

**MINNESOTA STATE BOARD  
OF INVESTMENT  
MEETING  
March 15, 1995  
&  
INVESTMENT ADVISORY  
COUNCIL MEETING  
March 14, 1995**

**AGENDA  
STATE BOARD OF INVESTMENT  
MEETING**

**Wednesday, March 15, 1995**

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

**State Capitol - Saint Paul**

**TAB**

- 1. Approval of Minutes of December 14, 1994**
  
- 2. Report from the Executive Director (H. Bicker)**
  - A. Quarterly Investment Review (October 1 - December 31, 1994) **A**
  - B. Portfolio Statistics (December 31, 1994) **B**
  - C. Administrative Report **C**
    1. Budget and travel reports
    2. Board meeting dates for remainder of calendar 1995
    3. Legislative update
  
- 3. Report from the Proxy Committee** **D**
  - A. Reauthorization of delegation of authority on proxy voting
  
- 4. Reports from the Investment Advisory Council (J. Yeomans)**
  - A. Asset Allocation Committee **E**
    1. Discussion of currency management issues
  
  - B. Stock and Bond Manager Committee **F**
    1. Review of manager performance
  
  - C. Alternative Investment Committee **G**
    1. Results of annual review sessions
    2. Approval of commitment to an existing oil and gas manager (SCF Partners)

**Minutes  
State Board of Investment  
December 14, 1994**

**NOT OFFICIAL  
DRAFT**

The State Board of Investment (SBI) met at 8:30 a.m. on Wednesday, December 14, 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 Mr. Dayton introduced State Auditor-Elect Judi Dutcher to the Board members. The minutes of the September 20, 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 had exceeded inflation over the ten year period ending September 30, 1994 (Combined Funds 12.3% vs. Inflation 5.6%), and slightly underperformed the median fund (Combined 8.7% vs. Median 8.8%) for the most recent five years. He added that the Combined Funds had outperformed its composite index (Combined 8.7% vs. Composite 8.4%) over the same five year period. He reported that the Basic Funds had exceeded their composite index (Basics 8.7% vs. Composite 8.4%) over the last five years and said that the Post Fund had matched its composite index for the one and one-quarter year period ending September 30, 1994 (Post 3.7% vs. Composite 3.7%). He reminded members that the Post Fund's new asset allocation had been in place only since July 1, 1993.

Mr. Bicker reported that the Basic Funds' assets increased 2.9% for the quarter ending September 30, 1994 and that the asset mix is basically in-line with policy targets. Mr. Bicker said that the Basic Funds had matched the performance of their composite index at 2.9% for the quarter.

Mr. Bicker reported that the Post Retirement Fund had increased in value by 2.7% during the quarter due to positive investment returns and that the asset mix for the Fund is basically in-line with policy targets. He said the total fund has slightly outperformed its composite index (Post Fund 3.1% vs. Composite 3.0%) for the quarter.

Mr. Bicker stated that the domestic stock manager group had slightly underperformed for the quarter (Domestic Stocks 5.1% vs. Wilshire 5000 5.4%) while the international stock manager group had outperformed its target for the quarter (International Stocks 1.9% vs. EAFE 0.1%). He added that the domestic bond manager group had slightly outperformed its target for the quarter (Domestic Bonds 0.7% vs. Lehman Aggregate 0.6%). In response to a question from Mr. Carlson, Mr. Bicker confirmed that the domestic stock segment had trailed its target over the last three and five year periods (Domestic Stocks

9.6% vs. Wilshire 5000 9.8% over three years; Domestic Stocks 8.5% vs. Wilshire 5000 8.9% over five years.)

Mr. Bicker reported that the Assigned Risk Plan (ARP) had slightly underperformed its composite index for the quarter (ARP 1.6% vs. Composite 1.8%). He reminded members that this was the first quarter that the equity segment had been managed internally. He stated that the equity segment had outperformed its target for the quarter (Equity Segment 5.0% vs. Benchmark 4.9%). He concluded his report with the comment that as of September 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. He informed the Board that the benefit increase for the Post Retirement Fund is 3.985%, payable January 1, 1995. He added that the SBI's 1994 Annual Report will be available for distribution in January 1995 and that 1995 meeting dates for the SBI have been tentatively scheduled.

Mr. Bicker stated that as requested by the Board at the September 1994 meeting, he had prepared some performance comparisons of the SBI's funds versus sixty (60) other large public funds. He reported that for the one year period ending June 30, 1994, the SBI return was 1.8% vs. a median return of 1.6% and top quartile return of 2.9%. He said that for the five year period ending June 30, 1994, the SBI return was SBI 9.5% vs. a median return of 9.3% and a top quartile return of 9.6%. In response to comments from Mr. Carlson and Ms. Growe, Mr. Bicker stated that the SBI's five year return ranked near the top quartile of other large public funds. Mr. Bicker also reported that the SBI's asset allocation policy is basically in-line with several other large public funds, although the SBI's domestic and international stock allocations are slightly higher than the average while the SBI's domestic bonds, international bonds and alternative investments allocations are slightly lower than the average. In response to a question from Mr. Dayton, Mr. Bicker confirmed that the SBI's target allocation for alternative investments is up to 15% and he reminded members that the actual allocation is currently low and will be increasing as alternative investments are made for the Post Retirement Fund.

Mr. Bicker stated that he had prepared a brief presentation on derivatives, as requested by Mr. Humphrey. He said the request was timely due to recent events involving derivatives at Piper Capital Management, a local firm, and in Orange County California. Mr. Bicker explained that the reported losses were due, in large part, to leveraging. He assured members that even though they do contain some derivative investments, the SBI's portfolios had not been leveraged. He emphasized that the SBI's cash portfolios use no derivatives and no leverage. He went on to define and categorize derivative securities and he reported that out of \$23 billion in assets, the SBI has a \$12 million net position in traditional derivatives such as S&P stock futures. He said that the SBI had \$2 billion in other derivative securities, most of which is mortgage backed securities that are rated by nationally recognized rating agencies and trade like traditional corporate or government bonds.



Mr. Bicker stated that the SBI uses derivatives to provide liquidity, to reduce costs associated with trading underlying securities, and to hedge currency risk in the international equity segment. He said that if used properly, derivatives should reduce risk, not increase it. He added that the SBI uses mortgage backed derivatives to enhance bond returns and he added that all of the SBI's manager contracts prohibit leveraging. Mr. Bicker stated that problems with derivatives can also occur when used in short term cash management if the portfolio holdings are not matched with the portfolio's liability structure.

He said that many reforms to the derivatives market are being considered and that he will keep the Board informed of changes as they take place. Mr. Bicker emphasized that staff feel its important for the SBI to maintain its ability to invest in derivatives. In response to a question from Mr. Humphrey, Mr. Bicker said that the managers' portfolios are monitored on a monthly basis to insure that the portfolios are not being leveraged. Mr. Dayton commended the staff for using good judgment in avoiding the problems other funds had encountered. Mr. Humphrey commented that he feels it is important for Mr. Bicker to inform and educate the Legislature about the nature of derivatives. Mr. Bicker stated that it will be necessary for him to testify before several committees and that he would like to confirm that Board's position is that the SBI should continue to use derivatives in the same manner described above. Mr. Carlson agreed stating that there had been no motion to the contrary.

#### **Investment Advisory Council Appointments**

Mr. Sausen reported that a Review Committee for Investment Advisory Council (IAC) membership has been formed to review the reappointment of four members and to fill two of three vacancies currently on the IAC. Mr. Bicker distributed a report from the Committee (see Attachment A). Mr. Sausen stated that the Committee is recommending that the Board reappoint John E. Bohan, Malcolm W. McDonald, Gary R. Norstrom, Jan Yeomans and appoint Daralyn Peifer and Michael Stutzer to the IAC. Mr. McGrath moved approval of the Committee's recommendation, as stated in the Committee Report. Ms. Growe seconded the motion. The motion passed.

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

Mr. Sausen reported that the Deferred Compensation Review Committee had issued a request for proposal (RFP) to select vendors to provide annuity products for the Individual Retirement Account Plan (IRAP) and the College Supplemental Retirement Plan which will be merged into the Higher Education Board on July 1, 1995. He stated that out of the seven insurance companies that responded to the RFP, three companies did not meet the minimum criteria outlined in the RFP. Mr. Sausen said that the Committee is recommending TIAA-CREF, VALIC, Great West and Minnesota Mutual as product providers for the Higher Education Plans, and that the contract terms be based on the terms set forth in the RFP. Ms. Growe moved approval of the Committee's recommendation, as stated in the Committee Report which reads: "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." Mr. Dayton seconded the motion. The motion passed.

#### **Semi-Passive Domestic Stock Manager Search Committee**

Mr. Sausen referred members back to Tab D of the meeting materials. He reported that the Committee had interviewed nine semi-passive domestic stock management firms and had initially recommended Franklin Portfolio Associates, Wells Fargo Nikko Investment Advisors, and Fidelity Management Trust for the retirement funds and GE Capital Management for the Assigned Risk Plan. He said that after an unsuccessful discussion on fees with Fidelity, the consensus of the Committee was to replace Fidelity with J.P. Morgan. In response to a question from Mr. Carlson, Mr. Bicker said that the addition of the semi-passive stock component will result in approximately 90% of the enhancement strategies for the funds being in place. Mr. McGrath moved approval of the Committee's recommendation, as stated in the Committee Report which reads: "The Committee recommends that the SBI authorize the executive director, with assistance from SBI legal counsel, to negotiate and execute contracts with the following semi-passive domestic equity managers: Franklin Portfolio Associates, Boston, MA, Retirement Funds; J.P. Morgan, New York, NY, Retirement Funds; Wells Fargo Nikko Investment Advisors, San Francisco, CA, Retirement Funds; GE Capital Management, Stamford, CT, Assigned Risk Plan." Mr. Dayton seconded the motion. The motion passed.

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

Ms. Yeomans referred members to Tab F of the meeting materials and noted the domestic stock manager performance for the year had been somewhat disappointing, as reported earlier by Mr. Bicker. She said the bond managers performed well against their benchmark and that the international stock managers had also performed very well.

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

Ms. Yeomans reported that the Committee is recommending a commitment reduction of one half of the SBI's commitment to the IMR Fund, from \$30 million to \$15 million. In response to a question from Mr. Dayton, Ms. Yeomans said that the manager has been unable to find appropriate investments for the original commitments. Mr. Bicker noted that the action to reduce the commitment was initiated by the manager/general partner. Ms. Grove moved approval of the Committee's recommendation, as stated in the Committee Report which reads: "The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to execute a commitment reduction of one half of the SBI's commitment to the IMR Fund, from \$30 million to \$15 million." Mr. Humphrey seconded the motion. The motion passed. In response to a question from Mr. Carlson, Ms. Yeomans stated that other managers have been able to find good investment opportunities and she suggested that the IMR Fund may be looking for specific types of investments that are not present at this point in time.

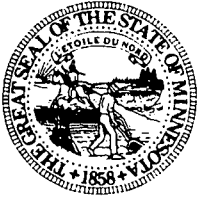
Mr. McGrath commended Mr. Dayton for his service on the Board. Mr. Carlson agreed.  
The meeting adjourned at 8:55 a.m.

Respectfully submitted,

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

Howard J. Bicker  
Executive Director

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

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**DATE:** December 14, 1994

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

**FROM:** Review Committee for IAC Membership

**SUBJECT: Investment Advisory Council Appointments**

The 17 member Investment Advisory Council (IAC) advises the Board and staff on investment related matters. The Board appoints ten members experienced in finance and investment. These members traditionally have come from the Minneapolis and St. Paul corporate investment community. The Commissioner of Finance and the Executive Directors of the three statewide retirement systems are permanent members of the IAC. Two active employee representatives and one retiree representative are appointed by the Governor.

The members appointed by the Board serve four year terms. The terms of four of these members are up for renewal in January 1995. In addition, there are three vacancies. An announcement of the vacancies was published in the State Register. After reviewing the applications received for membership to the IAC, (attached for Board review), the Review Committee, comprised of a representative from each Board member is recommending the following.

The Committee's original recommendation included Mr. Wayne Wicker, Manager of Pensions at Dayton's, for the final position. Mr. Wicker has recently resigned. The Committee will reconvene in 1995 to make a new recommendation to the Board.

**RECOMMENDATION:**

The Review Committee recommends that the Board reappoint to the IAC John E. Bohan, Malcolm W. McDonald, Gary R. Norstrom and Jan Yeomans and appoint Daralyn Peifer and Michael Stutzer to the IAC. Each will serve four year terms beginning January 1995.

**AGENDA**  
**INVESTMENT ADVISORY COUNCIL**  
**MEETING**  
**Tuesday, March 14, 1994**  
**2:00 P.M. - SBI Conference Room**  
**Room 105, MEA Building - Saint Paul**

- |  | <b>TAB</b> |
|--|------------|
| <b>1. Approval of Minutes of December 13, 1994</b>                             |            |
| <b>2. Report from the Executive Director (H. Bicker)</b>                       |            |
| A. Quarterly Investment Review (October 1 - December 31, 1994)                 | <b>A</b>   |
| B. Portfolio Statistics (December 31, 1994)                                    | <b>B</b>   |
| C. Administrative Report   | <b>C</b>   |
| 1. Budget and travel reports   |            |
| 2. Board meeting dates for remainder of calendar 1995                          |            |
| 3. Legislative update  |            |
| <b>3. Report from the Proxy Committee</b>                                      | <b>D</b>   |
| A. Reauthorization of delegation of authority on proxy voting                  |            |
| <b>4. Reports from the Investment Advisory Council</b>                         |            |
| <b>A. Asset Allocation Committee (J. Yeomans)</b>                              | <b>E</b>   |
| 1. Discussion of currency management issues                                    |            |
| <b>B. Stock and Bond Manager Committee (J. Bohan)</b>                          | <b>F</b>   |
| 1. Review of manager performance   |            |
| <b>C. Alternative Investment Committee (D. Veverka)</b>                        | <b>G</b>   |
| 1. Results of annual review sessions   |            |
| 2. Approval of commitment to an existing oil and gas manager<br>(SCF Partners) |            |

**Minutes  
Investment Advisory Council  
December 13, 1994**

**NOT OFFICIAL  
DRAFT**

The Investment Advisory Council (IAC) met on Wednesday, December 14, 1994 at 2:00 P.M. in the State Board of Investment (SBI) Conference Room, 55 Sherburne Avenue, St. Paul.

**MEMBERS PRESENT:** Gary Austin; John Bohan; Jim Eckmann; Ken Gudorf; Laurie Fiori Hacking; Keith Johnson; J. Peter Kiedrowski; Laura King; Han Chin Liu; Malcolm McDonald; Gary Norstrom; Barbara Schnoor; and Jan Yeomans.

**MEMBERS ABSENT:** Dave Bergstrom; and Debbie Veverka;

**SBI STAFF:** Howard Bicker; Beth Lehman; Jim Heidelberg; Dan Egeland; Karen Vnuk; Debbie Griebenow; Charlene Olson and Linda Nadeau.

**OTHERS ATTENDING:** Ann Posey and Jeff Bailey, Richards & Tierney; Judy Hunt, Public Employees Retirement Association; Daralyn Peifer, General Mills, Inc.; Michael Stutzer, Carlson School of Management; Ed Burek, Legislative Commission on Pensions and Retirement; Julie Bleyhl, AFSCME; Christie Eller; Jake Manahan; Peter Sausen; Elaine Voss; Robert Whitaker; Mike Ousdigian; John Hagman and Ed Stuart.

Ms. Yeomans began the meeting by introducing and welcoming the two candidates being recommended to the Board to fill two of the three IAC vacancies: Daralyn Peifer, currently with General Mills, and Michael Stutzer, currently on the faculty of the University of Minnesota. Mr. Bicker added that a third candidate, Wayne Wicker, became unavailable to serve on the IAC when he accepted a position outside the Twin Cities area. He said the Review Committee would reconvene in 1995 to recommend a candidate for the remaining open position. He noted that the terms of the three Governor's appointees (currently Barbara Schnoor, Keith Johnson and Han Chin Liu) also expire in January 1995 and that the Governor will decide on their reappointment. He added that the Board will decide on the reappointments of Jan Yeomans, Gary Norstrom, Malcolm McDonald and John Bohan. Mr. Sausen also introduced Laura King, the new Commissioner of Finance, to members of the IAC.

The minutes of the September 19, 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 had exceeded inflation over the ten year period ending September 30, 1994, and slightly underperformed the median fund (Combined 8.7% vs. Median 8.8%) for the most recent five years. He added that the Combined Funds had outperformed the composite index (Combined 8.7% vs. Composite 8.47%) over the same five year period. He reported that the Basic Funds had also exceeded their composite index over five years (Basics 8.7% vs. Composite 8.4%) and that the Post Fund had matched its composite index at 3.7% for the 1.25 year period ending September 30, 1994. He reminded members that the Post Fund's new asset allocation had been in place only since July 1, 1993. He stated that updated actuarial data will be available in the March 1995 materials.

Mr. Bicker reported that the Basic Funds' assets increased 2.9% for the quarter ending September 30, 1994 and that the asset mix is basically in-line with policy targets. Mr. Bicker said that the Basic Funds had matched the performance of their composite index at 2.9% for the quarter.

Mr. Bicker reported that the Post Retirement Fund had increased in value by 2.7% during the quarter due to positive investment returns and that the asset mix for the Fund is basically in-line with policy targets. He said that while domestic and international stock allocations are slightly above their targets, they do not require rebalancing at this time. He said the total fund has slightly outperformed its composite index (Post Fund 3.1% vs. Composite 3.0%) for the quarter.

Mr. Bicker stated that the domestic stock manager group had slightly underperformed for the quarter (Domestic Stocks 5.1% vs. Wilshire 5000 5.4%) while the international stock manager group had outperformed its target for the quarter (International Stocks 1.9% vs. EAFE 0.1%). He added that the domestic bond manager group had slightly outperformed its target for the quarter (Domestic Bonds 0.7% vs. Lehman Aggregate 0.6%).

Mr. Bicker reported that this was the first quarter that the Assigned Risk Plan's (ARP's) equity segment was managed internally. He noted that the segment had a slightly positive tracking error for the quarter (Equity Segment 5.0% vs. Benchmark 4.9%). He said that the total fund had slightly underperformed its composite index for the quarter (ARP 1.6% vs. Composite 1.8%) due to underperformance by the bond segment (Bond Segment 0.7% vs. Benchmark 1.0%). He said that as of September 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. He informed the IAC that the benefit increase for the Post Retirement Fund is 3.985%, payable January 1, 1995. He added that the SBI's 1994 Annual Report will be available for distribution in January 1995 and he presented the tentative IAC meeting dates for 1995.

Mr. Bicker reported that as requested by the Board at its September 1994 meeting, he had completed a report comparing the SBI's performance and asset allocation to that of other large statewide public funds. He said that for the year ending June 30, 1994, the SBI had outperformed the median of this universe (SBI 1.8% vs. Median 1.6%) and was slightly below the top quartile return for the five year period (SBI 9.5% vs. Top Quartile 9.6%). He stated that in comparing asset allocation levels of funds in the study, the SBI is positioned slightly higher than average in domestic and international stocks and slightly lower in international bonds and alternative investments. He said that he believes that SBI's asset allocation is very similar to allocations in what he considers the better public funds throughout the United States.

Mr. Bicker stated that the remainder of his Executive Director's Report involves his presentation on derivative securities. He reported that in the State's cash accounts there are no derivatives and no leverage. He noted that for the purpose of this report, staff had used the broadest definition of the term "derivative". He reported that as a result, the retirement funds do have exposure of approximately \$2 billion in derivative securities, mostly from mortgage backed securities. He said that the \$2 billion is approximately one-third of the SBI's bond portfolio, which is right in-line with the exposure of the entire bond market. He emphasized that the majority of the funds which are experiencing tremendous losses now are the ones that had used leverage in their portfolios. He said that the SBI's portfolios had not been leveraged because of staff's belief that leverage constitutes undue risk. In addition, he said that the Attorney General's Office has raised questions about the constitutionality of incurring such leverage which could be construed as debt. He also noted the potential problem of the SBI receiving unrelated business income, which could jeopardize the SBI's tax-exempt status. He reviewed the remaining derivatives materials and said that he hopes to receive an endorsement from the Board stating that the SBI should maintain its current derivatives strategy. He said he believes it is important for the SBI to take a position on this issue since some type of legislation regarding derivatives is likely to take place during the 1995 legislative session. He asked for comments on this issue from IAC members so that Ms. Yeomans could pass them along to the Board.

Mr. Bohan suggested that the SBI initiate statutory language to reflect its current derivative philosophy, rather than risk having someone else create a total prohibition. Mr. Bicker explained that such an approach would be difficult since the investment authority laid out in statute is different for the various entities (i.e. cities, counties, the SBI funds, Minneapolis Teachers, Duluth Teachers, Minneapolis Employees Retirement Fund, etc.). Mr. Bicker agreed with Mr. Bohan, however, that the SBI needs to be prepared to respond to all potential legislation.

Mr. Han Chin Liu referred members back to the material relating to performance and asset allocation comparison and suggested adding individual plan performance data. Mr. Bicker said that specific plan returns are not available.



In response to a question from Ms. King, Mr. Bicker stated that he had not been invited to participate in discussions regarding investment policies for city and county funds recently. Mr. Norstrom commented that he understood that a task force or committee was working with the Office of the State Auditor to draw up appropriate language. In response to a question from Mr. McDonald, Mr. Bicker said he would like to receive formal affirmation of the SBI's current derivative philosophy. Ms. Hacking moved approval of the SBI's use of derivatives, as presented at the meeting and in the meeting materials. Mr. McDonald seconded the motion. Ms. Yeomans emphasized that the motion would be limited to the current use of derivatives within the context of the current funds under the SBI's control. The motion passed.

Mr. Bicker announced that this meeting is Mr. Eckmann's last meeting as an IAC member and he thanked Mr. Eckmann for his years of service on the IAC.

#### **Semi-Passive Domestic Stock Manager Search Committee Report**

Mr. Sausen reported that the Semi-Passive Domestic Stock Manager Search Committee had interviewed nine firms that were candidates for the semi-passive domestic stock program for the Basic and Post Retirement Funds and the Assigned Risk Plan. He said that the Committee had initially recommended Franklin Portfolio Associates, Wells Fargo Nikko Investment Advisors, and Fidelity Management Trust for the retirement funds and had recommended GE Capital Management for the Assigned Risk Plan. He said that after an unsuccessful discussion of fees with Fidelity, the consensus of the Committee had been to replace Fidelity with J.P. Morgan. Mr. McDonald moved to endorse the Committee's recommendation, as stated in the Committee Report. Mr. Han Chin Liu seconded the motion. Mr. Norstrom noted that the Stock and Bond Manager Committee had also discussed the search and that the Committee supports the Search Committee's recommendation. The motion passed.

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

Mr. Sausen reported that the Deferred Compensation Review Committee had issued a request for proposal (RFP) to select vendors to provide annuity products for the Individual Retirement Account Plan (IRAP) and the College Supplemental Retirement Plan which will be under the jurisdiction of Higher Education Board, effective July 1, 1995. He said that out of the seven firms that responded to the RFP, three did not meet the minimum requirements outlined in the RFP. Mr. Sausen said that the Committee is recommending TIAA-CREF, VALIC, Great-West and Minnesota Mutual as product providers for the Higher Education Plans, and that the contract terms should be based on the terms set forth in the RFP. Mr. Bicker noted that the legislation authorizing this search allowed for up to five vendors to be selected and that the Committee had agreed to recommend only the four that met the criteria. Mr. McDonald moved to endorse the Committee's recommendation, as stated in the meeting materials. Mr. Kiedrowski seconded the motion. The motion passed. In response to a question from Ms. Yeomans, Mr. Bicker said that Prudential did not meet the minimum credit rating since they had recently been downgraded to AA.

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

Mr. Bohan discussed the performance of the stock and bond manager groups, noting that much of the stock managers' recent underperformance was due to being overweighted in the financial and consumer durables sectors, which performed poorly, while being underweighted in the consumer non-durable sector which performed well. He noted that the bond segment outperformed for the quarter but had underperformed for the year, due in part to the managers having a slightly longer duration than the Lehman Aggregate. He said the international stock segment performance was very good for all reporting periods. Mr. Bohan also added that the performance of several individual managers had been discussed by the Committee but that no action was required or taken.

### **Alternative Investment Committee Report**

Ms. Yeomans asked Mr. Gudorf to present the Alternative Investment Committee Report in Ms. Veverka's absence. Mr. Gudorf reported that during the quarter a review had taken place with Matrix Partners. He said that their second fund had performed well, however, he noted that the SBI has decided not to proceed with the approval process for their third fund due to an increased fee structure established by Matrix.

Mr. Gudorf reported that the Committee is recommending a commitment reduction of one half of the SBI's commitment to the IMR Fund, from \$30 million to \$15 million. He noted that this recommendation had come from the general partner and he moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. Kiedrowski seconded the motion. The motion passed.

In response to a question from Mr. Bohan, Mr. Bicker clarified that on Page IV of the meeting materials, the correct wording regarding the investment management of the Assigned Risk Plan is that Voyageur manages the fixed income portfolio and that SBI staff currently manage the equity segment of the plan. He added that a recommendation is currently before the Board to have GE Capital manage the equity segment using a semi-passive approach, effective January 1, 1995.

The meeting adjourned at 3:00 p.m.

Respectfully submitted,



Howard J. Bicker  
Executive Director

# Tab A

## RETURN OBJECTIVES

### Period Ending 12/31/94

COMBINED FUNDS: \$	Billion	Return	Compared to Objective
<b>Provide Real Return (10 yr.)</b>		<b>11.9% (1)</b>	<b>8.3 percentage points above target</b>
Provide returns that are 3-5 percentage points greater than inflation over moving 10 year periods.			
<b>Exceed Median Fund (5 yr.)</b>		<b>8.4% (1)</b>	<b>At target Rank: 50th percentile (2)</b>
Outperform the median fund from a universe of public and corporate funds with a balanced asset mix over moving 5 year periods.			
<b>Exceed Composite Index (5 yr.)</b>		<b>8.4% (1)</b>	<b>0.4 percentage points above target</b>
Outperform a composite market index weighted in a manner that reflects the actual asset mix of the Combined Funds over moving 5 year periods.			

BASIC RETIREMENT FUNDS: \$	Billion	Return	Compared to Objective
<b>Exceed Composite Index (5 Yr.)</b>		<b>8.5%</b>	<b>0.3 percentage points above target</b>
Outperform a composite index weighted in a manner that reflects the long-term asset allocation of the Basic Funds over moving 5 year periods.			

POST RETIREMENT FUND: \$	Billion	Return	Compared to Objective
<b>Exceed Composite Index</b>		<b>2.7% (3)</b>	<b>0.2 percentage points below target (3)</b>
Outperform a composite index weighted in a manner that reflects the long-term asset allocation of the Post Fund over moving 5 year periods.			

(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, 1994

	Active (Basics)	Retired (Post)	Total (Basics & Post)
<b>Liability Measures</b>			
1. Current and Future Benefit Obligation	\$16.5 billion	\$7.5 billion	\$24.0 billion
2. Accrued Liabilities	11.7	7.5	19.2
<b>Asset Measures</b>			
3. Current and Future Actuarial Value	\$15.7 billion	\$7.5 billion	\$23.2 billion
4. Current Actuarial Value	8.0	7.5	15.5
<b>Funding Ratios</b>			
Future Obligations vs. Future Assets (3 ÷ 1)	95%	100%	97%
Accrued Liabilities vs. Current Actuarial Value (4 ÷ 2)	68%	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 **82%** for the Basics, **100%** for the Post and **90%** 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**

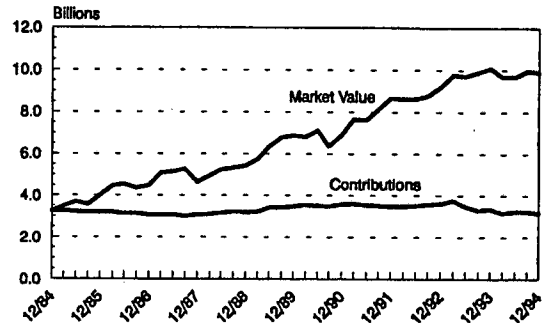
**Asset Growth**

The market value of the Basic Funds decreased 0.8% during the fourth quarter of 1994. Negative net contributions and investment return accounted for the decrease during the period.

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

Beginning Value  
 Net Contributions  
 Investment Return  
 Ending Value

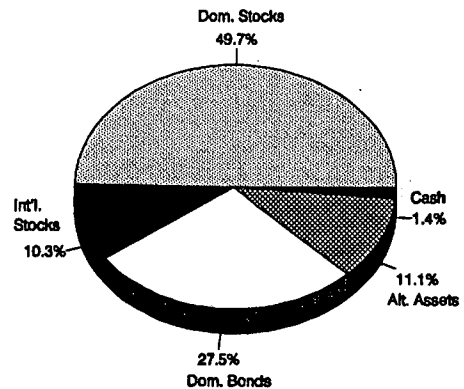
\$9,968  
 -65  
 -13  
 \$9,890



**Asset Mix**

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

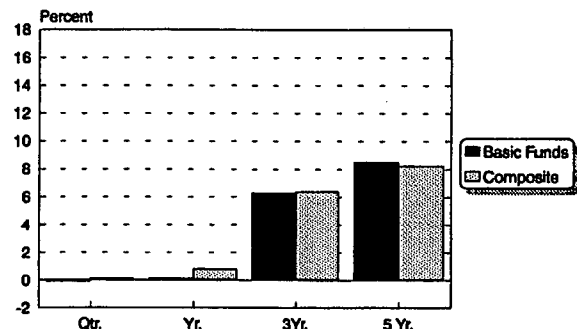
	Policy Asset Mix	Actual Asset Mix 12/31/94	Actual Market Value (Millions)
Domestic Stocks	50.0%	49.7%	\$4,916
Int'l. Stocks	10.0	10.3	1,023
Bonds	24.0	27.5	2,720
Alternative Assets	15.0	11.1	1,095
Unallocated Cash	1.0	1.4	136
	100.0%	100.0%	\$9,890



**Fund Performance**

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

	Qtr.	1 Yr.	3 Yr.	5 Yr.
Basics	-0.1%	0.1%	6.3%	8.5%
Composite	0.1	0.8	6.4	8.2



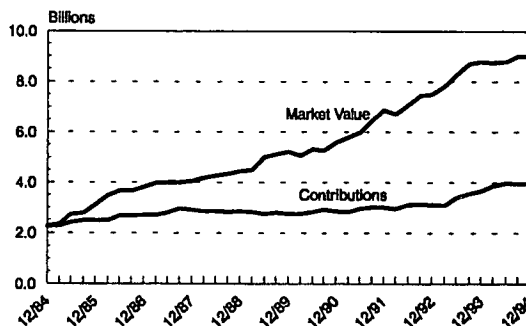
**EXECUTIVE SUMMARY**  
**Post Retirement Fund**

**Asset Growth**

The market value of the Post Fund decreased 0.1% during the fourth quarter of 1994. The decrease resulted from negative investment returns.

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

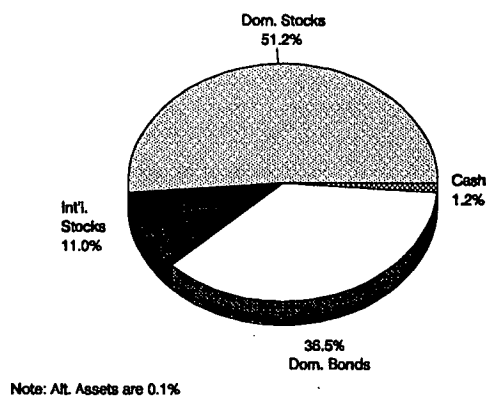
Beginning Value	\$9,012
Net Contributions	44
Investment Return	-55
Ending Value	\$9,001



**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.

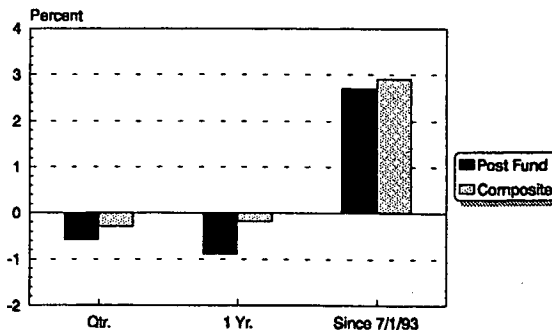
	Policy	Actual	Actual
	Asset	Mix	Market Value
	Mix	12/31/94	(Millions)
Domestic Stocks	50.0%	51.2%	\$4,611
Int'l. Stocks	10.0	11.0	988
Domestic Bonds	32.0	36.5	3,282
Alternative Assets	5.0	0.1	8
Unallocated Cash	3.0	1.2	112
	100.0%	100.0%	\$9,001



**Fund Performance**

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

	Qtr.	1 Yr.	Since 7/1/93*
Post Fund	-0.6%	-0.9%	2.7%
Composite	-0.3	-0.2	2.9



\* 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.
Dom. Stocks	-1.1%	-0.8%	6.2%	8.3%
Wilshire 5000*	-0.8	-0.3	6.6	8.6

\* 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) trailed its target for the quarter and for the year.

	Qtr.	1 Yr.	Since Incept.*
Int'l. Stocks	-1.7%	5.9%	15.0%
EAFE	-1.0	7.8	15.2

\* since 10/1/92.

**Domestic Bonds**

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

	Qtr.	1 Yr.	3 Yr.	5 Yr.
Bonds	0.2%	-3.3%	5.1%	8.1%
Lehman Agg.*	0.4	-2.8	4.8	7.8

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

**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.

	12/31/94 Target	12/31/94 Actual
Stocks	20.0%	20.7%
Bonds	80.0	76.8
Unallocated Cash	0.0	2.5
Total	100.0%	100.0%

**Investment Management**

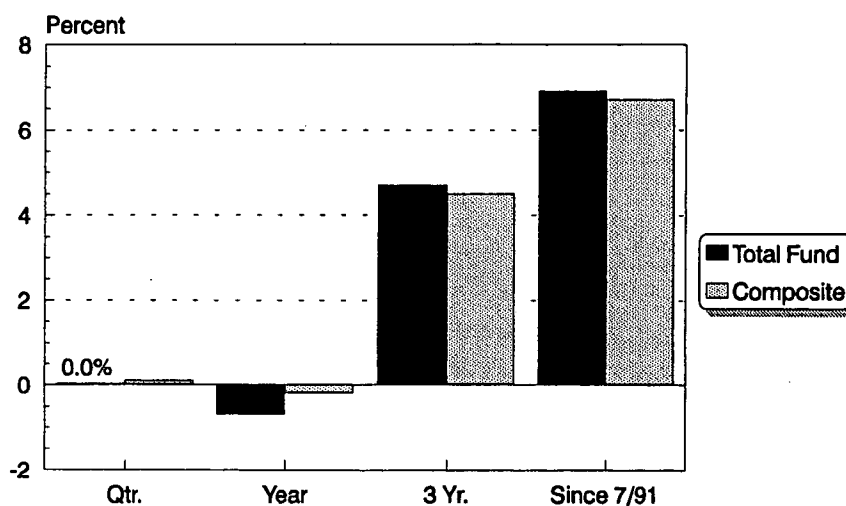
Voyageur Asset Management manages the bond segment of the Fund and SBI staff manage the equity segment. The portfolio was transferred from the Department of Commerce to the SBI on May 1, 1991.

