sensitive stocks. The portfolio also remains overweighted in stocks that rank high with respect to financial leverage, consonant with our belief that a portfolio of debtors will perform better than creditors in a rising interest rate environment, although that position has also been reduced. From an industry perspective we remain overweighted in financial/interest sensitive stocks. We believe that banks will continue to benefit from an environment in which return on assets (ROA) is above normal, credit losses are low and net interest margins have remained strong in the face of repeated increases in interest rates. Banks and thrifts should also benefit from continued rationalization of excess industry capacity. The portfolio overweight in insurance stocks, primarily property casualty, suggests a non-



## Brinson Partners, Inc. (con't)

consensus belief that industry earnings will improve as property casualty prices stabilize and costs continue to be adequately controlled.

The portfolio is underweighted in utilities, including both electric utilities and the traditional telephones. We continue to believe that deregulation of electric utilities and the advent of retail wheeling of power is accelerating competitive pressure from lower cost utility and non-utility generators and will increase the purchasing power of larger power users. Little if any rate relief appears available to utilities and investors remain concerned that utilities will use dividend cuts to manage cash flow problems. The decline in utility stock prices which began in September of 1993 has been somewhat indiscriminate and we have begun adding to electric utility shares in our portfolio as valuations for selected stocks become attractive. Competition will also intensify in the telecommunications industry as regulatory barriers between traditional business lines are blurred and protection diminishes for the traditional regional telephone companies.

We are underweight in the traditionally defensive consumer sector including retail/apparel and discretionary spending stocks, although recent portfolio changes have brought our holdings in retail/apparel to a near market weight. The portfolio also remains overweighted in selected health care and drug stocks. It appears that the effects of health care reform legislation will be less imposing than free market forces, although we expect drug price gains worldwide to grow at a rate below the general rate of price inflation. This position is further supported by the demographics of an aging population and technological advances in previously underserved areas of health care. Finally, we continue to be overweighted in some of the basic industries, including aluminum and paper stocks. Key holdings include Citicorp, Honeywell, Martin Marietta, Pfizer, Shering-Plough, Schlumberger and Sprint.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

On August 31, 1994, Brinson Partners, Inc. and Swiss Bank Corporation announced an agreement in principle to combine their respective investment management organizations into a single investment management business to be managed by Brinson Partners, Inc. The transaction is expected to be completed in early 1995, subject to various regulatory approvals to be sought by Swiss Bank Corporation. The most critical element in Brinson Partners, Inc.'s decision was the ability to remain a completely independent organization within Swiss Bank Corporation, enabling the firm to preserve the integrity of its investment process and management structure. Brinson Partners, Inc. will have direct control of the combined investment operation and Gary P. Brinson, CFA, will be the Chief Investment Officer and Chief Executive Officer.

Gained:	2 accounts	\$185 million
Lost:	0 accounts	\$0 million

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None of significance this quarter.

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### Staff Comments

No additional comments.

**Manager Commentary**  
**Forstmann-Leff Associates Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$2.9 billion	Actual	4.6%	-0.4%
Total Firm Assets Managed in this Discipline	\$1.3 billion	Benchmark	8.8%	4.9%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

*Over the last quarter* performance lagged the benchmark, which due to its heavy weight in the better performing sectors almost doubled the market's 4.9% return. The most obvious overweight was in the technology area, where almost 16% of the benchmark's assets were concentrated. These stocks rebounded from the substantial losses experienced earlier in the year. As discussed in our last report, we took action at mid-year to minimize exposure to high risk names, including the technology groups. This move proved costly, as the market rewarded more risk assumptive portfolios, particularly those with heavy exposure to the technology area. In addition, the consumer durables, including the autos, suffered under the market's evaluation that the cycle, record profits and restructured operations notwithstanding, is headed for an abrupt end. Our selections in the medical area provided a premium return to the benchmark, with our holdings up 58.2% versus the benchmark's 29.7% gain. On the whole, though we were unable to keep up with the benchmark for the period, performance showed significant improvement over the second quarter, approximating the return of the broader market, including the S&P 500 Index.

*The return for the year ending September 30th* was impacted by the aforementioned difficulties with the technology area, as well as the overweight to the consumer durable names. Again, the particular selections held within the medical area added considerable value to the portfolio, as these names were up almost 70% for the year. In short, the third quarter's underperformance relative to the benchmark is largely responsible for the poor showing over the full year period.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Though performance in the third quarter shows improvement, we are not pleased with results. As noted above, our mid-year action to minimize exposure to high risk names proved costly, as the market rewarded more risk assumptive portfolios. Looking forward, with a slowing economy we expect a shift away from the deep *cyclicals*, and have been selling some of our commodity names. Though we believe that these companies will enjoy a good environment long term, they have gotten ahead of themselves at current levels. For the near term, we like the intermediate cyclicals such as the autos and the rails which look attractive on a valuation basis, but which contributed to our problems in the third quarter. We expect to benefit from another leg in their cycle.

In the *energy area* we like the refining and marketing group, which is experiencing expanding margins and should benefit from reformulated gasoline restrictions on imports. Oil fundamentals should pick up somewhat, as stronger demand on a worldwide economic pickup coupled with seasonal factors should firm prices. Even factoring in Iraq's re-entry into the market, capacity increases are not expected to meet this demand.

## Forstmann (con't)

We also see opportunities in the *consumer non-durable area*, particularly among companies with a significant international component to earnings. Those companies with a greater exposure to the emerging economies have fared better, as the European recovery has been uneven. McDonald's is a good example of the type of name we favor, possessing strong international earnings growth. The stock has declined over the summer, on weakness in the domestic restaurant area and choppy performance in the French and German markets. Still, the company has a great future, with much further to go in its expansion cycle than earlier plays such as Coke. Technically, Price/Costco Inc. has firmed, with stable share price on even the worst down days. Here the fundamentals are improving, if grudgingly, in a tough retail environment. The *consumer services* offer opportunities in areas such as lodging, where we maintain a presence in Host Marriott. Their acquisition activity and dominant position in the full service end of the business combine to produce enviable cash generation. Similar in many ways to our REITs, the company will make money whether inflation picks up or rates fall.

- 3. *Organizational Issues.*** Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.

No organizational issues to note, except the addition of a Bermuda based mutual fund for individual investors listed on the Dublin exchange.

- 4. *Other Comments.*** Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

No issues of any significance to report at this time.

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## Staff Comments

Staff met with Forstmann Leff in early October at their office. Staff discussed a number of topics with them including economic outlook and portfolio strategy.

### **Economic Outlook:**

Forstmann Leff is neutral to negative on the stock market. They feel the market could be over priced by as much as 20% due to higher interest rates.

### **Portfolio Strategy:**

Information that staff collected in the meeting coincides with Forstmann Leff's comments above. In addition, they have cut in half the holdings in the financial industry over the last year by selling banks. They sold their bank holdings due to rising short-term interest rates which increases banks' short-term borrowing costs. Forstmann Leff indicated that they would continue to hold automotive stocks, and that they would be adding positions in airlines and railroads where they expect a turnaround soon.

**Manager Commentary**  
**Franklin Portfolio Associates Trust**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$5.7 billion	Actual	4.4%	-0.4%
Total Firm Assets Managed in this Discipline	\$373 million	Benchmark	5.5%	2.7%

1. *Past Performance.* Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?

**Third Quarter Performance:**

Positive earnings reports helped fuel a rally in the equity market, despite inflation and interest-rate jitters. The portfolio and benchmark returns were positive in the quarter, although the account lagged the benchmark. Industry exposure and stock bets were negative contributors to performance while risk index exposures made a small positive contribution.

The positive risk factor bets which helped performance were Foreign and Variability-in-Markets. Positive industry bets in Drugs, Business Machines, and Precious Metals helped performance.

A positive E/P ratio bet hurt performance as did a positive bet in Air Transportation. Under-exposure in the Telephones, Health (non-drug), and Paper industries caused a negative contribution since these groups performed well during the third quarter.

From a specific stock selection point of view the following were strong positive contributors to performance - EMC Corp. (A manufacturer of memory storage devices), Union Carbide Corp., Black & Decker, Safeway Inc., and Thermo Electron (a manufacturer of alternative energy power systems, analytical instruments, and biomedical products). Stocks in the account that hurt performance were Snapple Beverage, Federal Express, Texas Instruments, Lincoln National, First Fidelity Bancorp.

**Twelve Month Performance:**

Negative contributions to performance came from risk factor exposures and industry bets. Stock selection was also a small negative contributor.

The factor bets that contributed to return were Earnings-price and Book-to-Price. Both Earnings-to-Price and Book-to-Price are functions of our value process. Positive bets on Drugs, Business Machines and Cosmetics helped account performance. Detracting from performance were positive bet on the Success Factor and Air Transportation. Our negative bets in Producer Goods, Publishing, and Paper made a negative contribution.

From a specific stock point of view, the top five holdings which contributed to performance were: Compaq Computer, Safeway, Union Carbide Corp., Unisys Corp., and Johnson & Johnson. Holdings in Snapple, International Game Technology, Continental Corp., Bear Stearns, Williams Cos Inc. hurt performance over the past twelve months.

2. *Future Strategy.* What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.

As of 9/30/94, the following significant active bets existed in the account relative to the benchmark:

- A. Factor bets included a slight overweighting in success, earnings/price and book/price.

## Franklin (con't)

### B. Industry bets (bets stated as percentage deviation from benchmark weight):

#### 5 Most Positive Bets:

Food Stores	3.10%
Banks	3.07
Food	2.22
Motor Vehicles	1.94
Business Machines	1.92

#### 5 Most Negative Bets:

Telephones	-2.16%
Media	-2.15
Services	-1.88
Health Non-Drugs	-1.70
Retail	-1.49

### C. Ten largest issue bets (bets stated as percentage deviation from benchmark weight):

Archer Daniels Mid	2.44%
Johnson & Johnson	2.17
Compaq Computer	2.29
Colgate Palmolive	2.28
Baltimore Gas & El.	2.25

EMC Corp	2.16%
Abbott Labs	2.04
General Mtrs CL H	2.15
American Greeting	2.08
Union Carbide	2.02

We seek to achieve the maximum excess return while maintaining a total tracking error of approximately 3% relative to the benchmark with approximately 70% to 80% of the tracking error resulting from stock bets. As a result of the stock selection bets, the portfolio acquires the factor and industry bets as described above.

3. *Organizational Issues.* Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.

Brad Greenleaf, who was involved with our international equity management effort left the firm. We will be replacing him shortly. There were no account gains or losses during the quarter.

4. *Other Comments.* Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

We have recently acquired a global risk measurement and optimization system supplied by Quantec Investment Technology LTD, a London based firm with offices in New York, Australia and Switzerland. The firm started in 1980 and is considered one of the innovators in the area of quantitative technology as it applies to global markets. We have already integrated this technology into our global investment management process.

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### Staff Comments

Staff met with Franklin in early October at their office. Staff discussed a number of topics with them. Information that staff collected in the meeting coincides with Franklin's comments above.

**Manager Commentary  
GeoCapital Corporation**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$1.8 billion	Actual	8.0%	2.0%
Total Firm Assets Managed in this Discipline	\$1.8 billion	Benchmark	14.0%	7.9%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Performance in the last quarter trailed the benchmark portfolio, although it did better versus all other indices including the Russell 2000. Our continuing active bet in non-durables, technology and financial were negative in the quarter with the financial sector relative to the benchmark contributing the largest negative value added. Stocks that helped our performance included Banyan, DigiDesign, PeopleSoft, Santa Cruz Operations, Xcellenet, Informix, and Parametric Technology in the technology sector. The whole medical area did well except for Novacare. Particularly strong were Tokos, Relife, and Quantum Health. Greyhound and Mercury Finance performed poorly in special situations. Structural Dynamics did not perform well due to lower earnings expectations. Media stocks including Viacom, Vanguard Cellular, and Contel Cellular were positive performers during the period.

Performance for the past one year trailed the benchmark due to strength in the benchmark during the second half of the year. Positive factors contributing to the returns were in the consumer nondurable area, while negative factors were in the financial area.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Our active bets are in the same sector going forward specifically in the financial, technology, and consumer non-durables. We continue to believe that valuations are attractive in these segments. In addition a consolidation trend continues to occur in these investment areas.

## GeoCapital (con't)

3. **Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

### Gained

The Jicarilla Apache Tribe Severance Tax Fund  
The Jicarilla Apache Tribe Per Capita E

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

The third quarter of 1994 was a relatively strong period (especially August) for our accounts. While the overall market did well during these three months, small capitalization stock returns exceeded that of all major market indices. This performance, we believe, continues the long term uptrend of outperformance by small stocks after a difficult correction in the March to June 1994 time period.

We continue to believe that the U.S. economy will slow in the second half of 1994 and in 1995 because of the rise in interest rates and tax rates while inflation will be moderate. In our view, this is an excellent environment for small companies and should be reflected in their stock market performance.

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## Staff Comments

Staff met with GeoCapital Corporation in early October at their office. Staff discussed a number of topics with them including economic outlook and portfolio strategy.

### **Economic Outlook:**

GeoCapital's expectation is that long-term interest rates will remain near 8%. They feel the stock market is generally overvalued and will continue the bearish trend in the near term. They expect that this environment will create opportunities to identify companies that are selling below their intrinsic value.

### **Portfolio Strategy**

Information that staff collected in the meeting coincides with GeoCapital's comments above. GeoCapital is pursuing a new theme in the area of education and educational software based on their belief that the problems in our public schools will be addressed by the private sector with the use of technology. They also are investing in the computer networking area, both through companies involved in networking support and networking applications. They continue to stay invested in healthcare companies with plans to slowly reduce holdings going forward as the companies obtain full appreciation.

