

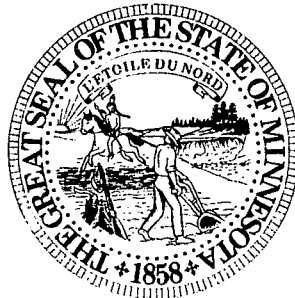
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# MINNESOTA STATE BOARD OF INVESTMENT

MINNESOTA STATE BOARD  
OF INVESTMENT  
MEETING  
September 2, 1998

&

INVESTMENT ADVISORY  
COUNCIL MEETING  
September 1, 1998



**Governor Arne H. Carlson**

**State Auditor Judi Dutcher**

**State Treasurer Michael A. McGrath**

**Secretary of State Joan Anderson Growe**

**Attorney General Hubert H. Humphrey III**

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**AGENDA  
STATE BOARD OF INVESTMENT  
MEETING**

**Wednesday, September 2, 1998  
8:30 A.M. -Room 125  
State Capitol - Saint Paul**

- |   |            |
|---|------------|
|   | <b>TAB</b> |
| <b>1. Approval of Minutes of June 11, 1998</b>  |            |
| <b>2. Report from the Executive Director (H. Bicker)</b>                                    |            |
| A. Quarterly Investment Review<br>(April 1, 1998 - June 30, 1998)                           | <b>A</b>   |
| B. Administrative Report  | <b>B</b>   |
| 1. Reports on budget and travel   |            |
| 2. Update on litigation   |            |
| <b>3. Report from the SBI Administrative Committee (M. McGrath)</b>                         | <b>C</b>   |
| A. Update on International Country Guidelines   |            |
| B. Review of proposed Biennial Budget Request for FY's 2000-2001                            |            |
| C. Discussion of SBI staff's move to new offices planned for FY 1999                        |            |
| D. Review of Executive Director's Job Description   |            |
| E. Executive Director's Salary Review   |            |
| <b>4. Report from the Proxy Committee (P. Sausen)</b>                                       | <b>D</b>   |
| 1. Update of Board Proxy Guidelines   |            |
| <b>5. Reports from the Investment Advisory Council (J. Yeomans)</b>                         |            |
| <b>A. Domestic Manager Committee</b>  | <b>E</b>   |
| 1. Review of manager performance  |            |
| 2. Review of short-term commercial paper issuers  |            |
| 3. Re-interview of Investment Advisers, Inc. and Wilke/Thompson<br>Capital Management, Inc. |            |
| 4. Discussion of SBI's actions related to restrictions on tobacco related<br>companies      |            |
| <b>B. International Manager Committee</b>   | <b>F</b>   |
| 1. Review of manager performance  |            |
| 2. Discussion of International Program  |            |
| <b>C. Alternative Investment Committee</b>  | <b>G</b>   |
| 1. Review of current strategy   |            |
| 2. Approval of new commitments for the Basic Retirement Funds:                              |            |
| • Piper Jaffray Ventures, Inc.  |            |
| • Crescendo Venture Management L.L.C.   |            |
| • TA Associates Realty  |            |
| 3. Approval of new commitment for the Post Retirement Funds                                 |            |
| • TCW Crescent Mezzanine Partners   |            |
| <b>6. Plan for Divestiture of Tobacco Stocks</b>  | <b>H</b>   |

**Minutes  
State Board of Investment  
June 11, 1998**

The State Board of Investment (SBI) met at 8:30 A.M. Wednesday, March 18, 1998 in Room 125 State Capitol, St. Paul, Minnesota. Governor Arne H. Carlson; State Auditor Judith H. Dutcher; State Treasurer Michael A. McGrath; Secretary of State Joan Anderson Growe, and Attorney General Hubert H. Humphrey III were present. The minutes of the March 18, 1998 Board meeting were approved.

**Executive Director's Report**

Mr. Bicker, Executive Director, referred members to Tab A of the meeting materials and reported that the Combined Funds had exceeded inflation over the ten year period ending March 31, 1998 (Combined Funds 14.2% vs. Inflation 3.4%), exceeded the median fund (30<sup>th</sup> percentile) and outperformed its composite index (Combined Funds 15.5% vs. Composite 15.0%) for the most recent five year period. He stated that the Basic Funds had exceeded its composite index (Basics 15.9% vs. Composite 15.5%) over the last five years and reported that the Post Fund had outperformed its composite index for the period since July 1, 1993 (Post Fund 15.4% vs. composite 14.7%).

Mr. Bicker reported that the Basic Funds' assets increased 9.2% for the quarter ending March 31, 1998 due to positive investment returns. He said that the asset mix is essentially on target and that the Funds outperformed its composite index for the quarter (Basics 9.3% vs. Composite 9.1%) and for the year (Basics 33.0% vs. Composite 30.7%).

Mr. Bicker reported that the Post Fund's assets increased 8.8% for the quarter ending March 31, 1998 due to positive investment returns. He said that the Post asset mix is also on target and that the Fund had outperformed its composite index for the quarter (Post 9.5% vs Composite 9.1%) and for the year (Post 31.1% vs. Composite 29.1%).

Mr. Bicker reported that the domestic stock manager group outperformed for the quarter (Domestic Stocks 13.4% vs. Wilshire 5000 13.3%) and for the year (Domestic Stocks 49.3% vs. Wilshire 5000 47.7%). He said that the international stock manager group underperformed for the quarter (International Stocks 12.9% vs. Int'l. Composite 13.7%) but had outperformed for the year (International Stocks 15.4% vs. Int'l. Composite 13.9%). He added that the bond segment outperformed for the quarter (Bonds 1.8% vs. Lehman Aggregate 1.6%) and for the year (Bonds 12.7% vs. Lehman Aggregate 12.0%). He concluded his report with the comment that as of March 31, 1998 the SBI was responsible for over \$43 billion in assets.

**Executive Director's Administrative Report**

Mr. Bicker referred members to Tab B for current budget and travel reports. Mr. Bicker distributed an additional item to members and stated that staff is requesting Board approval of an administrative amendment to the Minnesota Mutual 457 Deferred Compensation Plan document that simply puts the policy in compliance with Federal law

(see Attachment A). Mr. McGrath moved approval of the amendment, as stated in Attachment A. Ms. Growe seconded the motion. The motion passed.

Mr. Bicker asked Christie Eller, Assistant Attorney General, to update members on the status of litigation concerning Mercury Finance Corporation. Ms. Eller stated that an Illinois judge had stayed the parallel state actions pending resolution of the federal action. She said that the company has filed with the SEC notice that they intend to file for bankruptcy. She noted that aggregate claims against the company are roughly \$1 billion versus available monies for settlement of around \$23 million. In response to questions from Mr. Carlson, Ms. Eller stated that the SBI portion of the settlement is expected to be small and Mr. Bicker stated that the SBI has no further exposure.

Mr. Bicker referred members to the meeting materials in his Administrative Report for an update on tobacco information. He stated that the information has been updated to reflect the new report information staff had received from the Investors Responsibility Research Center (IRRC).

Ms. Growe stated that she had a tobacco resolution to propose and she distributed copies of the resolution to members of the Board (see Attachment B). She stated that she continues to have concerns regarding the risks associated with investing in tobacco companies. She explained that the proposed resolution is a “no new investment” policy for the actively managed portfolios only, concerning companies that derive more than 15% of their revenues from the manufacture of consumer tobacco products. Mr. Humphrey informed members that he would no longer be recusing himself from the vote since the state’s litigation against the tobacco industry was no longer pending. He briefly reviewed the results of the Minnesota case and stated his support of Ms. Growe’s proposed resolution. Mr. McGrath stated that he had supported a previous resolution and that he also supports the proposed resolution.

In response to several question from Mr. Carlson, Ms. Growe stated that opinions by outside money managers regarding tobacco are mixed with some managers stating that the risks are very difficult to evaluate. She discussed some data provided by the Board’s Consultant, Richards & Tierney that showed tobacco has a high risk for a low return when compared to other industries within the Wilshire 5000 universe. She added that Congress is also expected by many to take action soon regarding tobacco companies.

In response to more questions from Mr. Carlson, Ms. Posey stated that Richards & Tierney could not comment on the likelihood of tobacco companies filing for bankruptcy, but she stated that the active managers are making those types of decisions on an on-going basis. Mr. Bicker added that if tobacco divisions were separated from the conglomerate companies it is likely that the liabilities would still follow through to both entities. Ms. Dutcher stated that she would not support the proposed resolution because she is uncomfortable with the Board micro-managing the active equity money managers. She said that she would have preferred to have time to also receive input from members of the Investment Advisory Council (IAC) before making such a policy decision and she reminded members of their fiduciary responsibilities. She noted her concern about

putting investment restrictions on tobacco holdings which could then lead to pressure to put restrictions on other companies or industries that are associated with controversial social issues. She added that she is also uncomfortable passing the proposed resolution now when a new Board will be in place in January 1999.

Ms. Growe apologized for the late notice regarding the resolution and restated her belief that the proposed resolution represents an investment policy decision and not a political decision. She emphasized that the resolution does not call for divestment and that it only requires making no additional investments. Ms. Dutcher suggested that the IAC study the issue and make a recommendation to the Board next quarter. Ms. Growe stated that in the past, the IAC was uncomfortable addressing the tobacco issue.

Mr. Carlson stated that he would support the proposed resolution because he is concerned that the tobacco-related companies will not be able to remain profitable in the face of litigation from individual state, city, county, and even foreign country entities. He noted that the resolution is impacted by politics and he encouraged members to work cooperatively together during the upcoming election season. In response to questions from Mr. Carlson, Ms. Growe stated that the resolution was distributed to members late because she wanted to include the results of the June 10<sup>th</sup> Florida litigation in the wording.

Mr. Humphrey stated that he believes the Board's responsibility is to maximize profits, but in a prudent manner which constrains the level of risk. Mr. Humphrey seconded the resolution, as stated in Attachment B. The motion passed.

Ms. Growe stated that she had a second resolution involving tobacco and she distributed copies to members (see Attachment C). She stated that the resolution requests staff to prepare a study for the Board by July 15, 1998 regarding the potential divestiture of tobacco holdings and she moved approval of the resolution. Mr. Humphrey seconded the motion. In response to a question from Mr. Carlson, Mr. Bicker and Ms. Growe confirmed that the resolution only applies to the actively managed equity portfolios. The motion and resolution passed, as stated in Attachment C.

#### **Administrative Committee Report**

Mr. McGrath referred members to Tab C of the meeting materials and stated that the Committee was recommending approval of four items: the Executive Director's FY99 Workplan, the FY99 Administrative Budget, the SBI's Continuing Fiduciary Education Plan, and the Executive Director's FY98 Evaluation. Mr. McGrath moved approval of all four of the Committees' recommendations, as stated in the Committee Report, which reads: "The Committee recommends that the SBI approve the FY99 Executive Director's Workplan. Further, the Committee recommends that the workplan serve as the basis for the Executive Director's performance evaluation for FY99. The Committee recommends that the SBI approve the FY99 Administrative Budget Plan and that the Executive Director have the flexibility to reallocate funds between budget categories in the event budgeting needs change during the year. The Committee recommends that the SBI adopt the attached Continuing Fiduciary Education Plan. The Committee recommends that the

SBI adopt the following process for the Executive Director's FY98 performance evaluation: The evaluation will be completed prior to the September 1998 meeting of the SBI and will be based on the results of the Executive Director's workplan for FY98. The SBI deputies/designees will develop an appropriate evaluation form for use by each member which will reflect the categories in the Executive Director's position description and workplan. As the chair of the Board, the Governor's representative (Department of Finance), will coordinate distribution and collection of the evaluation forms and will forward the completed forms to the Executive Director. Board Members are encouraged to meet individually with the Executive Director to review their own evaluation." In response to a question from Ms. Growe, Mr. McGrath confirmed that the Executive Director's evaluation will be conducted in the same manner as it has been done during the last five years. Mr. Humphrey seconded the motion. The motion passed.

#### **Domestic Manager Committee Report**

Ms. Yeomans referred members to Tab D of the meeting materials and she noted that there were no serious performance issues during the quarter. She noted that the Committee had met with American Express Asset Management during the quarter to discuss the firm's underperformance. She reminded members that the firm's investment mandate changed in January 1997, moving to a more concentrated portfolio rather than the diversified approach used earlier. She reported that the Committee is recommending no action at this time, in order to give the manager more time to prove the validity of their approach.

Ms. Yeomans stated that the Committee is recommending that Voyager Asset Management be removed from watch status. She noted that the new portfolio manager is in place and that there are no other concerns at this time. Ms. Growe moved approval of the Committee's recommendation, as stated in the Committee Report, which reads: "In accordance with the SBI Manager Continuation Policy, the Committee recommends that the SBI remove Voyager Asset Management from the watch list." The motion passed.

Ms. Yeomans said that the Committee is also recommending that the SBI renew its contract with GE Investments, which inadvertently expired. Ms. Dutcher 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 a contract with GE Investment as the stock manager for the Assigned Risk Plan." The motion passed.

#### **International Manager Committee Report**

Ms. Yeomans referred members to Tab E of the meeting materials and stated that there were no action items from the Committee at this time. She noted that some technical changes were made to update the investment guidelines for the international area. In response to questions from Mr. Carlson, Ms. Yeomans and Mr. Bicker confirmed that the active international managers are underweighted in Asia and Japan.

### **Alternative Investment Committee Report**

Ms. Yeomans referred members to Tab F of the meeting materials and stated that the Committee is recommending four new alternative investments this quarter. She stated that the first recommendation is for an investment for the Basic Funds in a private equity fund called Welsh, Carson, Anderson & Stowe Fund VIII. She noted that the fund will invest primarily in the technology and healthcare sectors. In response to questions from Mr. Carlson, Mr. Bicker confirmed that the overall fund's size is \$3 billion, which is why the SBI's recommended commitment could be as high as \$100 million. He added that the investments would be made in U. S. technology and healthcare companies. In response to a question from Mr. Humphrey, Ms. Yeomans clarified that the investments will likely deal with medical devices, biotechnology, and other emerging technologies. 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 the SBI's legal counsel, to negotiate and execute a commitment of up to \$100 million or 20%, whichever is less, in Welsh, Carson, Anderson & Stowe Fund VIII, L.P. This commitment will be allocated to the Basic Retirement Fund. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by Welsh, Carson, Anderson & Stowe 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 Welsh, Carson, Anderson & Stowe or reduction or termination of the commitment." The motion passed.

Ms. Yeomans stated that the second recommendation is also for the Basic Funds with a new private equity manager, Richard C. Blum & Associates, in RCBA Strategic Partners, L.P. In response to a question from Mr. Carlson, Mr. Bicker confirmed that this is a new private equity manager for the SBI. Ms. Yeomans noted that the fund may invest in both private or public equity. The recommendation was approved, as stated in the Committee Report, which reads: "The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$50 million or 20%, whichever is less, in RCBA Strategic Partners, L.P.. Additionally, the Committee recommendation is contingent upon RCBA Strategic Partners, L.P. achieving at least \$500 million in total investor commitments. This commitment will be allocated to the Basic Retirement Fund. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by Richard C. Blum & Associates 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 Richard C. Blum & Associates or reduction or termination of the commitment." The recommendation was approved.

Ms. Yeomans said that the Committee is recommending an investment for the Basic Funds with an existing private equity manager, the Banc Funds, in Banc Fund V. 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 negotiate and execute a commitment of up to \$60 million or 20%, whichever is less, in Banc Fund V. This commitment will be allocated to the Basic Retirement Fund. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by The Banc Funds Company 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 The Banc Funds Company or reduction or termination of the commitment." The motion passed.

Ms. Yeomans stated that the Committee is also recommending an investment for the Post Fund with an existing resource manager, Merit Energy Partners C (CI and CII), L.P. She noted that the limited partnership actually has two components and that this fund is appropriate for the Post Fund since it is structured like more of a debt instrument. 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 the SBI's legal counsel, to negotiate and execute a commitment of up to \$60 million or 20%, whichever is less, in Merit Energy Partners C (CI and CII), L.P. This commitment will be allocated to the Post Retirement Fund. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by Merit Energy 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 Merit Energy Partners or reduction or termination of the commitment." The motion passed.

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

Mr. Sausen referred members to Tab G of the meeting materials and stated that some changes are being made to the Deferred Compensation Plan. He said that the SBI has issued a request for proposal (RFP) for investment product providers for the Plan and that the Minnesota State Retirement System (MSRS) has issued two separate RFP's seeking recordkeeping and enrollment/communication providers for the Plan. He added that state law requires the SBI to approve all contracts for the Plan. He said that the SBI received responses from 33 companies offering 135 investment options and that MSRS had received 7 responses for recordkeeping and 5 responses for enrollment/communication providers. Mr. McGrath referred members to the Committee's recommendation in the Committee Report for a listing of the recommended investment options. He added that the Committee is also recommending that the Board approve MSRS's selection of



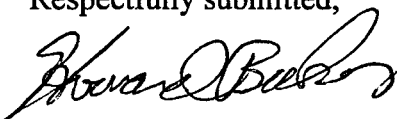
Minnesota Mutual/Great West as Plan Recordkeeper and NBI/Ochs services as Plan enroller/communicator. Mr. McGrath commended the staffs and Boards of both MSRS and the SBI in coordinating the joint process. Mr. McGrath moved approval of the Committee's recommendation, as stated in the Committee Report, which reads: "The Deferred Compensation Review Committee recommends that the executive director be authorized, in consultation with legal counsel, to negotiate and execute contracts for the following investment options:

Asset Class/Option	Recommendation
Large Cap Equity	Janus Twenty Fund
S&P 500 Index	Vanguard Institutional Index Fund
Small Cap Equity	T. Rowe Price Small Cap Stock Fund
International	Fidelity Diversified International Fund
Bond	Dodge & Cox Income Fund
Balanced	INVESCO Total Return Fund
Fixed Option	Great-West Life & Annuity Insurance Company The Minnesota Mutual Life Insurance Company Principal Mutual Life Insurance Company
Payout Annuities	Great-West Life & Annuity Insurance Company The Minnesota Mutual Life Insurance Company Principal Mutual Life Insurance Company

The Committee further recommends that the Board approve the selection by the Minnesota State Retirement System, subject to successful contract negotiations, of Minnesota Mutual/Great-West as Plan recordkeeper and NBI/Ochs Services, Inc. as Plan enroller/communicator. Approval by the SBI of these potential commitments 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 the referenced companies and product providers 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 the referenced companies and product providers or reduction or termination of the commitment." Mr. Humphrey seconded the motion. The motion passed.

The meeting adjourned at 10:50 a.m.

Respectfully submitted,



Howard J. Bicker  
Executive Director



**AMENDMENT NO. 1 TO GROUP POLICY 0844048 and 0844049**

WHEREAS, The Minnesota Mutual Life Insurance Company (herein called the "Insurance Company") and the State Board of Investment (herein called "SBI" or "Group Policyholder") and the Minnesota State Retirement System (herein called "MSRS" or "Group Policyholder") on behalf of the State of Minnesota and all employees participating in the State of Minnesota Deferred Compensation Plan, and all participants in the State of Minnesota Deferred Compensation Plan, agree that Group Policy Nos. 0844048 and 0844049 together with the Business Agreement (together collectively the "Group Annuity Contract") be amended to comply with changes required by the Small Business Job Protection Act of 1996.

WHEREAS, pursuant to Minn. Stat. 352.96, subd. 2 (1997 Supp.) and rules promulgated thereto by MSRS all amounts contributed to the State of Minnesota Deferred Compensation Plan and all earnings are held for the exclusive benefit of plan participants and beneficiaries in trust, in custodial accounts or in qualifying annuity contracts;

WHEREAS, the Minnesota State Retirement System approved such amendments; and

NOW, THEREFORE, it is agreed by and between the parties hereto that the Group Annuity Contract be amended in accordance with the terms attached hereto and to be incorporated by reference into the Group Annuity Contract.

IN WITNESS WHEREOF, the parties have, by their duly authorized officers or representatives, executed this Amendment, intending to be bound thereby.

MINNESOTA STATE BOARD OF INVESTMENT

APPROVED

As to form and execution by the ATTORNEY GENERAL

By: \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

Date: \_\_\_\_\_

MINNESOTA STATE RETIREMENT SYSTEM

STATE OF MINNESOTA DEPARTMENT OF ADMINISTRATION

By: \_\_\_\_\_

By: \_\_\_\_\_

Date: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

THE MINNESOTA MUTUAL LIFE INSURANCE COMPANY

As to Encumbrance

By: \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

Date: \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

After we issued your contract, Contract Number 0844049 (hereinafter "Contract"), to The Minnesota State Board of Investment, the Contract was amended. These amendments shall be part of the Contract as issued, such Amendments to be effective as of the date of the execution of this Amendment.

I.

The Definition of the term "Plan," in Section 1.01 of the Contract shall be amended to read as follows:

**1.01 Plan**

"Plan" means the Plan specified on Page 1 of this contract. The Plan must meet the requirements for qualification under Section 457 of the Internal Revenue Code (hereinafter "Code"), as amended, or other section of the Code allowing similar tax treatment.

The Contract Owner, as owner of this Contract, is deemed to be the trustee of the assets invested in the Contract, and such Contract is intended to satisfy the trust requirements of Code Section 457(g) and 401(f). The Contract Owner may exercise all rights hereunder for the exclusive benefit of the Plan Participants and their beneficiaries.

II.

Section 6.02, "Annuity Commencement Date," shall be amended to read:

**6.02 Annuity Commencement Date**

The Contract Owner or the Participant shall notify Minnesota Mutual in writing at its Home Office to begin Annuity payments for a Participant, specifying the date such Annuity Payments are to commence. Except in the case where a Participant is faced with an unforeseeable emergency (as determined by the Plan Administrator) or unless otherwise permitted by the Plan, such date may be the first day of any calendar month provided that it may not be earlier than (i) 30 days following the date such notice is given; or (ii) a Participant's separation from service or retirement and, provided further, that it may not be later than April 1st of the calendar year following the calendar year in which the Participant attains age 70 1/2 or separates from service. These restrictions as to the timing of benefit payments shall also apply to Section 6.10, "Lump Sum Settlement."

IV.

Section 6.10, "Lump Sum Settlement," shall be amended to read:

**6.10 Lump Sum Settlement**

By written notice to Minnesota Mutual by the Contract Owner or the Participant at least 30 days prior to the Annuity Commencement Date, a lump sum settlement of a Participant's Accumulation Value may be elected in lieu of the application of such value to provide Annuity Payments for the Participant under an Annuity Payment Option. After such lump sum settlement has been made, the Participant shall have no further rights under this contract. The payment of such a lump sum settlement shall be subject to the rules on timing as described in Section 6.02. The restrictions on timing shall not apply to the extent that the Plan provides for a cash out of a Participant's interest in the Contract for amounts which do not exceed \$5,000 and meet all of the other requirements of Code Section 457 (e)(9)(A).

III.

Section 8.07, "Assignment," shall be amended to read:

**8.07 Assignment**

The Participant's Accumulation Value may not be assigned, sold, transferred, discounted or pledged by the Participant as collateral for a loan or as security for the performance of an obligation or for any other purpose. To the maximum extent permitted by law, the Participant's Accumulation Value and any benefits payable under this contract shall be exempt from the claims of creditors of the Participant.

No portion of the Plan assets in this Contract or the earnings thereon may be used for, or diverted to, any purpose other than for the exclusive benefit of Plan Participants and beneficiaries prior to the satisfaction of all liabilities with respect to employees and their beneficiaries.

III.

The Contract shall be amended by the addition of Section 8.10, which shall read as follows:

**8.10 Exclusive Benefit**

The Contract, and the Plan described in it, are intended to meet the requirements of Section 457 of the Internal Revenue Code, as amended, through the use of the Contract and its terms. The Plan is for the "exclusive benefit" of the employees and beneficiaries and the purpose of the Plan is the distribution of funds accumulated under the Plan and the Contract to Participants or their beneficiaries. All assets and income of the Plan held within the Contract, prior to the satisfaction of all liabilities with respect to Plan Participants and their beneficiaries, shall be used for the exclusive benefit of Plan participants and their beneficiaries, and shall not be used for or diverted to any other purposes. In no event shall the assets under the Contract be subject to the claims of general creditors of the Plan or employers participating in the Plan.

As agreed to this \_\_\_\_\_ day of \_\_\_\_\_, 1998

The Minnesota State Board of Investment

The Minnesota Mutual Life Insurance Company

By: \_\_\_\_\_

By: \_\_\_\_\_

Position: \_\_\_\_\_

Position: \_\_\_\_\_

The Minnesota Mutual Life Insurance Company • 400 Robert Street North • St. Paul, Minnesota 55101-2098 • 612/665-3600

After we issued your contract, Contract Number 0844048 (hereinafter "Contract"), to The Minnesota State Board of Investment, the Contract was amended. These amendments shall be part of the Contract as issued, such Amendments to be effective as of the date of the execution of this Amendment.

I.

The Definition of the term "Plan," in Section 1.01 of the Contract shall be amended by the addition of the following paragraph:

**1.01 Plan**

The Contract Owner, as owner of this Contract, is deemed to be the trustee of the assets invested in the Contract, and such Contract is intended to satisfy the trust requirements of Code Section 457(g) and 401(f). The Contract Owner may exercise all rights hereunder for the exclusive benefit of the Plan Participants and their beneficiaries.

II.

Section 2.02, "Annuity Commencement Date," shall be amended to read:

**2.02 Annuity Commencement Date**

The Contract Owner shall notify Minnesota Mutual in writing at its Home Office to affect Annuity payments for a Participant, specifying the date such Annuity Payments are to commence. Except in the case where a Participant is faced with an unforeseeable emergency (as determined by the Plan Administrator) or unless otherwise permitted by the Plan, such date may be the first day of any calendar month provided that it may not be earlier than (i) 30 days following the date such notice is given; or (ii) a Participant's separation from service or retirement and, provided further, that it may not be later than April 1st of the calendar year following the calendar year in which the Participant attains age 70 1/2 or separates from service. These restrictions as to the timing of benefit payments shall also apply to Section 2.08, "Lump Sum Settlement."

III.

Section 2.08, "Lump Sum Settlement," shall be amended to read:

**2.08 Lump Sum Settlement**

By written notice to Minnesota Mutual by the Contract Owner at least 30 days prior to the Annuity Commencement Date, a lump sum settlement of a Participant's Accumulation Value may be elected in lieu of the application of such value to provide Annuity Payments for the participant under an Annuity Payment Option. After such lump sum settlement has been made, the Participant shall have no further rights under this contract. The payment of such a lump sum settlement shall be subject to the rules on timing as described in Section 2.02. The restrictions on timing shall not apply to the extent that the Plan provides for a cash out of a Participant's interest in the Contract for amounts which do not exceed \$5,000 and meet all of the other requirements of Code Section 457 (e)(9)(A).

IV.

Section 7.10, "Assignment," shall be amended to read:

**7.10 Assignment**

The Participant's Accumulation Value may not be assigned, sold, transferred, discounted or pledged by the Participant as collateral for a loan or as security for the performance of an obligation or for any other purpose. To the maximum extent permitted by law, the Participant's Accumulation Value and any benefits payable under this contract shall be exempt from the claims of creditors of the Participant.

No portion of the Plan assets in this Contract or the earnings thereon may be used for, or diverted to, any purpose other than for the exclusive benefit of Plan Participants and beneficiaries prior to the satisfaction of all liabilities with respect to employees and their beneficiaries.

V.

The Contract shall be amended by the addition of Section 7.16, which shall read as follows:

**7.16 Exclusive Benefit**

The Contract, and the Plan described in it, are intended to meet the requirements of Section 457 of the Internal Revenue Code, as amended, through the use of the Contract and its terms. The Plan is for the "exclusive benefit" of the employees and beneficiaries and the purpose of the Plan is the distribution of funds accumulated under the Plan and the Contract to Participants or their beneficiaries. All assets and income of the Plan held within the Contract, prior to the satisfaction of all liabilities with respect to Plan Participants and their beneficiaries, shall be used for the exclusive benefit of Plan participants and their beneficiaries, and shall not be used for or diverted to any other purposes. In no event shall the assets under the Contract be subject to the claims of general creditors of the Plan or employers participating in the Plan.

As agreed to this \_\_\_\_\_ day of \_\_\_\_\_, 1998

The Minnesota State Board of Investment

The Minnesota Mutual Life Insurance Company

By: \_\_\_\_\_

By: \_\_\_\_\_

Position: \_\_\_\_\_

Position: \_\_\_\_\_



**RESOLUTION OF THE  
MINNESOTA STATE BOARD OF INVESTMENT**

**Whereas**, funds under the direction of the Minnesota State Board of Investment (SBI) contain investments in companies that derive revenues from the manufacture of consumer tobacco products;

**Whereas**, by Resolution dated December 12, 1997, the SBI determined it prudent to monitor the exposure of funds under management by the SBI to the risk of higher volatility and lower annualized returns which have been associated with investments in companies that derive revenue from the manufacture of consumer tobacco products;

**Whereas**, the State of Minnesota recently settled its lawsuit with a number of tobacco companies pursuant to which the State of Minnesota will receive scheduled payments in perpetuity with scheduled payments over 25 years of \$6.1 billion and the tobacco companies agreed to significant changes in their marketing practices, particularly with respect to the marketing to young persons;

**Whereas**, in the course of the litigation with the State of Minnesota over 30 million pages of previously secret tobacco industry files have been made public;

**Whereas**, tobacco companies continue to be the subject of similar actions brought by over 40 other states, a number of cities, counties and foreign governments, each similarly seeking large monetary recoveries and changes in the operations of companies that derive revenue from the manufacture of consumer tobacco products and additional governmental jurisdictions, both within and without the United States, continue to file similar legal actions against the tobacco companies;

**Whereas**, companies that derive revenue from the manufacture of consumer tobacco products continue to be the subject of significant private actions and private class actions, including the Blue Cross Blue Shield plans in over 31 states, and Allina and Health Partners, and over 30 actions filed by Taft-Hartley health care plans operated by unions;

**Whereas**, on June 10, 1998, a Florida jury ordered Brown and Williamson to pay \$500,000 in compensatory damages and \$450,000 in punitive damages to pay the family of a smoker who died of lung cancer, marking the first time a jury has awarded punitive damages against a tobacco company in a case aided by the documents released as a result of the Minnesota tobacco case.

**Whereas**, according to published reports, the activities of tobacco companies currently are under criminal investigation by one or more federal grand juries;

**Whereas**, federal regulations promulgated in 1996 were upheld in the U.S. district court in North Carolina and are now on appeal to U.S. Fourth Circuit Court of Appeals, and, if fully

implemented, would alter the business activities of those tobacco companies in significant respects;

**Whereas**, on June 20, 1997, some companies and some state attorneys general agreed on federal legislation to be proposed to settle various legal claims. The proposed terms included other provisions calling for payment by the tobacco companies of at least \$368.5 billion over 25 years to settle various legal actions; certain protections for the tobacco companies from product liability suits; and changing certain tobacco company business practices;

**Whereas**, to date there has been no congressional action to implement the proposed settlement,

**Whereas**, in April 1998 the Senate Commerce Committee passed a bill authored by Senator John McCain that would substantially toughen the proposed national settlement; on April 8, 1998, certain tobacco companies led by RJR Nabisco Holdings Co. announced they would no longer negotiate with the White House, the Congress and state attorneys general concerning a settlement and subsequent Senate amendments have virtually eliminated the proposed product liability protection for tobacco companies contained in the original settlement, and there is no legislation pending in the House that would provide tobacco companies any product liability protection;

**Whereas**, during the five year period ending March 30, 1998, tobacco stocks have exhibited higher volatility and lower annualized returns than many other industry groups, and, as a result, may pose excessive and unnecessary investment risks;

**Whereas**, the Board has determined it is prudent to limit the exposure of its funds to the excessive and unnecessary risk resulting from the current litigation, legislative, regulatory and investment environment with respect to companies that derive revenue from the manufacture of consumer tobacco products; and

**Whereas**, the Board considers it prudent to continue to monitor the exposure of all its stock funds, both externally and internally managed, to the foregoing risks until those risks have been further clarified and in light of the Board's fiduciary responsibility.

**NOW THEREFORE** be it resolved:

1. No new or additional shares of any company which obtains more than 15 percent of its revenues from the manufacture of consumer tobacco products shall be purchased by the SBI's external or internal managers for its actively managed stock portfolios except as provided herein;
  - a. As soon as practicable after the date of approval of this Resolution and no later than June 30, 1998, the State Board of Investment staff shall notify its internal and external active stock managers of this Resolution and direct those active stock managers to discontinue purchases of stock covered by this Resolution.

- b. The process of limiting new investments in stocks held in the State Board of Investment's active stock managed portfolios must be conducted consistent with fiscal prudence and so as to minimize financial market disturbance.
2. To identify the tobacco companies covered by paragraph 1 hereinabove, the State Board of Investment executive director and State Board of Investment stock managers are directed to rely on information compiled by the Investor Responsibility Research Center (IRRC), Washington, D.C., as published in the most recent edition of the IRRC publication entitled "The Tobacco Industry."
3. This Resolution shall remain in effect until further order of the State Board of Investment.

Adopted this 11th day of June, 1998.



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




**RESOLUTION OF THE  
MINNESOTA STATE BOARD OF INVESTMENT**

**NOW THEREFORE BE IT RESOLVED:**

1. As soon as practicable after the date of approval of this Resolution, and no later than July 15, 1998 the State Board of Investment staff shall:
  - a. Prepare and submit to the members of the State Board of Investment a plan for divestiture by the State Board of Investment of any shares of a company which obtains more than 15% of its revenues from the manufacture of consumer tobacco products held in the State Board of Investment's actively managed portfolios, such divestiture to be completed by June 30, 2001 in a manner consistent with fiscal prudence and so as to minimize financial market disturbance; and
  - b. Notice and schedule a meeting of the State Board of Investment to consider divestiture and any other necessary business which may come before the State Board of Investment.
2. To identify the tobacco companies covered by paragraph 1 hereinabove, the State Board of Investment executive director and State Board of Investment stock managers are directed to rely on information compiled by the Investor Responsibility Research Center (IRRC), Washington, D.C., as published in the most recent edition of the IRRC publication entitled "The Tobacco Industry."
3. This Resolution shall remain in effect until further order of the State Board of Investment.

Adopted this 11th day of June, 1998.

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

**AGENDA  
INVESTMENT ADVISORY COUNCIL  
MEETING**

**Tuesday, September 1, 1998  
2:00 P.M. - SBI Conference Room  
Room 105, MEA Building - Saint Paul**

- |   | <b>TAB</b> |
|---|------------|
| <b>1. Approval of Minutes of June 2, 1998</b>   |            |
| <b>2. Report from the Executive Director (H. Bicker)</b>                                    |            |
| A. Quarterly Investment Review<br>(April 1, 1998 - June 30, 1998)                           | <b>A</b>   |
| B. Administrative Report  | <b>B</b>   |
| 1. Reports on budget and travel   |            |
| 2. Update on litigation   |            |
| <b>3. Report from the SBI Administrative Committee (M. McGrath)</b>                         | <b>C</b>   |
| A. Update on International Country Guidelines   |            |
| B. Review of proposed Biennial Budget Request for FY's 2000-2001                            |            |
| C. Discussion of SBI staff's move to new offices planned for FY 1999                        |            |
| D. Review of Executive Director's Job Description   |            |
| E. Executive Director's Salary Review   |            |
| <b>4. Report from the Proxy Committee (P. Sausen)</b>                                       | <b>D</b>   |
| 1. Update of Board Proxy Guidelines   |            |
| <b>5. Reports from the Investment Advisory Council</b>                                      |            |
| <b>A. Domestic Manager Committee (D. Gorence)</b>   | <b>E</b>   |
| 1. Review of manager performance  |            |
| 2. Review of short-term commercial paper issuers  |            |
| 3. Re-interview of Investment Advisers, Inc. and Wilke/Thompson<br>Capital Management, Inc. |            |
| 4. Discussion of SBI's actions related to restrictions on tobacco related<br>companies      |            |
| <b>B. International Manager Committee (J. Mares)</b>  | <b>F</b>   |
| 1. Review of manager performance  |            |
| 2. Discussion of International Program  |            |
| <b>C. Alternative Investment Committee (K. Gudorf)</b>                                      | <b>G</b>   |
| 1. Review of current strategy   |            |
| 2. Approval of new commitments for the Basic Retirement Funds:                              |            |
| • Piper Jaffray Ventures, Inc.  |            |
| • Crescendo Venture Management L.L.C.   |            |
| • TA Associates Realty  |            |
| 3. Approval of new commitment for the Post Retirement Funds                                 |            |
| • TCW Crescent Mezzanine Partners   |            |
| <b>6. Plan for Divestiture of Tobacco Stocks</b>  | <b>H</b>   |

**Minutes  
Investment Advisory Council  
June 2, 1998**

**MEMBERS PRESENT:** Gary Austin; Dave Bergstrom; John Bohan; Roger Durbahn; Doug Gorence; Ken Gudorf; P. Jay Kiedrowski; Han Chin Liu; Judy Mares; Malcolm McDonald; Gary Norstrom; Wayne Simoneau; Mike Troutman and Mary Vanek.

**MEMBERS ABSENT:** Bob McFarlin; Daralyn Peifer and Jan Yeomans.

**SBI STAFF:** Howard Bicker; Mansco Perry; Jim Heidelberg; Sheila Berube; Lois Buermann; John Griebenow; Debbie Griebenow; Charlene Olson and Carol Nelson.

**OTHERS ATTENDING:** Ann Posey, Richards & Tierney; Christie Eller; Bob Heimerl, Lloyd Belford, REAM; and Ed Burek, Legislative Commission on Pensions & Retirement.

Mr. McDonald called the meeting to order and the minutes of the March 3, 1998 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 March 31, 1998 (Combined Funds 14.2% vs. Inflation 3.4%), exceeded the median fund (30th percentile) and outperformed its composite index (Combined Funds 15.5% vs. Composite 15.0%) for the most recent five year period. He stated that the Basic Funds had exceeded its composite index (Basics 15.9% vs. Composite 15.5%) over the last five years and reported that the Post Fund had outperformed its composite index for the period since July 1, 1993 (Post Fund 15.4% vs. Composite 14.7).

Mr. Bicker reported that the Basic Funds' assets increased 9.2% for the quarter ending March 31, 1998 due to positive investment returns. He said that the Basic Funds is essentially on target and that the Funds outperformed its composite index for the quarter (Basics 9.3% Composite 9.1%) and for the year (Basics 33.0% vs. Composite 30.7%).

Mr. Bicker reported that the Post Fund's assets increased 8.8% for the quarter ending March 1, 1998 due to positive investment returns. He said that the Post asset mix is essentially on target and that the Fund had outperformed its composite index for the quarter (Post 9.5% vs. Composite 9.1%) and for the year (Post 31.1% vs. Composite 29.1%).

Mr. Bicker reported that the domestic stock manager group outperformed for the quarter (Domestic Stocks 13.4% vs. Wilshire 5000 13.3%) and for the year (Domestic Stocks 49.3% vs. Wilshire 5000 47.7%). He said that the international stock manager group underperformed for the quarter (International Stocks 12.9% vs. Int'l Composite 13.7%) but had outperformed for the year (International Stocks 15.4% vs. Int'l. Composite 13.9%). He added that the bond segment outperformed for the quarter (Bonds 1.8% vs. Lehman Aggregate 1.6%) and for the year (Bonds 12.7% vs. Lehman Aggregate 12.0).

He concluded his report with the comment that as of March 31, 1998 the SBI was responsible for over \$43 billion in assets.

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

Mr. Bicker referred members to Tab B for the current budget and travel reports.

Ms. Eller of the Attorney General's Office gave members a brief update on the status of the class action lawsuit against Mercury Finance Corporation. She stated that there was a settlement conference and that it is likely that the corporation will file bankruptcy, which would not be favorable to the SBI.

Mr. Bicker concluded his report by stating that an update on tobacco information using the updated Investors Responsibility Research Center (IRRC) data was included in his report.

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

Mr. Bicker referred members to Attachment A included in Tab C of the meeting materials and briefly summarized his FY99 proposed workplan. He stated that the major initiatives being proposed are to review the policy statement for the Assigned Risk Plan, to update the currency position paper to reflect recent changes to the currency overlay program and to review the states' cash flow needs and determine appropriate investment strategies in light of 1998 Legislative action. He added that staff also expects to continue working with the Minnesota State Retirement System (MSRS) regarding the proposed changes to the Deferred Compensation Plan. He said that staff will update the Disaster Recovery Plan and also develop and implement a Year 2000 compliance plan both at a staff level and for all vendors and investment managers. He added that the SBI's lease for the office space expires on June 30, 1999 and that staff should know by the end of July 1998 if new office space will be needed. Mr. Bicker concluded by stating that the other recommendations from the Committee pertain to the SBI's FY99 Administrative Budget, the Continuing Fiduciary Education Plan and the Executive Director's FY98 Evaluation. Mr. McDonald noted that the Department of Finance will once again coordinate the distribution and collection of the evaluation forms.

#### **Domestic Manager Committee Report**

Mr. Bicker referred members to Tab D of the meeting materials and briefly reviewed the performance of the domestic stock and bond managers. He said that during the quarter staff had completed the annual benchmark quality evaluation and that staff is working with Cohen, Klingenstein & Marks to address concerns regarding their benchmark. He



reported that the Committee had also approved some technical changes to the managers investment guidelines. Mr. Bohan said that the Committee met with American Express Asset Management during the quarter to discuss their investment process and portfolio performance. He stated that the firm had recently changed from a diversified approach to a more concentrated approach, which to date, has had negative performance. He said that the Committee agreed to give the manager more time to implement the concentrated approach and that their performance will be evaluated again in February 1999.

Mr. Bohan stated that the Committee is recommending that Voyageur Asset Management be removed from watch status. He noted that the portfolio is being managed on a team basis and that staff have no concerns at this time. Mr. Bohan said that the Committee is also recommending that the SBI renew its contract with GE Investments. Mr. Bicker noted that the contract had inadvertently expired. Mr. Norstrom moved approval of both Committee recommendations, as stated in the Committee Report. Mr. Bergstrom seconded the motion. The motion passed.

#### **International Manager Committee Report**

Ms. Mares referred members to Tab E of the meeting materials and briefly reviewed the international managers' performance. She stated that staff and the Committee had reviewed the international manager short list which is a list of up to 10 manager candidates deemed suitable in case an EAFE or emerging markets manager needed to be replaced. She noted that a separate manager list would be considered if the structure of the international segments changed to include a regional mandate. Mr. Bicker added that staff has maintained these "short lists" for most asset classes and he said IAC members should notify staff if there are other managers they believe should be considered for the list. In response to questions from Mr. Bohan and Mr. Gudorf, Mr. Bicker explained that Morgan Stanley is not accepting new accounts and that Franklin Templeton was recently terminated and their performance remains a concern. Ms. Mares concluded by saying that the Committee had reviewed and made technical updates to the international investment guidelines during the quarter.

In response to a question from Ms. Voss regarding a domestic stock manager, Mr. Bicker stated that IAI is scheduled to be re-interviewed by the Committee in August 1998.

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

Mr. Gudorf referred members to Tab F of the meeting materials and stated that the Committee is recommending investments for the Basic Funds with two new private equity managers (Welsh, Carson, Anderson & Stowe and Richard C. Blum & Associates (RCBA)) and an investment with an existing private equity manager (The Banc Funds Company). He added that the Committee is also recommending an investment with an existing resource manager (Merit Energy Partners) for the Post Fund. Ms. Vanek moved approval of all four of the Committees' recommendations, as stated in the Committee Report. Mr. Bohan seconded the motion. In response to questions from Ms. Mares, Mr. Bicker said that the RCBA fund is not expected to do any hostile takeovers, but that it is possible for any of the private equity investments to be involved in a hostile takeover situation. He said that ownership limitations are not a factor when an alternative manager

invests in a public company because we own the partnership and not the underlying securities. The motion passed.

**Deferred Compensation Plan Committee Report**

Mr. Bicker referred members to Tab G of the meeting materials and explained many of the changes being proposed to restructure the state's 457 Deferred Compensation Plan. He said that the changes will provide participants with one recordkeeper who will provide one statement for all investments, lower administrative and investment management fees, increased investment flexibility and increased flexibility in changing the various structural components of the Plan. Mr. Bergstrom stated that participants will now be able to gain access to their account to do transactions through the Internet or an interactive voice response system in addition to working with a live customer service representative. He added that additional savings will be realized because participants will be able to make direct investments in various mutual funds without going through an insurance provider. In response to a question from Mr. Liu, Mr. Bergstrom stated that Ochs and National Benefits had combined forces and that their job will be to educate and enroll participants. In response to a question from Mr. Bohan, Mr. Bergstrom stated that the Supplemental Investment Fund will remain valued monthly, but that same day trading can occur because of electronic transfers, rather than manually through the mail. Mr. Bicker added that the restructuring represents a significant improvement to the 457 Plan and that once these changes are put in place, further enhancements to the program will be possible. After further questions were addressed on a variety of program details, Mr. Bohan moved to endorse the Committee's recommendations regarding investment options, recordkeeper and enroller/communicator, as stated in the Committee Report. Mr. Liu seconded the motion. The motion passed.

In response to questions from Mr. Troutman, Mr. Bicker reviewed the SBI's rebalancing policy and noted that significant rebalancing took place on April 1, 1998 and therefore was not reflected in the meeting materials which are for the period ending March 31, 1998.

Mr. Bicker announced that Mansco Perry is now the SBI's Assistant Executive Director.

The meeting adjourned at 2:50 P.M.

Respectfully submitted,



Howard J. Bicker  
Executive Director

# Tab A

## LONG TERM OBJECTIVES

### Period Ending 6/30/98

COMBINED FUNDS: \$35.9 Billion	Result	Compared to Objective
<p><b>Provide Real Return (10 yr.)</b></p> <p>Provide returns that are 3-5 percentage points greater than inflation over the latest 10 year period.</p>	<b>13.9%</b> (1)	10.6 percentage points above CPI
<p><b>Exceed Composite Index (5 yr.)</b></p> <p>Outperform a composite market index weighted in a manner that reflects the actual asset mix of the Combined Funds over the latest 5 year period.</p>	<b>15.4%</b> (1)	0.5 percentage point above composite index
<p><b>Exceed Median Fund (5 yr.)</b></p> <p>Provide returns that are ranked in the top half of universe of public and corporate plans over the latest 5 year period.</p>	<b>28th</b> percentile (2)	above the median fund in TUCS

BASIC RETIREMENT FUNDS: \$18.9 Billion	Result	Compared to Objective
<p><b>Exceed Composite Index (5 Yr.)</b></p> <p>Outperform a composite market index weighted in a manner that reflects the long-term asset allocation of the Basic Funds over the latest 5 year period.</p>	<b>15.9%</b>	0.4 percentage point above target

POST RETIREMENT FUND: \$17.0 Billion	Result	Compared to Objective
<p><b>Exceed Composite Index (5 Yr.)</b></p> <p>Outperform a composite market index weighted in a manner that reflects the long-term asset allocation of the Post Fund over the latest 5 year period.</p>	<b>14.9%</b>	0.7 percentage point above target

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

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

## SUMMARY OF ACTUARIAL VALUATIONS

MSRS, TRA, PERA General Plans  
July 1, 1997

	Active (Basics)	Retired (Post)	Total (Combined)
<b>Liability Measures</b>			
1. Current and Future Benefit Obligation	\$18.7 billion	\$9.8 billion	\$28.5 billion
2. Accrued Liabilities	13.7	9.8	23.5
<b>Asset Measures</b>			
3. Current and Future Actuarial Value	\$19.9 billion	\$9.8 billion	\$29.8 billion
4. Current Actuarial Value	12.6	9.8	22.4
<b>Funding Ratios</b>			
Future Obligations vs. Future Assets (3 ÷ 1)	107%	100%	104%
Accrued Liabilities vs. Current Actuarial Value (4 ÷ 2)	92%	100%	95%*

\* 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 **103%** for the Basics, **100%** for the Post and **102%** 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, 6.0% Post

Full Funding Target Date: 2020

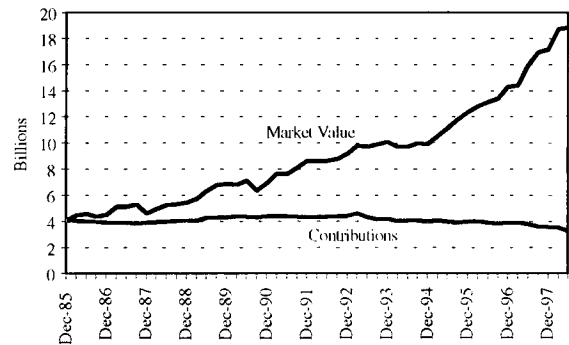
**EXECUTIVE SUMMARY**  
**Basic Retirement Funds (Net of Fees)**

**Asset Growth**

The market value of the Basic Funds increased 0.8% during the second quarter of 1998. Positive investment returns accounted for the rise. Net contributions were negative.

**Asset Growth**  
**During Second Quarter 1998**  
**(Millions)**

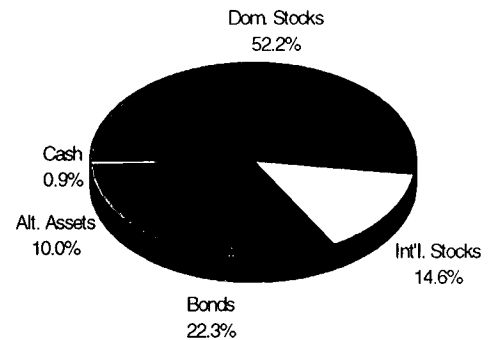
Beginning Value	\$ 18,715
Net Contributions	-297
Investment Return	441
Ending Value	\$ 18,859



**Asset Mix**

During the quarter, the allocation to domestic stocks declined reflecting an asset rebalancing.

	<b>Policy Targets</b>	<b>Actual Mix 6/30/98</b>	<b>Actual Market Value (Millions)</b>
Domestic Stocks	45.0%	52.2%	\$9,842
Int'l. Stocks	15.0	14.6	2,754
Bonds	24.0	22.3	4,205
Alternative Assets*	15.0	10.0	1,881
Unallocated Cash	1.0	0.9	177
	<b>100.0%</b>	<b>100.0%</b>	<b>\$18,859</b>

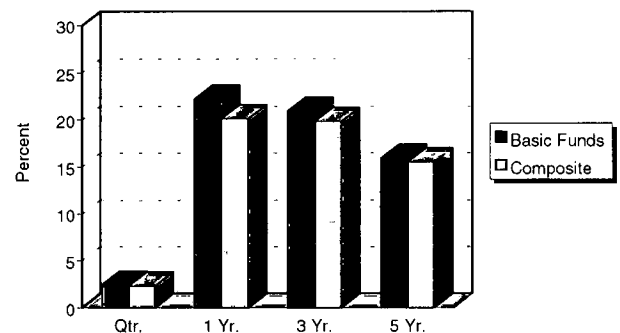


\* Any uninvested allocation is held in domestic stocks

**Fund Performance (Net of Fees)**

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

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Basics</b>	<b>2.4%</b>	<b>22.2%</b>	<b>20.9%</b>	<b>15.9%</b>
Composite	2.3	20.1	19.8	15.5



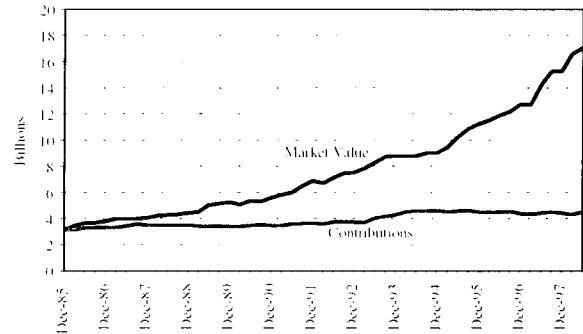
**EXECUTIVE SUMMARY**  
**Post Retirement Fund (Net of Fees)**

**Asset Growth**

The market value of the Post Fund increased 2.5% during the second quarter of 1998. The increase resulted from positive investment returns.