**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 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**

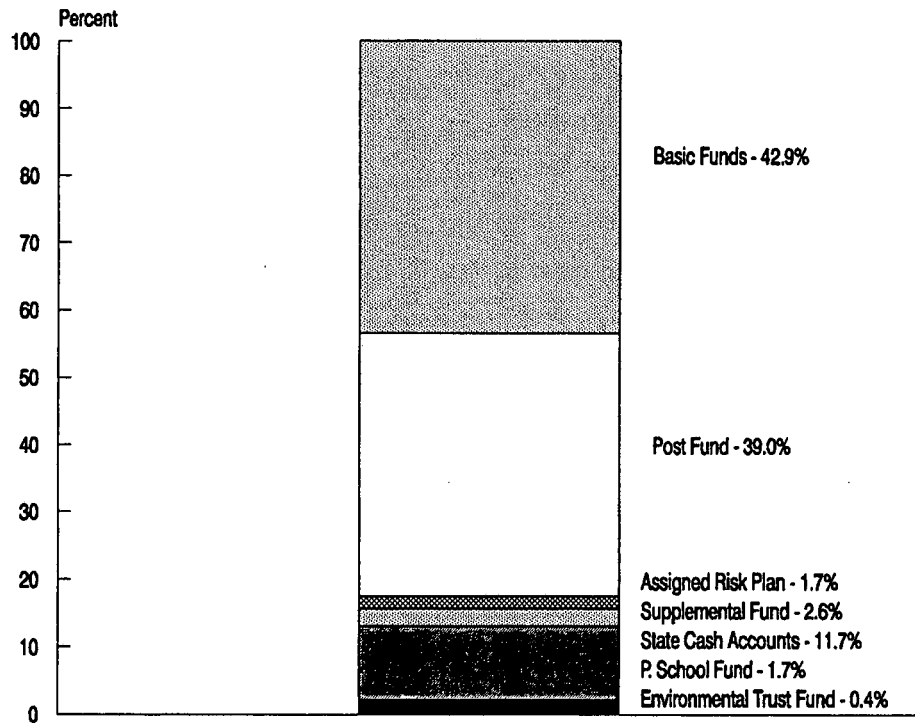
On December 31, 1994 the market value of the Assigned Risk Plan was \$459 million.



**Period Ending 12/31/94**

	Qtr.	Yr.	3 Yr.	Since 7/1/91
<b>Total Fund</b>	0.0%	-0.7%	4.7%	6.9%
<b>Composite Index</b>	0.1	-0.2	4.5	6.7
<b>Equity Segment</b>	0.0	-0.6	3.0	6.1
<b>Benchmark</b>	0.0	0.8	2.6	6.9
<b>Bond Segment</b>	0.0	-0.9	4.9	7.1
<b>Benchmark</b>	0.1	-0.5	4.8	6.6

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



**12/31/94**  
**Market Value**  
**(Billions)**

Basic Retirement Funds	\$9.9
Post Retirement Fund	9.0
Assigned Risk Plan	0.4
Supplemental Investment Fund	0.6
State Cash Accounts	2.7
Permanent School Fund	0.4
Environmental Trust Fund	0.1
<b>Total</b>	<b>\$23.1</b>

# MINNESOTA STATE BOARD OF INVESTMENT

## QUARTERLY INVESTMENT REPORT

Fourth Quarter 1994

(October 1, 1994 — December 31, 1994)

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## VARIOUS CAPITAL MARKET INDICES

	Period Ending 12/31/94				
	Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Domestic Equity</b>					
Wilshire 5000	-0.8%	-0.1%	6.6%	8.8%	13.9%
Dow Jones Industrials	0.5	5.0	9.7	10.2	16.2
S&P 500	0.0	1.4	6.3	8.7	14.3
Russell 2000	-1.9	-1.8	11.4	10.2	11.5
<b>Domestic Fixed Income</b>					
Lehman Aggregate	0.4	-2.9	4.6	7.7	10.0
Lehman Gov't./Corp.	0.4	-3.5	4.9	7.7	9.8
90 Day U.S. Treasury Bills	1.3	4.3	3.7	4.9	6.1
<b>International</b>					
EAFE**	-1.0	7.8	7.9	1.5	17.6
Salomon Non U.S. Gov't. Bond	0.6	6.0	8.5	11.4	15.5
<b>Inflation Measure</b>					
Consumer Price Index***	0.2	2.7	2.8	3.5	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 negative returns. The decrease was due to the Federal Reserve increasing short term interest rates by 0.75% in November to slow down the economy which they feel is going too fast. The Federal Reserve believes that if they do not slow down economic growth to a lower level, inflation will increase significantly in the near future. This rate increase caused the interest rate sensitive sectors (consumer durables, finance, and utilities) of the economy to incur significant negative returns. The only sector that generated significant positive return was the technology sector.

The Wilshire 5000 provided a -0.8% return for the quarter. Performance among the different Wilshire Style Indexes for the quarter are shown below:

Large Value	-0.5%
Small Value	-1.9
Large Growth	1.6
Small Growth	0.8

The Wilshire 5000 decreased 0.1% during the latest year.

DOMESTIC BONDS

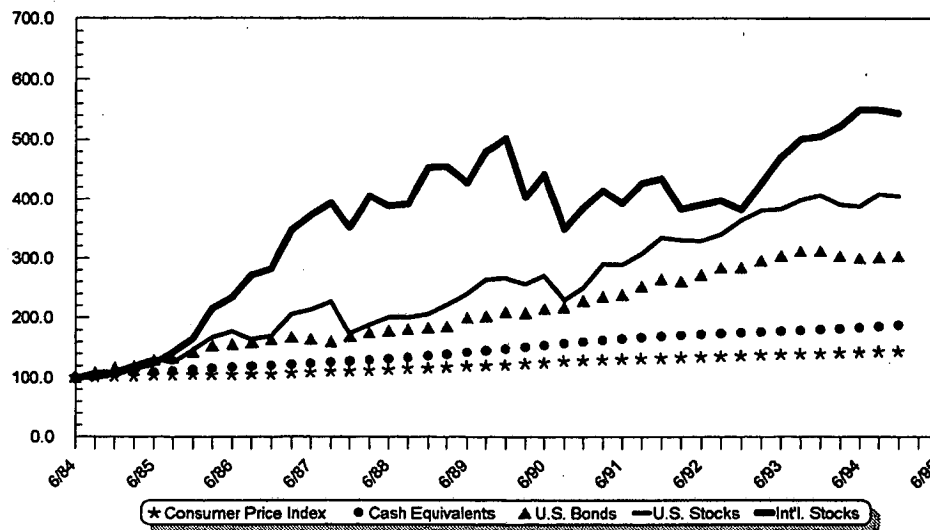
Returns were low because interest rates rose. The economy continued to strengthen forcing interest rates up as traders fear inflation. Two year rates increased 1.10% while long rates increased 0.06%, as the yield curve flattened significantly.

Overall, the Lehman Brothers Aggregate Bond Index increased 0.4% for the quarter. The Lehman Aggregate sector returns for the quarter were:

Treasury/Agency	0.35%
Corporates	0.43
Mortgages	0.43

The Lehman Aggregate declined 2.9% 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; Lehman Brothers Aggregate 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 -1.0% for the quarter. As shown below, performance varied widely among the major markets:

Japan	-1.3%
United Kingdom	1.4
Germany	3.6
France	-1.1

The EAFE index increased by 7.8% 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 *Private Equity Analyst*, "total commitments to private equity partnerships of all kinds soared 51% to \$19.4 billion. That's a new record, surpassing the previous peak of \$17.5 billion set in 1987."

### RESOURCE FUNDS

Crude oil prices averaged \$17.17 per barrel during the quarter compared to \$15.42 per barrel a year earlier. Natural gas prices were weak during the quarter averaging \$1.60 per thousand cubic feet versus an unusually strong \$2.11 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.

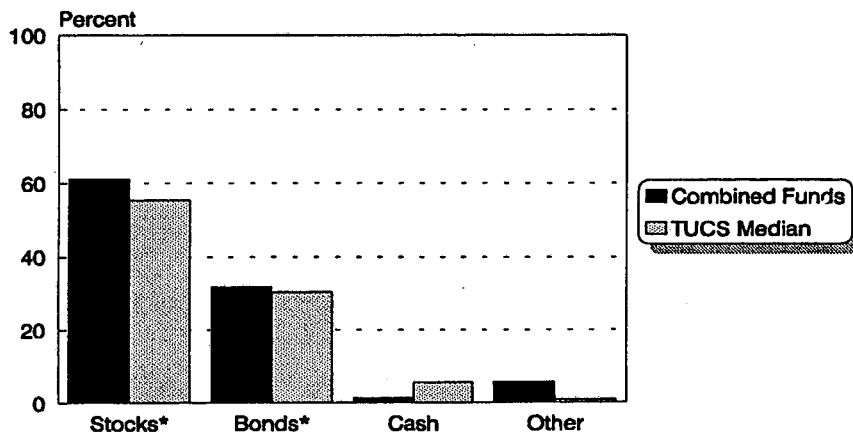
The comparison universe used by the SBI is the Master Trust portion of the Trust Universe Comparison Service (TUCS). This universe contains information on more than 200 public and corporate pension and trust funds with a balanced asset mix.

**Asset Mix Compared to Other Pension Funds**

On December 31, 1994, the actual asset mix of the Combined Funds was:

	\$ Millions	%
Domestic Stocks	\$9,527	50.4%
International Stocks	2,011	10.7
Bonds	6,002	31.8
Alternative Assets	1,103	5.8
Unallocated Cash	247	1.3
<b>Total</b>	<b>\$18,890</b>	<b>100.0%</b>

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 December 31, 1994 are shown below:



	Stocks*	Bonds*	Cash	Other
<b>Combined Funds</b>	<b>61.1%</b>	<b>31.8%</b>	<b>1.3%</b>	<b>5.8%</b>
<b>Median Allocation in TUCS</b>	<b>55.4</b>	<b>30.4</b>	<b>5.6</b>	<b>0.8</b>

\* Both domestic and international.

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

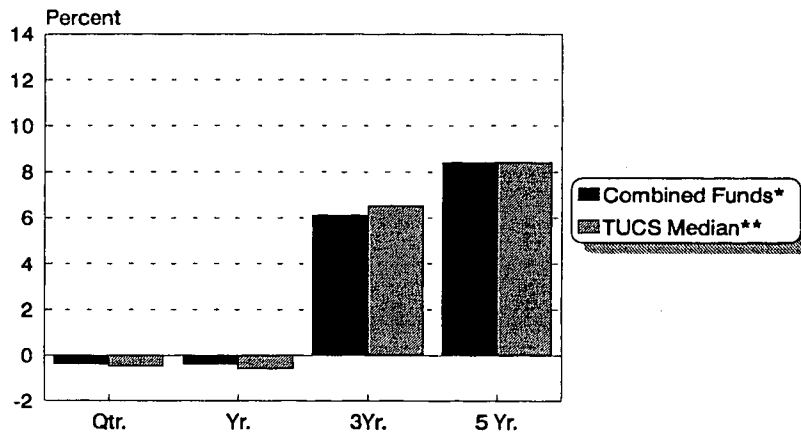
While the SBI is naturally concerned with how its returns compare to other pension investors, universe comparison data should be used with great care. There are several reasons why such comparisons will provide an "apples to oranges" look at performance:

- **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 12/31/94**

	Annualized			
	Qtr.	Yr.	3 Yr.	5 Yr.
Combined Funds Return*	-0.4%	-0.4%	6.1%	8.4%
TUCS Median Fund Return**	-0.5	-0.6	6.5	8.4
Percentile Rank in TUCS	44th	44th	61st	50th

\* 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).



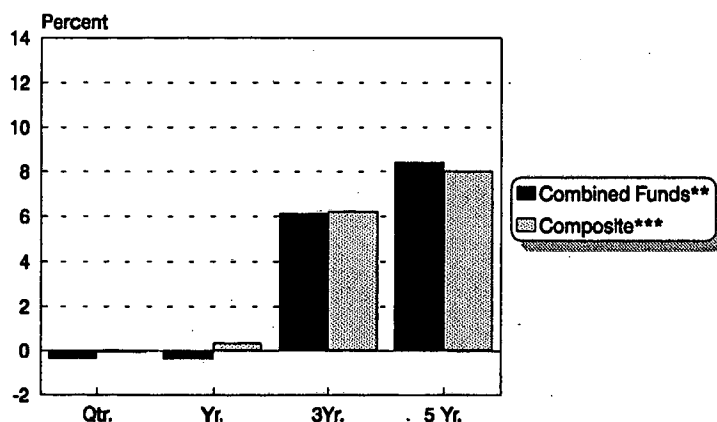
**COMBINED FUNDS**  
**Performance Compared to Composite Index**

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 10/1/94
Domestic Stocks	Wilshire 5000	50.0%
Int'l. Stocks	EAFE	10.0
Domestic Bonds	Lehman Aggregate	32.5*
Alternative Assets	Wilshire Real Estate	2.4*
	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 12/31/94**

	Qtr.	Yr.	Annualized 3 Yr.	Annualized 5 Yr.
Combined Funds**	-0.4%	-0.4%	6.1%	8.4%
Composite Index***	-0.1	0.3	6.2	8.0

\*\*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

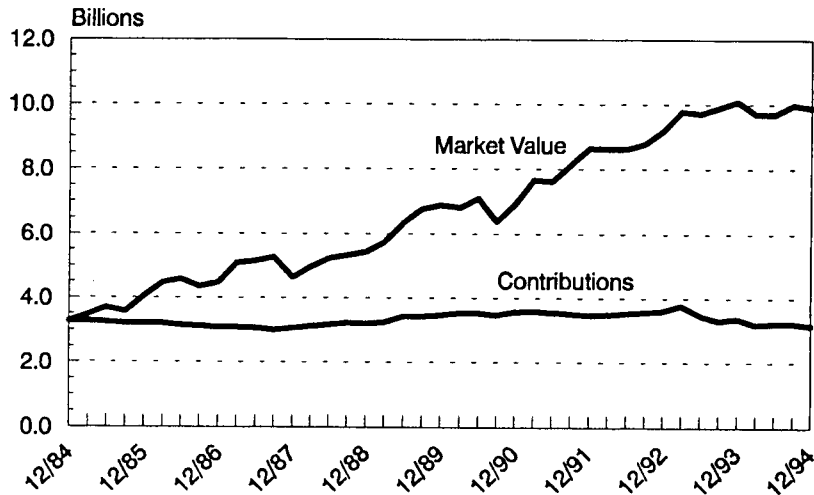
projected pension costs, the Basic Retirement Funds must generate investment returns of at least 8.5% on an annualized basis, over time.

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 decreased 0.8% during the fourth quarter of 1994.

Negative net contributions and investment returns accounted for the decrease.



	Last Five Years					Latest Qtrs.			
	In Millions								
	12/89	12/90	12/91	12/92	12/93	3/94	6/94	9/94	12/94
Beginning Value	\$5,420	\$6,875	\$6,919	\$8,639	\$9,191	\$10,086	\$9,697	\$9,688	\$9,968
Net Contributions	269	91	-92	-34	-239	-187	51	-5	-65
Investment Return	1,186	-47	1,812	586	1,134	-202	-60	285	-13
Ending Value	\$6,875	\$6,919	\$8,639	\$9,191	\$10,086	\$9,697	\$9,688	\$9,968	\$9,890

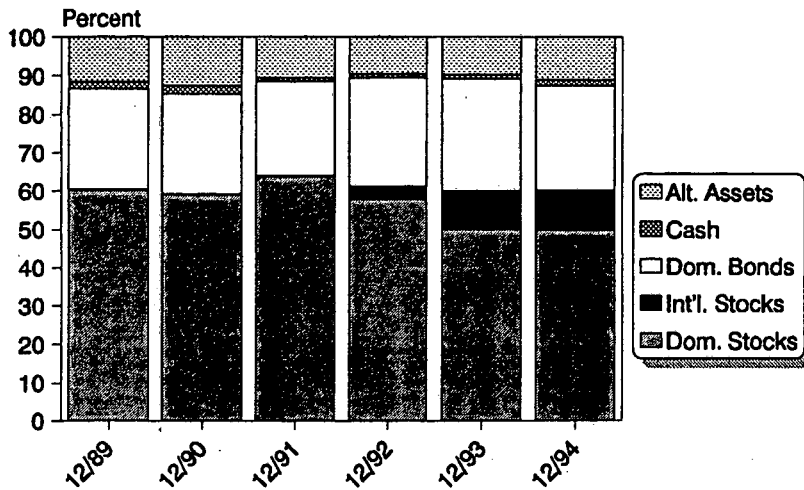
**BASIC RETIREMENT FUNDS**  
**Asset Mix**

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.



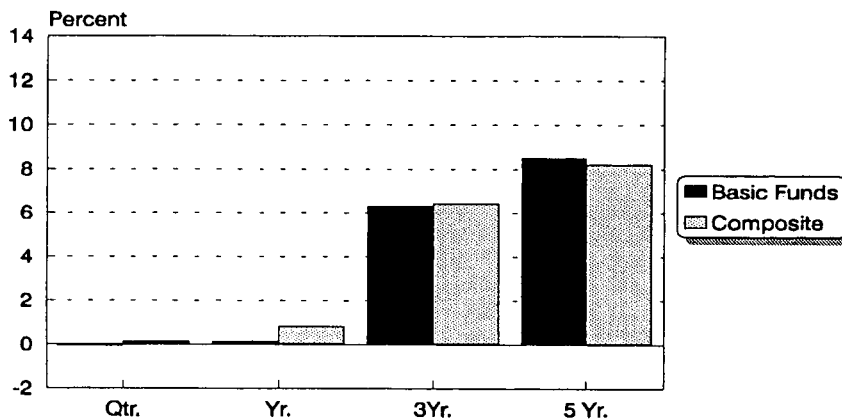
	Last Five Years					Latest Qtrs.			
	12/89	12/90	12/91	12/92	12/93	3/94	6/94	9/94	12/94
Domestic Stocks	60.2%	59.1%	63.9%	57.9%	49.9%	49.0%	49.1%	50.1%	49.7%
Int'l. Stocks	0.0	0.0	0.0	3.2	10.0	10.3	10.6	10.5	10.3
Domestic Bonds	26.4	26.2	24.7	28.5	29.4	28.6	28.1	27.5	27.5
Real Estate	7.5	7.0	4.8	4.2	4.1	4.2	4.4	4.4	4.6
Private Equity	2.8	4.2	4.7	4.2	4.6	5.1	5.2	5.2	5.6
Resource Funds	1.4	1.5	1.1	1.2	1.1	1.0	0.8	0.8	0.9
Unallocated Cash	1.7	2.0	0.8	0.8	0.9	1.8	1.8	1.5	1.4
Total	100.0%	100.0%	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 10/1/94
Domestic Stocks	50.0%	Wilshire 5000	50.0%
Int'l. Stocks	10.0	EAFE	10.0
Domestic Bonds	24.0	Lehman Aggregate	28.3*
Alternative Assets	15.0	Wilshire Real Estate	4.5*
		Private Equity Funds	5.2*
		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 12/31/94**

	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Basic Funds</b>	-0.1%	0.1%	6.3%	8.5%
<b>Composite Index**</b>	0.1	0.8	6.4	8.2

\*\*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.

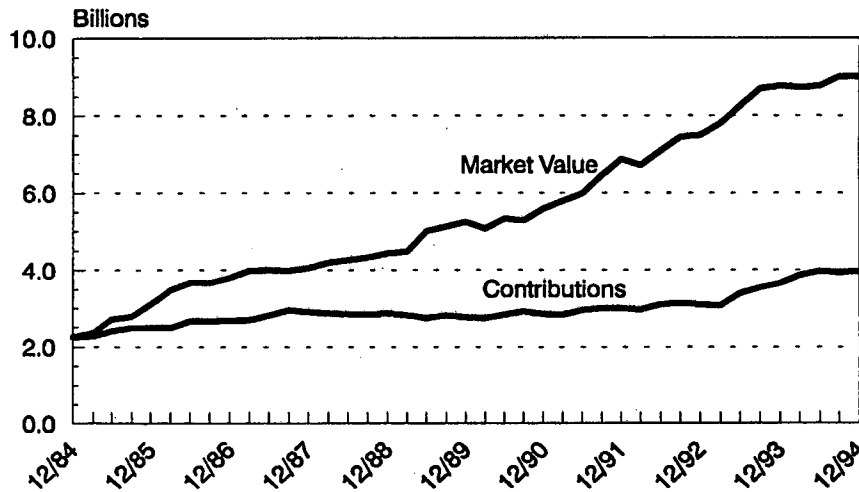
Through fiscal year 1992, unrealized capital gains (or losses) were excluded from the statutory definition of earnings. For this reason the Post Fund previously was not designed to maximize long-term total rates of return. Rather, the SBI attempted to generate a high, consistent stream of realized earnings 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 decreased by 0.1% during the fourth quarter of 1994.

The decrease was due to negative investment returns.



	In Millions					Latest Qtrs.			
	12/89	12/90	12/91	12/92	12/93	3/94	6/94	9/94	12/94
Beginning Value	4,434	\$5,238	\$5,590	\$6,855	\$7,500	\$8,766	\$8,742	\$8,772	\$9,012
Net Contributions	25	88	162	95	386	211	86	-27	44
Investment Return	779	264	1,103	550	880	-235	-56	267	-55
Ending Value	\$5,238	\$5,590	\$6,855	\$7,500	\$8,766	\$8,742	\$8,772	\$9,012	\$9,001

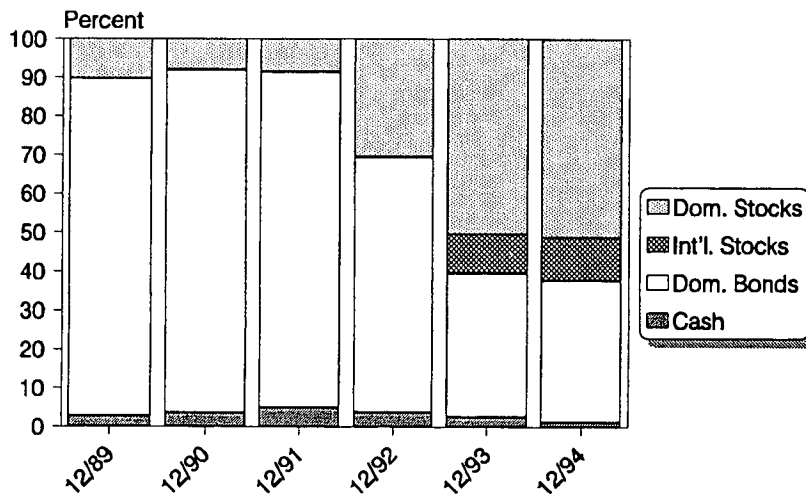
**POST RETIREMENT FUND**  
**Asset Mix**

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>



Note: Alt. Investments are 0.1%

	Last Five years					Latest Qtrs.			
	12/89	12/90	12/91	12/92	12/93	3/94	6/94	9/94	12/94
Dom. Stocks	10.2%	7.9%	8.5%	30.6%	50.5%	50.1%	50.3%	51.5%	51.2%
Int'l. Stocks	0.0	0.0	0.0	0.0	10.0	10.6	11.2	11.1	11.0
Dom. Bonds	87.1	88.5	80.0	65.6	36.9	36.8	36.7	36.1	36.5
Alt. Assets	0.0	0.0	0.0	0.0	0.0	0.0*	0.0*	0.0*	0.1
Unallocated Cash	2.7	3.6	5.0	3.8	2.6	2.5	1.8	1.3	1.2
<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>	<b>100.0%</b>	<b>100.0%</b>

\* less than 0.1%

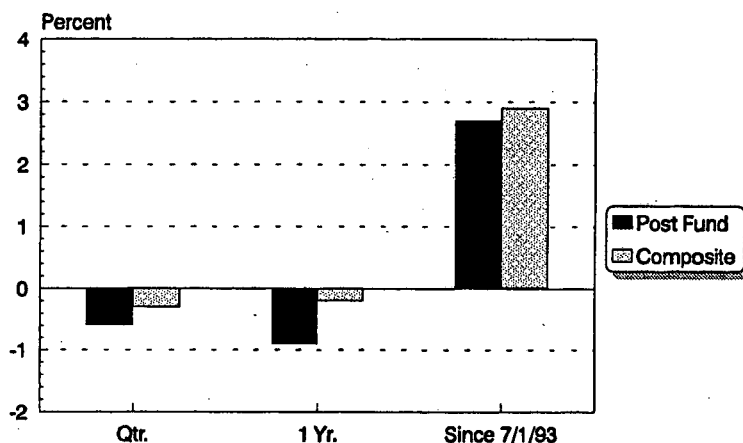
**POST RETIREMENT FUND**  
**Total Fund Performance**

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 10/1/94
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
Post Fund	-0.6%	-0.9%	2.7%
Composite Index	-0.3	-0.2	2.9

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

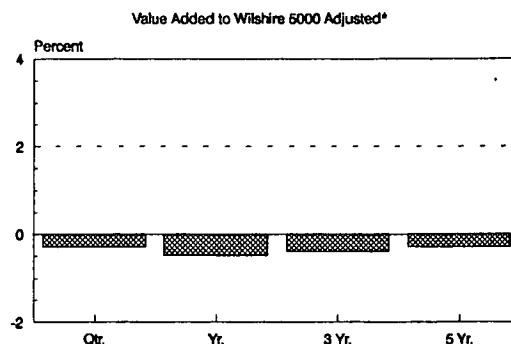
Domestic Stock Pool

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	-1.1%	-0.8%	6.2%	8.3%
Wilshire 5000*	-0.8	-0.3	6.6	8.6

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



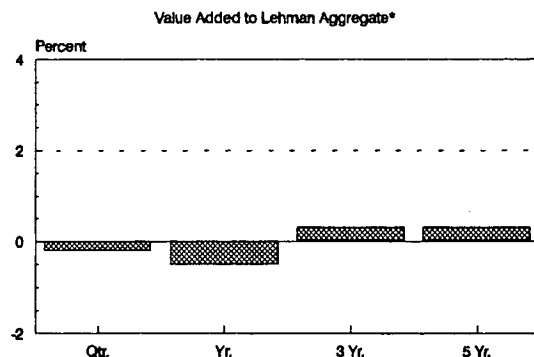
Domestic Bond Pool

Target: Lehman Brothers Aggregate Bond Index

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

	Qtr.	Yr.	Annualized	
			3 Yrs.	5 Yrs.
Bond Pool	0.2%	-3.3%	5.1%	8.1%
Lehman Aggregate*	0.4	-2.8	4.8	7.8

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

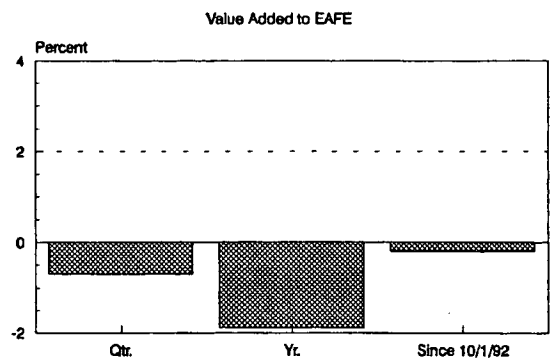


International Stock Pool

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	-1.7%	5.9%	15.0%
EAFE	-1.0	7.8	15.2





**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	1.1%	2.1%	-3.8%	-3.2%
Real Estate Index	1.1	3.5	-2.9	-4.2
Inflation	0.2	2.7	2.8	3.5

**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	7.9%	13.5%	9.3%	17.3%

**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	3.0%	4.1%	7.5%	6.5%

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.

	12/31/94 Target	12/31/94 Actual
Stocks	20.0%	20.7%
Bonds	80.0	76.8
Unallocated Cash	0.0	2.5
	100.0%	100.0%

**Investment Management**

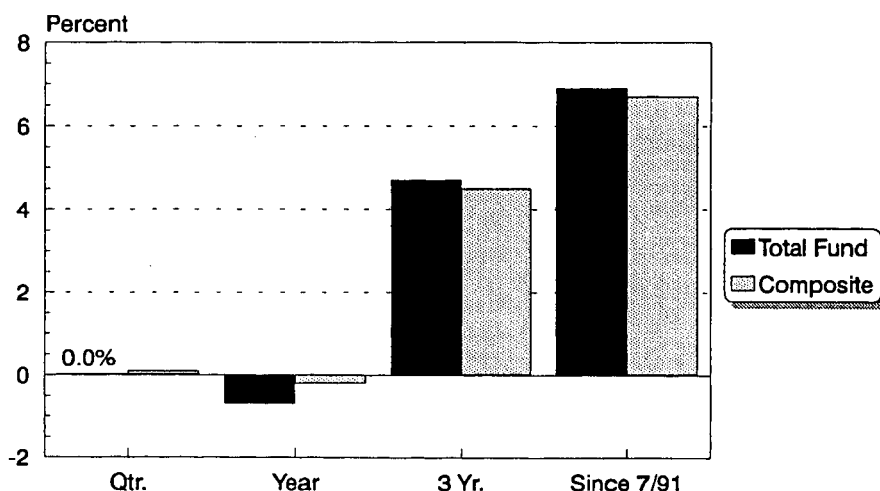
Voyageur Asset Management manages the bond segment of the Fund while SBI staff manage the equity segment. The portfolio was transferred from the Department of Commerce to the SBI on May 1, 1991.

**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 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 December 31, 1994 the market value of the Assigned Risk Plan was \$459 million.



	Period Ending 12/31/94			
	Qtr.	Yr.	1 Yr.	Since 7/1/91
<b>Total Account</b>	0.0%	-0.7%	4.7%	6.9%
Composite	0.1	-0.2	4.5	6.7
<b>Equity Segment</b>	0.0	-0.6	3.0	6.1
Benchmark	0.0	0.8	2.6	6.9
<b>Bond Segment</b>	0.0	-0.9	4.9	7.1
Benchmark	0.1	-0.5	4.8	6.6

## 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 December 31, 1994 the market value of the entire fund was \$601 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.

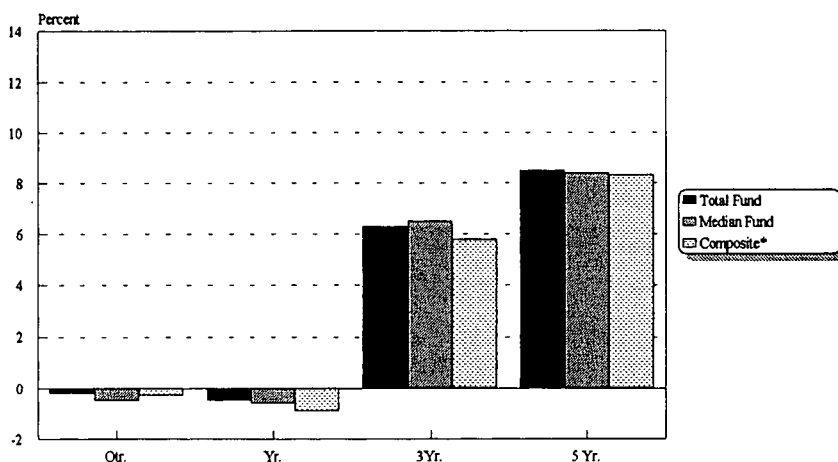
	Target	Actual
Stocks	60.0%	61.0%
Bonds	35.0	34.1
Unallocated Cash	5.0	4.9
	100.0%	100.0%

**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 December 31, 1994 the market value of the Income Share Account was \$290 million.



	Period Ending 12/31/94			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Total Account %</b>	<b>-0.2%</b>	<b>-0.5%</b>	<b>6.3%</b>	<b>8.5%</b>
Median Fund*	-0.5	-0.6	6.5	8.4
Composite**	-0.3	-0.9	5.8	8.3
<b>Equity Segment</b>	<b>-0.5</b>	<b>0.7</b>	<b>7.2</b>	<b>9.0</b>
Wilshire 5000***	-0.8	-0.3	6.6	8.6
<b>Bond Segment</b>	<b>0.1</b>	<b>-3.4</b>	<b>5.2</b>	<b>7.9</b>
Lehman Aggregate	0.4	-2.8	4.8	7.8

\*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.

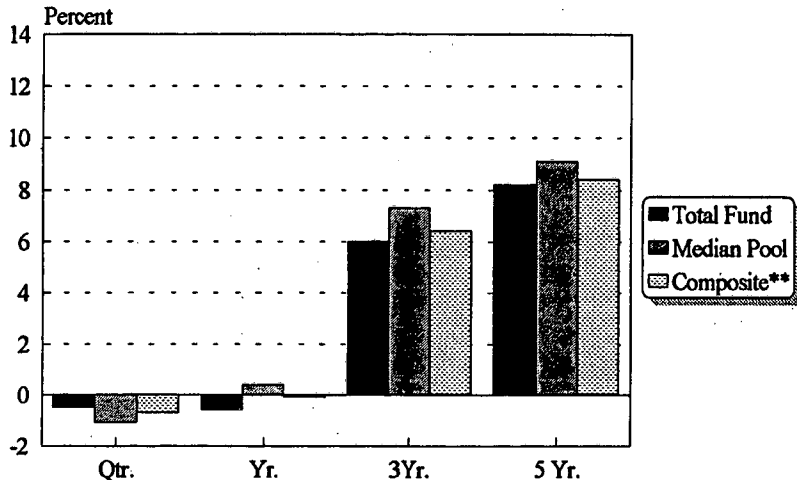
**Investment Management**

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 December 31, 1994 the market value of the Growth Share Account was \$108 million.

	Target	Actual
Stocks	95.0%	92.7%
Unallocated Cash	5.0	7.3
	100.0%	100.0%



	Period Ending 12/31/94			
	Qtr.	Yr.	3 Yr.	5 Yr.
Total Account	-0.5%	-0.6%	6.0%	8.2%
Median Pool*	-1.1	0.4	7.3	9.1
Composite**	-0.7	-0.1	6.4	8.4

\* 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.

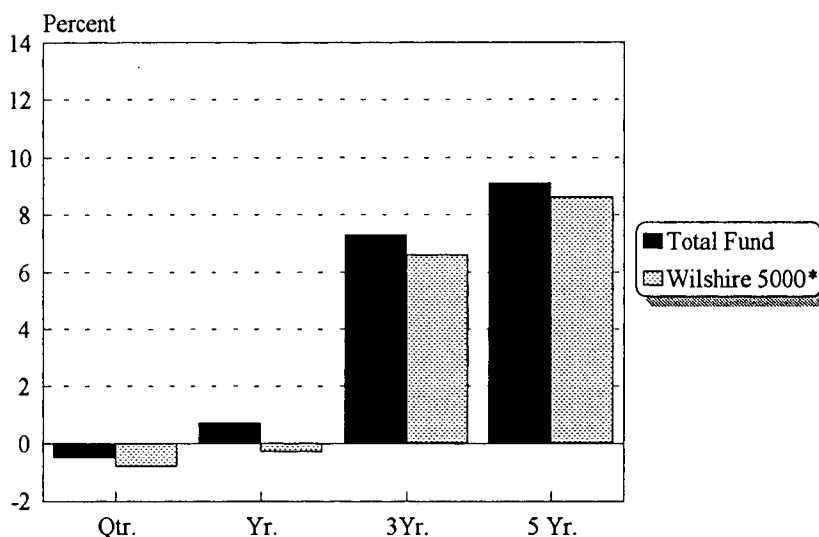
The Account is invested 100% in common stock.

**Investment Management**

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

**Market Value**

On December 31, 1994 the market value of the Common Stock Index Account was \$53 million.