**Manager Commentary**  
**Investment Advisers, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$13.2 Billion	Actual	7.0%	0.2%
Total Firm Assets Managed in this Discipline	\$718 Million	Benchmark	6.2%	3.8%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Quarterly Performance: The positive performance during the quarter was largely driven by three industry overweightings, and by very strong performance of a few individual holdings. The key industries driving our performance were: Medical Specialties, Saving and Loans, and Telecommunication Equipment. In the medical specialty industry, we had good relative performance from all our holdings. This was lead by two local companies; Sci-Med Life Systems (+68.27%) and Medtronic (+31.98%). As for the Savings and Loan industry, we had outperformance in what should have been a hostile environment (rising interest rates). However, we felt the flattening earnings growth of large commercial banks would drive them to continue to expand their deposit base by buying S&L's. During the quarter, Metropolitan Financial agreed to be purchased by First Bank Systems providing a 45.4% gain in the quarter. All our S&L holdings were up in the quarter and all but one outperformed the benchmark. Finally, our overweighting of Telecommunications Equipment companies help drive our relative performance. Three of our four holdings had outstanding performance: Motorola Inc. (+18.21%), Tellabs (+37.10%) and Andrew Corp. (+36.39%). In sum, the strong performance of these three industries and our 7.50% overweighting were a major factor in our relative performance. Three individual stocks also had a material positive impact on performance: CropGrowers Corp. (+58.7%), Berkshire Hathaway Inc. (+17.70%), and Best Buy (+35.50%).

Negatively impacting relative performance were the Office Automation and Food Distribution industries. Here both our relative industry overweightings and stock selection performed poorly. In Office Automation (3.6% of the beginning portfolio), performance was hurt by our two smallest positions; Racotek Inc. (0.68% weighting down 42.72% for the quarter), and Tricord Systems (0.4% weighting down 48.25% for the quarter). In the case of Racotek, we were able to dampen the loss by selling our stock prior to it reaching its lows. In the Food Distribution industry, our poor relative performance was solely due to SuperValu (2.53% beginning weight down 14.05%).

There was a fairly substantial amount of cash raised during the quarter. The cash position rose from 8.98% on June 30, to 21.82% on September 30. This was not due to a general market outlook, but instead was simply the result several stocks approaching valuation levels that mandated we cut back. The cash position could not be prudently deployed by quarter's end.

The performance over the past year has benefited from the strong secular performance in the telecommunications equipment industry. The overweighted position of the portfolio benefited from the move throughout the year. As for individual stocks, Department 56, United Healthcare, and BMC Industries were three strong performers throughout the year. Most of the portfolio mirrored the performance of the general market in the sense that individual stock and sector volatility made today's winners, losers the next day. On the negative side, the portfolio was impacted by two themes. Late 1993, the portfolio suffered relative losses from an overweighted position in financials and utilities. The Federal Reserve's move to tighten



## IAI (con't)

money supplies in late 1993 drove both financials and utilities lower. In the March to June period of 1994, the market hit lows for the year. During this period, the portfolio was impacted by the capitulation seen in the price of smaller growth company stocks. Portfolio holdings such as Grow Biz (down 37% in the first quarter), and DIGI International Inc. (down 31.4%) were good examples of this. The downward move in smaller capitalization stocks were significant to the point where even the smallest weighted holdings had measurable impact on the performance. Since the market lows in June, the portfolio has picked up in performance as noted in the quarterly commentary.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets*

We continue to believe the overall investment environment is hostile. On a day-to-day basis, this means the volatility of individual stocks and sectors will continue to be high. However, we expect this will create opportunities to buy good companies at attractive levels. We have been building positions in department stores. We are building positions in regional corporations with good foreign sales exposure (e.g. 3M, Honeywell) with the view that foreign exposure will support earnings growth.

We plan to bring the cash held in the portfolio down. Key to our strategy is to invest in regional companies with good earnings outlooks. In short, to invest in the growth of our region.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

During the third quarter, the IAI ownership issue was resolved. IAI continues to be owned by Trustee Savings Bank, London. However, some relationships were changed. Hill Samuel Investment Advisers (HSIA) was folded into IAI. This makes IAI responsible for the production and marketing of all investment services in the Western Hemisphere for Hill Samuel Group. In addition, IAI now reports directly to the CEO of Hill Samuel Group.

During the third quarter, Jim Sorenson (Vice President, Marketing), Jim Eckmann (Vice President, Client Service) and David McDonald (Equity Portfolio Manager) joined the firm.

We did not lose or gain any accounts in this discipline this past quarter.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

Our work in developing an acceptable benchmark portfolio is in its final stages. We feel we are on track to having a benchmark portfolio in place by the end of the fourth quarter.

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## Staff Comments

Staff recently reviewed the benchmark with IAI. Staff still has some concerns about the benchmark and discussed them with IAI during the meeting. IAI agreed to address these issues and review with staff the results of the analysis and recommendations for changes to the benchmark construction process. Staff still expects IAI to have the new benchmark in place so it can be implemented for the first quarter of 1995.

**Manager Commentary**  
**IDS Advisory Group, Inc.**

Period Ending:	9/30/94	Returns	Qtr.	1 Yr.
Total Firm Assets Under Management	\$20.5 billion	Actual	3.0%	2.9%
Total Firm Assets Managed in this Discipline	\$ 5.0 billion	Benchmark	5.0%	3.7%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Our sector weights have evolved as follows:

	9/30/93	9/30/94	Normal Portfolio 9/30/94
Technology	6.2	14.3	12.9
Consumer Stable	1.7	9.9	23.3
Consumer Cyclical	21.2	21.7	18.3
Utilities (non Electric)	6.6	1.9	7.7
Financial/Services	18.8	12.8	9.1
Energy	6.4	7.5	6.1
Industrial Basic	10.1	15.8	6.2
Industrial Growth	6.3	4.3	3.7
Industrial Cyclical	12.8	9.0	7.7
Equity Cash	<u>9.9</u>	<u>2.8</u>	<u>5.0</u>
	100.0	100.0	100.0

Performance in the latest three months was disappointing. The State of Minnesota's account advanced 3.0% versus an increase in the normal portfolio of 5.0%. Reflecting the latest quarter's disappointing numbers, the trailing 12 months also lagged the normal portfolio. Total account is up 2.9% over the latest 12 months, while the normal portfolio has advanced 3.7%. Unsatisfactory performance in the third quarter was a reflection of underperformance in the consumer cyclical and financial sectors. Both sectors were victims of rising interest rates. In the case of financials, rising rates generated concerns regarding margins. Concerning consumer cyclicals, advancing interest rates cast a pall over prospects for both the auto and housing industries. On a positive note, the industrial basic sector significantly outperformed the normal portfolio. However, performance in this sector was insufficient to offset disappointing returns in the consumer cyclical and financial areas. It should also be noted that the consumer stable and energy areas provided above average rates of return and the portfolio is underweighted in both sectors.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We are overweighted in the technology sector and, in fact, have been slowly increasing our exposure to this area. Top-line growth for technology companies remains buoyant, earnings continue to grow rapidly and valuations are extremely reasonable. We also remain overweighted in the industrial basic area. However, our next major move in this sector is likely to be a reduction in exposure. This reflects the fact that stocks have been excellent performers as well as the fact that the rate of gain in earnings growth is likely to slow in the second half of 1995. We have reduced our weighting in the consumer cyclical and financial areas to

## IDS (con't)

approximately that of the benchmark. While we believe that both sectors represent excellent value, rising short-term interest rates are likely to continue to restrain stock performance. Weightings in the consumer stable area are being increased reflecting our belief that relative earnings performance for this sector is likely to increase significantly in the second half of 1995. Finally, we expect a year-end rally and plan to increase cash positions modestly as stock prices advance.

3. *Organizational Issues.* Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.

There have been no ownership or personnel changes at IDS Equity Advisors in the last quarter.

### IDS ADVISORY GROUP Third Quarter 1994

Product	Gains		Losses	
	# of Accounts	Assets (\$MM)	# of Accounts	Assets (\$MM)
Large Cap Equities	2	44.6	0	0
Fixed Income	1	2.8	0	0
Balanced	3	41.3	0	0
International	2	47.3	0	0
Small Cap Equities	0	0	0	0
Mid Cap Equities	0	0	0	0
Research Core	0	0	0	0
Research Aggressive	0	0	0	0
Global Bonds	0	0	0	0

4. *Other Comments.* Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

None at this time.

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### Staff Comments

No additional comments.

**Manager Commentary**  
**Independence Investment Associates**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$15 billion	Actual	3.1%	1.3%
Total Firm Assets Managed in this Discipline	\$ 8 billion	Benchmark	4.9%	3.3%

1. *Past Performance.* Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?

The third quarter of 1994 was a disappointing one. Importantly, the cause of the underperformance is clearly identifiable and understandable within the context of our investment approach. Analysis shows that the performance shortfall can be attributed largely to individual stock selection and not to some unintended bet on industry or styles. It is in stock selection that we intentionally deviate from the benchmark and where our skill usually lies. Our stock selection process is driven by our Cybercode composite valuation model. Attribution of the model's performance for the third quarter reveals that Cybercode itself had negative stock selection skill with all components of the model lagging their historic skill levels. While this is not desirable, it is logical that our portfolios underperformed for exactly the same reason that the Cybercode rankings lagged. We have not inadvertently introduced any miscellaneous risk exposures into your portfolio.

Historically, we have observed that Cybercode tends to perform less successfully when markets are in transition, such as a move from value to growth. This was evident during the turbulence of 1986 and again in 1991, when Cybercode had several quarters of underperformance and investment styles shifted in favor from growth to value. Over the long term, these periods are relatively short and have been successfully counter-balanced by outperformance. Since the founding of Independence in mid-1982, Cybercode had outperformed in 75% of the quarters, producing cumulative portfolio outperformance of 150-200 basis points annually.

2. *Future Strategy.* What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.

Our philosophy of investing in stocks that combine cheapness and improving fundamentals will continue and is demonstrated by a 10.8x P/E ratio compared to the S&P 500 P/E of 15.2x and a long term expected growth rate of 9% relative to the S&P's 7%.

## Independence (con't)

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Independence has a notable history of very low personnel turnover. The principals of the company have been together since inception and continue to run the firm. As is inevitable from time to time an associate will leave the organization. Maureen Depp, a Vice President in the research area, left at the end of the quarter. Maureen had been working on a three day basis for several years following retail stocks. Senior Vice Presidents Dalton Avery and Sam Otis, who have dozens of years of experience following retailers, filled the gap. We will be filling Maureen's position with an experienced analyst shortly. Myra Wonish, a junior analyst with the company less than a year, also left to pursue a career outside security analysis.

During the third quarter of 1994, we gained eleven new accounts (six new clients) totaling \$409 million, so we now have 136 clients. Of the new accounts, 7 were in the NIXDEX diversified core strategy. During this period, we lost one client due to a plan restructure.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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### Staff Comments

Staff met with Independence in early October at their office. Staff discussed a number of topics with them including organizational changes, economic outlook, and portfolio strategy.

#### **Organizational Changes:**

Independence informed staff that they are taking steps to expand their fixed income area by using some of their equity tools such as their relative ranking system and risk control model. They have already added 4 or 5 people to cover the additional support needed for fixed income. There will be no changes affecting SBI's account.

#### **Economic Outlook:**

Independence is anticipating sustained growth in 1994 with a slower second half. They believe the period will see employment growth picking up and export demand improving. They feel long-term interest rates will stabilize near 7.5% with higher interest rates being a risk to the market. Independence expects a rebound in the stock market, but believes the decade will be a "Single Digit" decade.

#### **Portfolio Strategy:**

Information that staff collected in the meeting coincides with Independence's comments above. Independence continues to search for cheap stocks with improving fundamentals using their Cybercode model.

**Manager Commentary**  
**Jundt Associates, Inc.**

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<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$3.5 billion	Actual	15.9%	6.5%
Total Firm Assets Managed in this Discipline	\$2.5 billion	Benchmark	8.5%	5.7%

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1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

**Quarter:** Your actual portfolio return for the third quarter was +15.9% versus the benchmark return of +8.5%. Good sector allocations and excellent stock selection caused the nearly 90% increase over the benchmark. Specifically, the consumer non-durable area (46% of your portfolio) had a 21% gain vs. 11% for the benchmark. Technology (40% of your portfolio) showed a nearly 13% gain in the quarter. Cash level had a marginally negative impact. Four stocks were added and four were deleted during the quarter. The added stocks were Boston Chicken, Corporate Express, Mobile Telecommunications, and Wall Data. The deleted stocks were Newbridge Networks, BMC Software, Cicso Systems, and McCaw Cellular.

**Year:** The majority of the value added during the twelve month period ended September 30, 1994 came from our underweighting of two sectors in the actual portfolio compared to the benchmark portfolio. Specifically, the transportation and financial sectors were down substantially in the benchmark and accounted for nearly 9% of the benchmark versus less than 1% in the actual portfolio. The next greatest increment to added value was the overweight (39% versus 23%) in technology in the active portfolio. This overweight had a positive double digit return from the stocks making up that sector.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We continue to invest in the fastest growing areas of our economy. The areas that are generating the best top-line growth are found to be in the consumer non-durable area and technology. These areas make up nearly 90% of the portfolio vs. 70% of the benchmark.

## **Jundt (con't)**

- 3. *Organizational Issues.*** Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.

None to report.

- 4. *Other Comments.*** Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

Nothing new from previous quarters.

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## **Staff Comments**

No additional comments.

**Manager Commentary**  
**Lincoln Capital Management Company**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$26.2 billion	Actual	4.9%	5.5%
Total Firm Assets Managed in this Discipline	\$ 8.9 billion	Benchmark	6.4%	6.5%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

What a difference one quarter can make: the prior report showed the portfolio 0.8% over the benchmark for the second quarter and 1.0% ahead for one year. Now the comparable returns through September 30 are -1.5% and -1.0%, respectively. We went into the quarter 6% underweight in Health Care and the group enjoyed a blowout return of about 15% as investors became less concerned about legislation and slowing secular growth and more interested in takeovers/restructurings and the going-in historically low valuations. For example, the company with the largest health care market capitalization, Merck, was up 20%. On the other side of the lever, we were long the benchmark by 4% in Financials; this group lagged the growth indices materially and Freddie Mac and Fannie Mae offset almost all of their prior outperformance. This surprised us as the stocks appeared not to have been much influenced by higher interest rates earlier in the year. Elsewhere in the third quarter, Wal-Mart (-3%) and McDonald's (-9%) sagged, Coke (+20%) and P&G (+12%) jumped.