**Asset Growth**  
**During Second Quarter 1998**  
**(Millions)**

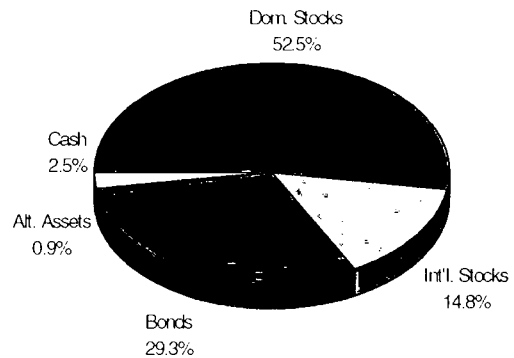
Beginning Value	\$16.610
Net Contributions	156
Investment Return	265
Ending Value	\$17.031



**Asset Mix**

During the quarter, the allocation to domestic stocks declined reflecting an asset rebalancing.

	Policy Targets	Actual Mix 6/30/98	Actual Market Value (Millions)
Domestic Stocks	50.0%	52.5%	\$8.946
Int'l. Stocks	15.0	14.8	2.518
Bonds	27.0	29.3	4.992
Alternative Assets*	5.0	0.9	157
Unallocated Cash	3.0	2.5	418
	100.0%	100.0%	\$17.031

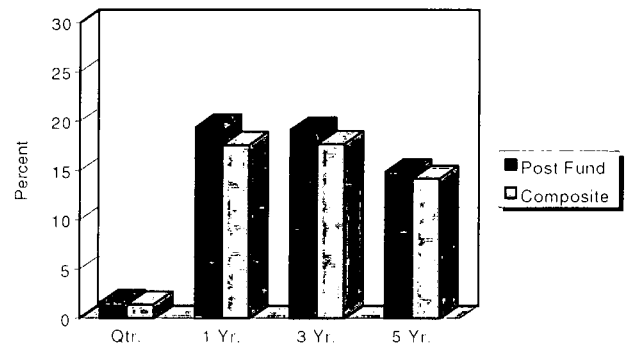


\* Any uninvested allocation is held in bonds

**Fund Performance (Net of Fees)**

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

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
Post	1.6%	19.4%	19.1%	14.9%
Composite	1.4	17.6	17.7	14.2



**EXECUTIVE SUMMARY**  
**Stock and Bond Manager Performance**  
**(Net of Fees)**

**Domestic Stocks**

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

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	Annualized 5 Yr.
<b>Dom. Stocks</b>	<b>2.2%</b>	<b>30.6%</b>	<b>28.7%</b>	<b>21.5%</b>
Wilshire 5000	1.9	28.9	28.1	21.5

**International Stocks**

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

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	Annualized 5 Yr.
<b>Int'l. Stocks</b>	<b>-1.7%</b>	<b>1.2%</b>	<b>11.8%</b>	<b>11.0%</b>
Composite Index*	-2.4	-1.1	8.3	8.6

\* EAFE-Free through 4/31/96. 87% EAFE-Free and 13% Emerging Markets Free as of 12/31/96.

**Bonds**

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

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	Annualized 5 Yr.
<b>Bonds</b>	<b>2.3%</b>	<b>11.0%</b>	<b>8.5%</b>	<b>7.3%</b>
Lehman Agg.	2.3	10.5	7.9	6.9

**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.

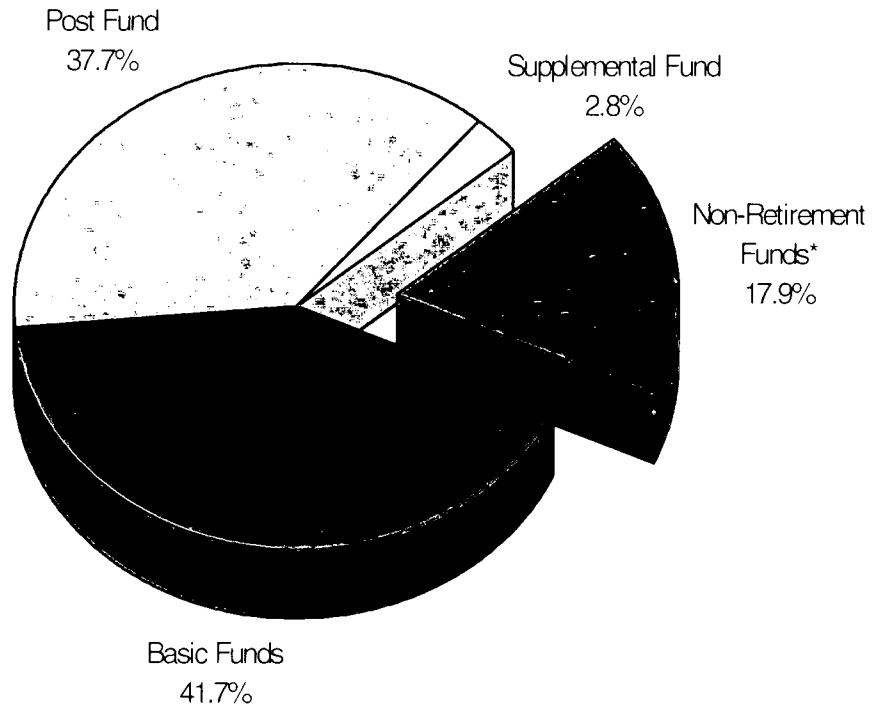
**Lehman Aggregate:** The Lehman Brothers Aggregate Bond Index reflects the performance of all investment grade (BAA or higher) bonds, U.S. treasury and agency securities and mortgage obligations with maturities greater than one year.

**EAFE:** The Morgan Stanley Capital International index of 20 stock markets in Europe, Australia and the Far East. EAFE-Free includes only those securities foreign investors are allowed to hold.

**Emerging Markets Free:** The Morgan Stanley Capital International index of 26 markets in developing countries throughout the world.



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



	<b>6/30/98</b>
	<b>Market Value</b>
	<b>(Billions)</b>
<b>Retirement Funds</b>	
Basic Retirement Funds	\$18.9
Post Retirement Fund	17.0
Supplemental Investment Fund	1.2
<b>Non Retirement Funds*</b>	
Assigned Risk Plan	0.7
Permanent School Fund	0.5
Environmental Trust Fund	0.2
State Cash Accounts	6.7
<b>Total</b>	<b>\$45.2</b>

# MINNESOTA STATE BOARD OF INVESTMENT

## QUARTERLY INVESTMENT REPORT

Second Quarter 1998  
(April 1, 1998 - June 30, 1998)

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## VARIOUS CAPITAL MARKET INDICES

	Period Ending 6/30/98				
	Qtr.	Yr.	3 Yr.	5 Yr.	10 Yr.
<b>Domestic Equity</b>					
Wilshire 5000	1.9%	28.9%	28.1%	21.6%	17.6%
Dow Jones Industrials	2.1	18.7	27.8	23.4	18.7
S&P 500	3.3	30.3	30.3	23.1	18.6
Russell 2000	-4.7	16.5	18.9	16.0	13.6
<b>Domestic Fixed Income</b>					
Lehman Aggregate*	2.3	10.5	7.9	6.9	9.1
Lehman Gov't./Corp.	2.6	11.3	7.9	6.9	9.1
90 Day U.S. Treasury Bills	1.3	5.3	5.3	5.0	5.6
<b>International</b>					
EAFE**	1.1	6.1	10.7	10.0	6.8
Emerging Markets Free***	-23.6	-39.1	-9.3	0.4	12.2
Salomon Non U.S. Gov't. Bond	1.7	0.9	0.4	6.4	8.2
<b>Inflation Measure</b>					
Consumer Price Index****	0.5	1.7	2.2	2.5	3.3

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

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

\*\*\* Morgan Stanley Capital International Emerging Markets Free index.

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

**FINANCIAL MARKETS REVIEW**

**DOMESTIC STOCKS**

The stock market generated overall positive returns for the quarter. A strong economic environment, overall positive corporate earnings reports, and high cash flows into the equity market contributed to the stock market's positive performance. During the quarter, the Asian crisis began affecting the earnings of many U.S. firms providing a break in the strong bull market of the last few years.

The Wilshire 5000 provided a 1.9% return for the quarter. Performance among the different Wilshire Style Indexes for the quarter is shown below:

Large Value	0.0%
Small Value	-4.8
Large Growth	5.4
Small Growth	-7.9

The Wilshire 5000 increased 28.9% for the year ending June 30, 1998.

**DOMESTIC BONDS**

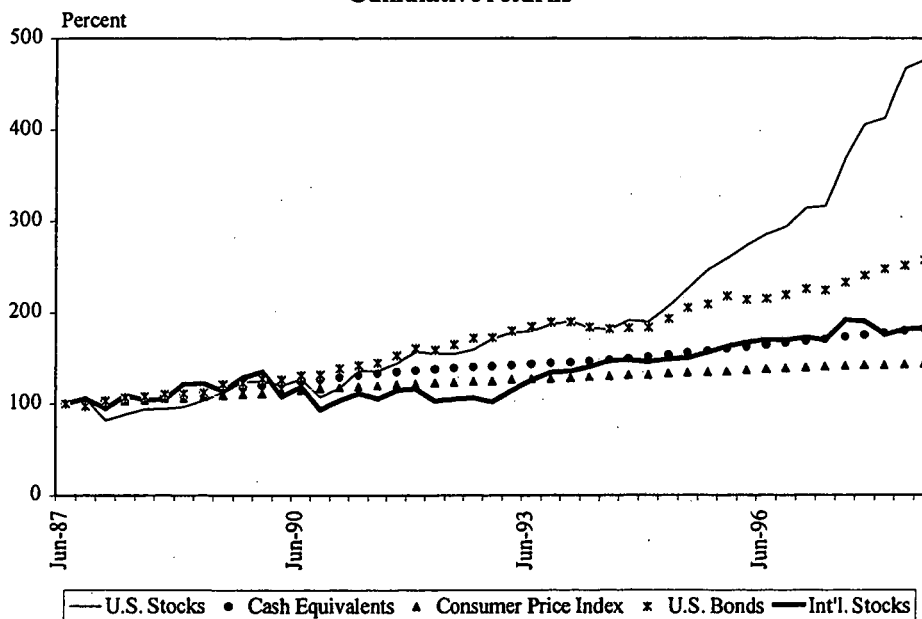
The bond market generated positive returns for the quarter with bond prices staying within a tight trading range. The bond market is expected to remain at current levels until the economic data shows a strong indication of the direction of inflation and economic growth.

Overall, the Lehman Brothers Aggregate Bond Index increased 2.3% for the quarter. The Lehman Aggregate sector returns for the quarter were:

Treasury/Agency	2.6%
Corporates	2.6
Mortgages	1.7

The Lehman Aggregate increased 10.5% 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 Stock Index; Lehman Brothers Aggregate Bond Index; 91 Day Treasury Bills; and the Consumer Price Index.

## FINANCIAL MARKETS REVIEW

### INTERNATIONAL STOCKS

In aggregate, international stock markets (as measured by the EAFE-Free index) provided a return of 1.0% for the quarter. As shown below, performance varied widely among the major markets:

United Kingdom	-2.0%
Japan	-4.6
Germany	16.7
France	11.2

The EAFE-Free index increased by 5.9% during the latest year.

The EAFE-Free index is compiled by Morgan Stanley Capital International (MSCI) and is a measure of 21 markets located in Europe, Australia and the Far East (EAFE), adjusted for free-float. The major markets listed above comprise about 65% of the value of the international markets in the index.

### EMERGING MARKETS

Emerging markets (as measured by MSCI Emerging Markets Free index) provided a return of -23.6% for the quarter. The performance of the five largest stock markets in the index is shown below:

Brazil	-22.0%
Mexico	-16.9
South Africa	-26.6
Taiwan	-23.1
India	-20.8

The Emerging Markets Free index had a decrease of -39.1% for the year.

The Emerging Markets Free index is compiled by MSCI and measures performance of 26 stock markets in Latin America, Asia, Africa and Eastern Europe. The markets listed above comprise about 60% of the value of the index.

### REAL ESTATE

Nationally, many real estate markets are now strong. Property types most favored by buyers at the present time include apartments, industrial parks and suburban office buildings.

### PRIVATE EQUITY

Private equity fund raising soared higher in this year's first six months, making it all but inevitable that 1998 will set a fifth consecutive annual record. Investors committed \$38.2 billion to U.S. private equity partnerships of all types in the first six months of the year. That marks a 50 percent increase from the \$25.5 billion raised in 1997's first half and already exceeds the total raised for all of 1996.

### RESOURCE FUNDS

During the second quarter of 1998, West Texas Intermediate crude oil averaged \$14.68 per barrel compared to an average price of \$15.95 per barrel during the first quarter of 1998. Despite the low oil prices, oil companies are continuing to aggressively drill for oil and gas.

**COMBINED FUNDS**

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

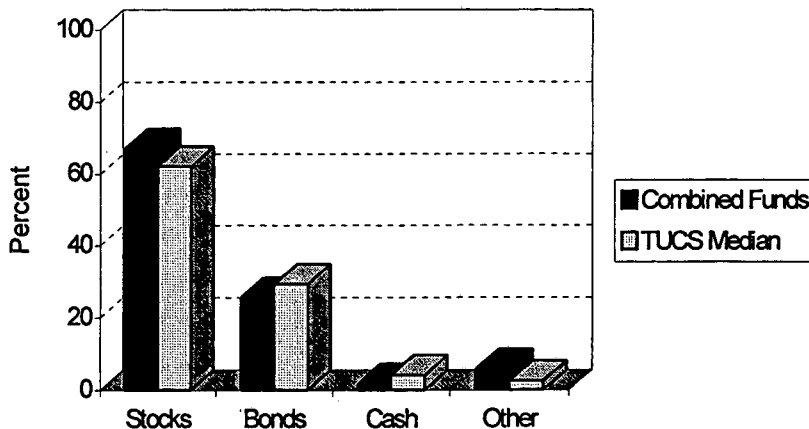
The comparison universe used by the SBI is the Trust Universe Comparison Service (TUCS). Only funds with assets over \$1 billion are included in the comparisons shown in this section.

**Asset Mix Compared to Other Pension Funds**

On June 30, 1998, the actual asset mix of the Combined Funds was:

	\$ Millions	%
Domestic Stocks	\$18,788	52.3%
International Stocks	5,271	14.7
Bonds	9,198	25.6
Alternative Assets	2,038	5.7
Unallocated Cash	595	1.7
<b>Total</b>	<b>\$35,890</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 over \$1 billion are shown below:



	Stocks*	Bonds*	Cash	Other
<b>Combined Funds</b>	<b>67.0%</b>	<b>25.6%</b>	<b>1.7%</b>	<b>5.7%</b>
<b>Median Allocation in TUCS**</b>	<b>62.1</b>	<b>29.4</b>	<b>4.1</b>	<b>2.5</b>

\* Both domestic and international.

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

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

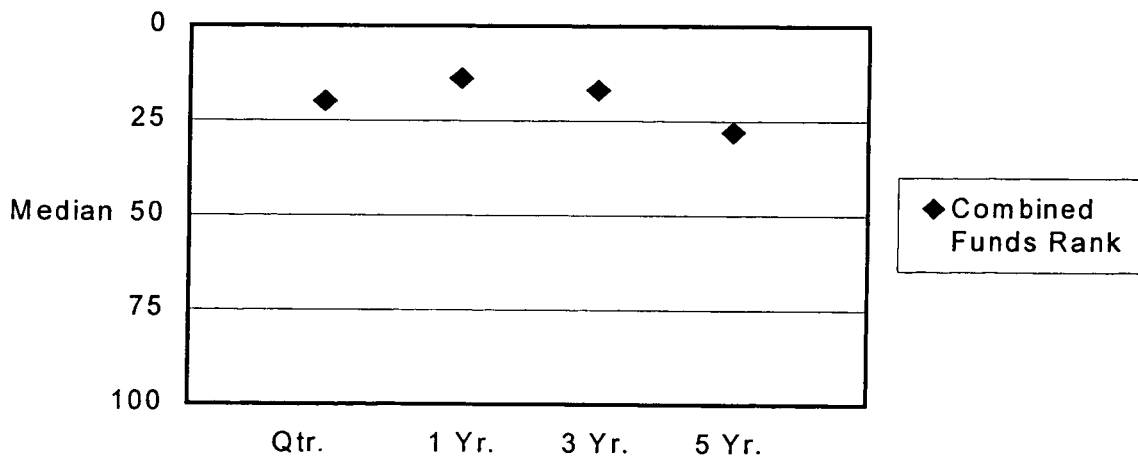
While the SBI is naturally concerned with how its returns compare to other pension investors, universe comparisons should be used with great care. There are several reasons why such comparisons will provide an “apples to oranges” look at performance:

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

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

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

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



	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yr.	5 Yr.
Combined Funds Percentile Rank in TUCS*	20 <sup>th</sup>	14 <sup>th</sup>	17 <sup>th</sup>	28 <sup>th</sup>

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

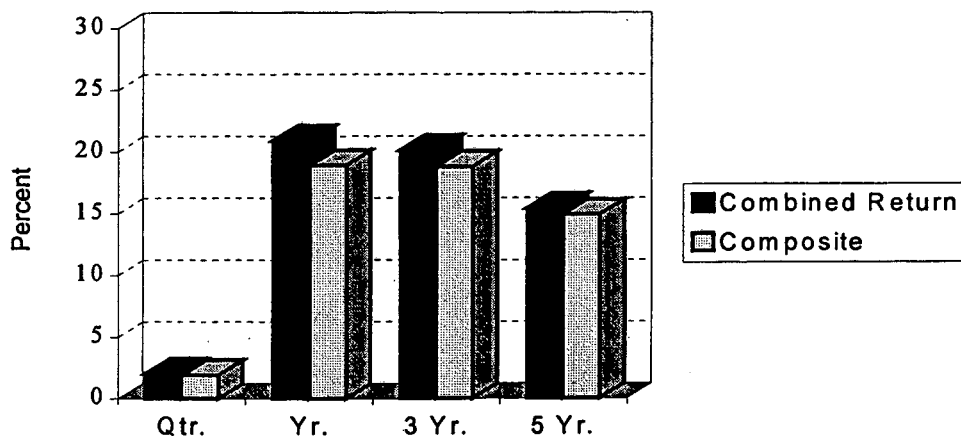
**COMBINED FUNDS**  
**Performance Compared to Composite Index**

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

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

	Market Index	Combined Index Weights 2Q98
Domestic Stocks	Wilshire 5000	50.2%*
Int'l. Stocks	Int'l. Composite	15.0
Bonds	Lehman Aggregate	27.3*
Alternative Assets	Wilshire Real Estate	2.2*
	Venture Capital Funds	2.9*
	Resource Funds	0.5*
Unallocated Cash	91 Day T-Bills	1.9
		100.0%

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



Period Ending 6/30/98

	Annualized			
	Qtr.	Yr.	3 Yr.	5 Yr.
Combined Funds**	2.0%	20.9%	20.1%	15.4%
Composite Index	1.9	18.9	18.8	14.9

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



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**BASIC RETIREMENT FUNDS**  
**Investment Objectives**

The Basic Retirement Funds are composed of the retirement assets for currently working participants in eight statewide retirement funds. The Funds serve as accumulation pools for the pension contributions of public employees and their employers during the employees' years of active service. Approximately 256,000 public employees participate in the Basic Funds.

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

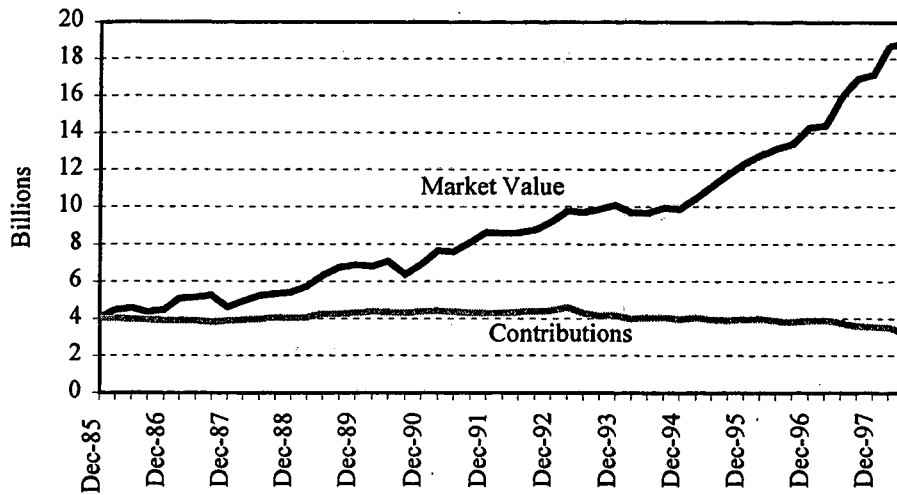
projected pension costs, the Basic Retirement Funds must generate investment returns of at least 8.5% on an annualized basis, over time.

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

**Asset Growth**

The market value of the Basic Retirement Funds' assets increased 0.8% during the second quarter of 1998.

Positive investment returns accounted for the increase during the quarter. Net contributions were negative.



	Last Five Years						Latest Qtr.
	12/93	12/94	12/95	12/96	12/97	3/98	6/98
Beginning Value	\$9,191	\$10,086	\$9,890	\$12,338	\$14,275	\$17,146	\$18,715
Net Contributions	-239	-206	-29	-59	-337	-21	-297
Investment Return	1,134	-10	2,477	1,996	3,208	1,590	441
Ending Value	\$10,086	\$9,890	\$12,338	\$14,275	\$17,146	\$18,715	\$18,859

## BASIC RETIREMENT FUNDS

### Asset Mix

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

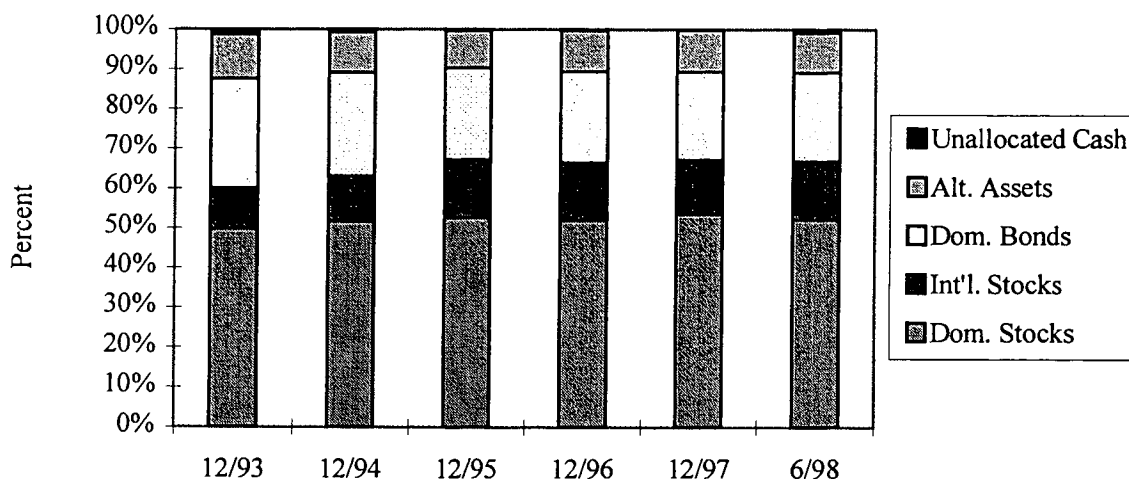
Domestic Stocks	45.0%
Int'l. Stocks	15.0
Bonds	24.0
Alternative Assets*	15.0
Unallocated Cash	1.0

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

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

Over the last year, assets have moved from international stocks to domestic stocks reflecting the strong performance of the U.S. equity markets.

During the last quarter, the allocation to domestic stocks declined reflecting an asset rebalancing.



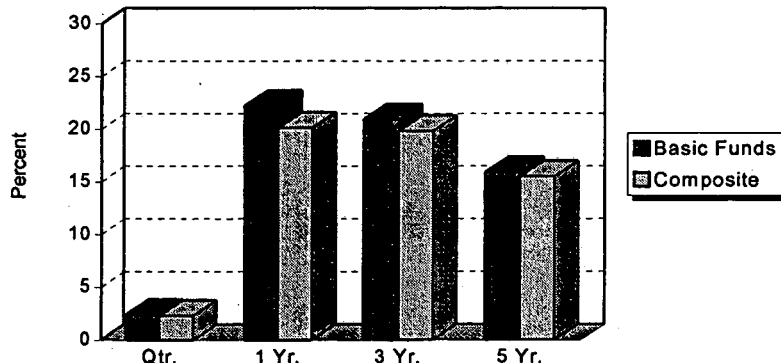
	Last Five Years					Latest Qtr.	
	12/93	12/94	12/95	12/96	12/97	3/98	6/98
Domestic Stocks	49.7%	51.7%	52.0%	52.0%	53.6%	53.9%	52.2%
Int'l. Stocks	10.3	11.3	14.5	14.5	13.6	14.6	14.6
Bonds	27.5	26.1	22.8	22.8	22.2	21.3	22.3
Real Estate	4.6	4.1	3.4	3.9	4.1	3.8	3.8
Private Equity	5.6	5.4	4.9	5.5	5.0	4.4	5.3
Resource Funds	0.9	0.7	1.0	1.0	1.4	1.0	0.9
Unallocated Cash	1.4	0.7	0.3	0.3	0.1	1.0	0.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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

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

	Basics Target	Market Index	Basics Composite 2Q98
Domestic Stocks	45.0%	Wilshire 5000	49.8%*
Int'l. Stocks	15.0	Int'l Composite	15.0
Bonds	24.0	Lehman Aggregate	24.0
Alternative Assets	15.0	Wilshire Real Estate	3.8*
		Private Equity Funds	5.0*
		Resource Funds	1.0*
Unallocated Cash	1.0	91 Day T-Bills	1.0
	100.0%		100.0%

\* Alternative asset and domestic stock weights are reset in the composite each quarter to reflect the uninvested portion of the allocation to alternative assets.



Period Ending 6/30/98

	Qtr.	Yr.	3 Yr.	5 Yr.
Basic Funds**	2.4%	22.2%	20.9%	15.9%
Composite Index	2.3	20.1	19.8	15.5

\*\*Returns are reported net of fees.

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

**POST RETIREMENT FUND**

The Post Retirement Investment Fund contains the pension assets of retired public employees covered by statewide retirement plans. Approximately 82,000 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 6% on its invested assets on an annualized basis. If the Post Fund exceeds this earnings rate, excess earnings are used to finance permanent benefit increases for eligible retirees.

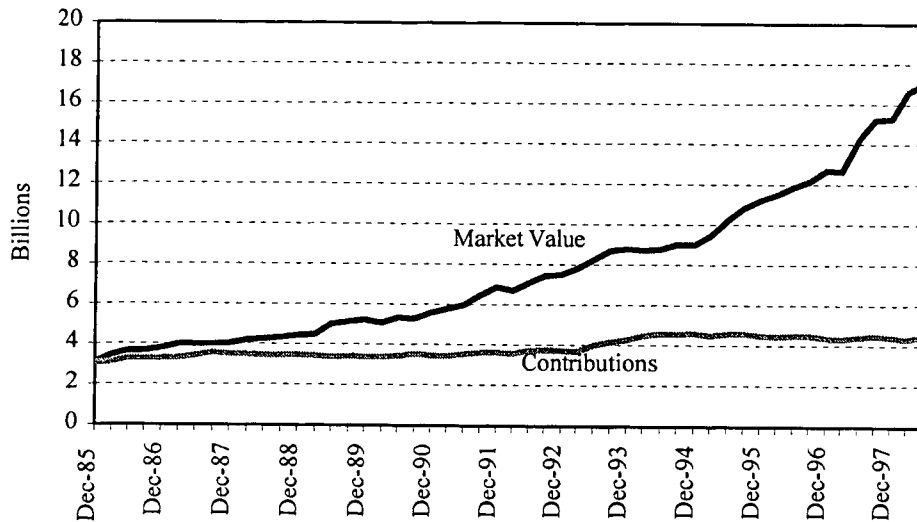
Through fiscal year 1992, unrealized capital gains (or losses) were excluded from the statutory definition of earnings. For this reason the Post Fund previously was not designed to maximize long-term total rates of return. Rather, the SBI attempted to generate a high, consistent stream of realized earnings for the Post Fund that maintained current benefits, as well as produced benefit increases over time.

Since fiscal year 1993, the post retirement benefit increase formula has been based on total return rather than realized earnings. As a result, the Board has adopted a long-term asset allocation strategy for the Post Fund which incorporates a substantial commitment to common stocks. The transition to a 50% allocation to domestic stocks was completed by the end of fiscal year 1993.

**Asset Growth**

The market value of the Post Retirement Fund increased by 2.5% during the second quarter of 1998.

The increase resulted from positive investment returns.



	Last Five Years						Latest Qtr.
	In Millions						
	12/93	12/94	12/95	12/96	12/97	3/98	6/98
Beginning Value	\$7,500	\$8,766	\$9,001	\$11,216	12,705	\$15,273	\$16,610
Net Contributions	386	314	-102	-94	23	-96	156
Investment Return	880	-79	2,317	1,583	2,545	1,433	265
Ending Value	\$8,766	\$9,001	\$11,216	\$12,705	\$15,273	\$16,610	\$17,031

**POST RETIREMENT FUND**

**Asset Mix**

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

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

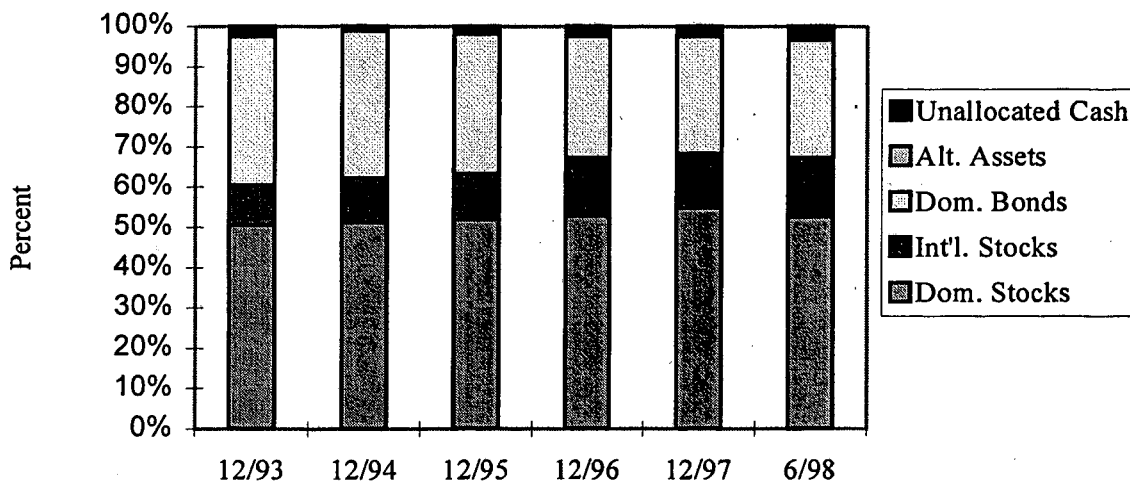
In October 1995, the Board revised its long term asset allocation targets for the Post Fund, increasing international stocks from 10% to 15% and decreasing bonds from 32% to 27%.

Over the last year, assets have moved from international stocks to domestic stocks reflecting the strong performance of the U.S. equity markets.

During the last quarter, the allocation to domestic stocks declined reflecting an asset rebalancing.

Domestic Stocks	50.0%
Int'l. Stocks	15.0
Bonds	27.0
Alternative Assets*	5.0
Unallocated Cash	3.0
<b>Total</b>	<b>100.0%</b>

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



	Last Five years					Latest Qtr.	
	12/93	12/94	12/95	12/96	12/97	3/98	6/98
Dom. Stocks	50.5%	51.2%	51.9%	52.7%	54.7%	53.9%	52.5%
Int'l. Stocks	10.0	11.0	11.4	14.6	13.6	14.7	14.8
Bonds	36.9	36.5	34.7	30.2	29.1	28.1	29.3
Alt. Assets	0.0	0.1	0.2	0.6	0.9	0.9	0.9
Unallocated Cash	2.6	1.2	1.8	1.9	1.7	2.4	2.5
<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>

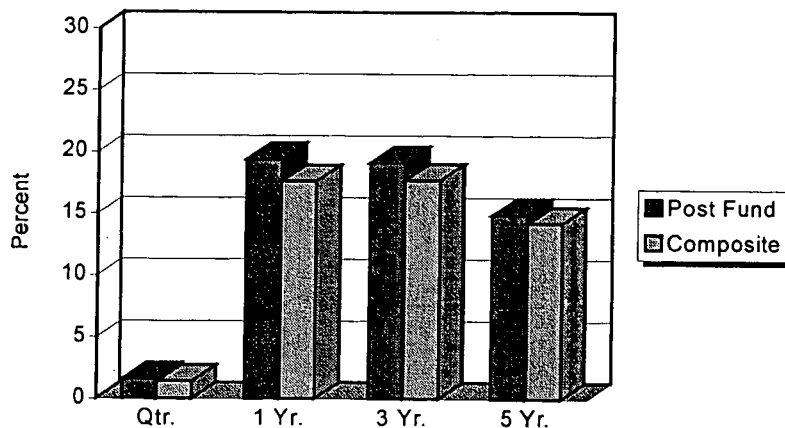
**POST RETIREMENT FUND**  
**Total Fund Performance (Net of Fees)**

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

Asset Class	Post Target	Market Index	Post Composite 2Q98*
Domestic Stocks	50.0%	Wilshire 5000	50.0%
Int'l. Stocks	15.0	Int'l. Composite	15.0
Bonds	27.0	Lehman Aggregate	31.0*
Alternative Assets	5.0	Wilshire Real Estate	0.5*
Unallocated Cash	3.0	Private Equity Funds	0.5*
		91 Day T-Bills	3.0
	100%		100.0%

\*Alternative assets and bonds are reset in the composite each quarter to reflect the uninvested portion of the allocation to alternative assets.

The asset mix of the Post Fund moved to a 50% stock allocation during fiscal year 1993.



Period Ending 6/30/98

Qtr.	Annualized			
	1 Yr.	3 Yr.	5 Yr.	
Post Fund**	1.6%	19.4%	19.1%	14.9%
Composite Index	1.4	17.6	17.7	14.2

\*\* Returns are reported net of fees.

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

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

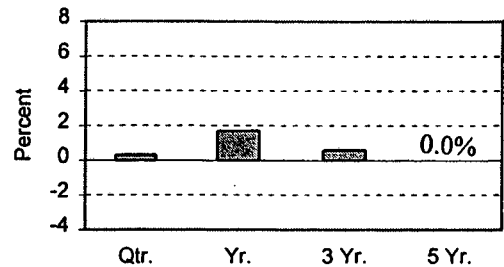
**Domestic Stock Pool**

**Target:** Wilshire 5000

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

	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yrs.	5 Yrs.
<b>Stock Pool</b>	<b>2.2%</b>	<b>30.6%</b>	<b>28.7%</b>	<b>21.5%</b>
Wilshire 5000	1.9	28.9	28.1	21.5

Value Added to Wilshire 5000



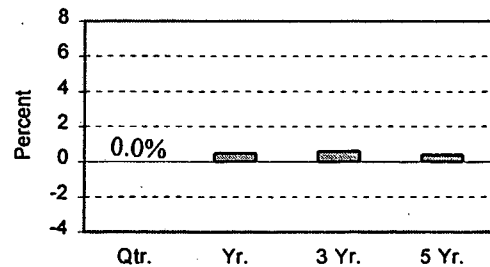
**Bond Pool**

**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.

	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yrs.	5 Yrs.
<b>Bond Pool</b>	<b>2.3%</b>	<b>11.0%</b>	<b>8.5%</b>	<b>7.3%</b>
Lehman Agg.	2.3	10.5	7.9	6.9

Value Added to Lehman Aggregate



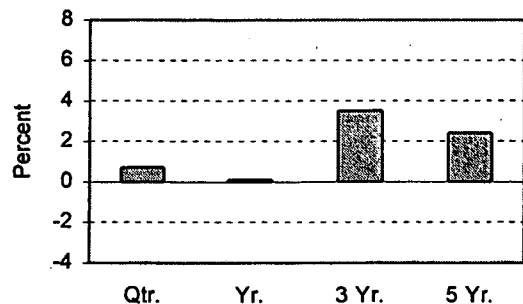
**International Stock Pool**

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

**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.

	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yr.	5 Yrs.
<b>Int'l. Pool</b>	<b>-1.7%</b>	<b>1.2%</b>	<b>11.8%</b>	<b>11.0%</b>
Composite Index*	-2.4	-1.1	8.3	8.6

Value Added to International Composite\*



\*As of December 1996, the composite index is weighted 87% EAFE-Free and 13% Emerging Markets Free. Prior to May 1996, the target was 100% EAFE-Free.



**ALTERNATIVE ASSET MANAGERS**  
**Performance of Asset Pools**  
**(Net of Fees)**

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

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

The 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. A return for the current quarter is not available at this time. The return for the one, three and five year periods are computed using the SBI's actual return for the latest quarter.

	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yrs.	Annualized 5 Yrs.
<b>Real Estate</b>	<b>1.8%</b>	<b>41.1%</b>	<b>16.4%</b>	<b>10.8%</b>
Real Estate Index		15.7	9.3	6.3
Inflation	0.4	1.6	2.2	2.4

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

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

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

	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yrs.	Annualized 5 Yrs.
<b>Private Equity</b>	<b>22.6%</b>	<b>49.0%</b>	<b>39.0%</b>	<b>26.0%</b>

**Resource Pool (Basic Funds only)**

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

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

	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yrs.	Annualized 5 Yrs.
<b>Resource Funds</b>	<b>-5.3%</b>	<b>33.3%</b>	<b>25.5%</b>	<b>18.8%</b>

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

**Expectation:** Yield oriented investments are expected to provide annualized returns at least 2% greater than historical public debt returns over the life of the investment. This equates to an absolute return of 10-11% annualized. The SBI began adding yield oriented alternative investments to the Post Fund in fiscal year 1996.

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

	Period Ending 6/30/98			
	Qtr.	Yr.	3 Yrs.	Annualized Since 3/1/94 5 Yrs.
<b>Yield Oriented</b>	<b>-0.2%</b>	<b>15.0%</b>	<b>12.4%</b>	<b>10.0%</b>

## SUPPLEMENTAL INVESTMENT FUND

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

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

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

The investment returns shown in this report are calculated using a time-weighted rate of return formula. They are **net of investment management fees** but they do *not* include a deduction for asset based charges used to defray costs of the administering retirement organizations.

**On June 30, 1998 the market value of the entire Fund was \$1.2 billion.**

## Investment Options

	6/30/98 Market Value (In Millions)
<b>Income Share Account</b> – a balanced portfolio utilizing both common stocks and bonds.	\$575
<b>Growth Share Account</b> – an actively managed, all common stock portfolio.	\$278
<b>Common Stock Index Account</b> – a passively managed, all common stock portfolio designed to track the performance of the entire U.S. stock market.	\$212
<b>International Share Account</b> – a portfolio of non U.S. stocks that incorporates both active and passive management.	\$25
<b>Bond Market Account</b> – an actively managed, all bond portfolio.	\$35
<b>Money Market Account</b> – a portfolio utilizing short-term, liquid debt securities.	\$47
<b>Fixed Interest Account</b> – an option utilizing guaranteed investment contracts (GIC's), which offer a fixed rate of return for a specified period of time.	\$75

**SUPPLEMENTAL INVESTMENT FUND ACCOUNTS**

**INCOME SHARE ACCOUNT**

**Investment Objective**

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

**Asset Mix**

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

	Target	Actual
Stocks	60.0%	61.8%
Bonds	35.0	32.8
Unallocated Cash	5.0	5.4
	100.0%	100.0%

**Period Ending 6/30/98**

**Annualized**

	Qtr.	1 Yr.	3 Yr.	5 Yr.
Total Account	2.1%	21.7%	20.2%	16.0%
Composite*	2.1	21.2	19.7	15.5

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

**GROWTH SHARE ACCOUNT**

**Investment Objective**

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

**Asset Mix**

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

**Period Ending 6/30/98**

**Annualized**

	Qtr.	1 Yr.	3 Yr.	5 Yr.
Total Account	2.2%	31.2%	28.4%	21.3%
Composite*	1.9	28.9	27.7	21.1

\* 95% Wilshire 5000/5% T-Bills Composite through October 1996. 100% Wilshire 5000 since November 1996.

**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 U.S. stock market as a whole. 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.

**Period Ending 6/30/98**

**Annualized**

	Qtr.	1 Yr.	3 Yr.	5 Yr.
Total Account	1.9%	29.4%	28.2%	21.8%
Wilshire 5000	1.9	28.9	28.1	21.5

**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-Free). The remainder of the Account is "actively managed" by several international managers and emerging markets specialists who buy and sell stocks in an attempt to maximize market value.

**Period Ending 6/30/98**

**Annualized**

**Since**

	Qtr.	1 Yr.	3 Yr.	9/1/94
Total Account	-1.7%	1.1%	11.8%	8.6%
Composite*	-2.4	-1.1	8.3	6.0

\* As of December 1996, the benchmark is weighted 87% EAFE-Free and 13% Emerging Markets Free. Prior to May 1996, the target was weighted 100% EAFE-Free.

## SUPPLEMENTAL INVESTMENT FUND ACCOUNTS

### 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.

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>2.3%</b>	<b>11.0%</b>	<b>8.5%</b>	<b>7.2%</b>
Lehman Agg.	2.3	10.5	7.9	6.9

#### Asset Mix

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

### MONEY MARKET ACCOUNT

#### Investment Objective

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

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Account</b>	<b>1.4%</b>	<b>5.8%</b>	<b>5.7%</b>	<b>5.2%</b>
91 Day T-Bills	1.3	5.3	5.3	4.9

#### Asset Mix

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

### FIXED INTEREST ACCOUNT

#### Investment Objectives

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

	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	Since
<b>GIC Pool</b>	<b>1.6%</b>	<b>6.5%</b>	<b>6.6%</b>	<b>11/1/94</b>
				<b>6.7%</b>

#### 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.

### ASSIGNED RISK PLAN

**Investment Objectives**

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

**Asset Mix**

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

	6/30/98 Target	6/30/98 Actual
Stocks	20.0%	26.7%
Bonds	80.0	73.3
Total	100.0%	100.0%

**Investment Management**

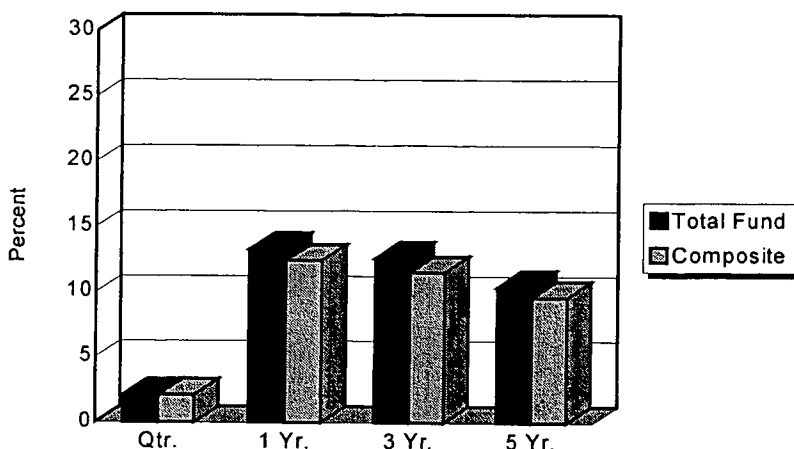
The portfolio was transferred from the Department of Commerce to the SBI on May 1, 1991. Voyager Asset Management has managed the bond segment of the Fund since inception. Since January 1995, GE Investment Management has managed the equity segment.

**Performance Benchmarks**

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

**Market Value**

On June 30, 1998 the market value of the Assigned Risk Plan was \$694 million.



**Period Ending 6/30/98**

	Annualized			
	Qtr.	Yr.	3 Yr.	5 Yr.
<b>Total Fund*</b>	<b>2.1%</b>	<b>13.3%</b>	<b>12.6%</b>	<b>10.4%</b>
Composite	2.1	12.4	11.5	9.6
<b>Equity Segment*</b>	<b>2.8</b>	<b>28.9</b>	<b>29.5</b>	<b>22.0</b>
Benchmark	3.3	30.3	30.3	22.9
<b>Bond Segment*</b>	<b>1.9</b>	<b>8.4</b>	<b>7.2</b>	<b>6.6</b>
Benchmark	1.7	8.1	7.1	6.4

\* Actual returns are calculated net of fees.

**PERMANENT SCHOOL FUND**

**Investment Objectives**

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

**Asset Mix**

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

	6/30/98 Target	6/30/98 Actual
Stocks	50.0%	52.7%
Bond	48.0	43.6
Unallocated Cash	2.0	3.7
	100.0%	100.0%

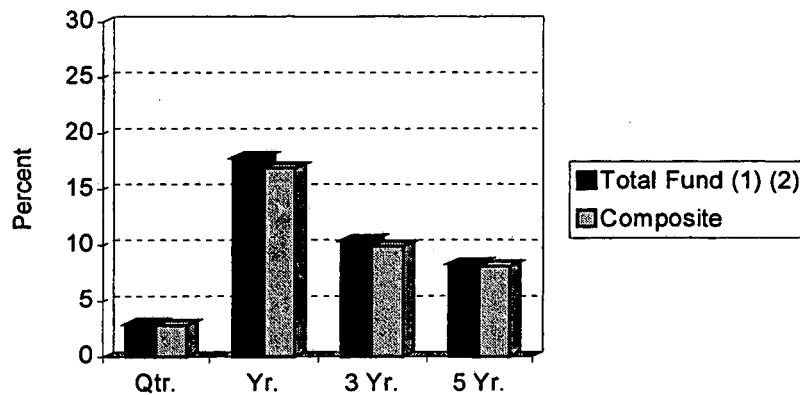
Prior to FY98, the Fund was invested entirely in fixed income securities in order to maximize current income. It is understood that the change in asset mix will reduce portfolio income in the short term, but will enhance the value of the fund, over time.

**Investment Management**

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

**Market Value**

On June 30, 1998 the market value of the Permanent School Fund was \$500 million.



	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Fund (1) (2)</b>	<b>2.9%</b>	<b>17.8%</b>	<b>10.4%</b>	<b>8.3%</b>
Composite	2.8	16.9	9.9	8.1
<b>Equity Segment (1) (2)</b>	<b>3.3</b>	<b>22.8</b>	<b>N/A</b>	<b>N/A</b>
S&P 500	3.3	22.7	N/A	N/A
<b>Bond Segment (1)</b>	<b>2.4</b>	<b>10.7</b>	<b>8.4</b>	<b>7.3</b>
Lehman Aggregate	2.3	10.5	7.9	6.9

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

**ENVIRONMENTAL TRUST FUND**

**Investment Objective**

The 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.

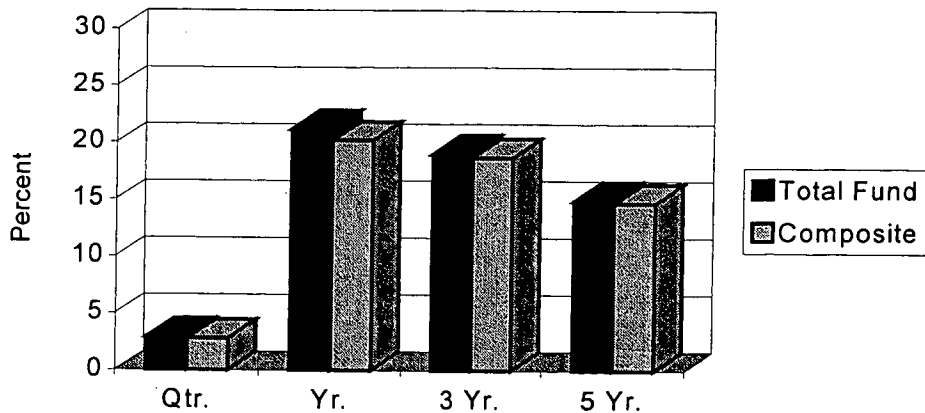
	6/30/98 Target	6/30/98 Actual
Stocks	50.0%	53.0%
Bonds	48.0	46.3
Unallocated Cash	2.0	0.7
	100.0%	100.0%

**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 June 30, 1998 the market value of the Environmental Trust Fund was \$236 million.



	Period Ending 6/30/98			
	Qtr.	1 Yr.	3 Yr.	5 Yr.
<b>Total Fund*</b>	2.9%	21.2%	19.0%	14.9%
Composite	2.8	20.2	18.7	14.7
<b>Equity Segment*</b>	3.3	30.4	30.3	23.1
S&P 500	3.3	30.3	30.3	23.1
<b>Bond Segment*</b>	2.4	12.1	8.5	7.6
Lehman Agg.	2.3	10.5	7.9	6.9

\* Actual returns are calculated net of fees.

## STATE CASH ACCOUNTS

**Description**

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

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

1. Trust Fund Pool contains the 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.

	Market Value (Millions)	Period Ending 6/30/98		Annualized	
		Qtr.	Yr.	3 Yr.	5 Yr.
Treasurer's Cash Pool*	\$5,921	1.4%	5.9%	5.7%	5.2%
Custom Benchmark**		1.3	5.4	5.6	5.2
Trust Fund Cash Pool*	53	1.4	5.8	5.7	5.3
Custom Benchmark***		1.3	5.2	5.5	5.1
91-Day T-Bills		1.3	5.3	5.3	4.9

\* Actual returns are calculated net of fees.

\*\* Beginning in January 1997, the Treasurer's Cash Pool is measured against a blended benchmark consisting of the Lehman Brother's 1 to 3 year Government Index for the first \$600 million and the IBC all Taxable Money Fund Index for the balance of the portfolio. From April 1993 through December 1996, the benchmark was 75% State Street Short Term Investment Fund/25% 1-3 year Treasuries.