	Period Ending 12/31/94			
	Annualized			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	-0.5%	0.7%	7.3%	9.1%
Wilshire 5000*	-0.8	-0.3	6.6	8.6

\*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**

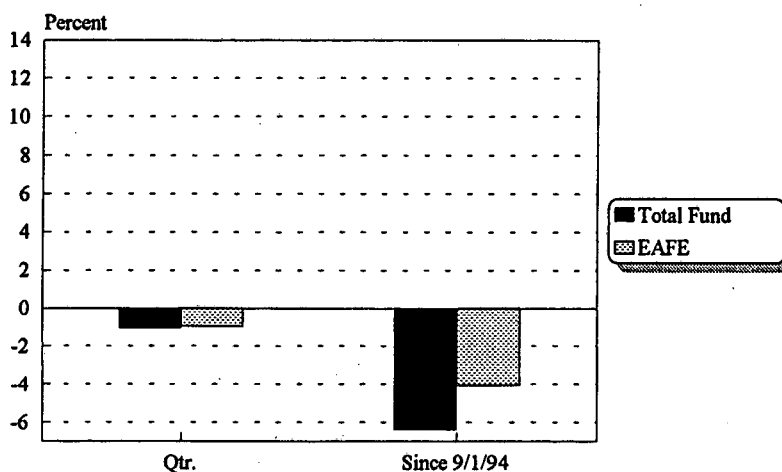
The investment objective of the International Share Account is to earn a high rate of return by investing in the stock of companies outside the U.S. Approximately half of the Account is "passively managed" and is designed to track the return of 20 markets included in the Morgan Capital International 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 December 31, 1994 the market value of the International Share Account was \$7 million.



**Period Ending 12/31/94**

	Qtr.	Since 9/1/94
<b>Total Account*</b>	-1.1%	-6.4%
<b>EAFE</b>	-1.0	-4.1

\* 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**

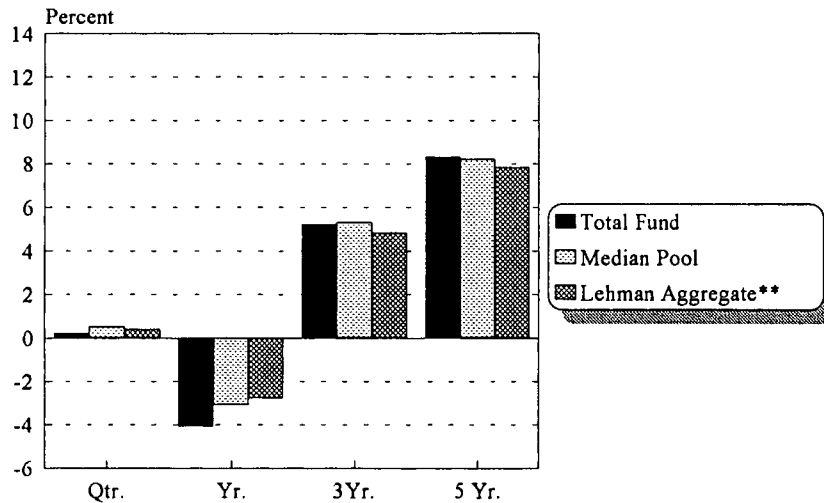
The Bond Market Account invests primarily in high-quality, government and corporate bonds that have intermediate to long-term maturities, usually 3 to 20 years.

**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 December 31, 1994 the market value of the Bond Market Account was \$20 million.



**Period Ending 12/31/94**

	<b>Annualized</b>			
	<b>Qtr.</b>	<b>Yr.</b>	<b>3 Yr.</b>	<b>5 Yr.</b>
<b>Total Account</b>	<b>0.2%</b>	<b>-4.1%</b>	<b>5.2%</b>	<b>8.3%</b>
<b>Median Pool*</b>	<b>0.5</b>	<b>-3.1</b>	<b>5.3</b>	<b>8.2</b>
<b>Lehman Aggregate**</b>	<b>0.4</b>	<b>-2.8</b>	<b>4.8</b>	<b>7.8</b>

\* 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**

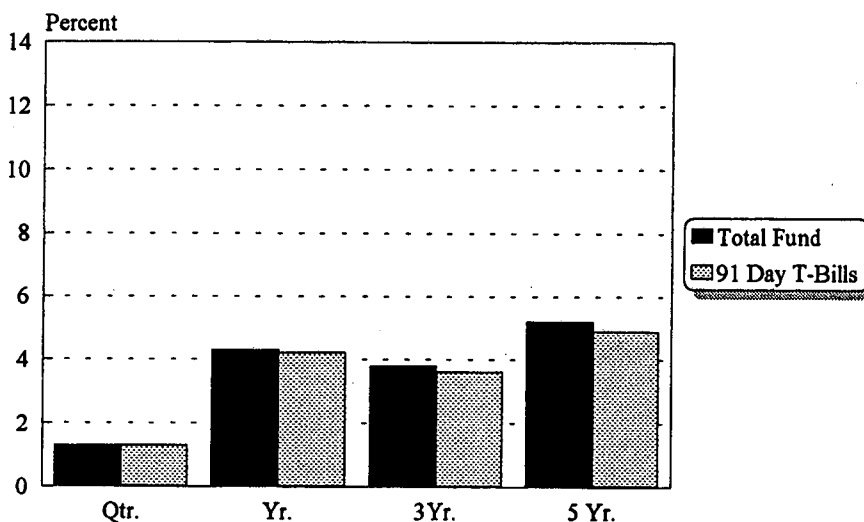
The Money Market Account is invested entirely in high quality short-term investments such as U.S. Treasury Bills, bank certificates of deposit, repurchase agreements, and high grade commercial paper. The average maturity of these investments is 30 to 60 days.

**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 December 31, 1994 the market value of the Money Market Account was \$57 million.



**Period Ending 12/31/94**

**Annualized**

Qtr. Yr. 3 Yr. 5 Yr.

<b>Total Account</b>	1.3%	4.3%	3.8%	5.2%
<b>91 Day T-Bills</b>	1.3	4.2	3.6	4.9

## SUPPLEMENTAL INVESTMENT FUND

### Fixed Interest Account

**Investment Objectives**

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

**Asset Mix**

The Fixed Interest Account is invested in guaranteed investment contracts (GIC's) offered by major U.S. insurance companies and banks and GIC type investments. Effective November 1, 1994 new contributions into the Account are deposited into a new pool of GIC's and GIC-type investments. The pool has a blend of maturities and a credited interest rate that changes monthly. Note that the two existing GIC's remain in place and mature in 1995 and 1996, respectively.

**Investment Management**

The new portfolio of GIC's and GIC-type investments is managed by Norwest Investment Management.

**Market Value**

On December 31, 1994 the market value of the Fixed Interest Account was \$66 million.

**Existing Contracts**

Contract Period	Annual Effective Interest Rate	Manager
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)

**Blended Portfolio**

Annual Effective Interest Rate December 1994	6.790%
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## 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%	92.0%
Unallocated Cash	5.0	8.0
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 decreased 5.2% during the fourth quarter due to negative net contributions.

#### Asset Growth During Fourth Quarter 1994 (Millions)

Beginning Value	\$420.3
Net Contributions	-24.1
Investment Return	2.2
Ending Value	\$398.4

### 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 8.11%, duration of 5.55 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 12/31/94

Value at Market	\$361,428,703
Value at Cost	366,967,018
Average Coupon	8.03%
Current Yield	8.11
Yield to Maturity	8.16
Current Yield at Cost	7.98
Average Time to Maturity	9.41
Duration	5.55
Average Quality Rating	AAA
Number of Issues	110
Treasury	57.0%
Agency	0.0
Corporate	20.6
Mortgages	22.4
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.

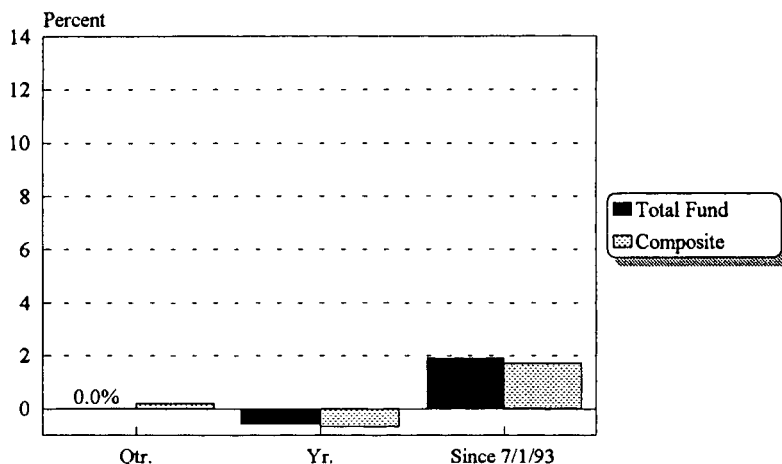
**Investment Management**

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 December 31, 1994 the market value of the Environmental Trust Fund was \$83 million.

	Target	Actual
Stocks	50.0%	48.9%
Bonds	50.0	47.7
Unallocated Cash	0.0	3.4
	100.0%	100.0%



	Period Ending 12/31/94		
	Qtr.	1 Yr.	Since 7/1/93
<b>Total Fund</b>	0.0%	-0.6%	1.9%
Composite	0.2	-0.7	1.7
<b>Equity Segment</b>	0.0	1.5	4.3
Benchmark	0.0	1.3	4.2
<b>Bond Segment</b>	-0.1	-2.2	0.7
Benchmark	0.4	-2.8	-0.1

## 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 12/31/94

	Market Value (Millions)	Qtr.	Yr.	3 Yrs. Annualized
Treasurer's Cash Pool	\$2,287	1.1%	3.5%	4.3%
Trust Fund Cash Pool	63	1.3	4.4	4.5
Benchmark*		1.0	3.4	NA
91-Day T-Bills		1.3	4.2	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 12/31/94</b>	<b>1</b>
<b>II. Cash Flow Available for Investment 10/1/94 - 12/31/94</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 December 31, 1994 (in Millions)**

	Cash And Short Term Securities	Bonds		Stocks		External Int'l.	Alternative Assets	Total
		Internal	External	Internal	External			
<b>BASIC RETIREMENT FUNDS:</b>								
Teachers Retirement Fund	\$93,025 2.17%	-0-	\$1,175,961 27.37%	-0-	\$2,116,802 49.27%	\$441,151 10.27%	\$469,326 10.92%	\$4,296,265 100%
Public Employees Retirement Fund	\$341 0.02%	-0-	\$568,963 27.53%	-0-	\$1,043,813 50.52%	\$216,414 10.47%	\$236,740 11.46%	\$2,066,271 100%
State Employees Retirement Fund	\$18,679 0.94%	-0-	\$549,620 27.71%	-0-	\$989,350 49.89%	\$206,185 10.40%	\$219,330 11.06%	\$1,983,164 100%
Public Employees Police & Fire Fund	\$17,514 1.78%	-0-	\$269,519 27.48%	-0-	\$485,151 49.46%	\$101,108 10.31%	\$107,558 10.97%	\$980,850 100%
Highway Patrol Retirement Fund	\$2,527 1.68%	-0-	\$41,249 27.51%	-0-	\$74,251 49.51%	\$15,474 10.32%	\$16,462 10.98%	\$149,963 100%
Judges Retirement Fund	\$178 1.68%	-0-	\$2,922 27.51%	-0-	\$4,959 46.69%	\$1,096 10.32%	\$1,466 13.80%	\$10,621 100%
Public Employees P.F. Consolidated	\$1,513 0.51%	\$255 0.09%	\$82,081 27.81%	\$19 0.01%	\$147,746 50.05%	\$30,791 10.43%	\$32,777 11.10%	\$295,182 100%
Correctional Employees Retirement	\$1,811 1.68%	-0-	\$29,571 27.51%	-0-	\$53,229 49.51%	\$11,093 10.32%	\$11,801 10.98%	\$107,505 100%
<b>POST RETIREMENT FUND</b>	\$111,831 1.24%	-0-	\$3,282,314 \$36.47%	-0-	\$4,611,415 51.23%	\$987,601 10.97%	\$7,492 0.09%	\$9,000,653 100%
<b>TOTAL BASIC &amp; POST</b>	\$247,419 1.31%	\$255 0.00%	\$6,002,200 31.77%	\$19 0.00%	\$9,526,716 50.43%	\$2,010,913 10.65%	\$1,102,952 5.84%	\$18,890,474 100%



	Cash And Short Term Securities	Bonds Internal	Bonds External	Stocks Internal	Stocks External	External Int'l.	Alternative Assets	Total
<b>MINNESOTA SUPPLEMENTAL FUNDS:</b>								
Income Share Account	\$14,100 4.87%	-0-	\$98,842 34.11%	-0-	\$176,827 61.02%	-0-	-0-	\$289,769 100%
Growth Share Account	\$7,874 7.31%	-0-	\$99,910 92.69%	-0-	-0-	-0-	-0-	\$107,784 100%
Money Market Account	\$56,986 100%	-0-	-0-	-0-	-0-	-0-	-0-	\$56,986 100%
Common Stock Index Account	-0-	-0-	-0-	-0-	\$53,976 100%	-0-	-0-	\$53,976 100%
Bond Market Account	-0-	-0-	\$19,759 100%	-0-	-0-	-0-	-0-	\$19,759 100%
International Share Account	-0-	-0-	-0-	-0-	\$6,572 100%	-0-	-0-	\$6,572 100%
Fixed Interest Account	-0-	-0-	\$66,117 100%	-0-	-0-	-0-	-0-	\$66,117 100%
<b>TOTAL SUPPLEMENTAL FUNDS</b>	\$78,960 13.14%	-0-	\$284,628 47.36%	-0-	\$237,375 39.50%	-0-	-0-	\$600,963 100%
<b>TOTAL RETIREMENT FUNDS</b>	\$326,379 1.67%	\$255 0.00%	\$6,286,828 32.25%	\$19 0.00%	\$9,764,091 50.10%	\$2,010,913 10.32%	\$1,102,952 5.66%	\$19,491,437 100%

	Cash And Short Term Securities	Bonds Internal	Bonds External	Stocks Internal	Stocks External	External Int'l.	Alternative Assets	Total
<b>ASSIGNED RISK PLAN</b>	\$11,722 2.56%	-0-	\$352,319 76.79%	-0-	\$94,748 20.65%	-0-	-0-	\$458,789 100%
<b>ENVIRONMENTAL FUND</b>	\$2,843 3.41%	\$39,703 47.66%	-0-	\$40,761 48.93%	-0-	-0-	-0-	\$83,307 100%
<b>PERMANENT SCHOOL FUND</b>	\$31,771 7.97%	\$366,633 92.03%	-0-	-0-	-0-	-0-	-0-	\$398,404 100%
<b>TREASURERS CASH</b>	\$2,307,259 100%	-0-	-0-	-0-	-0-	-0-	-0-	\$2,307,259 100%
<b>HOUSING FINANCE AGENCY</b>	\$63,523 31.99%	\$135,065 68.01%	-0-	-0-	-0-	-0-	-0-	\$198,588 100%
<b>MINNESOTA DEBT SERVICE FUND</b>	\$1,460 7.23%	\$18,746 92.77%	-0-	-0-	-0-	-0-	-0-	\$20,206 100%
<b>MISCELLANEOUS ACCOUNTS</b>	\$31,556 18.88%	\$135,573 81.12%	-0-	-0-	-0-	-0-	-0-	\$167,129 100%
<b>GRAND TOTAL</b>	\$2,776,513 12.01%	\$695,975 3.01%	\$6,639,147 28.71%	\$40,780 0.18%	\$9,858,839 42.63%	\$2,010,913 8.69%	\$1,102,952 4.77%	\$23,125,119 100%

**STATE OF MINNESOTA  
STATE BOARD OF INVESTMENT**

**Net Cash Flow Available For Investment  
October 1, 1994 - December 31, 1994**

Teachers Retirement Fund	\$12,300,000.00
Public Employees Retirement Fund	(77,000,000.00)
State Employees Retirement Fund	3,178,000.00
Public Employees Police & Fire	3,000,000.00
Highway Patrol Retirement Fund	(184,000.00)
Judges Retirement Fund	- 0 -
Public Employees P&F Consolidated	(5,976,424.90)
Correctional Employees Retirement Fund	- 0 -
Post Retirement Fund	44,140,281.63
Supplemental Retirement Fund - Income	(746,590.21)
Supplemental Retirement Fund - Growth	15,250.63
Supplemental Retirement Fund - Money Market	(5,022,531.01)
Supplemental Retirement Fund - Index	927,802.94
Supplemental Retirement Fund - Bond Market	(620,869.55)
Supplemental Retirement Fund - Fixed Interest	25,380,348.72
Supplemental Retirement Fund - International	6,766,820.11
<b>Total Retirement Funds Net Cash Flow</b>	<b>\$6,158,088.36</b>
Assigned Risk Plan	7,546,443.00
Permanent School Fund	(24,084,178.45)
<b>Total Net Cash Flow</b>	<b>(\$10,379,647.09)</b>

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

	Net Transactions			Asset Summary (at Market Value)				
	Bonds (Millions)	Stocks (Millions)	Total (Millions)	Cash Flow (Millions)	Short-Term % of Fund	Bonds % of Fund	Equity % of Fund	Total Mkt. Value (Millions)
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
October	0	2	2	22	1.9	30.9	67.2	19,824
November	0	0	0	-41	1.7	31.8	66.5	19,324
December	2	14	16	7	1.7	31.7	66.6	19,493

# Tab C

**EXECUTIVE DIRECTOR'S ADMINISTRATIVE REPORT**

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DATE: March 7, 1995

TO: Members, State Board Investment

FROM: Howard Bicker

**1. Budget Report**

A report on the SBI's FY95 administrative budget for the period ending February 28, 1995 is in Attachment A.

**2. Travel Report**

A travel report for the period from November 16, 1994 - February 15, 1995 is included as Attachment B.

**3. Board Meeting Dates for Calendar 1995.**

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

<b>SBI</b>	<b>IAC</b>
Wednesday, June 7, 1995	Tuesday, June 6, 1995
Wednesday, September 6, 1995	Tuesday, September 5, 1995
Wednesday, December 13, 1995	Tuesday, December 12, 1995

All Board members have indicated their availability for the above dates.

**3. Legislative Update**

A status report on bills of interest to the SBI is included as Attachment C. A similar summary will be sent to Board designees on a weekly basis throughout the 1995 Legislative Session.

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ATTACHMENT A

**STATE BOARD OF INVESTMENT  
FISCAL YEAR 1995 ADMINISTRATIVE BUDGET REPORT  
GENERAL FUND APPROPRIATION  
FISCAL YEAR TO DATE THROUGH FEBRUARY 28, 1995**

ITEM	FISCAL YEAR 1995 BUDGET	FISCAL YEAR 1995 EXPENDITURES
<b>PERSONAL SERVICES</b>		
CLASSIFIED EMPLOYEES	\$ 345,000	\$ 205,150
UNCLASSIFIED EMPLOYEES	1,160,000	666,738
SEVERENCE PAYOFF	0	0
WORKERS COMPENSATION INSURANCE	0	0
MISCELLANEOUS PAYROLL	7,686	2,543
<b>SUBTOTAL</b>	<b>\$ 1,512,686</b>	<b>\$ 874,431</b>
<b>EXPENSES &amp; CONTRACTUAL SERVICES</b>		
RENTS & LEASES	86,000	56,833
REPAIRS/ALTERATIONS/MAINTENANCE	10,000	6,297
BONDS AND INSURANCE	1,000	895
PRINTING & BINDING	8,000	9,997
PROFESSIONAL/TECHNICAL SERVICES	58,000	34,422
DATA PROCESSING & SYSTEM SERVICES	202,500	118,125
PURCHASED SERVICES	35,000	19,485
<b>SUBTOTAL</b>	<b>\$ 400,500</b>	<b>\$ 246,054</b>
<b>MISCELLANEOUS OPERATING EXPENSES</b>		
COMMUNICATIONS	27,000	13,459
TRAVEL, IN-STATE	2,000	25
TRAVEL, OUT-STATE	40,000	19,300
FEES & OTHER FIXED CHARGES	8,000	7,200
<b>SUBTOTAL</b>	<b>\$ 77,000</b>	<b>\$ 39,984</b>
<b>SUPPLIES/MATERIALS/PARTS</b>	<b>34,500</b>	<b>16,477</b>
<b>CAPITAL EQUIPMENT</b>	<b>54,000</b>	<b>18,339</b>
<b>TOTAL GENERAL FUND</b>	<b>\$ 2,078,686</b>	<b>\$ 1,195,285</b>



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ATTACHMENT B

STATE BOARD OF INVESTMENT

Travel Summary by Date  
November 16, 1994 - February 15, 1995

<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
<b>Manager Monitoring International Brinson, Scudder Consultant Richards &amp; Tierney</b>	K. Vnuk	Chicago, IL 1/11-1/14	\$539.33
<b>Manager Monitoring Alternative Investments Morgan Oil &amp; Gas, Apache Manager Search Simmons, Torch Energy Miscellaneous University of Texas Endowment Fund</b>	D. Egeland	Austin, TX Houston, TX 1/27-2/1	\$1,057.79

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ATTACHMENT C

**Bills of Interest to the Minnesota State Board of Investment  
1995 Legislative Session  
Includes Action Through 3/3/95**

<b>Description of Bill</b>	<b>HF/SF # and Author</b>	<b>Current Status</b>
Abolishing the Office of the State Treasurer	HF 87 (Greiling) and HF 140 (Kahn) and HF 338 (Knoblach) and HF 1043 (McElroy)	Referred to Governmental Operations
Oversight of consultant, professional and technical services contracts - Does not include SBI or constitutional officers	HF 123 (Opatz) SF 166 (Metzen)	Hearing, House Governmental Operations Comm., 3/2; 3/7 Hearing, Senate Governmental Operations Committee, 3/7
Limit on local government salaries - amendment limits compensation paid to consultants	HF 339 (Wenzel)	Amended in Local Government and Metro. Affairs; referred to Governmental Operations Committee
Ethical practices - gifts to public officials	HF 802 (Greiling) SF 339 (Marty)	Hearing, Senate Ethics Committee, 2/23 amended
Ethical practices - gifts to public officials	HF 856 (Bishop)	Referred to House Ethics Committee
Higher Ed retirement plans - requires the SBI to select a mutual fund as one investment provider	HF 1040 (Kahn) SF 806 (Morse)	Referred to House Governmental Operations and Senate Governmental Operations

# Tab D

## **COMMITTEE REPORT**

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DATE: March 7, 1995

TO: Members, State Board of Investment

FROM: Proxy Committee

**SUBJECT: Delegation Authority and Update of Board  
Proxy Voting Guidelines**

In March 1982, the Board established the Proxy Voting Committee to carry out the SBI's voting responsibilities. Each Board member has one designee on the Committee. The current designees are:

Peter Sausen, Chair	Governor's Designee
Cathy Haukedahl	Attorney General's Designee
Jake Manahan	State Treasurer's Designee
Carey Moe	State Auditor's Designee
Elaine Voss	Secretary of State's Designee

In September 1990, the Board formally adopted a resolution which specifies the authority of the Committee and thereby adopted Proxy Voting Guidelines by which the Board exercises its fiduciary responsibility as a shareholder to cast votes on a wide range of proxy issues.

SBI's legal counsel has suggested the Board reaffirm this delegation of authority by adopting a formal resolution to again specify the authority of the Committee. A resolution to accomplish this is attached.

The voting guidelines referenced in the resolution reflect an update of the Guidelines adopted by the Board in September 1990. They include changes in the issues that appear on corporate ballots, changes in Board policies and appropriate references to international proxy issues.

### **RECOMMENDATION:**

**The Proxy Voting Committee recommends the Board adopt the resolution reaffirming the Committee's authority and approve the revised Proxy Voting Guidelines.**

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

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

WHEREAS, the SBI has previously established a Proxy Committee; and

WHEREAS, the Proxy Committee has proposed proxy voting guidelines:

NOW THEREFORE, BE IT RESOLVED THAT:

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

Adopted this \_\_\_\_ day  
of March, 1995

\_\_\_\_\_  
Governor Arne H. Carlson  
Chair, Minnesota State  
Board of Investment

## **Proxy Voting Guidelines**

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

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

### **Overview of the SBI**

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

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

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

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

### **Statutory Purpose**

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

### **Fiduciary Responsibility**

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

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



**Voting  
Process**

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

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

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

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

**Corporate Governance Issues**

**Routine  
Matters**

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

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

## **MINNESOTA STATE BOARD OF INVESTMENT**

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### **Shareholder Rights**

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

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

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

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

### **Executive Compensation**

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

### **Buyouts**

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

**Special Cases**

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

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

Notwithstanding the above, in general, the SBI casts its votes to preserve existing management's discretion concerning corporate governance issues if the company is incorporated or is headquartered in Minnesota.

**Social Responsibility Issues**

**Northern  
Ireland**

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

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

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

**Environmental  
Protection/Awareness**

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

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

**South Africa**

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

## **MINNESOTA STATE BOARD OF INVESTMENT**

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### **Other Issues**

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

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

- 
- 1 *Minnesota Statutes* 1994, Section 11A.01.
  - 2 *Minnesota Statute* 1994, Section 356A.04, subdivision 1.
  - 3 *Minnesota Statutes* 1994, Section 11A.09, and Section 356A.04, subdivision 2.

# Tab E

## **COMMITTEE REPORT**

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**DATE:** March 7, 1995

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

**FROM:** Asset Allocation Committee

The Asset Allocation Committee met on February 21, 1995 to discuss a single agenda item:

- Currency management in the SBI's international stock portfolio.

No action is required by the SBI at this time.

### **INFORMATION ITEM:**

#### **1. Currency Management**

- *Background*

In September 1992, the Board adopted a position paper on international stock investing. That document outlined the rationale for international investing and recommended an implementation plan for the initial stages of the Board's international stock program.

Judged purely in terms of return, the SBI's decision to diversify internationally has been beneficial for the total portfolio to date. Comparative data since the inception of the program are shown below:

	Annualized Return (2.25 years) October 1992-December 1994
SBI International Stock Pool	15.0%
SBI Domestic Stock Pool	7.9
SBI Bond Pool	3.7
Combined Funds with International	7.1%
Combined Funds without International	6.3

While currency issues were addressed in the 1992 paper, it stated that the conclusions regarding those issues deserved further study. As a follow-up, staff is

currently preparing an additional position paper which discusses the topic of currency management in greater detail.

A "working draft" of that paper was distributed to the Committee and served as the basis of the Committee's discussion on February 21. The draft paper provides general background on currency issues and examines several management alternatives.

For your information, a copy of the executive summary from the paper is in **Attachment A**. *Please note* that it is a *working draft* which means that *all* conclusions and recommendations are subject to change.

- ***Committee Discussion***

The Committee discussed the strengths and weaknesses of the arguments presented in the draft paper but was not prepared to come to final resolution on many of the issues. The Committee did, however, endorse staff's suggestion to continue to investigate and analyze the track records of available currency managers. The outcome of the additional research is likely to weigh heavily on the Committee's conclusions and recommendations to the Board.

The Committee also suggested that staff provide additional opportunities for IAC members and Board members/designees to become more familiar with currency issues and currency managers. Staff hopes to host at least one such educational forum during the next quarter.

## ATTACHMENT A

**\*\*\*Working/Discussion Draft Only\*\*\*  
\*\*\*all recommendations are subject to change\*\*\***

### **Currency Management in the SBI's International Stock Portfolio**

#### **Executive Summary**

In September 1992, the State Board of Investment (SBI) adopted a position paper on international stock investing. That document outlined the rationale for international investing, reviewed a variety of investment management options and recommended an implementation plan for the initial stages of the Board's international stock program. This paper discusses one aspect of international investing, *currency management*, in greater detail.

For the purposes of this discussion, "currency management" means managing the foreign currency *exposure* in a portfolio of international stocks that a plan sponsor already holds. It does *not* mean allocating an additional a percentage of the fund to a new asset class called "currencies".

Currently, the SBI's policy with respect to currency management can be summarized as "half managed" and "half unmanaged". The active international stock managers have the authority to hedge opportunistically/tactically when they believe it will add value or protect from loss relative to their benchmark, which is the Morgan Stanley Capital International index of Europe, Australia and the Far East (EAFE). The passive component which is indexed to EAFE, on the other hand, is "unhedged" at all times. That means no attempt is made to alter any of the currency exposure of the underlying stock portfolio and the portfolio is fully exposed to the currency impact associated with the rise and fall of the US dollar.

#### **Background on Currency Issues:**

- There is no consensus among the experts on how a pension fund should approach currency management. The policies that plan sponsors choose will be highly dependent upon their individual views regarding currency management and particular constraints/needs of their respective retirement funds.
- Generally, securities are denominated in the currency of the country where they are issued. As a result, US investors incur foreign currency exposure at the same time they add international securities to their portfolios. The exchange rate in effect at the time of purchase affects the investor's initial cost in dollar terms. During the holding period, the exchange rate will move up or down from the rate in effect at the time of purchase. When those changes are translated back into dollars, the portfolio will



register gains or losses solely due to the fluctuation in exchange rates during the holding period.

- The portion of portfolio returns due to currency translation back to the US dollar is called the "currency impact". (Actual return in US dollars = Local market return + currency impact). Currency impact can be positive or negative and can vary widely from year to year:

When the dollar *strengthens/appreciates*, the currency impact for US investors is negative and their portfolios will suffer currency *losses*.

When the dollar *weakens/depreciates*, the currency impact for US investors is positive, and their portfolios will generate currency *gains*.

- The currency exposure of an international stock portfolio can be altered by hedging. "Hedging" means selling an amount of foreign currency equal to the value of the underlying foreign stock. If a portfolio of international stocks were fully hedged, all the exposure to foreign currency would be converted to US dollars and exchange rate fluctuations would have no impact on returns measured in dollar terms.
- The SBI needs to make two distinct policy decisions with respect to currency management:

*Strategic/Constant Hedging.* Should the SBI hedge currency exposure at all times? This is a strategic decision that affects the risk profile of the total fund. Therefore, this decision should be made within the structure of the SBI's long term asset allocation policy.

*Tactical/Active Hedging.* Should the SBI attempt to move in and out of foreign currency exposure at particular points in time? This is a tactical decision that is similar to the decision to use or not to use active management. Therefore, the decision should be made based on a belief that tactical hedging provides an opportunity to add value to the policy benchmark.

#### **Decision on Strategic/Constant Hedging:**

- Strategic/constant currency hedging can insulate international portfolios from the effect of currency fluctuations and thereby reduce the risk, or volatility of returns, associated with currency exposure. While expert opinions vary widely on this issue, research suggests that if a plan sponsor's international stock allocation is less than 20% of the total fund, constant hedging does not appear to generate significant risk reduction benefits for the total fund. **Consequently, staff recommends that the SBI reject constant hedging as long as the SBI's allocation to international stocks is less than 20% of the Combined Funds. (Currently, the allocation to**

international stocks is 10%. If the SBI chooses to increase the allocation beyond 20%, the decision to employ a constant hedge should be re-examined.)

- The SBI's policy benchmark/asset class target should reflect the SBI's strategic policy decision with respect to currency. As a result, staff recommends that the asset class target for the international stock program should remain the EAFE index, unhedged.

#### **Decision on Tactical/Active Hedging:**

- While staff does not recommend that the SBI employ a constant hedge at this time, tactical currency management remains an option. The goal of tactical hedging is to add value by increasing and decreasing exposure to particular currencies as they strengthen or weaken relative to other currencies. Tactical hedging adds value by hedging during periods of dollar strength/appreciation and not hedging during periods of dollar weakness/depreciation.
- Given the large impact that currency exposure can have on returns, staff recommends that the SBI should consider tactical currency management alternatives for the entire international stock program. The goal of tactical currency management should be to add value to the currency component of the policy benchmark (i.e., the currency impact in the EAFE index measured in US dollar terms).

*Active managers.* Since tactical currency management is already integrated into the investment management approaches of the SBI's active international stock managers, no change is required for that half of the international portfolio.

*Passive manager/index fund.* Staff recommends that the SBI implement a tactical currency management program for the EAFE index fund *only* if it believes it can identify and retain managers that will add at least 1 percentage point annualized, net of all costs, over time. If this goal is judged to be unrealistic or unattainable after investigating and analyzing available currency managers, the SBI should not proceed with a tactical hedging program for the EAFE index fund.

#### **Implementation:**

- If the SBI chooses to implement a tactical hedging program for the EAFE index fund, two approaches are available:

*Currency overlay management*, where a manager uses a hedging program to alter the currency exposure of a portfolio without affecting the underlying securities. In currency overlay, the manager is responsible for deciding when to hedge/not to hedge and executes the hedges on behalf of the client.

*Currency advisory relationships*, where an external firm (or firms) provides advice on when to hedge/not to hedge, but another entity (the plan sponsor, custodian bank or another investment manager) is responsible for executing the recommended hedges.

- Currency overlay styles generally fall into two groups: a *focus on risk control* to avoid loss, or a *focus on forecasting* to enhance returns through by timing currency exposure. Several of the firms offering currency overlay management also offer their services on an advisory basis as well. This means that essentially the same style options are available through currency advisory relationships.
- In general, tactical currency managers do not have long track records (usually no more than five years). As a result, it is difficult to say whether plan sponsors should have a high degree of confidence that tactical currency management can add value over time. The actual returns generated by some tactical currency managers to date, however, are encouraging. (Staff's preliminary investigation suggests that some currency managers have been able to generate 2-3 percentage points value added annualized to the benchmarks selected by their clients. It should be noted that unhedged benchmarks have not been widely used to date. Fully hedged or partially hedged benchmarks have been more common.)
- Even if the SBI believes it has identified one or more currency managers that are capable of meeting the stated objectives, it may be prudent to implement a hedging program with only a portion of the portfolio at the outset. Coverage could be expanded over time as experience with the program grows and actual results can be more thoroughly examined. If actual experience proves to be disappointing with a small portion of the portfolio, the tactical hedging program should be terminated.
- If the SBI chooses to retain a currency manager/advisor, staff recommends that one quarter to one half of the EAFE index fund be included in the hedging program initially. (This is \$250-500 million at the present time.) The higher the level of confidence in the manager(s)/advisor(s) selected, the greater the allocation should be.

# Tab F

## COMMITTEE REPORT

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DATE: March 7, 1995

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

FROM: Stock and Bond Manager Committee

The Stock and Bond Manager Committee met on February 15, 1995 to discuss the following agenda:

- Review of manager performance for the quarter ending December 31, 1994

No action is required by the SBI at this time.

### INFORMATION ITEM:

#### 1. Review of Manager Performance

- Domestic Stock Managers

For the quarter ended December 31, 1994, the domestic stock manager program underperformed the Wilshire 5000 by 0.3 percentage points and underperformed the aggregate benchmark by 0.5 percentage points. For the latest year the current managers underperformed the benchmark and the Wilshire 5000. For the latest three year period, the current manager group underperformed the Wilshire 5000 and the benchmark. For the five year period, the current manager group outperformed the Wilshire 5000 but underperformed the benchmark.

Time period	Actual	Wilshire 5000*	Benchmark
Quarter	-1.1%	-0.8%	-0.6%
1 Year	-0.8	-0.3	0.6
3 Years	6.4	6.6	7.0
5 years	8.9	8.6	9.0

\* Adjusted for SBI's restrictions, as appropriate

The active managers' decisions to hold consumer non-durable stocks (retail, food), telecommunications and medical stocks accounts for the underperformance for the current quarter.

The Committee noted the underperformance in the current year (-0.8% actual vs. -0.3% Wilshire 5000) also had a negative effect on returns over the last five years (8.4% vs. 8.6%). During discussion, staff informed the Committee that they believe that four active managers (Forstmann-Leff, GeoCapital, Lynch & Mayer, and Weiss, Peck & Greer) and the passive manager (Wilshire Associates) need to be reviewed due to recent underperformance relative to their respective benchmarks. Staff already planned to conduct the reviews, including extensive on-site visits with each firm, during the next quarter and expects to report back to the Committee with findings and recommendations before the June 1995 IAC/SBI meetings.