For the one year period, health care did well (the impetus being the quarter just completed) and financials not so well, at least our growth choices. Among specific large holdings of one year ago which were neither Health Care nor Financials, PepsiCo and Wal-Mart lagged, Automatic Data, P&G, Gillette did well. For PepsiCo and Wal-Mart current earnings estimates were trimmed along the way; for the outperforming trio, it was at least status quo ante.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Bets relative to the Lincoln benchmark are short Health Care by 5%, short Media by 6%, long Consumer by 3% and long Financials by 4%. Most of these divergences are in the nature of random variances since Lincoln is not a top-down strategist or a closet indexer. So one shouldn't read a lot into these numbers; we don't. I can imagine a further buildup in Technology, currently neutral to the benchmark at 16%, and perhaps Health Care.

Traditionally, the key to Lincoln's over/under performance has been the largest ten holdings. These represent 42% of the total portfolio (the next five constitute another 15%). We try to keep these holdings fresh and responsive to our expectations of unfolding fundamentals. Within the past three months, McDonald's was trimmed back and General Motors 'E' (Electronic Data Systems) moved up into the Top Ten.



**Lincoln (con't)**

3. **Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

It has already been reported that Ted Bosler has elected to take early retirement. Ted has been a yeoman analyst; at age 60 and with some heart problems, he felt it was timely to throttle back. A search for this replacement has been initiated with some attractive candidates already identified.

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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**Staff Comments**

No additional comments.

**Manager Commentary**  
**Lynch & Mayer, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$5.6 billion	Actual	5.7%	-3.2%
Total Firm Assets Managed in this Discipline	\$2.9 billion	Benchmark	6.6%	3.5%

1. *Past Performance.* Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?

Sector selection for the third quarter added value relative to the benchmark; however, stock selection for the quarter did not add value. For the year ended September 30, 1994, neither sector allocation nor stock selection, relative to the benchmark, added value. The technology sector produced the greatest value added relative to the benchmark for the quarter. However, this sector did not add value for the year ended September 30, 1994. Although the sector was properly overweighted, stock selection relative to the benchmark did not add value.

The capital goods sector contributed the greatest value added for the year ended September 30, 1994. This was due to both sector allocation and stock selection. For the year ended September 30, the energy sector produced the least value added relative to the benchmark. This is mainly due to stock selection relative to the benchmark.

2. *Future Strategy.* What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.

We have increased our holdings in the healthcare industry with recent purchases of Johnson & Johnson, Pfizer and U.S. Healthcare. With reduced fears of healthcare reform and the more constructive attitude towards growth stocks in general, these stocks should be beneficiaries of improving valuations.

Furthermore, we have reduced our exposure to the technology sector with recent sales of Compaq Computer Corp., DSC Communications and EMC Corp. Compaq was sold as it met its price objective; DSC Communications and EMC Corp. were sold due to deteriorating fundamentals.

The top ten holdings as of September 30, 1994 relative to the benchmark are:

<b>Rationale for Investment</b>	<b>Company</b>	<b>Portfolio Weight</b>	<b>Benchmark Weight</b>
Acceleration of Growth	Hewlett Packard	5.3%	1.1%
Acceleration of Growth	Procter & Gamble	5.3	0.6
Corporate Restructuring	Xerox	5.1	0.3
Turnaround	Citicorp	4.9	2.0
Corporate Restructuring	Columbia/HCA	3.8	1.3
Acceleration of Growth	Gillette	3.6	0.9
Acceleration of Growth	Wells Fargo	3.6	0.9
Improving Ind Environment	Caterpillar	3.5	1.0
Acceleration of Growth	Microsoft	3.5	2.0
Acceleration of Growth	Silicon Graphics	3.0	0.3

## Lynch & Mayer (con't)

Our investment philosophy hinges on the premise that earnings growth significantly above historical trend or consensus expectation invariably is preceded by a critical positive fundamental change. We search intensively for early indications of such change and group purchase candidates into four categories by source of earnings increase. The categories are: acceleration of growth; improving industry environment; corporate restructuring; and "turnaround" situations

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

No significant personnel or ownership changes occurred.

Accounts Gained (tax-exempt) Third Quarter, 1994:

Pacific Gas & Electric, Terra Industries, Tultex Corporation

Accounts Lost (tax-exempt) Third Quarter, 1994:

None

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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### Staff Comments

Staff met with Lynch & Mayer in early October at their office. Staff discussed a number of topics with them including economic outlook and portfolio strategy.

**Economic Outlook:**

Lynch & Mayer believe that, eventually, rising interest rates will moderate the pace of domestic economic growth. As business expansion slows, interest rates should also ease which usually improves growth stock valuation. They feel that the domestic economy is late in its expansionary phase so that growth stocks will be far more attractive in 1995. Lynch & Mayer also believe growth stocks will benefit from increasing foreign earnings.

**Portfolio Strategy:**

Information that staff collected in the meeting coincides with Lynch & Mayer's comments above. They indicated they will focus less on consumer cyclicals and focus more on areas that generate a significant portion of their revenue from foreign operations including consumer staples, capital equipment, basic materials, and chemicals.

**Manager Commentary  
Oppenheimer Capital**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$29.4 Billion	Actual	4.2%	2.6%
Total Firm Assets Managed in this Discipline	\$13.6 Billion	Benchmark	4.2%	2.6%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

**QUARTER ENDED SEPTEMBER 30, 1994**

Key factors contributing to performance were good security selection within the consumer non-durable, insurance, banking and utilities sectors. Our overweighing in banks and insurance detracted from performance. Several top contributing stocks for the quarter are as follows:

Warner Lambert	22.7%
Freeport McMoRan	21.2
Philip Morris	20.3
Becton Dickinson	18.5
MCI Communications	15.8

**TWELVE MONTHS ENDED SEPTEMBER 30, 1994**

Key factors contributing to performance were excellent security selection within the consumer non-durable, banks, insurance and utilities sectors. Overweighing in basic industry and capital goods, and underweighing in energy and utilities were rewarded strategies. Below are top performing securities within each economic sector that significantly affected performance:

Consumer Non-Durable:	Philip Morris, Becton Dickinson, Warner Lambert
Banks:	First Interstate Bancorp, BankAmerica
Insurance:	Aflac
Utilities:	Sprint

Our overweighing in Financial Services and Insurance detracted from performance during the period. Specifically, our holding in Travelers (-35%) negatively impacted overall return.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets*

We continue to maintain a significant position in financial stocks for company specific reasons like market share, high returns on capital and shareholder oriented managements. We fully realized that pressure on interest rates might continue to restrain performance in financial stocks but are convinced they will reward, patient long term investors. Further, our cash position is now somewhat defensive at greater than 10% of the portfolio. As opportunistic buyers we will utilize a portion of our cash position to add to positions at favorable prices.

## Oppenheimer (con't)

3. **Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There have been no changes to the staff directly involved with the Minnesota SBI portfolio. However, there have been other additions to staff as follows:

*Jeffrey Whittington* rejoined Oppenheimer Capital as a Senior Vice President and Senior Portfolio Manager/Analyst with responsibilities of research and management of mid-cap equity portfolios. For the previous two years Jeff has been a portfolio manager at Neuberger Berman. From 1986 to 1992 he was a portfolio manager with Oppenheimer Capital responsible for the Quest for Value Dual Purpose Fund, a closed-end registered investment fund and Paragon Partners, a limited partnership. Earlier, Jeff was with Wachovia Bank and Trust as an analyst and portfolio manager. At this time, he also taught at Wake Forest University's Babcock Graduate School of Business.

*David Santry* joined Oppenheimer Capital as a Senior Vice President and Senior Portfolio Manager/Analyst in our Public Fund Team. He brings 23 years of experience, most recently with the Boston Company where he served as the firm's director of equity research and senior portfolio manager. From 1986 to 1990 he was a security analyst with Porter, Felleman and prior to this, performed mergers and acquisition analysis as security analyst for Junction Partners. Earlier, Dave had an extensive career in publishing, as an associate editor of BusinessWeek Magazine and as a reporter. Dave is a CFA and has an MBA from Wharton

### ACCOUNTS GAINED/LOST:

Gained:	7 accounts with \$12 million in assets.
Lost:	2 accounts with \$50 million in assets.

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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### Staff Comments

Staff met with Oppenheimer in early October at their office. Staff discussed a number of topics with them including economic outlook and portfolio strategy.

#### **Economic Outlook:**

Oppenheimer believes the market is fair to over valued depending on whether one looks at book/price, price/earnings, or price/dividends.

#### **Portfolio Strategy:**

Information that staff collected in the meeting coincides with Oppenheimer's comments above. Oppenheimer has put a defensive policy in place by holding 10 to 15% cash in 1994.

**Manager Commentary**  
**Waddell & Reed**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$2.6 billion	Actual	5.3%	1.4%
Total Firm Assets Managed in this Discipline	\$4.8 billion	Benchmark	7.9%	7.4%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

During the quarter, heavy overweighting in Amgen (pharmaceuticals) and Computer Associates (software) served us well as demand for each company's products remained very strong. On the other hand, a continued rise in interest rates has negatively affected psychology for many financial service companies, also an area of heavy overweighting, and we have consequently eliminated or reduced positions in credit card, mortgage financing, and brokerage industry stocks over the past few months. Increased competition in the airline industry and a progressively more debt-extended consumer led us to eliminate or reduce positions in the airlines and significantly reduce our auto stock positions.

For the year, our active bets in the airline industry (Southwest, Delta and AMR) did not work as competition in the industry again intensified. A steady rise in interest rates and a strong industrial-based economy negatively affected the rate of growth in the brokerage industry (Merrill Lynch, Morgan Stanley and Bear Stearns).

On the positive front, we realized large gains in semiconductor and personal computer stocks (Compaq Computer, Micron Technology, Texas Instruments) as strong demand for their products buoyed share prices.

Also, in technology, as mentioned, large positions in Computer Associates (software) and Amgen (pharmaceuticals) are paying off with very good relative returns recently.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We recently added to our gold stock positions (e.g., American Barrick, Placer Dome, Homestake Mining) in an effort to hedge against a strong industrial recovery, a weak U.S. dollar, and rising inflationary expectations due to upward pressure on both import prices of finished goods and on raw materials such as paper, chemicals, etc. In addition, we have retained large positions relative to the benchmark in rapid earnings and cash flow growth companies selling at relatively attractive valuation levels, such as Viacom/Paramount/Blockbuster (cable, movies, video and music), Computer Associates (software), Amgen (drugs), and Mattell (toys). Moreover, we have raised cash due to the aggressive tightening of monetary conditions by the Federal Reserve and the coincident sharp rise in interest rates across the board (Treasury rates now approach 7% for 2 years and 8% for 10 years).

**Waddell (con't)**

3. **Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Two investment analysts were added to staff during the quarter. There were no accounts gained or lost in this discipline.

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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**Staff Comments**

No additional comments.

**Manager Commentary**  
**Weiss Peck and Greer**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$13.5 billion	Actual	12.1%	-6.2
Total Firm Assets Managed in this Discipline	\$ 1.5 billion	Benchmark	10.6%	1.1

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

**Quarter:**

Stock selection resulted in 2.2% positive contribution against a total value added of 1.5%. Two sectors, consumer non-durable and technology together contributed a positive value added of 3.7%.

Healthcare continued to be a problem, 1.5% negative contribution for the quarter. One of the issues is we have made an active choice to not own HMO's - a bet which has hurt.

**Year:**

We trail our benchmark by -5.1%. Stock selection has accounted for almost all that underperformance (approximately 4.9%). Healthcare accounted for -1.9% and technology -1.5% over that period. The nine months results shows technology stock selection as positive so there has been dramatic improvement in this sector.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

The active sector/industry bets which have been in place from inception are likely to continue. Industries under consideration for inclusion in the portfolio are environmental services as well as various companies associated with leisure.



## Weiss Peck (con't)

3. **Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

We are in the process of developing better benchmarks for our analysts. We are working with Richards & Tierney on the project. The objective is to get better focus on our universe from our analytic resources.

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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### Staff Comments

Staff met with Weiss, Peck & Greer in early October at their office. Staff discussed a number of topics with them including organizational change, economic outlook, and portfolio strategy.

**Organizational Change:**

Weiss, Peck & Greer promoted Candice Eggers to Research Director. She has been the technology analyst since joining Weiss, Peck & Greer in June 1993.

**Economic Outlook:**

Weiss, Peck & Greer believes the economy will grow 3-5%, but they feel this growth will not exacerbate inflation because other world economies are still quite subdued and productivity will hold down labor costs in the US. They also feel the market is fairly valued when looking at price/book and price/dividend, and it is undervalued when compared to interest rates. They expect corporate profits to support further advances in the market.

**Portfolio Strategy:**

Information that staff collected in the meeting coincides with Weiss, Peck & Greer's comments above. They also indicated that some investment ideas include biotech stocks which currently have depressed prices, wireless voice and wireless data companies, productivity enhancing technology that link offices and locations together, and HMO's because pretax returns are at their highest levels.

**Manager Commentary**  
**Wilshire Asset Management**  
**Tilted Index Fund**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$9.0 Billion	Actual	4.6%	2.2%
Total Firm Assets Managed in this Discipline	\$5.0 Billion	Benchmark	4.7%	2.8%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what caused the positive or negative tracking error relative to your benchmark?*

For the quarter ended September 30, 1994, the Minnesota SBI Completion Fund underperformed its benchmark index (DCF) by 0.1%. This is well within the normal tolerance bands for such a fund. There were \$248.7 million in purchases and \$179.2 million in sells executed during the quarter. There were no contributions or withdrawals. The total market value of the fund as of 9/30/94 was \$4,956.7 million.