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



**MINNESOTA STATE BOARD OF INVESTMENT**  
**Composition of State Investment Portfolios By Type of Investment**  
**Market Value June 30, 1998 (in Thousands)**

	Cash And		Bonds		Stocks		External Int'l.	Alternative Assets	Total
	Short Term Securities	Internal	External	Internal	External				
<b>BASIC RETIREMENT FUNDS:</b>									
Teachers Retirement Fund	73,507 0.93%	-0-	1,750,748 22.17%	-0-	4,122,761 52.21%	1,147,028 14.52%	802,743 10.17%	7,896,787 100%	
Public Employees Retirement Fund	36,768 0.90%	-0-	919,439 22.40%	-0-	2,142,319 52.20%	601,742 14.66%	403,673 9.84%	4,103,941 100%	
State Employees Retirement Fund	35,180 0.90%	-0-	880,836 22.41%	-0-	2,051,724 52.20%	576,459 14.67%	386,222 9.82%	3,930,421 100%	
Public Employees Police & Fire Fund	17,376 0.90%	-0-	434,007 22.40%	-0-	1,011,434 52.20%	284,048 14.66%	190,688 9.84%	1,937,553 100%	
Highway Patrol Retirement Fund	2,430 0.90%	-0-	60,650 22.41%	-0-	141,267 52.20%	39,692 14.67%	26,592 9.82%	270,631 100%	
Judges Retirement Fund	1,676 7.93%	-0-	4,402 20.82%	-0-	10,255 48.50%	2,881 13.62%	1,930 9.13%	21,144 100%	
Public Employees P.F. Consolidated	4,189 0.88%	63 0.01%	106,577 22.32%	16 -0%	249,281 52.21%	69,778 14.61%	47,614 9.97%	477,518 100%	
Correctional Employees Retirement	5,946 2.69%	-0-	48,723 22.00%	-0-	113,490 51.26%	31,886 14.40%	21,364 9.65%	221,409 100%	
<b>TOTAL BASIC FUNDS</b>	177,072 0.94%	63 -0-	4,205,382 22.30%	16 -0-	9,842,531 52.18%	2,753,514 14.60%	1,880,826 9.98%	18,859,404 100%	
<b>POST RETIREMENT FUND</b>	417,435 2.45%	-0-	4,992,469 29.32%	-0-	8,946,610 52.53%	2,517,705 14.78%	157,364 0.92%	17,031,583 100%	
<b>TOTAL BASIC &amp; POST</b>	594,507 1.66%	63 -0%	9,197,851 25.63%	16 -0%	18,789,141 52.35%	5,271,219 14.69%	2,038,190 5.67%	35,890,987 100%	

	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	30,852 5.37%	188,650 32.83%	-0-	-0-	355,187 61.80%	-0-	-0-	574,689 100%
Growth Share Account	-0-	-0-	-0-	-0-	278,151 100%	-0-	-0-	278,151 100%
Money Market Account	47,363 100%	-0-	-0-	-0-	-0-	-0-	-0-	47,363 100%
Common Stock Index Account	-0-	-0-	-0-	-0-	212,483 100%	-0-	-0-	212,483 100%
Bond Market Account	-0-	-0-	34,981 100%	-0-	-0-	-0-	-0-	34,981 100%
International Share Account	-0-	-0-	-0-	-0-	-0-	24,517 100%	-0-	24,517 100%
Fixed Interest Account	1,816 2.42%	-0-	73,186 97.58%	-0-	-0-	-0-	-0-	75,002 100%
<b>TOTAL SUPPLEMENTAL FUNDS</b>								
	80,031 6.42%	188,650 15.13%	108,167 8.67%	-0-	845,821 67.82%	24,517 1.96%	-0-	1,247,186 100%
<b>TOTAL RETIREMENT FUNDS</b>								
	674,538 1.82%	188,713 0.51%	9,306,018 25.06%	16 0.00	19,634,962 52.87%	5,295,736 14.26%	2,038,190 5.48%	37,138,173 100%

	Cash And		Bonds		Bonds		Stocks		External		Alternative		Total	
	Short Term		Internal		External		Internal		Int'l.		Assets			
	Securities													
<b>ASSIGNED RISK PLAN</b>	24,658	-0-	490,360	-0-	-0-	178,618	-0-	-0-	-0-	-0-	-0-	693,636	100%	
	3.56%		70.69%			25.75%								
<b>ENVIRONMENTAL FUND</b>	1,853	109,379	-0-	125,231	-0-	-0-	-0-	-0-	-0-	-0-	-0-	236,463	100%	
	0.78%	46.26%		52.96%										
<b>PERMANENT SCHOOL FUND</b>	18,461	218,013	-0-	263,204	-0-	-0-	-0-	-0-	-0-	-0-	-0-	499,678	100%	
	3.69%	43.63%		52.68%										
<b>TREASURERS CASH</b>	5,918,788	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	5,918,788	100%	
	100%													
<b>HOUSING FINANCE AGENCY</b>	8,610	200,292	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	208,902	100%	
	4.12%	95.88%												
<b>MINNESOTA DEBT SERVICE FUND</b>	29,758	106,554	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	136,312	100%	
	21.83%	78.17%												
<b>MISCELLANEOUS ACCOUNTS</b>	182,497	197,354	-0-	22,313	-0-	-0-	-0-	-0-	-0-	-0-	-0-	402,164	100%	
	45.38%	49.07%		5.55%										
<b>GRAND TOTAL</b>	6,859,163	1,020,305	9,796,378	410,764	19,813,580	5,295,736	2,038,190	45,234,116	11.71%	4.50%				
	15.16%	2.26%	21.66%	0.91%	43.80%									

# Tab B

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

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DATE: August 25, 1998

TO: Members, State Board of Investment

FROM: Howard Bicker

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

A final report on the SBI's administrative budget for FY98 is included as **Attachment A**. A report for the FY99 administrative budget through July 31, 1998 is included as **Attachment B**.

A report on travel for the period from May 16 – August 15, 1998 is included as **Attachment C**.

### **2. Litigation Update**

The SBI has been designated lead plaintiff in a class action suit against Mercury Finance Corporation. SBI legal counsel will give the Board a verbal update on the status of the litigation at the Board meeting on September 2<sup>nd</sup>.



ATTACHMENT A

**STATE BOARD OF INVESTMENT  
FISCAL YEAR 1998 ADMINISTRATIVE BUDGET REPORT  
GENERAL FUND APPROPRIATION  
FISCAL YEAR FINAL**

ITEM	FISCAL YEAR 1998 BUDGET	FISCAL YEAR 1998 EXPENDITURES
<b>PERSONAL SERVICES</b>		
FULL TIME EMPLOYEES	\$ 1,600,000	\$ 1,626,844
SEVERENCE PAYOFF	20,000	39,819
WORKERS COMPENSATION INSURANCE	1,000	729
MISCELLANEOUS PAYROLL	1,000	0
<b>SUBTOTAL</b>	<b>\$ 1,622,000</b>	<b>\$ 1,667,392</b>
<b>STATE OPERATIONS</b>		
RENTS & LEASES	92,500	92,489
REPAIRS/ALTERATIONS/MAINTENANCE	13,000	21,636
BONDS AND INSURANCE	0	0
PRINTING & BINDING	16,000	16,625
PROFESSIONAL/TECHNICAL SERVICES	45,000	32,500
COMPUTER SYSTEMS SERVICES	204,000	69,395
COMMUNICATIONS	26,000	29,133
TRAVEL, IN-STATE	3,000	564
TRAVEL, OUT-STATE	55,000	52,826
SUPPLIES	38,000	38,080
EQUIPMENT	12,500	16,777
EMPLOYEE DEVELOPMENT	12,000	9,402
OTHER OPERATING COSTS	24,000	26,533
<b>SUBTOTAL</b>	<b>\$ 541,000</b>	<b>\$ 405,960</b>
<b>TOTAL GENERAL FUND</b>	<b>\$ 2,163,000</b>	<b>\$ 2,073,352</b>

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ATTACHMENT B

**STATE BOARD OF INVESTMENT  
FISCAL YEAR 1999 ADMINISTRATIVE BUDGET REPORT  
GENERAL FUND APPROPRIATION  
FISCAL YEAR TO DATE THROUGH JULY 31, 1998**

ITEM	FISCAL YEAR 1999 BUDGET	FISCAL YEAR 1999 EXPENDITURES
<b>PERSONAL SERVICES</b>		
FULL TIME EMPLOYEES	\$ 1,715,475	\$ 89,204
SEVERENCE PAYOFF	20,000	0
WORKERS COMPENSATION INSURANCE	1,000	0
MISCELLANEOUS PAYROLL	1,000	0
<b>SUBTOTAL</b>	<b>\$ 1,737,475</b>	<b>\$ 89,204</b>
<b>STATE OPERATIONS</b>		
RENTS & LEASES	94,525	7,877
REPAIRS/ALTERATIONS/MAINTENANCE	23,000	0
MOVING EXPENSES	100,000	0
PRINTING & BINDING	20,000	0
PROFESSIONAL/TECHNICAL SERVICES	55,000	0
COMPUTER SYSTEMS SERVICES	5,000	0
COMMUNICATIONS	27,000	434
TRAVEL, IN-STATE	3,000	16
TRAVEL, OUT-STATE	60,000	590
SUPPLIES	42,000	1,822
EQUIPMENT	40,000	0
EMPLOYEE DEVELOPMENT	12,000	2,280
OTHER OPERATING COSTS	28,000	58
<b>SUBTOTAL</b>	<b>\$ 509,525</b>	<b>\$ 13,077</b>
<b>TOTAL GENERAL FUND</b>	<b>\$ 2,247,000</b>	<b>\$ 102,281</b>

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**ATTACHMENT C**

**STATE BOARD OF INVESTMENT**

**Travel Summary by Date  
May 16, 1998 – August 15, 1998**

<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
<b>Staff Conference</b> American Express Asset Management Group, Inc., 21 <sup>st</sup> Annual Client Seminar	H. Bicker	Washington, D.C. 5/12-5/15	\$99.99
<b>Miscellaneous</b> Class Action Litigation	M. Perry	Chicago, IL 5-22	\$45.00
<b>Staff Conference</b> Heitman Capital Management's Annual Client Conference	J. Griebenow	Chicago, IL 5/26-5/27	\$435.00
<b>Board Member Travel</b> Investment Management for Institutional Investors	E. Voss	Boston, MA 6/22-6/26	\$2,313.08
<b>Board Member Travel</b> 1998 Legal Education Conference National Association of Public Pension Attorneys	C. Eller	Newport, RI 6/23-6/26	\$2,178.00
<b>Staff Conference</b> Government Finance Officers Association 92 <sup>nd</sup> Annual Conference	H. Bicker	San Francisco, CA 6/29-6/30	\$159.00
<b>Manager Monitoring Alternative Investments:</b> Colony Capital, TCW/Crescent Mezzanine LLC	M. Regal	Los Angeles, CA 7/17-7/19	\$999.10
<b>Manager Search Alternative Investments:</b> Leonard Green & Partners			

<u>Purpose</u>	<u>Name(s)</u>	<u>Destination and Date</u>	<u>Total Cost</u>
<b>Manager Monitoring International Managers:</b> Marathon, Record Treasury, State Street Global Advisors	H. Bicker	London, England 7/17-7/24	\$3,607.97
<b>Manager Search International Managers:</b> Citibank Global Asset Mgmt., Investment Advisors, Western Asset Global Mgmt. Ltd.			
<b>Manager Monitoring Emerging Markets Managers:</b> City of London, Genesis			
<b>Manager Search Alternative Investments:</b> Civen, Doughty Hanson & Company, HarbourVest Partners			
<b>Manager Monitoring Alternative Investments:</b> Summit Partners, TA Associates Realty	J. Griebenow	Boston, MA 7/20-7/21	\$1,021.00

# Tab C



**STATE OF MINNESOTA  
OFFICE OF THE STATE TREASURER**

303 State Administration Building  
50 Sherburne Avenue  
Saint Paul, Minnesota 55155

**MICHAEL A. McGRATH**  
Treasurer

(612) 296-7091  
Fax (612) 296-8615

DATE: August 25, 1998

TO: Members, State Board of Investment

FROM: Michael A. McGrath, Chair  
SBI Administrative Committee

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

The SBI Administrative Committee met on August 17, 1998 to review the following agenda items:

- **Update on International Country Guidelines**
- **Review of proposed Biennial Budget request for FY's 2000-2001**
- **Discussion of SBI staff's move to new offices planned for FY 1999**
- **Review of Executive Director's Job Description**
- **Executive Director's Salary Review**

**1. Update on International Country Guidelines**

In September 1992, the State Board of Investment (SBI) established an International Investing Guidelines Task Force. Its charge was to make recommendations to the SBI concerning issues related to human and worker rights with respect to the SBI international investment program. The guidelines recommended by the Task Force were adopted by the SBI in December 1992 and have been used in the implementation of the international program since that date.

The SBI has delegated periodic review of the country groupings to the SBI Administrative Committee. The last formal review was in August 1994. In June 1996, the list was expanded to include several markets in which existing international managers were considering investments. The current review updates the existing list of countries and adds several new countries in which international managers have indicated an investment interest.

**The policy guidelines are outlined in Attachment A on page 5 of this tab.**

The review process as adopted by the Board at its June 1994 meeting is as follows:

- Staff reviews reports from the U.S. State Department against the worker and human rights issues that were highlighted by the Task Force in 1992. Staff designates countries "Group 1, 2 or 3" using the existing policy guidelines adopted by the Board.
- Staff designations are reviewed by the SBI Administrative Committee. This includes any movement of countries between categories as well as categorizations of any new countries being added to the list. The groupings are reported to the Board as an information item in the SBI Administrative Committee Report since it is implementation of a policy that has already been adopted by the Board.
- Active international stock managers must provide written notification to the SBI of the manager's decision to invest in any "Group 2" market(s).
- Active international managers must appear before a meeting of the SBI Administrative Committee to explain their decision to invest in one or more "Group 3" markets. The Committee reports to the Board on the results of such meetings as information items.

The updated changes and additions to the country guidelines is included as **Attachment B** beginning on **page 7** of this tab.

The current country groupings, which include the updated changes and additions, are in **Attachment C** on **page 9** of this tab.

The Committee approved the changes and additions to the country guidelines as recommended by staff.

## **2. Review of proposed Biennial Budget request for FY's 2000-2001**

As a state agency, the SBI's administrative budget is part of the State's biennial budget process and will be presented to the 1997 Legislature as part of the Governor's proposed budget.

A draft of the SBI's biennial budget document is attached for your review. It has been prepared in accordance with Department of Finance guidelines.

The general fund appropriation request is \$2,247,000 each year which is a "no change" base level funding.

The FY2000-2001 budget request is included as **Attachment D** beginning on **page 11** of this tab.

**RECOMMENDATION:**

**The SBI Administrative Committee recommends that the SBI approve and authorize the Executive Director to seek its approval during the 1999 Legislative Session.**

**3. Discussion of SBI staff's move to new offices planned for FY 1999**

The current lease for the SBI staff offices expires in June 1999. The SBI staff offices are located in the Minnesota Education Association (MEA) building. At this time, it appears as though the MEA will have expanded space needs and will not be renewing its lease with the SBI. The SBI staff has informed the Department of Administration (DOA) of the situation. DOA has begun to investigate potential sites for the SBI in the event the staff offices have to relocate. The Executive Director will keep the SBI and the Administrative Committee apprised of the status of the potential move.

**4. Review of Executive Director's Job Description**

The Committee reviewed the position description for the Executive Director and found it to continue to be a good representation of his duties and responsibilities. A copy of the Executive Director's position description is included as **Attachment E** on **page 19** of this tab.

**5. Executive Director's Salary Review**

In accordance with action approved by the SBI at its September 1997 meeting, the SBI Administrative Committee is authorized to review the Executive Director's no less than annually and report its recommendation to the SBI.

By law the Executive Director's compensation can equal up to 85% of the Governor's salary. The Executive Director's salary was established at \$99,764 effective July 1, 1997, which was 85% of the Governor's salary. On January 1, 1998 the governor's salary was increased by 2.5%. The Committee reviewed the Executive Director's salary in relationship to his peer group around the nation and also noted that Managerial employees throughout state government received a 3% salary increase effective July 1, 1998. The Committee recommended that The Executive Director's salary be increased by 2.5% effective July 1, 1998.

**RECOMMENDATION:**

**The SBI Administrative Committee recommends that the SBI recommend to the Legislative Coordinating Commission (LCC) that the salary for the SBI Executive Director be \$102,258 effective July 1, 1998.**



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## ATTACHMENT A

### POLICY GUIDELINES

In 1992, the International Investing Guidelines Task Force focused on information available from country reports compiled annually by the U.S. State Department. Based on that information, the Task Force recommended a policy framework that grouped countries into three broad categories. *It is important to underscore that the guidelines do not prohibit a manager from investing in the market of any country.* Rather, they may require either written notification or personal presentation from the manager:

**Group 1:** According to the U.S. State Department reports, these countries have legal protections or practices that generally respect internationally recognized worker and human rights. As a result, there is little concern that economic and social disruptions may occur that would have an adverse effect on financial markets. *No additional notification or presentation is required* regarding a manager's decision to invest in the market of any of these countries.

**Group 2:** These countries have legal protections for worker and human rights but violations of these rights have been cited in the U.S. State Department reports. Because violations of legally protected rights continue to occur in these countries, there is some concern that economic and social disruptions may occur that could have an adverse effect on their financial markets. If a manager chooses to invest in one or more of these markets, the manager *must notify SBI staff in writing* of the decision to do so.

**Group 3:** According to U.S. State Department reports, these countries appear to lack basic protections for worker and human rights and do not appear to be making adequate progress in establishing a legal structure to address these issues. As a result, the potential for economic, social and political unrest exists that could adversely affect the stability of the financial markets within these countries. If a manager chooses to invest in one or more of these markets, the manager *must appear at a meeting of the SBI administrative Committee to present its reasons for the decision* to do so.

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## ATTACHMENT B

### PROPOSED CHANGES/ADDITIONS TO THE COUNTRY GROUPINGS

#### From Group 1 to Group 2:

**Hong Kong** - Hong Kong officially became part of China in 1997, and some of Hong Kong's previous rights or freedoms have been rescinded or impeded.

#### From Group 2 to Group 1:

**Chile** - Improvements in the enforcement of occupational health and safety standards, and freedom from political killing or disappearance.

**Estonia** - Improvements in freedom of speech and press.

**Trinidad & Tobago** - Improvements in freedom of political killing or disappearance, freedom from torture, and freedom of speech and press.

#### From Group 2 to Group 3:

**Bangladesh** - Additional violations in the right to vote/affect government change, dispute resolution, and prohibition of forced labor.

**Egypt** - Additional violations in the right to fair public trial/due process, freedom of speech, and prohibition of forced labor.

**Russia** - Additional violations in the right of association, right to organize and bargain collectively, dispute resolution, prohibition of forced labor, standard workweek, and freedom from political killing or disappearance.

#### From Group 3 to Group 2:

**Swaziland** - Improvements in the right to strike.

Managers were asked to review the list for countries they may invest in, but weren't currently listed. Staff reviewed each additional country based upon the same U.S. State Department country reports that were used to update the existing list of countries. These additions are as follows:

#### **Additions to Group 1:**

Cyprus

#### **Additions to Group 2:**

Bulgaria

Dominican Republic

## ATTACHMENT B (con't)

### **Additions to Group 3:**

Guatemala

Liberia

Mauritania

Oman

Paraguay

Saudi Arabia

Turkmenistan

Uzbekistan

Information was compiled from the *Country Reports on Human Rights Practices for 1997*, dated March 1998.

## ATTACHMENT C

### INTERNATIONAL INVESTING GUIDELINES PROPOSED COUNTRY GROUPINGS September 1998

#### Group 1

Australia  
Austria  
Barbados  
Belgium  
Canada  
Chile  
Costa Rica  
Cyprus\*  
Czech Republic  
Denmark  
Estonia  
Finland  
France  
Germany  
Greece  
~~Hong Kong~~  
Hungary  
Ireland  
Italy  
Japan  
Luxembourg  
Mauritius  
Netherlands  
New Zealand  
Norway  
Poland  
Portugal  
Singapore  
Slovak Republic  
Slovenia  
Spain  
Sweden  
Switzerland  
Trinidad & Tobago  
United Kingdom  
Uruguay

#### Group 2

Argentina  
~~Bangladesh~~  
Bolivia  
Botswana  
Brazil  
Bulgaria\*  
~~Chile~~  
Colombia  
Cote d'Ivoire  
Dominican Republic\*  
Ecuador  
~~Egypt~~  
~~Estonia~~  
Ghana  
Hong Kong  
India  
Israel  
Jamaica  
Kazakhstan  
Kenya  
Korea, Republic of  
Latvia  
Lithuania  
Malawi  
Malaysia  
~~Mauritius~~  
Mexico  
Mongolia  
Namibia  
Nepal  
Panama  
Papua New Guinea  
Philippines  
Romania  
~~Russia~~  
South Africa  
Sri Lanka  
Swaziland  
Taiwan  
Thailand  
~~Trinidad & Tobago~~  
Tunisia  
Turkey  
Ukraine  
Venezuela  
Zambia  
Zimbabwe

#### Group 3

Bangladesh  
China, People Republic of  
Croatia  
Egypt  
Guatemala\*  
Indonesia  
Jordan  
Kuwait  
Lebanon  
Liberia\*  
Mauritania\*  
Morocco  
Myanmar-formerly Burma  
Nigeria  
Oman\*  
Pakistan  
Paraguay\*  
Peru  
Russia  
Saudi Arabia\*  
~~Swaziland~~  
Turkmenistan\*  
United Arab Emirates UAE  
Uzbekistan\*  
Vietnam

\*This country was not previously part of the Country Guidelines.

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ATTACHMENT D

MINNESOTA  
STATE  
BOARD OF  
INVESTMENT



Board Members:

Governor  
Arne H. Carlson

State Auditor  
Judi Dutcher

State Treasurer  
Michael A. McGrath

Secretary of State  
Joan Anderson Growe

Attorney General  
Hubert H. Humphrey III

DATE: August 10, 1998

TO: Members, SBI Administrative Committee

FROM: Howard Bicker

SUBJECT: Proposed Biennial Budget Request for FY's 2000 – 2001

A draft of my proposed budget narrative for the next biennium is attached for your review. The final deadline for submission of this document is tentatively set for October 15, 1998.

As in the past, the SBI will submit a same level budget request using the procedures and guidelines established by the Commissioner of Finance.

The following table shows the current biennial appropriation and the proposed request for the next biennium. The base level adjustment was calculated by the Department of Finance and is for salary inflation.

	<u>CURRENT BIENNIUM</u>		<u>NEXT BIENNIUM</u>	
	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>
BASE LEVEL APPROPRIATION	2,163,000	2,247,000	2,247,000	2,247,000
ADJUSTMENTS (1)	0	0	51,272	104,254
TOTAL REQUESTED	2,163,000	2,247,000	2,298,272	2,351,254

1. This is a base level adjustment for salary inflation that will be allowed all state agencies. It is calculated as a 3% increase per year, using as a base, the estimated salary expenditures during FY 1999.

Executive Director:  
Howard J. Bicker

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

An Equal Opportunity  
Employer





.....  
2000-01 BIENNIAL BUDGET  
STATE BOARD OF INVESTMENT

o Seek and retain superior money managers to manage the assets of each fund.

**AGENCY DESCRIPTION**  
**MISSION STATEMENT:**

The State Board of Investment (SBI) develops and implements investment policies and strategies for the state's retirement funds, trust funds and cash accounts. The statutory goal of the SBI is "to establish standards which will insure that state and pension assets...will be responsibly invested to maximize the total rate of return without incurring undue risk." (*Minnesota Statutes* Section 11A.01).

o Monitor and evaluate investment performance to insure investment objectives are met.

o Assess developments in the broad financial markets and evaluate their potential impact on SBI operations and policies.

o Communicate its investment policies to clients and constituents.

Investment activity is divided into 2 major areas; externally managed and internally managed funds. Each concentration requires different strategies and investment vehicles.

**External managed funds.** Assets of the Basic Retirement Funds, Post Retirement Fund, Supplemental Investment Fund and Assigned Risk Plan (approximately 84% of the total) are under external management.

The board retains an executive director, an internal investment management staff, and external investment managers to execute its policies. In performing its duties, the board is assisted by the Investment Advisory Council which is composed of 17 persons with investment and retirement fund expertise.

The Basic Retirement Funds invest the contributions of public employees and employers during the employees' years of public service. Approximately 256,000 public employees in eight statewide retirement funds participate in the Basic Funds. The purpose is to function in a fiduciary capacity, investing pension contributions to provide sufficient funds to finance promised benefits at retirement.

The SBI staff recommends strategic planning alternatives to the board and council and executes the board's decisions. The staff also provides internal management for the Permanent School Fund, the Environmental Trust Fund and State Cash accounts; closely monitors the performance of all external managers retained by the board; and reviews prospective investment vehicles for legislative consideration. The majority of the board's activity relates to investment of retirement funds (roughly 82%). Primary clients are the current and retired members of the three statewide retirement systems (PERA, TRA, MSRS). For cash accounts, the board's largest clients are the State Treasurer and the Department of Finance.

The Post Retirement Fund contains the assets of over 82,000 retired public employees covered by the nine statewide retirement plans. Upon retirement, money sufficient to finance fixed monthly annuities for the life of the retiree are transferred from the Basic Funds to the Post Fund. The Post Fund's main purpose is to ensure that each retiree's initially promised benefit is paid. The SBI must insure that assets transferred to the Post Retirement Fund generate sufficient returns to maintain promised benefits and to generate additional returns that will provide benefit increases to retired public employees.

**CLIMATE:**

All activities of the board are governed by M.S. Chapter 11A and Chapter 356A. To meet the goals established therein, the SBI must:

Fiscal year 1980 to fiscal year 1992 benefit increases were granted if investment realized earnings exceeded the statutory 5% required income. This formula, with its emphasis on current income, caused the asset allocation of the fund to be highly concentrated in fixed income securities. Since Fiscal Year 1993 benefit increases have been paid using a formula tied to the total rate of return of the fund. This change in formula enables the asset allocation of the Post Retirement Fund to be more balanced and include a larger percentage of equities.

o Establish and periodically update the investment objectives, asset allocation and investment management structure for each of the funds.

The Supplemental Investment Fund is a multi-purpose investment program that offers a range of investment options to state and local employees. It serves a wide range of participants and investment goals, and is, therefore, structured much like a family of mutual funds.

The Assigned Risk Plan is administered by the Dept. of Commerce to provide workers compensation insurance to companies unable to obtain private insurance. The goal is to match the projected liability stream while also maintaining adequate liquidity.

**Internally managed funds.** The SBI directly invests about 16% of the assets with which it is entrusted. This includes the assets of the Permanent School Fund, Environmental Trust Fund and all money in state cash accounts.

The Permanent School Fund is a trust fund created by the Minnesota State Constitution and designated as a long-term source of revenue for public schools. Income generated by the Permanent School Fund's assets is used to offset state school aid payments. The Fund's investment objectives have been influenced by the restrictive legal provisions under which its investments have been managed. Long run growth in Fund assets has been difficult to achieve without seriously reducing current spendable income and exposing the spendable income stream to unacceptable volatility. Effective with FY 1998 the Permanent School Fund is invested in a balanced portfolio of common stocks and bonds. Common stocks provide the potential for significant capital appreciation, while bonds provide portfolio diversification and a more stable stream of current income.

The Environmental Trust Fund is a trust fund created by the State Constitution and designed to be a long-term source of revenue for funding environmental projects. The Fund's investment objectives are driven by the desire to generate current income which is used to finance a variety of projects proposed by the Legislative Commission on Minnesota Resources (LCMR). Currently the Environmental Trust Fund invested in a balanced portfolio of fixed income securities and common stocks.

State Cash Accounts represent the cash balances in more than 400 individual accounts that flow through the Minnesota State Treasury. These accounts range in size from \$5,000 to over \$400 million, and are invested by SBI staff through two commingled short-term investment pools. The objectives of these pooled funds are to preserve capital, to provide a high level of current income and to meet the cash needs of state government without the forced sale of securities at a loss. The pools are expected to generate investment income equal to or greater than other money market-type funds.

#### **AGENCY BUDGET PLAN:**

By Statute, the SBI bills the statewide retirement funds and non-general fund cash accounts for approximately 90% of its General Fund appropriation. These receipts are deposited in the General Fund as non-dedicated revenue. The General Fund appropriation not recovered by the bill-back provision (approximately 10%) represents the portion of the SBI's budget that is associated with the investment of the General Fund portion of the Invested Treasurer's Cash Fund. Any reduction in appropriations and expenditures will result in a matching reduction in revenue to the General Fund, and reduced billings to non-general fund accounts.

#### **PERFORMANCE INDICATORS:**

Statutes establish investment goals for the Basic and Post Retirement funds. In addition, the board has set more exacting standards for investment returns. The following pages demonstrate that long-term performance has generally exceeded both statutory requirements and the board's investment performance targets at the total fund level. Returns shown on the following pages are presented net of management fees and investment expenses.

**SUMMARY OF INVESTMENT RESULTS**

**BASIC RETIREMENT FUNDS**  
Market Value 6/30/98: \$ 18.859 Billion

	6/30/98 Millions	Period Ending 6/30/98		
		1 Year (%)	3 Years (%)	Annualized 5 Years (%)
Basic Funds:	\$ 18,859	22.2	20.9	15.9
Market composite		20.1	19.8	15.5
Post Fund:	\$ 17,031	19.4	19.1	14.9
Market composite		17.6	17.7	14.2
Benefit increase		10.1	8.2	6.9
Supplemental Fund:				
Income Share	\$ 575	21.7	20.2	16.0
Composite		21.2	19.7	15.5
Growth Share	\$ 278	31.2	28.4	21.3
Composite		28.9	27.7	21.1
International Share	\$ 25	1.1	11.8	8.6
EAFE Index		-1.1	8.3	6.0
Common Stock Index	\$ 212	29.4	28.2	21.8
Wilshire 5000		28.9	28.1	21.5
Bond Market	\$ 35	11.0	8.5	7.2
Lehman Aggregate		10.5	7.9	6.9
Money Market	\$ 47	5.8	5.7	5.2
91 Day T-Bills		5.3	5.3	4.9
Fixed Interest	\$ 75	6.5	6.6	6.7
Assigned Risk Plan	\$ 694	13.3	12.6	10.4
Market composite		12.4	11.5	9.6
State Cash Accounts				
Treasurer's Pool	\$ 5,921	5.9	5.7	5.2
Trust Pool	\$ 53	5.8	5.7	5.3
91 day T-bill		5.3	5.3	4.9
Permanent School	\$ 500	17.8	10.4	8.3
Market composite		16.9	9.9	8.1
Environmental Trust Fund	\$ 236	21.2	19.0	14.9
Composite		20.2	18.7	14.7

Period Ending 6/30/98  
Annualized  
1 Year (%) 22.2  
3 Years (%) 20.9  
5 Years (%) 15.9

Basic Funds 22.2 20.9 15.9

Comparisons:

Market Composite 20.1 19.8 15.5

TUCS Median Fund 17.9 18.5 14.8

Inflation (CPI) 1.7 2.2 2.5

Actuarial Assumption 8.5 8.5 8.5

The Basic Retirement Funds contain the assets of active employees in the three statewide retirement systems: MSRS, PERA, and TRA. The long term asset allocation of the portfolio on 6/30/98 was 60% stocks, 24% bonds, 1% cash and 15% alternative assets (real estate, venture capital and resource funds).

For fiscal year 1998, the Basic Funds exceeded their market composite index by 2.1 percentage points and surpassed the median fund in the Trust Universe Comparison Service (TUCS) by 4.3 percentage points.

Performance over the longer term has been favorable as well. Over the latest 5 year period, the Basic Funds have exceeded their market index composite by nearly 0.4 percentage points annualized, and the median fund by approximately 1.1 percentage points. The Basic Funds continue to keep well ahead of the inflation rate and have surpassed the actuarially assumed rate of return.

**POST RETIREMENT INVESTMENT FUND**  
**Market Value on 6/30/98: \$ 17.031 Billion**

	Period Ending 6/30/98		
	1 Year	3 Years	5 Years
Post Fund	19.4%	19.1%	14.9%
Comparisons:			
Market Composite	17.6%	17.7%	14.2%
Inflation (CPI)	1.7%	2.2%	2.5%
Actuarial Assumption	6.0%	5.0%	5.0%
Benefit increase	10.1%	8.2%	6.9%

The Post Retirement investment Funds contain the assets of retired employees in the three statewide retirement plans: MSRS, PERA, TRA. The long term asset allocation of the portfolio on 6/30/98 was 65% stocks, 27% bonds, 5% alternative assets and 3% cash.

Through fiscal year 1992, the statutory retirement benefit increase formula required the fund to generate realized earnings (dividends, interest, and net gain or loss from the sale of securities) in order to provide benefit increases to retirees. In fact, the benefit increases granted were among the highest in the nation. However, as interest rates fell during the 1980's, the Fund was forced to invest an increasing percentage of the portfolio in fixed income securities in order to maintain high levels of realized income. This diminished the prospect for future benefit increases and reduced the long term earning power of the Fund.

Since fiscal year 1993, the statutory formula has been based on total return and actual market value of the portfolio. The new formula has two components:

- An inflation adjustment which will provide 100% of the CPI, capped at 2.5%. (Between 1993 and 1997 the CPI was capped at 3.5%. This was changed in 1998 to 2.5%. This will be provided regardless of investment performance.
- An investment adjustment which will be based on Post Fund returns over a 5-year period. This will be provided only if the Fund generates returns above the actuarial assumed rate of 6% and the cumulative value of all inflation based adjustments previously granted. (Prior to 1998 the actuarial assumed rate was 5%.)

The formula changes, which were sought by the retirement systems and enacted by the 1992 and 1997 Legislatures, have allowed the Post Fund to increase its exposure to stocks and should increase the long term growth potential of its assets. Benefit increases granted since 1993 have surpassed inflation by significant amounts.

**SUPPLEMENTAL INVESTMENT FUND**

	Market Value 6/30/98	Period Ending 6/30/98		
		1 Year	3 Years	5 Years
Supplemental Fund:				
Income Share Account	\$ 575 M	21.7%	20.2%	16.0%
TUCS Median Fund		17.9%	18.5%	14.8%
Growth Share Account	\$ 278 M	31.2%	28.6%	21.3%
TUCS Median Stock Pool		25.9%	27.2%	21.2%
Common Stock Index Account	\$ 212 M	29.4%	28.2%	21.8%
Wilshire 5000 Stock Index		28.9%	28.1%	21.5%
International Share Account	\$ 14 M	1.1%	11.8%	8.6%
EAFE Index		-1.1%	8.3%	6.0%
Bond Market Account	\$ 35 M	11.0%	8.5%	7.2%
Lehman Aggregate		10.5%	7.9%	6.9%
Money Market Account	\$ 47 M	5.8%	5.7%	5.2%
91 Day Treasury Bills		5.3%	5.3%	4.9%
Fixed Interest Account	\$ 75 M	6.5%	6.6%	6.7%

The Supplemental Investment Fund is an investment vehicle available to a wide range of state and local public employee groups for retirement related purposes. The largest participants in the Fund are the Deferred Compensation Plan and the Unclassified Employees Retirement Plan.

Overall, fiscal year 1998 was a strong year for the Fund. All investment accounts exceeded their performance targets for the year.

Over the last 3 and 5 year periods, all accounts in the Supplemental Investment Fund have met or exceeded their targets.

The Fixed Interest Account utilizes investments in guaranteed investment contracts (GIC's) available through insurance companies and banks.

**Permanent School Trust Fund**  
**Market Value on 6/30/98: \$ 500 Million**

	Period Ending 6/30/98		
	1 Year	3 Years	5 Years
Permanent School	17.8%	10.4%	8.3%
Market composite	16.9%	9.9%	8.1%

The Permanent School Trust Fund is a trust established for the benefit of Minnesota public schools. Income from the Trust is used to offset state expenditures for school aid payments. The investment objective of the Permanent School Fund is to produce a growing level of spendable income, within the constraints of maintaining adequate portfolio quality and liquidity.

Effective with FY 1998 the Permanent School Fund is invested in a balanced portfolio of common stocks and bonds. Common stocks provide the potential for significant capital appreciation, while bonds provide portfolio diversification and a more stable stream of current income.

Prior to FY 1998, the Fund was invested entirely in fixed income securities in order to maximize current income. It is understood that the change in asset mix will reduce portfolio income in the short term, but will enhance the value of the fund, over time.

**Environmental Trust Fund**  
**Market Value on 6/30/98: \$ 236 Million**

	Period Ending 6/30/98		
	1 Year	3 Years	5 Years
Environmental Trust Fund	21.2%	19.0%	14.9%
Composite	20.2%	18.7%	14.7%

The Environmental Trust Fund is to be used to supplement traditional sources of funding for environmental and natural resource activity. The Trust will receive a portion of the net lottery proceeds until 2001.

The SBI added stocks to the portfolio during fiscal year 1994. Currently, the asset mix of the Trust is targeted at 50% common stocks and 50% fixed income to provide for long term growth.

**Assigned Risk Plan**  
**Market Value on 6/30/98: \$ 694 Million**

	Period Ending 6/30/98		
	1 Year	3 Years	5 Years
Assigned Risk Plan	\$ 694	13.3%	12.6%
Market composite		12.4%	11.5%

The Minnesota Assigned Risk Plan is the insurer of last resort for Minnesota companies seeking workers compensation insurance. The Plan is administered by the Dept. of Commerce. Investment management responsibility for the assets of the plan was transferred to the SBI by the Legislature in May 1991.

The investment goals of the Plan are to match the projected liability/payment stream and to provide sufficient liquidity/cash for payment of claims and operating expenses. Due to the relatively short duration of the liability stream, the asset mix of the plan was 20% stocks and 80% bonds during fiscal year 1998. This allocation is reviewed annually upon receipt of new actuarial valuations and will be changed to reflect changes in plan liabilities.

State Cash Accounts

Market Value on 6/30/98: \$ 5,974 Million

		Period Ending 6/30/98		
		1 Year	3 Years	5 Years
Treasurer's Pool	\$5,921	5.9%	5.7%	5.2%
Trust Pool	\$ 53	5.8%	5.7%	5.3%
91 day T-bill		5.3%	5.3%	4.9%

The SBI invests the cash balances in more than 400 separate accounts in the Minnesota State Treasury. These accounts range in size from \$5,000 to over \$400 million.

Most of these accounts are invested through two pooled funds.

1. The Trust Fund Pool holds cash balances of retirement related accounts managed internally and cash balances in the Permanent School Fund.
2. The Treasurer's Cash Pool holds the cash balances of special or dedicated accounts necessary for the operation of certain State agencies and the balances of the Invested Treasurer's Cash.

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

All state cash accounts are managed by the SBI investment staff.

## ATTACHMENT E

Date: August 1998

**POSITION DESCRIPTION:** Executive Director  
Minnesota State Board of Investment

### **POSITION PURPOSE:**

The position is created by Minnesota Statutes Section 11A.07. The Executive Director is appointed by and reports directly to the Minnesota State Board of Investment (SBI).

The individual is responsible for the implementation, administration and review of the investment policies determined by the SBI. This involves directing the activities of an internal staff and external asset managers and communicating information to the SBI, Minnesota State Legislature, pension fund trustees, the Investment Advisory council (IAC) and others.

The objective of the Executive Director is to meet or exceed the goals for return on assets required to satisfy, with prudent risk, the purposes of the funds for which the SBI is responsible.

### **DUTIES AND RESPONSIBILITIES:**

#### **A. Development of Investment Policies**

1. Develop and recommend investment policies that meet the need of each fund controlled by the SBI. The policies shall address:
  - a. Risk tolerance.
  - b. Long term investment objectives.
  - c. Long term asset allocation strategy.
  - d. Asset class targets.
  - e. Performance standards for the total fund, asset class segments, and individual managers.
  - f. Re-balancing strategy.
2. Develop and recommend an appropriate investment management structure for each fund that meets the investment policies outlined above. This shall consider:
  - a. Mix of active and passive management.
  - b. Use of internal or external managers.
  - c. Types of investment vehicles (e.g., publicly traded securities, private placements, commingled funds, limited partnerships).
  - d. Custody relationships.
  - e. Brokerage relationships.



3. Assess developments within the financial markets that may positively or negatively affect the ability of the funds to meet their long term goals/liabilities. Where appropriate, recommend modifications to the SBI's statutory authority or investment policies that take these developments into account and seek approval for those changes.

#### **B. Implementation of Investment Policies Approved by the SBI**

1. Develop appropriate procedures for selecting investment managers, custodians and consultants necessary to implement the SBI's investment plan for each fund.
2. Ensure that applicable policies are communicated to each internal and external investment manager retained by the SBI.
3. Allocate and re-balance assets and contributions among the investment managers for each fund on an on-going basis.

#### **C. Review and Control of Investment Policies**

1. Assure that investment policies are regularly reviewed by the SBI.
2. Evaluate the performance of each fund relative to the policies established by the SBI and recommend corrective action, where appropriate.
3. Monitor the activities of internal and external investment managers to ensure they adhere to established policies.
4. Develop and administer systems to evaluate the performance of individual investment managers retained by the SBI.

#### **D. Administration and Management Staff Operations**

1. Prepare the SBI's biennial budget within guidelines established by the Department of Finance, present the budget to the SBI for review, seek legislative approval of the SBI's budget request and manage its execution.
2. Prepare an annual management and budget plan for the SBI's review and approval and manage its execution.
3. Retain, supervise, and evaluate all SBI staff and, when necessary, discipline and terminate employees. Staff compensation is governed by applicable contracts and plans established by the Department of Employee Relations.
4. Negotiate favorable terms with contractors and vendors for goods and services. Contractual relationships are governed by the applicable law and the rules of the Department of Administration.

5. Maintain accurate and complete records of all financial transactions and official activities of the SBI.
6. Apportion actual expenses among the funds managed by the SBI according to statutory requirements.

#### **E. Communication and Reporting**

1. Prepare quarterly reports on investment results and the status of the management and budget plan for review by the SBI, the IAC and the SBI's consultant.
2. Meet with the SBI and the IAC on a quarterly basis and at other times as required.
3. Prepare the SBI's annual report. Financial statements shall be prepared according to generally accepted accounting principles.
4. Meet with pension fund trustees and other clientele whose assets are managed by the SBI on a regular basis, or as requested, concerning the SBI's activities and investment performance.
5. Meet with representatives of the local and national financial community.
6. Testify before legislative committees as required. Meet with legislators as needed to discuss issues of importance to the SBI.
7. Respond promptly to special requests for information from the SBI, Legislature, pension funds, IAC and other interested parties, including the press.
8. Provide educational forums for the SBI and others, in conjunction with the IAC and the SBI's consultant, concerning investment issues and policy alternatives.
9. Plan and conduct conferences or seminars for the SBI or its clientele annually or as requested by the SBI.
10. Prepare other reports as requested by the SBI or required by the Legislature or by law.

## **APPROXIMATE ALLOCATION OF TIME**

1. Development of Investment Policies	15%
2. Implementation of Investment Policies	15%
3. Review and Control of Investment Policies	20%
4. Administration and Management of Staff Operations	20%
5. Communication and Reporting	<u>30%</u>
	100%

# Tab D

## COMMITTEE REPORT

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DATE: August 25, 1998

TO: Members, State Board of Investment

FROM: Proxy Committee

**SUBJECT: Update of Board Proxy Voting Guidelines**

At its August 17, 1998 meeting, the Proxy Committee reviewed the Board's Proxy Voting Guidelines. The Committee approved two changes:

- addition of language to reflect activity with respect to sponsoring, cosponsoring and voting shareholder resolutions concerning tobacco related issues
- amending the language concerning the review of corporate governance initiatives at Minnesota companies to better reflect Committee practice.

These changes are reflected in the attached Guidelines, originally adopted by the Board in September 1990.

### **RECOMMENDATION:**

**The Proxy Committee recommends the Board approve the revised Proxy Voting Guidelines.**

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## **Proxy Voting Guidelines**

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

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

### **Overview of the SBI**

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

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

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

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

### **Statutory Purpose**

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

### **Fiduciary Responsibility**

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

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

**Voting  
Process**

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

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

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

International voting: The SBI 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.



**Shareholder Rights**

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

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

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

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

**Executive Compensation**

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

**Buyouts**

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

**Special Cases**

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

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

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

**Social Responsibility Issues**

**Tobacco**

In general, the SBI **supports** resolutions to reduce youth access to tobacco products, to request companies to voluntarily comply with FDA regulations, to eliminate smoking in restaurants, and other related issues.

In addition to casting proxy votes, the SBI sponsors and co-sponsors tobacco resolutions on these subjects.

**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.

## MINNESOTA STATE BOARD OF INVESTMENT

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### **South Africa**

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

### **Other Issues**

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

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

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1 *Minnesota Statutes* 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: August 25, 1998

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

FROM: Domestic Manager Committee

The Domestic Manager Committee met on August 14, 1998 to consider the following agenda items:

- Review of manager performance for the period ending June 30, 1998.
- Review of short-term commercial paper issuers.
- Re-interview of Investment Advisers, Inc. and Wilke/Thompson Capital Mgmt. Inc.
- Discussion of SBI's actions related to restrictions on investment in tobacco related companies.

Action is requested by the SBI/IAC on the third item.

### INFORMATION ITEMS:

1. Review of manager performance for the period ending June 30, 1998.

- *Stock Managers*

For the period ending June 30, 1998, the domestic stock manager program outperformed its aggregate benchmark and the Wilshire 5000 for the quarter and for the latest one-year and three year periods. The current managers outperformed the benchmark and the Wilshire 5000 for the quarter and for the latest one year, three year, and five-year periods.

Time period	Total Program	Wilshire 5000*	Current Mgrs. Only	Aggregate Benchmark
Quarter	2.2%	1.6%	2.2%	1.6%
1 Year	30.6	28.6	30.6	28.5
3 Years	28.7	27.9	29.2	28.0
5 Years	21.5	21.6	22.2	21.9

\* Adjusted for SBI's restrictions, as appropriate.

The performance evaluation reports for the stock managers start on the first "blue page" of this Tab.

- **Bond Managers**

For the period ending June 30, 1998, the **bond manager program** and **current managers** outperformed the Lehman Aggregate and the aggregate benchmark for the quarter, and for the latest one year, three year, and five year periods.

Time period	Total Program	Lehman Aggregate*
Quarter	2.3%	2.3%
1 Year	11.0	10.5
3 Years	8.5	7.9
5 Years	7.3	6.9

Current Mgrs. Only	Aggregate Benchmark
2.3%	2.3%
11.0	10.5
8.5	7.9
7.3	6.9

\* Reflects Salomon BIG index prior to 7/94.

The performance evaluation reports for the bond managers start on the **third "blue page"** of this Tab.

## 2. Review of short-term commercial paper issuers.

Staff conducts an annual review of domestic and foreign commercial paper issuers. The analysis looks at short-term and long-term credit ratings, the average value of commercial paper outstanding with each firm, and whether there are any supporting entities. The purpose of the review is to identify a list of eligible issuers that may be included in the short-term state cash accounts managed internally.

A summary of eligible commercial paper issuers is included beginning on **page 5** of this tab.

## ACTION ITEMS:

### 3. Re-interview of Investment Advisers and Wilke/Thompson.

In August 1997, Investment Advisers (IAI) and Wilke/Thompson (W/T) were re-interviewed by the Domestic Manager Committee. At the June 1998 meeting, the Committee requested follow-up meetings with these two managers. These meetings took place as part of the Domestic Manager Committee meeting held on August 14, 1998.

Staff's comments and Committee discussions on the firms can be summarized as follows:

- ◆ The SBI retained IAI to manage a Regional Fund in July 1993. At this time, the concerns with IAI are both quantitative and qualitative. Assets at the firm have declined from \$17 billion in 1997 to \$8 billion as of June 1998. Significant

turnover in the equity organization over the last 18 months has left the firm with staffing issues that the Committee believes are impacting the investment process. While the equity team has made changes to the benchmark twice in the past eighteen months, performance relative to the benchmark continues to lag. Attribution analysis indicates that poor stock selection has been a major contributing factor in their under-performance. For these reasons, the Committee voted to terminate the contractual relationship with IAI for equity investment management services.

- ◆ **Wilke/Thompson** was retained by the SBI in April 1994. At this time, there are no organizational issues, however performance has been a concern of the Committee. Wilke/Thompson manages a small cap portfolio of high quality growth companies that is likely to experience a substantial amount of volatility relative to the benchmark at times significantly under or out performing. For the past year, the return of the portfolio has exceeded the returns of the benchmark. The Committee voted to retain the investment services of Wilke/Thompson, but to continue monitoring their stock selection capabilities.

Additional information on each firm begins on **page 15**.

#### **RECOMMENDATION:**

**The Committee recommends that the SBI terminate its contractual relationship with Investment Advisers, Inc. for equity investment management services.**

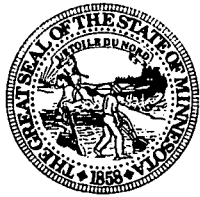
#### **4. Discussion of SBI's actions related to restrictions on investment in tobacco related companies.**

Members of the Domestic Manager Committee discussed the tobacco-related actions taken by the Board at the June 1998 meeting. The Committee prepared a recommendation to the Board found on **page 25**.

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**MINNESOTA  
STATE  
BOARD OF  
INVESTMENT**



**Board Members:**

Governor  
Arne H. Carlson

State Auditor  
Judi Dutcher

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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55 Sherburne Avenue  
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DATE: August 7, 1998

TO: Members, Domestic Manager Committee

FROM: John Kinne 

SUBJECT: **Short-Term Commercial Paper Review**

Annually, staff performs an evaluation of domestic and foreign commercial paper issuers. This review results in a list of eligible issuers appropriate for inclusion in the short-term state cash accounts managed internally.

Attached is a copy of the eligible commercial paper issuers.