After discussing staff's plans, Committee members said they felt the staff was taking timely and appropriate steps to address the issues of current concern. The Committee recognizes that staff's findings may include recommendations for further manager changes in the domestic equity program. Since such changes would incur additional turnover, the Committee urges that the associated transactions costs must be factor in the decision making process.

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 December 31, 1994, the bond manager program underperformed the Lehman Aggregate and the aggregate benchmark by 0.1 percentage point. For the latest year, the managers underperformed the aggregate benchmark and the index by 0.4 percentage points. For the latest three and five year periods, the **current** manager group outperformed both the aggregate benchmark and the index.

Time period	Actual	Lehman Aggregate*	Benchmark
Quarter	0.3%	0.4%	0.4%
1 Year	-3.2	-2.8	-2.8
3 Years	5.2	4.8	4.8
5 years	8.2	7.8	7.8

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

The active managers' decision to hold a longer than market duration as interest rates rose accounts for the underperformance 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 period ended December 31, 1994, the international stock managers program underperformed the EAFE index by 0.7 percentage points for the quarter and by 1.9 percentage points for the year. Since inception in October 1992, the program has underperformed by 0.2 percentage point.

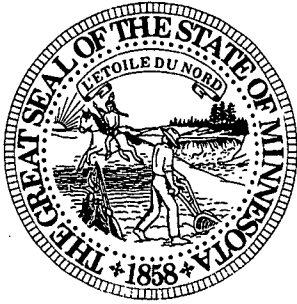
Time period	Actual	EAFE
Quarter	-1.7%	-1.0%
1 Year	5.9	7.8
Since Inception	15.0	15.2

The active managers' decisions to underweight Japan accounts for the majority of the underperformance in the current quarter. On December 31, 1994 the entire program (both active and passive) was underweighted in Japan by 9.3 percentage points (Managers 36.5% vs. EAFE 45.8%).

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

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# STATE BOARD OF INVESTMENT

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## Stock Manager Evaluation Reports

Fourth Quarter, 1994

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**- 6 -**

**DOMESTIC STOCK MANAGERS**  
Period Ending 12/31/94

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	1.0	0.4	-1.9	1.2	6.5	3.7	11.0	8.0	6.5	3.7	15.9	10.6	\$703.23	7.3%
Brinson	-3.4	-1.1	1.0	0.1							4.0	3.9	\$263.17	2.7%
Forstmann-Leff	-3.3	-1.3	-6.5	0.8	2.3	6.6	7.0	8.4	2.3	6.6	11.1	10.8	\$339.14	3.5%
Franklin Portfolio	-0.3	-0.8	0.4	0.1	9.6	8.4	9.4	9.6	9.6	8.4	11.4	10.7	\$371.81	3.9%
GeoCapital	-2.2	-0.1	-4.5	4.2	4.0	11.5			4.0	11.5	13.2	14.5	\$254.34	2.6%
IAI	0.4	0.3	0.8	3.2							6.8	6.5	\$115.24	1.2%
IDS	0.9	0.4	0.9	2.3	8.0	9.5	9.7	9.8	8.0	9.5	13.5	13.1	\$373.33	3.9%
Independence	-0.9	0.0	-1.0	1.4							7.8	7.9	\$364.04	3.8%
Jundt Associates	-0.2	1.2	5.1	3.9							6.0	7.5	\$222.47	2.3%
Lincoln	1.9	1.3	4.1	4.4							5.4	5.5	\$262.03	2.7%
Lynch & Mayer	0.2	1.0	-0.7	2.7							5.1	8.4	\$314.82	3.3%
Oppenheimer	-1.3	-0.7	0.5	1.1							3.8	3.5	\$262.26	2.7%
Waddell & Reed	-1.3	-1.4	1.0	1.3	9.7	10.2	9.0	10.0	9.7	10.2	11.2	10.9	\$387.56	4.0%
Weiss Peck & Greer	-3.3	-0.4	-7.6	-1.0							-0.9	5.9	\$199.03	2.1%
Emerging Managers (3)	0.0	0.4									3.7	4.7	311.16	3.2%
Wilshire Associates (4)	-1.5	-1.1	-1.0	-0.5	6.1	6.6	8.1	8.6	6.1	6.6	12.4	12.7	\$4,883.29	50.7%
													\$9,626.92	100.0%
											Since 1/1/84			
Current Aggregate	-1.1	-0.6	-0.8	0.6	6.4	7.0	8.9	9.0	6.4	7.0	12.9	12.6		
Historical Aggregate (5)	-1.1	-0.6	-0.8	0.6	6.2	7.1	8.3	8.9	6.2	7.1	12.3	12.6		
Wilshire Adjusted (6)		-0.8		-0.3		6.6		8.6		6.6		12.5		
Wilshire 5000		-0.8		-0.3		6.6		8.8		6.6		12.8		

(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 12/31/94**

Current Managers	Quarter		1 Year		3 years		5 Years		Since Inception		Market Value (in millions)	Pool %
	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk		
	%	%	%	%	%	%	%	%	%	%		
CIC Assets (1)	-0.2	0.0							1.2	5.4	\$30.36	9.8%
Cohen, Davis & Marks (1)	1.5	0.0							10.6	5.4	33.18	10.7%
Compass Capital (2)	1.6	-1.7							5.4	3.5	31.62	10.2%
First Capital (1)	-1.2	0.0							0.7	5.4	30.20	9.7%
Kennedy Capital (3)	-4.3	-1.9							-0.5	0.9	29.84	9.6%
New Amsterdam (4)	-1.2	-0.4							-2.1	4.5	29.36	9.4%
Valenzuela Capital (1)	-3.2	0.0							1.3	5.4	30.40	9.8%
Wilke/Thompson (5)	4.2	-2.1							9.1	1.2	32.72	10.5%
Winslow Capital (6)	0.8	0.8							8.5	7.4	32.54	10.5%
Zevenbergen Capital (6)	2.0	0.8							3.1	7.4	\$30.94	9.9%
<b>Current Aggregate</b>	<b>0.0</b>	<b>-0.7 *</b>							<b>3.7</b>	<b>4.4 *</b>	<b>\$311.16</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 12/31/94

**Portfolio Manager: Jack Koltes**

**Assets Under Management: \$703,229,235**

**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.

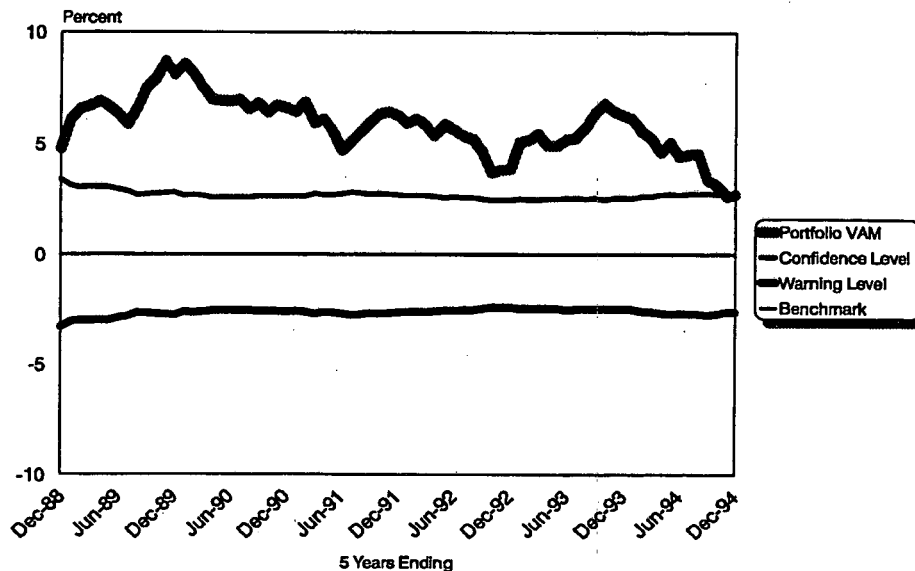
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.0%	0.4%
Last 1 year	-1.9	1.2
Last 2 years	4.3	1.4
Last 3 years	6.5	3.7
Last 4 years	14.5	11.0
Last 5 years	11.0	8.0
Since Inception (1/84)	15.9	10.6

**Recommendation**

No action recommended.

**Alliance Capital Management  
 Rolling Five Year Time Periods**



Note: Graph uses 80/20 confidence interval.

**BRINSON PARTNERS**  
Period Ending 12/31/94

**Portfolio Manager: Jeff Diermeier**

**Assets Under Management: \$263,172,425**

**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	-3.4%	-1.1%
Last 1 year	1.0	0.1
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)	4.0	3.9

**Recommendation**

No action recommended.

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

**FORSTMANN LEFF ASSOCIATES**  
 Period Ending 12/31/94

**Portfolio Manager: Joel Leff**

**Assets Under Management: \$339,137,247**

**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.

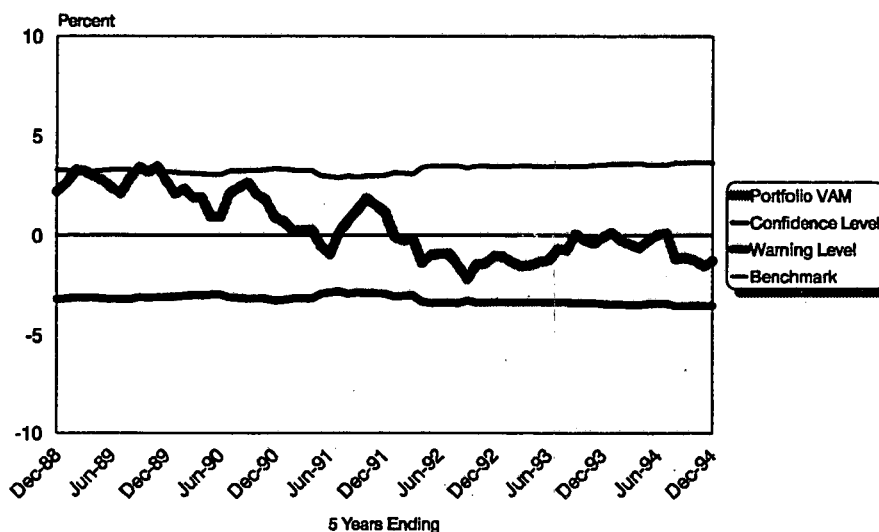
**Recommendations**

No action recommended.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.3%	-1.3%
Last 1 year	-6.5	0.8
Last 2 years	1.5	4.7
Last 3 years	2.3	6.6
Last 4 years	10.6	11.9
Last 5 years	7.0	8.4
Since Inception (1/84)	11.1	10.8

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



Note: Graph uses 80/20 confidence interval.

**FRANKLIN PORTFOLIO ASSOCIATES**  
**Period Ending 12/31/94**

**Portfolio Manager: John Nagorniak**

**Assets Under Management: \$371,810,722**

**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.

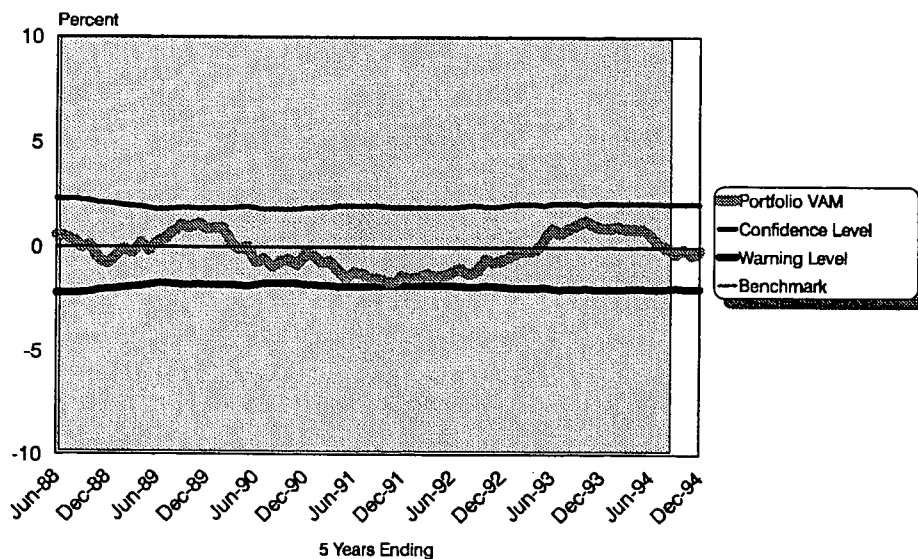
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.3%	-0.8%
Last 1 year	0.4	0.1
Last 2 years	8.5	6.0
Last 3 years	9.6	8.4
Last 4 years	14.8	14.5
Last 5 years	9.4	9.6
Since Inception (4/89)	11.4	10.7

**Recommendation**

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 12/31/94**

**Portfolio Manager: Barry Fingerhut**

**Assets Under Management: \$254,344,713**

**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:**

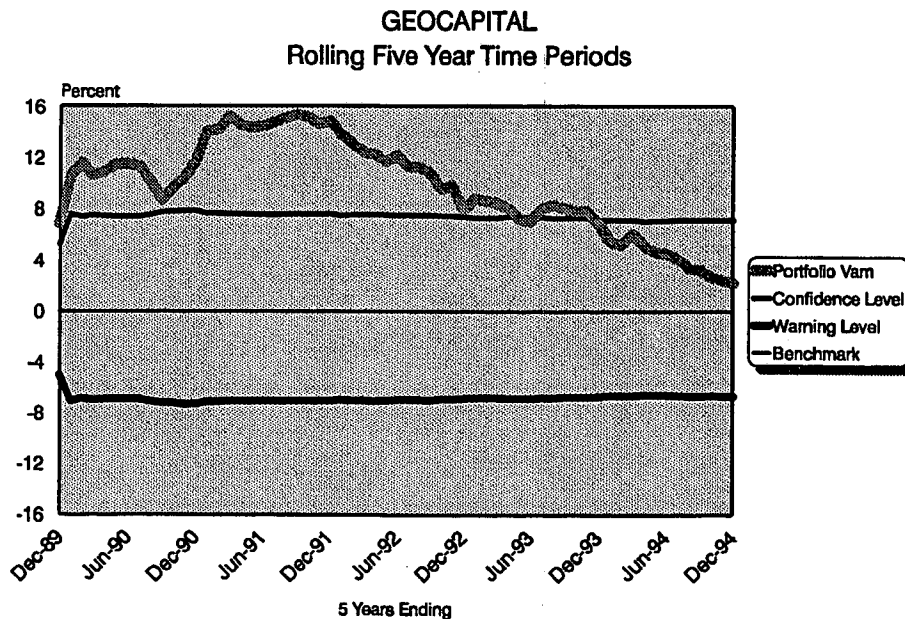
- Investment style consistently and successfully applied over a variety of market environments.
- Attractive, unique investment approach.
- Highly successful and experienced professionals.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-2.2%	-0.1%
Last 1 year	-4.5	4.2
Last 2 years	5.1	12.5
Last 3 years	4.0	11.5
Last 4 years	17.9	20.2
Last 5 years	N/A	N/A
Since Inception (4/90)	13.2	14.5

**Recommendation**

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 12/31/94**

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

**Assets Under Management: \$115,236,997**

**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. Staff expects the new benchmark to be implemented by April 1995.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.4%	0.3%
Last 1 year	0.8	3.2
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)	6.8	6.5

**Recommendation**

No action recommended.

**IDS ADVISORY**  
**Period Ending 12/31/94**

**Portfolio Manager: Pete Anderson**

**Assets Under Management: \$373,330,083**

**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.

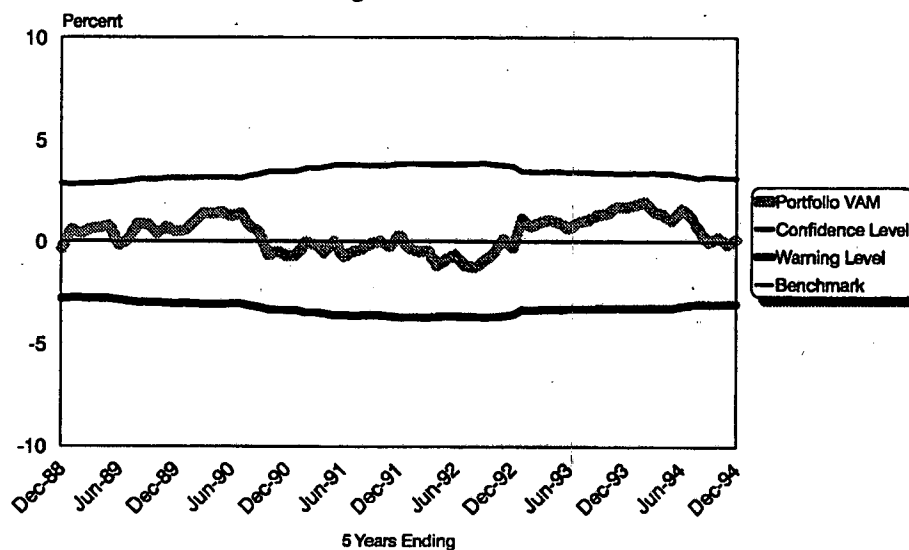
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.9%	0.4%
Last 1 year	0.9	2.3
Last 2 years	6.4	7.0
Last 3 years	8.0	9.5
Last 4 years	14.9	14.0
Last 5 years	9.7	9.8
Since Inception (1/84)	13.5	13.1

**Recommendation**

No action recommended.

**IDS ADVISORY**  
**Rolling Five Year Time Periods**



Note: Graph uses 80/20 confidence interval.

**INDEPENDENCE INVESTMENT ASSOCIATES**  
**Period Ending 12/31/94**

**Portfolio Manager: Bill Fletcher**

**Assets Under Management: \$364,043,209**

**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.

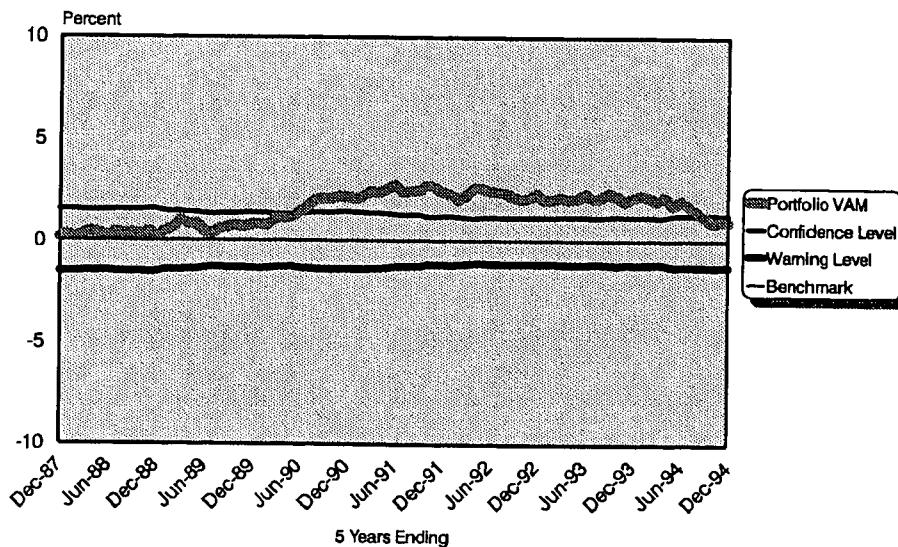
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.9%	0.0%
Last 1 year	-1.0	1.4
Last 2 years	5.3	5.7
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)	7.8	7.9

**Recommendation**

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 12/31/94**

**Portfolio Manager: James Jundt**

**Assets Under Management: \$222,474,668**

**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	-0.2%	1.2%
Last 1 year	5.1	3.9
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)	6.0	7.5

**Recommendation**

No action recommended.

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

**LINCOLN CAPITAL MANAGEMENT**  
**Period Ending 12/31/94**

**Portfolio Manager: Parker Hall**

**Assets Under Management: \$262,031,727**

**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	1.9%	1.3%
Last 1 year	4.1	4.4
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)	5.4	5.5

**Recommendation**

No action recommended.

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

**LYNCH & MAYER**  
 Period Ending 12/31/94

**Portfolio Manager: Eldon Mayer**

**Assets Under Management: \$314,815,402**

**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.

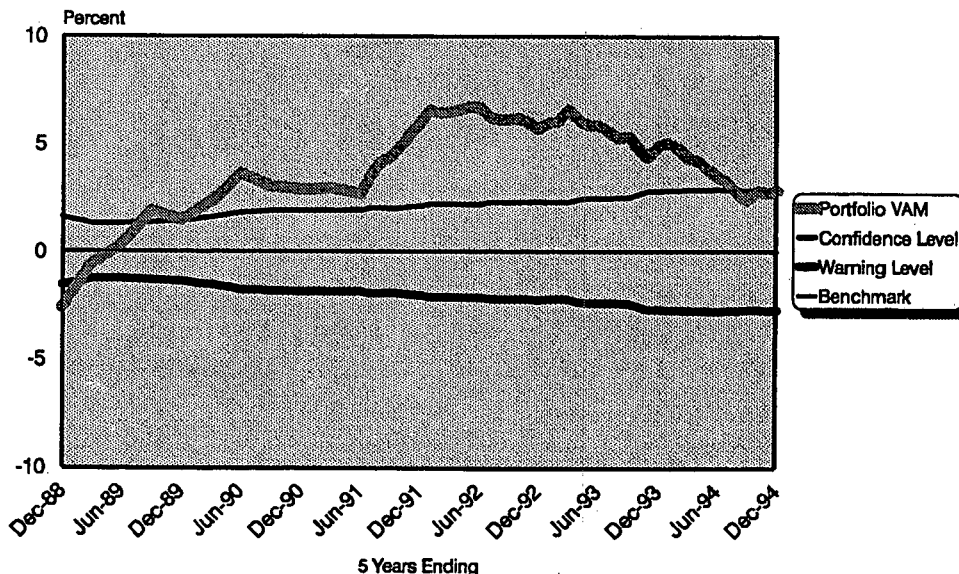
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.2%	1.0%
Last 1 year	-0.7	2.7
Last 2 years	2.6	7.7
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)	5.1	8.4

**Recommendation**

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 12/31/94**

**Portfolio Manager: John Lindenthal**

**Assets Under Management: \$262,258,949**

**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	-1.3%	-0.7%
Last 1 year	0.5	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)	3.8	3.5

**Recommendation**

No action recommended.

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



**WADDELL & REED ASSET MANAGEMENT**  
 Period Ending 12/31/94

**Portfolio Manager: Henry Herrmann**

**Assets Under Management: \$387,560,387**

**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 April 1995.

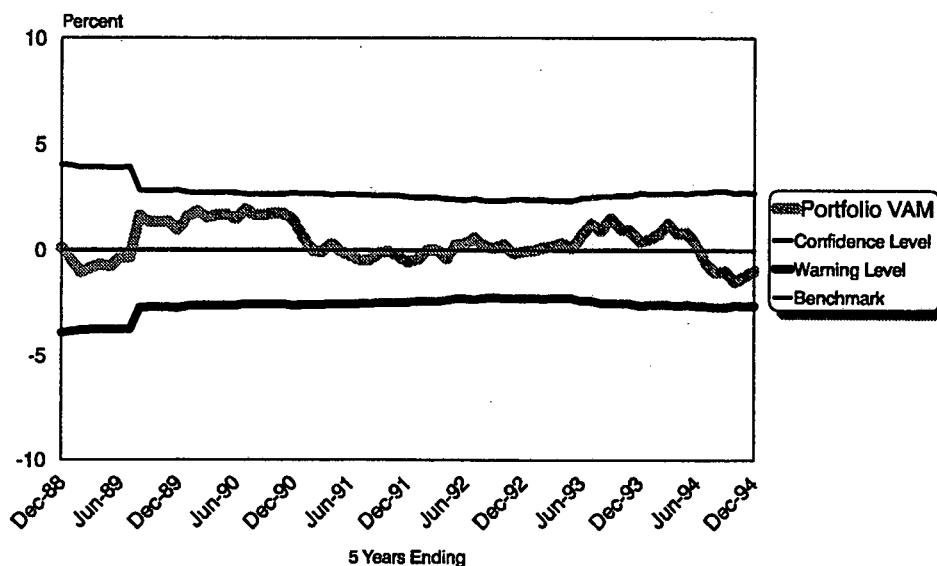
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-1.3%	-1.4%
Last 1 year	1.0	1.3
Last 2 years	7.2	9.0
Last 3 years	9.7	10.2
Last 4 years	13.7	15.3
Last 5 years	9.0	10.0
Since Inception (1/84) (1/84)	11.2	10.9

**Recommendation**

No action recommended.

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



Note: Graph uses 80/20 confidence interval.

**WEISS, PECK & GREER**  
**Period Ending 12/31/94**

**Portfolio Manager: Melville Straus**

**Assets Under Management: \$199,028,914**

**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	-3.3%	-0.4%
Last 1 year	-7.6	-1.0
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)	-0.9	5.9

**Recommendation**

No action recommended.

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

**CIC ASSET MANAGEMENT**  
Period Ending 12/31/94

**Portfolio Manager: Jorge Castro**

**Assets Under Management: \$30,355,153**

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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	-0.2%	0.0%
Since Inception (4/94)	1.2	5.4

**COHEN DAVIS & MARKS INCORPORATED**  
Period Ending 12/31/94

**Portfolio Manager: George Cohen**

**Assets Under Management: \$33,178,221**

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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	1.5%	0.0%
Since Inception (4/94)	10.6	5.4

**COMPASS CAPITAL MANAGEMENT**  
**Period Ending 12/31/94**

**Portfolio Manager: Charles Kelley**

**Assets Under Management: \$31,619,205**

**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	1.6%	-1.7%
Since Inception (4/94)	5.4	3.5

**FIRST CAPITAL ADVISORS, INC.**  
**Period Ending 12/31/94**

**Portfolio Manager: Phil Orlando**

**Assets Under Management: \$30,204,131**

**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	-1.2%	0.0%
Since Inception (4/94)	0.7	5.4

**KENNEDY CAPITAL MANAGEMENT**  
Period Ending 12/31/94

**Portfolio Manager: Richard Sinise**

**Assets Under Management: \$29,842,286**

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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	-4.3%	-1.9%
Since Inception (4/94)	-0.5	0.9

**NEW AMSTERDAM PARTNERS**  
Period Ending 12/31/94

**Portfolio Manager: Michelle Clayman**

**Assets Under Management: \$29,355,857**

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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	-1.2%	-0.4%
Since Inception (4/94)	-2.1	4.5

**VALENZUELA CAPITAL MANAGEMENT**  
**Period Ending 12/31/94**

**Portfolio Manager: Mariko Gordon**

**Assets Under Management: \$30,404,248**

**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**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-3.2%	0.0%
Since Inception (4/94)	1.3	5.4

**WILKE/THOMPSON CAPITAL MANAGEMENT INC.**  
**Period Ending 12/31/94**

**Portfolio Manager: Mark Thompson**

**Assets Under Management: \$32,722,360**

**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**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	4.2%	-2.1%
Since Inception (4/94)	9.1	1.2

**WINSLOW CAPITAL MANAGEMENT**  
**Period Ending 12/31/94**

**Portfolio Manager: Clark Winslow**

**Assets Under Management: \$32,540,108**

**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**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.8%	0.8%
Since Inception (4/94)	8.5	7.4

**ZEVENBERGEN CAPITAL INC**  
**Period Ending 12/31/94**

**Portfolio Manager: Nancy Zevenbergen**

**Assets Under Management: \$30,939,940**

**Investment Philosophy**

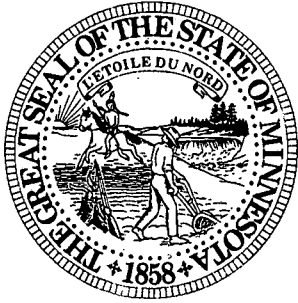
Zevenbergen is an equity growth manager. The investment philosophy is based on the belief that earnings drive stock prices while quality provides capital protection. Hence, portfolios are constructed with companies showing above-average earnings growth prospects and strong financial characteristics. 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**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.0%	0.8%
Since Inception (4/94)	3.1	7.4







# STATE BOARD OF INVESTMENT

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## **Bond Manager Evaluation Reports**

**Fourth Quarter, 1994**



**DOMESTIC BOND MANAGERS**  
**Period Ending 12/31/94**

Current Managers	Quarter		1 Year		3 years		5 Years		Since (1) Inception		Market Value (in millions)	Pool %
	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk		
	%	%	%	%	%	%	%	%	%	%		
BEA	1.3	0.4	-3.3	-2.8					-0.1	-0.1	\$278.49	4.6%
IAI	1.2	0.4	-3.9	-2.8	5.3	4.7	8.1	7.7	11.5	11.2	458.34	7.6%
Miller	0.1	0.4	-4.3	-2.8	4.8	4.7	8.6	7.8	11.3	11.2	502.43	8.3%
Standish	0.3	0.4	-4.0	-2.8					-0.7	-0.1	455.09	7.6%
Western	0.3	0.4	-4.1	-2.8	5.9	4.7	8.6	7.9	12.2	11.1	848.64	14.1%
IDS (2)	0.8	0.4	-3.4	-3.4					-0.1	-0.3	238.35	4.0%
TCW (3)	-3.4	0.4	-5.9	-1.4					-2.0	0.3	231.09	3.8%
Goldman (4)	0.9	0.4	-2.1	-2.8					0.6	-0.1	1,011.55	16.8%
Fidelity (4)	-0.4	0.4	-2.6	-2.8	5.2	4.7	8.2	7.8	8.9	8.6	1,001.43	16.6%
Lincoln (4)	0.5	0.4	-2.6	-2.8	4.8	4.7	7.8	7.8	8.6	8.6	996.54	16.5%
											\$6,021.95	100.0%
									<b>Since 7/1/84</b>			
Current Aggregate	0.3	0.4	-3.2	-2.8	5.2	4.8	8.2	7.8	11.6	11.1		
Historical Aggregate (5)	0.2	0.4	-3.3	-2.8	5.1	4.8	8.1	7.8	11.0	11.0		
Lehman Aggregate (6)		0.4		-2.8		4.8		7.8		10.5		

- (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 12/31/94**

**Portfolio Manager: Bob Moore**

**Assets Under Management: \$278,490,317**

**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	1.3%	0.4%
Last 1 year	-3.3	-2.8
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)	-0.1	-0.1

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

**INVESTMENT ADVISERS**  
**Period Ending 12/31/94**

**Portfolio Manager: Larry Hill**

**Assets Under Management: \$458,344,446**

**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.

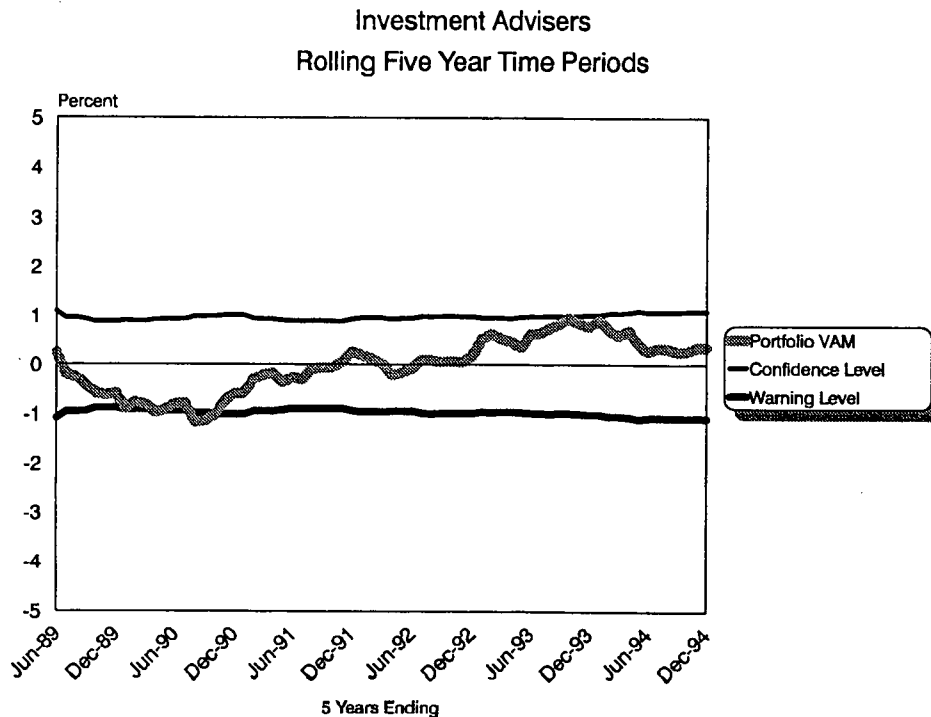
**Qualitative Evaluation**  
(reported by exception)

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.2%	0.4%
Last 1 year	-3.9	-2.8
Last 2 years	4.1	3.4
Last 3 years	5.3	4.7
Last 4 years	8.2	7.4
Last 5 years	8.1	7.7
Since Inception (7/84)	11.5	11.2

**Recommendations**

No action recommended.



Note: Graph uses 80/20 confidence interval.

**MILLER ANDERSON & SHERRERD**  
 Period Ending 12/31/94

**Portfolio Manager: Tom Bennett**

**Assets Under Management: \$502,429,853**

**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.

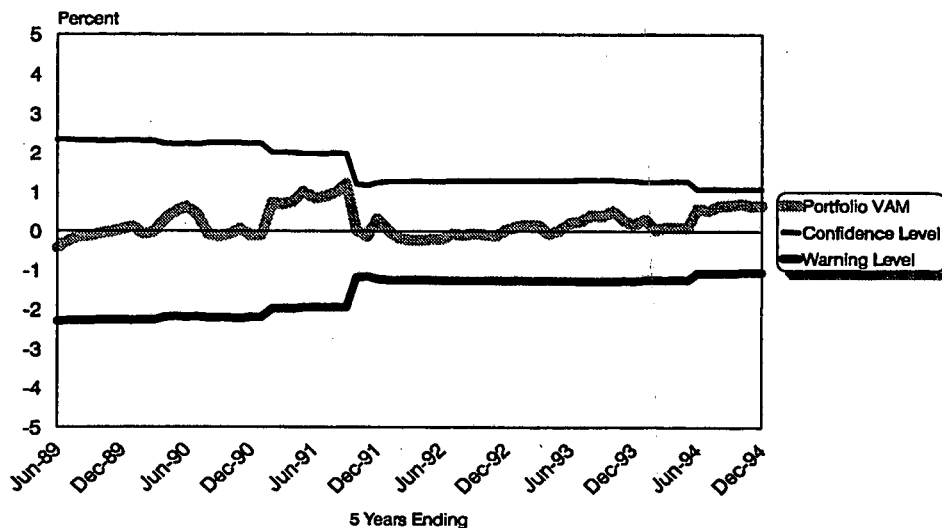
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.1%	0.4%
Last 1 year	-4.3	-2.8
Last 2 years	3.6	3.4
Last 3 years	4.8	4.7
Last 4 years	8.6	7.5
Last 5 years	8.6	7.8
Since Inception (7/84)	11.3	11.2

**Recommendations**

No action recommended.

**MILLER ANDERSON**  
 Rolling Five Year Time Periods



Note: Graph uses 80/20 confidence interval.