For the year ended September 30, the fund underperformed its benchmark by 0.6%. While this is not an unusual variance for a broad based market fund it does include one other quarter - the fourth quarter of 1993. During the final quarter of last year, the Fund underperformed the DCF by 51 basis points. As we have discussed previously, turnover was particularly high in that quarter contributing to the variance.

2. *Future Strategy. Going forward, what strategies, if any, do you plan to implement to control tracking error within expectations?*

We have continued to take a less aggressive trading stance compared with our approach when this fund was first created. We are pleased to note a lower level of turnover in the index (6.3% this quarter) and a still lower level of turnover in the fund.

## Wilshire (con't)

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Ownership of Wilshire Associates is in the hands of working principals. We have expanded ownership to a larger group of individuals in recent years and currently there are 23 principals. Within Wilshire Asset Management, staff has grown dramatically in the last year and we currently number 15 individuals.

There have been no gains or losses in the Wilshire 5000 Index category of business but overall, Wilshire Asset Management has grown dramatically. As a result we have added four junior and mid-level people to our staff. They will be assisting in back office work, trading analytics and special projects.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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## Staff Comments

No additional comments.

**Manager Commentary**  
**Wilshire Asset Management**  
**Wilshire 5000 Index**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$9.0 Billion	Actual	5.3%	3.7%
Total Firm Assets Managed in this Discipline	\$1.6 Billion	Benchmark	5.4%	2.5%

- 1. Past Performance. Summarize your performance over the last quarter and year. Specifically, what caused the positive or negative tracking error relative to your benchmark?*

The fund's tracking relative to the benchmark was negative in the third quarter underperforming by 0.1%. For the latest 12 months, the fund has outperformed the index by 1.2%. While this is well beyond normal expectations, we continue to monitor the factor exposure of the portfolio and do not feel any inappropriate bets are being taken relative to the benchmark. As we have recently discussed with the SBI staff, the decrease in the external cash flows to and from this fund in the last several years has resulted in fewer opportunities for fine-tuning. The result has been an increase in the overall level of tracking. We have recently completed a small rebalance which will bring the fund more closely in line with the index.

- 2. Future Strategy. Going forward, what strategies, if any, do you plan to implement to control tracking error within expectations?*

To the extent that there will be only limited external cash flow in this fund, we will continue to carry out our fine-tuning through periodic rebalance programs. These will be small trades which will have no urgency at the time they are prepared and hence can be expected to have only a minimal impact on the fund's performance.

## Wilshire (con't)

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Ownership of Wilshire Associates is in the hands of working principals. We have expanded ownership to a larger group of individuals in recent years and currently there are 23 principals. Within Wilshire Asset Management, staff has grown dramatically in the last year and we currently number 15 individuals.

There have been no gains or losses in the Wilshire 5000 Index category of business but overall, Wilshire Asset Management has grown dramatically. As a result we have added four junior and mid-level people to our staff. They will be assisting in back office work, trading analytics and special projects.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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### Staff Comments

The recent rebalancing program was initiated by staff due to its concern about the recent large tracking error in the Wilshire 5000 index fund. Staff requested an analysis of the tracking error by Wilshire that showed that a rebalancing needed to be done to bring the tracking error within expectations. Staff reiterated its expectations to Wilshire in that staff expects the index to have a tracking error of  $\pm 0.6\%$ .

**Manager Commentary**  
**CIC Asset Management, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$186 Million	Actual	1.5%	N/A
Total Firm Assets Managed in this Discipline	\$186 Million	Benchmark	4.9%	N/A

1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

During the quarter CIC underperformed the S&P 500, 1.65% vs. 4.97%.

Relative to the S&P 500, the active bets continued to be on consumer durables, financial services, capital goods, and basic industries. We also underweighted significantly the utilities, technology, consumer non-durables, and energy sectors.

Three sectors where active bets worked were: (1) We overweighted Basic Industries, which added 41 bp, led by International Paper (+29 bp) and USX (+26 bp) and notwithstanding a significant decline by ConRail (-26 bp) in that sector. In the S&P the sector was up 7.8%, and hence our stock selection compares unfavorably. (2) Utilities, contributed 11 bp of performance, with a small position in Union Electric being the sole winner. The sector in the S&P was up 1.8%, less than the index. (3) Energy, where we were also underweighted, was essentially flat for the quarter for us and up 1.2% in the S&P, less than the index. Exxon, which had a negative impact the prior quarter, partially recovered. ARCO was pared down at an attractive price.

Active bets that did not work were: (1) Capital goods, which added 42 bp on the strength of MMM (+20 bp) and General Electric (+12 bp). In the S&P the sector was up about 3.6%. (2) Consumer durables, which cost us 41 bp of performance as the group was weak across the board (the sector in the S&P was down 4.3%), and (3) the Financial sector, which partially reversed its 81 bp contribution to performance of the second quarter and cost us 23 bp, principally because declines in Federal Home Loan Mortgage (-25 bp), Lincoln National (-24 bp), and PNC Financial Corp (-23 bp) outweighed the contributions from American Express (+40 bp), Beneficial Corp (+17 bp) and Household International (+14 bp). Here, the sector in the S&P was down 1.7%, indicating our stock selection in the consumer finance stocks outperformed.

Underweighted sectors that outperformed in the S&P were: (1) Consumer non-durables, which added 103 bp to performance, as nearly the entire group was strong, permitting us to effect sells of six companies into this strength. In the S&P, the sector was up about 9.8%. (2) Technology, with 17 bp of contribution to performance, primarily from Hewlett Packard. The technology sector in the S&P was up about 15.6%. As value investors we compare unfavorably for the quarter in large part because of the performance of these two sectors that have primarily growth stocks.

## CIC Asset Management (con't)

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

As of this writing, we continue to be overweighted in consumer durables, financial services, capital goods and basic industries. We also are underweighting significantly the utilities, technology, consumer non-durables, and energy sectors. For this quarter we do foresee paring back active bets in consumer durables, which has underperformed for two quarters, and financial services, which was weak last quarter.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

During the second quarter, there were no ownership changes at the firm. As for personnel changes, in July, we hired one administrative staff member, adding to our capacity in anticipation of long-term growth. More recently, we are looking for a fourth investment professional who will add depth and experience to the team. During the quarter, CIC did not lose any accounts. Our last new account was Chrysler (May 1994).

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

There are no issues to report at this time.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Cohen, Davis & Marks Incorporated**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$110 Million	Actual	6.9%	N/A
Total Firm Assets Managed in this Discipline	\$110 Million	Benchmark	4.9%	N/A

1. **Past Performance.** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The account increased by 6.9% during the second quarter which compares to a 4.9% gain for the benchmark (S&P 500). Broadly speaking, the account was moderately overweighted in Cyclical stocks and Growth stocks. The account is underweighted somewhat in the Energy sector. The performance impact of this positioning was as follows. Consumer Cyclical as a sector generally performed in line with the benchmark but we were emphasizing "heavier" cyclicals (Metals, Machinery) which did better than the sector overall. This, then helped our performance. The biggest help to performance, however, were Growth stocks (Health Care, in particular) which generally outperformed the benchmark, as did the particular stocks we owned in this sector. By contrast, Interest-rate sensitive stocks did relatively poorly over this period, while the particular interest-rate sensitive stocks that we held (Misc. Financials) did poorer still. Underweighting in the Energy sector added to performance though this advantage was partially offset by poor stock selection within the sector.

2. **Future Strategy.** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We continue to make the same bets as described in the answer to the first question. Our economic outlook calls for moderate growth, lower interest rates, continued strong corporate profits and market volatility. As a result of expected volatility we are placing above-average emphasis on diversification and high quality companies. The portfolio is moderately cyclical, moderately growth oriented with increasing emphasis on interest-rate sensitive stocks.



**Cohen, Davis & Marks (con't)**

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There were no significant ownership or personnel changes last quarter.

**Accounts Gained**

None

**Accounts Lost**

None

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

There were no other pertinent issues/events.

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**Staff Comments**

No comments at this time.

**Manager Commentary**  
**Compass Capital Management, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$146 Million	Actual	5.5%	N/A
Total Firm Assets Managed in this Discipline	\$ 81 Million	Benchmark	5.9%	N/A

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

**Quarter**

Consumer Staples	Overweighted	Worked
Technology	Overweighted	Worked
Basic Industry	Even	Worked
Energy, Utilities, Financial	No Weightings	Worked
Consumer Cyclical	Overweighted	Did Not Work

**6 Mos.**

Consumer Staples	Overweighted	Worked
Technology	Overweighted	Worked
Basic Industry	Even	Worked
Energy, Utilities, Financial	No Weightings	Worked
Consumer Cyclical	Overweighted	Did Not Work

The overweightings in Consumer Staples and Technology with no weightings in Energy, Utilities and Financial stocks worked because of the attempt by the Fed to slow the economy by increasing interest rates. In the consumer cyclical sector the overweighting did not work because of rising interest rates which put pressure on consumer disposable income, hence slower retail sales.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

There are no equity positions in the following economic sectors of the S&P 500: Energy, Financial and Utilities (10.5%, 11.4%, and 11.9%) of the S&P 500 respectively. Overweighting within the portfolio occurs in the following economic sectors: Consumer Cyclical (26.9%) and Consumer Staples (32.9%).

## Compass Capital Management (con't)

In adhering to our investment disciplines of buying growth stocks at attractive valuations, utilizing a bottoms-up approach, we have found both the Consumer Cyclical and Staples sectors very attractive. Based on valuation concerns, the economically sensitive sectors of the S&P 500 appear overvalued. The drug and retail stocks still look attractive based upon growth rates and valuation criteria; therefore, larger positions have been taken in these two industries.

With the probability that interest rates will continue to rise and the slow growth in earnings in Energy and Utility Stocks historically, the portfolio has been structured with no representation in either of these two sectors.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

No significant ownership or personnel changes during the quarter.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**First Capital Advisers, Inc.**

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<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$125 Million	Actual	2.4%	N/A
Total Firm Assets Managed in this Discipline	\$ 65 Million	Benchmark	4.9%	N/A

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1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The third quarter of 1994 was a tale of two periods - the 10 weeks from June 30th through September 6th, and the ensuing three-week period through the end of the quarter.

Our broad market forecast at the beginning of the third quarter was for a 10% summer rally from about 3,600 on the Dow Jones Industrial Average to a range of 3,900 to 4,000 by Labor Day. Our industry focus was on economically-sensitive and financial stocks.

As the third quarter unfolded, the DJIA and our focus stocks performed in-line with our forecast, as the DJIA hit 3,950 by mid-September, and our relative performance was nearly 100 basis points better than our benchmark (S&P 500) on a total-return basis for the third quarter to date.

When the DJIA hit the 3,950 level in mid-September, however, our models flashed a sell signal to us, and we became more cautious. We took profits in many of the economically sensitive stocks that had rallied strongly during the quarter, and we rotated the funds into retail stocks and transportation stocks, which had been beaten down and which we believed were poised to rally strongly in the fourth quarter.

What actually transpired, however, during the final three weeks of the quarter, was that the retailers and transports continued to underperform the market and the cyclicals continued to perform strongly. As a result, our excellent performance quickly reversed itself, and our relative performance swung more than 300 basis points in the wrong direction over those final three weeks.

2. ***Future Strategy.** What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

When the DJIA hit the 3,950 level in mid-September, we forecast a modest correction to at least 3,750, with support below that at 3,650 and with major support at 3,550. We expect a fourth-quarter rally after that consolidated pattern is completed, to a record 4,000+ by year-end 1994. Our preliminary forecast for 1995 is for an upside DJIA target of about 4,300.

We expected the fourth-quarter rally to piggy-back on superb quarterly corporate earnings, a trend we believe will continue into next year.

## First Capital Advisers, Inc. (con't)

Also, we believe that the five interest-rate increases we have already seen (plus another one possible on November 15 at the Federal Open Market Committee meeting), in conjunction with President Clinton's massive, retroactive tax increase, will keep economic growth and inflation in the 2.5 - 3.0% range for the next few quarters.

Our investment focus remains on selectively overweighting Blue Chip value stocks, including technology, retailers, transports, financials and some economically sensitive stocks that have corrected back to attractive levels, such as the papers, chemicals, metals, machinery, autos, housing, electrical equipment, publishing and gaming. We believe that these stocks will benefit from a moderate growth/moderate inflation economic environment, strong expected earnings gains and well-below market relative valuation profiles.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

None

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Kennedy Capital Management**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$799 Million	Actual	7.3%	N/A
Total Firm Assets Managed in this Discipline	\$502 Million	Benchmark	6.9%	N/A

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Kennedy Capital is diversified by industry group and therefore does not make active sector bets. We also stay fully invested and do not make market bets. We do purchase lower capitalization stocks that may also have lower trading floats; this has been a difficult market for these type of stocks due to the high degree of concern with interest rates and the value of the dollar.

The best investments were those most connected to the economy, while those that did the worst were those connected to interest rates. Thus a Bordens Chemical increased over 40% (connected to economic development); Inter-Regional Financial a brokerage firm declined 25% (tied to interest rates).

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

There are no net industry or market bets that we are making. Investment interest in smaller cap stocks with higher trading costs is dependent on a continued moderate economic recovery. If the present lack of interest in smaller cap issues under the \$200 million market cap continues, we will slightly overweight out larger issues in the \$200 to \$300 million market cap to bring our overall account market cap from the present \$150 million size to a \$250 million market size closer to the Russell 2000 Average.

KCM has emphasized the small cap segment of the Russell 2000 universe and even lower since long term studies have shown the best risk to reward ratio for gains occurs in this area. However, as in 1989 through 1990, when there is no intentional interest in this low end market cap we do move towards a more neutral cap weighting compared to the index.

## Kennedy Capital Management (con't)

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There were no significant changes in ownership or management at Kennedy Capital. We have an intern program at Washington University for MBA or Finance Masters students. These students are brought in to work our "evening shift". We have hired one of these students for a January start date. This brings our total employee count to 19.