# MINNESOTA STATE BOARD OF INVESTMENT

## STATE OF MINNESOTA

DOMESTIC & FOREIGN COMMERCIAL PAPER ANALYSIS

April 1998 Report

(Revised/Updated July 1998)

ISSUER	Short-Term Ratings					Long-Term Ratings					QTR AVG OUTSTANDING	INVESTMENT LIMIT	SUPPORTING ENTITY	NATURE OF SUPPORT
	DEALERS	S&P	Midy's	Fitch	Diff	S&P	Midy's	Fitch	Diff					
Abbey National PLC **	MUL	A-1+	P-1	F-1+	NR	AA	Aa2	AA	NR		\$0	Own Operations	Own Operations	
Abbey National N. A. Corp	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR		\$3,608,000,000	\$100,000,000	Abbey National PLC	Guarantee
ABN Amro Bank NV **	MUL	A-1+	P-1	F-1+	NR	AA	Aa1	AA+	NR		\$0	Own Operations	Own Operations	
ABN Amro N.A. Finance Inc.	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR		\$3,562,000,000	\$100,000,000	ABN Amro Bank NV	Guarantee
A. I. Credit Corporation	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR		\$861,000,000	\$86,100,000	American Int'l. Group, Inc.	Operating Agreement
AIG Funding Inc.	MUL	A-1+	P-1	NR	NR	AAA	Aaa	NR	NR		\$425,000,000	\$42,500,000	American Int'l. Group, Inc.	Guarantee
Air Products & Chemical, Inc.	MUL	A-1	P-1	NR	NR	A	A2	NR	NR		\$180,000,000	\$18,000,000	Own Operations	Own Operations
Alfa Corporation *	GS	A-1+	P-1	NR	NR	NR	NR	NR	NR		\$66,000,000	\$6,600,000	Alfa Mutual Insurance Co.	Guarantee
Allied Signal, Incorporated	MUL	A-1	P-1	F-1	D-1	A	A2	A+	A+		\$1,130,000,000	\$100,000,000	Guarantor S & P Outlook: No Outstanding Debt/Not Rated	Own Operations
Allstate Corp. (The) *	MUL	A-1	P-1	NR	NR	A+	A1	NR	NR		\$204,000,000	\$20,400,000	Own Operations	Own Operations
American Express Credit Corp.	DIR	A-1	P-1	NR	D1+	A+	A1	NR	AA-		\$14,377,000,000	\$100,000,000	American Express Company	Operating Agreement
American General Corp. *	DIR	A1+	P-1	F-1+	D-1+	AA-	A2	NR	AA-		\$2,715,000,000	\$100,000,000	Own Operations	Own Operations
American General Finance	DIR	A-1	P-1	F1+	D1+	A-	A2	NR	A+		\$2,063,000,000	\$100,000,000	Own Operations	Own Operations
American Home Products *	MUL	A-1	P-1	NR	D-1	A	A2	NR	A		\$1,550,000,000	\$100,000,000	Own Operations	Own Operations
American International Group **	N/A	A-1+	NR	F-1+	NR	AAA	Aaa	AAA	NR		\$0	\$0	Own Operations	Own Operations
Archer Daniels Midland *	MUL	A-1+	P-1	NR	NR	AA-	Aa3	NR	NR		\$1,146,000,000	\$100,000,000	Own Operations	Own Operations
Associates First Capital Corp. *	DIR	A-1	P-1	F-1+	D-1	A+	A1	A+	A+		\$1,348,000,000	\$100,000,000	Associates Corp. Of NA	Guarantee
Associates Corp. of No. America	DIR	A-1+	P-1	F-1+	D-1+	AA-	Aa3	AA	AA-		\$17,676,000,000	\$100,000,000	Own Operations	Own Operations
Atlantic Richfield. Co.	MUL	A-1	P-1	NR	NR	A	A2	NR	NR		\$58,800,000	\$5,880,000	Own Operations	Own Operations
Australia, Commonwealth of	MUL	NR	NR	NR	NR	AAA	Aa2	NR	NR		\$0	\$0	Own Operations	Own Operations
Australian Wheat Board	MUL	A-1+	P-1	NR	NR	AA	Aa2	NR	NR		\$812,000,000	\$81,200,000	Australian Government	Guarantee
AYCO Financial Services, Inc.	MUL	A-1	P-1	F-1	NR	A	A2	A+	NR		\$1,700,000,000	\$100,000,000	Own Operations	Own Operations
Baker Hughes *	MUL	A-1	P-1	NR	NR	A	A2	NR	NR		\$162,000,000	\$16,200,000	Own Operations	Own Operations
Bank of New York Corp., Inc.	DIR	A-1	P-1	F-1+	D-1	A+	A1	AA	A		\$848,000,000	\$84,800,000	Own Operations	Own Operations
BankAmerica Corporation	BSI	A-1	P-1	F-1+	D-1	A+	Aa3	AA-	A+		\$815,000,000	\$81,500,000	Own Operations	Own Operations
Bayer Corp.	MUL	A-1+	P-1	NR	NR	AA	Aa2	NR	NR		\$647,000,000	\$64,700,000	Own Operations	Own Operations
Becton Dickinson & Co.	GMM	A-1	P-1	NR	NR	A+	A1	NR	NR		\$72,000,000	\$7,200,000	Own Operations	Own Operations

ISSUER	Short-Term Ratings										Long-Term Ratings										CTR AVG	OUTSTANDING	INVESTMENT LIMIT	SUPPORTING ENTITY	NATURE OF SUPPORT
	DEALERS	S&P	Mdy's	Fitch	Duff	S&P	Mdy's	Fitch	Duff	Outlook	S&P	Mdy's	Fitch	Duff	Outlook	Outstanding	Investment Limit	Supporting Entity	Nature of Support						
Bell Atlantic Financial Services	MUL	A-1	P-1	NR	NR	D-1 +	A +	A1	NR	A +						\$3,646,000,000	\$100,000,000	Bell Atlantic Corporation	Operating Agreement						
Bemis Company, Inc.	GMM	S & P Outlook: STABLE														\$185,000,000	\$18,500,000	Review before purchase.	Own Operations						
Bestfoods	MUL	A-1	P-1	NR	NR	D-1	A +	A2	NR	A +						\$479,000,000	\$47,900,000	Own Operations	Own Operations						
Campbell Soup Co. *	MUL	A-1	P-1	NR	NR	NR	AA-	Aa3	NR	NR						\$1,606,000,000	\$100,000,000	Formerly known as CPC International Inc.	Own Operations						
Canada Bills	MUL	A-1 +	P-1	F-1 +	NR	NR	AA +	Aa2	AA	NR						N/A	N/A	Government of Canada	Direct Obligation						
Canadian Imperial Bank **	MUL	A-1	P-1	F-1 +	NR	NR	AA +	Aa3	AA	NR						\$0	\$0	Own Operations	Own Operations						
Canadian Imperial Holdings	MUL	A-1 +	P-1	F-1 +	NR	NR	AA-	NR	NR	NR						\$2,642,000	SBI Comments: Ratings Affirmed, Stable after merger,	Canadian Imperial Bank	Toronto Dominion						
Canadian Wheat Board	MUL	A-1 +	P-1	NR	NR	NR	AA +	Aa2	NR	NR						N/A	N/A	Government of Canada	Guarantee						
Cargill Financial Services Corp.	MUL	A-1 +	P-1	NR	NR	NR	NR	NR	NR	NR						\$742,000,000	\$74,200,000	Cargill Incorporated	Direct Obligation						
Cargill Global Funding PLC *	MUL	A-1 +	P-1	NR	NR	NR	NR	NR	NR	NR						\$136,000,000	\$13,600,000	Cargill Incorporated in this report.	Operating Agreement						
Cargill Incorporated	MUL	A-1 +	P-1	NR	NR	NR	NR	NR	NR	NR						\$2,023,000,000	\$100,000,000	Cargill Incorporated in this report.	Guarantee						
Caterpillar Financial Service Corp. *	MUL	A-1	P-1	NR	NR	D-1	A +	A2	NR	NR						\$1,290,000,000	\$100,000,000	Own Operations	Own Operations						
Caterpillar Inc.	MUL	A-1	P-1	NR	NR	NR	NR	NR	NR	NR						\$1,290,000,000	\$100,000,000	Own Operations	Operating Agreement						
Chevron Oil Finance Company	DIR	A-1 +	P-1	NR	NR	NR	AA	NR	NR	NR						\$1,942,000,000	\$100,000,000	Chevron Corporation	Guarantee						
Chevron Transport Corporation *	DIR	A-1 +	P-1	NR	NR	NR	AA	NR	NR	NR						\$466,000,000	\$46,600,000	Guarantor S & P Outlook: STABLE	Guarantee						
Chevron UK Investment PLC	DIR	A-1 +	P-1	NR	NR	NR	NR	NR	NR	NR						\$335,000,000	\$33,500,000	Chevron Corporation	Guarantee						
Chicago, University of	FCC	A-1 +	P-1	NR	NR	NR	NR	NR	NR	NR						\$43,000,000	\$4,300,000	Chevron USA	Guarantee						
CIT Group Holdings, Inc.	DIR	A-1	P-1	NR	NR	NOT AVAILABLE	A +	Aa3	NR	AA-						\$4,959,000,000	\$100,000,000	Own Operations	Own Operations						
Citizens Utilities Company	MUL	A-1 +	P-1	F-1 +	NR	D1 +	AA +	Aa3	AA +	NR						\$77,000,000	\$7,700,000	Own Operations	Own Operations						
Coca-Cola Company	MUL	A-1 +	P-1	F-1	NR	NR	AA	Aa3	NR	NR						\$2,305,000,000	\$100,000,000	Review before purchase.	Own Operations						
Colgate-Palmolive Company	MUL	A-1	P-1	NR	NR	NR	A	A1	NR	NR						\$349,000,000	\$34,900,000	Own Operations	Own Operations						
Colonial Piping Company *	MUL	A-1 +	P-1	NR	NR	NR	AA-	A1	NR	NR						\$270,000,000	\$27,000,000	9 Major Oil Companys	Agreements						
Commercial Credit Corp.	DIR	A-1	P-1	F-1 +	NR	D-1	A +	A1	A	A +						\$3,175,000,000	\$100,000,000	Own Operations	Own Operations						
Commerzbank AG **	LCP	A-1 +	P-1	F-1 +	NR	NR	AA-	Aa3	AA-	NR						\$0	\$0	Own Operations	Own Operations						
Commerzbank US Finance	MUL	A-1 +	P-1	NR	NR	NR	AA-	Aa3	NR	NR						\$1,072,000,000	\$100,000,000	Commerzbank AG	Guarantee						
Commloco, Inc.	DIR	A-1	P-1	NR	NR	D-1 +	NR	NR	NR	NR						\$241,000,000	\$24,100,000	American Gen. Finance Group	Guarantee						
Consolidation Coal Co.	JPM	A-1	P-1	NR	NR	NR	A-	A2	NR	NR						\$42,000,000	\$4,200,000	Own Operations	Own Operations						
Corestates Capital Corp. *	DIR	A-1 +	P-1	NR	NR	DEVELOPING (possible divestiture of DuPont hldgs.)	A	A1	NR	A +						\$1,035,000,000	\$100,000,000	Review before purchase.	Own Operations						
CSW Credit, Inc. *	MUL	A-1	P-1	NR	NR	D-1 +	NR	NR	NR	NR						\$761,000,000	\$76,100,000	Guarantor S & P Outlook: POSITIVE	Guarantee						
Daimler Benz N. America	MUL	A-1	P-1	NR	NR	NR	A +	A1	NR	NR						\$5,266,000,000	\$100,000,000	Central & So West Corp.	Installment Sales Agreement						
Deere & Company	MUL	A-1	P-1	F-1	NR	NR	A-	A2	A	NR						\$57,000,000	\$5,700,000	Own Operations	Own Operations						
Deere & Company	MUL	S & P Outlook: STABLE														\$57,000,000	\$5,700,000	S&P long-term outlook negative (acquisitions).	Own Operations						

ISSUER	Short-Term Ratings					Long-Term Ratings					QTR/AVG OUTSTANDING	INVESTMENT LIMIT	SUPPORTING ENTITY	NATURE OF SUPPORT
	DEALERS	S&P	Midy's	Fitch	Duff	S&P	Midy's	Fitch	Duff					
Deere, John Capital Corp.	MUL	A-1	P-1	F-1	D-1	A	A2	A	A	\$2,102,000,000	\$100,000,000	Deere & Co.	Operating Agreement	
Deutsche Bank AG **	MLM	A-1+	P-1	F-1+	NR	AAA	Aa1	AA+	NR	\$0	\$0	Own Operations	Own Operations	
Deutsche Bank Financial	MUL	A-1+	P-1	NR	NR	AAA	Aa1	NR	NR	\$2,583,000	\$258,300	Deutsche Bank AG	Guarantee	
Donnelly (R. R.) & Sons Co. *	MUL	A-1	P-1	NR	NR	A+	A1	NR	NR	\$312,000,000	\$31,200,000	Own Operations	Own Operations	
Dow Chemical *	MUL	A-1	P-1	NR	NR	A	A1	NR	A+	\$737,000,000	\$73,700,000	Own Operations	Own Operations	
Dresdner Bank AG **	DIR	A-1+	P-1	F-1+	NR	AA	Aa1	AA+	NR	\$0	\$0	Own Operations	Own Operations	
Dresdner US Financial	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$2,146,000,000	\$100,000,000	Dresdner Bank AG	Support Agreement	
duPont, E. I. deNemours & Co.	MUL	A-1+	P-1	NR	NR	AA-	Aa3	NR	NR	\$5,596,000,000	\$100,000,000	Own Operations	Own Operations	
Eaton Corporation	MUL	A-1	P-1	NR	NR	A	A2	NR	NR	\$532,000,000	\$53,200,000	Own Operations	Own Operations	
Edison International *	MUL	A-1	P-1	NR	NR	D-1	NR	NR	NR	\$684,000,000	\$68,400,000	Own Operations	Own Operations	
Eksporffinas A/S	MUL	A-1+	P-1	NR	NR	AAA	Aa2	NR	NR	\$1,447,000,000	\$100,000,000	Own Operations	Own Operations	
Electronic Data Systems Corp.	MUL	A-1	P-1	F-1+	D-1	A+	A1	AA-	AA-	\$418,000,000	\$41,800,000	Own Operations	Own Operations	
Eli Lilly & Company	MS	A-1+	P-1	NR	NR	AA	Aa3	NR	NR	\$2,278,000,000	\$100,000,000	Own Operations	Own Operations	
Export Finance & Inds.	MUL	A-1+	P-1	NR	NR	AA	Aa2	NR	NR	\$216,000,000	\$21,600,000	Gov't. of Australia	Guarantee	
Exxon Asset Management Co.	DIR	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$804,000,000	\$80,400,000	21 Major US & Int'l Banks	Credit Agreements	
Exxon Imperial USA, Inc. *	MUL	A-1	P-1	NR	NR	NR	NR	NR	NR	\$607,000,000	\$60,700,000	Exxon Corporation	Guarantee	
First Chicago Financial Corp. *	FCC	A-1	P-1	NR	NR	NR	NR	NR	NR	\$948,000,000	\$94,800,000	First Chicago NBD Corp.	Guarantee	
First Data Corp. *	MUL	A-1	P-1	F-1	NR	A	A2	NR	NR	\$587,000,000	\$58,700,000	Own Operations	Own Operations	
First Union Corporation	MUL	A-1	P-1	F-1	D-1	A	A1	A+	A	\$7,800,000,000	\$100,000,000	Own Operations	Own Operations	
Florida Power & Light Co.	MUL	A-1+	P-1	NR	NR	AA-	Aa3	NR	NR	\$16,000,000	\$1,600,000	Own Operations	Own Operations	
Ford Credit Europe PLC (FCE Bank)	DIR	A-1	P-1	F-1	D-1	A	A1	NR	NR	\$1,000,000,000	\$100,000,000	Own Operations	Own Operations	
Ford Motor Credit Company	DIR	A-1	P-1	F-1	D-1	A	A1	A+	A	\$29,000,000,000	\$100,000,000	Ford Motor Co.	Operating Agreement	
Ford Motor Creditof PR*	DIR	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$542,000,000	\$54,200,000	Ford Motor Credit Co.	Guarantee	
General Electric Capital Corp.	MUL	A-1+	P-1	NR	NR	AAA	Aaa	AAA	NR	\$59,472,000,000	\$100,000,000	General Electric Co.	Affiliation, No Support	
General Electric Capital Services Corp.	DIR	A-1+	P-1	NR	NR	AAA	Aa1	NR	NR	\$3,287,000,000	\$100,000,000	General Electric Co.	Affiliation, No Support	
General Electric Co.	DIR	A-1+	P-1	NR	NR	AAA	Aaa	NR	NR	\$5,235,000,000	\$100,000,000	Own Operations	Own Operations	
General Motors Accept. Corp.*	DIR	A-1+	P-1	D-1	F-1	A	A3	A	A-	\$25,048,000,000	\$100,000,000	General Motors Corporation	Affiliation, No Support	
Gillette Company	MUL	A-1+	P-1	NR	NR	AA	Aa3	NR	NR	\$531,000,000	\$53,100,000	Own Operations	Own Operations	
Great Lakes Chemical Corp.	MUL	A-1+	P-1	NR	NR	AA-	A2	NR	NR	\$531,000,000	\$53,100,000	Own Operations	Own Operations	

ISSUER	Short-Term Ratings				Long-Term Ratings				QTR AVG OUTSTANDING	INVESTMENT LIMIT	SUPPORTING ENTITY	NATURE OF SUPPORT	
	DEALERS	S&P	Mdy's	Fitch	Duff	S&P	Mdy's	Fitch					Duff
Great West Life & Annuity Ins.	DIR	A-1	P-1	NR	NR	AA+	Aa2	NR	NR	\$59,000,000	Own Operations	Own Operations	
Guardian Industries Corp.	MUL	S & P Outlook: STABLE											
Harvard University	MUL	A-1	P-1	NR	NR	A+	A1	NR	NR	\$1,600,000,000	Own Operations	Own Operations	
Hasbro, Inc.	MUL	A-1+	P-1	NR	NR	AAA	Aaa	NR	NR	\$124,000,000	Own Operations	Own Operations	
Hewlett-Packard Company	MUL	S & P Outlook: CURRENTLY NOT AVAILABLE											
H. J. Heinz Company	MUL	A-1	P-1	NR	NR	A	A2	NR	NR	\$262,000,000	Own Operations	Own Operations	
Household Finance Corp.	MUL	S & P Outlook: STABLE											
Hubbell Incorporated	MUL	A-1+	P-1	NR	NR	AA+	Aa2	NR	NR	\$193,000,000	Own Operations	Own Operations	
IBM Corporation	DIR	A-1	P-1	NR	NR	A+	A1	NR	NR	\$1,904,000,000	Own Operations	Own Operations	
IBM Credit Corporation	DIR	S & P Outlook: STABLE											
Imperial Oil Co. **	MUL	A-1	P-1	F-1	D-1+	A	A2	A+	A+	\$5,600,000,000	Household International, Inc.	Guarantee	
Intel Corporation	MUL	S & P Outlook: NEGATIVE/CREDIT WATCH (Acquisition activity)											
Island Finance Puerto Rico Inc.	MUL	A-1+	P-1	NR	NR	AA-	A2	AA-	NR	\$5,000,000	SBI Comments: Review before purchase.	Own Operations	
John Hancock Capital Corp.*	MUL	S & P Outlook: STABLE											
Kellogg Company	MUL	A-1	P-1	F-1+	D-1	A+	A1	AA-	NR	\$527,000,000	Own Operations	Own Operations	
Koch Industries, Inc.	MUL	S & P Outlook: STABLE											
McGraw-Hill Co. (The)	MUL	A-1	P-1	NR	NR	A+	A1	AA-	A+	\$4,178,000,000	IBM Corporation	Operating Agreement	
Mellon Financial Company	MUL	A-1+	P-1	NR	NR	AA+	Aa2	NR	NR	\$0	\$0	Own Operations	70% owned by Exxon Corp.
Merck & Co, Inc.	MUL	S & P Outlook: STABLE											Own Operations
Minnesota Mining & Mfg Co.*	MUL	A-1+	P-1	NR	NR	A+	A1	AA-	NR	\$100,000,000	Own Operations	Own Operations	
Monsanto Company	MUL	A-1	P-1	NR	NR	AA	Aa1	NR	NR	\$705,000,000	Norwest Corporation	Support Agreement	
Montreal, Bank of	MUL	S & P Outlook: STABLE											Own Operations
Morgan, J.P. & Co., Inc.	MUL	A-1+	P-1	NR	NR	AA+	Aa2	NR	NR	\$302,000,000	SBI Comments: Review before purchase.	Operating Agreement	
Nestle Capital Corp.	MUL	A-1	P-1	NR	NR	AA	Aa1	NR	NR	\$717,000,000	SBI Comments: Review before purchase.	Operating Agreement	
Nestle NA **	MUL	S & P Outlook: NEGATIVE (Higher investment credit risk profile.)											Own Operations
National Rural Utilities CFC	LCP	A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$3,482,000,000	Own Operations	Own Operations	
NationsBank Corporation	DIR	S & P Outlook: STABLE											Own Operations
New England Power Co.	MUL	A-1	P-1	NR	NR	AA	Aa1	NR	NR	\$40,000,000	Own Operations	Own Operations	
Northern States Pwr Co. (MN)	MUL	A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$7,000,000	Mellon Bank Corp.	Guarantee	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$41,400,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$99,400,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$100,000,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$92,200,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$100,000,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$92,200,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$100,000,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$30,200,000	Nestle NA	Guarantee	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$0	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$100,000,000	Gov't. REA supplm't loan program	Gov't. REA supplm't loan progr.	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$100,000,000	Own Operations	Own Operations	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$96,000,000	New England Elec. System	Affiliation, No Support	
		A-1+	P-1	NR	NR	AA	Aa1	NR	NR	\$108,000,000	Own Operations	Own Operations	

ISSUER	Short-Term Ratings				Long-Term Ratings				QTR. AVG OUTSTANDING	INVESTMENT LIMIT	SUPPORTING ENTITY	NATURE OF SUPPORT
	DEALERS	S&P	Mdy's	Fitch	Duff	S&P	Mdy's	Fitch				
Northwestern University	FCC	A-1+	P-1	NR	NR	NR	NR	NR	\$50,000,000	\$5,000,000	Own Operations	Own Operations
Norwest Corp.	MUL	A-1+	P-1	F-1+	D-1+	AA-	Aa3	AA+	\$1,042,000,000	\$100,000,000	Own Operations	Own Operations
Norwest Financial, Inc.	DIR	A-1+	P-1	F-1+	D-1+	AA-	Aa3	AA+	\$1,754,000,000	\$100,000,000	Nonwest Corp	Affiliation, No Support
Novartis **	MUL	A-1+	P-1	NR	NR	NR	NR	NR	\$853,000,000	\$85,300,000	Novartis AG	Repurchase Agreement
Novartis AG	MUL	NR	NR	NR	NR	AAA	Aaa	NR	\$0	\$0	Own Operations	Own Operations
Old Republic Capital Corp.	MLM	A-1+	P-1	NR	NR	NR	NR	NR	\$16,000,000	\$1,600,000	Old Republic Int'l. Corp.	Guarantee
PACCAR Financial Corp.	MUL	A1+	P-1	NR	NR	AA-	A1	NR	\$660,000,000	\$66,000,000	PACCAR, Inc.	Operating Agreement
Pacific Gas & Electric Co.	MUL	A-1	P-1	NR	NR	A	A2	A	\$547,000,000	\$54,700,000	Own Operations	Own Operations
PepsiCo, Inc	MUL	A-1	P-1	NR	NR	A	A1	NR	\$283,000,000	\$28,300,000	Own Operations	Own Operations
Petrofina Delaware Inc.	MUL	A-1	P-1	NR	NR	NR	NR	NR	\$305,000,000	\$30,500,000	Petrofina SA	Guarantee
Petrofina SA **	MUL	A-1	P-1	NR	NR	A+	A1	NR	\$0	\$0	Own Operations	Own Operations
Pfizer Inc.	MUL	A-1+	P-1	NR	NR	AAA	Aaa	NR	\$1,278,000,000	\$100,000,000	Own Operations	Own Operations
Rabo Bank Nederland NV	MUL	A-1+	P-1	F-1+	NR	AAA	Aaa	NR	\$300,000,000	\$30,000,000	Own Operations	Own Operations
Repsol International Finance	MUL	A-1+	P-1	F-1+	NR	AA-	Aa3	AA-	\$395,000,000	\$39,500,000	Repsol SA	Guarantee
Repsol SA **	MLM	A-1+	P-1	NR	NR	AA-	Aa3	NR	\$0	\$0	Own Operations	Own Operations
PHH Corporation	MUL	A-1	P-1	F-1	NR	A+	A2	A+	\$3,280,000,000	\$100,000,000	Own Operations	Own Operations
Pitney Bowles Credit Corp. *	MUL	A-1	P-1	NR	NR	AA	Aa3	NR	\$1,468,000,000	\$100,000,000	Pitney Bowles, Inc.	Operating Agreement
PPG Industries	MUL	A-1	P-1	NR	NR	A	A1	NR	\$52,000,000	\$5,200,000	Own Operations	Own Operations
Private Export Funding *	MUL	A-1+	P-1	NR	NR	AAA	Aaa	NR	\$498,000,000	\$49,800,000	Export-Import Bank of US	Guarantee
Procter & Gamble Company *	GMM	A-1+	P-1	NR	NR	AA	Aa2	NR	\$3,436,000,000	\$100,000,000	Own Operations	Own Operations
Prudential Funding Corp.	MUL	A-1	P-1	NR	NR	A+	A2	NR	\$7,476,000,000	\$100,000,000	Prudential Insurance Co. of NA	Operating Agreement
Reed Elsevier, Inc.	MUL	A-1+	P-1	NR	NR	AA-	Aa3	NR	\$491,000,000	\$49,100,000	Reed International PLC	Guarantee
Relistar Mortgage Corporation	MLM	A1+	P1	NR	D1+	NR	NR	NR	\$220,000,000	\$22,000,000	Reliastar Life Insurance Co.	Guarantee
Republic New York Corp.	MUL	A-1+	P-1	F-1+	D-1+	AA	Aa3	AA	\$567,000,000	\$56,700,000	Own Operations	Own Operations
Rockwell, International Corp.	MUL	A-1+	P-1	NR	D-1+	AA-	A1	NR	\$67,000,000	\$6,700,000	Own Operations	Own Operations
Rohm & Haas Finance Co. *	MUL	A-1+	P-1	NR	NR	A	A1	NR	\$14,000,000	\$1,400,000	Rohm & Haas Company	Guarantee
Royal Bank of Canada	MUL	A-1+	P-1	F-1+	NR	AA-	Aa2	AA	\$1,045,000,000	\$100,000,000	Own Operations	Own Operations
Rubbermaid Incorporated	MUL	A-1	P-1	NR	NR	A	A2	NR	\$82,000,000	\$8,200,000	Own Operations	Own Operations
Schering Corporation	MUL	A-1+	P-1	NR	NR	AA	Aa3	NR	\$477,000,000	\$47,700,000	Schering-Plough Corporation	Guarantee
Sherwin-Williams Company	MUL	A-1	P-1	NR	NR	A1	A2	NR	\$191,000,000	\$19,100,000	Own Operations	Own Operations
Siemens A. G.	MUL	A-1+	P-1	NR	NR	AA+	Aa1	NR	\$1,666,000,000	\$100,000,000	Own Operations	Own Operations

ISSUER	Short-Term Ratings				Long-Term Ratings				QTR AVG OUTSTANDING	INVESTMENT LIMIT	SUPPORTING ENTITY	NATURE OF SUPPORT
	DEALERS	S&P	Mdy's	Fitch	Duff	S&P	Mdy's	Fitch				
Siemens Capital Corp.	MUL	A-1+	P-1	NR	NR	AA+	Aa1	NR	NR	\$983,000,000	Siemens A. G.	Guarantee
SmithKline Beechman Corp.	MUL	A-1+	P-1	NR	NR	AA-	Aa3	NR	NR	\$100,000,000	SmithKline Beechman PLC	Guarantee
Snap-On Incorporated	MLM	A-1+	P-1	NR	NR	AA	Aa3	NR	NR	\$95,000,000	Guarantor: No US Ratings	Own Operations
Societe Generale **	DIR	A-1+	P-1	NR	NR	AA-	Aa3	A	NR	\$0	Own Operations	Own Operations
Societe Generale N. Amer.	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$100,000,000	Societe Generale	Own Operations
Sonoco Products Company	MUL	A-1	P-1	NR	NR	A	A2	NR	NR	\$27,200,000	Own Operations	Guarantee
South Australia Gov't. Fin. Authority	MUL	A-1+	P-1	NR	NR	AA	Aa2	NR	NR	\$36,300,000	So. Australia Gov't.	Own Operations
Stanford University	BT	A-1+	P-1	NR	NR	AAA	Aaa	NR	NR	\$108,000,000	Guarantor: Australian State	Own Operations
Stanley Works (The)	MUL	A-1	P-1	NR	NR	A	A2	NR	NR	\$118,000,000	Own Operations	Own Operations
Swedish Export Credit Corp.	MUL	A-1+	P-1	NR	NR	AA+	Aa2	NR	NR	\$2,108,000,000	Own Operations	50% Owned by Swedish Govt.
Sweden, Kingdom of	MUL	A-1+	P-1	F-1+	NR	AA+	Aa2	AA-	NR	\$100,000,000	Swedish Gov't.	50% Owned by Swedish Govt.
TECO Finance Inc.	MUL	A-1+	P-1	NR	D-1+	AA-	A1	NR	AA	\$24,300,000	Teco Energy Inc.	Guarantee
Texaco Inc.	DIR	A-1	P-1	NR	NR	A+	A1	NR	A	\$45,000,000	Guarantor S & P Outlook: STABLE	Own Operations
Texas Agriculture Finance Auth. *	JPM	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$23,000,000	G.O. State of Texas	Guarantee
Toronto Dominion Bank **	MUL	A-1+	P-1	NR	NR	AA	Aa2	AA	NR	\$0	Guarantor State of Texas	Guarantee
Toronto Dominion Hldgs (USA)	MUL	A-1+	P-1	F-1+	NR	AA	Aa2	AA	NR	\$3,580,000,000	Own Operations	Own Operations
TransAmerica Corporation	MUL	A-1	P-1	NR	D-1	A	A	NR	A	\$111,000,000	SBI Comments: Moody's/S&P Watch Negative (Merger CIBC)	Own Operations
TransAmerica Finance Corp.	MUL	A-1	P-1	NR	D-1	A+	A2	A+	A+	\$1,182,000,000	SBI COMMENT: Hold poss. downgrade/ other developments	Own Operations
Travelers Group, Inc.	DIR	A-	P-1	F-1+	D-1+	AA-	Aa3	AA	AA-	\$45,000,000	SBI Comments: Hold poss. downgrade/ other developments	Own Operations
Travelers Insurance Company	DIR	A-1+	P-1	NR	D-1+	NR	NR	NR	NR	\$2,000,000	Own Operations	Own Operations
United Parcel Service of America	MUL	A-1+	P-1	NR	NR	AAA	Aaa	NR	NR	\$813,000,000	Own Operations	Own Operations
U. S. Bancorp (New)	MUL	A-1	P-1	F-1	D-1+	A	A1	A+	AA-	\$39,000,000	SBI Comments: Review before purchase.	Own Operations
US Borax, Inc.	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$282,000,000	RTZ Corporation PLC (The)	Deed Poll
Venantius A. B.	MUL	A-1+	P-1	NR	NR	AA+	Aa2	NR	NR	\$147,000,000	Guarantor: No US Ratings	Guarantee
Vermont American Corp.	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$271,000,000	Swedish Gov't.	Guarantee
Warner-Lambert Company	GMM	A-1+	P-1	NR	NR	AA	A1	NR	NR	\$100,000,000	SBI Comments: Company wholly owned by Sweden	Guarantee
Wells Fargo Company *	DIR	A-1	P-1	F-1	D-1	A	A1	A	A	\$295,000,000	Emerson Electric Company	Guarantee
Western Australian Treasury	MUL	A-1+	P-1	NR	NR	AA	Aaa	NR	NR	\$1,145,000,000	Guarantor S & P Outlook: STABLE	Own Operations
Weyerhaeuser Company	GMM	A-1	P-1	NR	NR	A	A2	NR	NR	\$100,000,000	Gov't. of Western Aust.	Guarantee
Wool Int'l.	MUL	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$50,000,000	Australian State	Own Operations
Xerox Credit Corp. *	MUL	A-1	P-1	F-1	NR	A	A2	A	NR	\$271,000,000	Gov't. of Australia	Guarantee
Yale University	LCP	A-1+	P-1	NR	NR	NR	NR	NR	NR	\$1,379,000,000	Xerox Corporation	Operating Agreement



ISSUER	Short-Term Ratings			Long-Term Ratings			QTR AVG OUTSTANDING	INVESTMENT LIMIT	SUPPORTING ENTITY	NATURE OF SUPPORT
	DEALERS	S&P	Mdy's	Fitch	Duff	S&P				

S & P Outlook: NOT AVAILABLE										
<b>ASSET-BACKED COMMERCIAL PAPER</b>	MUL	A-1+	P-1	F-1+	D-1+	NA	NA	\$8,720,000,000	Canadian Imperial Bank of Comm.	Multiseller
Asset Securitization Cooperative Corp.	FBC	A-1+	P-1	F-1+	D-1+	NA	NA	\$3,359,000,000	Credit Suisse-First Boston	Multiseller
Alpine Securitization *	MUL	A-1+	P-1	F-1+	D-1+	NA	NA	\$3,459,000,000	Wachovia Bank, NA	Loan-Backed
Centric Capital Corp. *	MUL	A-1+	P-1	F-1+	D-1+	AAA	NR	\$5,079,000,000	Citibank	Multiseller
CIESCO L. P.	MUL	A-1+	P-1	F-1+	D-1+	NA	NA	\$100,000,000	Citibank	Multiseller
Corporate Asset Funding Co., Inc.	MUL	A-1+	P-1	F-1+	D-1+	NR	NR	\$5,264,000,000	Citibank	Multiseller
Corporate Receivables Corp.	MUL	A-1+	P-1	F-1+	D-1+	NA	NA	\$6,153,000,000	Citibank	Multiseller
CXC Incorporated	MUL	A-1+	P-1	NR	D-1+	NA	NA	\$100,000,000	JP Morgan (Delaware)	Multiseller
Delaware Funding Corp. *	MUL	A-1+	P-1	NR	D-1+	NA	NA	\$6,696,000,000	NationsBank	Multiseller
Enterprise Funding Corp.	MUL	A-1+	P-1	NR	NR	NA	NA	\$4,797,000,000	Citibank	Multiseller
Eureka Securitization Corp. *	MUL	A-1+	P-1	NR	NR	NA	NA	\$3,161,000,000	General Electric Capital Corp.	Multiseller
Fleet Funding Corporation	MUL	A-1+	P-1	NR	NR	NA	NA	\$1,554,000,000	The Fifth Third Bank	Loan-Backed
Fountain Square Com. Funding *	MUL	A-1+	P-1	NR	NR	NA	NA	\$469,000,000	Citibank	Loan-Backed
Fountaine Asset Funding *	MLM	A-1+	P-1	NR	NR	NA	NA	\$0	Citibank	Multi-US Gov't.
Greenwich Asset Funding *	MLM	A-1+	P-1	NR	NR	NA	NA	\$319,000,000	Credit Suisse-First Boston	Loan-Backed
Greenwich Funding *	CSF	A-1+	P-1	NR	NR	NA	NA	\$3,945,000,000	Credit Suisse-First Boston	Loan-Backed
Kitty Hawk Funding Corp. *	MUL	A-1+	P-1	NR	NR	NA	NA	\$1,522,000,000	NationsBank	Multiseller
Monte Rosa Capital *	MUL	A-1+	P-1	NR	NR	NA	NA	\$5,159,000,000	Union Bank of Switzerland	Multiseller
New Center Asset Trust (Plus)	DIR	A-1+	P-1	NR	NR	NA	NA	\$6,197,000,000	GMAC	Single-Seller
Pooled Acc'ts Receivable Capital Corp	MUL	A-1+	P-1	NR	D-1+	NA	NA	\$1,440,000,000	Bank of Montreal	Multiseller
Receivables Capital Corp.	MUL	A-1+	P-1	NR	D-1+	NA	NA	\$4,558,000,000	Bank of America	Multiseller
Retailer Funding Corp.	LCP	A-1+	P-1	NR	D-1+	NA	NA	\$203,000,000	General Electric Capital Corp.	Multiseller
Triple A One Plus Funding Corp.	MLM	A-1+	P-1	NR	D-1+	NA	NA	\$80,000,000	CapMAC	Multiseller
Twin Towers *	MUL	A-1+	P-1	NR	NR	NA	NA	\$2,384,000,000	Deutsche Bank	Multiseller

**ADMINISTRATOR**  
 Canadian Imperial Bank of Comm.  
 Credit Suisse-First Boston  
 Wachovia Bank, NA  
 Citibank  
 Citibank  
 Citibank  
 Citibank  
 JP Morgan (Delaware)  
 NationsBank  
 Citibank  
 General Electric Capital Corp.  
 The Fifth Third Bank  
 Citibank  
 Credit Suisse-First Boston  
 Credit Suisse-First Boston  
 NationsBank  
 Union Bank of Switzerland  
 GMAC  
 Bank of Montreal  
 Bank of America  
 General Electric Capital Corp.  
 CapMAC  
 Deutsche Bank

**PROGRAM TYPE**  
 Multiseller  
 Multiseller  
 Loan-Backed  
 Multiseller  
 Multiseller  
 Multiseller  
 Multiseller  
 Multiseller  
 Multiseller  
 Multiseller  
 Loan-Backed  
 Loan-Backed  
 Loan-Backed  
 Multiseller  
 Multiseller  
 Single-Seller  
 Multiseller  
 Multiseller  
 Multiseller  
 Multiseller  
 Multiseller

**DELETED SINCE APR 1997 REPORT:**  
 American General Capital Services  
 AT&T Corporation  
 Armstrong World Industries Inc.  
 Banc One Corporation  
 Beneficial Corporation  
 Echlin, Inc.  
 Engelhard Corporation  
 Falcon Asset Securitization  
 Hertz Corporation  
 MCI Communications Corp.  
 Penney, J.C. Funding Corporation  
 Preferred Receivables Funding Corp.  
 SAFCO Credit Corp.  
 Southwest Bell Capital Corp.  
 Student Loan Corporation  
 Three Rivers Funding Corp.

**DEALER DIRECTORY:**  
 BSI Bank of America Int'l. Ltd.  
 BT BT Securities Corporation  
 CSF CS First Boston  
 CSI Chemical Securities, Inc.  
 DIR Direct Issuer  
 FCC First Chicago Capital Mkts., Inc.  
 FFS Ford Financial Services  
 GMM Goldman Sachs Money Markets, Inc.  
 JPM J. P. Morgan Securities Inc.  
 LCP Lehman Brothers Commercial Paper  
 MLM Merrill Lynch Money Mkts.  
 MNB Mellon Bank, N.A.  
 MUL Multiple Dealership  
 PW Paime Webber Incorporated

**DATA SOURCE:**  
 Moody's Global Short-Term Market Record April/July 1996  
 Bloomberg Financial Markets

**ADDITIONS SINCE APR 1997 REPORT**  
 \*\* Guarantor/Not Necessarily An Issuer



**MINNESOTA  
STATE  
BOARD OF  
INVESTMENT**



**Board Members:**

Governor  
Arne H. Carlson

State Auditor  
Judi Dutcher

State Treasurer  
Michael A. McGrath

Secretary of State  
Joan Anderson Growe

Attorney General  
Hubert H. Humphrey III

**Executive Director:**

Howard J. Bicker

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

*An Equal Opportunity  
Employer*

DATE: August 7, 1998

TO: Members, Domestic Manager Committee

FROM: Mansco Perry III and Lois Buermann *MB*

SUBJECT: **Review of Investment Advisers, Inc.  
and Wilke/Thompson Capital Management Inc.**

Investment Advisers, Inc. (IAI) and Wilke/Thompson Capital Management Inc. (W/T) have been asked to attend the Domestic Manager Committee meeting on August 14. Both firms met with the Committee in August 1997. At that time, the Committee voted to revisit SBI's relationship with each firm in the future. In February, the Committee met with IAI a second time due to concerns about the organization, benchmark and performance.

Each firm has been asked to prepare 20 to 30 minutes of material to address the following points:

1. Discuss the changes in assets under management since the last review.
2. Discuss any changes in the organization and personnel since the last review.
3. Discuss the performance of the SBI's portfolio relative to the benchmark.
4. Explain your past investment strategy. What has worked? What has not worked?
5. Briefly describe your current/future investment strategy.

Historical returns, cumulative VAM graphs, and 18-month rolling VAM graphs are attached for both firms.



Investment Manager: IAI Regional Fund							
Benchmark: Revised Custom							
		—PORTFOLIO—		—BENCHMARK—		—VAM—	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
93	Q1						
	Q2						
	Q3	9.86 *					
	Q4	-0.19	9.65 *				
94	Q1	-2.00		-2.57		0.89	
	Q2	-4.30		-1.34		-4.13	
	Q3	7.04		6.15		0.82	
	Q4	0.42	0.80	-0.92	1.11	0.15	-2.33
95	Q1	7.09		7.14		-1.72	
	Q2	8.30		6.97		0.17	
	Q3	7.29		9.51		-1.40	
	Q4	7.02	33.17	2.24	28.31	2.41	-0.59
96	Q1	4.25		4.14		-0.80	
	Q2	5.53		3.77		2.43	
	Q3	-1.83		0.87		-4.62	
	Q4	5.86	14.34	4.25	13.64	-0.39	-3.46
97	Q1	-4.49		-2.79		-4.17	
	Q2	15.98		15.58		-0.84	
	Q3	12.01		12.73		-0.63	
	Q4	-6.26	16.31	-1.00	25.38	-5.31	-10.59
98	Q1	8.45		11.62		-2.84	
	Q2	-2.69		-2.23		-0.47	
	Q3						
	Q4						
Latest:							
1 yr			10.80		21.78		-9.01
3 yr			17.24		20.29		-2.54
Cum 9401-9806			15.11		16.88		-1.51
Std Dev			11.63		10.68		3.74

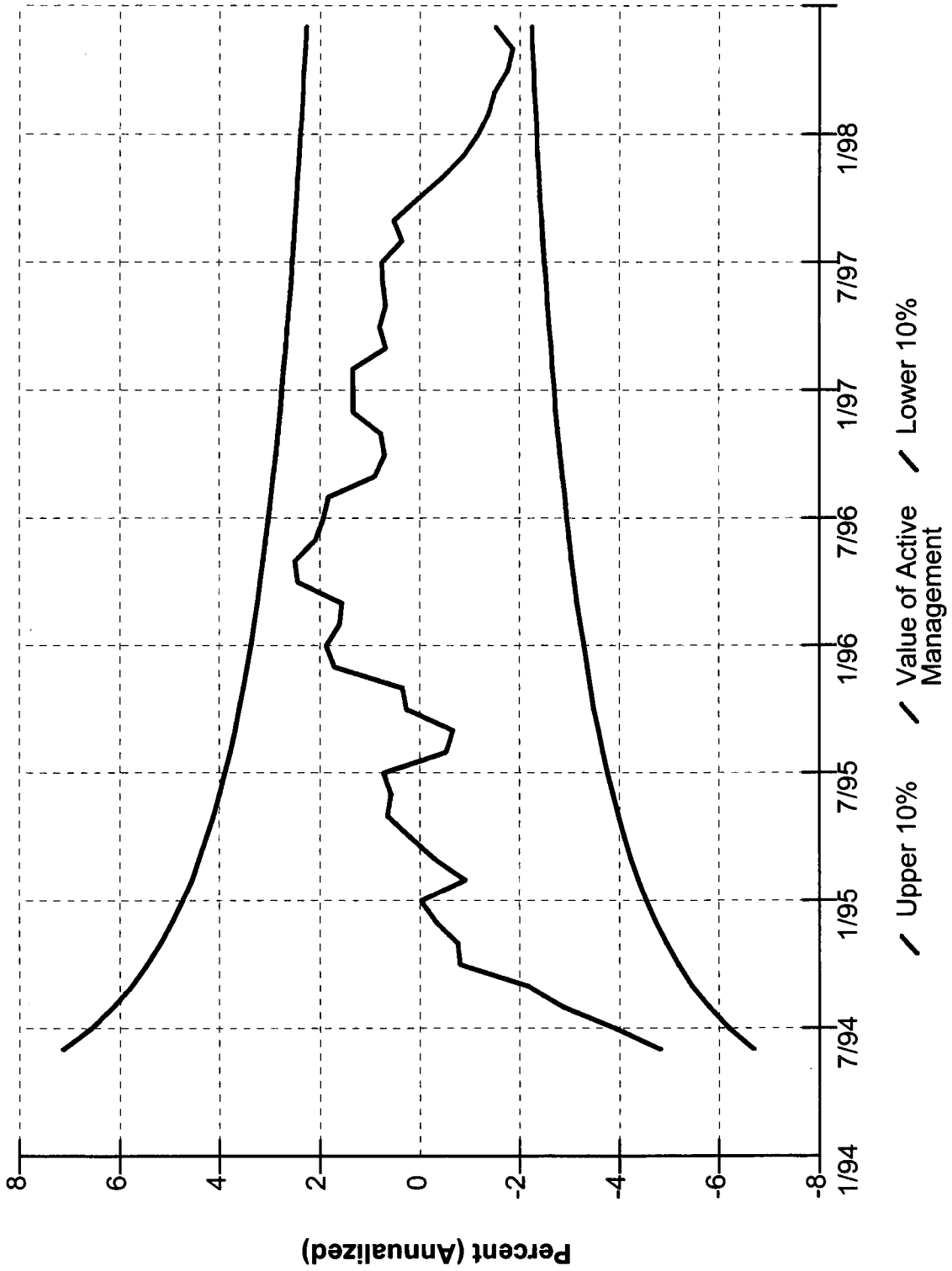
\*Partial Period: Since 8/1/93

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# Value of Active Management - Cumulative Graph

IAI REG FUND vs BCHMRK per MGR TOTAL

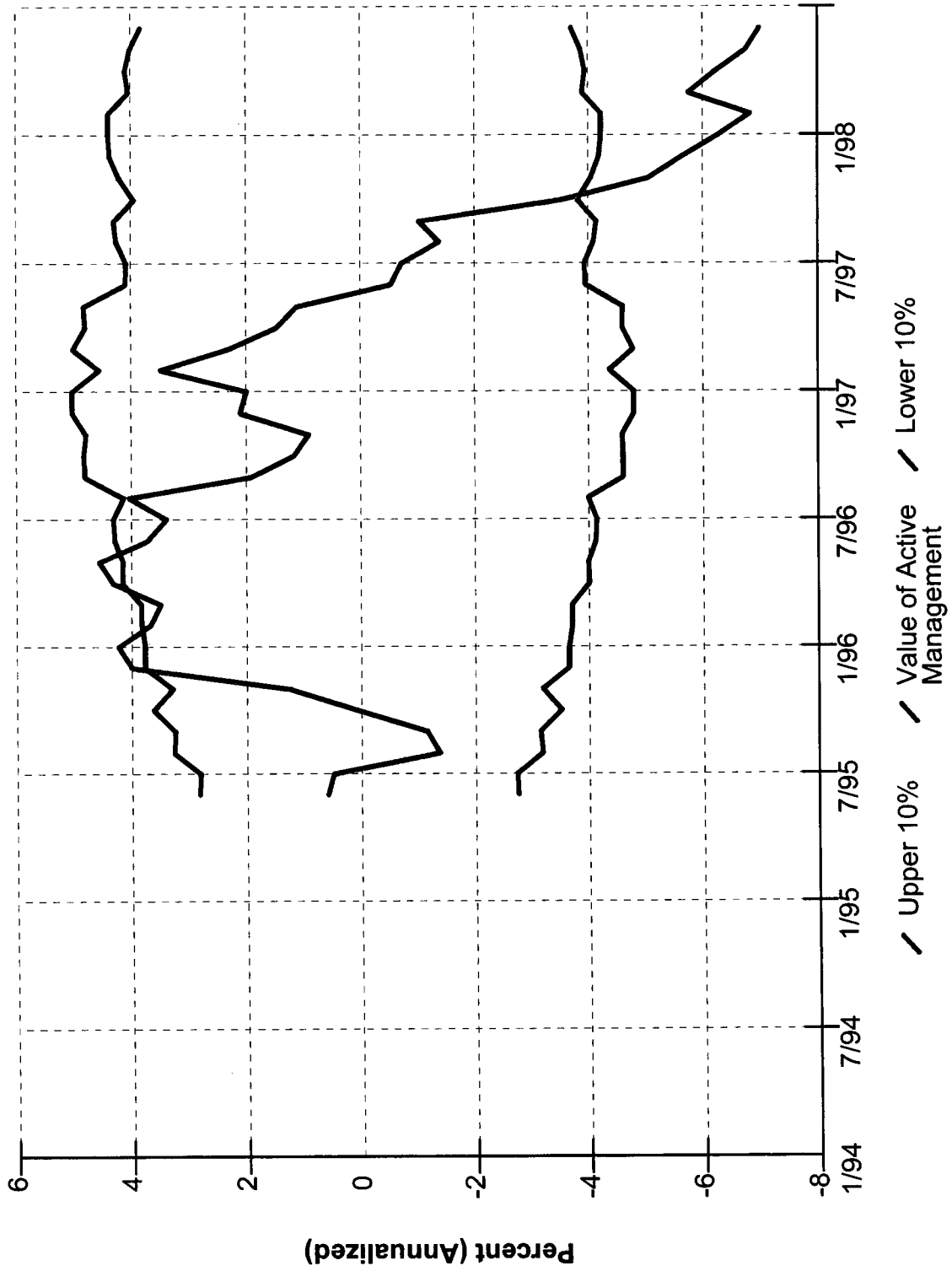
Monthly from period ending January, 1994 to period ending June, 1998 (54 periods)



# Value of Active Management - Rolling 18 periods Graph

IAI REG FUND vs BCHMRK per MGR TOTAL

Monthly from period ending January, 1994 to period ending June, 1998 (54 periods)