**STANDISH, AYER & WOOD**  
**Period Ending 12/31/94**

**Portfolio Manager: Austin Smith**

**Assets Under Management: \$455,089,903**

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**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	0.3%	0.4%
Last 1 year	-4.0	-2.8
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)	-0.7	-0.1

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95**



**WESTERN ASSET MANAGEMENT**  
**Period Ending 12/31/94**

**Portfolio Manager: Kent Engel**

**Assets Under Management: \$848,636,103**

**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.

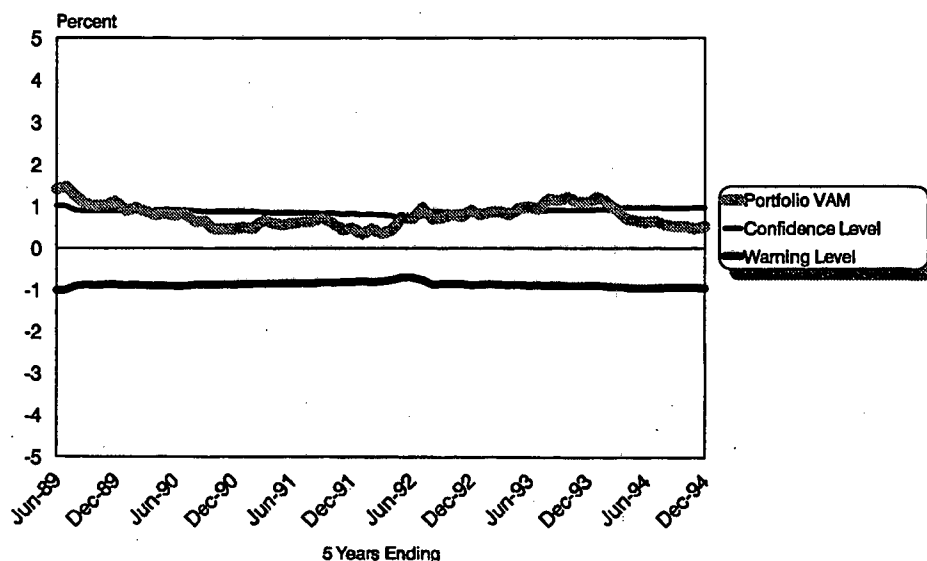
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.3%	0.4%
Last 1 year	-4.1	-2.8
Last 2 years	4.6	3.4
Last 3 years	5.9	4.7
Last 4 years	8.8	7.6
Last 5 years	8.6	7.9
Since Inception (7/84)	12.2	11.1

**Recommendations**

No action recommended.

**Western Asset Management  
 Rolling Five Year Time Periods**



Note: Graph uses 80/20 confidence interval.

**IDS ADVISORY GROUP**  
**Period Ending 12/31/94**

**Portfolio Manager: Ed Labenski**

**Assets Under Management: \$238,349,955**

**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	0.8%	0.4%
Last 1 year	-3.4	-3.4
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)	-0.1	-0.3

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

**TCW**  
**Period Ending 12/31/94**

**Portfolio Manager: Philip Barach**

**Assets Under Management: \$231,086,003**

**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	-3.4%	0.4%
Last 1 year	-5.9	-1.4
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)	-2.0	0.3

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

**GOLDMAN SACHS**  
Period Ending 12/31/94

**Portfolio Manager: Sharmin Mossavar Rahmani**

**Assets Under Management: \$1,011,554,928**

**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	0.9%	0.4%
Last 1 year	-2.1	-2.8
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	0.6	-0.1

**Recommendations**

No action recommended.

**Tracking graph will be drawn for the period ending 9/30/95.**

**FIDELITY MANAGEMENT TRUST**

Period Ending 12/31/94

**Portfolio Manager: Charles Morrison**

**Assets Under Management: \$1,001,429,895**

**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.

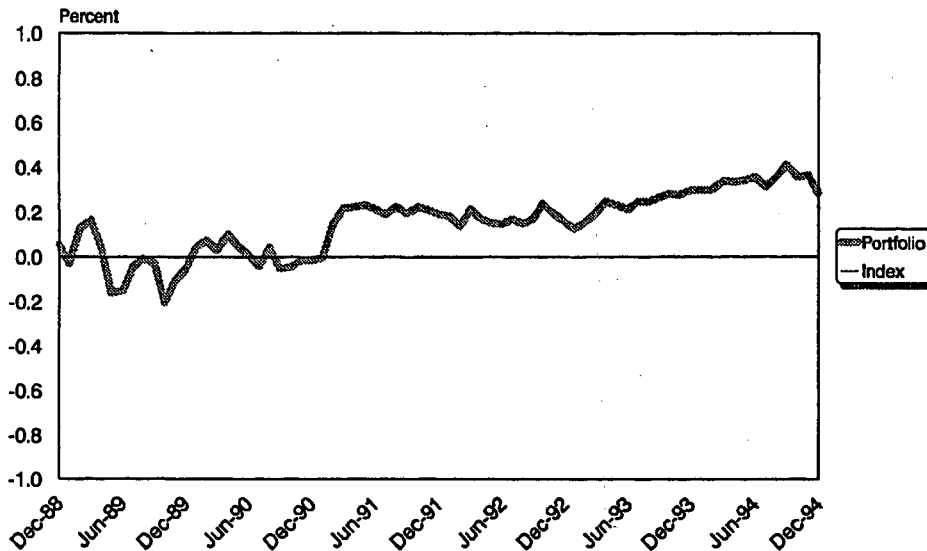
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.4%	0.4%
Last 1 year	-2.6	-2.8
Last 2 years	4.0	3.4
Last 3 years	5.2	4.7
Last 4 years	8.0	7.5
Last 5 years	8.2	7.8
Since Inception (7/88)	8.9	8.6

**Recommendations**

No action recommended.

**Fidelity Management Trust  
Cumulative Annualized Tracking Report**



**LINCOLN CAPITAL MANAGEMENT**  
**Period Ending 12/31/94**

**Portfolio Manager: Brian Johnson**

**Assets Under Management: \$996,543,588**

**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.

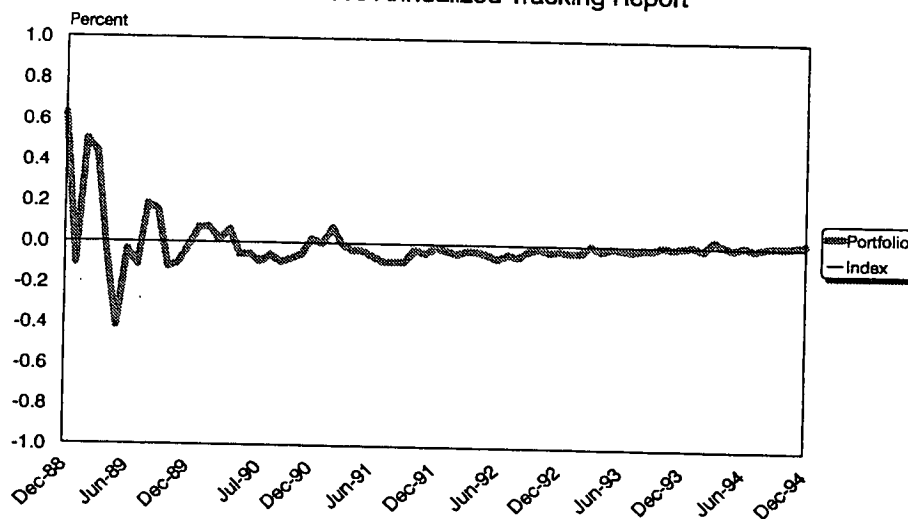
**Quantitative Evaluation**

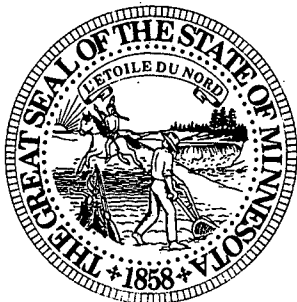
	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.5%	0.4%
Last 1 year	-2.6	-2.8
Last 2 years	3.5	3.4
Last 3 years	4.8	4.7
Last 4 years	7.5	7.5
Last 5 years	7.8	7.8
Since Inception (7/88)	8.6	8.6

**Recommendations**

No action recommended.

**LINCOLN CAPITAL MANAGEMENT**  
**Cumulative Annualized Tracking Report**





# STATE BOARD OF INVESTMENT

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## International Manager Evaluation Reports

Fourth Quarter, 1994





**INTERNATIONAL STOCK MANAGERS**  
**Period Ending 12/31/94**

Current Managers	Quarter		1 Year		3 years		5 Years		Since Inception		Market Value (in millions)	Pool %
	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk	Actual	Bmk		
	%	%	%	%	%	%	%	%	%	%		%
Baring (1)	-3.1	-1.0	1.1	7.8					15.4	14.9	\$185.99	9.2%
Brinson (1)	-1.3	-1.0	3.4	7.8					7.9	14.9	167.32	8.3%
Marathon (2)	-0.6	-1.0	16.8	7.8					13.9	4.7	174.55	8.6%
Rowe Price (2)	-3.5	-1.0	-0.1	7.8					6.2	4.7	160.71	8.0%
Scudder (2)	-2.6	-1.0	-2.1	7.8					2.4	4.7	157.42	7.8%
Templeton (2)	-3.0	-1.0	3.8	7.8					4.6	4.7	161.29	8.0%
State Street (3)	-1.0	-1.0	8.3	7.8					15.4	15.2	1,010.21	50.1%
<b>Current Aggregate</b>	<b>-1.7</b>	<b>-1.0</b>	<b>5.9</b>	<b>7.8</b>					<b>15.0</b>	<b>15.2</b>	<b>\$2,017.49</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 12/31/94**

**Portfolio Manager: Philip Bullen**

**Assets Under Management: \$185,990,456**

**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	-3.1%	-1.0%
Last 1 year	1.1	7.8
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)	15.4%	14.9%

**Recommendations**

No action recommended.

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

**BRINSON PARTNERS**  
Period Ending 12/31/94

**Portfolio Manager: Richard Carr**

**Assets Under Management: \$167,318,517**

**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.

Brinson utilizes currency equilibrium bands to determine which currencies are over or under valued. The firm will hedge to control the potential risk for real losses from currency depreciation.

**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	-1.3%	-1.0%
Last 1 year	3.4	7.8
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)	7.9%	14.9%

**Recommendations**

No action recommended.

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

**MARATHON ASSET MANAGEMENT**  
**Period Ending 12/31/94**

**Portfolio Manager: William Arah**

**Assets Under Management: \$174,550,317**

**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	-0.6%	-1.0%
Last 1 year	16.8	7.8
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 (11/93)	13.9%	4.7%

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

**ROWE PRICE-FLEMING INTERNATIONAL, INC.**  
Period Ending 12/31/94

**Portfolio Manager: Martin Wade**

**Assets Under Management: \$160,708,613**

**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	-3.5%	-1.0%
Last 1 year	-0.1	7.8
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 (11/93)	6.2%	4.7%

**Recommendations**

No action recommended.

**VAM graph will be created for period ending 3/31/96.**

**SCUDDER, STEVEN & CLARK**  
Period Ending 12/31/94

**Portfolio Manager: Nicholas Bratt**

**Assets Under Management: \$157,418,706**

**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	-2.6%	-1.0%
Last 1 year	-2.1	7.8
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 (11/93)	2.4%	4.7%

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

**TEMPLETON INVESTMENT COUNSEL, INC.**  
**Period Ending 12/31/94**

**Portfolio Manager: Harry Ehrlich**

**Assets Under Management: \$161,290,854**

**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	-3.0%	-1.0%
Last 1 year	3.8	7.8
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 (11/93)	4.6%	4.7%

**Recommendations**

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

# Tab G



## **COMMITTEE REPORT**

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**DATE:** March 7, 1995

**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 sessions with a private equity manager, T. Rowe Price and a real estate manager, TA Associates Realty.
- Additional investment for the Basic Retirement Funds with an existing resource manager, L.E. Simmons of SCF Partners.

Board action is requested on the investment with L.E. Simmons listed above.

### **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).

#### **Basic Funds**

- The real estate investment strategy calls for the establishment and maintenance of a broadly diversified real estate portfolio comprised of investments that provide overall diversification by property type and location. The main component of this portfolio consists of investments in diversified 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 twenty-nine (29) commingled private equity funds for a total commitment of \$823 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.

### **Post Fund**

- The Post Fund assets allocated to alternative investments will be invested separately from the Basic Funds' alternative investments to assure that returns are accounted for appropriately. 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. Currently, the SBI has committed \$60 million to two (2) yield oriented private equity funds.

## **2) Results of Review Sessions with Existing Managers.**

During the quarter, staff held a review session with one of the SBI's private equity managers, T. Rowe Price Stock Distribution Service and one of the SBI's real estate managers, TA Associates Realty.

The meeting with TA Associates Realty went well and produced no major surprises.

The Alternative Investment Committee and staff, however, have been concerned with the performance of T. Rowe Price over the last year. During the last year, a single large stock holding within the T. Rowe Price portfolio has severely hampered T. Rowe Price's otherwise satisfactory performance. Going forward, the Alternative Investment Committee and staff will closely monitor the performance of T. Rowe Price and recommend to the Board any actions needed to be taken, if appropriate, regarding T. Rowe Price.

Summaries of the review sessions are included as **Attachments C and D** of this Committee Report.

**ACTION ITEM:**

- 1) Additional investment with an existing resource manager, L.E. Simmons of SCF Partners, in SCF Partners 1995 Investment Fund.**

SCF Partners is seeking investors in a new \$150 million resource fund, SCF Partners 1995 Investment Fund. The fund will be a follow-on fund to two previous funds. Fund I was raised in 1989 with total committed capital of \$50.3 million. Fund II was raised in 1992 with total committed capital of \$90 million. The Minnesota Investment Board invested \$17 million in Fund II. Like Fund I and II, the 1995 Investment Fund will make investments in the energy service and equipment industry.

More information on SCF Partners 1995 Investment Fund is included as **Attachment E**.

**RECOMMENDATION:**

**The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$25 million or 20%, whichever is less, in SCF Partners 1995 Investment Fund. This commitment will be allocated to the Basic Retirement Funds.**

**Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by SCF Partners upon this approval. Until a formal agreement is executed by the Executive Director on behalf of the SBI, further due diligence and negotiations may result in the imposition of additional terms and conditions on SCF Partners or reduction or termination of the commitment.**

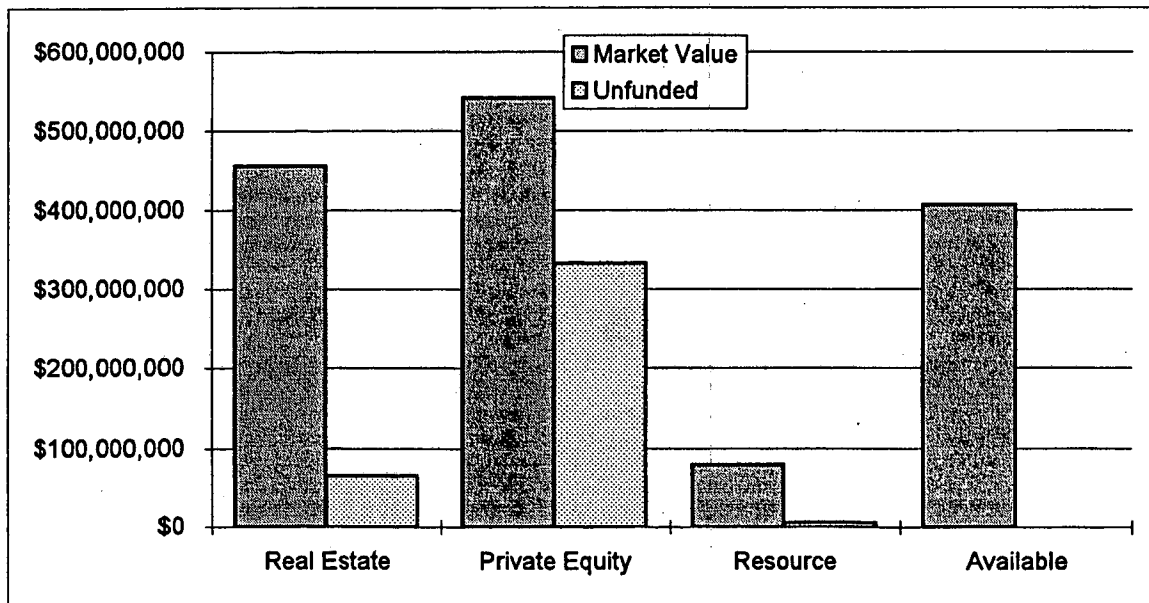


**ATTACHMENT A**  
**Minnesota State Board of Investment**  
*Alternative Investments Basic Retirement Funds*  
 December 31, 1994

Market Value of Basic Retirement Fund (Basic)                      \$9,889,820,444  
 Amount Available For Investment    \$406,419,279

	<i>Current Level</i>	<i>Target Level</i>	<i>Difference</i>
Market Value	\$1,077,053,788	\$1,483,473,067	\$406,419,279
MV + Unfunded	\$1,480,733,012	\$1,977,964,089	\$497,231,077

Asset Class	Market Value	Unfunded Commitment	Total
Real estate	\$455,764,656 4.6%	\$65,318,636 0.7%	\$521,083,292 5.3%
Private Equity	\$541,639,741 5.5%	\$332,297,016 3.4%	\$873,936,757 8.8%
Resource	\$79,649,391 0.8%	\$6,063,573 0.1%	\$85,712,964 0.9%
<b>Total</b>	<b>\$1,077,053,788</b> <b>10.9%</b>	<b>\$403,679,225</b> <b>4.1%</b>	<b>\$1,480,733,012</b> <b>15.0%</b>



# ATTACHMENT A (con't)

## STATE OF MINNESOTA ALTERNATIVE INVESTMENTS - BASIC FUNDS December 31, 1994

	INCEPTION DATE	TOTAL COMMITMENT	FUNDED COMMITMENT	MARKET VALUE	DISTRIBUTIONS	UNFUNDED COMMITMENT	IRR (%)	PERIOD (YEARS)
<b>REAL ESTATE</b>								
AETNA 013420	Sep-94	2,591,431	2,591,431	2,638,168	0	0	N/M	0.3
AETNA 007367	Apr-82	40,000,000	40,000,000	62,304,742	0	0	3.92	12.7
AEW III	Sep-85	20,000,000	20,000,000	17,447,735	3,555,705	0	0.55	9.3
AEW IV	Sep-86	17,400,000	15,000,000	4,568,124	829	2,400,000	-13.72	8.3
AEW V	Dec-87	15,000,000	15,000,000	10,745,728	342,517	0	-4.43	7.0
AMERICAN REPUBLIC	Feb-90	1	1	1	0	0	0.00	4.9
ARCH STREET CORP.	Jul-93	10,000,000	10,000,000	0	2,628,620	0	-61.55	1.5
EQUITABLE	Oct-81	40,000,000	40,000,000	72,072,172	0	0	4.97	13.2
FIRST ASSET REALTY	Apr-94	907,097	907,097	837,811	0	0	N/M	0.7
HEITMAN I	Aug-84	20,000,000	20,000,000	12,199,704	11,842,633	0	2.90	10.4
HEITMAN II	Nov-85	30,000,000	30,000,000	25,069,589	13,106,875	0	3.53	9.1
HEITMAN III	Jan-87	20,000,000	20,000,000	14,233,960	6,109,479	0	0.28	7.9
HEITMAN V	Dec-91	20,000,000	20,000,000	21,793,537	1,905,390	0	7.42	3.1
LASALLE	Sep-91	15,000,000	7,398,818	7,632,783	753,218	7,601,182	5.69	3.3
PAINE WEBBER	Feb-90	500,000	500,000	308,265	121,448	0	-3.38	4.9
REALTY ASSOCIATES FUND III	Jun-94	40,000,000	31,400,000	32,053,505	0	8,600,000	N/M	0.6
RREEF	May-84	75,000,000	75,000,000	68,829,796	23,574,712	0	2.73	10.7
TCW III	Aug-85	40,000,000	40,000,000	27,973,646	10,900,073	0	-0.38	9.4
TCW IV	Nov-86	30,000,000	30,000,000	21,718,690	2,399,405	0	-3.16	8.2
ZELL/MERRILL LYNCH II	Nov-91	50,000,000	37,482,546	37,601,400	260,134	12,517,454	0.55	3.1
ZELL/MERRILL LYNCH III	Jan-94	50,000,000	15,800,000	15,735,300	0	34,200,000	N/M	0.9
<b>TOTAL REAL ESTATE</b>		<b>536,398,529</b>	<b>471,079,894</b>	<b>455,764,656</b>	<b>77,501,038</b>	<b>65,318,636</b>		

<b>PRIVATE EQUITY</b>								
ALLIED	Sep-85	5,000,000	5,000,000	2,884,045	3,668,252	0	5.00	9.3
BANK FUND III TRUST	Oct-92	20,000,000	13,000,000	12,494,270	219,955	7,000,000	-2.52	2.2
BLACKSTONE PARTNERS II	Nov-93	50,000,000	4,817,985	3,981,230	297,381	45,182,015	-27.88	1.1
BRINSON	May-88	5,000,000	5,000,000	2,942,385	4,266,807	0	9.38	6.6
BRINSON II	Nov-90	20,000,000	15,800,000	12,135,837	11,889,798	4,200,000	25.06	4.1
CHURCHILL CAPITAL PARTNERS II	Oct-92	20,000,000	9,400,000	8,384,210	1,851,251	10,600,000	6.36	2.2
CORAL PARTNERS I SUPERIOR	Jun-86	7,160,972	7,160,972	4,957,336	2,707,667	0	2.72	8.5
CORAL PARTNERS II	Jul-90	10,000,000	8,000,000	7,721,156	1,579,857	2,000,000	0.73	4.4
CORAL PARTNERS IV	Jul-94	15,000,000	2,269,110	2,078,833	0	12,730,890	N/M	0.4
DSV	Apr-85	10,000,000	10,000,000	9,155,324	2,986,061	0	2.26	9.7
FIRST CENTURY	Dec-84	10,000,000	10,000,000	7,713,227	6,185,970	0	7.62	10.1
GOLDER THOMA III	Oct-87	14,000,000	13,025,000	10,159,465	14,486,100	975,000	19.01	7.2
GOLDER THOMA IV	Jan-94	20,000,000	5,600,000	5,398,252	0	14,400,000	N/M	0.9
HELLMAN & FRIEDMAN III	Sep-94	40,000,000	0	0	0	40,000,000	0.00	0.3
IAI VENTURES I	Mar-91	1,222,828	1,222,828	630,572	570,049	0	8.89	3.8
IMR PARTNERSHIP	Aug-92	15,000,000	1,176,900	1,165,602	38,997	13,823,100	-0.60	2.4
INMAN BOWMAN	Jun-85	7,500,000	7,500,000	5,512,099	2,910,732	0	1.80	9.6
KKR I	Jun-84	25,000,000	25,000,000	45,610,000	70,842,805	0	29.29	10.6
KKR II	Apr-86	18,365,339	18,365,339	51,570,000	44,325,404	0	23.70	8.7
KKR III	Nov-87	145,950,000	145,950,000	225,390,000	106,112,943	0	10.74	7.1
KKR IV	Dec-93	150,000,000	15,631,949	8,290,000	5,922,324	134,368,051	-19.43	1.0
MATRIX II	Aug-85	10,000,000	10,000,000	3,541,651	15,379,066	0	12.51	9.4
MATRIX III	May-90	10,000,000	8,750,000	14,641,092	4,570,563	1,250,000	36.70	4.7
NORTHWEST	Jan-84	10,000,000	10,000,000	1,545,901	10,411,651	0	2.59	11.0
SUMMIT I	Dec-84	10,000,000	10,000,000	2,118,840	16,807,381	0	12.41	10.0
SUMMIT II	May-88	30,000,000	28,865,455	17,148,073	35,417,255	1,134,545	23.38	6.6
T.ROWE PRICE	Nov-87	64,152,711	64,152,711	32,937,973	29,923,904	0	-3.39	7.1
WARBURG PINCUS	Dec-94	50,000,000	6,000,000	5,995,530	0	44,000,000	N/M	0.0
ZELLCHILMARK	Jul-90	30,000,000	29,366,585	35,536,838	2,757,024	633,415	12.84	4.5
<b>TOTAL VENTURE CAPITAL</b>		<b>823,351,850</b>	<b>491,054,834</b>	<b>541,639,741</b>	<b>396,129,197</b>	<b>332,297,016</b>		

<b>RESOURCES</b>								
AMGO I	Sep-81	15,000,000	15,000,000	6,258,108	3,614,536	0	-4.06	13.3
AMGO II	Feb-83	7,000,000	7,000,000	7,323,355	2,325,453	0	3.64	11.9
AMGO IV	May-88	12,300,000	12,300,000	10,929,012	1,508,552	0	0.22	6.6
AMGO V	May-90	16,800,000	15,925,203	19,130,056	3,403,869	874,797	11.46	4.7
APACHE III	Dec-86	30,000,000	30,000,000	7,131,983	36,617,926	0	10.86	8.0
MORGAN OIL&GAS	Aug-88	15,000,000	13,799,697	16,062,133	1,642,266	1,200,303	5.43	6.4
SIMMONS OFS	Aug-91	17,000,000	13,011,527	12,814,744	774,080	3,988,473	2.85	3.4
<b>TOTAL RESOURCES</b>		<b>113,100,000</b>	<b>107,036,427</b>	<b>79,649,391</b>	<b>49,886,682</b>	<b>6,063,573</b>		
<b>TOTAL PORTFOLIO</b>		<b>1,472,850,379</b>	<b>1,069,171,155</b>	<b>1,077,053,788</b>	<b>523,516,917</b>	<b>403,679,225</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 (con't)**  
**STATE OF MINNESOTA**  
**ALTERNATIVE INVESTMENTS - POST FUND**  
**December 31, 1994**

	<b>INCEPTION DATE</b>	<b>TOTAL COMMITMENT</b>	<b>FUNDED COMMITMENT</b>	<b>MARKET VALUE</b>	<b>DISTRIBUTIONS</b>	<b>UNFUNDED COMMITMENT</b>	<b>IRR (%)</b>	<b>PERIOD (YEARS)</b>
<b>REAL ESTATE</b>								
<i>TOTAL REAL ESTATE</i>		0	0	0	0	0		
<b>PRIVATE EQUITY</b>								
SUMMIT III (GP58)	Mar-94	20,000,000	4,000,000	4,023,948	0	16,000,000	N/M	0.8
CITICORP MEZZANINE (GP58)	Dec-94	40,000,000	3,478,261	3,478,261	0	36,521,739	N/M	
<i>TOTAL VENTURE CAPITAL</i>		60,000,000	7,478,261	7,502,209	0	52,521,739		
<b>RESOURCES</b>								
<i>TOTAL RESOURCES</i>		0	0	0	0	0		
<i>TOTAL PORTFOLIO</i>		60,000,000	7,478,261	7,502,209	0	52,521,739		



**ATTACHMENT C**

**ANNUAL REVIEW SESSION  
T.A. ASSOCIATES REALTY FUND III  
FEBRUARY 9, 1995**

**MANAGER REPRESENTATIVES:** Mike Ruane, Andrew Neher

**SBI ASSETS UNDER MANAGEMENT:** \$32,053,505

**BACKGROUND AND DESCRIPTION:**

T. A. Associates Realty, a Boston based real estate firm, established Fund III in January 1994 and received \$387 million in capital commitments from investors. The investment focus of Fund III is to make equity investments in small to medium (\$12-\$15 million) properties with an emphasis on industrial property. The fund has a term of 10 years. The SBI's investment commitment to Fund III is \$40 million. As of December 31, 1994 \$31.4 million of that commitment has been funded

**QUALITATIVE EVALUATION:**

- 20 investments have been made totaling \$274 million out of the funds' total capital of \$387 million. Property acquisitions, to date, have emphasized industrial properties. The fund is expected to be fully invested by December 1995. Overall, the properties in the fund have an average occupancy rate of 96%.
- Since fund inception, TA Associates Realty has added 3 administration people, an acquisition person, and an asset manager to the organization. Additionally, another asset manager and administration person will be added in early 1995.
- The average investment size per property has been approximately \$13 million which is within the originally expected range of \$12-\$15 million.
- The fund continues to emphasize maximizing property cash flow with limited leverage. The date, the operating income return on invested assets has been 10.2%.

**ATTACHMENT C (con't)**

**QUANTITATIVE EVALUATION**

<b>COMMITMENT:</b>	\$40.0 million
<b>FUNDED COMMITMENT:</b>	\$31.4 million
<b>MARKET VALUE OF FUNDED COMMITMENT:</b>	\$32.1 million
<b>CASH DISTRIBUTIONS:</b>	\$0
<b>INCEPTION DATE:</b>	January 1994
<b>INTERNAL RATE OF RETURN (IRR): (annualized since inception)</b>	N/M

**DIVERSIFICATION PROFILE**

<b>LOCATION</b>		<b>PROPERTY TYPE</b>	
Northeast	49.0 %	Industrial	44.0 %
Midwest	25.0	Office	32.0
Southeast	5.0	Retail	14.0
Southwest	17.0	Multi-Family	<u>10.0</u>
Pacific	<u>4.0</u>		100.0 %
	100.0 %		

**ATTACHMENT D**

**ANNUAL REVIEW SUMMARY  
T. ROWE PRICE STOCK DISTRIBUTION SERVICE  
FEBRUARY 13, 1995**

**MANAGER REPRESENTATIVES:** Preston Athey, Charles Ober

**SBI ASSETS UNDER MANAGEMENT:** \$34,937,973

**BACKGROUND AND DESCRIPTION:**

T. Rowe Price, a Baltimore-based money management firm, was selected in 1987 to manage stock distributions from the SBI's alternative investment portfolios. T. Rowe Price has extensive research capabilities and an expertise in the small capitalization company area. In addition, the firm has a large trading staff with particular expertise in the trading of small capitalization and illiquid stocks.

**QUALITATIVE EVALUATION:**

Over the last year, T. Rowe Price's performance has been severely hampered by the poor performance of British Petroleum Royalty Trust (BPT). In February 1994, the SBI transferred its holding of BPT, which was previously in the resource segment of the alternative investment portfolio, to T. Rowe Price for eventual sale. Since the BPT transfer to T. Rowe Price, BPT's stock price has declined significantly from \$25.625 per share at the time of transfer to \$17.25 per share at 12/31/94. Excluding the BPT holding, T. Rowe Price's performance from inception through 12/31/94 was a 28% annualized internal rate of return. Including BPT, T. Rowe Price's performance from inception through 12/31/94 was -3.39%.

Currently, T. Rowe Price feels that BPT's stock price has little downside from its current level. At the current stock price of \$17.25, BPT is generating an annual dividend yield for the SBI of 9.10%

T. Rowe Price currently has 11 clients, including the SBI, in the stock distribution service as of 12/31/94. No new clients are expected to be added as T. Rowe Price feels they are at capacity regarding their ability to service clients effectively.

ATTACHMENT D (con't)

QUANTITATIVE EVALUATION

COMMITMENT:	\$64,152,711
FUNDED COMMITMENT:	\$64,152,711
MARKET VALUE OF FUNDED COMMITMENT:	\$34,937,973
CASH DISTRIBUTIONS:	\$29,923,904
INCEPTION DATE:	November, 1987
INTERNAL RATE OF RETURN (IRR): (annualized since inception)	-3.39 %

DIVERSIFICATION PROFILE  
INVESTMENTS CURRENTLY HELD

STOCKS HELD

Consumer Nondurables	19.0 %
Consumer Service	1.0
Technology	18.0
Capital Equipment	1.0
Business Services and Transportation	9.0
Miscellaneous	<u>52.0</u>
	100.0 %

## ATTACHMENT E

### PRIVATE EQUITY MANAGER SUMMARY PROFILE

#### ***I. Background Data***

***Name of Fund:*** SCF Partners 1995 Investment Fund

***Type of Fund:*** Private Equity Limited Partnership

***Total Fund Size:*** \$150 million

***Fund Manager:*** SCF Partners  
6600 Texas Commerce Tower  
Houston, TX 77002-3007  
Phone (713) 227-7888  
Fax (713) 227-7850

***Manager Contact:*** L. E. Simmons  
Anthony DeLuca

#### ***II. Organization & Staff***

SCF Partners has an office in Houston, Texas and is staffed with five investment professionals: L. E. Simmons, David Baldwin, Anthony DeLuca, Clay Williams, and Nancy Peretz. They have also retained Sam Sorrell, who has 37 years industry experience, as an advisor to the fund.

SCF has raised two previous funds. Fund I was raised in 1989 with total committed capital of \$50.3 million. Fund II was raised in 1992 with total committed capital of \$90 million. The Minnesota Investment Board invested \$17 million in Fund II.

#### ***III. Investment Strategy***

The fund will make investments in the energy service and equipment industry. Primary emphasis will be placed on identifying transactions which display strong fundamentals, value-added opportunities, reasonable pricing, and appropriate financial structuring.

In evaluating businesses SCF will look for excellent management, a history of cash flow from operations and a defensible market and product position. In addition, emphasis will be given to companies having a significant degree of operating leverage from increased sales volume and expected price increases. In most cases, companies should be in a position to produce 25 to 35 percent cash flow on

## ATTACHMENT E (con't)

incremental revenues. This will allow for significant increases in earnings as the market cycles upward.

When possible, and as appropriate, transactions will be based upon a multiple of approximately six times Earning Before Interest, Depreciation, and Taxes (EBIDT). Valuations should be attractive enough to allow for a reasonable investment return if the oil field service (OFS) industry continues to be soft while providing upside through strategic growth and industry recovery.

Significant value can be created by combining companies to affect strategic growth. The nature of the OFS industry lends itself to such consolidation and synergistic growth. Consolidation transactions include combining companies in similar markets to achieve a strong market presence, geographical expansion or product line extension. These transactions also often create significant cost savings. In many cases, the cost saving made possible by an acquisition results in a purchase price multiple of less than the targeted six times EBIDT.

Additional value can be added by an appropriate but often creative financial structure that is intended to minimize downside risk while retaining maximum upside potential. The financial structures often involve the use of seller and third-party financing. The financial structure of each transaction is tailored to best fit a company's cash flow, risk profile and future growth opportunities.

### *IV. Investment Performance*

As of December 31, 1994, Fund I had invested \$54.9 million, distributed \$112 million, and had a residual market value of \$28.8. This corresponds to a net IRR to investors of 33.7%. The SBI's commitment to Fund II is \$17 million, SCF has invested \$13 million, distributed \$774 thousand, and had a residual market value of \$12.8 million. This corresponds to a net IRR to investors of 2.85%.

### *V. General Partners Investment*

At least 1% of the total capital of the partnership.

### *VI. Takedown Schedule*

Capital contributions by the limited partners will be on a transaction-by-transaction basis on not less than 15 days notice.

## ATTCHMENT E (con't)

### ***VII. Management Fees***

An annual fee of 2 percent of each subscriber's subscription, payable quarterly in advance by each subscriber. The fee on unfunded subscriptions will be reduced as subscriptions are drawn down for investment, and will expire when subscriptions are drawn down completely or five years after commencement of the fund, whichever is earlier. The management fee will be reduced by a portion of distributions up to the cost of an investment giving rise to the distribution.

### ***VIII. Organizational Costs***

The subscribers will share, in proportion to their subscription amounts, a maximum of \$300,000 in legal expenses and other costs associated with establishing the fund.

### ***IX. Term***

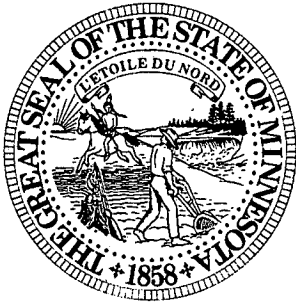
Ten years with possible extension by vote thereafter.

### ***X. Distributions***

An incentive fee will be paid to the general partner, equal to 20 percent of all profits on an overall investment basis, provided that no payment will be made to the general partner until after the limited partners have received back an amount equal to all amounts invested, management fee's, and expenses with respect to all investments and a 10 percent compound annual return.