No accounts lost over the second quarter. R.R. Donnelly was added as an account for \$30 million dollars in our growth program (Minnesota is in our value program)

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**New Amsterdam Partners L.P.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$160 Million	Actual	3.8%	N/A
Total Firm Assets Managed in this Discipline	\$155 Million	Benchmark	5.1%	N/A

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Our investment style is a logical and structured discipline that may be described as Growth at a Reasonable Price or Relative Value that ranks securities on an expected return rating. Our portfolios look for high expected return stocks with better than average forecast growth and return on equity but lower valuation ratios (P/E and Price/Book). Your portfolio meets those characteristics shown below, as of September 30, 1994:

<b>Minnesota</b>	<b>S&amp;P MidCap</b>	
Expected Return	14.8%	10.5%
P/E	15.6x	20.8x
Price to Book	2.6x	2.7x
Yield	2.0%	2.1%
Forecast Growth	10.0%	10.3%
Return on Equity	18.5%	11.9%
Wtd Avg Mkt Cap	\$4.7bn	\$1.9bn

During the second quarter of 1994, the main factor affecting our performance was size. (Our portfolio's market capitalization is more similar to the S&P MidCap than the S&P 500.) The third quarter was disappointing even though the smaller capitalization stocks rebounded after a brutal second quarter. Particularly in the month of September, low PE, interest rate sensitive stocks and cyclicals got hard hit. On balance, our sector selection in the third quarter was relatively neutral. Our main problem was in stock selection. Within the Technology area, while Cabletron Systems (+23.2%) rebounded sharply, as we had expected, our holding in Cray Research (-9.4%) caused our picks as a group in that sector to underperform their peers. Cray, we believe, is very cheap with a 7.7x P/E and a growth rate of 11%. The company is gaining new contracts while at the same time taking steps to improve product delivery time and reduce costs.

Other disappointing stocks were First Brands (-8.3%), Superior Industries (-9.3%) and CML Group (-14.9%). First Brands owns solid consumer brands such as Glad Bags, has solid forecast growth (10%) and a low P/E (12.1x). Superior Industries is a supplier to the auto industry, yet with forecast growth of 14% (twice that of the market), and a market P/E, we believe the stock will rebound. CML Group continued to disappoint this quarter, CML's P/E of only 7.5x and forecast growth in the 14% range, we think it is oversold at these levels. Phillips Van Heusen (-17.8%) is in the process of being sold due to a negative change in fundamentals and outlook.



## **New Amsterdam Partners (con't)**

On the positive side, individual stocks doing particularly well this quarter were MCI Communications (+15.8%), Caesars World (+19.0%), Wellman (+15.7%), Health Management Associates (+18.7%), Merck (+21.3%), and Allegheny Ludlum (+16.9%).

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets*

We manage money using a logical and consistent strategy of looking for stocks with higher expected return, higher forecast growth and return on equity but a lower P/E and Price to book ratio than the benchmark, since companies which have superior growth and return on equity (a "Franchise Factor"), should ultimately trade at premium multiples thus yielding even more return potential. Although the last two quarters were difficult, over the long term the strategy has added significant value. We are therefore sticking to our discipline. Right now, we believe that the Finance and Consumer Sectors offer attractive opportunities. Financial stock prices have fallen with rising interest rates yet have good yields and decent earnings prospects. The consumer stocks offer relatively stable long term growth at cheap valuation ratios.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Two accounts, totaling \$27.5 million, were gained in this discipline this quarter. None were lost.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

We anticipate having our custom benchmark from Richards & Tierney by December of this year. We believe that we will gain insight into our style from this process

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### **Staff Comments**

No comments at this time.

**Manager Commentary**  
**Valenzuela Capital Management, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$905 Million	Actual	3.3%	N/A
Total Firm Assets Managed in this Discipline	\$905 Million	Benchmark	4.9%	N/A

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Under our "bottom up" style, each stock pick is an active bet. Positions most affecting performance during the third quarter period were Manpower (which contributed +0.74%) Circuit City Stores (+0.74%), Aver Dennison (+0.68%), MacFrugal's Bargains (+0.53%), and Olsten Corp. (+0.53%). Manpower continues to benefit from improved business in France. Strong sales gains, particularly in computers, has let to better than expected earnings for Circuit City. Avery Dennison is experiencing strong unit growth coupled with better cost containment. MacFrugal's has had strong comparable store sales gains, and Olsten's revenue growth is benefiting from increased hospital outsourcing of personnel needs. Performance was adversely affected by Houghton Mifflin (costing the portfolio -0.22%), Lubrizol Corp. (-0.25%), Pitney Bowes (-0.26%), Bergen Brunswig (-0.28%), and Airborne Freight (-0.50%). Disappointing results in the adoption of California text books are postponing earnings gains for Houghton Mifflin. Lubrizol is experiencing raw material cost pressures. Disappointing sales of new products is affecting Pitney Bowes. Slowdown in overnight package delivery is likely to affect Airborne Freight's earnings and the outlook for the stock. Heightened competition in hospital drug sales is placing severe pressure on Bergen Brunswig's margins.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Our investment philosophy is one of "risk-averse growth." We believe that growth in earnings and cash flow fuel price appreciation. We also believe that high price-to-earnings ratios cause volatility and risk. Hence, we try to sell higher P/E stocks and buy stocks in companies whose earnings will grow but whose P/E's are at or below the market. New investments meeting this criteria during the quarter are Colgate-Palmolive Co., Consolidated Stores Corp., Precision Castparts and Raychem. Realized gains were taken in Shawmut National Corp. because poor cost containment on acquired banks may affect future earnings. The positions in Airborne Freight and Bergen Brunswig were also sold. At the end of the quarter, the portfolio held thirty-three positions.

## Valenzuela Capital (con't)

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There has been no significant change in the firm over the last quarter. The New York State Common Retirement Fund became a client. The Americas Fund, a pooled fund under the auspices of Evaluation Associates, was liquidated at the request of the individual plan sponsors. Valenzuela Capital Management was funded separately in an individual account by one of the participants. In addition, Evaluation Associates added Valenzuela as one of the managers for a fund on behalf of a small Eastern city.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

Solid growth with low inflation has been the economic backdrop for the past ten quarters. We are now at a point where capacity utilization and labor availability are showing signs of tightening. The Federal Reserve, fearing the possibility that this could lead to an acceleration of inflation, has raised interest rates, which is expected to slow the economy gradually and relieve the building pressure for further inflation. In this environment, equity investing becomes more difficult as rising rates push valuations lower, and the slowing economy puts earnings growth in question. It is, therefore, important to concentrate on finding those companies that will deliver solid and consistent earnings.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Wilke/Thompson Capital Management**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr. Year</b>
Total Firm Assets Under Management	\$387 Million	Actual	12.1% N/A
Total Firm Assets Managed in this Discipline	\$194 Million	Benchmark	7.2% N/A

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Wilke/Thompson Capital Management does not make active bets relative to a benchmark, rather we invest in high quality growth companies that have the ability to grow their earnings regardless of the economic environment. The third quarter was a very strong one for the Minnesota State Board of Investment portfolio. The strong third quarter performance by growth stocks follows a weak first half performance. Such activity is not unusual; following periods of market corrections growth stocks, and in particular small-cap growth stocks often lead the market upward. In addition, growth stocks have in general been lagging value stocks since 1991, and their valuations have been compressed making them poised for a rebound. Our work indicates that we are in the early stages of a period that will see an outperformance by growth stocks. Such periods can run two to three years in duration. The returns, however, come in bunches, not in straight-line fashion, as can be seen by the big jump in the third quarter. The irregularity of returns and the big moves that can occur month-to-month are why it pays to be fully invested in growth stock portfolios. Ill-fated attempts at market-timing can result in large lost opportunities if investors are not fully invested when growth stocks surge upward.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Looking ahead, the fourth quarter should prove challenging for all stock investors. Interest rates have already increased by over 2% across the board in 1994, and the Federal Reserve Board appears ready to keep the upward pressure on rates into 1995. Rising rates will eventually bite and slow economic activity. In addition, rising interest rates result in downward pressure on P/E multiples for all stocks. By focusing on growth stocks posting strong gains in earnings we can mitigate the pressures of contracting P/Es. Companies that have strong unit growth and whose products help other companies increase productivity will be the growth stocks of the 90's, posting strong revenue and earnings gains. These are the companies that remain the focus of Wilke/Thompson growth stock portfolios.

## Wilke/Thompson Capital (con't)

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Wilke/Thompson had minimal staff turnover in the third quarter. Vicky Assell, receptionist/secretary and minority owner, left the firm. This triggered Wilke/Thompson's buy/sell agreement as the Firm is negotiating repurchasing Ms. Assell's shares. After her maternity leave, Barbara Marshall, one of our equity traders, left the firm and we are currently in the process of filling the position she vacated. As was the case in the second quarter, we did not experience any terminated accounts in this discipline and have gained two accounts worth a combined total of approximately \$52 million.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

The SBI account experienced phenomenal performance in the third quarter as Wilke/Thompson continues to enjoy a great year managing small cap growth stocks. We remain very optimistic for the fourth quarter as well as for the upcoming year.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Winslow Capital Management, Inc.**

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<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$425 Million	Actual	10.7%	N/A
Total Firm Assets Managed in this Discipline	\$425 Million	Benchmark	7.7%	N/A

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1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Winslow Capital began managing assets for the Minnesota State Board of Investment on April 1, 1994. In the quarter ended September 30 the SBI portfolio appreciated 10.87% on a total return basis versus the benchmark Russell 1000 Growth increase of 7.68%. The performance for the SBI account since inception shows an increase of 7.69% versus 6.59% for the benchmark. Over the past 12 months our comparable accounts rose 8.17% compared with an increase of 5.83% in the Russell 1000 Growth index.

As reported, during the price weakness in the second quarter of 1994, we added to our positions in technology, telecommunications and the consumer service sectors. On a fundamental basis these companies exhibit strong earnings potential in growing industries. Through the third quarter we continued to believe that these companies were very attractive. They combine outstanding future earnings growth potential with attractive valuations relative to their growth prospects. Each sector was selling at price/earnings multiples that we believed to be attractive on both an absolute and a relative basis. The considerable overweighting of the portfolio in these sectors was additive to performance during the quarter ending 9/30/94. The portfolio was slightly overweighted in healthcare and underweighted in financial services and energy during this time period. All of these factors had a positive impact on total return.

The P/E contraction, precipitated by the rise in Fed Funds rates during the first and second quarters, was noticeable absent in the quarter ending 9/30/94. This stabilization of P/E ratios allowed the market to concentrate on corporate earnings. Our disciplined approach to investing in companies with strong future earnings growth benefited from the renewed attention paid to growing profits. Without the P/E contraction the portfolio appreciated based on the earnings growth prospects.

2. ***Future Strategy.** What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Winslow Capital Management, Inc. was hired to manage a Large Cap growth portfolio for the SBI. We have always been and always will be driven by strong future earnings growth potential at reasonable valuations. We continue to believe the sectors that are likely to exhibit the best earnings growth will be technology, specialty retail/consumer services, healthcare and telecommunications. Winslow Capital is overweighted in these sectors because on fundamental, bottom up analysis we believe specific companies within the aforementioned sectors are poised to achieve strong future earnings growth. This growth will become more

## Winslow Capital (con't)

important as we enter the fourth year of an economic recovery. We believe many economists and market participants are overestimating GDP growth and the rise of inflation. As the growth of GDP slows, we will see companies and sectors of the market receive a premium for their ability to grow earnings. The sectors that are likely to benefit from this will be technology, telecommunications, healthcare and consumer services. This premium will be apparent through a moderate expansion of the P/E ratios of growth companies. Notwithstanding the strong results of the third quarter, we continue to believe that on an absolute and relative basis P/E ratios remain attractive. The portfolio is currently forecasted to achieve earnings growth of 24% over the next year, while only selling at 16.4 times our 1995 estimates.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Karen M. Cloud joined the firm in August as an Administrative Assistant. Previously, she worked for Triad Financial Services. Karen is a graduate of the College of St. Benedict. With her addition, Winslow Capital Management has 10 employees.

During the third quarter the Minnesota Masonic Homes hired Winslow Capital to manage a Large Cap growth equity portfolio. The total assets under management are now in excess of \$425 million for 12 clients.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Zevenbergen Capital, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$283 Million	Actual	6.6%	N/A
Total Firm Assets Managed in this Discipline	\$283 Million	Benchmark	7.7%	N/A

1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Two out of the three months during the quarter exhibited positive performance, with the last month showing slightly negative returns, resulting from a pull back in our finance and capital goods sectors (attributed to continued rising interest rates and inflation fears).

The largest active bet sectors in Zevenbergen Capital's portfolio are telecommunications and technology, with a combined weighting of 34.4% as of September 30, 1994. The Russell 1000 Growth Index contained an average technology weighting of 17.3% at the end of third quarter, 1994. The two sectors performed well and added to the portfolio's positive returns.

The relative underweighting of the consumer staples and consumer discretionary sectors in Zevenbergen Capital's portfolio did not add as much to returns when compared to the Russell 1000 Growth, which contained an average weighting of 15.9% and 22.3% in these sectors, respectively.

2. ***Future Strategy.** What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

It is Zevenbergen Capital's belief that a long-term secular trend will continue in the telecommunications and technology sectors throughout the current and next decade. Hence, the portfolio overweighting in each of these sectors relative to the Russell 1000 Growth Index.

Economic growth in the U.S. is being technologically driven. Corporations, as well as consumers, are investing in technology to enhance current and future profitability. Investments in technology and telecommunications companies continue to be the highest growth-potential investments, given this trend. Economic progress is also dependent on global business and global competition, aided by new telecommunications infrastructures and equipment which can deliver multitudes of varied information instantaneously.



## **Zevenbergen Capital (con't)**

3. ***Organizational Issues.** Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

No significant ownership or personnel changes to report for the quarter. One account was gained during third quarter 1994, General Board of Pensions of the United Methodist Church.

4. ***Other Comments.** Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

Zevenbergen Capital wishes to request a review of the ADR-investment restriction set by the SBI. Non-restricted portfolios managed by Zevenbergen Capital currently contain approximately 12% ADR's, which may contribute to a difference in performance. Due to U.S. government regulatory policies, many U.S. companies are not as viable an investment opportunity as some of their foreign counterparts.