Investment Manager: Wilke/Thompson

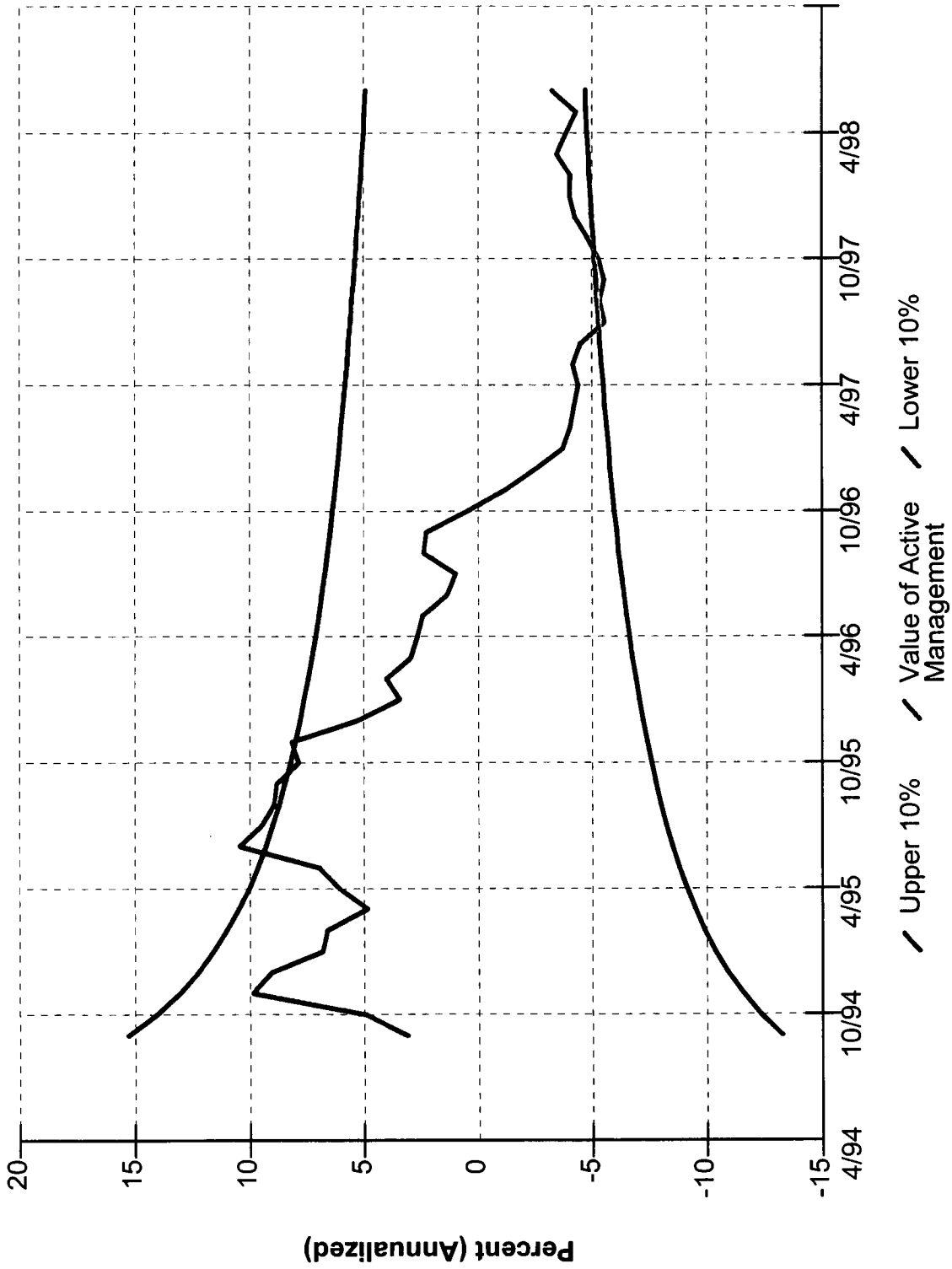
Benchmark: Custom

		—PORTFOLIO—		—BENCHMARK—		—VAM—	
		Qrtly Return	Annual Return	Qrtly Return	Annual Return	Qrtly Return	Annual Return
94	Q1						
	Q2	-6.56		-6.45		-0.11	
	Q3	12.08		10.26		1.65	
	Q4	4.15	9.07 *	-0.90	2.21 *	5.10	6.72 *
95	Q1	4.33		6.17		-1.73	
	Q2	16.54		7.90		8.01	
	Q3	11.69		11.41		0.25	
	Q4	-2.62	32.25	0.99	28.90	-3.57	2.60
96	Q1	3.36		6.74		-3.17	
	Q2	3.41		6.30		-2.72	
	Q3	2.67		0.12		2.55	
	Q4	-11.86	-3.28	-0.13	13.45	-11.74	-14.75
97	Q1	-13.51		-8.22		-5.76	
	Q2	18.50		20.85		-1.95	
	Q3	9.87		15.43		-4.82	
	Q4	-4.54	7.50	-7.92	17.90	3.66	-8.83
98	Q1	18.22		15.67		2.20	
	Q2	-4.43		-4.48		0.05	
	Q3						
	Q4						
Latest:							
1 yr			18.50		17.44		0.90
3 yr			8.51		18.47		-8.41
Cum 9404-9806			13.21		16.97		-3.22
Std Dev			18.38		15.83		7.70

\*Partial Period: 9404-9412



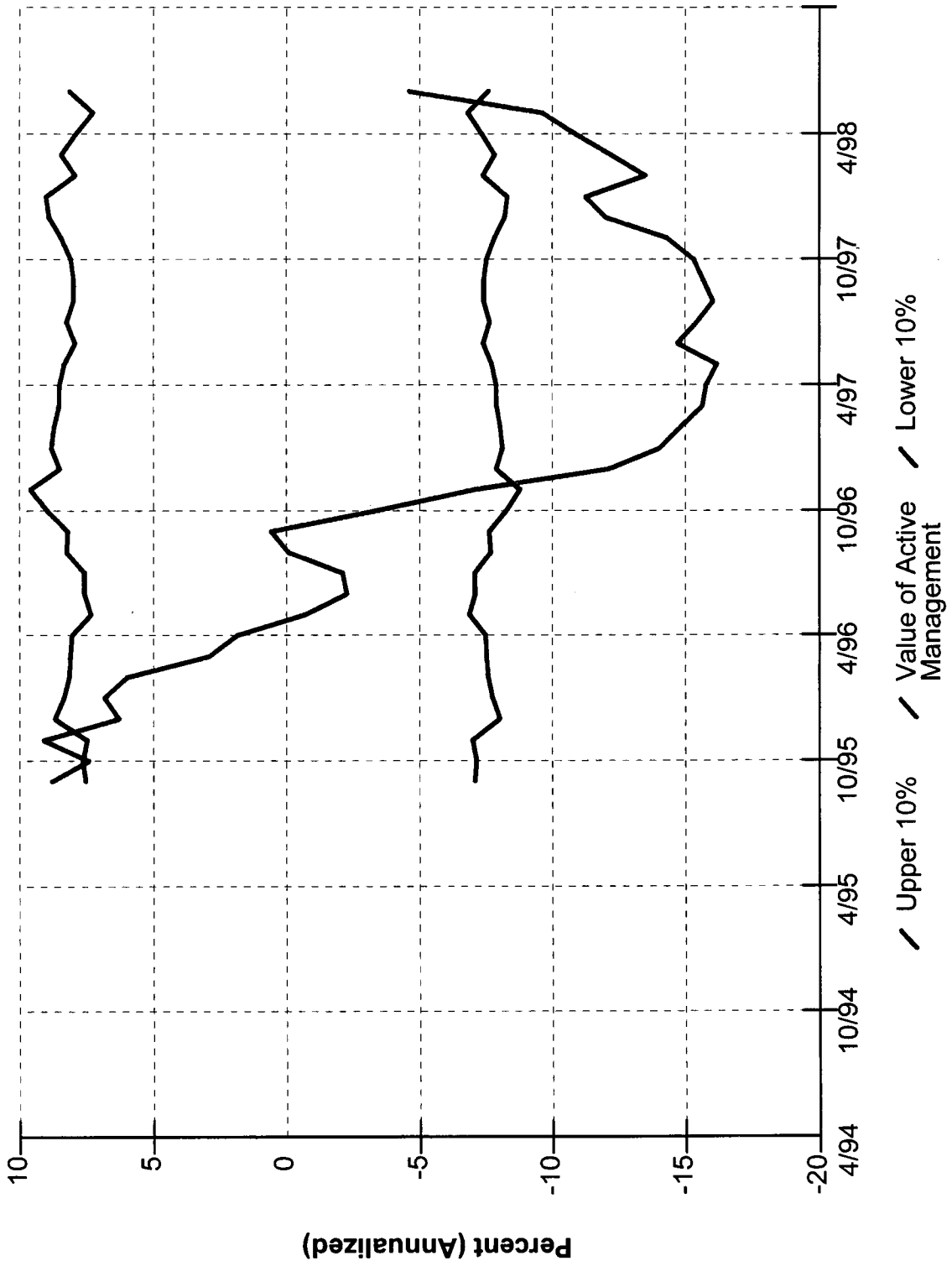
**Value of Active Management - Cumulative Graph**  
 WILKE THOMPSON CAPITAL vs/WILKE THOMPSON CAPITAL BNMK  
 Monthly from period ending April, 1994 to period ending June, 1998 (51 periods)



### Value of Active Management - Rolling 18 periods Graph

WILKE THOMPSON CAPITAL vs WILKE THOMPSON CAPITAL BNMK

Monthly from period ending April, 1994 to period ending June, 1998 (51 periods)



DATE: August 25, 1998

TO: Members, Minnesota State Board of Investment

FROM: Members, Minnesota Investment Advisory Council

**SUBJECT: Minnesota State Board of Investment Action Related to Restrictions on Investment in Tobacco Related Companies**

On June 11, 1998 the State Board of Investment (SBI) voted to limit additional investments in companies that derive 15 percent or more of their revenue from tobacco products. Further, the staff was ordered to submit to the SBI at its next meeting a plan to divest over the next three years all presently-held investment in such companies.

As members of the Investment Advisory Council (IAC) to the SBI, we feel it is important to present our recommendations on this subject.

First, with respect to no future investment in tobacco-related companies, we recommend that the SBI leave this decision to the professional judgement of the active investment managers retained by the Board. We are aware that the Board members who supported the resolution utilized input from various sources and that the final decision is that of the SBI, but the members of the IAC feel it is important that we go on record relating to this matter.

Second, with respect to divestment of tobacco holdings in the current SBI portfolio, we recommend that the SBI not force any liquidations. The Board has directed the staff to present a plan to divest. Any divestment will incur cost. The members of the IAC strongly believe and would advise the SBI not to adopt policies that incur additional cost that will have the effect of reducing overall returns for the assets under its control.



# STATE BOARD OF INVESTMENT

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## Stock Manager Evaluation Reports

Second Quarter, 1998



**COMBINED RETIREMENT FUNDS  
DOMESTIC STOCK MANAGERS  
Periods Ending June, 1998**

	Quarter		1 Year		3 Years		5 Years		Since Inception (1)		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active Managers</b>												
Alliance Capital	8.5	5.0	50.6	36.0	38.0	31.7	28.0	24.1	21.3	15.8	\$1,332.35	6.8%
American Express AMG	1.2	2.7	21.9	30.6	23.9	30.2	19.0	23.5	16.3	17.4	\$547.48	2.8%
Brinson Partners	-1.8	0.0	22.0	27.7	28.4	26.4	21.9	20.6	21.9	20.6	\$668.12	3.4%
Forstmann-Leff	-0.8	-2.1	32.1	15.8	31.4	22.2	22.2	17.8	15.9	13.9	\$564.27	2.9%
Franklin Portfolio	3.6	0.5	34.3	27.2	29.8	25.5	22.1	20.1	18.6	16.9	\$557.15	2.8%
GeoCapital	-2.8	-6.1	28.1	12.2	21.0	17.4	17.8	17.3	17.2	16.8	\$521.12	2.7%
LAI	-2.7	-2.2	10.8	21.8	17.2	24.1			15.6	19.9	\$215.37	1.1%
Lincoln	8.2	5.7	33.2	35.6	32.5	33.1	25.3	25.2	25.3	25.2	\$746.13	3.8%
Oppenheimer	3.6	2.0	32.0	29.3	32.3	28.6	25.0	21.5	25.0	21.5	\$756.06	3.9%
Weiss Peck & Greer	-7.2	-3.2	9.9	14.7	16.5	15.4	12.7	15.3	12.7	15.3	\$366.48	1.9%
<b>Emerging Managers (2)</b>	1.8	0.5	31.7	26.5	26.8	26.4			23.8	24.1	\$666.66	3.4%
<b>Semi-Passive Managers (3)</b>												
Franklin Portfolio	2.4	1.8	33.1	30.5	30.6	29.7			31.7	31.0	\$2,034.60	10.4%
JP Morgan	1.9	1.8	31.2	30.5	29.9	29.7			31.3	31.0	\$2,059.57	10.5%
Barclays Global Investors	1.5	1.8	29.8	30.5	30.4	29.7			32.0	31.0	\$2,055.68	10.5%
<b>Passive Manager (4)</b>												
Barclays Global Investors	1.9	1.9	29.4	28.9	28.2	28.0			28.2	28.0	\$6,543.09	33.3%
<b>Since 1/1/84</b>												
Current Aggregate	2.2	1.6	30.6	28.5	29.2	28.0	22.2	21.9	18.1	15.9	\$19,634.14	100.0%
Historical Aggregate (5)	2.2	1.6	30.6	28.6	28.7	27.9	21.5	21.6	16.4	16.5		
Wilshire Adjusted		1.9		28.9		28.1		21.5		16.5		
Wilshire 5000		1.9		28.9		28.1		21.6		16.8		

- (1) Since retention by the SBI. Time period varies for each manager.  
(2) Aggregate of emerging manager group. The benchmark reflects a composite of published indexes prior to implementation of custom benchmarks on 4/1/96.  
(3) Semi-passive managers retained 1/95. All use completeness fund benchmark.  
(4) Passive manager retained 7/95 to manage a Wilshire 5000 index fund.  
(5) Includes the performance of terminated managers.





**ALLIANCE CAPITAL MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Jack Koltes**

**Assets Under Management: \$1,332,353,919**

**Investment Philosophy**

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

**Staff Comments**

No comments at this time.

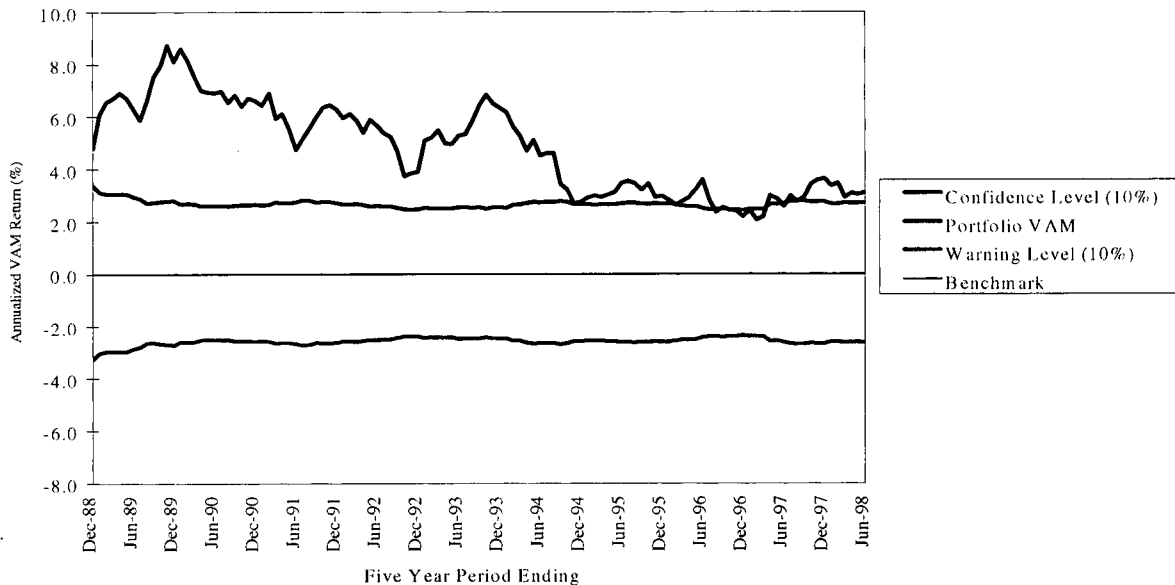
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	8.5%	5.0%
Last 1 year	50.6	36.0
Last 2 years	46.1	35.6
Last 3 years	38.0	31.7
Last 4 years	36.0	30.6
Last 5 years	28.0	24.1
Since Inception (1/84)	21.3	15.8

**Recommendation**

No action required.

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



**AMERICAN EXPRESS ASSET MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Jim Johnson**

**Assets Under Management: \$547,482,734**

**Investment Philosophy**

American Express Asset Management Group (AMG) employs a concentrated style of management. The methodology by which the portfolio is managed is based on a fundamentally driven and quantitatively managed process. Using 20 to 30 of the top-rated stocks by American Express Financial research analysts, the portfolio seeks to maximize the greatest level of risk-adjusted return for a predetermined level of risk tolerance. Due to the level of concentration, the active risk versus the normal portfolio will be higher than that of the typical active manager. Trading within the portfolio is also analyst driven, which will lead to turnover between 80 and 120 percent per year. Because the focus of the methodology is concentrated stock selection, the portfolio will remain fully invested at all times.

**Staff Comments**

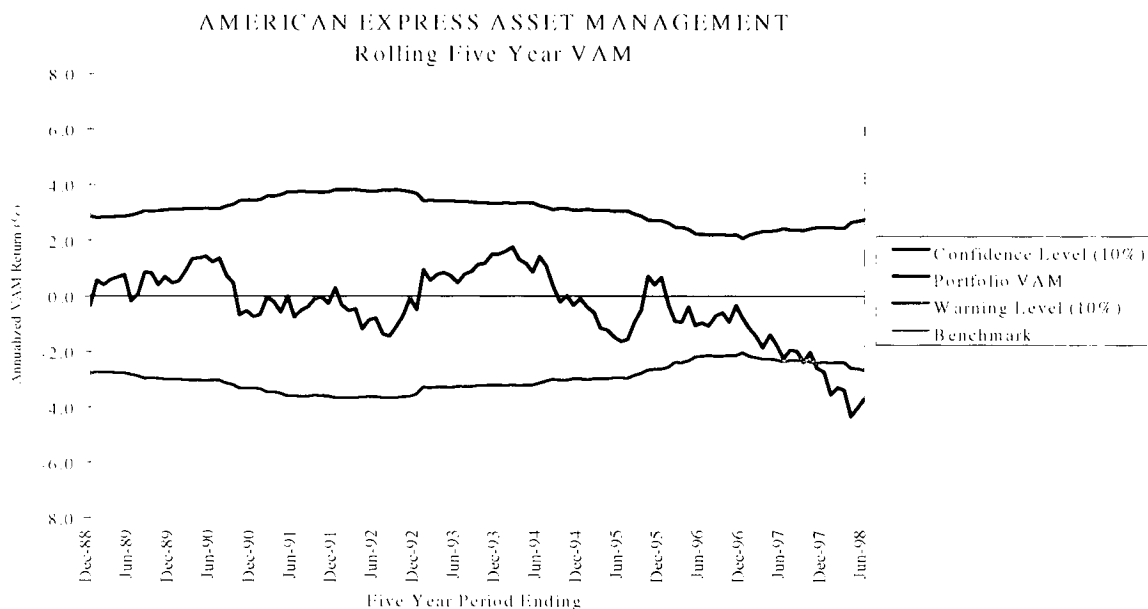
AMG discussed their investment strategy and portfolio construction process at the May 1998 Domestic Manager Committee meeting. The Committee will revisit the AMG strategy and process in 12 months.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.2%	2.7%
Last 1 year	21.9	30.6
Last 2 years	23.6	32.5
Last 3 years	23.9	30.2
Last 4 years	23.3	29.3
Last 5 years	19.0	23.5
Since Inception (1/84)	16.3	17.4

**Recommendation**

No action at this time.



**BRINSON PARTNERS**  
**Periods Ending June, 1998**

**Portfolio Manager: Jeff Diermeier**

**Assets Under Management: \$668,122,756**

**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 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.

**Staff Comments**

Swiss Bank Corporation (SBC) and Union Bank of Switzerland have merged into a single organization called United Bank of Switzerland (UBS). SBC Brinson and UBS Asset Management have become the UBS Brinson Division, headed by Gary Brinson.

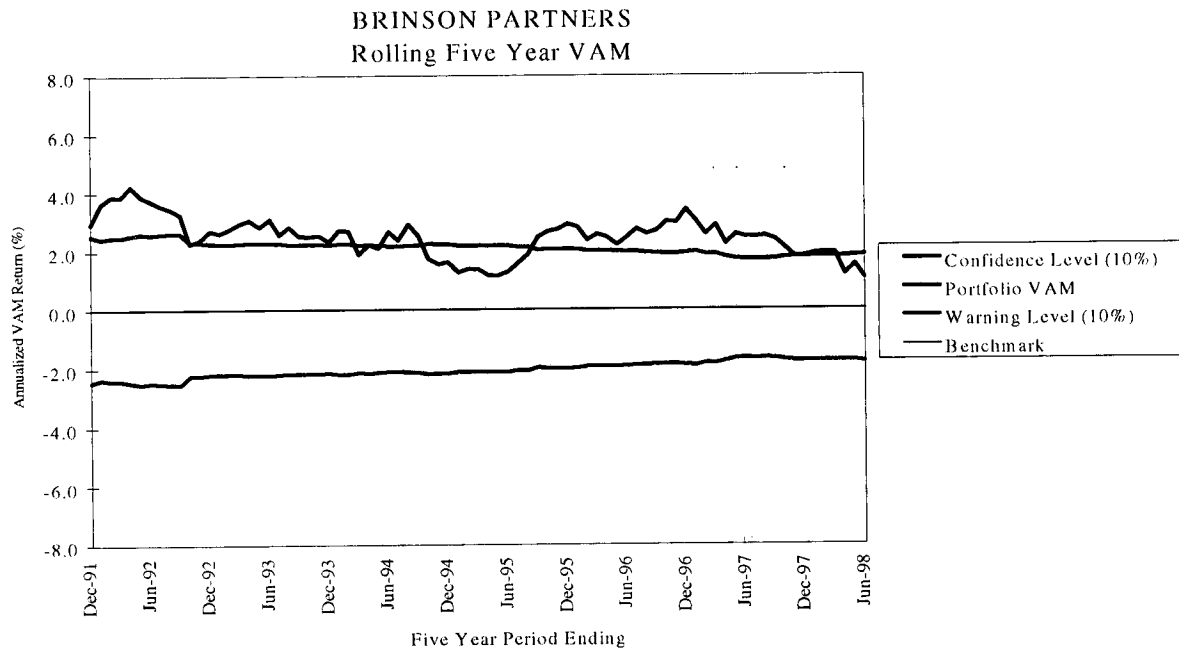
Staff does not believe that the merger will adversely affect the management of SBI's account.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-1.8%	0.0%
Last 1 year	22.0	27.7
Last 2 years	27.2	28.2
Last 3 years	28.4	26.4
Last 4 years	26.8	26.0
Last 5 years	21.9	20.6
Since Inception (7/93)	21.9	20.6

**Recommendation**

No action required.



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

**FORSTMANN-LEFF ASSOCIATES**  
**Periods Ending June, 1998**

**Portfolio Manager:** Joel Leff

**Assets Under Management:** \$564,274,859

**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, medium to large capitalization stocks. In the past, Forstmann-Leff has made sizable market timing moves at any point during a market cycle.

**Staff Comments**

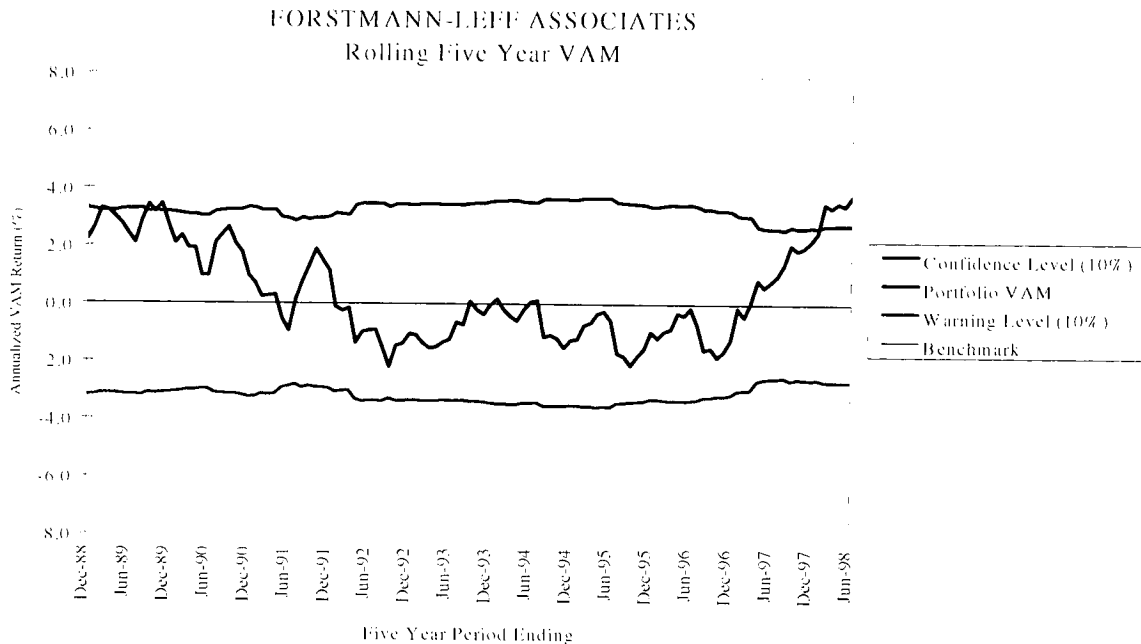
No comments at this time

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-0.8%	-2.1%
Last 1 year	32.1	15.8
Last 2 years	31.0	21.2
Last 3 years	31.4	22.2
Last 4 years	28.2	23.3
Last 5 years	22.2	17.8
Since Inception (1/84)	15.9	13.9

**Recommendation**

No action required.



**FRANKLIN PORTFOLIO ASSOCIATES**  
**Periods Ending June, 1998**

**Portfolio Manager: John Nagorniak**

**Assets Under Management: \$557,148,743**

**Investment Philosophy**

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

**Staff Comments**

Peter Robbins, Sr. Vice President, Investments, has gone to part-time status. He will continue to work on investment related projects. Franklin has been adding to their staff in preparation for this change. Staff believes this will not impact the management of SBI's portfolio.

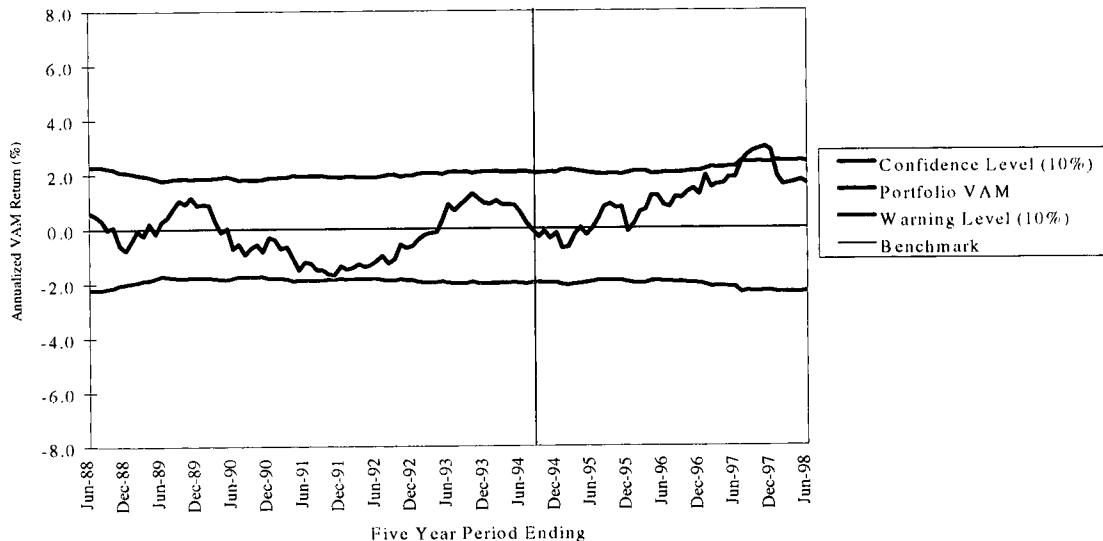
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	3.6%	0.5%
Last 1 year	34.3	27.2
Last 2 years	32.9	26.7
Last 3 years	29.8	25.5
Last 4 years	28.2	25.3
Last 5 years	22.1	20.1
Since Inception (4/89)	18.6	16.9

**Recommendation**

No action required.

FRANKLIN PORTFOLIO ASSOCIATES  
 Rolling Five Year VAM



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

**GEOCAPITAL CORP.**  
**Periods Ending June, 1998**

**Portfolio Manager: Barry Fingerhut**

**Assets Under Management: \$521,124,696**

**Investment Philosophy**

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

**Staff Comments**

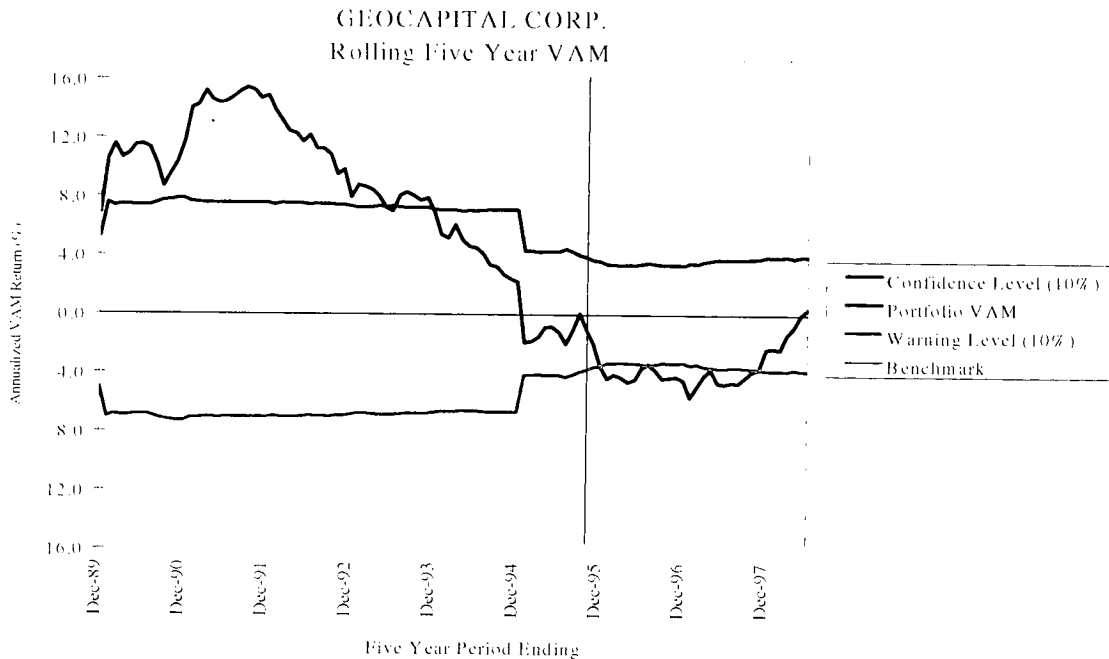
No comments at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-2.8%	-6.1%
Last 1 year	28.1	12.2
Last 2 years	18.2	8.8
Last 3 years	21.0	17.4
Last 4 years	21.3	21.0
Last 5 years	17.8	17.3
Since Inception (4/90)	17.2	16.8

**Recommendation**

No action required.



Note: Scale differs from other VAM graphs.

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

**INVESTMENT ADVISERS INC.**  
**Periods Ending June, 1998**

**Portfolio Manager: Mark Hoonsbeen**

**Assets Under Management: \$215,374,148**

**Investment Philosophy**

IAI's investment philosophy is to own the highest quality companies which demonstrate sustainable growth. 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, or South Dakota. If IAI cannot find enough investment opportunities in the region, up to 20% of the portfolio can be used to purchase stocks that display the same quality and growth characteristics but have headquarters outside this region.

**Staff Comments**

- Due to concerns about organizational changes and a poor benchmark, IAI was re-interviewed by the Domestic Manager Committee and retained by the Board in September 1997. The Committee reviewed the firm again in January 1998 and recommended that IAI be reviewed again at the August 1998 Committee meeting.
- IAI has completed work on an improved benchmark to be implemented May 1, 1998. This revision eliminated many illiquid names, as well as securities that are currently not included in their research universe.

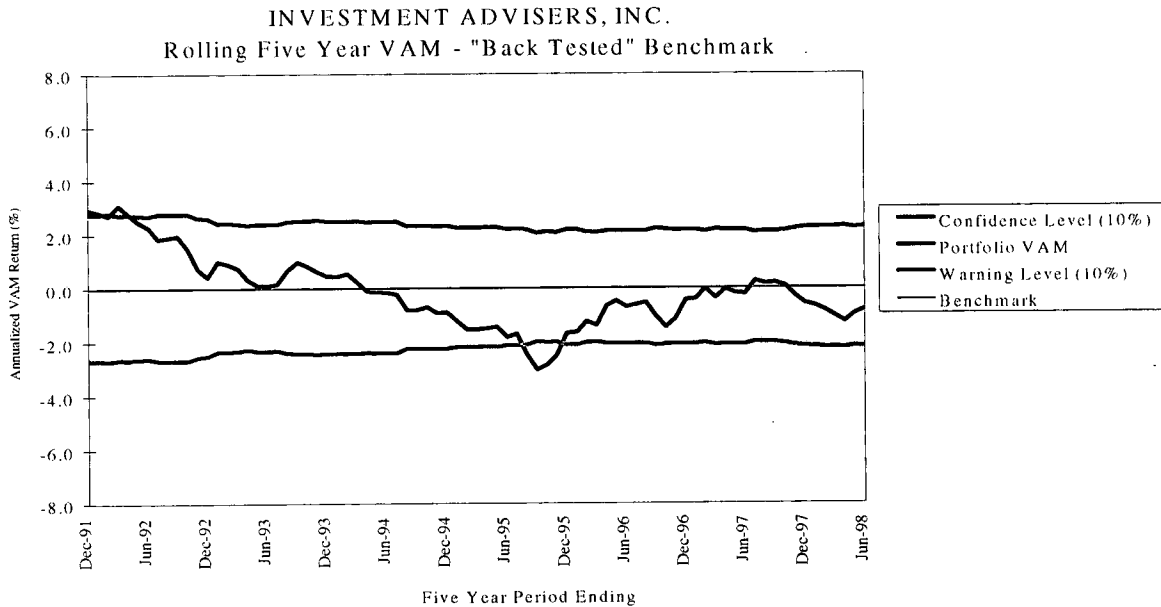
**Quantitative Evaluation**

	<b>Actual</b>	<b>Hist. Bnmk</b>	<b>New Bnmk</b>
Last Qtr.	-2.7%	-2.2%	-2.2%
Last 1 Yr.	10.8	21.8	21.8
Last 2 Yrs.	13.0	24.6	20.0
Last 3 Yrs.	17.2	24.1	20.3
Last 4 Yrs.	19.1	24.4	20.4
Last 5 Yrs.	N.A.	N.A.	N.A.
Since Incep. (7/93)	15.6	19.9	N.A.

Note: The VAM graph below depicts IAI's historical performance relative to the historical benchmark from December 1991 through January 1994, relative to the backtested benchmark from January 1994 through September 1997, and relative to the revised benchmark from September 1997 forward.

**Recommendation**

No action required.



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



**LINCOLN CAPITAL MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Parker Hall**

**Assets Under Management: \$746,127,859**

**Investment Philosophy**

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

**Staff Comments**

No comments at this time.

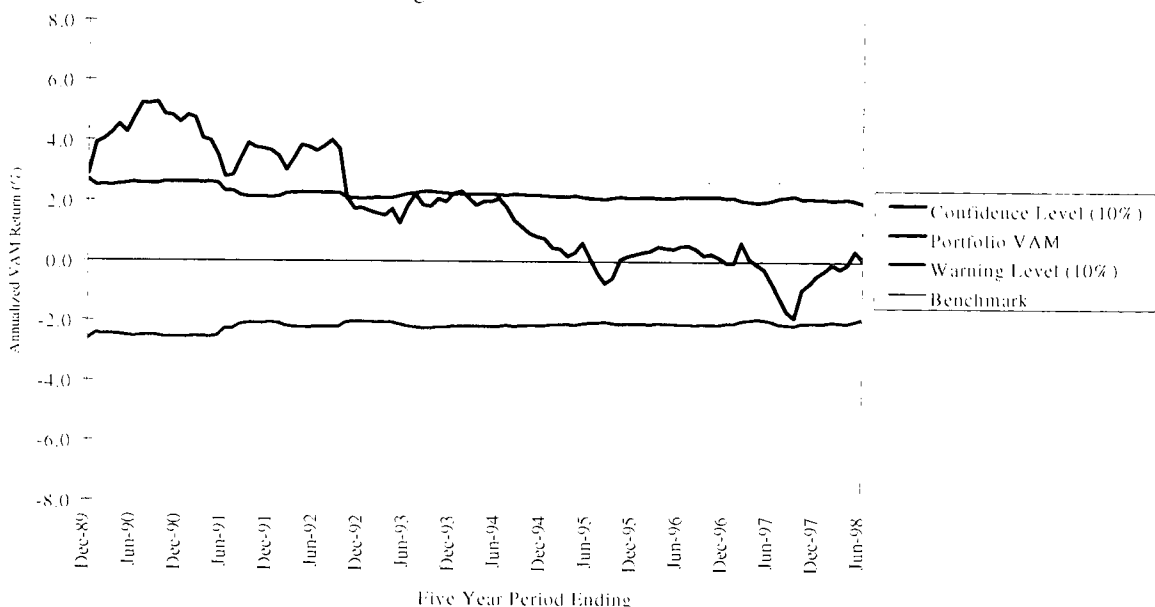
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	8.2%	5.7%
Last 1 year	33.2	35.6
Last 2 years	32.7	35.7
Last 3 years	32.5	33.1
Last 4 years	32.1	32.2
Last 5 years	25.3	25.2
Since Inception (7/93)	25.3	25.2

**Recommendation**

No action required.

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



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

**OPPENHEIMER CAPITAL**  
**Periods Ending June, 1998**

**Portfolio Manager: John Lindenthal**

**Assets Under Management: \$756,059,015**

**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.

**Staff Comments**

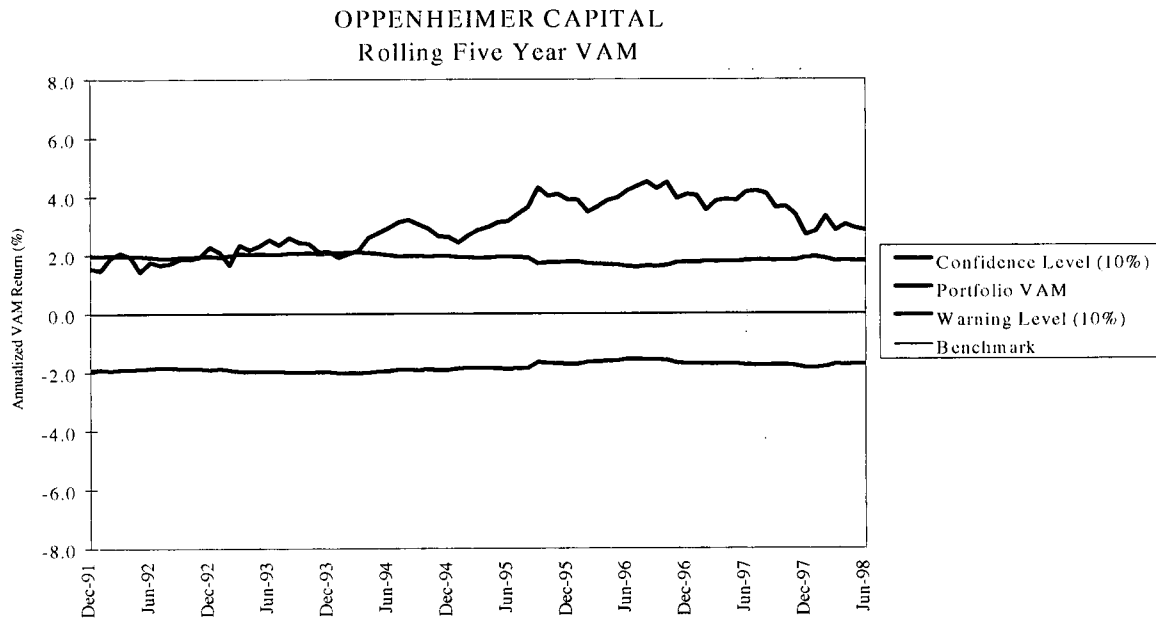
No comments at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	3.6%	2.0%
Last 1 year	32.0	29.3
Last 2 years	34.5	30.3
Last 3 years	32.3	28.6
Last 4 years	31.2	27.0
Last 5 years	N.A.	N.A.
Since Inception (7/93)	25.0	21.5

**Recommendation**

No action required.



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

**WEISS, PECK & GREER**  
**Periods Ending June, 1998**

**Portfolio Manager: Adam Starr**

**Assets Under Management: \$366,479,396**

**Investment Philosophy**

Weiss, Peck & Greer's dynamic growth process concentrates on small to medium size growth companies that have demonstrated consistently 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.

**Staff Comments**

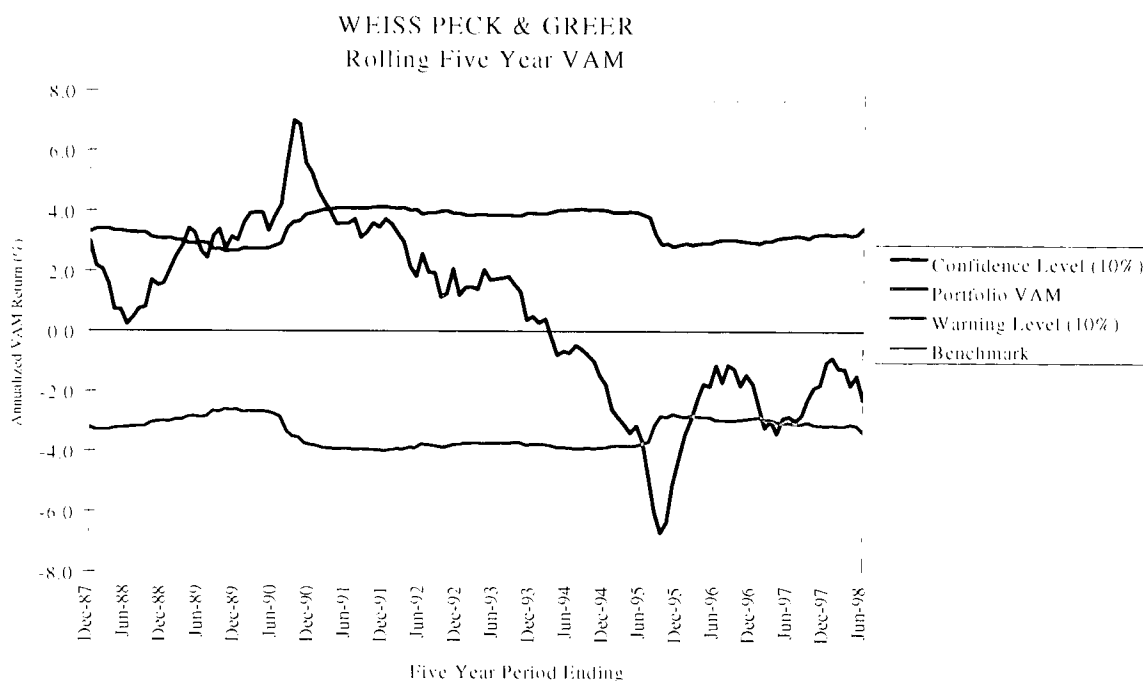
During this quarter, WP&G announced that they would be acquired by Robeco Groep, a Rotterdam, Holland based investment advisor. Robeco brings international investment and quantitative abilities, while WP&G brings private equity, venture capital, and domestic U.S. investing to the relationship. The transaction to be complete in early Fall is not expected to impact the management of SBI's small cap portfolio.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-7.2%	-3.2%
Last 1 year	9.9	14.7
Last 2 years	5.6	11.5
Last 3 years	16.5	15.4
Last 4 years	18.9	19.8
Last 5 years	N.A.	N.A.
Since Inception (7/93)	12.7	15.3

**Recommendation**

No action required.



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

**FRANKLIN PORTFOLIO ASSOCIATES**  
**Periods Ending June, 1998**

**Portfolio Manager: John Nagorniak**

**Assets Under Management: \$2,034,597,537**

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

**Staff Comments**

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

No comments at this time.

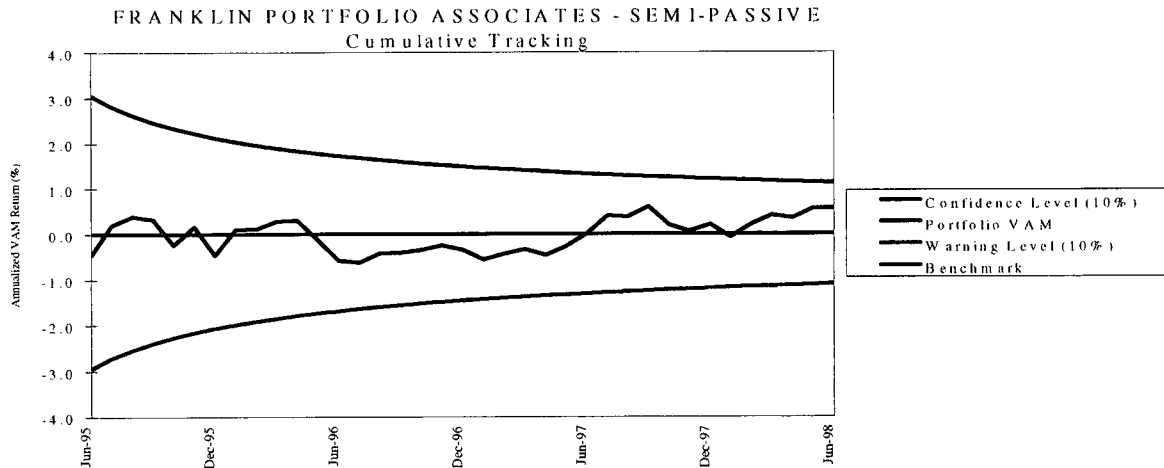
**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	2.4%	1.8%
Last 1 year	33.1	30.5
Last 2 years	33.4	31.5
Last 3 years	30.6	29.7
Last 4 years	N.A.	N.A.
Last 5 years	N.A.	N.A.
Since Inception (1/95)	31.7	31.0

No action required.

\* Completeness Fund



**J.P. MORGAN INVESTMENT MANAGEMENT, INC.**  
**Periods Ending June, 1998**

**Portfolio Manager: Rick Nelson**

**Assets Under Management: \$2,059,565,787**

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

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

**Staff Comments**

No comments at this time.

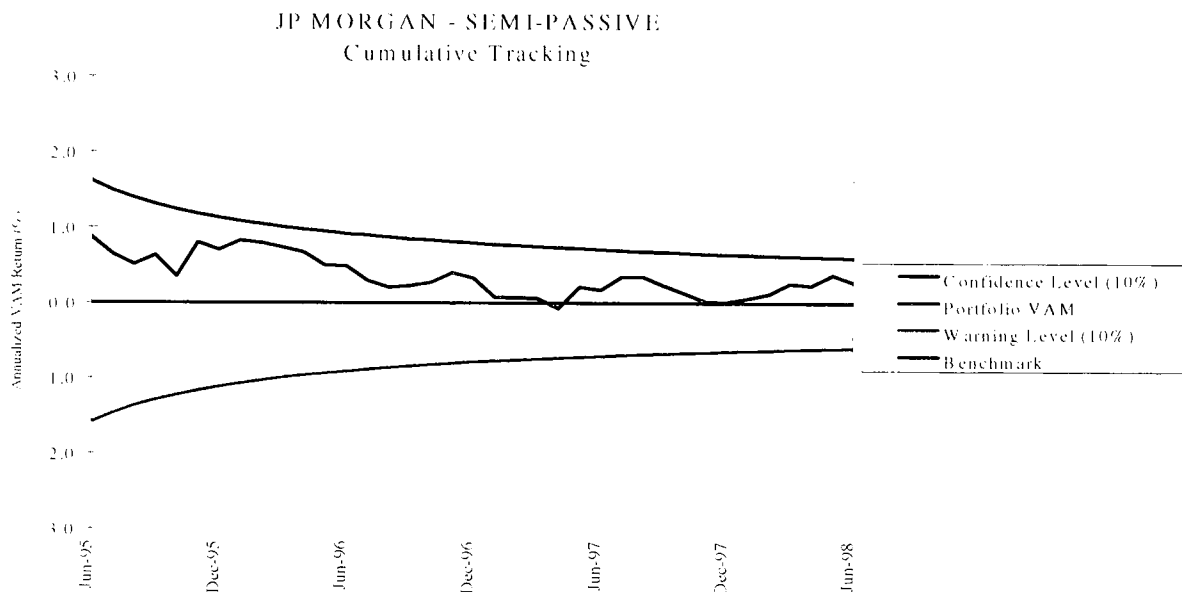
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	1.9%	1.8%
Last 1 year	31.2	30.5
Last 2 years	31.6	31.5
Last 3 years	29.9	29.7
Last 4 years	N.A.	N.A.
Last 5 years	N.A.	N.A.
Since Inception (1/95)	31.3	31.0

**Recommendation**

No action required.

\* Completeness Fund



**BARCLAYS GLOBAL INVESTORS**  
**Periods Ending June, 1998**

**Portfolio Manager: Nancy Feldkircher**

**Assets Under Management: \$2,055,683,691**

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

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

**Staff Comments**

No comments at this time.

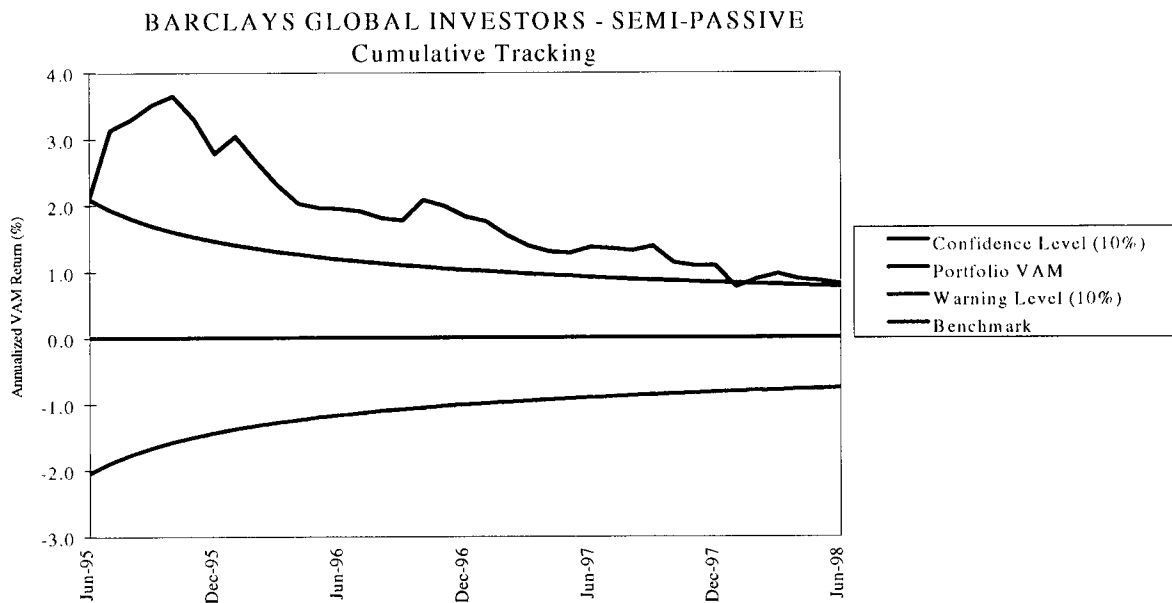
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	1.5%	1.8%
Last 1 year	29.8	30.5
Last 2 years	31.5	31.5
Last 3 years	30.4	29.7
Last 4 years	N.A.	N.A.
Last 5 years	N.A.	N.A.
Since Inception (1/95)	32.0	31.0

**Recommendation**

No action required.

\* Completeness Fund



**BARCLAYS GLOBAL INVESTORS**  
**Periods Ending June, 1998**

**Portfolio Manager: Tom Seto**

**Assets Under Management: \$6,543,089,126**

**Investment Philosophy**

**Passive**

Barclays Global Investors passively manages the portfolio against the Wilshire 5000 by minimizing tracking error and trading costs, and maximizing control over all investment and operational risks. Their strategy is to fully replicate the larger capitalization segments of the market and to use an optimization approach for the smaller capitalization segments. The optimizer weighs the cost of a trade against its contribution to expected tracking error to determine which trades should be executed.