# Tab H





# STATE BOARD OF INVESTMENT

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## Manager Commentaries

**Period Ending December 31, 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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$124 billion	Actual	1.0%	-1.9%
Total Firm Assets Managed in this Discipline	\$ 11 billion	Benchmark	0.4%	1.2%

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 outperformed the benchmark. While we were only slightly overweighted in technology, our major positions, i.e. Microsoft, Compaq and Motorola, were particularly strong performers along with smaller holdings such as Cisco and Hewlett Packard. This sector was the single biggest contributor to the positive performance. Our overweight in consumer services, i.e. McDonalds, Disney and Viacom, also added to the positive performance. The latter company completed its acquisition of Blockbuster at the beginning of the quarter and a great deal of interest was created in this major new media company. In the quarter our overweight in retail was a negative as stocks such as May, Toys R Us and WalMart reacted negatively to the sluggish Christmas selling season. In addition as interest rates continued to rise our financial overweight was a negative with the bank stocks particularly underperforming. Rising interest rates, Orange County and Mexico all weighed negatively on this sector.

In calendar 1994, we underperformed the benchmark. Our underweight in consumer staples and our overweight in the financial sector were the primary reasons. As previously mentioned, several events negatively affected financial stocks during the year while consumer staple stocks were helped by the perception that the interest rate rise would ultimately slow economic growth and make the relative earnings of these companies more attractive. On the positive side was our technology overweight, particularly Microsoft +52% and Motorola +20% which were large positions held throughout the year. Our overweighting in consumer services was mixed as cellular; LIN +35% was offset by cable; Time Warner -20% and Telecommunications -25%. Cable was particularly hurt by Federal rate re-regulation. However the recent national elections have changed the regulatory environment significantly. While we were modestly underweighted in healthcare, our three major holdings were strong performers; United Healthcare and Amgen +19% and Abbott +10%.

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.*

Currently our strategy is based on our belief that 1995 will be a year of strong corporate profits, cash flow growth, and a more stable interest rate environment. We continue to have a significant portion of the portfolio in the technology area and while it is only a modest overweight to the benchmark, we are significantly overweighted in semi-conductor stocks and other companies benefiting from the strong growth of the PC cycle. Our financial overweight continues as we believe the multiple to growth rate for many financial stocks is extremely attractive and performance will improve as interest rates stabilize. Our underweight in consumer staples continues as we believe the fundamentals for many of these companies, particularly those with primarily a domestic orientation are less compelling.

**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.*

**New Accounts**

Arizona Public Service  
Anne Arundel County

**Lost Accounts**

Bush Foundation  
Wilder Foundation

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**  
**Brinson Partners, Inc.**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$37.3 Billion	Actual	-3.4%	1.0%
Total Firm Assets Managed in this Discipline	\$ 9.8 Billion	Benchmark	-1.1%	0.1%

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?*

Despite strong growth of corporate profits and cash flows, the U.S. stock market was impeded by rising interest rates and low but increasing market volatility during 1994. The portfolio is overweighted with respect to stocks with high earnings/price and book/price measures. These exposures had a positive effect on fourth quarter performance but were largely offset by negative contributions from issues that are more economically sensitive and financially levered than the market. Finally, the portfolio began the year with an overweight in stocks that rank high in terms of foreign earnings exposure. This exposure declined as a result of changes made to the portfolio throughout the year and the portfolio is presently underweighted with respect to foreign earnings exposure. In light of the relative weakness of the dollar compared with other major currencies, this exposure contributed materially to performance during 1994.

Industry weightings detracted slightly from fourth quarter performance although they added the largest increment to portfolio performance during the year. Positive returns from relative overweights in the aluminum, paper, electronics and drug sectors and from underweights in electric utilities and autos more than offset negative contributions to performance from our relative overweights in airline, tobacco and oil service stocks. Paper and aluminum stocks benefited from strong commodity price gains. Technology and electronic issues performed well during the year and drug stock prices rebounded during the third and fourth quarters reflecting diminished concerns over the potential effect of health care reform legislation and government regulation of drug prices. Airline and other transportation stocks were among the worst performing industry groups in 1994. Finally, electric utility stocks underperformed throughout 1994, consistent with rising interest rates and increasing competitive pressures in the industry. Due in part to strong industry effects, stock selection has detracted from portfolio performance during both the fourth quarter and for the year ending in December. Holdings which contributed to negative stock selection during these periods included Cooper Industries, Honeywell, Nextel, RJR Nabisco and Sprint.

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 prior portfolio changes have resulted in a measured shift away from economically sensitive stocks. Similarly, the portfolio remains modestly overweighted in stocks that rank high with respect to financial leverage, an exposure that will be selectively reduced.

From an industry perspective we have an overweight in financial/interest sensitive stocks. In an environment in which return on assets (ROA) remains above normal and credit losses are low, banks should continue to perform surprisingly well unless the Federal Reserve slows the economy more than expected. The portfolio overweight in insurance stocks, primarily property

## Brinson Partners, Inc. (con't)

casualty, suggests a non-consensus belief that industry earnings will improve as property casualty prices stabilize and loss costs continue to be adequately controlled.

The portfolio is underweighted utilities, including both electric utilities and the traditional telephones. We continue to believe that the eventual deregulation of power generation 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 underweighted in the traditionally defensive consumer sector including nondurables, retail/apparel and discretionary spending stocks, although prior portfolio changes have brought our holdings in retail/apparel to a near market weight. The portfolio also remains overweighted in selected healthcare and drug stocks. It appears that the effects of healthcare reform legislation will be less imposing than free market forces. Finally, the portfolio continues to be overweighted in some of the basic industries including aluminum and paper stocks although prior portfolio changes have reduced this overweight. Key holdings include Citicorp, Honeywell, Martin marietta, Pfizer, Schering-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.*

As indicated in our last quarterly update, 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.

During the fourth quarter of 1994, Brinson Partners, Inc. gained one U.S. equity mandate portfolio for a total of \$200 million. We did not lose any U.S. equity mandate portfolios during the fourth quarter of 1994. Firmwide assets as of September 30, 1994 (the latest date for which data are available) totaled \$37,249 million. U.S. equity assets under management across all portfolio mandates totaled \$9,814 million as of September 30, 1994.

- 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**  
**Forstmann-Leff Associates Inc.**

Period Ending:	12/31/94	Returns	Qtr.	1 Yr.
Total Firm Assets Under Management	\$2.7 billion	Actual	-3.3%	-6.5%
Total Firm Assets Managed in this Discipline	\$1.2 billion	Benchmark	-1.3%	0.8%

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?*

*For the fourth quarter*, performance was constrained by stock selection in the consumer non-durable sector, including the position in Price/Costco Inc., which, like other retailers, weathered an extremely competitive holiday shopping environment which temporarily depressed same store sales comparisons and fed investor skepticism. Since the end of the holiday season, comparable store sales have picked up and share price is improving. In addition, the portfolio's health related holdings declined, including HEALTHSOUTH Rehabilitation, which eased from extremely strong gains, as noted in our last report. Portfolio strength was seen in the consumer services area, particularly with the advance in McDonald's Corporation, one of the names which suffered in the previous quarter's sell off of restaurant stocks.

*For the year as a whole*, our view that the year would see moderate economic growth, with no recession through 1995, led us to focus upon economically sensitive issues including the autos, rails, hotels, aerospace and retail. Through the first quarter of the year the market rewarded this strategy, particularly among smaller companies with higher earnings leverage. However, Fed actions began to produce a shift in investor sentiment by the second quarter, as the market moved away from these economically sensitive names toward a more defensive strategy geared to a moderation of economic growth and favoring mature, large cap issues with more predictable, albeit lower, earnings growth.

Although we were correct on our economic and earnings forecasts, this shift produced an environment which, after the first quarter, severely discounted otherwise healthy profits, particularly in the more cyclically oriented segment of the market. Holdings such as our autos and rails were hit hard, and though their earnings met our expectations, the market has so far ignored this fact and appears to require further evidence of their ability to produce profits in a moderating growth environment. Further difficulties were experienced among the retail holdings. In spite of the consumer's willingness to take on additional debt to finance purchases, the retail environment remained extremely competitive through the end of the year, causing weakness across the group. Lastly, mid-cap names, traditionally our area of focus, experienced p/e contractions in a market which viewed them as vulnerable to both rising inflation and an economic slowdown. We were helped by a considerable underweighted position in the consumer non-durables and the utilities, two segments of the market which performed very poorly for the year. However, the negative effects of the overweighted economically sensitive issues were significant enough to overwhelm these positives.

## Forstmann (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.*

The manufacturing sector should prosper in 1995 on continued improvements in efficiency and strong worldwide demand for capital goods and technology. If 1995 earnings projections can be realized, the late 1994 sell-off in economically sensitive issues has produced an attractive valuation case for this segment of the market. However, further signs of an economic slowdown could alter investor enthusiasm in this area. Consequently, uncertainty as to the timing and degree of the Fed's success with the economy favors a strategic focus upon those industrial issues which have demonstrated improving growth patterns.

We continue to favor those names with significant exposure to foreign economies. 1995 should produce opportunities for attractive gains in consumer oriented companies with strong franchises and a healthy international component to earnings growth, such as McDonald's Viacom and Disney. Further, as interest rates peak the financial area, which has been heavily besieged, should provide attractive risk/reward potential.

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. Two accounts were lost in the fourth quarter, totaling \$33 million dollars. Both portfolios were for a fund of funds program at a consulting firm which is taking more control of the investment process. Neither were discretionary accounts.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

We are quite disappointed with the results of 1994. Our analysis of the portfolio suggests that in some instances the realization of our appreciation expectations has been delayed. We have eliminated those positions where improvement in earnings power appears elusive, and have redeployed those assets into other areas. As a further portfolio overlay, we are superimposing a more stringent risk management policy, with the objective of reducing overall portfolio volatility. In 1995 we expect the intrinsic values of our holdings to be realized, again producing an attractive premium to the benchmark. We look forward, with you, to a more productive year ahead.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Franklin Portfolio Associates Trust**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$5.8 billion	Actual	-0.3%	0.4%
Total Firm Assets Managed in this Discipline	\$372 million	Benchmark	-0.8%	0.1%

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?*

**Fourth Quarter Performance:**

For the fourth quarter, the account was ahead of the benchmark. The total return for the account was -0.3% compared to the benchmark's -0.8%. According to our performance attribution analysis, stock selection, industry exposures and risk factor exposures were all positive contributors to performance for the fourth quarter.

The positive risk factor bets which helped performance were the E/P and B/P factors. These two factors contributed an estimated 50 basis points to the active return. Positive industry bets in Business Machines and Cosmetics also contributed to active return. An under-exposure in Miscellaneous Metals & Mining sector also contributed to return since this sector underperformed the benchmark during the period. Industries which detracted from the account's return during the period were Precious Metals, Banks, Thrifts, and Oil Refiners. The account had a positive bet in these groups and they underperformed in the quarter. In all cases these groups were hurt, in part, by rising interest rates or by concerns that the Fed's aggressive interest rate posture could cause the economy to slow significantly and thus hurt profits. A positive active bet on Success, a measure of past performance, also hurt performance during the period.

From a specific stock selection point of view the following were strong positive contributors to performance - Micron Technology Inc. (a manufacturer of semiconductor devices), Silicon Graphics (a manufacturer of visual processing computer systems), Compaq Computer Corp., Archer Daniels Midland, and Texas Instruments. Negative contributors to performance were Sprint Corp., Ahmanson (H.F.) & Co., RJR Nabisco, Keycorp, and Unum Corp. Earnings concerns were the primary cause for the declines in these issues.

**Twelve Month Performance:**

For the full year, risk factor and stock bets were positive contributors and industry differences were a net negative. Factor bets that had a positive contribution to return were positive bets on E/P and B/P ratios. Positive bets on earnings-to-price and book-to-price tend to be functions of our value process. Also contributing to performance were positive bets on Drugs, Cosmetics and Food. All three groups experienced an improvement in earnings prospects during the year. Detracting from performance were positive industry bets in Air Transport (too much capacity and too much competition), Precious Metals (reduced inflation worries), Electric Utilities (rising interest rates and competition), and Consumer Durables (earnings slowdown). As in the fourth quarter, the risk factor bet which had the most negative impact on performance was our positive bet on the Success factor.

From a specific stock point of view, the top contributors to performance were: Compaq Computer, Safeway, Johnson & Johnson, DSC Communications (digital switching systems), and Syntex Corp. (takeover). Holdings in Snapple, International Game Technology,



## Franklin (con't)

Continental Corp., Keycorp, and Unum Corp., hurt performance over the year. In all cases negative earnings surprises were the major reason for the stocks' declines.

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 12/31/94, the following significant active bets existed in the account relative to the benchmark:

A. Factor bets (bets stated as standard deviation from benchmark):

Success = 0.34      Earnings/Price = 0.23      Book/Price = 0.11

B. Industry bets (bets stated as percentage deviation from benchmark weight):

5 Most Positive Bets:		5 Most Negative Bets:	
Gas Utilities	3.22	Health Non-Drugs	-2.69
Food Stores	3.09	Misc. Finance	-2.61
Banks	2.86	Telephones	-2.52
Food	2.68	Producer Goods	-2.12
Publishing	1.97	Retail	-1.97

C. Ten largest Stock bets (bets stated as percentage deviation from benchmark weight):

Archer Daniels Mid	2.52%	EMC Corp	2.38
Compaq Computer	2.31	Johnson & Johnson	2.11
American Stores	2.09	Phillips Petroleum	2.05
General Motors Cl H	2.03	American Greeting	1.96
Computer Associates	1.92	ConArga Inc.	1.87

All active bets in the portfolio are based on two considerations - the rank of individual issues and the impact of each issue on overall tracking error or risk of the total portfolio relative to the benchmark. The portfolio construction objective is to obtain as high a rank as possible consistent with the residual risk (tracking error relative to the benchmark) objective. We maintain 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. As of year-end, the forecast total tracking error for the portfolio was 3.34% with 82% of the tracking coming from stock specific risk.

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.*

In December, David Jiang joined Franklin as a Quantitative Research Analyst. David's schooling includes an undergraduate degree from Georgetown University and a Masters from Harvard. David's work experience includes time in Tokyo as a manager and financial analyst for Unisys. No accounts were gained or lost in this discipline during the period.

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  
GeoCapital Corporation**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$1.7 billion	Actual	-2.2%	-4.5%
Total Firm Assets Managed in this Discipline	\$1.7 billion	Benchmark	-0.1%	4.2%

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. 1994 was a difficult year for small caps as investors ignored strong earnings gains and focused more on interest rate hikes, derivatives, Orange County, and emerging market debacles. During the fourth quarter we added value on a return basis in both the technology and financial areas which is in sharp contrast to the overall year. Although it is early in 1995 this trend, we believe, has continued. Consumer non-durables did not work during the fourth quarter as the medical service stocks consolidated after early gains. Stocks that performed well included Alantec, NetManage, BMC Software, Applied Digital Access, and Digidesign in technology. These companies all reported higher than expected earnings. The Learning Company, Corvel, Maxicare, U.S. Trust, and Tatham Offshore also did well because of earnings gains and asset value increases. Performing poorly were Brookstone, US HomeCare, and Network due to less than expected earnings reports.

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 be invested in small caps as we strongly believe that 1995 will be a strong performance period for these stocks relative to the rest of the market. Our belief is based on the following factors: 1.) the valuations of small stocks on a relative basis is historically low based on the T. Rowe Price New Horizons Fund versus the S&P 500, and 2.) while the Fed may raise rates early in 1995, we think this trend may reverse as the economy slows in the second half of the year. Small stocks usually perform well in this environment as earnings continue to grow. We continue to make bets in technology as companies and individuals implement computer technology in critical mission applications. In addition, the financial area is an important area for us as we continue to see increased consolidation. The consumer non-durable sector which includes medical services and special services where we see consolidation and earnings growth is also an important bet.

## 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.

No change in ownership or personnel.

<u>Lost</u>	<u>Reason</u>
A.S.E.F. Fluor Corporation	Focus is on large caps - no longer in smaller stocks Asset allocation restructure

4. **Other Comments.** Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

*Why we are bullish in 1995.* Our activity has increased during the last quarter of 1994 and the early part of 1995 as we structure the SBI portfolio. New stocks include MapInfo, Network General, Sybase, and Pinnacle Systems in technology, and Summit Care, Phamis, Homedco, and Gulf South Medical in medical services. We added significantly to NovaCare and Coastal Healthcare on weakness. Major sales include Oracle, Value Health, and Department 56 due to high valuations. Topps, Health Risk Management, and Multimedia were sold due to disappointing fundamentals.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Investment Advisers, Inc.**

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<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$13.7 Billion	Actual	0.4%	0.8%
Total Firm Assets Managed in this Discipline	\$702 Million	Benchmark	0.3%	3.2%

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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?*

**Quarterly Performance:** The portfolio was aided by our continued overweighting of Telecommunication Equipment Manufacturers and Medical Product companies. We were also aided by our decision early in the quarter to eliminate our overweighting in S&Ls. On the negative side, our performance was impacted by individual stocks breaking down versus any relative industry bets. Stocks like LifeUSA and Discovery Zone impacted our performance.

**Year Performance:** For the year performance was helped by Telecommunications Equipment and the resurgence of the healthcare sector (mainly product companies). Our overweighting in the Manufacturing sector was a mixed bag with stocks like Harley Davidson helping and the auto related companies hurting performance. Within the individual quarters, our temporary overweight of S&Ls helped performance. The largest drag on performance were many of the smaller cap growth stocks and one large cap company - Supervalu.

It is important to note that the full year benchmark return represents the linking of quarterly benchmarks which evolved significantly during the year. As such it may not be indicative of our "Normal" strategy. The benchmark portfolio used in 4Q had a full year return of -1.06%.

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 impact of active bets has been moderated as of the first of the year. We do not feel the market is rewarding investors for significant deviations from neutral weightings. The active bets we do have in place favor producers/manufacturing companies with pricing power and worldwide sales.

## IAI (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.*

During the fourth quarter, Dave Himebrook (Vice President and Portfolio Manager - Small Cap Growth) joined the firm, Jim Diedrich (Vice President and Portfolio Manager - Large Cap Growth) left the firm.

No accounts were gained or lost in this discipline during the quarter.

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

During the fourth quarter, we continued to work with Staff to develop an appropriate benchmark. The regional emphasis of the portfolio has complicated the benchmark development process. We hope to have resolved all of Staff's concerns before the beginning of the second quarter.

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### Staff Comments

The current benchmark being used to evaluate Investment Advisors has been in place since the inception of the account. The benchmark construction process was approved by Investment Advisors before it was implemented. In January 1994, Staff started expressing some concerns about the appropriateness of the benchmark and Investment Advisors agreed that some modifications needed to be done. Since then Investment Advisors has been working on the new benchmark but to date has not provided Staff with a revised benchmark that addresses all of Staff's concerns.

The -1.06 return quoted in their commentary on the preceding page reflects the return from a preliminary revised benchmark that was built in October 1994 and not the current benchmark in place. The preliminary revised benchmark was reviewed by Staff in the fourth quarter of 1994 and Staff's analysis showed that it still did not address all of Staff's concerns.

Currently, Staff is monitoring Investment Advisers' progress in building a revised benchmark. Investment Advisers expects to have the revised benchmark completed by the middle of February for Staff to review. If the benchmark resolves Staff's concerns, it will be implemented for the second quarter of 1995.

**Manager Commentary**  
**IDS Advisory Group, Inc.**

Period Ending:	12/31/94	Returns	Qtr.	1 Yr.
Total Firm Assets Under Management	\$20.8 billion	Actual	0.9%	0.9%
Total Firm Assets Managed in this Discipline	\$ 5.2 billion	Benchmark	0.4%	2.3%

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?*

Our sector weights have evolved as follows:

	12/31/93	12/31/94	Normal Portfolio 12/31/94
Technology	8.2	15.3	13.9
Consumer Stable	3.2	9.1	22.3
Consumer Cyclical	24.2	18.2	19.7
Utilities (non Electric)	6.8	1.2	6.7
Financial Services	18.8	13.5	9.7
Energy	5.6	7.4	5.8
Industrial Basic	11.5	14.0	5.5
Industrial Growth	6.5	4.1	4.2
Industrial Cyclical	13.5	11.0	7.2
Equity Cash	<u>1.7</u>	<u>6.0</u>	<u>5.0</u>
	100.0	100.0	100.0

Performance in the latest three months was satisfactory. The State of Minnesota's account advanced 0.9% versus an advance of 0.4% for the normal portfolio. For the calendar year 1994, the portfolio was up 0.9% versus the normal portfolio's gain of 2.3%. In short, we underperformed the normal portfolio for the year. Performance in the quarter was enhanced by our heavy weighting in technology and a year-end surge by several key cyclical sectors including the industrial basic area. During the course of the year, technology, industrial growth and some industrial basic securities provided positive rates of return. In addition, our underweighting of utilities was also a plus. On the negative side, we were underweighted in the consumer stable area which outperformed the general market, and we were also overweighted in the financial services sector which underperformed. However, the biggest drag on performance was our heavy weighting in the consumer cyclical area especially retailing and autos.

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 remain optimistic about both the economy and the equity market. It is our belief that we will experience a soft landing in 1995 and 1996. As a result, we believe that interest rates will peak by this summer and begin to decline in 1996. Corporate profits should advance at least 10% this year and post further very modest gains next year.

Regarding the outlook for the equity market, it is our view that the market can generate a total rate of return on the order of 10% in 1995. First, we believe the economic framework is a positive for financial assets. Secondly, we believe that stocks are selling at reasonable valuations. Based on our 1995 earnings estimate for the S&P 500 of \$35, the market is

## IDS (con't)

currently selling for 13 1/2 times. Thirdly, most investors are cautious and are building liquidity. We believe that the market always seeks to frustrate the consensus.

Given our economic and market views, we continue to seek to position the portfolio in the path of strong earnings growth. We continue to carry a very heavy weighting in the technology area reflecting that sector's strong future earnings growth and reasonable valuations. We have been slowly increasing our weighting in the consumer stable area, and this trend is likely to continue in light of slowing earnings growth in 1996. Consumer cyclical positions have been steadily reduced, and that process is also likely to continue. Given our belief that interest rates will continue to peak by the middle of this year, the financial services sector looks extremely attractive particularly in light of current bargain basement valuations. The industrial basic sector continues to be characterized by extremely strong earnings growth and very low P/E multiples. However, earnings strength in this sector is likely to slow as the year wears on. As a result, further increases in this sector are unlikely. We are carrying a cash position of approximately 10%. While we are reasonably optimistic about the equity market, we do expect significant volatility. This cash reserve will be deployed during periods of market decline.

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	3	11.9	0	0.0
Fixed Income	0	0.0	0	0.0
Balanced	5	129.7	1	2.4
International	1	5.0	0	0.0
Small Cap Equities	0	0.0	0	0.0
Mid Cap Equities	0	0.0	0	0.0
Research Core	0	0.0	0	0.0
Research Aggressive	0	0.0	0	0.0
Global Bonds	2	58.0	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**  
**Independence Investment Associates**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$15.6 billion	Actual	-0.9%	-1.0%
Total Firm Assets Managed in this Discipline	\$ 8 billion	Benchmark	0.0%	1.4%

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?*

1994 stock and bond market performance was hampered by rising interest rates and oscillating fears of economic boom or bust. 1994's market performance was the second lowest in the last 13 years. While the performance of your portfolio was disappointing for the year, performance of our valuation models and your portfolio stabilized in November and outperformed in December. Performance lagged because the valuation approach which drives our process did not work in the July - October period. Neither the intrinsic value nor earnings momentum components of our model added value, an unusual but not unprecedented event. Most of the shortfall relative to your benchmark occurred in the third quarter and during the month of October. Results in November and December reflect a positive turn in the performance trend, and the models we use to identify stocks which are cheap with improving fundamentals are adding value once again. In fact, our valuation system was skillful in stock selection for the month of December and your account performed accordingly.

Best performing stocks in your portfolio this quarter included technology issues such as Texas Instrument, Motorola and Hewlett Packard, some of the big oils like Mobil and Chevron, many of the health care companies (Johnson & Johnson, Merck and Amgen) as well as a lot of the consumer stocks such as Disney, Colgate-Palmolive and Sara Lee. In addition, some of the electric utilities (Pacific Gas & Electric and Unicom Corp.) rallied while selected economic issues like KeyCorp, First Interstate and Fleet Financial lagged in the quarter as did such specialty retailers as Price/Costco and Toys "R" Us and forest product companies like Weyerhaeuser and Louisiana Pacific.

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.*

Over time our investment approach has added value in both growth and value cycles due to its unbiased nature. But as we discussed last quarter, transition periods have sometimes proven to be difficult times for our valuation models. The good news is that these transitions tend to be short-lived. We continue to believe in our philosophy of buying cheap stocks with improving fundamentals and we continue to emphasize a discipline that steers us clear of the bad stocks. Our stock selection system remains sound with no changes and we are confident that sticking to what we believe in and what we do best will yield consistent, long term performance in the future as it has in the past.

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 of 14.4x 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.*

Throughout the ups and downs of 1994 our business continued to grow. Current funds under management is now up to \$15.6 billion for 144 clients in the US and abroad. During the fourth quarter we began managing 14 new portfolios, 5 for existing clients and 8 for new clients. We lost 2 accounts, one in fixed income for performance and one in equities due to a plan restructure.

Our staff has remained stable and has been gradually expanded during the year well in advance of our needs. There has been a new development at our parent company, John Hancock. After more than a decade of supporting our growth and that of several other associated asset management groups, Hancock management has decided to create a new subsidiary holding company. The purpose is to create a financial structure which will allow for future flexibility in realizing on its balance sheet the true market value of these subsidiaries which are now carried at book value. This structure is intended to maintain Independence's autonomy and ability to meet our clients needs and expectations. The difference between the new holding company and the one that currently owns Independence is that it will only include investment management groups and that Bill Fletcher, our President and your portfolio manager, will be Chief Executive Officer of the new entity, while retaining the presidency of Independence. Since the business units will operate as separate organizations, his primary focus will continue to be the management of Independence and the portfolios under his care.

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**  
**Jundt Associates, Inc.**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$3.4 billion	Actual	-0.2%	5.1%
Total Firm Assets Managed in this Discipline	\$2.5 billion	Benchmark	1.2%	3.9%

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?*

**Quarter:** Qualitatively, we view fourth quarter performance as a period of consolidation after the very strong third quarter of 1994. Our modest underperformance relative to the benchmark was caused primarily by the stocks making up the consumer non-durable area. While about equal weighted versus the benchmark, the consumer related securities declined by about 7% while the benchmark's stocks in this area were unchanged. Somewhat offsetting this group was the strong performance in the technology category which rose by about 9%. Technology was strongly overweighted compared to the benchmark in the quarter.

**Year:** After a slow start in the first half of 1994, the year in total showed strong absolute and relative performance versus the benchmark and S&P 500. Broadly speaking, the technology overweight was very beneficial, as the group on average increased by 18% and accounted for nearly 40% of all assets. On an individual stock basis, top performing names were Informix, Oracle, Microsoft, Staples, and Oxford Health. Underperforming names were primarily consumer related and included such companies as Brinker, Cott Corp., Cracker Barrel, and WalMart Stores.

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.*

Your portfolio remains positioned in what we consider will be the fastest growing companies over the next several years. Technology continues to be a large relative and absolute weight, accounting for over 35% of assets versus the benchmark of 23%. Areas of interest include networking, software, and companies providing wireless communication infrastructure. The consumer non-durable areas accounts for approximately 50% of the assets, about the same as the benchmark. Important investments here include category dominant retailers and HMO's. Cyclical industries such as transportation, energy, finance, consumer durables and basic materials areas remain underweighted.

## 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.

We feel that 1995 has a chance of being a good year for the market and especially growth stocks. Cyclical companies' earnings momentum should begin to wane, while the consistent growers will continue to show robust sales and earnings growth. We also believe the long end of the bond market has stabilized, and we in fact see rates lower a year from now. Additionally, the new Congress may begin a process of lowering some taxes such as the capital gains tax rate which would also benefit growth stocks.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Lincoln Capital Management Company**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$26.0 billion	Actual	1.9%	4.1%
Total Firm Assets Managed in this Discipline	\$ 8.6 billion	Benchmark	1.3%	4.4%

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 fourth quarter of 1994, the Minnesota Lincoln equity portfolio generated a return just slightly ahead of the benchmark. There was a wide dispersion of active bet returns in this short period. Large cap stocks not owned such as Microsoft did well, while Philip Morris did poorly. Fannie Mae and Freddie Mac lagged, AIG, Gillette, McDonald's and Pfizer did well. Within growth sub-sectors, we are underweighted in healthcare which restrained the portfolio, overweighted in finance, a draw, underweighted in media and overweighted in other. Overall, it was a wash.

For the year as a whole, the portfolio added 1-2% of value over the two broad growth stock indices, but lagged Lincoln's own benchmark by an estimated .3%, the agreed standard of performance. So there was a lot of energy expended for nearly a dead heat. We built up Technology, the right direction and with good selections but on average underweighted. Health was generally underweighted, which constrained returns, as did retailing with poor selections. The proportion in Finance was reduced moderately as each of the four major holdings was trimmed during the year. Other increased as GME, Morton International and 3M were each supplemented by about 1%.

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 portfolio remains about 5% underweighted in Healthcare and Media, similarly overweighted in Finance and other (general industrials). We continue to be very picky about Healthcare, especially medical supplies and services (holdings are representative in pharmaceuticals) and similarly for cable/broadcasting. Finance continue to look cheap, particularly large-position Fannie Mae and Freddie Mac.

The top ten holdings, representing 44% of the portfolio, normally have a material influence on subsequent returns. These companies are making good earnings progress but nonetheless sell at a discount to the market multiple (as does the total portfolio). We visualize five-year earnings growth averaging 13% for these companies, compared with a more modest 6% for the S&P 500. With only a 1% differential in cash dividend yield, your largest commitments look like a collective performance shoo-in over a several year period. Admittedly these are not fast-growers, but the risk of shortfalls also seems to be appropriately diminished.

## 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.

No change from the prior report. We have one search in process for the successor to retiring Ted Bosler, now 60 and in uncertain health.

4. *Other Comments.* Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

Lincoln's investment process is unusual and we think intellectually appealing. It is that all of the investment professionals participate in the construction of a single portfolio for all clients (modified only by specific directed constraints). While most individual stock ideas are initiated by one of seven analysts, the final decision includes all the professionals that can be rounded up at the time. We actually take a vote and the majority carries. This permits each analyst to feel he or she is an integral part of the team, which is correct. We think this approach is the way to go, rather than to have analysts recommending and multiple portfolio managers individually deciding and competing with one another (this works well if the client is assigned to the best performing manager!).

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Lynch & Mayer, Inc.**

Period Ending:	12/31/94	Returns	Qtr.	Year
Total Firm Assets Under Management	\$5.6 billion	Actual	0.2%	-0.7%
Total Firm Assets Managed in this Discipline	\$2.1 billion	Benchmark	1.0%	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?*

Significant over and underweighted average sector results for the quarter and year were:

Sector		Portfolio Weighting	Portfolio Results	Benchmark Weighting	Benchmark Results	Value Added
Technology	4Q	32.7%	4.4%	27.8%	8.0%	-0.8%
	Yr.	31.4	15.4	26.5	21.3	-0.7
Consumer Non Durables	4Q	29.0%	1.8%	31.9%	0.6%	0.3%
	Yr.	22.3	-0.8	32.0	0.3	0.1
Capital Goods	4Q	9.4%	-1.9%	4.3%	-0.6%	-0.2%
	Yr.	13.1	4.9	4.8	-2.7	0.7
Energy	4Q	2.9%	-11.4%	3.9%	-0.2%	-0.2%
	Yr.	2.0	-20.5	3.3	0.6	-0.7
Basic Materials	4Q	8.4%	-3.6%	7.4%	-10.1%	0.5%
	Yr.	7.5	-19.2	5.8	4.5	-1.3
Total	4Q		0.2%		1.0%	-0.8%
	Yr.		-0.7		2.7	-3.4

Sector bets during the fourth quarter and year added value relative to the benchmark; however, overall stock selection relative to the benchmark were negative. Energy issues, such as Anadarko Petroleum and YPF S.A., were down 15% during the fourth quarter. Anadarko was sold during the quarter due to weak natural gas prices. Shares of YPF, an Argentinean oil company, suffered a decline due to the recent devaluation of the Mexican Peso.

During the fourth quarter and throughout 1994 your portfolio's exposure to the Consumer Non-Durables sector was increased. Specifically, we established new positions and boosted existing positions in the Healthcare industry.

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 discussed above, we have increased your portfolio's exposure to the Healthcare industry with a recent purchase of Pfizer and larger positions in Humana and U.S. Healthcare. Further, during the quarter, we established a position in Home Depot which should benefit from larger stores and new store concepts. Our bottom-up fundamental stock selection approach has resulted in the following sector bets relative to the Benchmark:

- a) Overweighting in the Basic Materials, Capital Goods and Technology sectors, and;
- b) Underweighting in the Consumer Durables, Transportation and Utilities sectors.

## Lynch & Mayer (con't)

The top ten holdings as of December 31, 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	Procter & Gamble	5.5%	0.56%
Corporate Restructuring	Xerox	4.7	0.23
Acceleration of Growth	Gillette	3.8	0.78
Acceleration of Growth	Silicon Graphics	3.6	0.57
Acceleration of Growth	Hewlett Packard	3.5	1.36
Improved Industry Environment	Motorola	3.4	1.95
Turnaround	Citicorp	3.4	1.60
Acceleration of Growth	Browning Ferris	3.3	0.14
Acceleration of Growth	Pfizer	3.2	0.35
Acceleration of Growth	Coca-Cola	3.2	0.62

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.*

Thomas B. Maher, Phillip C. Coburn and Rufus R. Winton have joined our staff as research analysts. Kevin W. Putt also joined us as Vice President for client services.

**Accounts Gained (tax-exempt) Fourth Quarter, 1994:**

Diocese of Camden, Electrician's Local #995, and Interstate/Johnson Lane.

**Accounts Lost (tax-exempt) Fourth Quarter, 1994:**

Lake Forest College - Short term performance

Asea Brown Boveri - Shift from active management strategy to passive/index strategy.

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  
Oppenheimer Capital**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$30.1 Billion	Actual	-1.3%	0.5%
Total Firm Assets Managed in this Discipline	\$13.3 Billion	Benchmark	-0.7%	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 ENDED DECEMBER 31, 1994**

Key factors contributing to performance were good security selection within the capital goods and basic industry sectors. The best performing holding for the quarter was McDonnell Douglas. Our analysis was correct in anticipating that the restructuring of both the commercial and defense businesses would result in excess cash flow that would be deployed for the benefit of the shareholder. In the fourth quarter, McDonnell Douglas announced a stock split, a dividend increase and substantial share repurchase program. They are in the early stages of a multi-year effort to transform the company into a more efficient aircraft supplier.

Relative to the benchmark, stock selection within consumer non-durable and utilities detracted from performance. Specifically, we believe Sprint was negatively affected by the market's reaction to news that AT&T had increased its share of the consumer market. This segment represents less than 30% of Sprint's business and we believe the market share shift to be a result of heavy advertising by AT&T. It does not change our investment thesis for Sprint.

Those stocks which most significantly affected performance for the quarter are listed below:

<b>Top Five</b>		<b>Bottom Five</b>	
McDonnell Douglas	23.5%	Sprint	-26.9%
Hercules	12.7	Mellon Bank	-17.3
Pfizer	12.5	Dole Food	-16.8
American International Group	10.4	First Interstate Bancorp	-15.8
Pepsico	10.0	May Department Stores	-13.7

**TWELVE MONTHS ENDED DECEMBER 31, 1994**

Key factors positively contributing to performance during the year were security selection within the capital goods and consumer non-durable sectors. However, selection within basic industry and an overweighting in financial stocks impaired returns. The series of interest rate increases during 1994 proved difficult for a broad range of perceived interest sensitive industry groups such as banks, insurance companies and brokerage firms. With one third of the portfolio in financial stocks, performance was negatively impacted.