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### **Staff Comments**

No comments at this time.

**Manager Commentary**  
**BEA Associates**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$22.2 billion	Actual	-0.3%	-4.4%
Total Firm Assets Managed in this Discipline	\$3.6 billion	Benchmark	0.6%	-3.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The portfolio continued to benefit from a decline in the volatility of financial assets. The derivative related strategies continued to rebound and provided another 25 basis points of incremental return. The decision to barbell the portfolio's cash flows also added approximately 10 basis points of return for the quarter as the U.S. yield curve continued to flatten. In mid September, BEA moved the Minnesota State Board of Investments portfolio to a neutral position with regard to cash flows. We also witnessed relative outperformance of the investment grade non-dollar market. Our 6% position in hedged non-dollar bonds added approximately 5 basis points. We continued to have a meaningful (5.4%) position in long dated FRN and expect them to provide positive relative returns in the next quarter.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

The strategies that were in place at the end of last quarter continue to be in place at this time. BEA continues to see good value in the International Perpetual Floating Rate Note market, select BBB issues, and government bonds of securities outside of the United States. As interest rates stabilize, all of the above sectors should provide superior relative returns as investors re-focus their energies on relative value. We have unwound our barbell strategy and have structured the Minnesota State Board of Investments portfolios' cash flows to closely match those of the Salomon BIG Index.

**BEA Associates (con't)**

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

No change in personnel or ownership.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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**Staff Comments**

No comments at this time.

**Manager Commentary  
Investment Advisers, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$14.0 billion	Actual	0.1%	-5.6%
Total Firm Assets Managed in this Discipline	\$4.9 billion	Benchmark	0.6%	-3.1%

1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The portfolio performed in line with the benchmark for the recent quarter but has underperformed during the past year. Our overweighting in long duration assets reduced performance for the year. Lower duration, the overweighting in asset-backed securities and mortgage pass-through issues improved relative performance during the quarter. Canadian Yankee bond issues were also employed to take advantage of political uncertainty and excess returns available in Canada.

2. ***Future Strategy.** What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Treasuries are underweighted, asset-backed and mortgage pass-through issues are overweighted reflecting our current emphasis on higher yielding issues. Approximately 5% is invested in corporate put bonds which add convexity to the portfolio and should perform well in a flat to declining market. Short duration (0-3 years) and long duration (9+ years) assets are emphasized in our yield curve strategy, providing a barbelled structure that will perform well as the Fed continues to raise short term rates. Portfolio duration is shorter than the market by approximately .3 year, reflecting our view that interest rates are in a cyclical uptrend.

3. ***Organizational Issues.** Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

No losses in professional staff during the quarter.

David McDonald, Vice President, was hired as an equity analyst/portfolio manager in our large cap equity team.

IAI was given an expanded role by our parent, Hill Samuel, to manage and distribute our asset management services on a global basis. This represents a significant commitment to our business at IAI.

Two accounts were gained and one account was lost due to an asset allocation shift.

**Investment Advisors, Inc. (con't)**

4. *Other Comments.* *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

No additional comments.

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**Staff Comments**

No comments at this time.

**Manager Commentary**  
**Miller, Anderson & Sherrerd**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$29.3 billion	Actual	0.4%	-4.6%
Total Firm Assets Managed in this Discipline	\$17.5 billion	Benchmark	0.6%	-3.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Over the last quarter, your portfolio provided a 0.2% return versus 0.5% for its benchmark. For the last twelve months, your portfolio has provided a (-4.3%) return versus a (-3.9%) return for its benchmark.

In managing your portfolio, we focus on duration, yield curve exposure, credit risk, prepayment risk, and allocation to the foreign fixed income markets. During the last year, we've had a duration greater than your benchmark, a portfolio that was somewhat more barbelled with regard to yield curve reshaping risk than your benchmark, were overweight mortgages, neutral with respect to corporates, and had an allocation to foreign fixed income securities which are not included within your benchmark.

Throughout the year, interest rates have risen sharply and the yield curve has flattened. In addition, foreign interest rates have moved up in step with U.S. interest rates. Over the last twelve months, the duration decision detracted from investment results and has resulted in the shortfall vis-a-vis your benchmark. Over that time period, the decision to have a barbell position within the portfolio and the allocation both to corporate and mortgages securities contributed positively to investment results. In the first half of the year, the allocation to foreign fixed income securities detracted from results. For the latest quarter, the duration decision, reflecting the on-going increase in interest rates, was responsible for the performance shortfall. The other active decisions - the overweighting in mortgages, the neutral weighting in corporates, the allocation to foreign, and the yield curve exposure - were either neutral or mildly positive for investment results.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

In the face of historically high real interest rates, both here and abroad, we have maintained the duration or interest rate sensitivity of your portfolio at about 10% greater than that of your benchmark. Because the level of real interest rates in western European economies is high, we have maintained a 10% commitment to the foreign fixed income markets.

## Miller, Anderson & Sherrerd (con't)

The increase in interest rates over the last twelve months has resulted in a slow-down of mortgage prepayment expectations and in relatively strong performance of the mortgage sector. Consequently, we've cut mortgage holdings to the lowest level in several years, and mortgages represent about 34% of your portfolio. Our holdings are currently focused on adjustable rate mortgages (ARMs), and prepayment-protected mortgages. Consequently, we have significantly less prepayment sensitivity within your portfolio than within the benchmark.

High quality corporate securities are currently fully valued, and we have an exposure slightly below your benchmark weight.

- 3. Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Over the last quarter, we added five investment professionals. No investment professionals left the firm during this period.

Two fixed income accounts were gained in the third quarter, and none lost

- 4. Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

We continue to view medium quality corporate credits as attractive. They offer potential for significant incremental return when included within an overall high grade fixed income portfolio. Where permitted, we have approximately 10% of our client portfolios in such securities. For the last one, three and five years, this strategy has provided about 50 basis points of incremental return for clients who have granted us permission to invest in such securities. We would encourage you to expand your guidelines to allow such securities within your portfolio.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Standish, Ayer & Wood**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$23.7 billion	Actual	0.2%	-4.2%
Total Firm Assets Managed in this Discipline	\$8.1 billion	Benchmark	0.6%	-3.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

**3rd Quarter Commentary**

- For the second quarter the MSBI Account underperformed the Salomon Index by 2 basis points.
  - The MSBI account outperformed the index in July and August but gave back this positive differential in September.
- The MSBI account underperformance was caused by the following:
  - International: Rising yields overseas
  - Duration: The MSBI account duration was slightly longer than that of the index during the third quarter.
- Mortgages outperformed
- Corporates outperformed

**3rd Quarter Bets vs. Benchmark**

**Comment**

International (overweight)

Did not work in the third quarter as interest rates continued to increase in spite of mediocre (at best) economic fundamentals.

Corporate (overweight)

Investment grade and split-rated bond spreads narrowed in the third quarter - a function of lower supply, continued economic growth and earnings improvement.

Mortgages (overweight)

Lower supply helps promote tighter spreads.

Duration

See third quarter commentary.



## Standish (con't)

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets*

Sector	Weighting Strategy	Rationale
Corporates	<u>Overweight</u> Prefer medium quality versus investment grade.	Economy improving. Spreads in medium quality attractive versus investment grade especially in light of improving medium quality credit fundamentals.
Mortgages	<u>Overweight</u>	Demand to exceed supply, rising rates to reduce prepayment risk.
International	<u>Overweight</u> Continue to maintain hedged position	International bond markets have over-reacted relative to underlying economic fundamentals. Selling wave appears to be over. Outlook positive.
Duration	<u>Underweight</u> Currently one tenth of a year <u>under</u> the index	Rate outlook is negative

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

No significant ownership changes to report

Personnel changes: New employees: Richard Davis - Private Client Group

Departing Employee: Robert P. Clancy - Fixed Income Group

Accounts gained/lost: (Year-To-Date)

See attached

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Western Asset Management**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr. Year</b>
Total Firm Assets Under Management	\$12.2 billion	Actual	0.9% -4.1%
Total Firm Assets Managed in this Discipline	\$6.8 billion	Benchmark	0.6% -3.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The portfolio lagged its benchmark modestly in the latest quarter. Underperformance was primarily due to the portfolio's long duration posture in a rising interest rate environment. Although the yield curve flattened last quarter, it was not a significant factor for portfolio returns, as it was only a modest flattening and the portfolio did not have a substantial barbell exposure as in previous quarters. The portfolio benefited from its overweight exposure to mortgages, as somewhat lower interest rate volatility allowed mortgage spreads to narrow, though its emphasis on discount coupon collateral detracted somewhat from performance as this sub-sector trailed the broad mortgage sector. A modest overweighting to corporates contributed to relative returns, as credit spreads narrowed modestly, and selected issues performed well.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

The prospects for economic growth continue to dominate the bond market. Although growth has not moderated to the extent we had anticipated, the economy still does not appear to be in danger of overheating. At the same time, inflation fundamentals, particularly slow growth in all measures of the money supply and on-going corporate restructuring efforts, continue to look quite positive. Although the Fed may be "behind the curve" in the market's estimation, it has taken fairly aggressive measures so far this year to rein in inflation expectations. Consequently, interest rates of all maturities appear quite attractive, justifying a continued long duration posture.

The broad outlines of investment strategy were unchanged last quarter, though there were some minor modifications. Due to the news that, despite higher interest rates, economic growth was continuing at a moderate pace, we reduced our long duration exposure somewhat. Since corporate spreads are approaching fully-valued levels, we are gradually trimming our overweighting to the corporate sector. Mortgage spreads continue to be relatively wide, justifying a continued overweighting to this sector, and particularly to discount coupon collateral with little prepayment risk. We do not have a strong view on the yield curve, but are at times employing tactical strategies to benefit from changes in the shape of the curve in the short and long end.

**Western (con't)**

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

The significant ownership or personnel change was the retiring of Eberle I. Wilson, Jr., Research Analyst

Western Asset added one account. No accounts were lost.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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**Staff Comments**

No comments at this time.

**Manager Commentary**  
**IDS Advisory (IDS Fixed-Income Advisors)**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$20.5 billion	Actual	0.3%	-5.0%
Total Firm Assets Managed in this Discipline	\$4.8 billion	Benchmark	0.5%	-4.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

In the latest quarter and thus far in 1994, investment performance has been essentially in line with the Lehman Brothers Government/Corporate Index. During the quarter there were no major investment changes made. This is evidenced by the fact that the duration of 5.4 years at quarter end differs little from the 5.5 years held in your account at the outset of the period.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We have noted before that we remain convinced that the secular decline in interest rates is intact. However, short-term cyclical forces concern us enough that a less aggressive investment posture has been instituted in your portfolio. We believe that the forces are in place to slow economic activity thereby establishing a stronger base for a renewed decline in interest rates. Until that time, we believe it prudent to remain cautious and to re-deploy the cash raised in your account in the higher interest rate environment we envision.

IDS (con't)

3. *Organizational Issues.* Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.

There have been no significant ownership or personnel changes for IDS Fixed-Income Advisors over the last quarter.

Product	Second Quarter 1994			
	Gains		Losses	
	<u># of Accounts</u>	<u>Assets (\$MM)</u>	<u># of Accounts</u>	<u>Assets (\$MM)</u>
Large Cap Equities	2	44.6	0	0
Fixed Income	1	2.8	0	0
Balanced	3	41.3	0	0
International	2	47.3	0	0
Small Cap Equities	0	0	0	0
Mid Cap Equities	0	0	0	0
Research Core	0	0	0	0
Research Aggressive	0	0	0	0
Global Bonds	0	0	0	0

4. *Other Comments.* Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

None at this time.

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Staff Comments

No comments at this time.

**Manager Commentary**  
**TCW Asset Management**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$49.6 billion	Actual	5.2%	-2.4%
Total Firm Assets Managed in this Discipline	\$7.6 billion	Benchmark	0.9%	-0.9%

1. **Past Performance.** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The mortgage-backed securities sector appears to be recovering slowly following the difficulties encountered this past spring. The CMO sector, after underperforming during the first seven months of the year, stabilized in August and outperformed in September. The TCW strategy emphasizes CMOs and call-protected securities, both of which have underperformed relative to other sectors of the mortgage-backed market. This year has been very difficult for mortgage related investors and our strategy in particular. We are pleased that the third quarter results show a gradual improvement in market conditions, an improvement we view as part of the normal process of a market entering onto the road to recovery.

2. **Future Strategy.** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We continue to emphasize various types of CMO securities that are misvalued by the market. An increase in investor confidence regarding fixed income will have a strong and positive impact on the mortgage-backed securities market and CMO sub-sectors. We are managing portfolios with an eye to exposing holdings particularly in those sub-sectors where recovery can be expected to come first and be most rewarding.

3. **Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There were no significant ownership or personnel changes at the firm in the last quarter. The firm gained three accounts and lost none in this discipline in the last quarter.

## TCW Asset Management (con't)

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

While we are encouraged by the most recent mortgage market developments, we believe that large benefits to be derived from our mortgage strategy will not be felt until mid-1995. By this time the imbalance of supply and demand should swing back very favorably for holders of mortgage securities and CMOs in particular. Also, we expect a leveling of interest rates and a meaningful period of falling yields will emerge no later than this time frame, which would provide the psychological impetus for strong investment flows into fixed income in general and the Government/GNMA mutual fund arena in particular.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Goldman Sachs Asset Management**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr. Year</b>
Total Firm Assets Under Management	\$37.2 billion	Actual	0.5% -2.7%
Total Firm Assets Managed in this Discipline	\$13.5 billion	Benchmark	0.6% -3.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The portfolio outperformed the Lehman Brothers Aggregate Index by 14 bps in the third quarter. Superior security selection and portfolio overweighting in both the corporate and mortgage sectors were primarily responsible.