**Staff Comments**

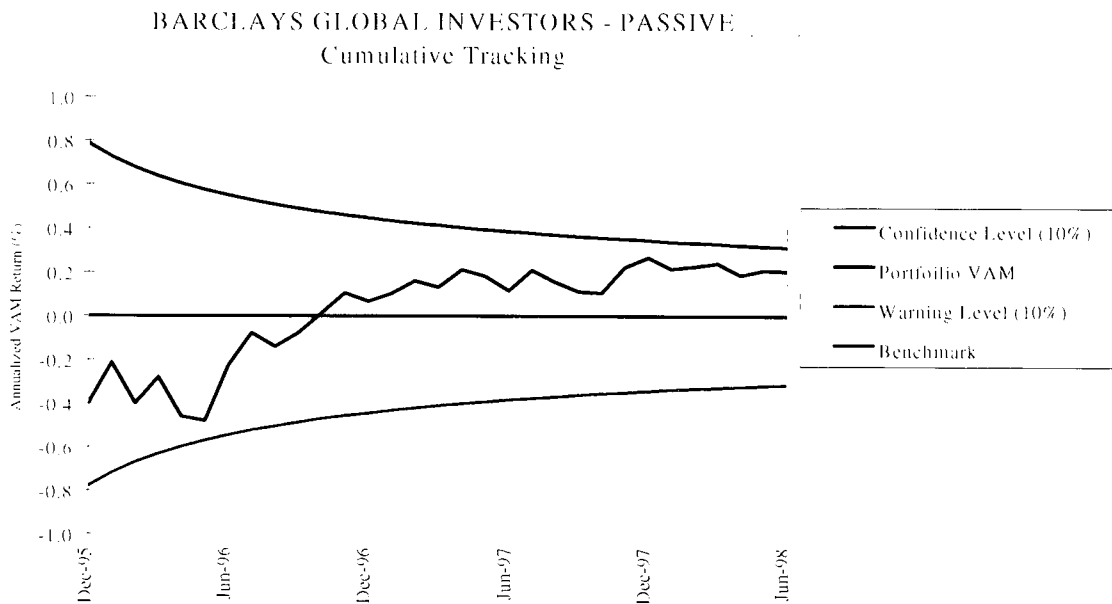
No comments at this time.

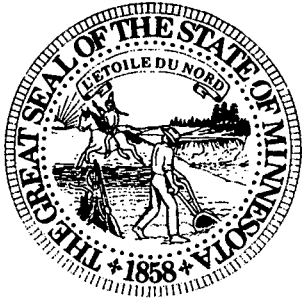
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.9%	1.9%
Last 1 year	29.4	28.9
Last 2 years	29.6	29.1
Last 3 years	N.A.	N.A.
Last 4 years	N.A.	N.A.
Last 5 years	N.A.	N.A.
Since Inception (7/95)	28.2	28.0

**Recommendation**

No action required.





# STATE BOARD OF INVESTMENT

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## Emerging Stock Manager Evaluation Reports

Second Quarter, 1998





**COMBINED RETIREMENT FUNDS  
EMERGING EQUITY MANAGERS**  
Periods Ending June, 1998

	Quarter		1 Year		3 years		5 Years		Since Inception		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active Managers</b>												
CIC Assets	-2.4	0.9	27.1	28.5	27.9	28.6			23.9	25.9	\$74.61	11.2%
Cohen, Klingenstein, & Marks	5.0	2.0	34.1	27.9	32.2	27.0			29.2	24.7	159.16	23.9%
Compass Capital	1.4	1.7	28.1	28.7	25.5	29.4			24.2	25.3	75.22	11.3%
New Amsterdam	3.1	-0.4	38.0	25.2	31.1	24.1			25.1	22.4	77.68	11.7%
Valenzuela Capital	-4.2	-3.2	24.0	21.0	29.8	23.8			24.7	21.3	76.68	11.5%
Wilke/Thompson	-4.4	-4.5	18.5	17.4	8.5	18.5			13.2	17.0	50.83	7.6%
Winslow Capital	4.1	2.8	39.1	29.7	25.4	26.6			23.5	24.4	73.55	11.0%
Zevenbergen Capital	7.2	2.0	40.7	29.8	29.8	26.9			25.6	24.5	78.93	11.8%
											<b>\$666.66</b>	<b>100.0%</b>
									<b>Since 4/1/94</b>			
<b>Current Aggregate</b>	1.8	0.5 *	31.7	26.5 *	27.0	26.0 *			24.4	23.5 *		
<b>Historical Aggregate</b>	1.8	0.5 *	31.7	26.5 *	26.8	25.5 *			23.8	23.0 *		

Note:

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

\* The current and historical aggregates reflect the weighted average of the individual manager customized benchmarks since inception of the program on 4/1/94.



**CIC ASSET MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Jorge Castro**

**Assets Under Management: \$74,608,877**

**Investment Philosophy**

CIC Asset Management (CIC) uses a disciplined relative value approach to manage 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 analysis.

**Staff Comments**

No comments at this time.

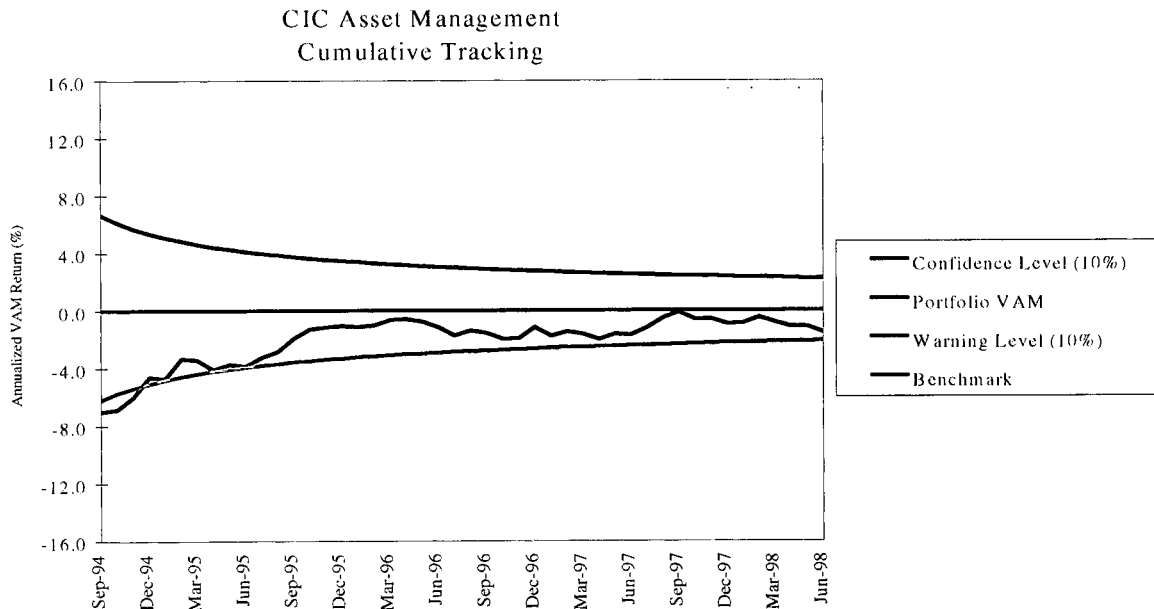
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	-2.4%	0.9%
Last 1 Year	27.1	28.5
Last 2 Years	28.0	30.6
Last 3 Years	27.9	28.6
Since Inception (4/94)	23.9	25.9

**Recommendation**

No action required.

\* Custom benchmark since inception date.



**COHEN KLINGENSTEIN & MARKS INCORPORATED**  
**Periods Ending June, 1998**

**Portfolio Manager: George Cohen**

**Assets Under Management: \$159,162,567**

**Investment Philosophy**

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

**Staff Comments**

No comments at this time.

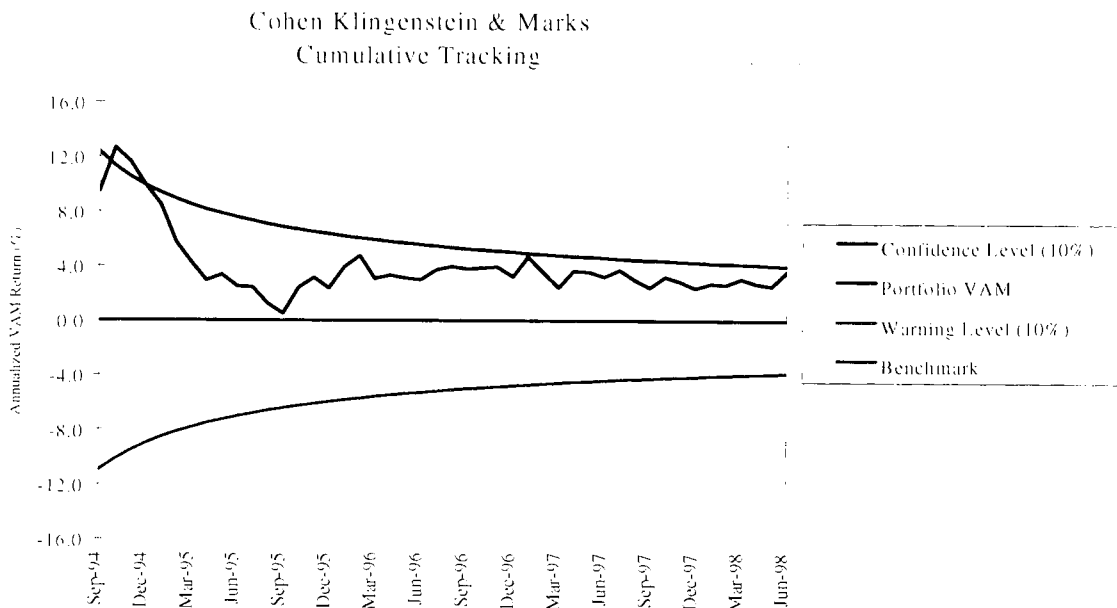
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	5.0%	2.0%
Last 1 Year	34.1	27.9
Last 2 Years	35.9	30.4
Last 3 Years	32.2	27.0
Since Inception. (4/94)	29.2	24.7

**Recommendation**

No action required.

\* Custom benchmark since inception date.



**COMPASS CAPITAL MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Charles Kelley**

**Assets Under Management: \$75,219,074**

**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 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 do not hold utility, bank, deep cyclical (auto companies for example), or oil and gas stocks.

**Staff Comments**

No comments at this time.

**Quantitative Evaluation**

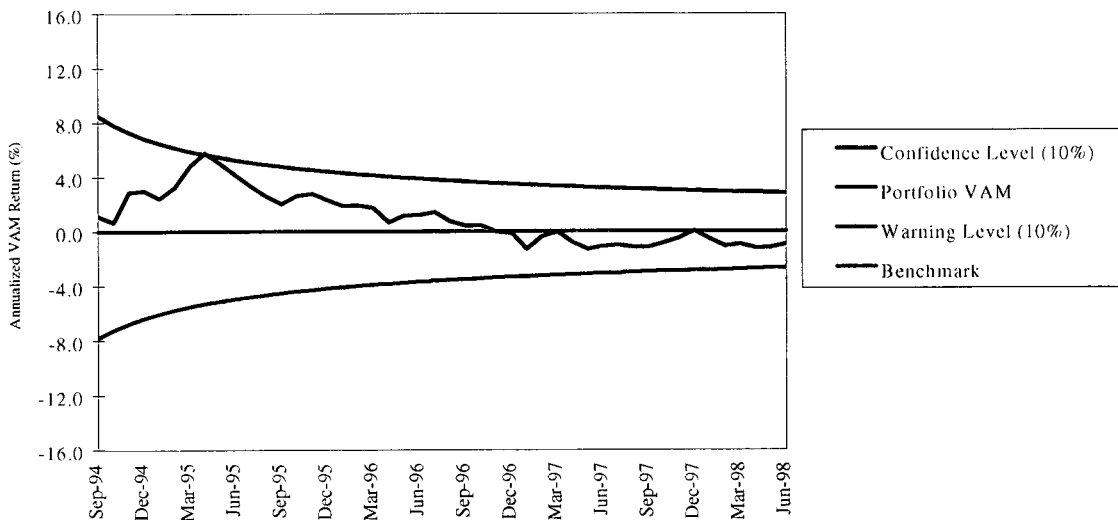
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	1.4%	1.7%
Last 1 Year	28.1	28.7
Last 2 Years	26.2	30.5
Last 3 Years	25.5	29.4
Since Inception (4/94)	24.2	25.3

**Recommendation**

No action required.

\* Custom benchmark since inception date.

Compass Capital Management  
 Cumulative Tracking



**NEW AMSTERDAM PARTNERS**  
**Periods Ending June, 1998**

**Portfolio Manager: Michelle Clayman**

**Assets Under Management: \$77,682,611**

**Investment Philosophy**

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

**Staff Comments**

No comments at this time.

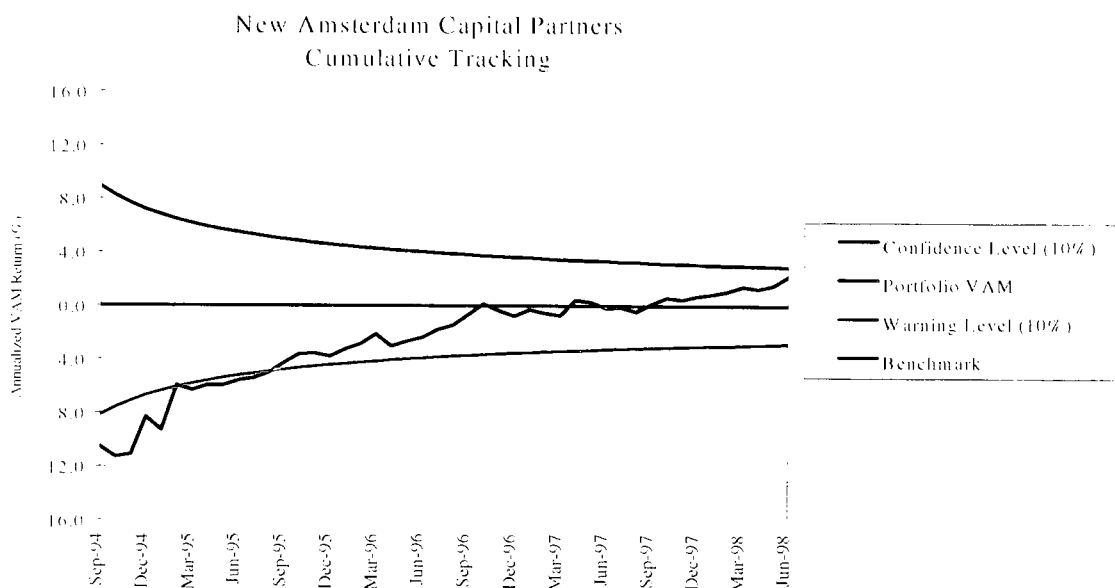
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	3.1%	-0.4%
Last 1 Year	38.0	25.2
Last 2 Years	36.3	26.7
Last 3 Years	31.1	24.1
Since Inception (4/94)	25.1	22.4

**Recommendation**

No action required.

\* Custom benchmark since inception date.



**VALENZUELA CAPITAL MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Tom Valenzuela**

**Assets Under Management: \$76,677,719**

**Investment Philosophy**

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

**Staff Comments**

No comments at this time.

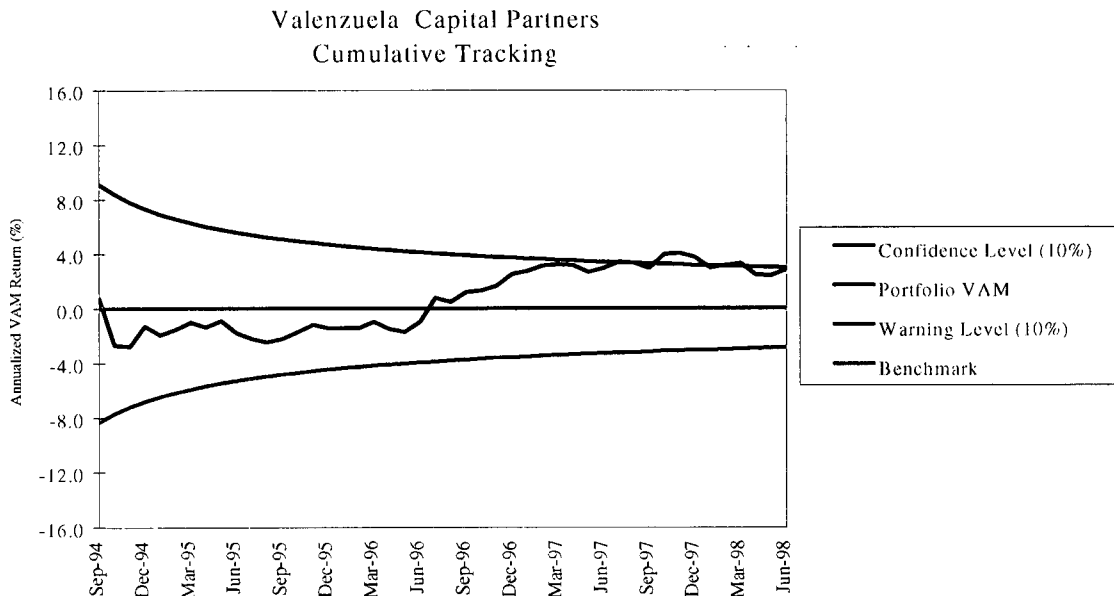
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	-4.2%	-3.2%
Last 1 Year	24.0	21.0
Last 2 Years	32.9	23.9
Last 3 Years	29.8	23.8
Since Inception (4/94)	24.7	21.3

**Recommendation**

No action required.

\* Custom benchmark since inception date.





**WILKE/THOMPSON CAPITAL MANAGEMENT INC.**  
**Periods Ending June, 1998**

**Portfolio Manager: Mark Thompson**

**Assets Under Management: \$50,834,645**

**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.

**Staff Comments**

Due to concerns regarding organizational changes and disappointing performance, Wilke/Thompson was re-interviewed by the Domestic Manager Committee and retained by the Board in September 1997. The Committee will conduct a one-year follow up review at the August 1998 meeting.

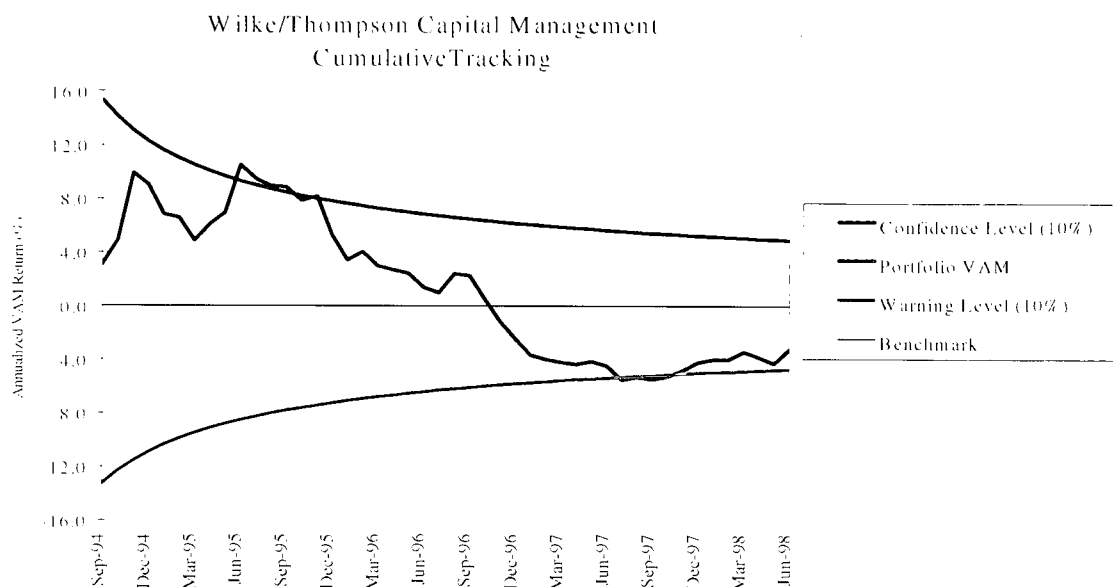
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	-4.4%	-4.5%
Last 1 Year	18.5	17.4
Last 2 Years	4.8	14.1
Last 3 Years	8.5	18.5
Since Inception (4/94)	13.2	17.0

**Recommendation**

No action required.

\* Custom benchmark since inception date.



# WINSLOW CAPITAL MANAGEMENT

Periods Ending June, 1998

**Portfolio Manager:** Clark Winslow

**Assets Under Management:** \$73,548,821

## Investment Philosophy

Winslow Capital Management (WCM) believes that investing in companies with above average earnings growth provides 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.

## Staff Comments

No comments at this time.

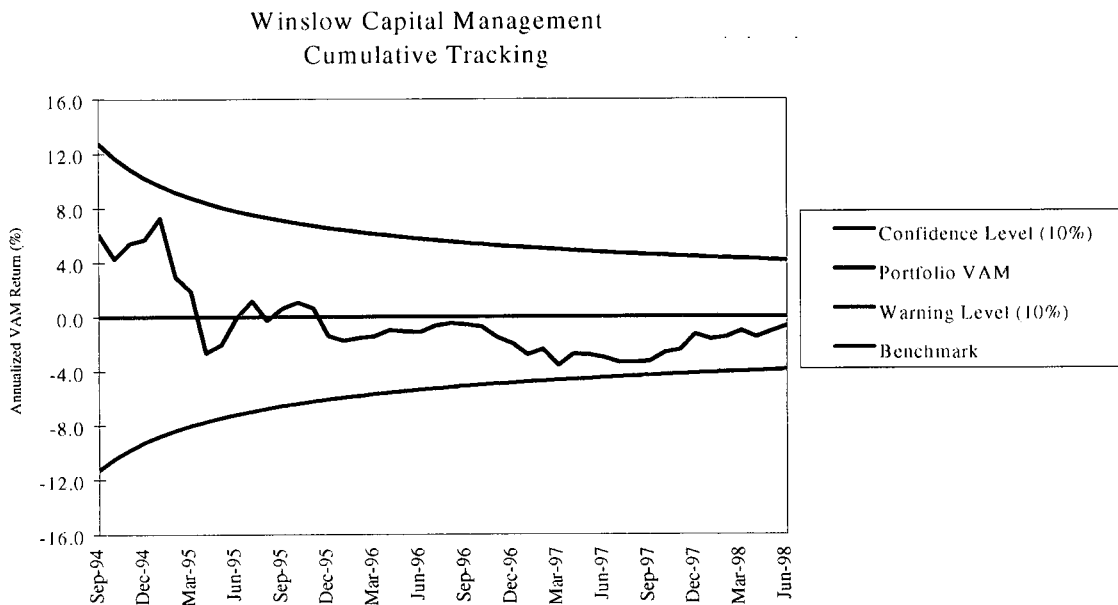
## Quantitative Evaluation

	Actual	Benchmark*
Last Quarter	4.1%	2.8%
Last 1 Year	39.1	29.7
Last 2 Years	28.6	28.8
Last 3 Years	25.4	26.6
Since Inception (4/94)	23.5	24.4

## Recommendation

No action required.

\* Custom benchmark since inception date.



**ZEVENBERGEN CAPITAL INC**  
**Periods Ending June, 1998**

**Portfolio Manager:** Nancy Zevenbergen

**Assets Under Management:** \$78,925,434

**Investment Philosophy**

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

**Staff Comments**

No comments at this time.

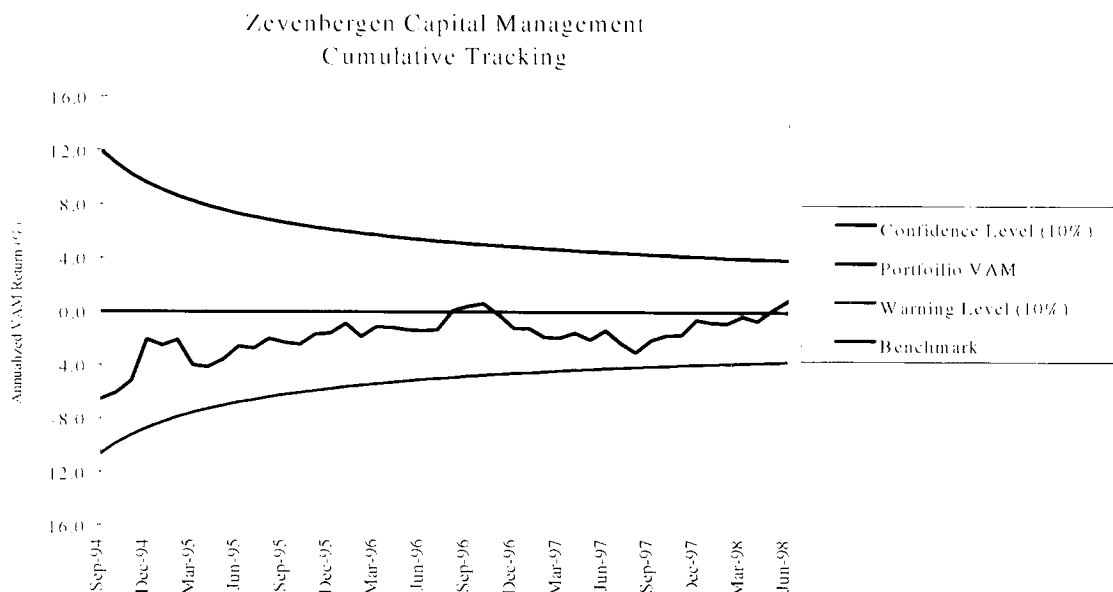
**Quantitative Evaluation**

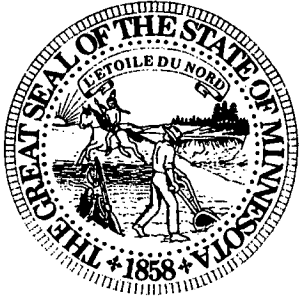
	<b>Actual</b>	<b>Benchmark*</b>
Last Quarter	7.2%	2.0%
Last 1 Year	40.7	29.8
Last 2 Years	33.1	28.6
Last 3 Years	29.8	26.9
Since Inception (4/94)	25.6	24.5

**Recommendation**

No action required.

\* Custom benchmark since inception date.





# STATE BOARD OF INVESTMENT

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## Bond Manager Evaluation Reports

Second Quarter, 1998



**COMBINED RETIREMENT FUNDS**  
**BOND MANAGERS**  
**Periods Ending June, 1998**

	Quarter		1 Year		3 years		5 Years		Since (1) Inception		Market Value (in millions)	Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active Managers</b>												
American Express (AMG)	2.5	2.3	11.2	10.5	7.9	8.0	7.1	7.0	7.1	7.0	\$573.33	6.2%
BEA	1.8	2.3	11.1	10.5	8.6	7.9	7.5	6.9	7.5	6.9	597.84	6.5%
IAI	2.5	2.3	10.0	10.5	7.7	7.9	6.2	6.9	10.9	10.9	630.24	6.8%
Miller	1.6	2.3	9.9	10.5	9.0	7.9	7.4	6.9	11.2	10.9	840.55	9.1%
Standish	2.3	2.3	10.1	10.5	8.6	7.9	7.0	6.9	7.0	6.9	702.76	7.6%
Western	2.4	2.3	12.7	10.5	9.7	7.9	8.4	6.9	12.2	10.8	1,270.63	13.8%
<b>Semi-Passive Managers</b>												
BlackRock	2.6	2.3	11.0	10.5					8.9	8.5	1,552.40	16.8%
Goldman	2.3	2.3	10.9	10.5	8.3	7.9	7.4	6.9	7.4	6.9	1,547.61	16.8%
Lincoln	2.5	2.3	10.9	10.5	8.0	7.9	7.0	6.9	9.2	9.1	1,517.47	16.4%
											<b>\$9,232.82</b>	<b>100.0%</b>
									<b>Since 7/1/84</b>			
Current Aggregate	2.3	2.3	11.0	10.5	8.5	7.9	7.3	6.9	11.4	10.8		
Historical Aggregate (2)	2.3	2.3	11.0	10.5	8.5	7.9	7.3	6.9	10.6	10.7		
Lehman Aggregate (3)		2.3		10.5		7.9		6.9		10.3		

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

(2) Includes performance of terminated managers.

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

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**AMERICAN EXPRESS ASSET MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Jim Snyder**

**Assets Under Management: \$573,326,599**

**Investment Philosophy**

IDS 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.

**Staff Comments**

Staff met with American Express Asset Management to review the investment process on the fund. Jim's approach incorporates more of a team oriented, sector rotation methodology than did the prior portfolio manager. Staff believes there are no issues at this time.

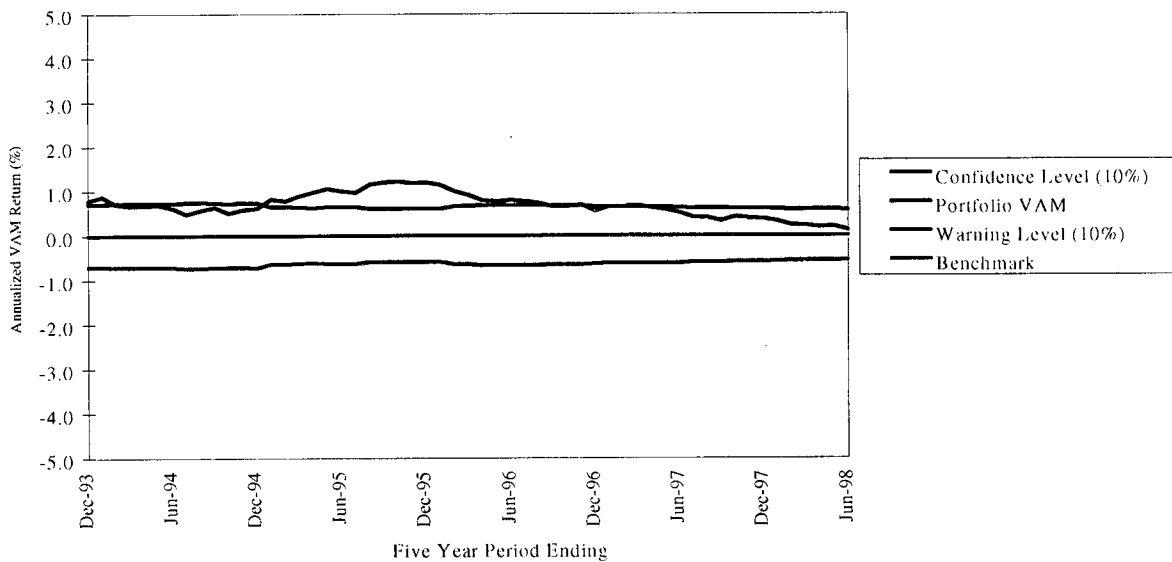
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.5%	2.3%
Last 1 year	11.2	10.5
Last 2 years	10.0	9.3
Last 3 years	7.9	8.0
Last 4 years	9.3	9.1
Last 5 years	7.1	7.0
Since Inception (7/93)	7.1	7.0

**Recommendations**

No action required.

**AMERICAN EXPRESS ASSET MANAGEMENT - Fixed Income**  
**Rolling Five Year VAM**



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



**BEA ASSOCIATES**  
**Periods Ending June, 1998**

**Portfolio Manager: Bob Moore**

**Assets Under Management: \$597,839,664**

**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.

**Staff Comments**

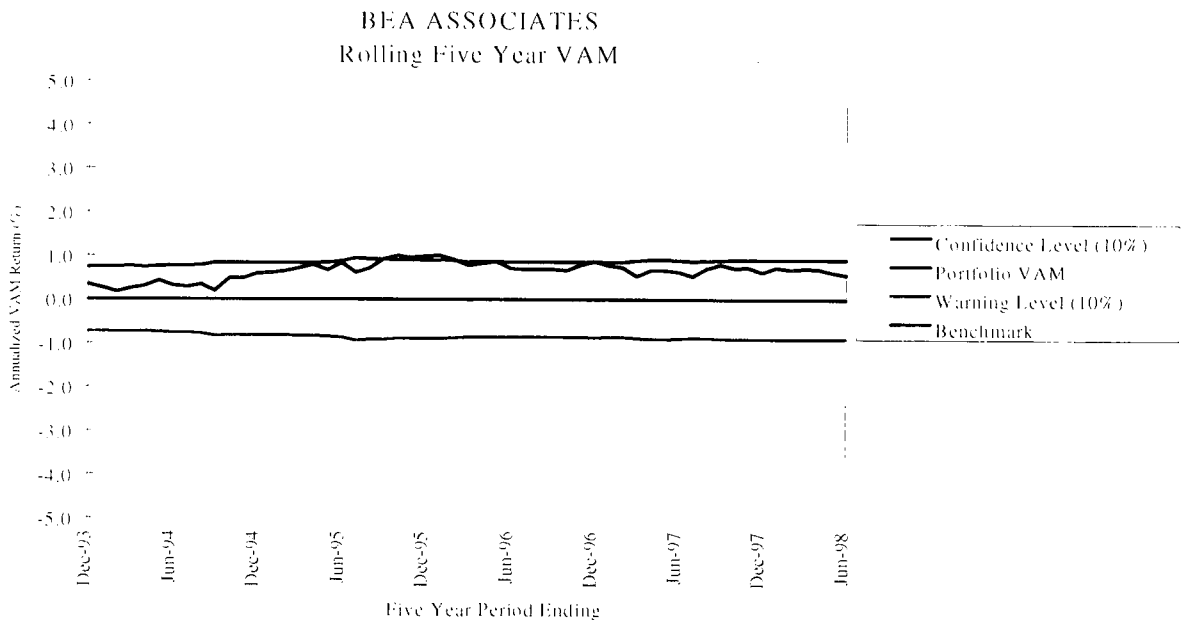
No comments at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.8%	2.3%
Last 1 year	11.1	10.5
Last 2 years	10.7	9.3
Last 3 years	8.6	7.9
Last 4 years	9.8	9.0
Last 5 years	7.5	6.9
Since Inception (7/93)	7.5	6.9

**Recommendations**

No action required.



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

**INVESTMENT ADVISERS**  
**Periods Ending June, 1998**

**Portfolio Manager: Larry Hill**

**Assets Under Management: \$630,235,917**

**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.

**Staff Comments**

During the quarter, Noel Rahn, CEO and CIO, retired. Investment Advisers (IAI) has promoted Roy Gillson, former CIO of IAI International, to the position of CIO and has promoted Kip Knelman to the position of CEO. In his position as CIO, Roy will create a new compensation structure. He also plans to improve communication with both the fixed income and equity teams. He has no plans to change the investment strategy of the fixed income team.

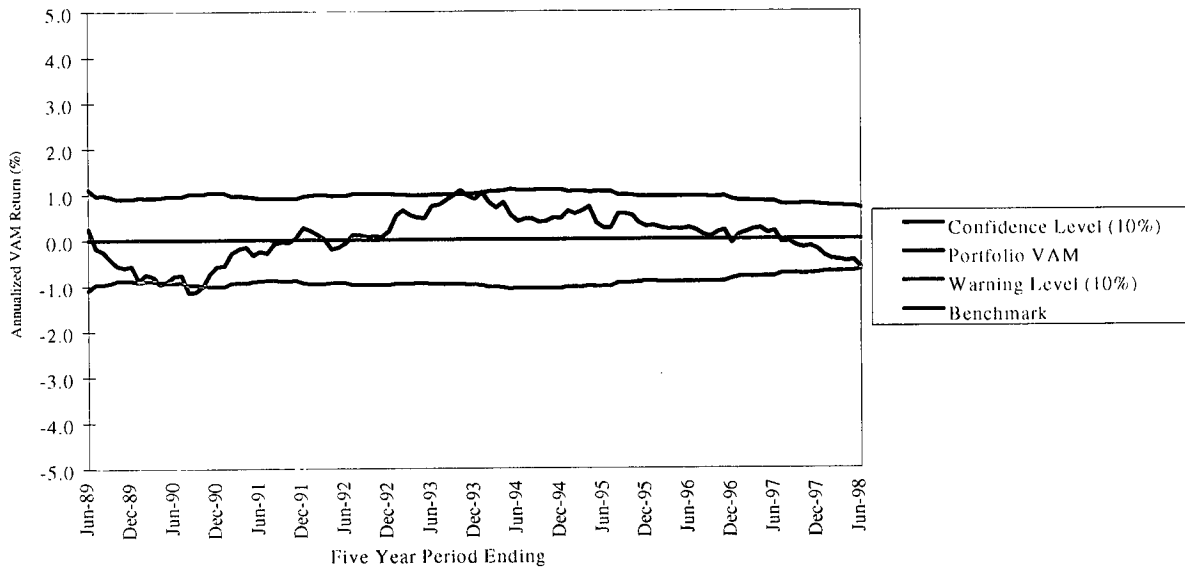
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.5%	2.3%
Last 1 year	10.0	10.5
Last 2 years	9.2	9.3
Last 3 years	7.7	7.9
Last 4 years	8.3	9.0
Last 5 years	6.2	6.9
Since Inception (7/84)	10.9	10.9

**Recommendations**

No action required.

**INVESTMENT ADVISERS - Fixed Income**  
**Rolling Five Year VAM**



**MILLER ANDERSON & SHERRERD**  
**Periods Ending June, 1998**

**Portfolio Manager: Tom Bennett**

**Assets Under Management: \$840,551,818**

**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.

**Staff Comments**

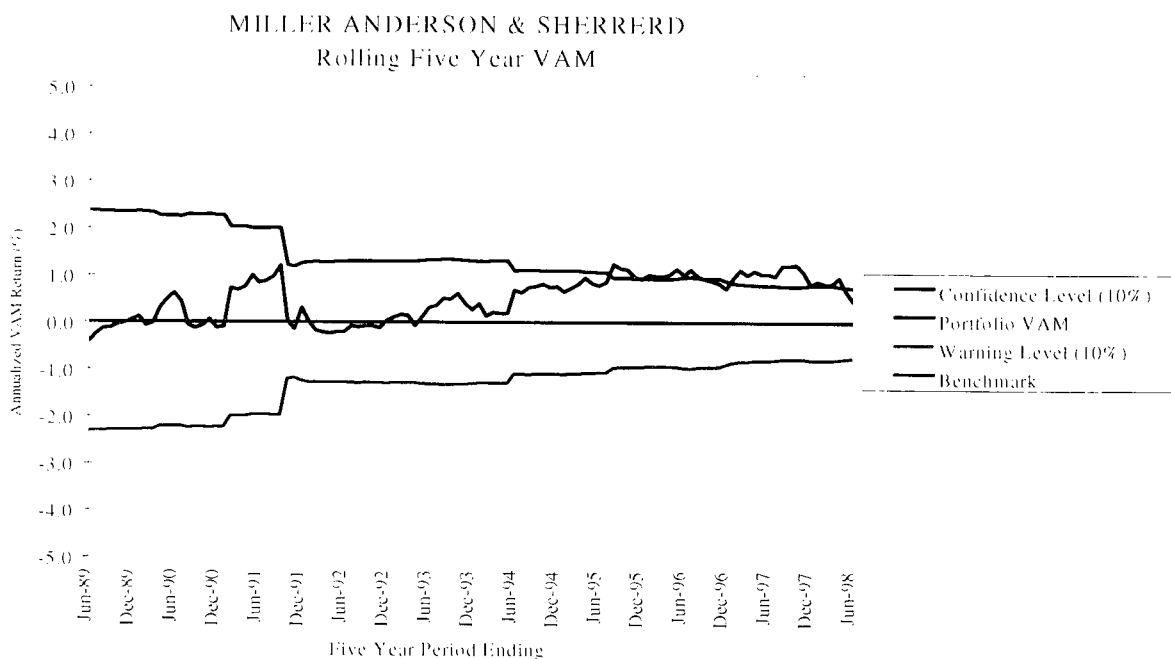
Staff met with Miller Anderson & Sherrerd (MAS) during the second quarter. Performance of the fund was hurt by short duration, corporate bond selection and emerging market issues. However, the firm's investment strategy and organizational structure remains solid. Staff is confident in the abilities of MAS to add value over time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.6%	2.3%
Last 1 year	9.9	10.5
Last 2 years	10.4	9.3
Last 3 years	9.0	7.9
Last 4 years	9.8	9.0
Last 5 years	7.4	6.9
Since Inception (7/84)	11.2	10.9

**Recommendations**

No action required.



**STANDISH, AYER & WOOD**  
**Periods Ending June, 1998**

**Portfolio Manager: Austin Smith**

**Assets Under Management: \$702,756,323**

**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.

**Staff Comments**

Staff met with Standish, Ayer & Wood (SAW) during the second quarter. Although the portfolio underperformed the benchmark for the year, staff is confident in the ability of SAW to add value over time. The organization has remained stable and the investment process is sound.

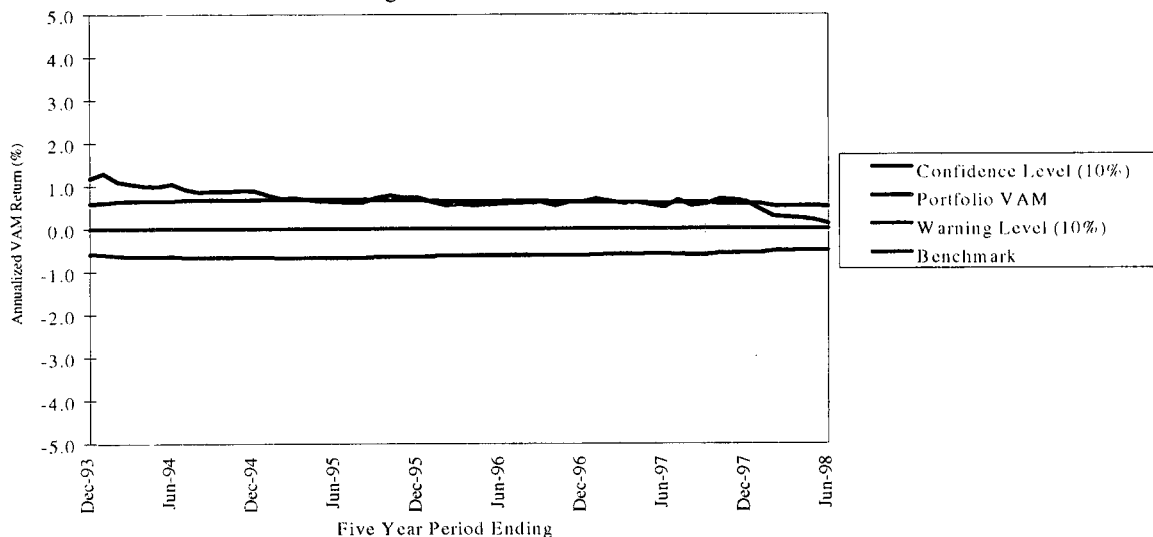
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.3%	2.3%
Last 1 year	10.1	10.5
Last 2 years	10.0	9.3
Last 3 years	8.6	7.9
Last 4 years	9.3	9.0
Last 5 years	7.0	6.9
Since Inception (7/93)	7.0	6.9

**Recommendations**

No action required.

**STANDISH, AYER & WOOD**  
**Rolling Five Year VAM**



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

**WESTERN ASSET MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Kent Engel**

**Assets Under Management: \$1,270,631,733**

**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.

**Staff Comments**

No comments at this time.

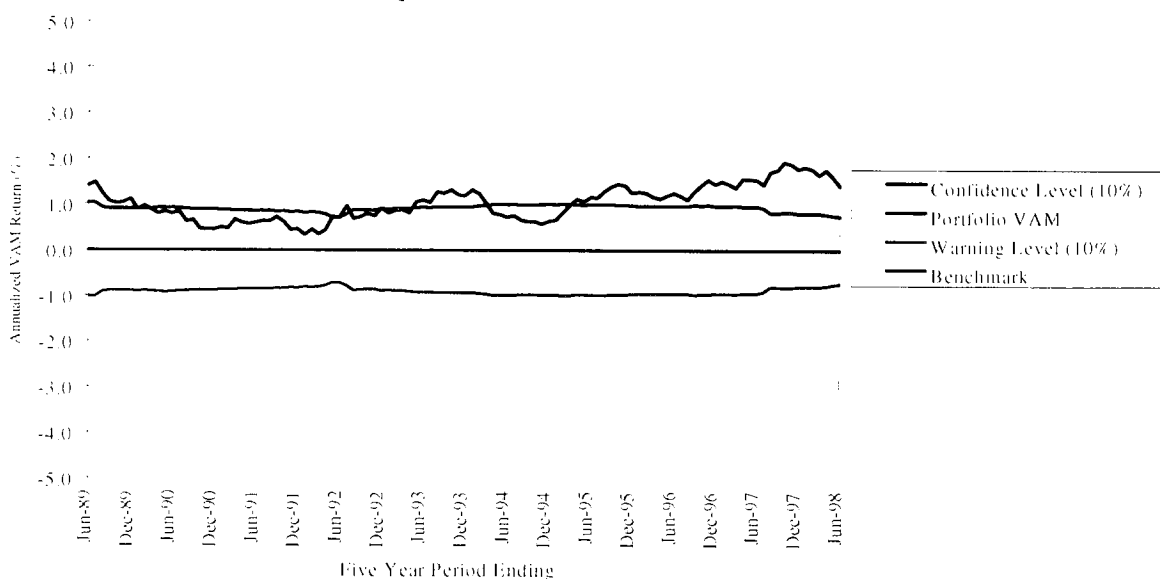
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.4%	2.3%
Last 1 year	12.7	10.5
Last 2 years	11.8	9.3
Last 3 years	9.7	7.9
Last 4 years	11.0	9.0
Last 5 years	8.4	6.9
Since Inception (7/84)	12.2	10.8

**Recommendations**

No action required.

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



**BLACKROCK FINANCIAL MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Keith Anderson**

**Assets Under Management: \$1,552,398,450**

**Investment Philosophy**

BlackRock uses a controlled-duration style. BlackRock's enhanced index strategy can be described as active management with tighter duration and sector constraints to ensure that the portfolio's aggregate risk characteristics and tracking error never significantly differ from the desired index. BlackRock's value added is derived primarily from sector and security selection driven by relative value analysis while applying disciplined risk control techniques.

**Staff Comments**

Staff met with BlackRock during the second quarter. BlackRock's parent company, PNC Corp., is discussing the possibility of spinning-off 20% of their ownership. This is not expected to affect the investment strategy at BlackRock.

Performance was strong in the second quarter due to sector and issue selection.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.6%	2.3%
Last 1 year	11.0	10.5
Last 2 years	9.9	9.3
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (4/96)	8.9	8.5

**Recommendation**

No action required.

**Tracking graph will be created for period ending 6/30/99.**

**GOLDMAN SACHS**  
**Periods Ending June, 1998**

**Portfolio Manager: Sharmin Mossavar Rahmani**

**Assets Under Management: \$1,547,608,470**

**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.

**Staff Comments**

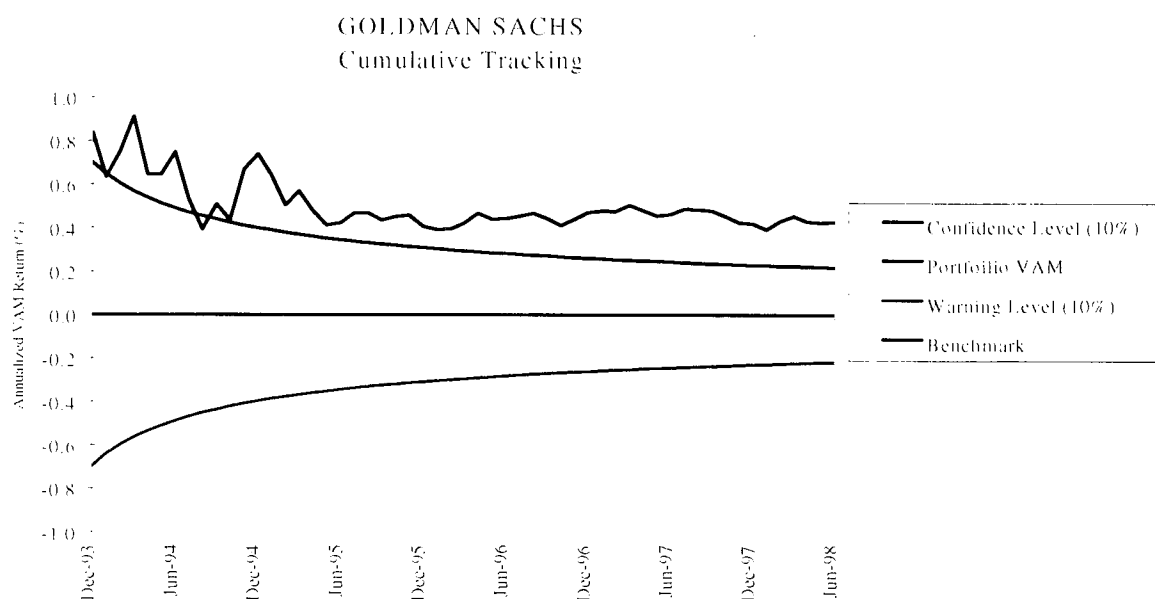
Staff met with Goldman during the second quarter to review their organization, investment strategy and portfolio performance. Staff believes there are no issues at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.3%	2.3%
Last 1 year	10.9	10.5
Last 2 years	9.8	9.3
Last 3 years	8.3	7.9
Last 4 years	9.4	9.0
Last 5 years	7.4	6.9
Since Inception (7/93)	7.4	6.9

**Recommendations**

No action required.



**LINCOLN CAPITAL MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Andrew Johnson**

**Assets Under Management: \$1,517,469,790**

**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.

**Staff Comments**

Staff met with Lincoln during the second quarter to review their organization, investment strategy and portfolio performance. Staff believes there are no issues at this time.

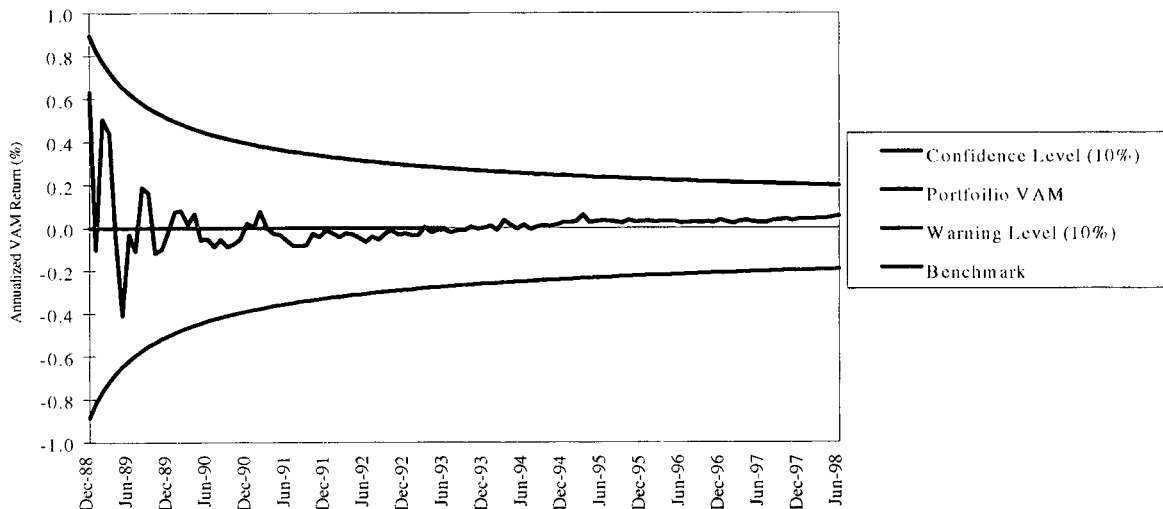
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.5%	2.3%
Last 1 year	10.9	10.5
Last 2 years	9.5	9.3
Last 3 years	8.0	7.9
Last 4 years	9.2	9.0
Last 5 years	7.0	6.9
Since Inception (7/88)	9.2	9.1

**Recommendations**

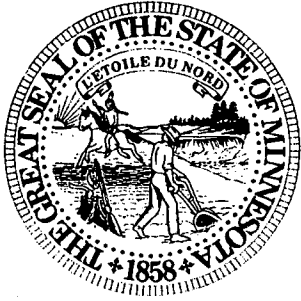
No action required.