## Oppenheimer (con't)

Those stocks which most significantly affected performance for the year are listed below:

Top Five		Bottom Five	
Becton Dickinson	36.8%	Travelers	-21.9
McDonnell Douglas	34.5	Time Warner	-19.9
Avon Products	27.0	Hasbro	-19.0
Warner Lambert	18.2	Sprint	-18.2
Pfizer	15.3	Dole Food	-16.8

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 portfolio holding of financial stocks is approximately twice the weighting of the benchmark. Our investment thesis for these stocks relate to specific business attributes: their attractive industrial positions, value creating prospects and shareholder oriented managements and not because of a particular interest rate forecast.

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.

Geoff Mullen joined Oppenheimer Capital as a Vice President and client executive. Prior to joining the firm, Geoff was with Bankers Trust for ten years, most recently a Vice President in the Client Advisory Group where he assisted institutional investors with strategic investments, employee benefit and risk management issues. Earlier, he held management positions in Bankers Trusts' Defined Contribution and Asset Services Divisions. Geoff has an MBA from New York University and is a level III Chartered Financial Analyst candidate.

### ACCOUNTS GAINED/LOST (in this discipline):

Gained: 9 accounts with \$165 million in assets.  
Lost: 5 accounts with \$ 92 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

No comments at this time.

**Manager Commentary**  
**Waddell & Reed**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$2.6 billion	Actual	-1.3%	1.0%
Total Firm Assets Managed in this Discipline	\$4.7 billion	Benchmark	-1.4%	1.3%

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?*

Strong demand for computer software and Amgen's drugs (Epogen and Neupogen) helped drive up stock prices of Computer Associates and Amgen. Neupogen (stimulator of white blood cells) is being given to more patients with breast or lung cancer to combat infections, thereby enabling them to complete high dose chemotherapy treatment. Epogen is being administered in larger doses and to a greater proportion of the dialysis patient population than a year ago for chronic kidney failure. On the negative side, Federal Reserve tightening drove up short-term interest rates beyond our expectation and increased the carrying cost of gold, while inflation remained in check due to strong global competition.

Accelerating demand for semiconductors and personal computers helped stock prices rise for Compaq Computer and Micron Technology, and we took profits during the first half of the year.

We reduced our exposure in brokerage stocks (Merrill, Salomon, Morgan Stanley) and banks (Wells Fargo, First Interstate, Chase) to seek better opportunities elsewhere, as the rise in interest rates negatively impacted the profitability of the financial service sector and hurt stock 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.*

Industrial activity remains robust despite Fed tightening. Given the strong upward trend in backlogs of unfilled orders, industrial production in December continued to exceed market expectations and the factory utilization rate pierced the 85% mark (15 year high).

Consumer spending is on a pattern to exceed a 5% annualized real gain in the fourth quarter, due to a double digit rate of growth in consumer debt.

The higher interest rates now available (e.g., one-year Treasury Bill rates have doubled from 3.6% to 7.2% over the past year) offer investors an attractive risk-free alternative to equities.

## Waddell (con't)

We remain hedged against what we consider to be poor valuation conditions for stocks. Cash reserves and gold stocks represent close to half of the portfolio. Well managed rapid earnings growth companies selling at attractive price-earnings ratios, such as Computer Associates (software), Amgen (drugs), Mattell (toys) and Loral (aerospace/defense), are the mainstay of our equity positions.

We anticipate lowering cash over the balance of the year as selected earnings growth opportunities present themselves.

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.*

A Manager of Account Administration was added to back office, and a marketing administration support person resigned. There were no accounts gained or lost in this discipline 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

Waddell & Reed is currently working on revising their benchmark to address some concerns that Staff has with the current benchmark. Waddell & Reed expects to have a revised benchmark by the middle of February for Staff to review. If the benchmark resolves Staff's concerns, it will be implemented for the second quarter of 1995.

**Manager Commentary**  
**Weiss Peck and Greer**

Period Ending:	12/31/94	Returns	Qtr.	1 Yr.
Total Firm Assets Under Management	\$13.2 billion	Actual	-3.3%	-7.6
Total Firm Assets Managed in this Discipline	\$ 1.3 billion	Benchmark	-0.4%	-1.0

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:**

Two sector bets, an overweight in consumer non-durable and an underweight in technology cost this portfolio 67 basis points in aggregate.

The single largest factor affecting performance was a -2.21% in stock selection in the technology section. This was primarily an issue of not owning some outperforming securities in the technology sector of the benchmark. The one area that did particularly well and that we didn't have enough representation in was the semiconductor and related stocks. 20% of the normal portfolio was in this category. We had substantially cut back our holdings in this sector earlier in the year because we felt we were approaching the end of the cycle, that the companies were over-earning, i.e., the returns on equity were at historic high levels, and the stocks had already had substantial outperformance.

**Year:**

One sector bet, an overweight consumer non-durables, cost the portfolio 54 basis points.

Stock selection in technology (not owning winners) and healthcare (bad stock selection) and an active bet not to own HMO's cost this portfolio 5.14 in aggregate. This represented nearly 90% of the underperformance.

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 bets which have existed from the inception remain overweight consumer non-durables area, underweighted healthcare, and overweight technology.

The healthcare and consumer non-durables bets have hurt. In the consumer non-durables area we remain convinced of the dynamic growth of companies within this sector. This is a micro call, based on our research.

In terms of our sector bets, we feel more than ever that the technology overweight is particularly appropriate today. Technology stocks are compelling because relative valuations are so attractive, the stocks are underowned, and the fundamentals are strong and getting stronger. During 1994 this group was the best performing group in our portfolio so I think the market is finally starting to appreciate our point of view. In terms of healthcare, we had underweighted the group for the past year primarily because of the uncertainty of Clinton's Health Care bill which would have been quite negative for a broad range of the companies in healthcare, particularly pharmaceuticals. Since the failure of the Health Care bill and the

## Weiss Peck (con't)

election, we have started to add to our holdings in this area and will go toward a neutral weight. The overweight of other consumer non-durables comes about from bottom-up, stock-by-stock decisions primarily in the specialty retail sector. We think there are some unusual opportunities in this sector and have weighted the portfolio accordingly.

**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.

In order to be more focused and to ensure that individual securities receive appropriate weights, we have reorganized our research into teams:

- |                      |  |
|----------------------|--|
| 1. Healthcare        | *J.P. Callaghan, A. Anderson, L. Greetham              |
| 2. Industrials       | *J.P. Callaghan, R. Zellers, T. Mitchell, A. Giammalva |
| 3. Consumer          | *M. Straus, J. Schainuck, A. Giammalva                 |
| 4. Business Services | *M. Straus, A. Anderson                                |
| 5. Technology        | *M. Straus, C. Eggerss, A. Anderson                    |
| * Group Leaders      |  |

One analyst has resigned, Harvey Katz. The specialty retail area is now covered by A. Giammalva, and R. Zellers is an addition to the group.

**4. *Other Comments.*** Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

We lost one customized portfolio and today manage 11 customized portfolios plus Weiss, Peck & Greer mutual funds. We are not accepting additional customized portfolio clients. Jonathan Smith is leaving Weiss, Peck & Greer to focus on portfolio management. Judith Lane is joining to assume his responsibilities.

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### Staff Comments

No comments at this time.

**Manager Commentary  
Wilshire Asset Management  
Minnesota Completeness Fund**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$9.0 Billion	Actual	-1.5%	-1.0%
Total Firm Assets Managed in this Discipline	\$4.9 Billion	Benchmark	-1.1%	-0.5%

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?*

For the year ended December 31, the Minnesota Completeness Fund managed by Wilshire Asset Management underperformed its benchmark by 0.5%. While this in itself is not remarkable, we note that 0.4% of this negative tracking occurred in the fourth quarter. Observing a similar experience in the prior year, we must also point out that turnover was significantly lower in 1994 than in 1993.

During the month of December, in anticipation of the transfer of assets out of the fund scheduled for the first of the year, we essentially stopped trading in this account. The transfer gave us a way to accomplish the same rebalancing as we would otherwise have done and accomplish it in a lower cost, more efficient manner. Much of December's variance can be explained in light of these foregone trades.

It is our policy, on a regular basis, to review the exposures of the fund relative to its benchmark with respect to factors which are believed to be related to performance. This would include P/E ratios, yields, and earnings growth and expectations, to name a few. The portfolio in our view continue to be representative of the exposures incorporated in the benchmark and as a result should adequately complement Minnesota's active managers.

2. *Future Strategy. Going forward, what strategies, if any, do you plan to implement to control tracking error within expectations?*

The portfolio as it is now constituted substantially reflects the characteristics of the DCF index due in large measure to the opportunity for fine tuning provided by the recent transfer of assets. For this reason we do not expect significant trading to be necessary during the first quarter of 1995. When the new index becomes available at the end of the quarter we will continue our policy of trying to capture the spirit and exposure of the changes with minimal and low cost turnover.

## 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 17 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.

Our product line has been expanded beyond our style and index products. We now offer a fixed income product as well as a real estate product. We have also added two enhanced growth equity products with very favorable performance profile relative to their peers.

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

Richard Dixon, Trading Director, has resigned from Wilshire Asset Management. Staff has been assured that this will not impact performance, however staff intends to monitor the situation closely.

**Manager Commentary**  
**Wilshire Asset Management**  
**Wilshire 5000 Fund**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>1 Yr.</b>
Total Firm Assets Under Management	\$9.0 Billion	Actual	-0.5%	0.7%
Total Firm Assets Managed in this Discipline	\$1.6 Billion	Benchmark	-0.8%	-0.3%

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 index continued positive in the fourth quarter outperforming by 0.3%. For the latest 12 months the fund has outperformed the index by 1.0%. While this is somewhat 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 index. 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 a decrease 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 17 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.

Our product line has been expanded beyond our style and index products. We now offer a fixed income product as well as a real estate product. We have also added two enhanced growth equity products with very favorable performance profile relative to their peers.

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

Richard Dixon, Trading Director, has resigned from Wilshire Asset Management. Staff has been assured that this will not impact performance, however staff intends to monitor the situation closely.

**Manager Commentary**  
**CIC Asset Management, Inc.**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$182 Million	Actual	-0.2%	N/A
Total Firm Assets Managed in this Discipline	\$182 Million	Benchmark	0.0%	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 slightly underperformed the S&P 500, -0.24% vs. -0.02%.

Relative to the S&P 500, the active bets (overweights) continued to be on consumer durables (9.6% weighting vs. 3.3% in the S&P), capital goods (15.5% vs. 8.4%), financial services (23.4% vs. 10.9%), and basic industries (15.5% vs. 10.6%). During the quarter, we significantly brought down the financial services exposure (20.5% weighting at quarter-end), as we indicated to you that we would. We underweighted significantly the utilities (4.0% vs. 13.2%), technology (3.4% vs. 9.3%), consumer non-durables (18.8% vs. 34.2%), and energy (6.2% vs. 10.7%) sectors. During the quarter, we added significantly to utilities (5.7% at quarter-end).

Of the sectors that we overweighted, the S&P capital goods sector (+2.6%) outperformed the overall S&P 500. Basic industries matched the S&P 500. The other two overweighted sectors underperformed the S&P 500: consumer durables (-2.6% in the S&P) and financial services (-2.7%). Of the sectors that we underweighted, technology (+6.9%), consumer non-durables (+0.8%) and energy (+1.9%) outperformed the S&P, and only utilities underperformed (-2.8%).

In sum, only two sector bets (overweighting capital goods and underweighting utilities) were correct, but our stock selection brought our performance closer to the S&P 500.

The primary drivers for our performance in the quarter were stock selection in three sectors: consumer non-durables, utilities, and energy. Our consumer non-durables sector was up about 2.9% (vs. 10.8% for the sector in the S&P) on the strength of Clorox, Campbell Soup, Walgreen, Pepsico, Merck and Hershey and notwithstanding weakness in three retailers (JC Penney, Toys R Us and Sears). Walgreen reached our sell target in January and was sold. The utility concentration in telecommunications and the price recovery in Allegheny Power contributed to very good performance in utilities +4% vs. -2.8% for the S&P 500, but only moderately because of the aforementioned low weighting. We did add to our position in BellSouth and also invested in AT&T. Our energy sector was up about 5.8% (vs. +1.9% for the S&P 500) as Chevron and Exxon, both at large weights, significantly outperformed and more than made up for a small natural gas exposure in Equitable Resources.

## CIC Asset Management (con't)

While our capital goods stocks contributed to performance, they slightly lagged the capital goods sector of the S&P (+1.8% vs. +2.6%). Appreciation in General Electric, ITT and Caterpillar was undermined somewhat by weaknesses in Deere, Minnesota Mining and Paccar.

Stock selection exacerbated underperformance in three sectors: Financial services were down 3.2% vs. -2.7% in the S&P, as derivatives and bond exposure at PNC (-16.9%) and Bankers Trust (-18.6%) hurt us considerably. Here we should mention that we took steps to decrease our exposure to bank stocks and also that some of our holdings have recovered in January 1995. Basic industries were down 3.5% vs. -0.1% in the S&P, with weaknesses in Dover, USX and Union Pacific being primarily responsible. Finally, consumer durables were down 2.9% vs. -2.6%, as Dana Corporation and General Motors were weak.

- 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 the utilities, technology, consumer non-durables, and energy 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.*

There are no significant ownership or personnel changes. We continue to search for a fourth investment professional. During the quarter we did not gain or lose accounts.

- 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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$110 Million	Actual	1.5%	N/A
Total Firm Assets Managed in this Discipline	\$110 Million	Benchmark	0.0%	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 1.5% during the fourth quarter of 1994 which compares to no gain (0%) 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. Cyclical as a sector generally and quite uniformly underperformed the benchmark. While this hurt performance (as we were overweighted here), the fact that the account owned above-average performing cycles mitigated somewhat the negative impact from overweighting the sector. Underweighting Energy hurt performance some as well. On the other hand, the decision to overweight growth stocks (in combination with the decision to emphasize Health Care and Technology in particular) more than made up for the above-noted decisions and was the single largest contributor to out-performing 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 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 and moderately growth oriented. While our exposure to interest-rate sensitive stocks is only market like at present, we anticipate overweighting this sector rather soon.

**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**

Two

**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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$167 Million	Actual	1.6%	N/A
Total Firm Assets Managed in this Discipline	\$ 83 Million	Benchmark	-1.7%	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?*

**Quarter (Active Bets)**

Technology	Overweighted	Worked
Consumer Staples	Overweighted	Worked
Transportation/Utilities	No Weightings	Worked
Capital Goods	Overweighted	Worked
Financial	Underweighted	Worked
Consumer Cyclical	Overweighted	Did Not Work
Energy	No Weightings	Did Not Work

The underlying strength in the economy benefited Capital Goods and Technology stocks. The portfolio's overweighted positions in Technology and Capital Goods stocks, to the S&P 500 and correct stock selection within those groups benefited the portfolio greatly in the fourth quarter of 1994. However, with interest rates rising through the quarter, defense issues, such as Consumer Staple stocks, did well. The avoidance of Utilities, Transportation and only a small position in Financial stocks also benefited the portfolio as interest rates rose.

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 largest overweighting active bets are within the Consumer Cyclical (22.3%) and Consumer Staples (32.4%) sectors of the portfolio. The largest underweighting active bets are within the Energy (0%), Utilities (0%) and Financial (3.9%) sectors of the portfolio.

With a bottoms-up approach to issue selection with a growth and valuation bias, Compass finds the two Consumer sectors attractive. During the quarter, the portfolio established its first position in the Financial sector (State Street). This position was established based upon growth of State Street and the underlying valuation of the company.

### Compass 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.*

No significant ownership or permanent 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.**

Period Ending:	12/31/94	Returns	Qtr.	Year
Total Firm Assets Under Management	\$115 Million	Actual	-1.2%	N/A
Total Firm Assets Managed in this Discipline	\$ 55 Million	Benchmark	0.0%	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 fourth quarter of 1994, we underperformed the S&P 500 on a total-return basis by about 1%; for the nine-month period, we underperformed the benchmark by more than 4%. For the full year 1994, we underperformed the S&P 500 by 235 basis points.

Although 1994, as the only negative year we have suffered in our six-year history, was well below our normal standards, we apparently produced results that were better than the industry as a whole, according to a survey published by Lipper Analytical Services in *The Wall Street Journal* on Friday, January 6, 1995. In that survey, the average diversified U.S. stock fund underperformed the S&P 500 by 3.00% on a total return basis; the average growth fund had 3.48% relative underperformance; and the average value fund suffered 4.69% relative underperformance. Unfortunately, an extremely volatile market environment poisoned the investment climate for all managers in 1994, which somewhat mitigates our below-par returns.

During the fourth quarter, our defensive utility exposure and our growth-related issues performed well, while our more economically sensitive issues were harmed by fears that Federal Reserve Chairman Alan Greenspan would overshoot, in his zeal to combat inflation, and would, instead, create a recession rather than engineer a soft landing.

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.*

With the Dow Jones Industrial Average (DJIA) approaching the 3,600 level around Thanksgiving, we felt that the market was significantly oversold and would rally sharply to about the 3,950 level through December and January on the strength of excellent fourth quarter corporate earnings. At that point, we felt that the market would find itself at a crossroads, and its subsequent direction would be determined by whatever monetary policy action the Federal Reserve deems necessary at the upcoming FOMC meeting on January 31 - February 1. We expect a 50 - 75 basis point increase in interest rates at that time, although the Federal Reserve Board may act more cautiously because of the slowing domestic economy, the Mexican currency crisis and the Orange County bankruptcy.

We expect that the monetary policy lag will catch up with the economy by mid-year 1995, such that the 4.0% rate of GDP growth in 1994 will slow to about 2.5 - 3.0%. We believe that



## First Capital Advisers, Inc. (con't)

this slowdown will spark a bond rally to about 7.00 - 7.25% at the long end, and an equity rally above 4,000 for the first time ever, to a full-year upside target of about 4,200. Downside support exists at 3,750 and at 3,600 - 3,650.

Given our forecast for an economic slowdown, we have rotated the portfolio over the last few months to emphasize more defensive issues, such as growth stocks, utilities, energy stocks and cash, and to de-emphasize more economically sensitive stocks.

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.*

Evaluation Associates' Americas Fund recently closed due to the withdrawal of assets by several large investors. EAI was very happy with our work, however, and they supplied us with direct introductions to their client base, so that one or more of them may commence doing some business with us directly. To that end, the Pennsylvania School Employees' Retirement System has selected us as one of a dozen chosen from a pool of 60 managers to start a farm team for them. Funding will take place in the Spring of 1995. Finally, the San Diego City Employees' Retirement System recently decided to re-balance their global assets by shifting domestic funds into international assets.

Michele Wolf, who joined our staff during the fourth quarter as an equity research analyst, brings with her a solid computer and quantitative background.

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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$810 Million	Actual	-4.3%	N/A
Total Firm Assets Managed in this Discipline	\$505 Million	Benchmark	-1.9%	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 Charter Power System increased over 25%, and Bordons Chemical retained its second quarter gain of 40% (connected to economic development); Tucker Properties a REIT declined 21% (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. As the present lack of interest in smaller cap issues under the \$150 million market cap continues, we have slightly overweighted in larger issues of the \$200 to \$300 million market cap size to bring our overall account market cap from the present \$150 million size to a \$190 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 1995 start date. This brings our total employee count to 19.

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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$160 Million	Actual	-1.2%	N/A
Total Firm Assets Managed in this Discipline	\$155 Million	Benchmark	-0.4%	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). The portfolio has a midcap orientation. Your portfolio meets those characteristics:

<b>December 31, 1994</b>	<b>Minnesota</b>	<b>S&amp;P MidCap</b>	<b>S&amp;P 500</b>
Expected Return	14.7%	10.5%	10.0%
P/E	16.4x	20.2X	16.8X
Price to Book	2.5x	2.7x	3.1x
Yield	2.0%	2.1%	2.9%
Forecast Growth	9.9%	10.3%	7.5%
Return on Equity	17.9%	12.2%	18.5%
Wtd Avg Mkt Cap	\$6.3bn	\$1.9bn	\$22.2bn

Our sector selection skill this quarter was fair. The best performing sectors of the S&P 500 were Technology Services, Electronic Technology, Consumer Non-Durables, and Health Technology. The poorest performing sectors were Non-Energy Minerals, Industrial Services, Retail Trade and Health Services

As far as the best performing sectors were concerned, we were overweighted in Technology Services, market weighted in Electronic Technology and Consumer Non-Durables and underweighted in Health Technology. As far as the worst performing S&P sectors were concerned, we were market weighted in Non-Energy Minerals, underweighted in Industrial Services and overweighted in Health Services and Retail Trade. On balance it appears that our sector selection was fairly neutral this quarter.

As far as stock selection was concerned, within the Energy Minerals sector, our picks did better than the sector as a whole as did our Consumer Services, Producer Manufacturing, Transportation, and Commercial Services picks. Our Consumer Non-Durables, Utilities, Retail Trade and Electronic Technology choices underperformed their market sectors. Our other sector picks proved generally in line with their peers.

## New Amsterdam Partners (con't)

Our stellar performer was Caesars World in the Consumer Services sector. CAW has been taken over by ITT. This represented an over 60% gain for the quarter. One of our major disappointments in the Consumer Non-Durables area was Phillips Van Heusen which we sold during the quarter. We had been optimistic on the company's future in the short-term but the near-term outlook has been downwardly revised by the company and by many analysts. Other disappointing stocks were MCI Communications (-27.9%), Lands' End and Musicland Stores (both down more than 30%). Retailers were particularly hard hit this quarter. Fortunately, Pier 1 was up 16%. Investors were not kind to MCI which has seen increased competition and pricing pressure.

This quarter and this year have been tough ones for our strategy since the market has penalized lower capitalization and P/E stocks. Examining our year, with the exception of an over-allocation to retail and apparel stocks, our sector selection skill has been on target. We have had a few major individual stock disappointments - notably, among the retailers, MCI, Phillips Van Heusen and Cray Research. Those stocks met our purchase criteria of higher than consensus forecast growth and reasonable multiples. With the exception of Phillips Van Heusen (which we sold because the company says it is unclear when the profit outlook will turn around), we have held on to the stocks because we thought they represented good opportunities. Such an approach worked in the case of Caesars World which, earlier quarterly reports will attest, certainly gave us some anxious moments. We therefore continue to stick to our discipline.

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.*

Right now, we believe that the Finance and Consumer Sectors continue to offer attractive opportunities as do certain technology stocks. 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.*

There were no significant ownership or personnel changes. One account of \$12.5 million was 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 are fine-tuning benchmark with Richards & Tierney and expect to be able to present it to you this quarter.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Valenzuela Capital Management, Inc.**

Period Ending:	12/31/94	Returns	Qtr.	Year
Total Firm Assets Under Management	\$905 Million	Actual	-3.2%	N/A
Total Firm Assets Managed in this Discipline	\$905 Million	Benchmark	0.0%	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 fourth quarter period were Consolidated Stores (which contributed +0.36%), Bandag (+0.34%), Houghton Mifflin (+0.33%), McDonnell Douglas (+0.32%), and Lubrizol (+0.27%). A recent acquisition is enhancing growth prospects for Consolidated Stores, and Bandag experienced improved overseas product sales. Houghton Mifflin rebounded due to adoption of a course offering for the State of California. McDonnell Douglas initiated a financial restructuring favoring shareholders, and Lubrizol's earnings were helped by improved product pricing. Performance was adversely affected by FirstFed Michigan Corp. (costing the portfolio -0.37%), Olsten Corp. (-0.45%), Precision Castparts (-0.49%), TJX Companies (-0.60%), and MCI Communications (-0.81%). FirstFed Michigan is experiencing margin contractions due to rising interest rates, TJX's earnings were penalized by a further deterioration in the retail environment, and MCI Communications faced heated competition in the long distance market. There is no fundamental development to justify the price corrections in Olsten and Precision Castparts.

- 2. Future Strategy.** *What active bets are in place at the present time relative to our benchmark? Summarize the rationale for making these active bets.*

After strong performance for the first six months of our management, the fourth quarter of 1994 was a volatile period, causing a disappointing return for the 1994 period. We addressed these difficulties by slightly realigning the portfolio, adding to positions we felt still represent good value and trimming others, largely for reasons of valuation. New investments were initiated in AT&T Corp., Crompton & Knowles, General Re Corp., McDonnell Douglas, Perkin Elmer, Reader's Digest Association, and Walgreen Company. Realized gains were taken in Olsten Corp. The position in Pitney Bowes was sold due to disappointing earnings and an expected further deterioration of fundamentals.

## 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.

4. *Other Comments.* Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

The economy continued its strong growth with low inflation in the fourth quarter of 1994, pushing capacity utilization to a point where fears of rising inflation upset the bond market. The Federal Reserve moved again to raise interest rates in an attempt to slow economic growth and thereby inflation, a process not yet complete as the economy is not showing any meaningful signs of slowing. Until some slowing is apparent, the Fed will likely continue to raise rates, but gradually. In this environment, the equity markets will no doubt be more volatile than they have been over the past several years, and investors will focus on companies whose earnings growth is more predictable. We feel our portfolio is well positioned, but we continuously review all holdings to be sure each one suits the realities of the current market climate.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Wilke/Thompson Capital Management**

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<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$387 Million	Actual	4.2%	N/A
Total Firm Assets Managed in this Discipline	\$194 Million	Benchmark	-2.1%	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?*

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 tremendous relative performance enjoyed by the Minnesota State Board of Investment is the direct result of several factors. Business service companies (those firms that aid their customers in improving productivity) performed particularly well in 1994. Furthermore, strong personal computer sales served as a catalyst, propelling those companies who retail or distribute personal computers or develop software for the personal computer. Restaurant stocks struggled over the fourth quarter as fears of over capacity pervaded the market. The most significant positive influence on the portfolio over the year was superior stock selection including such names as: CDW Computer Centers, Broderbund Software, Best Buy Company, Staples, and Linear Technology. The uncertain market conditions throughout the year underscores the importance of investing in high quality companies that have the ability to grow their earnings irrespective of the economic environment.

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 new year will present investors with several new challenges while mixing in a few prevailing trends. Most economists expect the Fed to once again raise interest rates in the first quarter of 1995 in a further attempt to slow economic growth. Unemployment should remain relatively low and inflation should also remain modest. 1995 will begin with the convening of the Republican controlled 104th Congress. The Republican Contract with America should generate a reduction in the capital gains tax rate combined with an overall tax break whether championed by the Republicans or by President Clinton. Investors will benefit from both of these actions and the investment environment should continue to favor a high quality growth investment style.



## 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 Capital Management had a minor ownership change and added three new employees during the fourth quarter. Vicky Assell, former receptionist/secretary and minority owner, left the firm in the third quarter. This triggered Wilke/Thompson's buy/sell agreement with the completion of the transaction occurring in the fourth quarter. Jacque Nelson was hired to replace Vicky. Joanie Silverberg was added to the trading/operations department while Nancy Gustufson was hired as the Office Manager. Wilke/Thompson added two accounts in this style during the quarter that total \$3.5 million while losing one account worth \$.8 million.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

The SBI experienced phenomenal performance in the fourth quarter as well as throughout the year in which the account was managed by Wilke/Thompson. 1995 promises to be another great year for small cap growth stocks and we look forward to continuing to serve the SBI.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Winslow Capital Management, Inc.**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$465 Million	Actual	0.8%	N/A
Total Firm Assets Managed in this Discipline	\$350 Million	Benchmark	0.8%	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?*

Winslow Capital began managing assets for the Minnesota State Board of Investment on April 1, 1994. In the quarter ended December 31, 1994 the SBI portfolio appreciated 0.95% on a total return basis versus the benchmark Russell 1000 Growth increase of 0.75%. The performance for the SBI account since inception shows an increase of 8.71% versus 7.39% for the benchmark and 5.32% for the S&P 500. Over the past 12 months our comparable accounts rose 3.05% compared with an increase of 2.66% in the Russell 1000 Growth index and 1.32% for the S&P 500.

During the fourth quarter of 1994, our Large Cap growth portfolios were overweighted in technology, telecommunications, healthcare and specialty retailing. On a fundamental basis these companies continued to exhibit strong earnings growth. The most recent quarterly gain from a year ago in actual reported earnings averaged 34%. Through the fourth quarter we continued to believe that these companies had capital appreciation potential because they combine outstanding future earnings growth potential and attractive valuations.

The considerable overweighting of the portfolio in the technology and telecommunication sectors was additive to performance during the quarter ending 12/31/94. Our exposure to the healthcare and specialty retailing sectors proved to be a negative to relative performance. Specifically, the managed care companies entered the fourth quarter at or near record highs. The fourth quarter decline in the broad market led to a somewhat greater reaction in these stocks. We viewed this underperformance as a buying opportunity and added to positions. We are confident that the underlying fundamentals in the managed care industry are strong and will deliver rapid earnings growth into the foreseeable future.

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 will always 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

## Winslow Capital (con't)

sectors are poised to achieve strong future earnings growth. This growth will become more 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 certain companies and sectors of the market receive a premium for their ability to grow earnings. The sectors that are likely to benefit from this, in our opinion, will be technology, telecommunications, healthcare and consumer services. This premium will be realized through a moderate expansion of the P/E ratios of these 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 25% over the next year, while only selling at 16.7 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.*

During the fourth quarter The Amherst Wilder Foundation hired Winslow Capital to manage a High Growth-Combined Cap equity portfolio. The total assets under management are now in excess of \$465 million for 13 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.**

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<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$271 Million	Actual	2.0%	N/A
Total Firm Assets Managed in this Discipline	\$271 Million	Benchmark	0.8%	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?*

Zevenbergen Capital significantly outperformed the S&P 500 and Russell 1000 Growth Indices for the last two quarters, due largely in part to an overweighting in the technology sector.

To increase diversification and better protect against downside volatility, defensive, stable growth issues were added to the portfolio during the fourth quarter. High, single-digit growth issues such as Proctor & Gamble, Coca-Cola and Avon Products, were added to balance overall portfolio returns while further providing excellent opportunities through strong growth in foreign markets.

The energy and materials sectors were the underperformers for the quarter. Price declines in the face of slowing demand due to warm weather and ample supply contributed to the negative returns for the 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 strategic overweighting on the technology and telecommunications represents our continued commitment to the following growth themes for the coming decade:

Substitution of labor with capital and outsourcing of more routine tasks to specialists;

The need for telecommunications infrastructure (wired & wireless) for growing economies and technological enhancements as a means to facilitate the rapid exchange of information;

Shifting demographics favoring savings over spending with a continuing move toward a global economy.

## **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.*

There are no ownership or personnel changes since our last reporting. One account was gained during the fourth quarter, The Northwest Fund for the Environment. Two accounts were lost, RCB Trust Company and Casey Family Program.

4. *Other Comments. Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

Zevenbergen Capital continues to make progress with the customized benchmark study. Mr. Steve Grenadier, associate of William Sharpe at Stanford University was chosen to work with ZCI on an appropriate benchmark comparison.

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### **Staff Comments**

No comments at this time.

**Manager Commentary**  
**BEA Associates**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$21.5 billion	Actual	1.3%	-3.3%
Total Firm Assets Managed in this Discipline	\$3.6 billion	Benchmark	0.4%	-2.8%

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?*

In mid September, BEA shifted the portfolio's cashflows to be yield curve neutral relative to the benchmark except for added relative exposure in 30-year maturities. As the curve flattened, performance was enhanced by 5 basis points. The position in currency hedged non-dollar bonds provided insulation from higher rates in the US and added 17 basis points of return. The portfolio was underweighted in the most cashflow sensitive portions of the mortgage market. As rates rose and the year end approached, mortgages became cheaper and we increased the portfolio's mortgage allocation. The strategy of avoiding poorly structured mortgage securities and buying on weakness added 17 basis points of performance. We continue to hold a meaningful position in long dated FRN's and expect them to provide positive relative returns. In corporate bonds, underweighting Banks, Airlines and Utilities had a positive impact on performance. The portfolio also benefited from drops in global volatility. In derivative strategies, the short Yen volatility position was unwound in November. With volatility at low levels, positions are maintained which will benefit from increased volatility in European cross rates and Nikkei index levels. Derivative strategies added 7 basis pointed of incremental return during 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.*

Most of the strategies in place at the end of the third quarter continue to look attractive. International Perpetual FRN's and Yankees continue to provide good relative value. Government bonds from countries other than the US still earn high yields relative to domestic government bonds. The portfolio will be overweighted in Mortgages because of their excellent cashflow characteristics and supply outlook. The cashflow structure of the account will continue to be duration and curve neutral to the benchmark except from a modest overweighting in 30-year bonds. Limited new issuance of 30-year bonds should enhance their performance. As interest rates stabilize, all of the above sectors should provide superior performance as investors are forced to focus on maximizing relative value in their portfolios in order to optimize potential returns. In derivatives, because volatility is priced at low levels, the portfolio is positioned to benefit from increases in volatility.

**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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$14.0 billion	Actual	1.2%	-3.9%
Total Firm Assets Managed in this Discipline	\$4.8 billion	Benchmark	0.4%	-2.8%

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 portfolio outperformed the benchmark during the fourth quarter but underperformed during the year 1994. Our overweighting in long duration assets reduced performance for the year while our overweighting in asset-backed securities, our barbelled portfolio structure, and our corporate put bonds helped our relative performance. Lower-than-benchmark duration and our barbelled portfolio structure helped us outperform the benchmark during the fourth quarter as yields surged higher and the yield curve flattened. Our overweighting in asset-backed securities reduced relative returns in the fourth 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.*

Treasuries are underweighted with corresponding overweightings in asset-backed securities. ABS are defensive, high-quality (AAA-rated) investments - ideal for a bear market. Mortgage passthroughs are modestly underweighted with the focus on discount coupons to avoid extension risk and to maximize convexity in this sector. The portfolio has a slight barbell bias to benefit from additional yield curve flattening. Given the flattening that has already occurred, this barbell is much more modest than it was during early 1994. The portfolio is defensively postured for higher interest rates during 1995, with a portfolio duration that is 0.75 years less than the duration of the benchmark.



**Investment Advisors, Inc. (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.*

Jim Diedrich, large cap equity manager resigned.

David Himebrook, Vice President, was hired as a small cap equity analyst/portfolio manager.

The ownership of IAI by TSB Group, plc. remains unchanged.

On the international side of our business, long-time affiliate Hill Samuel Investment Advisers (HSIA) changed its name to IAI International Ltd. The name change reflects the further integration of the Minneapolis and London offices. The change also encompasses new responsibilities for IAI in developing and marketing all domestic, global and international products sold in the Americas, and consolidates the reporting relationship of the London office to IAI in Minneapolis.

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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$29.3 billion	Actual	0.1%	-4.3%
Total Firm Assets Managed in this Discipline	\$17.5 billion	Benchmark	0.4%	-2.8%

- 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?*

Over the last quarter, your portfolio provided a 0.4% return versus 0.4% for its benchmark. For the last twelve months, your portfolio has provided a -3.9% return versus a -3.5% return for its benchmark.

During the quarter, interest rates rose and the yield curve flattened as short rates increased much more than long-term rates. The duration of your portfolio is approximately 10% greater than that of your benchmark and a barbell strategy was embedded within the portfolio. About 9.8% of the portfolio was invested in non-dollar securities and the portfolio was underweighted in exposure to the mortgage sector. During the quarter, the duration decision detracted from investment results, while the yield curve exposure was a positive offset. Mortgage securities, which were rich at the beginning of the quarter, appreciated further. Your portfolio's underweighting in the mortgage sector detracted from the quarterly performance.