In the corporate sector, security selection accounted for 7 of the 9 bps added. In particular, spreads on the portfolio's finance securities tightened an average of 10 bps, while average sector spreads tightened just 2 bps. Similarly, the portfolio's Canadian paper tightened about 17 bps while average Yankee spreads tightened 8 bps. The portfolio also benefited from its lack of exposure to utility credits, where spreads did not tighten.

Duration/Term Structure Exposure	-3.0	Asset-backed	0.7
Agency	0.2	Mortgage	7.7
Corporate	9.1	Incremental Yield (OAS)	8.3
		Residual	<u>-8.6</u>
		Total	14.4

Security selection contributed about 4 of the 8 bps gained from mortgages, mainly as a result of the portfolio's overweighting in discount GNMAs and cusp coupon FNMA's in September. The portfolio's inverse floater added about 3 bps over the quarter.

Finally, the portfolio's overweighting in corporates and mortgages helped performance due to the incremental yield and sector spread tightening.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Due to our expectation that volatility will continue in the near term, we are targeting the duration and yield curve exposure of the benchmark.

We are continuing to target a 34% allocation to the corporate sector based on our constructive outlook (strong economy and corporate earnings, investment grade corporate issuance averaged \$5.7 billion monthly YTD 1994, about 42% of 1993 monthly average). Our overweightings continue to be in industrial (cable/media and autos), financial and Canadian credits.



## Goldman (con't)

As mortgages have tightened about 30 bps since the end of the first quarter, much of the mortgage market is currently fairly valued. However, the tightening has been far more significant for higher coupon pass-throughs, while discounts continue to offer attractive spreads. In September we decreased our position in the higher coupons and increased our discount allocation. While we anticipate taking further advantage of opportunities in the discount sector, we may reduce our mortgage allocation (33%) if spreads tighten further.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Alan Shuch, President and Chief Operating Officer of GSAM, recently announced his intention to retire at the end of the current fiscal year and will continue as a consultant during 1995.

There were no changes in the ownership of GSAM.

GSAM had two additions and one loss to our U.S. fixed income portfolio management staff:

- Gains:**
1. Christopher Blume; Associates; Fixed Income Portfolio Analyst
  2. James Clark; Associates; Fixed Income Portfolio Management

- Loss:**
1. Peter Zimmermann; Vice President; Portfolio Manager

**U.S. Fixed Income Accounts Gained: 7**

U.S. Clients	2
Non-U.S. Clients	5

**U.S. Fixed Income Accounts Lost: 0**

U.S. Clients	0
Non-U.S. Clients	0

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Fidelity Management Trust Company**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$22.3 billion	Actual	1.1%	-2.0%
Total Firm Assets Managed in this Discipline	\$5.4 billion	Benchmark	0.6%	-3.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The portfolio outperformed the Lehman Government/Corporate Index by 23 basis points during the quarter. The portfolio's emerging market holdings accounted for most of the strong performance.

Mexican holdings benefited from the successful election of Ernesto Zedillo of the PRI party. The market favored a Zedillo presidency because of his commitment to economic growth currency stability and controlled inflation. The portfolio's allocation to Mexican securities remains high in anticipation of a country upgrade by Standard & Poor's.

The portfolio's continued emphasis in lower quality corporate issues also helped performance. BBB-rated securities outperformed AAA issues by over 50 basis points during the quarter. Credit concerns fell as companies experienced improved earnings. In response, spreads of lower quality issues tightened causing these issues to outperform.

Slowing prepayment expectations, as a result of higher interest rates, caused mortgage-backed securities to perform well during the quarter. Collateralized mortgage obligations, therefore, added to relative portfolio returns.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

**Corporates**

We remain defensive on the corporate market due primarily to valuation. Fundamentals and technicals remain positive.

Primary focus is on building Mexican Yankee positions, special situations, and implementing the "upgrade trade" where appropriate.

## Fidelity Management Trust (con't)

### Mortgages

We are neutral on mortgage pass-throughs which are currently at fair value.

We continue to overweight seasoned pass-throughs when possible. They have superior convexity to newer issue pass-throughs.

### Yield Curve

Have recently moved from having a bulleted term structure exposure to a more neutral one-will lock for opportunities to re-establish the bullet bet.

Some of the factors that influenced this trade were supply in the front end of the yield curve, defeasance demand in the long end and heightened market fears of further Fed tightening.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

FMTC lost two Targeted Active Management fixed income accounts:

1. The UGI Corporation (\$22.5 million) left due to Investment Management Fees.
2. Kansas Gas & Electric left due to a plan reallocation of assets (\$23.0 million).

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Lincoln Capital Management Company**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$26.2 billion	Actual	0.6%	-3.0%
Total Firm Assets Managed in this Discipline	\$9.1 billion	Benchmark	0.6%	-3.1%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

	<b>3rd Quarter 1994</b>		<b>12 Months Ended 9/30/94</b>	
		<b>Value</b>		<b>Value</b>
	<b>Active Strategy</b>	<b>Added</b>	<b>Active Strategy</b>	<b>Added</b>
Mortgages	Overweighted	+0.01%	Overweighted	+0.09%
Corporates	Neutral	0.00	Neutral	0.00
BBBs	Neutral	0.00	Underweighted	0.00
Asset-Backeds	Overweighted	+0.01	Overweighted	+0.05
Agencies	Overweighted	0.00	Overweighted	0.00
<b>Miscellaneous</b>				
Rebalancing Transaction Cost	N/A	-0.01%	N/A	-0.04%
Security Selection	N/A	<u>+0.01</u>	N/A	<u>+0.10</u>
<b>Total</b>		<b>+0.02%</b>		<b>+0.20%</b>

The mortgage overweighting helped the portfolio due to the yield advantage and modest spread narrowing. Security selection explains the balance of the return difference between the portfolio and the index. Due to the short relative duration, the mortgage sector again outperformed both Governments and corporates during the quarter.

**Lincoln (con't)**

2. **Future Strategy.** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

<b>Future Strategy</b>	<b>Strategy</b>	<b>Rationale</b>
Government Trust Certificates	Overweighted vs Treasuries	1. Government Guarantee 2. Attractive Yield 3. Certain Cash Flow
Asset-Backed	Overweighted vs Treasuries and Corporates	1. High Quality 2. Attractive Yield 3. Low Event Risk 4. Low Prepayment Risk
Discount 15 year Mortgages	Overweighted vs Treasuries	1. Agency Quality 2. Low Prepayment Risk 3. Wide Nominal Spreads 4. Deferred Settlement

3. **Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

	<b>Number</b>	<b>Market Value (\$ millions)</b>
Accounts Gained	2	550
Accounts Lost	0	N/A

There were no personnel changes

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

There are no issues or developments that would impact the SBI account.

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**Staff Comments**

No comments at this time.

**Manager Commentary**  
**Baring Investment Services**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$10.8 Billion	Actual	4.3%	18.5%
Total Firm Assets Managed in this Discipline	\$ 1.1 Billion	Benchmark	0.1%	9.8%

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The following figures give a breakdown of this quarter's performance:

	<b>Total Return</b>	<b>Currency</b>	<b>Market Weighting</b>	<b>Tracking Error</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Minnesota State Board	4.4	1.3	3.0	---
Benchmark	0.1	1.1	-0.1	---
Relative Return	4.3	0.2	4.0	---

Your relative outperformance of 4.3% is a result of good country selection, adding 4.0%; and positive currency management, adding 0.1%; and a neutral tracking error. As was the case last quarter, the US Dollar was weak against most other currencies. In this period, the Dollar appreciated against Yen and the Mexican Peso. This resulted in the absolute currency effect being positive. Within your portfolio, the relative outperformance from currency selection was due mainly to the hedge out of the Japanese Yen back into the US Dollar. In your portfolio, local market returns ranged from +20.2% for Korea to -5.0% for Japan, with the MSCI EAFE Free returning -0.9%. The main contributors to your relative outperformance were the continued underweighting in Japan, which was the quarter's worst performing equity market; the continued overweighting of both Hong Kong and Singapore; and exposure to the non index countries of Mexico, South Korea and Thailand.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

The main features in your portfolio are:

Significantly overweight in Singapore;  
Underweight in Japan;  
Continued underweight in Continental Europe;  
Exposure to the non-index markets of Thailand and Mexico;  
12% hedge back into the US Dollar from the Japanese Yen.

South East Asian growth continues to surprise many forecasters, both in terms of GDP and corporate profitability. During the second quarter in Singapore the economy expanded at an annualized rate of 9.3%, whilst inflationary pressures eased, allowing the government to reduce the forecast inflation rate for 1994 to 3.5%. Strong earnings growth, cheap valuation and abundant liquidity lead to a heavy overweighting.

## Baring (con't)

Japan now looks as though, for the first time in four years, it can achieve positive earnings momentum. The economy is showing some signs of life. In June, car sales showed positive year-on-year growth for the first time in 15 months: Consumer goods saw strong demand during the summer months as the unusually hot weather prompted purchases of a wide variety of goods, from air conditioners to beer! Political and market reform will continue at a slow pace. These changes are significant, but are not sufficient enough to change our conviction that the market is discounting a substantial recovery in earnings which we believe will turn out to be disappointing.

Our focus in Europe is on the core economics of Germany, France and The Netherlands where economic growth is accelerating and corporate restructuring will lead to positive earnings surprises. We remain cautious in the peripheral markets of Europe, particularly Scandinavia, where macro economic fundamentals continue to look poor.

The outlook for emerging economies continues to be excellent as economic growth accelerates worldwide and this group of economies benefits from the growth of world trade. Our focus remains on Mexico, Thailand and Korea, where we see strong growth at attractive valuations. The Japanese government continues to face relentless pressure from President Clinton's administration, in an effort to open Japanese markets to foreign competition. This political pressure, and the reluctance of Japanese financial institutions to invest funds overseas, has resulted in the Japanese Yen showing only slight weakness. In the face of the Yen's extreme over valuation, your portfolio's hedge out of the Yen and into the US Dollar has been increased to 12%.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

**Accounts Gained**  
New York State Teachers

**Accounts Lost**  
None

**Personnel Changes:**

- No leavers
- Joiners: W. Nishimura - Japanese Specialist  
A. Klapka - Latin American Specialist

4. *Other Comments.*

None.

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## Staff Comments

Performance attribution from State Street Analytics confirm the data in #1. State Street shows that hedging activity contributed 0.1 of the 0.2 relative currency return.

**Manager Commentary**  
**Brinson Partners, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$35.8 Billion	Actual	2.0%	7.6%
Total Firm Assets Managed in this Discipline	\$ 6.9 Billion	Benchmark	0.1%	9.8%

1. *Past Performance.* Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?

Market allocation was positive in the third quarter due to the 12% underweight in Japan which was one of the weakest markets. The overweight in Canada also added value as this market's 9.1% hedged return was one of the strongest. Overweights in Australia, New Zealand and the U.K. were also beneficial. These were partially offset by underweights in several Southeast Asian markets (Malaysia, Singapore and H.K.), which staged strong rebounds in the third quarter. All three markets were also strong during the 12 month period, rising on average over 25% in hedged terms; underweighting these markets was the principal cause of negative market allocation for the year just ended. For the quarter, currency allocation was a strong positive, helped by the weak yen and the strong Canadian dollar, but hurt somewhat by the weakness of the U.S. dollar. Over the past year the yen position has been substantially reduced and is now importantly underweight at 32% below the benchmark. The relative strength of the yen and weakness in both the Canadian and U.S. dollars were significantly negative factors.

2. *Future Strategy.* What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.

At the end of September, the allocation to Japan was 12% below the benchmark weight. Although the valuations for Japan have improved, the market has risen strongly and prices have gotten ahead of value. It also appears that the deterioration in capital investment may have ended, but this sector is unlikely to regain strength in the near term. On the other hand, the problems of excess capacity, over capitalized balance sheets, a weakened banking sector and a strong yen are likely to continue to exert downward pressure on the economy.

Within the All Other Markets segment, the portfolio has been overweighted in several of the Anglo-Saxon markets that have been experiencing a healthy recovery, as well as a few others that display relatively attractive price/value relationships. These markets include Australia, Canada, Belgium, New Zealand and the Netherlands. The large underweight in Germany was recently scaled back as evidence has surfaced of a healthy revival in exports, particularly to Southeast Asia, where a growing demand for capital goods and the strong yen has allowed German companies to compete against their Japanese peers. Although the portfolio's exposure to Hong Kong was recently increased, it remains a moderate underweight. On a relative basis, the valuations for this market remain unattractive in view of the market's exceptional performance in 1993 and ongoing risks of an overheated Chinese economy and an uncertain political situation. A neutral weight in Italy reflects the improvements in corporate profitability that should result from the economic and political reforms currently underway, as well as the surge in exports resulting from the sharp depreciation of the lira.

The portfolio modestly reduced its strategic cash position from 10% to 9%, which is just below the maximum of the normal range of 0-10%. These funds were used to reduce the size of the



## Brinson (con't)

German underweighting. The large strategic cash position reflects our view that most non-U.S. equity markets are overvalued, albeit to varying degrees. There is a minimal exposure to the overvalued ERM currencies, which have recently become even more expensive. To offset these underweights, the portfolio maintains a 20% allocation to the Canadian dollar and a 26% position in the U.S. dollar, both overweight positions. The Canadian dollar is trading below fair value and also offers to a U.S. based investor a positive short-term cash differential.