**LINCOLN CAPITAL MANAGEMENT - Fixed income**  
**Cumulative Tracking**





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# STATE BOARD OF INVESTMENT

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## Non-Retirement Manager Evaluation Reports

Second Quarter, 1998

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**COMBINED RETIREMENT FUNDS  
NON - RETIREMENT MANAGERS  
Periods Ending June, 1998**

	Quarter		1 Year		3 years		5 Years		Since Inception		Market Value (in millions)
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	
GE Investment Management (1)	2.8	3.3	28.9	30.3	29.5	30.3			31.4	32.3	\$184.97
Voyageur Asset Management (2)	1.9	1.7	8.4	8.1	7.2	7.1	6.6	6.4	8.1	7.7	508.66
Internal Stock Pool (3)	3.3	3.3	30.4	30.3	30.3	30.3	23.1	23.1	23.1	23.1	410.74
Internal Bond Pool - Income Share (4)	2.5	2.3	11.0	10.5	8.5	7.9	7.3	6.9	9.2	8.8	188.65
Internal Bond Pool - Trust (5)	2.4	2.3	10.9	10.5	8.2	7.9			9.6	9.0	345.92

- (1) GE Investment Management was retained by the SBI in January 1995.  
The benchmark is the S&P 500 Index.
- (2) Voyageur Asset Management was retained by the SBI in July 1991.  
The benchmark is a custom index.
- (3) The Internal Stock Pool was initiated in July 1993.  
The benchmark is the S&P 500 Index.
- (4) The Income Share Account was initiated in July 1986.  
The benchmark is the Lehman Aggregate.  
Prior to July 1994, this index reflects the Salomon BIG.
- (5) The Trust Account was initiated in July 1994.  
The benchmark is the Lehman Aggregate.



**GE INVESTMENT MANAGEMENT - Assigned Risk Plan  
Periods Ending June, 1998**

**Portfolio Manager: Gene Bolton**

**Assets Under Management: \$184,965,891**

**Investment Philosophy  
Assigned Risk Plan**

GE Investment's Multi-Style Equity program attempts to outperform the S&P 500 consistently while controlling overall portfolio risk through a multiple manager approach. Four portfolio managers with different styles ranging from growth to value are supported by industry analysts and research assistants. The four portfolios are combined to create a well diversified equity portfolio while maintaining low relative volatility and a style-neutral position between growth and value. All GE managers focus on stock selection from a bottom-up prospective.

**Staff Comments**

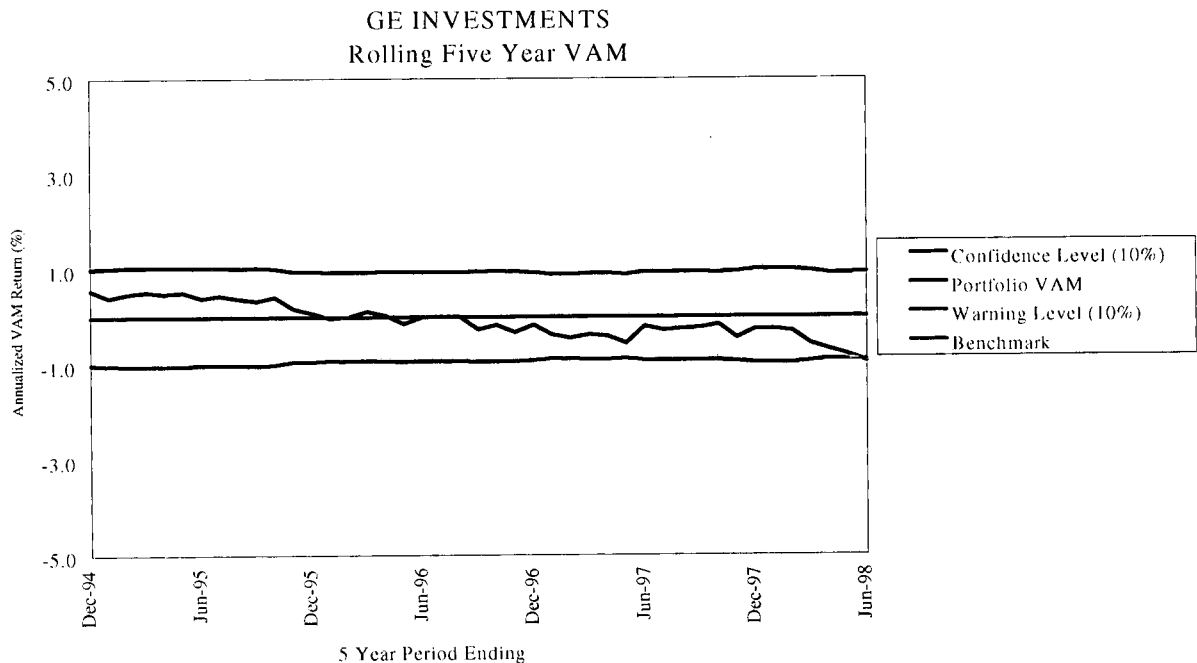
Staff met with GE during the second quarter. Although their performance has trailed the benchmark, the organization is stable and the process is valid. Most of the underperformance since the beginning of the year can be attributed to underweighting Microsoft which increased over 60% in the first half of 1998.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.8%	3.3%
Last 1 year	28.9	30.3
Last 2 years	31.6	32.4
Last 3 years	29.5	30.3
Last 4 years	N.A.	N.A.
Last 5 years	N.A.	N.A.
Since Inception (1/95)	31.4	32.3

**Recommendation**

No action required.



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

**VOYAGEUR ASSET MANAGEMENT - Assigned Risk Plan**  
**Periods Ending June, 1998**

**Portfolio Manager: Melissa A. Uppgren**

**Assets Under Management: \$508,660,562**

**Investment Philosophy**  
**Assigned Risk Plan**

Voyageur uses a top-down approach to fixed income investing. Their objective is to obtain superior long-term investment returns over a pre-determined benchmark that reflects the quality constraints and risk tolerance of the Assigned Risk Plan. Due to the specific liability requirement of the plan, return enhancement will focus on sector analysis and security selection. Yield curve and duration analysis are secondary considerations.

**Staff Comments**

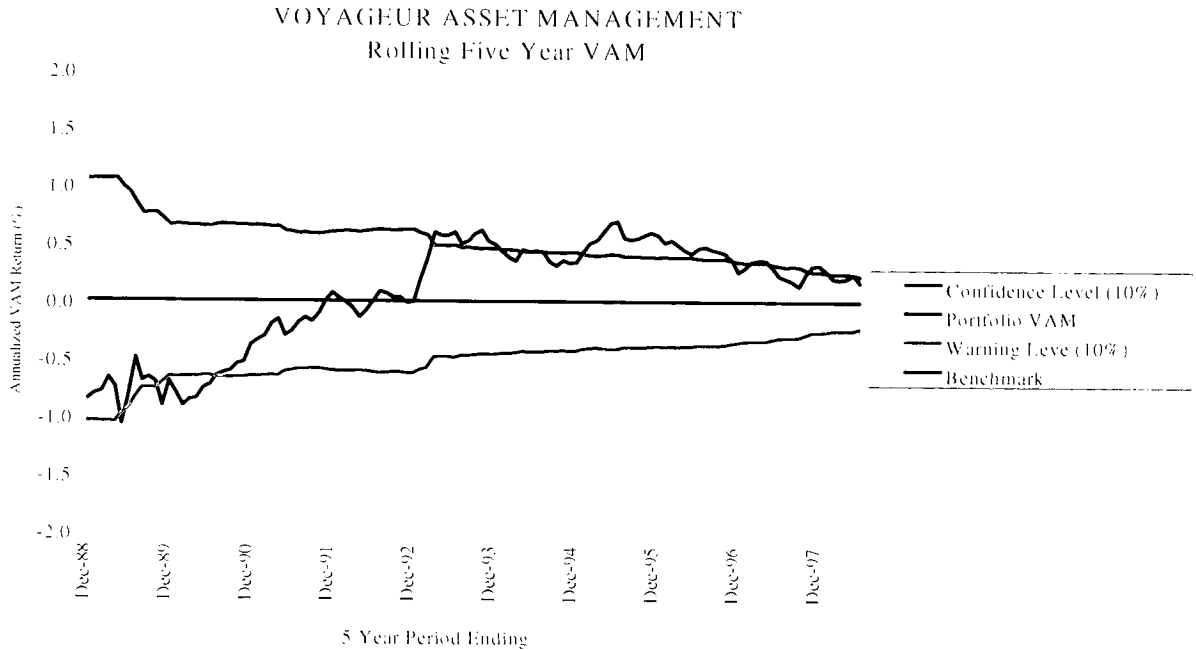
Staff met with Voyageur in their offices to review their organization, investment strategy and portfolio performance. Staff believes there are no issues at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.9%	1.7%
Last 1 year	8.4	8.1
Last 2 years	8.1	7.9
Last 3 years	7.2	7.1
Last 4 years	8.1	7.9
Last 5 years	6.6	6.4
Since Inception (7/91)	8.1	7.7

**Recommendation**

No action required.



**INTERNAL STOCK POOL - Trust/Non-Retirement Assets**  
**Periods Ending June, 1998**

**Portfolio Manager: Lois Buermann**

**Assets Under Management: \$410,743,760**

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

**Staff Comments**

The current manager assumed responsibility for the account in December 1996. The Internal Equity Pool is managed to closely track the S&P 500 Index. The strategy replicates the S&P 500 by owning all of the names in the index at weightings similar to those of the index. The optimization model's estimate of tracking error with this strategy is approximately 10 basis points per year.

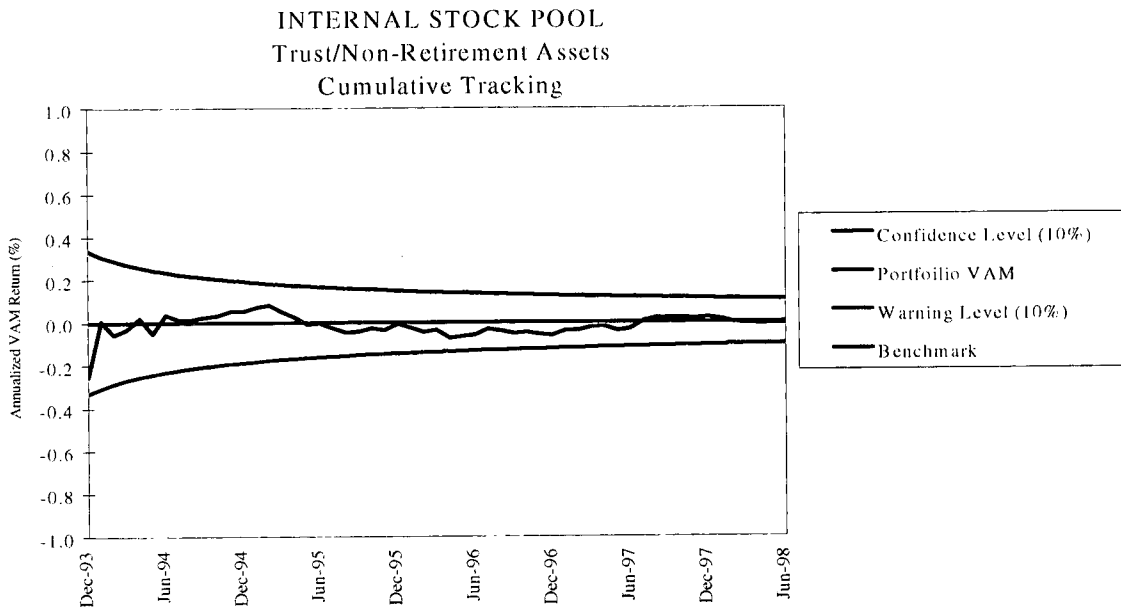
No comments at this time.

**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	3.3%	3.3%
Last 1 year	30.4	30.3
Last 2 years	32.5	32.4
Last 3 years	30.3	30.3
Last 4 years	29.2	29.3
Last 5 years	23.1	23.1
Since Inception (7/93)	23.1	23.1

No action required.





**INTERNAL BOND POOL - Income Share Account**  
**Periods Ending June, 1998**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$188,651,470**

**Investment Philosophy**  
**Income Share Account**

**Staff Comments**

The current manager assumed responsibility for this portfolio in December 1996. The investment approach emphasizes sector and security selection. The approach utilizes sector trading and relative spread analysis of both sectors and individual issues. The portfolio weightings in mortgage and corporate securities are consistently equal to or greater than the market weightings. The portfolio duration remains close to the benchmark duration but may be shortened or lengthened depending on changes in the economic outlook.

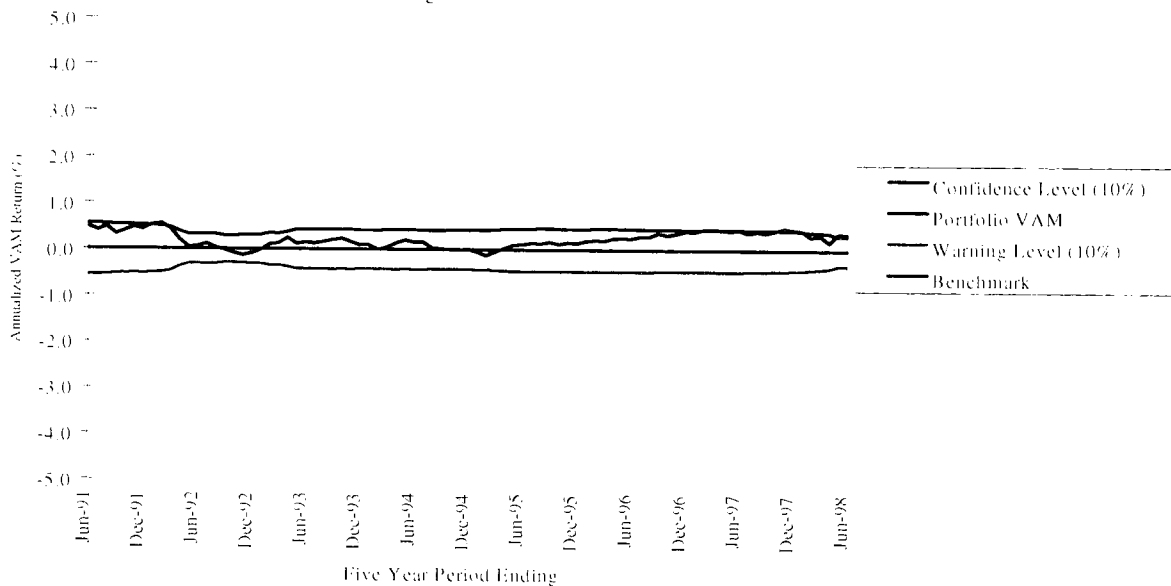
No comments at this time.

**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	2.5%	2.3%	No action required.
Last 1 year	11.0	10.5	
Last 2 years	9.9	9.3	
Last 3 years	8.5	7.9	
Last 4 years	9.5	9.0	
Last 5 years	7.3	6.9	

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



**INTERNAL BOND POOL - Trust/Non-Retirement Assets**  
**Periods Ending June, 1998**

**Portfolio Manager: Mike Messen**

**Assets Under Management: \$345,919,750**

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

**Staff Comments**

The current manager assumed responsibility for the portfolio in December 1996. The internal bond portfolio's investment approach emphasizes sector and security selection. The approach utilizes sector trading and relative spread analysis of both sectors and individual issues. The portfolio weightings in mortgage and corporate securities are consistently equal to or greater than the market weightings. The portfolio duration remains close to the benchmark duration but may be shortened or lengthened depending on changes in the economic outlook.

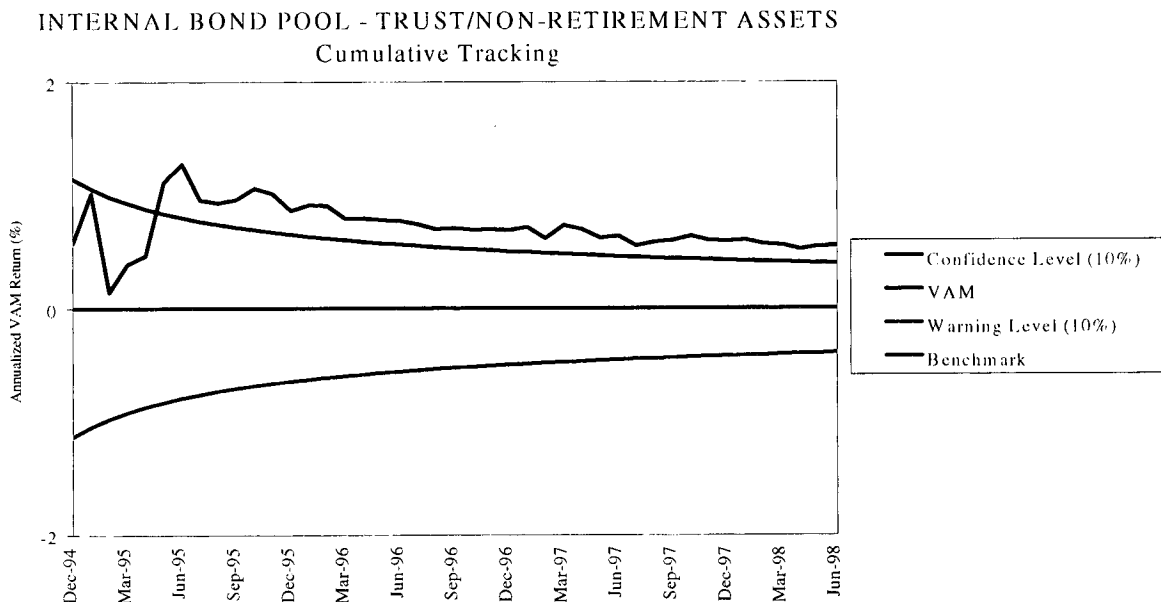
No comments at this time.

**Quantitative Evaluation**

**Recommendation**

	<b>Actual</b>	<b>Benchmark</b>	
Last Quarter	2.4%	2.3%	No action required.
Last 1 year	10.9	10.5	
Last 2 years	9.7	9.3	
Last 3 years	8.2	7.9	
Last 4 years	N/A	N/A	
Last 5 years	N/A	N/A	
Since Inception (7/94)*	9.6	9.0	

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



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# Tab F

## COMMITTEE REPORT

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DATE: August 25, 1998

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

FROM: **International Manager Committee**

The International Manager Committee met on August 13, 1998 to review the following agenda items:

- Review of manager performance for the period ending June 30, 1998.
- Discussion of the International Program

### INFORMATION ITEMS:

#### 1. Review of manager performance

The international stock program outperformed its composite index by 0.7 percentage points for the quarter ending June 30, 1998. The program outperformed by 2.3 percentage points over the last year, by 3.5 percentage points annualized for the last three years, by 2.4 percentage points annualized for the last five years, and by 1.8 percentage points since inception (5.5 years). Performance of the equity managers (without the currency overlay) outperformed the target for all periods:

Time Period	Total Program	Composite Index*	Equity Managers Only
Quarter	-1.7%	-2.4%	-1.8%
1 Year	1.2	-1.1	-0.5
3 Year	11.8	8.3	10.4
5 Year	11.0	8.6	10.2
Since Incept. 10/92	12.5	10.7	11.7

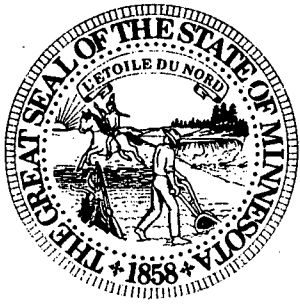
\* The composite index has been weighted 87% EAFE Free/13% Emerging Markets Free since 12/1/96. 100% EAFE Free prior to 5/1/96.

Performance evaluation (VAM) reports are behind the "blue page" in this section.

## **2. Discussion of the International Program**

The Committee discussed Staff's plans to do a comprehensive study of the International Program. The program has been in place for five years, and the staff believes that it would be beneficial to review the program to determine if any changes are warranted. The Committee agreed with staff.

Potential issues to be addressed would include the benchmark, global versus international investing, active versus passive management, multiple manager structure and the currency overlay program. It is estimated that this study will take approximately 6-12 months.



# STATE BOARD OF INVESTMENT

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## **International Manager Evaluation Reports**

**Second Quarter, 1998**





**COMBINED RETIREMENT FUNDS  
INTERNATIONAL STOCK MANAGERS  
Periods Ending June, 1998**

	Quarter		1 Year		3 years		5 Years		Since Inception		Market Value (in millions)	Equity Pool %
	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %	Actual %	Bmk %		
<b>Active EAFE</b>												
Brinson (1)	1.1	1.0	5.4	5.9	16.1	10.6	11.7	10.0	11.7	11.6	\$532.07	10.1%
Marathon (2)	-1.7	1.0	-1.9	5.9	8.9	10.6			8.3	8.5	376.65	7.2%
Rowe Price (2)	0.4	1.0	4.1	5.9	13.3	10.6			10.9	8.5	573.74	10.9%
Scudder (2)	2.9	1.0	7.8	5.9	16.7	10.6			12.5	8.5	355.59	6.8%
<b>Active Emerging Markets</b>												
City of London (3)	-20.2	-23.6	-29.4	-39.1					-8.1	-17.0	86.22	1.6%
Genesis (4)	-21.2	-23.6	-34.7	-39.1					-9.4	-15.8	214.01	4.1%
Montgomery (4)	-22.3	-23.6	-39.6	-39.1					-12.6	-15.8	201.69	3.8%
<b>Passive EAFE</b>												
State Street (5)	1.1	1.0	5.8	5.9	10.7	10.6	10.4	10.0	12.1	11.9	2,924.14	55.5%
									<b>Since 10/1/92</b>			
Equity Only*	-1.8	-2.4	-0.5	-1.1	10.4	8.3	10.2	8.6	11.7	10.7	5,264.10	100.0%
<b>Total Program**</b>	<b>-1.7</b>	<b>-2.4</b>	<b>1.2</b>	<b>-1.1</b>	<b>11.8</b>	<b>8.3</b>	<b>11.0</b>	<b>8.6</b>	<b>12.5</b>	<b>10.7</b>	<b>\$5,295.74</b>	

\* Equity managers only. Includes impact of terminated managers. Aggregate benchmark weighted 87% EAFE-Free/13% Emerging Markets Free as of 12/30/96. 100% EAFE-Free prior to 5/1/96.

\*\* Includes impact of currency overlay unrealized gain/loss. Aggregate benchmark weighted 87% EAFE-Free/13% Emerging Markets Free as of 12/30/96. 100% EAFE-Free prior to 5/1/96.

(1) Active country/passive stock. Retained April 1, 1993.

(2) Fully active. Retained November 1, 1993.

(3) Retained November 1, 1996.

(4) Retained May 1, 1996.

(5) Retained October 1, 1992.

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**Impact of Currency Overlay Program**

Cumulative Dollar Value Added                      \$176,453,499  
(Since inception, December 1, 1995)



**BRINSON PARTNERS**  
**Periods Ending June, 1998**

**Portfolio Manager: Richard Carr**

**Assets Under Management: \$532,066,708**

**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.

**Staff Comments**

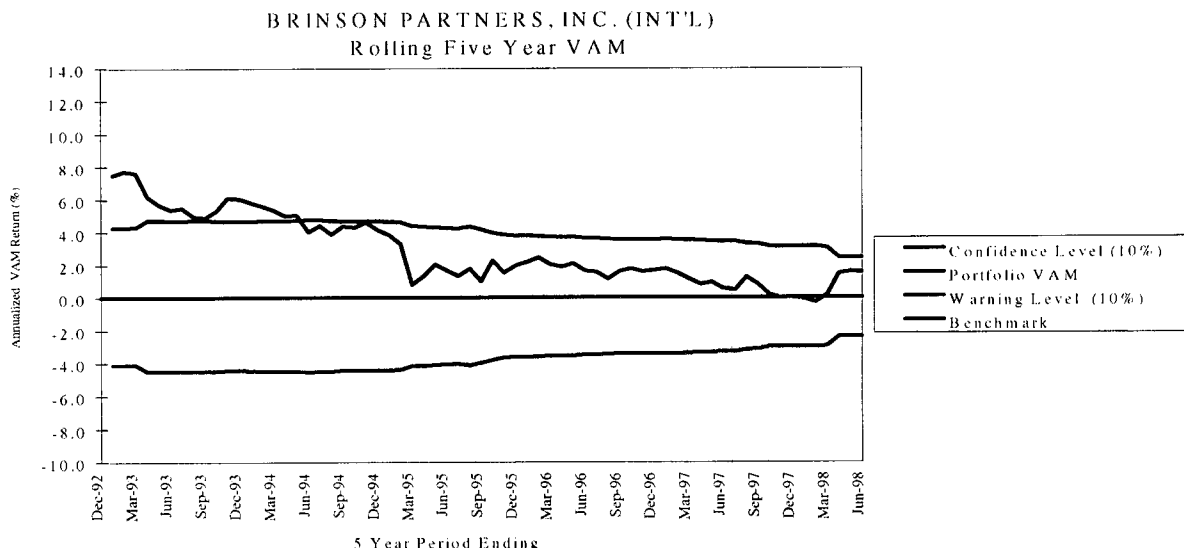
Staff met with Brinson in June to discuss investment strategy, portfolio performance and Swiss Bank Corp.'s merger with UBS. Final approval for the merger was completed in June. Staff will continue to monitor Brinson after the merger to ensure there are no adverse impacts on the SBI's portfolio.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.1%	1.0%
Last 1 year	5.4	5.9
Last 2 years	11.6	9.3
Last 3 years	16.1	10.6
Last 4 years	12.1	8.3
Last 5 years	11.7	10.0
Since Inception (4/93)	11.7	11.6

**Recommendations**

No action required.



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

**MARATHON ASSET MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager:** William Arah

**Assets Under Management:** \$376,651,623

**Investment Philosophy**

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

**Staff Comments**

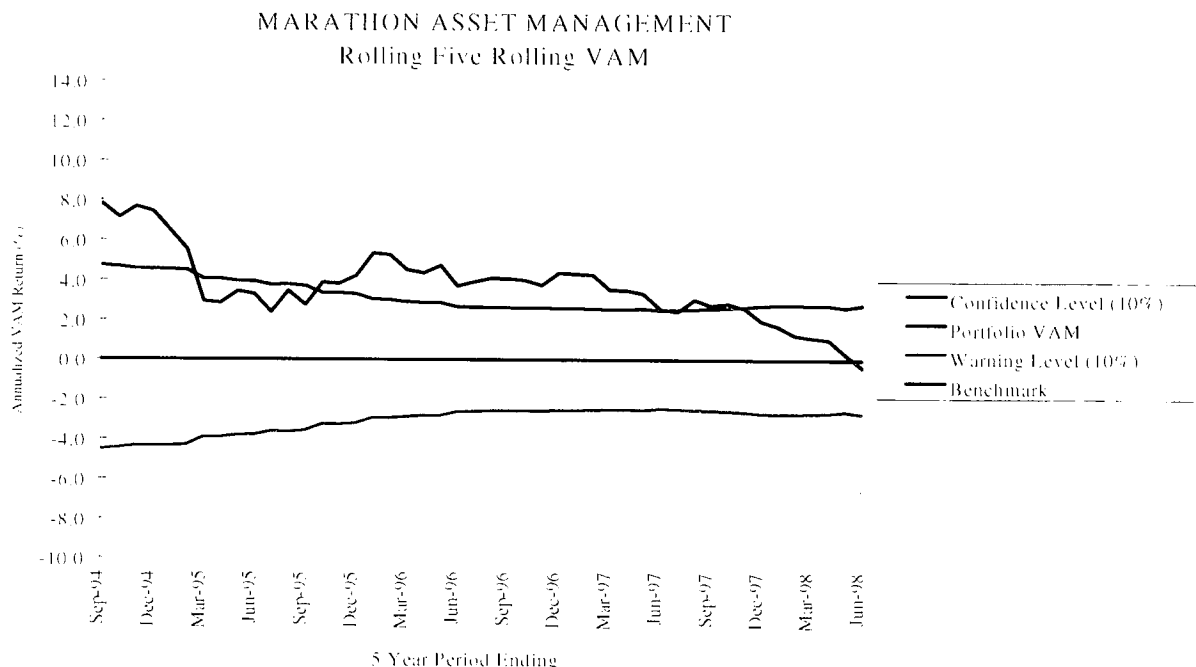
No comment at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-1.7%	1.0%
Last 1 year	-1.9	5.9
Last 2 years	3.7	9.3
Last 3 years	8.9	10.6
Last 4 years	5.9	8.3
Last 5 years	N/A	N/A
Since Inception (11/93)	8.3	8.5

**Recommendations**

No action required.



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

**ROWE PRICE-FLEMING INTERNATIONAL, INC.**  
**Periods Ending June, 1998**

**Portfolio Manager: David Warren**

**Assets Under Management: \$573,742,819**

**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.

**Staff Comments**

David Warren, Executive Vice President responsible for Japanese equities has been promoted to President. John Ford, also an Executive Vice President, has been promoted to Chief Executive Officer. Martin Wade is retaining the title of Chief Investment Officer and has become Vice Chairman. The promotions for David Warren and John Ford serve a succession planning role.

David Warren is now the portfolio manager for the SBI replacing Martin Wade. Staff has met with David frequently over the years, and has full confidence in his abilities.

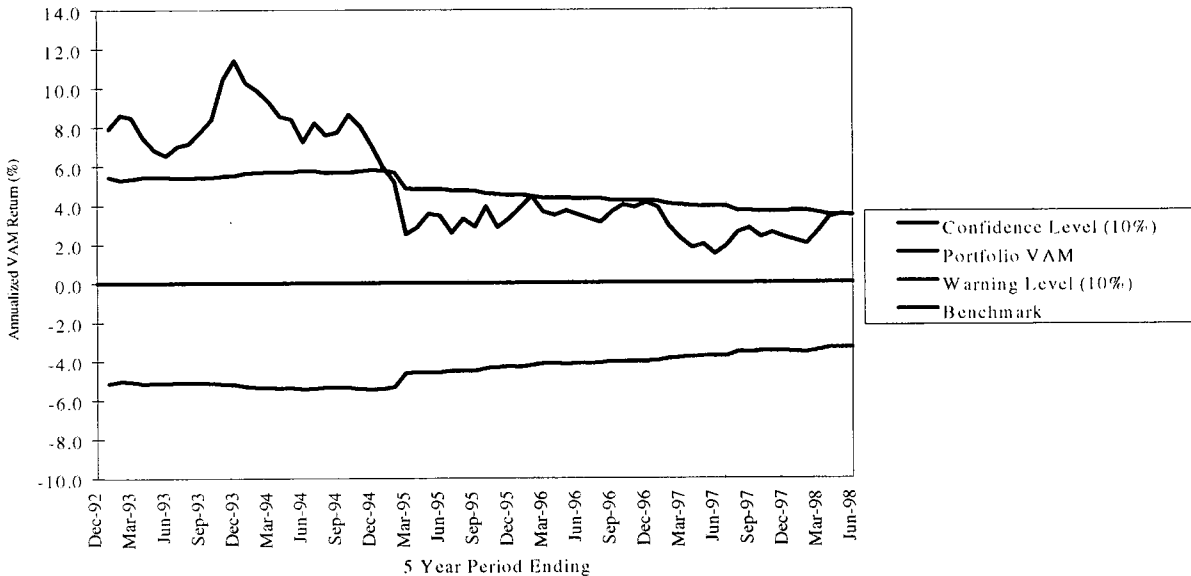
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	0.4%	1.0%
Last 1 year	4.1	5.9
Last 2 years	11.0	9.3
Last 3 years	13.3	10.6
Last 4 years	11.3	8.3
Last 5 years	N/A	N/A
Since Inception (11/93)	10.9	8.5

**Recommendations**

No action required.

**ROWE PRICE-FLEMING**  
**Rolling Five Year VAM**



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

**SCUDDER, STEVENS & CLARK**  
**Periods Ending June, 1998**

**Portfolio Manager:** Sheridan Reilly

**Assets Under Management:** \$355,589,683

**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.

**Staff Comments**

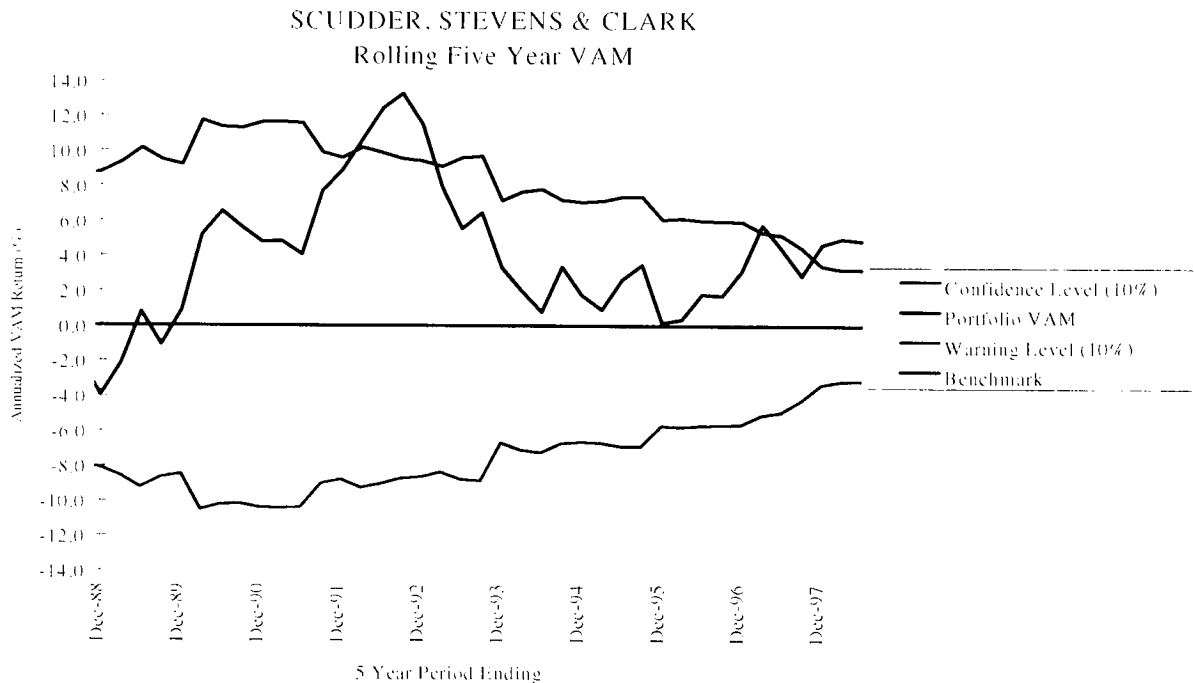
No comment at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	2.9%	1.0%
Last 1 year	7.8	5.9
Last 2 years	14.3	9.3
Last 3 years	16.7	10.6
Last 4 years	13.9	8.3
Last 5 years	N/A	N/A
Since Inception (11/93)	12.5	8.5

**Recommendations**

No action required.



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

**CITY OF LONDON**  
**Periods Ending June, 1998**

**Portfolio Manager: Barry Olliff**

**Assets Under Management: \$86,216,310**

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**Investment Philosophy**

City of London is an emerging markets specialist. The firm invests in closed-end country and regional funds to enhance performance when discounts to net asset value (NAV) narrow and to assure broad diversification within markets. They perform two levels of analysis. The first level is to compile macro-economic data for each country in their universe. Countries are ranked nominally according to the relative strength of their fundamentals and the expected upward potential of their stock markets. The second level is research on closed-end country and regional funds which use analyzed funds for corporate activity, liquidation dates, liquidity and discounts to NAV. They also analyze the quality and expertise of the closed-end fund managers. Countries are then re-ranked according to the relative pricing and discounts to NAV of country specific funds.

**Staff Comments**

No comment at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-20.2%	-23.6%
Last 1 year	-29.4	-39.1
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 (11/96)	-8.1	-17.0

**Recommendations**

No action required.

**VAM Graph will be drawn for period ending 12/31/98.**

**GENESIS ASSET MANAGERS, LTD.**  
**Periods Ending June, 1998**

**Portfolio Manager: Paul Greatbatch**

**Assets Under Management: \$214,005,215**

**Investment Philosophy**

Genesis is an emerging markets specialist. The firm believes that the critical factor for successful investment performance in emerging markets is stock selection. They also believe that structural changes in emerging markets will continue to create both winners and losers in the corporate sector. Finally, they believe that following index stocks will not necessarily expose an investor to the highest returns since those stocks are typically concentrated in large capitalization companies that have already attained a certain level of recognition. They identify those countries in which structural change will most likely generate growth opportunities for business and/or where the environment is supportive of a flourishing private sector. Stock selection is based on Genesis' estimate of the value of the company's future real earnings stream over five years relative to its current price. The portfolio consists of the most undervalued stocks across all markets with emphasis on growth with value.

**Staff Comments**

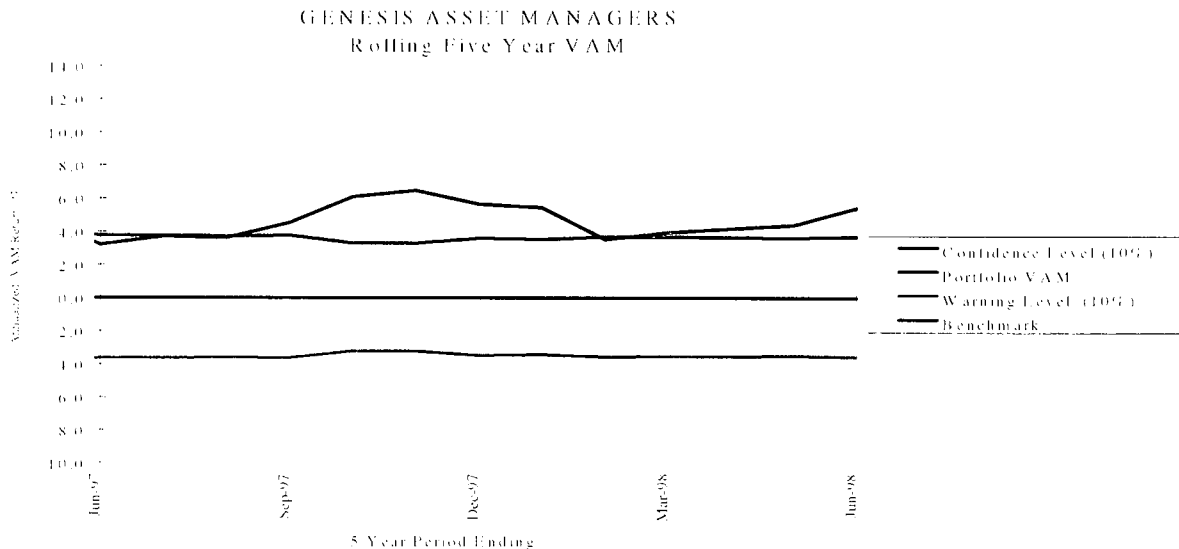
No comment at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-21.2%	-23.6%
Last 1 year	-34.7	-39.1
Last 2 years	-10.8	-17.1
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (5/96)	-9.4	-15.8

**Recommendations**

No action required.



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



**MONTGOMERY ASSET MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Josephine Jimenez**

**Assets Under Management: \$201,686,006**

**Investment Philosophy**

Montgomery is an emerging markets specialist. The firm combines quantitative investment techniques and fundamental stock selection to take advantage of market inefficiencies and low correlations within the emerging markets. Their top-down analysis begins with a quantitative approach which evaluates historical volatility and correlations between markets. The model identifies attractive countries which are then qualitatively analyzed for "event risk" which the model cannot take into account. Fundamental analysis is used to evaluate the financial condition, quality of management, and competitive position of each stock. Stocks will come from two tiers. Tier 1 will be 60-100 blue chip stocks. Tier 2 will be 100-150 smaller cap stocks with substantial growth potential. Characteristics of selected stocks may include low PE's to internal growth rates, above average earnings growth potential or undervalued/hidden assets.

**Staff Comments**

No comment at this time.

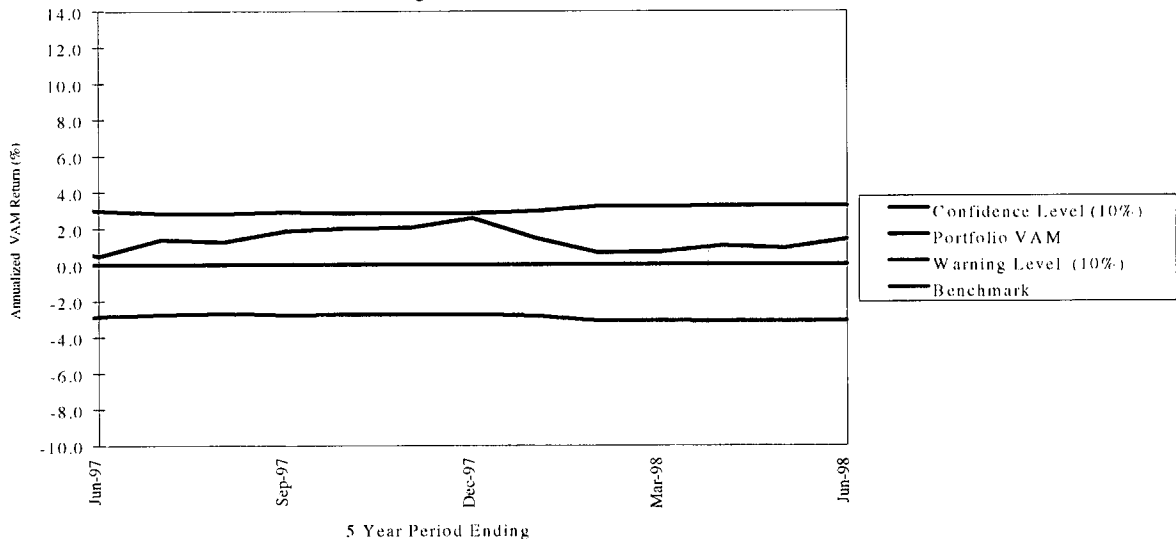
**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	-22.3%	-23.6%
Last 1 year	-39.6	-39.1
Last 2 years	-14.2	-17.1
Last 3 years	N/A	N/A
Last 4 years	N/A	N/A
Last 5 years	N/A	N/A
Since Inception (5/96)	-12.6	-15.8

**Recommendations**

No action required.

**MONTGOMERY ASSET MANAGEMENT**  
**Rolling Five Year VAM**



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

**STATE STREET GLOBAL ADVISORS**  
**Periods Ending June, 1998**

**Portfolio Manager: Lynn Blake**

**Assets Under Management: \$2,924,140,098**

**Investment Philosophy**

State Street Global Advisors passively manages the portfolio against the Morgan Stanley Capital International (MSCI) index of 20 markets located in Europe, Australia and the Far East (EAFE). They buy only securities which are eligible for purchase by foreign investors, therefore they are benchmarked against the MSCI EAFE-Free index. SSgA fully replicates the index whenever possible because it results in lower turnover, higher tracking accuracy and lower market impact costs. The MSCI EAFE-Free reinvests dividends at the Belgian tax rate. The portfolio reinvests dividends at the lower U.S. tax rate, which should result in modest positive tracking error, over time.

**Staff Comments**

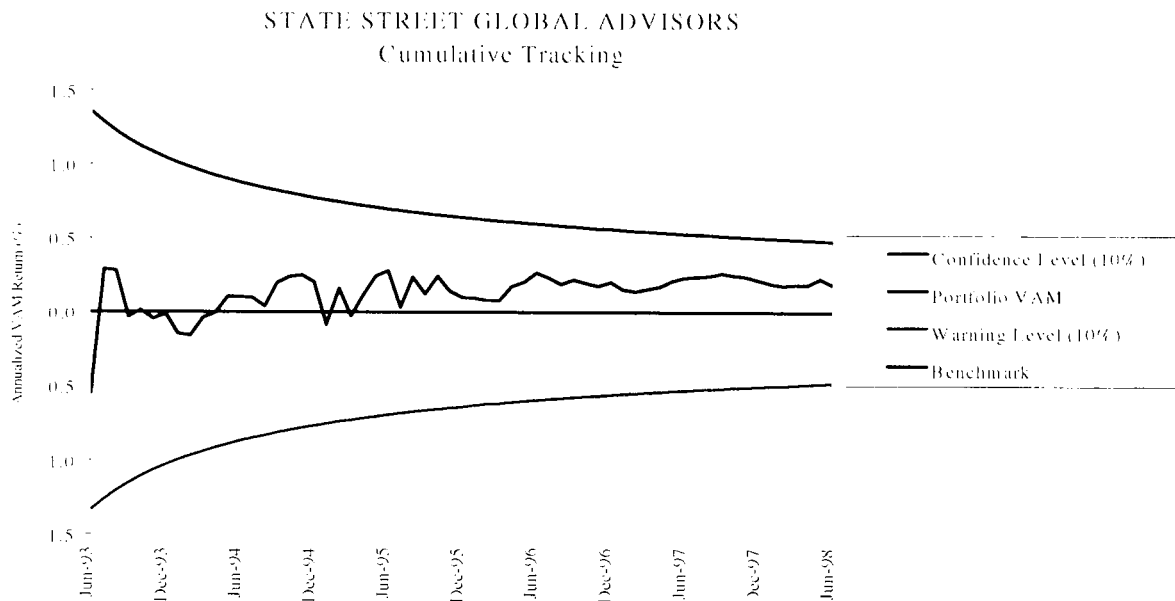
No comment at this time.

**Quantitative Evaluation**

	<b>Actual</b>	<b>Benchmark</b>
Last Quarter	1.1%	1.0%
Last 1 year	5.8	5.9
Last 2 years	9.4	9.3
Last 3 years	10.7	10.6
Last 4 years	8.6	8.3
Last 5 years	10.4	10.0
Since Inception (10/92)	12.1	11.9

**Recommendation**

No action required.



**RECORD TREASURY MANAGEMENT**  
**Periods Ending June, 1998**

**Portfolio Manager: Wilbur Kim**

**Exposure Included in Overlay: \$1,089,677,479**

**Investment Philosophy**

Record Treasury avoids all forms of forecasting in its approach to currency overlay. Rather, the firm employs a systematic model which uses a form of dynamic hedging. The firm creates a portfolio of synthetic currency options using forward contracts. Like traditional options, Record's "in-house options" allow the client to participate in gains associated with foreign currency appreciation and avoid losses associated with foreign currency depreciation. As with all dynamic hedging programs, Record will tend to sell foreign currency as it weakens and buy as it strengthens.

The SBI has chosen to limit the overlay program to currencies that comprise 5% or more of the EAFE index: Japanese Yen, British Pound Sterling, German Mark, French Franc, Swiss Franc, Dutch Guilder. One twelfth of the exposures in the SBI's EAFE index fund were added to the overlay program each month from December 1995 to November 1996. Each currency is split into equal tranches that are monitored and managed independently. The strike rate for each tranche is set at 2% out-of-the money at the start date of each tranche. This requires a 2% strengthening of the US dollar to trigger a hedge for that tranche.

**Staff Comments**

In April, the reduction of the currency overlay was implemented by Record Treasury. They encountered no problems.

**Quantitative Evaluation**

	<b>Index Fund + Record</b>	<b>Index Fund(1)</b>
Last Quarter	1.2%	1.1%
Last 1 Year	9.0	5.8
Last 2 Years	13.5	9.4
Last 3 Years	N/A	N/A
Last 4 Years	N/A	N/A
Last 5 Years	N/A	N/A
Since Inception (12/95)	14.1	10.8

**Recommendations**

No action required.

(1) Actual unhedged return of the entire EAFE-Free index fund managed by State Street Global Advisers. Includes return of underlying stock exposure. (As reported by State Street Bank)

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# Tab G

## COMMITTEE REPORT

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DATE: August 25, 1998

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

FROM: **Alternative Investment Committee**

The Alternative Investment Committee met on August 14, 1998 to review the following information and action items:

- Review of current strategy.
- Investments for the Basic Retirement Fund with two existing private equity managers, Piper Jaffray Ventures and Crescendo Venture Management L.L.C. (formerly IAI Ventures Inc.) and an existing real estate manager, TA Associates Realty. An investment with an existing private equity manager (TCW Crescent Mezzanine Partners) is being recommended for the Post Retirement Fund.

**The Board/IAC action is required on the last item.**

### INFORMATION ITEMS:

#### 1) **Review of Current Strategy.**

To increase overall portfolio diversification, 15% of the Basic Retirement Funds and 5% of the Post Retirement Fund are allocated to alternative investments. Alternative investments include real estate, private equity and resource investments where Minnesota State Board of Investment (SBI) participation is limited to commingled funds or other pooled vehicles. Charts summarizing the Board's current commitments are attached (see **Attachments A and B**).

#### **Basic Funds**

- The real estate investment strategy calls for the establishment and maintenance of a broadly diversified real estate portfolio comprised of investments that provide overall diversification by property type and location. The main component of this portfolio consists of investments in diversified 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 an investment at market value of \$661 million in twenty (20) 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. Currently, the SBI has an investment at market value of \$987 million in forty-four (44) commingled private equity funds.
- The strategy for resource investment is to establish and maintain a portfolio of resource investment vehicles that are specifically designed for institutional investors to provide an inflation hedge and additional diversification. Individual resource investments will include proved producing oil and gas properties, royalties and other investments that are diversified geographically and by type. Currently, the SBI has an investment at market value of \$155 million in eleven (11) 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 employees' pension assets, an allocation to yield oriented alternative investments will be emphasized. The Basic Retirement Funds' invest the active employees' pension assets and have less concern regarding the current yield for their alternative investments. The SBI has an investment at market value of \$156 million in twelve (12) yield oriented funds for the Post Fund: Four (4) are in real estate, six (6) are in private equity and two (2) are in resource funds.

### **ACTION ITEMS:**

- 1) Investment for the Basic Retirement Fund with an existing private equity manager, Crescendo Venture Management, L.L.C. in Crescendo Fund III, L.P.**

Crescendo Venture Management, L.L.C. (formerly IAI Ventures Inc.) is seeking investors for a new \$250 million private equity fund, Crescendo Fund III, L.P. This Fund is the third private equity fund managed by Crescendo Venture Management, L.L.C.. Crescendo Fund III, L.P. will focus, like prior funds, on assembling a diverse portfolio of venture capital and private equity investments in the technology, communications and healthcare sectors.