Year-to-date the duration of your portfolio has been greater than its benchmark, and this decision has detracted from overall investment results. An offsetting bet was the barbell yield curve strategy, which dampened the impact of rising interest rates on the portfolio. Additionally, the portfolio has had an exposure to the non-dollar fixed income market for the better part of the year and this has detracted from 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.*

The active bets in the portfolio include a duration that is about 10% greater than your benchmark, a 9% exposure to the non-dollar fixed income market (with the currency risk largely hedged back into dollars), an underweighting in the corporate sectors, and an underweighting in mortgage security sector exposure.

The large rise in interest rates last year and the flattening of the yield curve has resulted in a significant increase in real interest rates, both here and abroad. Because high levels of real interest rates are generally associated with attractive fixed income returns, we find the fixed income markets attractive and think it is appropriate to bear above benchmark levels of interest rate risk.

**Miller, Anderson & Sherrerd (con't)**

In our judgment, the mortgage market and the high grade corporate market offer little value and we are underweighting these sectors within your portfolio.

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, one investment professional retired. During this period, we added one investment professional.

Two fixed income accounts were gained in the fourth quarter, and one lost.

4. **Other Comments.** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

For many of our clients with similar objectives, we are permitted to invest in below-investment grade securities. For these clients, we currently have 10% of their portfolios invested in BB-rated corporate securities, including a 1.5% commitment to Brady bonds. Exposure to these securities has made a significant contribution to investment results over the last three years and we think that this experience will be repeated in the upcoming year.

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**Staff Comments**

No comments at this time.

**Manager Commentary  
Standish, Ayer & Wood**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$24.4 billion	Actual	0.3%	-4.0%
Total Firm Assets Managed in this Discipline	\$8.4 billion	Benchmark	0.4%	-2.8%

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?*

**4th Quarter Commentary**

MSBI Portfolio underperformed the Lehman Aggregate by 23 basis points during the quarter.

- Continued bearish flattening of yield curve hurt intermediates and asset backed securities. More barbelled distribution of index outperformed.
- Widening of industrial/bank bond spreads in October not fully offset by narrowing in December.
- ARMs constrained by caps in rising rate environment.
- Non-dollar provides positive contribution after poor performance earlier in year.

**4th Quarter Bets vs. Benchmark**

**Commentary**

Mortgages (overweight)

Positive contributions as prepayment risk declines Dramatically. (ARMs an exception)

Corporate (overweight)

Spreads tighten in December but BBB sector does not make up for October spread widening.

International (overweight)

Dollar hedge ok. Bond spreads tighten slightly.

**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.*

<u>Sector</u>	<u>Weighting Strategy</u>	<u>Rationale</u>
Mortgages (including asset backed)	Overweight	Demand continues to exceed supply. Upset from '94 derivation blowups provide opportunity. Spreads attractive.
Corporates	Overweight (prefer medium qual.)	Careful review of high quality (event risk) spreads attractive.
International	Overweight	Dollar hedged foreign bonds. Opportunity after poor year.

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

<b>Personnel changes:</b>	Nevin Markwart Christopher VanAlstyne	Domestic Equity Marketing and Client Service
<b>Departing Employees:</b>	Lawrence Coburn	Private Client Group (Retired)
<b>Accounts gained/lost:</b>	Corporate ERISA \$210 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**  
**Western Asset Management**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$12.7 billion	Actual	0.3%	-4.1%
Total Firm Assets Managed in this Discipline	\$6.8 billion	Benchmark	0.4%	-2.8%

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 portfolio experienced benchmark returns in the latest quarter, and continued to lag the benchmark year to date. The negative impact of long duration exposure last quarter was offset to some extent by the portfolio's overweighting to low-coupon mortgage issues, which did quite well relative to the overall market. Our shift to a more neutral, less barbelled stance last quarter was probably premature, but the portfolio was not adversely impacted by the sharp rise in short and intermediate rates and the very modest rise in long rates, as holdings of long maturity and zero coupon issues benefited from the flattening of the yield curve.

Year to date underperformance was primarily due to the portfolio's long duration posture during a period of sharply rising interest rates. The negative impact of higher rates was offset to a large degree by the portfolio's barbell maturity exposure during most of this period, which benefited as the yield curve flattened. The portfolio's modest overexposure to corporate securities had little impact on performance (the corporate sector trailed the broad market, but our issue selection largely offset this), while over-exposure to mortgages was an important contributor to overall results, as the mortgage sector was the strongest performer for 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.*

The Fed's inflation-fighting obsession has not yet resulted in any perceptible slowing in the U.S. economy, but it has produced several casualties: Orange County, Mexico (dragging many emerging market securities down with it), and funds heavily exposed to rising short-term interest rates. Going forward, economic growth is likely to be limited by several factors: last year's pronounced deceleration in money supply growth and sharply higher interest rates, significant reductions in capital flows to emerging markets (resulting in reduced demand for US exports), and continued emphasis on reductions in government spending.

We thus believe that the market is over-estimating the degree of future Fed tightening needed to prevent a resurgence of inflation in the future. These expectations have caused a dramatic flattening of the yield curve which is likely to reverse during the course of this year as the reality of growth proves less worrisome than currently feared and interest rates trend down. Intermediate maturities look increasingly attractive therefore, as do very short-term interest rates, so we are increasingly adopting a bullet exposure to the yield curve. We continue to see

### Western Asset (con't)

value in low-coupon mortgages, though we have recently reduced somewhat our exposure in his area as spreads have narrowed. Selected corporate issues continue to look attractive as a source of attractive yields.

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 hiring of Keith J. Gardner, Senior Portfolio Manager.

Western Asset added four accounts. One account was 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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$20.8 billion	Actual	0.8%	-3.4%
Total Firm Assets Managed in this Discipline	\$4.9 billion	Benchmark	0.4%	-3.4%

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?*

In the last quarter ended December 31, 1994, investment performance of +0.8% compared favorably to the +0.4% return on the Lehman Brothers Government/Corporate Bond Index. For the calendar year your account return of -3.4% was essentially identical with the -3.5% return on the Benchmark Index. The return in the fourth quarter benefited from the barbell investment structure being employed as both cash and longer dated debt obligations provided better returns than intermediate maturities. Duration of the portfolio was maintained at 5.4 years during 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 expect the Federal Reserve Board to raise short term interest rates when they meet again in late January or early February. Thus, the flattening of the yield curve, seen in 1994, is expected to continue at least into the first quarter of 1995. Currently yield spreads between Corporates and Treasuries are as narrow as they have been for many years. With the increase in interest rates that has occurred over the past 15 months, a slowdown in the domestic economy is expected. We believe this will lead to a widening of yields spreads between Corporates and Treasuries and will provide an opportunity to advantageously improve portfolio yield. These economic forces could also reduce inflation expectations, at which time an increase in portfolio duration should be expected.



**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	Fourth Quarter 1994			
	Gains		Losses	
	<u># of Accounts</u>	<u>Assets (\$MM)</u>	<u># of Accounts</u>	<u>Assets (\$MM)</u>
Large Cap Equities	3	11.9	0	0
Fixed Income	0	0	0	0
Balanced	5	129.7	1	2.4
International	1	5.0	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	2	58.0	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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$50 billion	Actual	-3.4%	-5.9%
Total Firm Assets Managed in this Discipline	\$7.2 billion	Benchmark	0.4%	-1.4%

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?*

The investment strategy over the last quarter remained unchanged from previous quarters. We continued to emphasize a barbell strategy of cash and other short assets combined with longer duration assets and discounted CMOs. The past year was extremely difficult for the CMO market. As prepayment forecasts plunged to an all time low over the course of 1994, mortgage-backed securities that had once been perceived as two year assets were now evaluated as 20+ year securities. In combination with higher rates and a steep yield curve, this extension of average life caused prices to fall sharply. Not surprisingly, large numbers of investors were forced to sell when the maturities of their mortgage holdings lengthened, and a truly spectacular supply/demand imbalance ensued. As extension risk became the dominant feature in the market's evaluation of mortgage assets, the call protection TCW works to build into portfolios lost value. The massive de-leveraging of fixed income positions and steady stream of mutual fund redemptions had a strong and negative impact on the CMO market as well. The TCW strategy emphasizes CMOs and call-protected securities, both of which underperformed during this past quarter, and for most 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.*

No one knows how quickly the CMO market will improve, but the technical negatives which plagued this sector in recent quarters are steadily diminishing. The issuance of new CMOs is virtually non-existent. By mid-1995 mutual fund flows should turn positive, and by the summer months prepayment rates will accelerate seasonally, lending support to discount mortgages and call-protected CMOs. Additionally, the supply of fixed rate mortgages is dropping due to slower housing activity and increased market share of Adjustable Rate Mortgages (ARM) originations. Therefore, we continue to emphasize CMOs and the discount sector.

## TCW Asset 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 ownership or personnel changes in the first quarter. No accounts were lost in this strategy during the fourth quarter. Five accounts were gained.

4. *Other Comments.* Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.

We believe that the bond market will have some rough periods ahead. Our goal in managing your portfolio will be to capture an incremental return above that of the market while reducing the portfolio's risk profile. To that goal, we will be funneling a significant portion of cash flow into ARMs which are historically cheap due to increased supply. With the yield curve nearly flat, these securities provide a high return with low volatility and offset some of the longer duration assets in the portfolio. We want to emphasize that in no way are we changing our long term strategy at this juncture. We continue to adhere to the process of structuring high quality, high yielding mortgage portfolios with call protection. We appreciate your confidence and look forward to a more profitable 1995.

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### Staff Comments

No comments at this time.

**Manager Commentary**  
**Goldman Sachs Asset Management**

Period Ending:	12/31/94	Returns	Qtr.	Year
Total Firm Assets Under Management	\$37.4 billion	Actual	0.9%	-2.1%
Total Firm Assets Managed in this Discipline	\$13.5 billion	Benchmark	0.4%	-2.8%

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?*

In the fourth quarter the portfolio outperformed the Lehman Brothers Aggregate Bond Index by 22 bps. Term structure exposure, option-adjusted spread (OAS) advantage, and mortgage securities were primarily responsible.

The portfolio gained about 10 bps due to underweighting the 10- and 20- year part of the curve and overweighting the 30- year sector as the curve flattened dramatically.

About 7 bps were added due to the incremental OAS of the portfolio's securities versus those in the Index. The portfolio's corporates accounted for about 1.5 bps each month.

Pass-through security selection added about 10 bps, mainly as a result of overweighting GNMA's as they outperformed in December. Overweighting collateral as spreads tightened 10 bps over the quarter added an additional 3 bps. However, the spread widening of the portfolio's inverse floater detracted about 7 bps from the mortgage sector's contribution.

A municipal cross-over trade executed as the municipal/Treasury ratio decreased from 85.8% to 83.8% added about 4 bps.

Duration/Term Structure Exposure	10.4	Mortgage	6.2
Agency	0.5	Municipal	3.7
Corporate	-5.8	Incremental Yield (OAS)	7.1
Asset-backed	-0.7	Residual	<u>0.6</u>
		<b>Total</b>	<b>22.0</b>

The only significant factor detracting from the portfolio's performance was the corporate sector. The underperformance of the portfolio's industrial and foreign securities cost about 4 bps. Overweighting the industrial and finance subsectors, which underperformed the foreign and utility subsectors, cost an additional 2 bps.

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 a positive outlook for the mortgage sector, where we continue to target a 33% allocation. Mortgages should benefit from supportive technicals as well as more stable

## Goldman (con't)

prepayment activity. Within the sector, we are looking for opportunities in 15-year securities, which we believe have been excessively penalized as the yield curve has flattened.

We have a more cautious outlook for the corporate sector. Fundamentally, the momentum in corporate profits has begun to slow and the rise in short term rates will negatively affect debt coverage ratios. The increase in short ratios and flatter yield curve will also have a negative impact on corporate technicals, due to reduced liquidity and investor demand. Although in the near term spreads may tighten on strong fourth quarter earnings reports, we expect to take advantage of such opportunities to lighten our exposure to the sector.

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.*

Michael Armellino, Chairman and Chief Executive Officer retired in November 1994 and David Ford became sole Chairman and CEO. Alan Shuch, President and Chief Operating Officer of GSAM, also retired in November 1994 and will continue as a consultant during 1995.

There were no changes in the ownership of GSAM.

GSAM had no additions and one loss to our U.S. fixed income portfolio management staff: Tom Dunn, Vice President; Portfolio Manager resigned in December 1994.

U.S. Fixed Income Accounts Gained: 2  
U.S. Clients 2  
Non-U.S. Clients 0

U.S. Fixed Income Accounts Lost: 4  
U.S. Clients 1  
Non-U.S. Clients 3

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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$21.8 billion	Actual	-0.4%	-2.6%
Total Firm Assets Managed in this Discipline	\$4.5 billion	Benchmark	0.4%	-2.8%

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 portfolio's Mexican emerging market holdings dominated performance during the quarter. The change in Mexico's currency policy has profoundly shaken investor confidence, which has been very important to sustaining economic growth in Mexico. As such, the impact on peso and dollar-denominated debt has been significant. Short-term, peso-denominated, Mexican Cetes (U.S. treasury bill equivalents) were offered at 31% yields at the end of the quarter, versus 16% yields prior to the devaluation. The portfolio had no exposure to peso-denominated obligations. Dollar-denominated corporate obligations widened significantly relative to U.S. Treasuries during this time. The portfolio's Mexican holdings are mostly corporate obligations. Mexico's economic growth is expected to slow significantly due to the Central Bank's dramatic increase in short-term rates in an effort to offset the devalued Peso's inflationary impact. The devalued Peso has also made the repayment of dollar-denominated debt a much greater burden to Mexican issuers. Both of these factors along with investor uncertainty have caused the widening in Mexican corporate debt obligations. The companies we are exposed to, however, are the highest quality companies in Mexico. We expect spreads to ultimately settle at tighter than current levels as the situation stabilizes.

Year-to-date, the portfolio remains slightly ahead of its benchmark. Strong corporate issuer selection, emphasis in the bank and finance corporate subsector, exposure to strong-performing collateralized mortgage obligations, and a barbelled yield curve strategy as the yield curve flattened all helped to add to portfolio returns during 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.*

**Corporates**

No change in the domestic corporate strategy as high valuation offsets improving fundamentals. We continue to be modestly underweighted on a dollar duration basis. Emphasis remains on the asset-based and finance/bank sectors.

Exposure to dollar-denominated Mexican Yankees continues to be monitored closely following the recent peso devaluation. Successful passage of the proposed U.S. loan guarantee package will stabilize and improve trading levels in this market.

## Fidelity Management Trust (con't)

### Mortgages

We are neutral on residential MBS. We have a 2.5% CMO overweighting versus a collateral underweighting.

We also have a 2.5% commercial MBS overweighting relative to other credit types.

### Yield Curve

We maintain a barbelled curve structure. The portfolio is underweighted in 2-year bonds and overweighted in 30-year bonds.

Technical and fundamental factors have led to continued pressure on the front end of the curve.

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 fourth quarter of 1994 FMTC lost the following two separately managed Targeted Active Management accounts:

UGI Corporation	*
Ameritech	*
Total	\$600 mm

- \* Due to the sensitivity of our clients we are not at liberty to provide account asset information.

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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$26.0 billion	Actual	0.5%	-2.6%
Total Firm Assets Managed in this Discipline	\$8.1 billion	Benchmark	0.4%	-2.8%

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?*

	<b>4th Quarter 1994</b>		<b>12 Months Ended 12/31/94</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	+0.07%
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
Miscellaneous				
Rebalancing Transaction Cost	N/A	-0.01%	N/A	-0.04%
Security Selection	N/A	<u>+0.09</u>	N/A	<u>+0.14</u>
<b>Total</b>		<b>+0.10%</b>		<b>+0.22%</b>

The portfolio structure was stable this quarter. The overweighting in discount mortgages and asset-backed securities was unchanged and contributed favorably to the portfolio's excess return. The yield curve reshaping was the dominant factor in determining relative performance across the mortgage sector. Security selection also enhanced returns.



**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 30 Year Mortgages	Overweighted vs Treasuries	1. Agency Quality 2. Low Prepayment Risk 3. Wide Nominal Spreads

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	1	100
Accounts Lost	1	227

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>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$11.8 Billion	Actual	-3.1%	1.1%
Total Firm Assets Managed in this Discipline	\$ 1.5 Billion	Benchmark	-1.0%	7.8%

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?*

This has been a disappointing quarter and year for investment performance. Our strategy of emphasizing some of the Asian growth economies and underweighting Japan, which made such a strong contribution to performance in 1993, did not pay off in 1994. The following figures show a breakdown of the fourth quarter 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	-3.1	-0.6	-2.3	-0.2
Benchmark	-1.0	-0.5	-0.5	---
Relative Return	-2.1	-0.1	-1.8	-0.2

The contributions to return from currency, market weightings, and the tracking error were all negative. The relative currency contribution was -0.1%. The positives of underweighting the Yen and Italian Lira, and overweighting the Singapore Dollar, were offset by the weakness of the Mexican Peso. Through November, returns from our country allocation had been neutral. In December the Korean, Mexican and Hong Kong markets fell sharply resulting in a negative contribution to return in this category. Our move to reduce Hong Kong and Mexico in December avoided further underperformance. Japan, through its stability, outperformed other markets during December. Our underweighting of this market proved a negative. The third constituent of the period's return, tracking error, was negative due to Korean exposure where full index replication is not possible.

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.*

Underweight in Japan;  
Significant overweighting in Singapore;  
Overweighting in France and Germany;  
Reduced exposure to Korea;  
Hedge from the Japanese Yen into both Sterling and the US Dollar;

The economy in France is showing further signs of recovery and with the corporate sector having cut costs dramatically we are forecasting a substantial profits recovery. Your weighting in France has been increased to 8.0%. In Germany there has been a substantial bounce in both business and consumer confidence. This combined with a strong pick-up in Germany's export performance led us to increase your portfolio's weighting in Germany to 8.3%.

## Baring (con't)

Within the Asian component of your portfolio we have shifted the emphasis away from Hong Kong and Korea and increased the weighting in Singapore. The Hong Kong weighting was reduced to 3.3%. We have become increasingly concerned about the effect rising US interest rates will have on financial assets in Hong Kong and believe that the deteriorating political climate will depress the market valuation. The Korean weighting was reduced from 7.1% to 4.1% as we took advantage of the market's strength to take further profits. Singapore is now our main focus in the region with a 9.9% weighting compared to 1.2% for the benchmark. Economic and corporate profit growth continues at a rapid pace and there is abundant liquidity due to the large current account surplus and liberalization of the Central Provident Fund. The economic recovery in Japan is fragile. Consumer confidence is low and the banking system remains weak. Your weighting in Japan is 31.4% compared to 45.8% for the benchmark. Although we can identify some areas of the market that are looking more attractive we remain cautious on the market as a whole. We have maintained our 12% hedge from the yen into both Sterling and the US Dollar.

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.*

John Bolsover, who has been Chief Executive and Chief Investment Officer of our Company, has decided to focus his attention on the role of Chief Executive Officer and James Williams succeeded John as Chief Investment Officer on the 1st January 1995. James has worked for us, and very closely with John, since 1975. John will continue to play an important role in our investment process as a member of the Strategic Policy Group. Peter Hartley has returned to London as planned after three years in Boston and has become Chairman of our Northern American operations. Philip Bullen, who moved to Boston earlier in 1994, has succeeded him as President and Managing Director. Peter Hartley's responsibilities will now also include the management of our UK, European and Middle East business. The following people also joined the group during the fourth quarter:

John Taylor - Multi-currency bond specialist - London  
Gerhardt Schoninger - European specialist - London  
Wataru Nishimura - Japanese specialist - Tokyo  
Dr. Paul Sheard - Japanese specialist - Tokyo

**Active Passive Accounts Gained- Koch Industries    Active Passive Accounts Lost- None**

We continue to expand our coverage of emerging markets and have opened an office in Bombay, India.

4. **Other Comments.**

None.

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### Staff Comments

Staff does not believe that the organizational changes referenced in #3 will negatively impact the management of SBI's account.

**Manager Commentary**  
**Brinson Partners, Inc.**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$37.3 Billion	Actual	-1.3%	3.4%
Total Firm Assets Managed in this Discipline	\$ 8.3 Billion	Benchmark	-1.0%	7.8%

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 both the fourth quarter and the full year, in large part due to underweighting Hong Kong and Malaysia. The overweight in Canada had a neutral effect on fourth quarter performance, but was a positive for the full year, when the Canadian market earned a relatively strong 2.17% hedged return (versus a loss of 1.65% for the non-U.S. universe). The portfolio's underweights of several of the better performing Scandinavian markets had only a slightly negative effect during the quarter, but was somewhat more of a detraction for the full year. Japan, on the other hand, returned a slightly better than market dollar-hedged return in the quarter, but had the year's third best dollar-hedged return. The Japan underweight detracted somewhat from the fourth quarter's, but more especially from the full year's performance.

Cash was a small positive for the quarter, and added value for the full year. During the fourth quarter, currency allocation was modestly negative, helped by the strength of the U.S. dollar against most of the European currencies (a reversal of the third quarter's scenario), as well as the strength of the Australian and New Zealand dollars, which gained against the U.S. dollar. Underweighting the relatively weak yen also added value. On the other hand, the Canadian dollar's weakness both in the quarter and the year detracted from portfolio returns in both time periods. Over the past year, the yen position has been substantially reduced and is now importantly underweight at 32% below the benchmark. These underweights and overweights have not, as yet, worked out, as the yen continued to strengthen, while the Canadian and U.S. dollars both weakened. For the year just ended, currency allocation was the most significant negative factor contributing to the portfolio's underperformance.

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.*

No market strategy changes were made in the fourth quarter. At year-end, the allocation to Japan was 12% below the benchmark weight. Although the valuations for Japan have improved, the market rose strongly in 1994 and prices have gotten ahead of value. Areas of the economy which appear to be growing are housing, public works and some areas of consumer spending. 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, overly 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. In Australia, New Zealand and

## Brinson (con't)

Canada, the economies have begun to show strong growth. The large underweight in Germany was scaled back. Although the portfolio's exposure to Hong Kong was increased, it remains a moderate underweight. Italy's neutral weight reflects the improvements in corporate profitability that should result from the economic and political reforms currently underway.

In the third quarter, the portfolio modestly reduced its strategic cash position from 10% to 9%. The large strategic cash position reflects our view that despite the declines of 1994, most non-U.S. equity markets remain overvalued, albeit to varying degrees. In the fourth quarter, the small hedge into the Spanish peseta was lifted and placed into the U.S. dollar, as the peseta appeared to have become fully valued. The significant underweight of the yen (-32%) is based on our view that the yen is an extremely overvalued currency. There is also a minimal exposure to the overvalued ERM currencies, which over the course of the year became even more expensive. To offset these underweights, the portfolio maintains overweights in the more attractively priced North American currencies: a 20% allocation to the Canadian dollar and a 26% position in U.S. dollar. 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.

During the fourth quarter of 1994, Brinson Partners, Inc. gained no non-U.S. equity mandate portfolios. We lost one non-U.S. equity mandate portfolio for a total of \$93 million during the fourth quarter of 1994. Firmwide assets as of September 30, 1994 (the latest date for which data are available) totaled \$37,249 million. Non-U.S. equity assets under management across all portfolio mandates totaled \$8,256 million as of September 30, 1994.

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

Performance attribution relative to EAFE for the quarter is shown below:

	Oct. -Dec. 1994
Country selection*	0.21
Stock selection*	0.08
Currency effect	0.26
Hedging activity	-0.75
Total Value Added to EAFE	-0.21

Source: State Street Analytics \* in local currency

**Manager Commentary**  
**Marathon Asset Management**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$2.3 Billion	Actual	-0.6%	16.8%
Total Firm Assets Managed in this Discipline	\$1.0 Billion	Benchmark	-1.0%	7.8%

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 portfolio declined 0.6% in the fourth quarter of 1994 versus a 1.0% decline in the MSCI EAFE Index. Market and stock returns differed markedly between Europe and the Pacific, with European market selection boosted by overweightings in Finland and Sweden (2.1% and 4.8% of the fund versus index weightings of 0.6% and 1.6% respectively) which both continued to benefit from accommodative growth policies. Stock returns were positive in Asia, largely due to outperformance from Japan, whilst a background of rising interest rates and growing caution saw consolidation in European holdings. Changes in geographical distribution over the quarter were primarily due to market action, and no major shifts are planned.

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.*

Global markets are currently dominated by a tug of war between interest rates (the bears) and earnings momentum (the bulls). The U.S., the U.K. and, with the notable exception of Japan, Asia's economies are now far advanced in economic expansions that have lasted up to four years. Bottlenecks are beginning to appear, wage push is rearing its ugly head and, with Continental Europe and Japan set to join the party, the global balance has become considerably less accommodating. Attempts to control these demand pressures have by no means been universally successful, and it seems highly probable that 1995 will see continued increases in reported inflation rates from historically low levels.

This however is what 1994 was all about. Markets, fixed income or equity, are still desperately seeking evidence of further long-term inflationary pressures, of uncontrolled growth, and yet several factors continue to argue that such pressures will be more muted than in previous cycles. Firstly there is the pre-emptive nature of many of the measures that have been taken; secondly the dampening pressure of new, lost cost sources of supply and the internationalization of corporate cash flow; thirdly the shift in the broad nature of financial systems, with banks unlikely to lend quite as recklessly as in the 1980's, if only because of closer and more efficient supervision; and finally the high levels of unemployment, suggesting that wage push will be constrained.

What then of corporate earnings momentum? The answer seems to be that it will be maintained, but far more selectively. Easy money, fueled in particular from the U.S., and expansive fiscal policies are already in retreat. As a result key sectors in many markets in both economic and market terms - noticeably real estate, financials and construction - are likely to be placed under growing pressure as focused fiscal and monetary tightening begun to bite. Other areas - manufacturing, processing, materials - however should see continued (and in Japan and parts of Europe, accelerating) earnings momentum, offering the real likelihood of

## Marathon (con't)

considerable positive earnings surprises against consensus estimates that, mirroring share price movements, have been consistently revised down over the last few quarters. We are entering then in many markets the latter stages of a sustained period of economic expansion in which some cooling-off (particularly in asset backed, speculative or leveraged areas) is both desirable and inevitable: whilst depressing to the top down asset allocator this however is usually a period of strong stock specific returns and the portfolio is positioned to benefit from such trends.

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.*

Founding directors gained 100% control of Marathon's holding company, MAM Investments Ltd, following buy-out of the 44.8% shareholding in that company previously held by Sphere Investment Trust plc.

No personnel changes.

Gained one client in this discipline during the quarter and set up own EAFE mandated group trust.

No clients were lost in the period.

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 views the ownership change referenced in #3 as positive for the firm. The change should not affect management of the SBI's account.

Performance attribution for the quarter relative to EAFE is shown below:

	Oct. -Dec. 1994
Country selection*	-0.48
Stock selection*	0.52
Currency effect	0.56
Hedging activity	-0.08
Total Value Added to EAFE	0.52

Source: State Street Analytics \* in local currency

**Manager Commentary**  
**Rowe Price-Fleming International**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$18.3 Billion	Actual	-3.5%	-0.1%
Total Firm Assets Managed in this Discipline	\$12.8 Billion	Benchmark	-1.0%	7.8%

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?*

Over the quarter, country allocation accounted for two thirds of the underperformance relative to the EAFE Index. In particular, overweightings in Mexico (3.5% of your portfolio), Brazil (3% weighting) and Malaysia (3% weighting) accounted for almost the entire value subtracted. Stock selection was also negative with smaller companies continuing to underperform.

Over the year, the story was broadly similar. Three quarters of the underperformance relative to the Index was the result of country allocation with the underweighting in Japan (24% of your portfolio) accounting for almost half of this and the remainder the result of overweightings in South East Asia (Hong Kong, Malaysia and Thailand) and Mexico. Stock selection for the year was also negative with performance in the Pacific, in particular, held back by poor smaller company 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.*

**Countries** - International markets were generally disappointing in 1994 with sentiment depressed by sharply rising interest rates and valuations which were mixed to expensive. Entering 1995, many countries remain at an early stage of their economic cycle, inflation is not rising and valuations have improved on the back of rising corporate profits. We are optimistic that the thrust of your portfolio away from Japan towards continental Europe, South East Asia and the markets of Latin America makes sense given the likelihood of renewed investor confidence this year on the back of good corporate profits and growth and improved valuations.

**Stocks** - Your portfolio's tilt towards the consumer and capital goods sectors at the expense of financials and utilities has remained unchanged over the quarter. We continue to emphasize medium sized and smaller companies given their sensitivity to improved levels of economic activity particularly as they remain generally out of favour with investors.



### Rowe Price (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 in the ownership of RPFI in the fourth quarter.

During the fourth 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.

None.

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### Staff Comments

Performance attribution relative to EAFE for the quarter is shown below:

	Oct.-Dec. 1994
Country selection*	2.16
Stock selection*	0.21
Currency effect	-4.59
Hedging activity	-0.02
Total Value Added to EAFE	-2.34

Source: State Street Analytics \* in local currency

**Manager Commentary**  
**Scudder, Stevens and Clark**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$90.0 Billion	Actual	-2.6%	-2.1%
Total Firm Assets Managed in this Discipline	\$ 7.0 Billion	Benchmark	-1.0%	7.8%

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?*

1994 was a difficult, volatile period for financial investments. The largest single cause of your portfolio's underperformance was its significant underweighting of Japan at the beginning of the year. Japan was the only major market to rally strongly in 1994, aided by a currency that appreciated to historic highs. While we had substantially increased your portfolio's exposure to Japan early in the first quarter, relative to EAFE we still were materially underweight. We were also hurt by the fact that we had hedged away part of the yen position, and consequently missed the final leg of the yen's first half rally. These hedges were instituted based on our conviction that over one to two year time horizon the overvaluation of the yen would reverse itself, a conviction that we still maintain.

The second factor that contributed to your portfolio's underperformance was our exposure to the emerging markets. When the Fed began its series of rate increases in early February and triggered an abrupt reversal in the global interest rate environment, these small liquidity-driven markets went into a tailspin. While our view on the long term attractiveness of the markets remains intact, we tend to maintain our positions and not potentially "sell against ourselves", despite the negative impact on short term portfolio performance. In the cases where the fundamentals or the valuations were no longer compelling, however, like Malaysia or Mexico, we took advantage of rallies to lighten up or exit the markets.

Another factor that hurt performance was our exposure to financials early on in the year. Compensating for this on the plus side, we had built up positions in commodity metals and oil stocks on a timely basis, and benefited from a broadly increased cyclical exposure in both Europe and Japan.

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 market jitters that characterized 1994 beginning with the watershed rate hikes by the Fed are likely to persist through at least the early part of this year. In the near term, volatile but directionless markets may be all that can be expected. Notwithstanding the condition of the financial markets, global economic fundamentals continue to look favorable and we look to a year of solid growth around the world. Our investment outlook calls for a reasonable slowdown in the US, further economic growth across Europe, and incipient recovery in Japan, all set against continued robust economic expansion in the emerging markets. Your portfolio is invested to take advantage of these fundamental developments, which ultimately will be manifest in higher equity prices. We are underweight Japan at somewhat over half the index exposure, and have concentrated investments on the sectors most leveraged to the earnings recovery now underway and the anticipated reversal in the yen. In Europe, we maintain an

## Scudder (con't)

overweight position and continue to emphasize the economically sensitive sectors. We find particularly compelling the German industrial sectors and the tenacity with which these companies are tackling threats to their long term competitiveness. As positive evidence has continued to come through, we have increased the portfolio exposure accordingly.

We continue to watch for additional opportunities in the emerging markets. However, so long as the environment for global liquidity remains tight and the full ramifications of the Mexican collapse have yet to play out, we are inclined to be cautious on new investments.

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.*

Clients Lost: None

Clients Gained: 5 (all went into co-mingled accounts)

\* Note: figures do not take into account client who entered/left the International Fund

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

Performance attribution relative to EAFE for the quarter is shown below:

	Oct. -Dec. 1994
Country selection*	-0.23
Stock selection*	-1.31
Currency effect	0.24
Hedging activity	-0.27

Total Value Added to EAFE -1.56

Source: State Street Analytics \* in local currency

**Manager Commentary**  
**Templeton Investment Counsel, Inc.**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$42.0 Billion	Actual	-3.0%	3.8%
Total Firm Assets Managed in this Discipline	\$12.1 Billion	Benchmark	-1.0%	7.8%

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?*

UNDERWEIGHT JAPAN - Did not work last year because many investors perceived that the Japanese economy was in full recovery. Additionally the Yen strengthened significantly against the US Dollar. In the last quarter of the year, however, this strategy was marginally additive.

EMERGING MARKETS EXPOSURE - Did not work last year because of several adverse political and economic events which negatively affected these markets. The Mexican monetary crisis in December is particularly noteworthy.

OVERWEIGHT EUROPE - Did not work last year because the Japanese market outperformed.

BOTTOM-UP SHARE SELECTION - Generally added value.

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 organization offers its clients a longer-term bottom-up share selection investment strategy with low portfolio turnover. The active bets that we take for your portfolio are therefore very focused and do not typically change over a short period of time. We believe in this process and we remain confident in underweighting Japan because we believe many Japanese shares remain fundamentally overvalued compared to peers in other markets, and will eventually be recognized by other investors as being overvalued. Additionally, despite recent volatility, your emerging markets exposure probably continues to offer longer-term value. These markets can be categorized as higher risk, higher return assets, that over time are being driven by above-average economic growth.

### 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.

4th Quarter 1994 - Two fixed income research analysts were hired.

27 accounts/\$272 MM were gained in this discipline and none 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

In January 1995, our portfolio manager, Harry Erlich, left Templeton for a position at Warburg Pincus. Our backup portfolio manager, Jim Chaney, has replaced Harry as portfolio manager. Staff does not believe the change will negatively impact the SBI account, but will monitor the situation closely.

Performance attribution relative to EAFE for the quarter is shown below:

	Oct. -Dec. 1994
Country selection*	-0.39
Stock selection*	-0.98
Currency effect	-0.65
Hedging activity	0.00
Total Value Added to EAFE	-2.00

Source: State Street Analytics      \* in local currency

**Manager Commentary**  
**State Street Global Advisors**

<b>Period Ending:</b>	<b>12/31/94</b>	<b>Returns</b>	<b>Qtr.</b>	<b>Year</b>
Total Firm Assets Under Management	\$150.0 Billion	Actual	-1.0%	8.3%
Total Firm Assets Managed in this Discipline	\$ 4.6 Billion	Benchmark	-1.0%	7.8%

- 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.

The majority of the Portfolio's outperformance for the year is due to the account's more favorable dividend withholding tax rate compared to the benchmark. Additionally, the gain experienced in handling index changes in Japan also added to the positive tracking error.

- 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:**

After being on maternity leave since April 1994, Lynn Bogle formally resigned from State Street Global Advisors in December 1994 opting to continue full-time motherhood. Peter Leahy assumed Lynn's management responsibilities last Spring and will remain in the position as Department Head of the International Structured Products Group.

**Gained and Lost Clients**

During the fourth quarter, we lost two clients following an EAFE Index strategy with total assets of \$230 million, and gained two new EAFE Index clients with assets of \$125 million.

## 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.

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### Staff Comments

Stuart Peskin, formerly back up manager for the SBI account, became the designated portfolio manager during Lynn Bogle's maternity leave and will remain the portfolio manager now that Lynn has resigned. Staff does not believe the change will materially impact the operation or performance of the SBI account.

Performance attribution relative to EAFE for the quarter is shown below:

	Oct. -Dec. 1994
Country selection*	0.00
Stock selection*	-0.01
Currency effect	0.07
Hedging activity	0.00
Total Value Added to EAFE	0.06

Source: State Street Analytics      \* in local currency