**3. Organizational Issues.** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

On August 31, 1994, Brinson Partners, Inc. and Swiss Bank Corporation announced an agreement in principal to combine their respective investment management organizations into a single investment management business to be managed by Brinson Partners, Inc. The transaction is expected to be completed in early 1995, subject to various regulatory approvals to be sought by Swiss Bank Corporation. The most critical element in Brinson Partners, Inc.'s decision was the ability to remain a completely independent organization within Swiss Bank Corporation, enabling the firm to preserve the integrity of its investment process and management structure. Brinson Partners, Inc. will have direct control of the combined investment operation and Gary P. Brinson, CFA, will be the Chief Investment Officer and Chief Executive Officer. During the second quarter of 1994, non-U.S. equity mandate portfolios showed the following changes:

Gained:	1 accounts	\$30 million
Lost:	0 accounts	0 million

**4. Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None of significance in this quarter.

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### Staff Comments

Staff understands that Brinson's purchase by Swiss Bank was based on Brinson's ability to remain independent. Staff will monitor the situation to ensure that neither their independence nor investment approach changes. Performance attribution relative to EAFE for the quarter is shown below:

	Jul. -Sep. 1994
Country selection*	1.23
Stock selection*	0.28
Currency effect	0.18
Hedging activity	0.23
<b>Total Value Added to EAFE</b>	<b>1.93</b>

Source: State Street Analytics \* in local currency

**Manager Commentary**  
**Marathon Asset Management**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$2.1 Billion	Actual	1.5%	N/A
Total Firm Assets Managed in this Discipline	\$0.7 Billion	Benchmark	0.1%	N/A

1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The portfolio rose 1.5% during the third quarter of 1994 versus a 0.1% rise in the MSCI EAFE Index. Returns were driven by market selection, with the portfolio benefiting from overweightings in soft currency Europe (Finland, Sweden) and the commodity markets of Australia and South Africa, whilst exposure to Japan was reduced early in the quarter. Stock returns during the quarter were broadly neutral reflecting the difficult investing environment as markets struggle to digest the continued weakness in global bonds.

2. ***Future Strategy.** What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Two key developments, bond market weakness and the persistent decline in the dollar, are clearly dominating the current investment climate. On both issues it is worth re-iterating Marathon's stance. We consider that the sharp rise in global real interests is primarily being driven by long term considerations of capital supply and demand rather than cyclical inflationary fears within the developed world, and that the current climatic sell-off in the dollar will force a more realistic pricing of money onto the U.S. Fed. If so, both trends should be nearing turning points: short-term cyclical inflationary concerns in the developed world have been over-exaggerated with specific bottlenecks (particularly in capital-intensive, upstream areas) more than offset by the structural nature of unemployment and the dampening influence of the global redistribution of corporate cash flow (i.e. the multiplier effect will be far more muted than in the previous cycles). Whilst we believe that international interest rates have risen too far too fast, the level of real US interest rates remains too low to restore the competitiveness of dollar assets in the financial markets. It is possible then that rises in US rates may be accompanied by declining international rates; either way the spread between real US and international rates will contract, removing a key factor in recent dollar weakness.

What then are the implications for an international investor? Firstly any dollar rally will be at the expense of US growth, suggesting that one should be reducing exposure to markets offering a high correlation to the US equity market or, at the stock/sector level, a high exposure to the US economy. Secondly, domestic real interest rates in nearly all international markets have over-reacted whilst equity markets have remained largely unaffected; bond returns may hence appear more attractive short-term to investors. Markets are likely then to remain subdued, with such considerations supporting Marathon's country allocation (underweight S.F., Asia, move away from export orientated Europe, maintain exposure to Japan) and reinforcing our heavy stock specific focus, with long term (rather than cyclical or one-off) growth increasingly dominating static value.

### Marathon (con't)

3. **Organizational Issues.** Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.

No personnel changes.

No separate account EAFE mandate clients gained or lost in third quarter

4. **Other Comments.** Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

No comment.

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### Staff Comments

None at this time.

Performance attribution for the quarter relative to EAFE is shown below:

	Jul. -Sep. 1994
Country selection*	1.74
Stock selection*	-0.55
Currency effect	0.26
Hedging activity	0.01
Total Value Added to EAFE	1.47

Source: State Street Analytics      \* in local currency

**Manager Commentary**  
**Rowe Price-Fleming International**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$18.9 Billion	Actual	5.2%	N/A
Total Firm Assets Managed in this Discipline	\$12.6 Billion	Benchmark	0.1%	N/A

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Country allocation was responsible for the outperformance relative to the EAFE index over the quarter. The principle reasons were:

- Underweight in Japan (23% of your portfolio as against 46% of the index); this accounted for one third of the value added.
- Overweight in Latin America (9% of your portfolio); 40% of the value added came from this source with Brazil (2% weighting) and Mexico (5% weighting) particularly helpful.
- Overweight in South East Asia (19% of your portfolio) added the remaining one third of the value added with Malaysia (5% weighting) most beneficial.

Stock selection was neutral over the quarter. A good performance in France was balanced by underperformance elsewhere in Europe while South East Asian outperformance was matched by a small underperformance in Japan. Medium-sized and smaller companies generally underperformed larger companies over the quarter; this was particularly true in Europe and Japan.

Currency hedging had a neutral impact over the quarter. We have further reduced the remaining hedges out of European currencies into the yen to only 2% of your portfolio. We expect these hedges to be closed out completely by the end of the year.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

**Countries** - At the end of the second quarter, we wrote that we felt that pessimism had been overdone and that international markets generally represented good value. Despite the rises seen over the third quarter, we continue to believe that this is the case. The economic cycle outside the USA is only just beginning to turn up and our analysis suggests that growth in areas such as Continental Europe and Japan should not peak until late 1996 at the earliest. In the light of this, we believe that corporate profits are likely to be stronger for longer than the consensus thinks.

The major concern of international equity investors has remained the behavior of local bond markets which have continued to take their lead from the USA. We believe that long-term interest rates are now near peak levels given subdued inflationary expectations world-wide and moderate to high real yields. Equities should be helped by more resilient bond markets over the next year. Finally, valuations continue to look reasonable in most markets with comparisons against bonds most supportive.

## Rowe Price (con't)

This relatively benign overview encourages us to emphasize areas where we believe growth will be strongest and valuations are most acceptable. In particular, we still like the smaller markets of the Pacific and Latin America although we continue to take profits in the former area. In Europe, we are gently increasing exposure to France at the expense of the UK, Belgium and Switzerland. In Japan, we continue to add to reasonably valued stocks in economically sensitive areas but remain daunted by overall valuation levels.

**Stocks** - The sectoral tilt of your portfolio towards the consumer and capital goods sectors has increased further over the quarter funded by a small reduction in financials in which your portfolio is already substantially underweight. Exposure to medium-sized and smaller companies has remained steady over the quarter but is likely to increase further given our optimism on world-wide economic growth as we move into 1995.

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There have been no changes in the ownership of RPFI in the third quarter.

We have added a graduate to our investment team, by the name of Greg Austen. He will be spending the next few months on a graduate trainee scheme and thereafter become more integrated into the investment team.

During the third quarter, RPFI gained one new account with a fully international mandate.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

Proxy voting issues: We will be responding in the very near future to your request for information on our proxy voting policies and procedures.

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## Staff Comments

Performance attribution relative to EAFE for the quarter is shown below:

	Jul. -Sep. 1994
Country selection*	4.01
Stock selection*	0.81
Currency effect	0.37
Hedging activity	-0.12
Total Value Added to EAFE	5.13

Source: State Street Analytics      \* in local currency

**Manager Commentary**  
**Scudder, Stevens and Clark**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$90.0 Billion	Actual	2.3%	N/A
Total Firm Assets Managed in this Discipline	\$7.0 Billion	Benchmark	0.1%	N/A

1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

After trailing the EAFE index throughout the first half of 1994, your portfolio made up some ground in the third quarter. Spearheaded by rising European equity prices, your portfolio posted a gain of 2.3% during the third quarter. The EAFE index, by comparison, managed only a 0.1% gain, dragged down primarily by a 5.3% fall in Japanese equity prices. Weakness of the US dollar enhanced portfolio returns in most European markets, while a minor strengthening of the dollar against the yen slightly worsened the negative returns in the local Japanese market. Since the beginning of the year, your portfolio has posted a cumulative gain of 3.4%, lagging the 8.9% return by the EAFE index.

2. ***Future Strategy.** What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

Our investment strategy continues to evolve around the belief that the world is entering a period of synchronous global growth. In line with this strategy, we increased your portfolio's exposure to economically-sensitive and raw materials-related companies primarily domiciled in Europe. These sectors are highly geared to global expansion and are among the few where we anticipate both volume growth and some pricing leverage.

The fundamental attractiveness of Europe is further enhanced by the fact that many major European companies are in the process of aggressive cost-cutting programs, having recognized the need for massive change in order to survive in the fact of global competition. The benefits of this restructuring, coupled with cyclical upturn, set the stage for potentially explosive profits growth.

The funds for these European purchases came primarily from selected trimming in Japan, where in general the market and the yen have appreciated since the beginning of the year to levels where the relative risk/reward tradeoff (particularly versus Europe) has become much less compelling. Securities that were sold either had reached full relative valuation or were less leveraged to an anticipated reversal in the yen. These tended to be more domestically or consumer-oriented companies.

We also reduced our holdings in selected emerging markets like Mexico and Malaysia. Although we remain very positive on the long-term growth stories for these economies, we feel that much of the near term improvements have already been factored into the markets and some profit-taking was in order.

## Scudder (con't)

3. *Organizational Issues. Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Changes in Personnel:

Added: Joanna Scharf (UK Analyst)

Dan Csuma (European analyst)

Maureen Hays (Int'l portfolio manager - moved over from marketing)

Accounts Gained in this discipline in Q3, 1994: 3

Accounts Lost in this discipline in Q3, 1994 1

\* Note: figures do not factor in clients who joined/left the Int'l Fund or int'l commingled trusts

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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## Staff Comments

None at this time.

Performance attribution relative to EAFE for the quarter is shown below:

	Jul. -Sep. 1994
Country selection*	1.87
Stock selection*	-0.05
Currency effect	0.35
Hedging activity	0.13
Total Value Added to EAFE	2.33

Source: State Street Analytics \* in local currency

**Manager Commentary**  
**Templeton Investment Counsel, Inc.**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$ 42.4 Billion	Actual	5.4%	N/A
Total Firm Assets Managed in this Discipline	\$ 11.5 Billion	Benchmark	0.1%	N/A

1. *Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The third quarter was particularly strong for your portfolio, gaining 5.4% while the EAFE index gained 0.1%. YTD your portfolio has gained 7.5% vs. the EAFE index of 8.9%.

The strength in the quarter was a function of our exposure to chemicals, metals, pulp and paper, and stability from our financial exposure. We are generally overweighted to Europe and underweight Japan. The Japanese market has been very strong in the earlier part of this year, which caused us to lag the EAFE Index. Additionally, emerging markets regained some of their luster during this period. Interest rate fears have settled down and Japan's relative outperformance has slowed, thus permitting us to outperform in the third quarter.

2. *Future Strategy. What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

The Templeton investment process is one of individual stock selection via a value approach. At this time it is highly unlikely that our exposure to Japan would change much. Accordingly, we will maintain an overweight to the European markets. Our exposure to various emerging markets will also remain, although overall mix will change over time.



### Templeton (con't)

3. **Organizational Issues.** Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.

No ownership or personnel changes.

We gained 3 Non-US Equity separate accounts with an inception value of \$73.8 MM. We gained 26 new clients in our Templeton Institutional Funds, Inc. (TIFI)-Foreign Equity Series totaling \$101.0 MM.

We have lost 0 Non-US Equity accounts.

4. **Other Comments.** Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

None.

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### Staff Comments

None at this time.

Performance attribution relative to EAFE for the quarter is shown below

	Jul. -Sep. 1994
Country selection*	4.62
Stock selection*	-1.29
Currency effect	2.12
Hedging activity	0.0
Total Value Added to EAFE	5.53

Source: State Street Analytics      \* in local currency

**Manager Commentary  
State Street Global Advisors**

<b>Period Ending:</b>	<b>9/30/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$132.0 Billion	Actual	0.4%	10.3%
Total Firm Assets Managed in this Discipline	\$ 4.7 Billion	Benchmark	0.1%	9.8%

1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, explain the reasons for the tracking error between the portfolio and the index.*

In the third quarter, the account outperformed the benchmark primarily due to the semi-annual payment of dividends in Japan during September. The account also outperformed the benchmark in several other countries due to significant dividend payments. The account is outperforming this year due to the gain experienced in handling index changes in Japan along with the better dividend withholding tax rate the account has compared to the benchmark.

2. ***Organizational Issues.** Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Organization

State Street Global Advisors has some new developments to share with you. Peter Leahy has assumed the responsibilities of our International Passive Group. Lynn Bogle, on leave after having her first child, has decided to extend her leave until December 31, 1994. Upon her return to Global Advisors in January 1995, we will mutually decide upon the role she will play in continuing her career at State Street Global Advisors. Jeff Davis, Vice President in the Non U.S. Active Equity Group will be spearheading this group's marketing effort and simultaneously enforcing our commitment to a consultative relationship. Jeff will stress the availability of customized strategies, and our desire to offer unique and creative solutions to meet our clients' needs.

Gained and Lost Clients

There have been no clients lost in this discipline during the last quarter. In the last quarter five new clients with over \$100 million in assets joined the EAFE index strategy.

### State Street (con't)

3. *Other comments.* Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

The changes in personnel described above are accompanied by a change in our group's name. The international Passive Group has changed its name to the International Structured Products Group. With the change of name comes a new focus. Passive Funds are tools - Structured Products are solutions. Solutions include advice on how, when and in what form to use the various passive funds. Solutions are finding the best instruments to provide target returns.

We have renewed a very serious R&D effort in structured products. Global investors are asking different questions today than they were even five years ago-benchmark questions, derivative issues, prudence issues-these are different times for institutional investing, and International Structured Products Group is preparing to respond to these changes.

The name change also emphasizes State Street Global Advisors focus on providing indexed and enhanced vehicles in the non-U.S. equity markets. Furthermore, our focus will be to broaden our current services to provide advice and solutions for a wide variety of challenging individual circumstances which our clients face regularly.

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### Staff Comments

Staff will monitor the personnel changes noted in #3. However, at this time, staff is not overly concerned. Stuart Peskin, the back-up/co-manager for the SBI account since its inception, remains with State Street and should provide the necessary continuity.

Performance attribution relative to EAFE for the quarter is shown below:

	Jul. -Sep. 1994
Country selection*	0.00
Stock selection*	0.22
Currency effect	0.07
Hedging activity	0.00
<b>Total Value Added to EAFE</b>	<b>0.28</b>

Source: State Street Analytics      \* in local currency