More information on Crescendo Fund III, L.P. is included as **Attachment C**.

**RECOMMENDATION:**

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

Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by Crescendo Venture Management, L.L.C. 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 Crescendo Venture Management, L.L.C. or reduction or termination of the commitment.

- 2) Investment for the Basic Retirement Fund with an existing private equity manager, Piper Jaffray Ventures, Inc., in Piper Jaffray Healthcare Fund III, L.P.

Piper Jaffray Ventures, Inc. is seeking investors for a new \$100 million private equity fund, Piper Jaffray Healthcare Fund III, L.P.. Piper Jaffray Healthcare Fund III, L.P. will focus on assembling a diverse portfolio of healthcare venture capital and private equity investments.

More information on Piper Jaffray Healthcare Fund III, L.P. is included as Attachment D.

**RECOMMENDATION:**

The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$20 million or 20%, whichever is less, in Piper Jaffray Healthcare Fund III, L.P. This commitment will be allocated to the Basic Retirement Fund.

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



**3) Investment for the Basic Retirement Fund with an existing real estate manager, TA Associates Realty, in The Realty Associates Fund V.**

TA Associates Realty is seeking investors for a new \$500 million real estate fund, The Realty Associates Fund V. This Fund is the fifth real estate fund managed by TA Associates Realty. The Realty Associates Fund V will focus, like prior funds, on assembling a diverse portfolio of real estate investments.

More information on The Realty Associates Fund V 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 \$50 million or 20%, whichever is less, in The Realty Associates Fund V. This commitment will be allocated to the Basic Retirement Fund.**

**Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by TA Associates Realty 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 TA Associates Realty or reduction or termination of the commitment.**

**4) Investment for the Post Retirement Fund with an existing private equity manager, TCW Crescent Mezzanine Partners, in TCW Crescent Mezzanine Partners II, L.P.**

TCW Crescent Mezzanine Partners is seeking investors for a new \$650 million private equity fund, TCW Crescent Mezzanine Partners II, L.P. This Fund is the second private equity fund managed by TCW Crescent Mezzanine Partners. TCW Crescent Mezzanine Partners II, L.P. will focus, like the prior fund, on assembling a portfolio of subordinated debt with equity participation investments in a diverse group of portfolio companies.

More information on TCW Crescent Mezzanine Partners II, L.P. is included as **Attachment F**.

**RECOMMENDATION:**

**The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$100 million or 20%, whichever is less, in TCW Crescent Mezzanine Partners II, L.P. This commitment will be allocated to the Post Retirement Fund.**

**Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the State Board of Investment or its Executive Director have any liability for reliance by TCW Crescent Mezzanine 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 TCW Crescent Mezzanine Partners or reduction or termination of the commitment.**



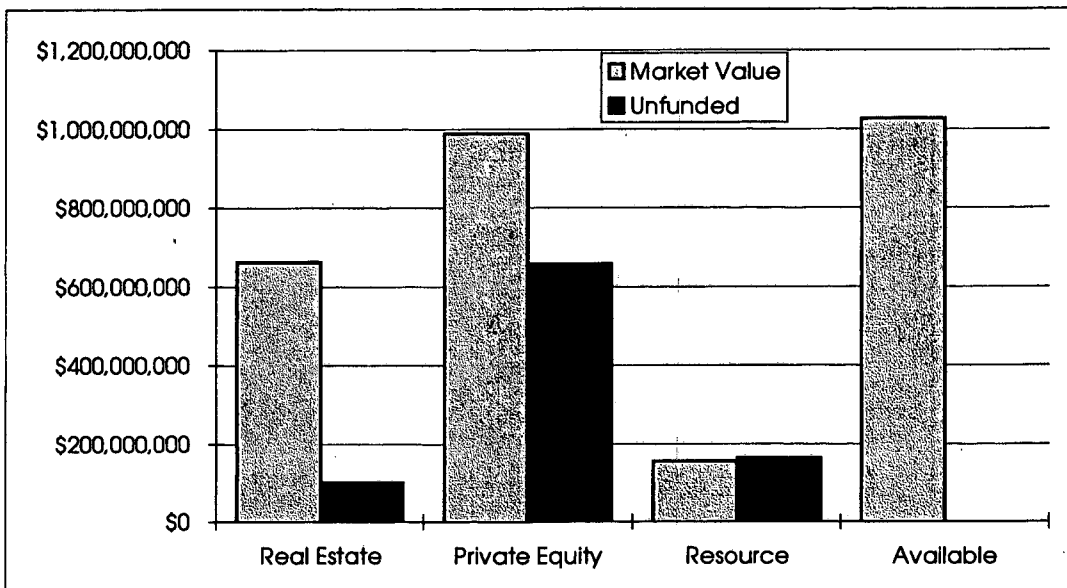
**ATTACHMENT A**

**Minnesota State Board of Investment  
Alternative Investments  
Basic Retirement Funds  
June 30, 1998**

Market Value of Basic Retirement Funds	\$18,858,981,849
Amount Available For Investment	\$1,025,883,534

	<i>Current Level</i>	<i>Target Level</i>	<i>Difference</i>
Market Value	\$1,802,963,743	\$2,828,847,277	\$1,025,883,534
MV + Unfunded	\$2,722,448,615	\$3,771,796,370	\$1,049,347,755

<b>Asset Class</b>	<b>Market Value</b>	<b>Unfunded Commitment</b>	<b>Total</b>
Real Estate	\$661,038,426 3.5%	\$100,023,703 0.5%	\$761,062,129 4.0%
Private Equity	\$987,300,263 5.2%	\$656,519,327 3.5%	\$1,643,819,590 8.7%
Resource	\$154,625,054 0.8%	\$162,941,842 0.9%	\$317,566,896 1.7%
<b>Total</b>	<b>\$1,802,963,743</b> 9.6%	<b>\$919,484,872</b> 4.9%	<b>\$2,722,448,615</b> 14.4%

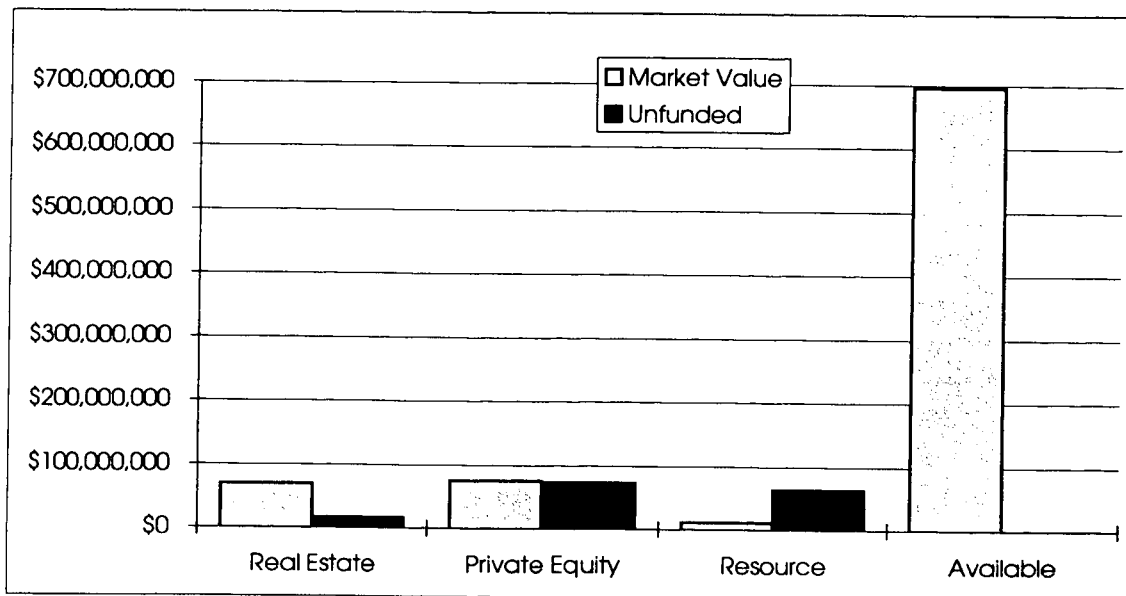


**Minnesota State Board of Investment**  
**Alternative Investments**  
**Post Retirement Fund**  
**June 30, 1998**

Market Value of Post Retirement Fund                                      \$17,031,196,634  
 Amount Available For Investment    \$695,875,912

	<b>Current Level</b>	<b>Target Level</b>	<b>Difference</b>
Market Value	\$155,683,920	\$851,559,832	\$695,875,912
MV + Unfunded	\$307,428,732	\$1,703,119,663	\$1,395,690,932

<b>Asset Class</b>	<b>Market Value</b>	<b>Unfunded Commitment</b>	<b>Total</b>
Real Estate	\$69,145,969 0.4%	\$16,195,810 0.1%	\$85,341,779 0.5%
Private Equity	\$75,158,825 0.4%	\$73,006,660 0.4%	\$148,165,485 0.9%
Resource	\$11,379,126 0.1%	\$62,542,342 0.4%	\$73,921,468 0.4%
<b>Total</b>	<b>\$155,683,920</b> 0.9%	<b>\$151,744,812</b> 0.9%	<b>\$307,428,732</b> 1.8%



**ATTACHMENT B**

**MINNESOTA STATE BOARD OF INVESTMENT**

**ALTERNATIVE INVESTMENT REAL ESTATE**

**6/30/98**

<b>BASIC FUN</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>
AETNA	42,376,529	42,376,529	104,867,148	0	0	6.40	16.2
<b>AEW</b>							
<i>AEW III</i>	20,000,000	20,000,000	85,709	24,053,653	0	1.75	12.8
<i>AEW IV</i>	15,000,000	15,000,000	16,872	4,410,656	0	-10.86	11.8
<i>AEW V</i>	15,000,000	15,000,000	1,677,914	10,301,595	0	-2.42	10.5
AMERICAN REPUBLIC	1	1	1	0	0	0.00	8.4
<b>COLONY CAPITAL</b>							
<i>Colony Investors II</i>	40,000,000	35,540,364	31,623,539	7,731,133	4,459,636	7.35	3.2
<i>Colony Investors III</i>	100,000,000	9,091,532	9,091,532	0	90,908,468	0.00	0.5
<b>EQUITABLE</b>	40,000,000	40,000,000	93,198,005	0	0	5.56	16.7
<b>EQUITY OFFICE PROPERTIES TRUST</b>	140,388,854	140,388,854	209,984,622	32,352,994	0	18.85	6.6
<b>FIRST ASSET REALTY</b>	916,185	916,185	364,185	679,784	0	4.55	4.2
<b>HEITMAN</b>							
<i>Heitman I</i>	20,000,000	20,000,000	2,990,040	19,360,546	0	1.47	13.9
<i>Heitman II</i>	30,000,000	30,000,000	20,674,846	19,443,820	0	3.30	12.6
<i>Heitman III</i>	20,000,000	20,000,000	6,559,225	15,568,402	0	1.26	11.4
<i>Heitman V</i>	20,000,000	20,000,000	20,850,802	7,898,621	0	7.19	6.6
<b>LASALLE INCOME PARKING FUND</b>	15,000,000	14,644,401	13,438,832	5,394,675	355,599	6.60	6.8
<b>RREEF USA FUND III</b>	75,000,000	75,000,000	43,723,082	69,239,287	0	4.21	14.2
<b>T.A. ASSOCIATES REALTY</b>							
<i>Realty Associates Fund III</i>	40,000,000	39,200,000	48,547,789	8,239,714	800,000	13.30	4.1
<i>Realty Associates Fund IV</i>	50,000,000	46,500,000	42,347,668	2,103,869	3,500,000	8.51	1.4
<b>TCW</b>							
<i>TCW III</i>	40,000,000	40,000,000	6,333,670	42,332,449	0	2.05	12.9
<i>TCW IV</i>	30,000,000	30,000,000	4,662,945	25,026,533	0	-0.11	11.7

<b>TOTAL REAL ESTATE BASIC FUNDS</b>	<b>753,681,569</b>	<b>663,657,866</b>	<b>661,038,426</b>	<b>294,137,731</b>	<b>100,023,703</b>		
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<b>POST FUND</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>COLONY INVESTORS II</b>	40,000,000	35,540,364	31,623,539	7,731,133	4,459,636	7.35	3.2
<b>WESTMARK REALTY ADVISORS</b>							
<i>Westmark Comm. Mtg. Fund II</i>	13,500,000	13,397,500	13,221,582	3,024,392	102,500	10.14	1.6
<i>Westmark Comm. Mtg. Fund III</i>	21,500,000	20,264,000	20,409,189	1,398,622	1,236,000	10.40	1.6
<i>Westmark Comm. Mtg. Fund IV</i>	14,300,000	3,902,326	3,891,659	93,460	10,397,674	9.45	0.5

<b>TOTAL REAL ESTATE POST FUNDS</b>	<b>89,300,000</b>	<b>73,104,190</b>	<b>69,145,969</b>	<b>12,247,607</b>	<b>16,195,810</b>		
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<b>TOTAL REAL ESTATE</b>	<b>842,981,569</b>	<b>726,762,056</b>	<b>730,184,395</b>	<b>306,385,338</b>	<b>116,219,513</b>		
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**MINNESOTA STATE BOARD OF INVESTMENT**  
**ALTERNATIVE INVESTMENT PRIVATE EQUITY**  
**6/30/98**

<b>BASIC FUN</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>ALLIED</b>	5,000,000	5,000,000	414,781	5,913,368	0	3.75	12.8
<b>BANK FUND</b>							
<i>Fund III</i>	20,000,000	20,000,000	42,740,660	8,634,496	0	27.28	5.7
<i>Fund IV</i>	25,000,000	25,000,000	28,082,916	2,044,280	0	18.48	2.4
<i>Fund V</i>	48,000,000	0	0	0	48,000,000	0.00	0.0
<b>BLACKSTONE PARTNERS II</b>	50,000,000	42,271,743	33,835,937	41,191,091	7,728,257	53.74	4.6
<b>BRINSON PARTNERS</b>							
<i>VPAF I</i>	5,000,000	5,000,000	929,942	7,511,553	0	9.61	10.1
<i>VPAF II</i>	20,000,000	18,579,998	5,983,484	29,254,441	1,420,002	25.80	7.6
<b>CHURCHILL CAPITAL PARTNERS II</b>	20,000,000	20,000,000	9,817,957	16,474,275	0	11.97	5.7
<b>CONTRARIAN CAPITAL II</b>	37,000,000	25,918,535	26,872,490	12,446	11,081,465	6.55	1.1
<b>CORAL PARTNERS</b>							
<i>Fund I Superior</i>	7,011,923	7,011,923	2,246,672	4,845,028	0	0.20	12.0
<i>Fund II</i>	10,000,000	8,135,294	10,077,147	23,545,087	1,864,706	21.19	7.9
<i>Fund IV</i>	15,000,000	10,500,000	12,134,191	1,608,655	4,500,000	13.52	3.9
<i>Fund V</i>	15,000,000	1,535,815	1,535,815	0	13,464,185	0.00	0.0
<i>IAI Ventures I</i>	1,146,890	1,146,890	0	1,536,770	0	14.70	7.3
<b>DSV</b>	10,000,000	10,000,000	4,124,476	20,244,324	0	8.53	13.2
<b>FIRST CENTURY</b>	10,000,000	10,000,000	2,607,426	13,846,138	0	8.90	13.6
<b>FOX PAINE &amp; CO</b>	40,000,000	497,971	497,971	0	39,502,029	0.00	0.2
<b>GOLDER THOMA CRESSEY RAUNDER</b>							
<i>Fund III</i>	14,000,000	14,000,000	9,933,799	51,021,716	0	31.40	10.7
<i>Fund IV</i>	20,000,000	19,000,000	21,027,802	19,067,387	1,000,000	31.42	4.4
<i>Fund V</i>	30,000,000	19,500,000	18,664,636	518,995	10,500,000	-1.82	2.0
<b>GTCR GOLDER RAUNER FUND VI</b>	90,000,000	0	0	0	90,000,000	0.00	0.0
<b>HELLMAN &amp; FRIEDMAN III</b>	40,000,000	25,242,969	12,694,927	19,009,528	14,757,031	17.02	3.8
<b>IAI U.S. VENTURE FUND II</b>	15,000,000	8,394,773	7,941,051	1,628,874	6,605,227	16.51	1.5
<b>IMR PARTNERSHIP</b>	15,000,000	1,524,900	0	1,148,997	13,475,100	-11.13	5.9
<b>INMAN BOWMAN</b>	7,500,000	7,500,000	569,545	9,519,814	0	3.90	13.1
<b>KOHLBERG KRAVIS ROBERTS</b>							
<i>1984 Fund</i>	25,000,000	25,000,000	10,241,404	115,061,979	0	28.48	14.1
<i>1986 Fund</i>	18,365,339	18,365,339	88,379,377	134,951,973	0	29.09	12.2
<i>1987 Fund</i>	145,950,000	145,950,000	226,113,927	248,993,117	0	13.48	10.6
<i>1993 Fund</i>	150,000,000	150,000,000	215,592,240	110,779,403	0	28.78	4.5
<i>1996 Fund</i>	200,000,000	72,778,675	57,000,435	8,429,065	127,221,325	-18.22	1.8
<b>MATRIX</b>							
<i>Fund II</i>	10,000,000	10,000,000	1,960,098	19,868,174	0	13.81	12.9
<i>Fund III</i>	10,000,000	10,000,000	2,116,533	70,242,885	0	74.84	8.2
<b>NORTHWEST VENTURE CAPITAL</b>	10,000,000	10,000,000	154,304	15,368,680	0	5.71	14.5
<b>PIPER JAFFREY HEALTHCARE FUND</b>	10,000,000	5,600,000	5,175,646	415,800	4,400,000	-0.28	1.3
<b>SUMMIT PARTNERS</b>							
<i>Fund I</i>	10,000,000	10,000,000	209,476	20,106,935	0	13.15	13.5
<i>Fund II</i>	30,000,000	28,500,000	3,703,928	65,325,350	1,500,000	28.56	10.1
<i>Fund V</i>	25,000,000	2,500,000	2,489,660	421	22,500,000	-2.05	0.2
<b>T. ROWE PRICE</b>	189,675,452	189,675,452	21,136,019	190,503,010	0	13.03	10.6
<b>THOMA CRESSEY FUND VI</b>	35,000,000	0	0	0	35,000,000	0.00	0.0
<b>WARBURG PINCUS</b>							
<i>Equity Partners</i>	100,000,000	3,000,000	3,000,000	0	97,000,000	0.00	0.0
<i>Venture Partners</i>	50,000,000	45,000,000	73,520,247	8,980,338	5,000,000	38.17	3.5
<b>WELSH, CARSON, ANDERSON &amp; STOWE VIII</b>	100,000,000	0	0	0	100,000,000	0.00	0.0
<b>ZELLCHILMARK</b>	30,000,000	30,000,000	23,773,344	45,059,845	0	16.30	8.0
<b>TOTAL PRIVATE EQUITY BASIC FUNDS</b>	<b>1,718,649,604</b>	<b>1,062,130,277</b>	<b>987,300,263</b>	<b>1,332,664,238</b>	<b>656,519,327</b>		

MINNESOTA STATE BOARD OF INVESTMENT  
 ALTERNATIVE INVESTMENT PRIVATE EQUITY  
 6/30/98

POST FUND	TOTAL COMMITMENT	FUNDED COMMITMENT	MARKET VALUE	DISTRIBUTIONS	UNFUNDED COMMITMENT	IRR %	PERIOD YEARS
CITICORP MEZZANINE	40,000,000	16,569,686	11,525,080	9,232,580	23,430,314	11.91	3.5
KLEINWORT BENSON	25,000,000	15,861,589	14,140,734	450,973	9,138,411	-7.99	2.7
SUMMIT PARTNERS (POST)							
<i>Summit Sub-Debt Fund I</i>	20,000,000	18,000,000	5,204,952	21,817,577	2,000,000	28.31	4.3
<i>Summit Sub-Debt Fund II</i>	45,000,000	15,750,000	15,380,548	831,652	29,250,000	4.84	0.9
T. ROWE PRICE	3,504,967	3,504,967	1,951,913	1,327,817	0	-34.45	1.3
TCW/CRESCENT MEZZANINE	40,000,000	30,812,065	26,955,598	6,931,927	9,187,935	9.69	2.2
<b>TOTAL PRIVATE EQUITY POST FUNDS</b>	<b>173,504,967</b>	<b>100,498,307</b>	<b>75,158,825</b>	<b>40,592,526</b>	<b>73,006,660</b>		
<b>TOTAL PRIVATE EQUITY</b>	<b>1,892,154,571</b>	<b>1,162,628,584</b>	<b>1,062,459,088</b>	<b>1,373,256,764</b>	<b>729,525,987</b>		



**MINNESOTA STATE BOARD OF INVESTMENT**  
**ALTERNATIVE INVESTMENT RESOURCE**  
6/30/98

<b>BASIC FUN</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>APACHE III</b>	30,000,000	30,000,000	5,730,691	42,220,182	0	11.56	11.5
<b>FIRST RESERVE CORP.</b>							
<i>AMGO I</i>	15,000,000	15,000,000	8,537,438	6,664,976	0	0.10	16.8
<i>AMGO II</i>	7,000,000	7,000,000	10,288,735	5,482,744	0	6.93	15.4
<i>First Reserve Fund IV (SEA)</i>	12,300,000	12,300,000	845,667	24,801,614	0	13.45	10.1
<i>First Reserve Fund V</i>	16,800,000	16,800,000	30,254,620	24,519,754	0	19.68	8.2
<i>First Reserve Fund VII</i>	40,000,000	28,460,450	26,474,948	2,981,814	11,539,550	4.24	2.0
<i>First Reserve Fund VIII</i>	100,000,000	2,976,439	2,976,439	0	97,023,561	-47.92	0.2
<b>MORGAN OIL&amp;GAS</b>	15,000,000	15,000,000	3,774,698	20,529,941	0	6.91	9.9
<b>SIMMONS</b>							
<i>SCF Fund II</i>	17,000,000	14,847,529	29,483,696	6,148,819	2,152,471	18.93	6.9
<i>SCF Fund III</i>	25,000,000	18,653,740	32,138,122	8,110,359	6,346,260	49.58	3.0
<i>SCF Fund IV</i>	50,000,000	4,120,000	4,120,000	0	45,880,000	-59.86	0.2
<b>TOTAL RESOURCE BASIC FUNDS</b>	<b>328,100,000</b>	<b>165,158,158</b>	<b>154,625,054</b>	<b>141,460,203</b>	<b>162,941,842</b>		

<b>POST FUND</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>MERIT ENERGY PARTNERS</b>							
<i>Merit Energy Partners B</i>	24,000,000	11,457,658	11,379,126	1,197,382	12,542,342	9.28	2.0
<i>Merit Energy Partners C</i>	50,000,000	0	0	0	50,000,000	0.00	0.0
<b>TOTAL RESOURCE POST FUNDS</b>	<b>74,000,000</b>	<b>11,457,658</b>	<b>11,379,126</b>	<b>1,197,382</b>	<b>62,542,342</b>		

<b>TOTAL RESOURCE</b>	<b>402,100,000</b>	<b>176,615,816</b>	<b>166,004,180</b>	<b>142,657,584</b>	<b>225,484,184</b>		
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**PRIVATE EQUITY MANAGER SUMMARY PROFILE**

**I. Background Data**

**Name of Fund:** Crescendo III, L.P.

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

**Total Fund Size:** \$250 million

**Fund Manager:** Crescendo Ventures III, LLC  
601 2nd Avenue South, Suite 3800  
Minneapolis, Minnesota 55402  
Telephone: (612) 376-2834  
Facsimile: (612) 376-2824

**Manager Contact:** David Spreng

**II. Organization & Staff**

Crescendo Venture Management, LLC ("Crescendo"), formerly IAI Ventures, Inc. ("IAI Ventures"), is a global venture capital investment organization with a primary focus on early-stage investment opportunities in the areas of information technology, communication services and health care. The principals of Crescendo (the "Principals") are experienced venture capitalists and have originated and managed investments in more than 79 early-stage companies since 1989.

The Fund will be managed and directed by its general partner, Crescendo Ventures III, LLC, a Delaware limited liability company (the "General Partner"), which will be controlled by the Principals. Investment management and administrative services will be provided to the General Partner and the Fund by Crescendo.

The Principals of Crescendo, namely R. David Spreng, Jeffrey R. Tollefson, Anthony S. Daffer and Lorraine S. Fox, bring nearly 25 years of combined experience in the venture capital industry and have collectively managed three previous venture funds. The Principals are complemented by other members of the Crescendo team, including five additional investment professionals and seven members of the finance and administration group, all of whom bring a rich and diverse set of skills and experiences to the Fund. They have initiated, negotiated, closed and managed numerous equity investments of the type targeted by the Fund. Crescendo operates out of offices in Minneapolis, Minnesota and Palo Alto, California.

### **III. Investment Strategy**

The fund will invest in a diversified portfolio of venture capital investments, will primarily invest nationally and will emphasize early stage healthcare, technology and communications companies. In addition, the Fund anticipates investing approximately 10-20% of its capital into companies either located, or predominantly conducting business, outside of the United States. Regions of Western Europe, the U.K. and Israel are of particular interest.

In order to stimulate additional proprietary deal flow in the Midwest, Crescendo, Vanguard Ventures of California, and Medtronic Inc., a medical device company located in Minnesota have formed and sponsored Itasca Ventures, LLC, a healthcare incubator. Itasca's mission is to identify new investment opportunities in healthcare for its sponsors.

David Spreng is Chairman of the Board of Itasca.

### **IV. Investment Performance**

The Principals have managed nearly \$300 million of venture capital commitments over the last nine years. Since 1989, the Principals have been responsible for investments in 79 companies.

The Principals' most recent direct venture fund, Crescendo II, L.P., was created in January, 1997 and is capitalized at \$83.5 million. This partnership has invested in 22 companies in the information technology, communication services and health care fields and will be fully-invested/committed for investment prior to closing the Fund. Two portfolio holdings have already been profitably distributed, which have helped generate a net investment IRR of 14.3% as of June 30, 1998.

Crescendo I, L.P., a \$12.6 million fund which closed in December, 1995, has made investments in 12 information technology, communication service and health care companies and is fully-invested. To date, more than \$82 million has been distributed to investors and with a remaining fair market value of more than \$9 million, this fund has generated a net annual IRR of 463%.

The Crescendo World Fund, LLC, is a \$110 million investment fund which held an initial closing in August, 1997. It is designed as a "participating fund-of-funds" investing approximately 50% of its capital in leading early-stage venture capital investment partnerships around the world, and the balance directly into promising early-stage companies in North America, Europe and Israel. Commitments have been made to 15 venture funds and 5 operating companies over the past year. No returns of capital have been generated from this relatively new fund.

In addition, the Principals were responsible for sourcing and managing an additional 48 venture capital investments that were made from 1989 to 1995 utilizing the assets of the IAI Mutual Funds and the Farm Bureau Life Insurance Company. Analyzed as a single fund, these investments, involving \$76.7 million of invested capital, \$188 million of realized proceeds and \$50 million of remaining fair market value.

## **V. General Partners Investment**

The General Partner will contribute 1% of the Fund's aggregate capital commitments to the capital of the Fund. Such contributions will be made at the same time as the Investors' contributions are made.

## **VI. Takedown Schedule**

Each Investor will be required to make capital contributions from time to time when called by the General Partner upon at least 14 days notice, in order to fund investments and fees and expenses of the Fund.

## **VII. Management Fee**

The Fund will bear all of its operating and other expenses, including but not limited to legal, auditing and accounting fees and expenses, as well as custodial fees, taxes, commissions, brokerage, investment banking fees and consulting fees. The Fund will pay the Management Company an annual management fee equal to 2.5% of committed capital, payable at the beginning of each quarter. Commencing in 2005, the Management Fee will decrease according to the following schedule: 2005/2.25%; 2006/2.03%; 2007/1.82%; and 2008 and thereafter/1.64%. In the event the Fund makes any investment in another investment pool or partnership on which there is a carried interest or management fee, the General Partner and the Management Company will waive their carried interest and Management Fee, respectively, payable from the Fund with respect to such investments, to the extent necessary to avoid duplication of the payment of carried interest and management fees between the two funds. The Fund will bear the costs and expenses incurred in connection with its organization and with the offering of Interests. Such amount shall not exceed \$500,000; any excess will be borne by the General Partner.

## **VIII. Term**

The Fund's term will continue for a period of ten years from the Fund's final closing, but may be extended for up to three additional one-year periods in the discretion of the General Partner and for additional periods with the approval of the a majority in interest of the Investors.

## **IX. Distributions**

The Fund's capital transaction gain and loss generally will be allocated each year (i) 20% to the General Partner and (ii) 80% to the Investors and the General Partner in proportion to their capital contributions. The Fund's net income and net loss other than as a result of capital transactions (including temporary investment income and the Management Fee expense) will be allocated 99% to the Investors and 1% to the General Partner

Annual cash distributions will be made to each partner to cover estimated income tax liabilities from Fund operations. Additional distributions of cash and marketable securities may be made at the discretion of the General Partner. Any such discretionary distributions will be made in the following manner:

Prior to Payout (i.e., receipt by the Investors of distributions equal to their capital contributions), any distributions (other than tax distributions) will be made subject to the "Fair Value Test." The Fair Value Test means that the sum of the amount of cumulative distributions to the Investors, plus the amount of the Investors' fair value capital accounts, after giving effect to the proposed distribution, is equal to at least 120% of the Investors' capital contributions.

If the Fair Value Test is not satisfied, distributions (other than tax distributions) prior to Payout will be made to the partners of the Fund (including the General Partner) in proportion to their capital contributions.

If the Fair Value Test is satisfied, distributions (other than tax distributions) prior to Payout will be made, at the discretion of the General Partner, either (i) among the partners of the Fund in proportion to their capital contributions, or (ii) to the General Partner until the General Partner has received 20% of the net capital transaction gains made by the Fund, and then among the partners of the Fund (including the General Partner) in proportion to their capital contributions.

After Payout, all distributions (other than tax distributions) will be made among the partners of the Fund in accordance with their Capital Account balances. The General Partner will be required, upon the termination of the Fund, to recontribute distributions (less any taxes deemed paid by the General Partner as a result of net taxable income from the Fund) previously received and attributable to its 20% "carried interest" to the extent such distributions exceed the cumulative net income (in excess of net losses) allocated to the General Partner with respect to its carried interest. This clawback obligation will be guaranteed by the members of the General Partner.

## **X. Limitations**

Additionally, except with the approval of the Majority in Interest of the Limited Partners, the Fund (a) will not invest more than 15% of its committed capital in any single investment; (b) will not invest more than 15% of its committed capital in any other investment pool or partnership; (c) will not invest more than 15% of its committed capital in publicly traded securities; and (d) will not invest more than 10% of its committed capital in bridge financings.

**PRIVATE EQUITY MANAGER SUMMARY PROFILE****I. Background Data**

**Name of Fund:** Piper Jaffray Healthcare Fund III, L.P.

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

**Total Fund Size:** \$100 million

**Fund Manager:** Piper Jaffray Ventures, Inc.  
222 South Ninth Street  
Minneapolis, MN 55402  
Phone: (612) 342-6335  
Fax: (612) 342-1036

**Manager Contact:** Buzz Benson

**II. Organization and Staff**

The General Partner of the Fund is Piper Jaffray Healthcare Management, a Delaware limited partnership. Piper Jaffray Ventures ("PJV") is the general partner of the Fund's General Partner. PJV is a wholly-owned subsidiary of Piper Jaffray Companies, Inc. U.S. Bancorp's acquisition of Piper Jaffray Companies, Inc. in May 1998 requires the Fund to apply for a Small Business Investment Company ("SBIC") license. The Fund's managers are experienced SBIC operators and the SBIC license is not expected to have any impact on the Fund's method of operations.

PJV employs six professionals and two administrative personnel. Buzz Benson is the President of PJV. Prior to his employment at Piper Jaffray, Mr. Benson was a Partner at Stonebridge Capital and an Investment Officer at Cherry Tree Investments. Assisting Mr. Benson in the management of the Fund will be Ned Scheetz (focusing on medical technology) and Ken Higgins (focusing on healthcare services). Messrs. Benson, Scheetz and Higgins will devote substantially all of their professional time to the Fund. In addition, the Fund will have two dedicated financial analysts, as well as one financial analyst that will be added in 1999. The Fund will also have access to 30 professionals in Piper Jaffray's investment banking and healthcare research teams. All members of these teams are eligible to receive a portion of the General Partner's carried interest.

### III. Investment Strategy

The Fund will make venture capital investments, primarily equity and equity-oriented securities of privately held companies in the healthcare industry. Areas of focus include medical technology and healthcare services. The Fund may also invest up to 10% of its committed capital in publicly traded securities.

The Fund intends to invest across a range of early to late stage investments within the targeted healthcare sectors. Characteristics of companies the Fund will target include: unique and proprietary technologies or services; early market entrants; and the potential for number one or number two market share.

The Fund will generate and lead investments or co-invest in venture syndicates led by other private equity firms. In addition, Piper Jaffray's investment banking group and healthcare research team will assist the Fund with industry research, deal flow and due diligence. These professionals are also expected to provide assistance with financing and liquidity alternatives.

The Fund has a national investment scope, which is essential to its top-down strategy of pursuing leading emerging growth companies in attractive healthcare sectors, regardless of their location or stage. PJV believes that its location in Minnesota is a strategic advantage because the Twin Cities region is a large incubator of new medical device technologies which allows "backyard access" to attractive companies. It also provides relatively easy access to both coasts.

### IV. Investment Performance

Previous healthcare-related fund performance as of June 30, 1998 is shown below. An asterisk (\*) indicates a fund in which the SBI has invested.

Fund Name	Inception Date	Total Equity Commitments	Net IRR from Inception
Piper Jaffray Investors Fund VI #	10/90	\$ 2.0 million	42.0%
Piper Jaffray Healthcare Fund I	11/92	\$12.3 million	16.5% ##
*Piper Jaffray Healthcare Fund II	3/97	\$50.0 million	NM

# Fund VI was wound down in May 1996.

## PJHcF I is negatively impacted by nonrecurring costs, specifically, non-just in time drawdowns and SBA leverage costs. Without these costs, the net IRR to investors is 27.5%.

## **V. General Partners Investment**

The General Partner will contribute 1% of the capital contributed by all Partners. In addition, U.S. Bancorp will commit a minimum of \$10 million as a limited partner.

## **VI. Takedown Schedule**

5% of committed capital upon closing. Thereafter, capital will be called as needed with not less than 15 days' written notice.

## **VII. Management Fee**

The General Partner shall receive an annual fee, payable quarterly in advance and based on the Fund's committed capital, as follows:

Years 1-5:	2.50%
Years 6-7:	2.25%
Year 8:	2.00%
Year 9:	1.75%
Year 10:	1.50%

The management fee will be reduced by all fees (including equity incentives) received from portfolio companies.

The Fund will pay all organizational expenses, not to exceed \$300,000.

## **VIII. Term**

The Fund will have a term of ten years, with an option to extend for an additional period of two years at the General Partner's discretion. The Fund may be extended for an additional one year period after the two year extension if at least two-thirds in interest of the Limited Partners consent to such extension.

## **IX. Distributions**

Distributions will be made in the form of cash or marketable securities, with the possible exception of distributions pursuant to the dissolution or winding up of the Fund. However, it is anticipated that most distributions will be made in kind.

Interest on short-term cash investments of the Fund shall be allocated to all Partners pro rata according to their contributed capital.



As soon as reasonably practicable, cash from the disposition of investments will be distributed to the Partners as follows:

- Cash representing a return of the cost basis of investments shall be distributed in proportion to committed capital.
- Cash representing gains will be distributed 80% to the Partners and 20% to the General Partner. In the event that (a) the value of the Fund's remaining portfolio securities would be less than 115% of the cost basis of such securities and (b) after such cash distribution, the balance in the General Partner's capital account would be less than 20.8% of the remaining partnership capital, then the amount to be distributed to the General Partner shall be retained by the Fund until condition (a) or (b) is satisfied.
- Following the end of each taxable year, the Fund will make cash distributions to all Partners in amounts intended to defray the tax liabilities attributable to their interests in the Fund (30% of the profit allocated to a Partner's capital account in such fiscal year), to the extent that the cash distributions described above are insufficient.

Marketable securities shall be distributed 80% to the Partners and 20% to the General Partner. In the event that after the in kind distribution, the value of the Fund's remaining portfolio securities would be less than 115% of the cost basis of such securities and the balance in the General Partner's capital account would be less than 20.8% of remaining partnership capital, then the General Partner will either (a) place and hold its portion of such in kind distribution in escrow or (b) cause such in kind distribution to be made to all Partners in proportion to capital commitments. Concurrent with any distribution of marketable securities, the General Partner will contribute to the Fund an amount equal to the cost basis of the portion of the securities distributed to the General Partner (excluding amounts distributed in proportion to capital commitments). Such return of cost basis shall be paid in cash or in the form of a promissory note secured by the securities distributed.

#### **X. *General Partner Clawback***

If, upon liquidation of the Partnership, it is determined that distributions made to the General Partner with respect to its 20% share of Partnership profits have exceeded 20% of the Partnership's net profits over its entire term, the General Partner will return such distributions, excluding certain tax distributions, to the extent of such excess. This clawback will be guaranteed by Piper Jaffray Companies, Inc.

## ATTACHMENT E

### REAL ESTATE MANAGER PROFILE

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

**Name of Fund:** The Realty Associates Fund V

**Type of Fund:** Real Estate Limited Partnership

**Total Fund Size:** \$150 - 500 million

**Fund Manager:** TA Associates Realty  
28 State Street  
Boston, MA 02109  
Phone (617) 476-2700  
Fax (617) 476-2799

**Manager Contact:** Michael A. Ruane  
Arthur I. Segel

#### **II. Organization and Staff**

TA Associates Realty (TA) was formed in 1982. It is a privately held limited partnership with two managing partners: Michael Ruane and Arthur Segel. Including Ruane and Segel, TA currently has thirty-nine real estate management employees.

Property management at the local level is administered through third party contractors. These contractors are responsible for all aspects of the day to day operations and are overseen by the asset management group at TA.

The Realty Associates Fund V is the fifth commingled, closed-end fund for TA. In addition to the commingled funds, TA has separate account commitments totaling \$1.5 billion. Total real estate assets under management, including both commingled and separate accounts, exceeds \$2.8 billion.

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

The investment strategy of The Realty Associates Fund V is consistent with the strategies of the previous four funds. The fund will make geographically diversified equity

investments in small to medium sized properties (\$10 to \$15 million average), primarily office and industrial property acquisitions. When possible, the fund will use modest leverage. Under no circumstances will leverage exceed 50%.

**IV. Investment Performance**

In 1994, the SBI invested \$40 million in the \$487 million Realty Associates Fund III. Today, the portfolio is fully invested and has produced a 13.3 % net internal rate of return (IRR) to investors.

In 1996, the SBI invested \$50 million in the \$450 million Realty Associates Fund IV. Today, the portfolio is over two-thirds invested and has produced an 8.5 % net internal rate of return (IRR) to investors.

**V. Takedown Schedule**

Capital will be called as needed.

**VI. Management Fee**

<i>Year</i>	<i>Fee</i>	<i>Basis</i>
1	.500%	Committed Capital
2	.800%	Committed Capital
3	1.100%	Committed Capital
4	1.200%	Committed Capital
5	.875%	Aggregate Invested Equity
6	.850%	Aggregate Invested Equity
7	.800%	Aggregate Invested Equity
8 and thereafter	.600%	Aggregate Invested Equity

**VII. Term**

The acquisition period will last between two and four years depending on the ultimate size of the fund and the state of the real estate markets during the acquisition phase. Liquidation is expected within ten years from being fully invested.

### **VIII. Distributions**

Distributions are made quarterly at the discretion of the advisor, after appropriate reserves are established. The advisor may reinvest proceeds from sales or debt financing during the two to four year property acquisition period.

Distributions are allocated 100% to the investors until they have received a return of capital and an annual compound preference return equal to inflation. Thereafter, distributions will be shared 95% to investors and 5% to the advisor.

At 1% real, all income is divided 94.0% to the investor and 6.0% to the advisor;

At 2% real, all income is divided 92.5% to the investors and 7.5% to the advisor;

At 3% real, all income is divided 90.5% to the investors and 9.5% to the advisor;

At 4% real, all income is divided 88.5% to the investors and 11.5% to the advisor;

At 5% real, all income is divided 86.5% to the investors and 13.5% to the advisor;

At 6% real, all income is divided 84.5% to the investors and 15.5% to the advisor;

At 7% real, all income is divided 82.5% to the investors and 17.5% to the advisor;

At 8% real and thereafter, all income is divided 80% to the investors and 20% to the advisor.

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<b>PRIVATE EQUITY MANAGER SUMMARY PROFILE</b>
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**I. Background Data**

**Name of Fund:** TCW/Crescent Mezzanine Partners II, L.P.

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

**Total Fund Size:** \$650 million

**Fund Manager:** TCW Crescent Mezzanine, L.L.C.  
11100 Santa Monica Blvd.  
Suite 2050  
Los Angeles, CA 90025  
Phone (310) 575-9700  
Fax (310) 575-1997

**Manager Contact:** Jean-Marc Chapus  
John Rocchio

**II. Organization & Staff**

TCW/Crescent Mezzanine Partners was established by the former operating partners of Crescent Capital Corporation, the principals of Hicks, Muse, Tate & Furst, Inc. and TCW Asset Management Company to continue the mezzanine investment strategy followed by Crescent Capital Corporation. The Crescent principals have worked together for over twelve years, while the principals of Hicks Muse have extensive experience in leveraged acquisitions and merchant banking activities. TCW has over \$50 billion in assets under management and offers more than forty domestic and international fixed income, equity and specialized investment strategies.

The Crescent principals and Hicks Muse formed Crescent Capital Corporation in 1991 to create an entity specializing in below-investment-grade securities. In March 1995, Crescent entered into a strategic alliance with TCW to assist in the management of TCW's high yield bond portfolios. In September 1995, Crescent was acquired by TCW. As of June 1998, aggregate assets managed by the TCW/Crescent Leveraged Finance Group totaled \$7.0 billion.

TCW/Crescent's principals will be responsible for the day-to-day operations of the Partnership. TCW/Crescent has thirty professionals employed in its Leveraged Finance Group and seven dedicated mezzanine professionals. The mezzanine group plans to add a CFO, a senior vice president and a partner in the next 12 months, as well as an additional associate in the near future.

### **III. Investment Strategy**

The Partnership will invest primarily in profitable, middle market companies with revenues ranging from \$25-300 million. Mezzanine investments will include subordinated debt with equity participation, as well as senior debt, preferred stock and common stock.

The Partnership generally will act as the lead investor, investing \$10-40 million in privately negotiated subordinated debt and equity securities issued in connection with leveraged transactions (e.g., management buyouts, acquisitions, refinancings, recapitalizations and later-stage growth capital financings). In order to maintain maximum flexibility in structuring investments and to take advantage of changing markets, the Partnership may also pursue other related investments on a limited basis (e.g., convertible securities, senior equity instruments, common stock and liquid mezzanine investments).

Credit research will be the single most fundamental important component of the investment process. In selecting investments, research professionals will analyze opportunities with an emphasis on principal preservation (i.e., an issuer's ability to service its debt and maintain profitability). The Partnership will target companies with strong businesses evidenced by well-established products or services, defensible market niches, stable cash flows and experienced and proven management teams.

The Partnership will not:

- invest in hostile transactions;
- invest more than 20% of aggregate committed capital in a single portfolio company;
- invest more than 20% of aggregate committed capital in foreign securities;
- invest more than 25% of aggregate committed capital in equity securities that exceed a debt to equity ratio of 4:1.

### **IV. Investment Performance**

From November 1992 through June 1995, Crescent Capital Corporation invested approximately \$219 million in mezzanine securities. These investments have yielded a net IRR of 17.9% through June 30, 1998.

TCW/Crescent Mezzanine Partners ("Fund I") was raised in 1996 with aggregate commitments of \$482 million. The SBI committed \$40 million to Fund I. As of June 30, 1998, Fund I has generated a net IRR of 20.1%.

## **V. General Partners Investment**

A total of at least 1% of the Partnership's total contributed capital will be provided by the General Partner and its affiliates.

## **VI. Takedown Schedule**

Capital will be called as needed with ten business days' written notice.

## **VII. Management Fee**

The Partnership will pay the General Partner an annual management fee, payable quarterly in advance, of 1.75% of aggregate capital commitments for the five years after the final closing of the Partnership (the commitment period). Thereafter, the fee will equal 1.25% of net invested capital. At the end of the original ten-year of the Partnership, the General Partner and the Investors will renegotiate the management fee, provided that in no event shall the management fee after such time exceed 1.0% of net invested capital.

The management fee will be reduced by all fees received by the General Partner from portfolio companies.

The Fund will bear up to \$1,000,000 in organizational expenses.

## **VIII. Term**

The Partnership's term will be ten years from the initial closing date, subject to three additional one year extensions at the General Partner's discretion to allow for an orderly liquidation of the Partnership's investments.

## **IX. Distributions**

Dividend and interest income, net of expenses, will be distributed quarterly, 80% pro rata to the Limited Partners and 20% to the General Partner.

Distributions of cash and securities will be made as soon as reasonable practicable at the discretion of the General Partner. Cash and non-cash proceeds from the disposition of investments will be distributed as follows:

- (i) 100% to the Partners, pro rata according to their respective commitments, until the Partners have received distributions equal to an 8% per annum compounded return on their contributed capital and allocated costs for such investment;



- (ii) 100% to the Partners, pro rata according to their respective commitments, until the Partners have received aggregate distributions to date equal to their contributed capital and allocated costs for such investment;
- (iii) 100% to the Partners, pro rata according to their respective commitments, until the Partners have received aggregate distributions to date equal to the sum of all losses on realized investments and unrealized losses on other investments;
- (iv) 100% to the General Partner until the General Partner has received distributions equal to 20% of the excess of all distributions over all amounts distributed pursuant to (ii) and (iii) above; and
- (v) 80% to the Partners and 20% to the General Partner in respect of its carried interest.

The General Partner shall use reasonable efforts to distribute only cash during the life of the Partnership and upon final liquidation.

#### **X. General Partner Giveback**

After the final distribution of the assets of the Partnership among the Partners, the General Partner will contribute to the Partnership an amount equal to the greater of the following:

- (i) the amount by which the Partners' total distribution are less than their contributed capital for investment plus the preferred return thereon; or
- (ii) the amount by which total distributions to the General Partner on account of the General Partner's carried interest exceed 20% of the Partnership's net profits over the life of the Partnership.

In no event will the General Partner be required to contribute an amount in excess of 100% of the net amount distributed to the General Partner (reduced by distributions to the General Partner used to pay taxes) on account of its carried interest.

#### **XI. Affiliated Funds**

The General Partner will establish a separate investment entity or structure primarily for insurance company investors (an "Affiliated Fund") to accommodate certain regulatory restrictions applicable to such investors. The Affiliated Fund will co-invest with the Partnership in each Partnership investment on a fixed-ratio basis and will have the same terms as the Partnership, except for increased up-front organizational costs associated with establishing an investment trust.

## ***XII. Other Funds***

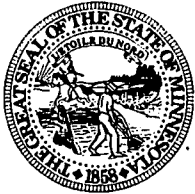
A portion of Crescent's mezzanine investments may be allocated toward other funds managed by the TCW/Crescent Leverage Finance Group. Specific restrictions apply as to the allocation of mezzanine debt to these funds:

- The Fund will receive an allocation of the mezzanine investment identical to the one it would receive if there were no other funds managed by Crescent.
- The other funds must co-invest in every consecutive mezzanine investment of the Fund or they lose the right to be a co-investor for any future mezzanine investments.
- Funds other than the mezzanine partnership cannot be allocated more than 20% of the aggregate mezzanine investment.

Other funds may also be raised that will have the same restrictions with respect to the allocation of mezzanine investments.

# Tab H

**MINNESOTA  
STATE  
BOARD OF  
INVESTMENT**



**Board Members:**

Governor  
Arne H. Carlson

State Auditor  
Judi Dutcher

State Treasurer  
Michael A. McGrath

Secretary of State  
Joan Anderson Growe

Attorney General  
Hubert H. Humphrey III

**Executive Director:**

Howard J. Bicker

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

*An Equal Opportunity  
Employer*

**DATE:** August 25, 1998

**TO:** Members, State Board Investment

**FROM:** Howard Bicker, Executive Director

**SUBJECT: Plan for Divestiture of Tobacco Stocks**

At its June 11, 1998, meeting, the State Board of Investment (SBI) passed a resolution requiring staff to prepare and submit a plan for divestiture of tobacco stocks. This document addresses that request.

The Board's resolution defined a tobacco company as any company that obtains more than 15% of its revenue from the manufacture of consumer tobacco products, and the resolution proposed divestiture of tobacco stock held in SBI's actively managed equity portfolios.

**Estimate of Transaction Costs**

Staff sought input from the following sources regarding the costs to liquidate current tobacco holdings and reinvest those dollars:

Alliance Capital	Portfolio Manager
Barclays Global Investors	Portfolio Manager
J.P. Morgan	Portfolio Manager
Abel/Noser Corporation	Trade Analysis Service
SEI Capital Resources	Trade Analysis Service
Richards & Tierney	Consultant

Transaction costs are a combination of commission cost and market impact. Commission cost is the amount paid to a broker for facilitating the transaction. Market impact is a result of transacting in the market and is a measure of the influence of the trade on the market price. Market impact can be significant when trading a large volume of shares over a short time period, while spreading a large trade over a longer period of time can minimize the impact.

Based on input from the parties listed above, the transaction cost to sell the current tobacco holdings in the active equity portfolios and to reinvest the funds in S&P500 stocks is estimated to be \$2,058,128 (\$260,610 in commission costs and \$1,797,518 due to market impact). This estimate is based on the specific tobacco names in the portfolio, the size of those holdings as of June 30, 1998 (see list attached), and an extended period of time over which to trade the securities.

### **Proposed Plan**

If the Board proceeds with divestiture of the tobacco holdings in the active equity portfolios, staff recommends that the portfolio managers be allowed to liquidate the holdings over the three-year period allowed by the SBI's resolution. This strategy will allow the portfolio manager to use their research resources to assess the best timing for their liquidation. Divestiture will cause some tracking error relative to the SBI's equity asset class target.

**TOBACCO HOLDINGS  
ACTIVE EQUITY PORTFOLIOS  
AS OF 6/30/98**

**SECURITIES TRADED ON US MARKETS**

Security Name	Shares	Total Cost	Market Value
BAT INDUSTRIES	223,000	1,767,803	2,232,452
IMPERIAL TOBACCO	26,500	248,370	195,431
PHILIP MORRIS COS INC	4,626,547	123,532,256	182,170,288
RJR NABISCO HLDGS CORP	275,200	8,495,621	6,536,000
SCHWEITZER MAUDUIT INTL I	1,000	33,920	29,000
UNIVERSALCORP VA	<u>106,520</u>	<u>3,491,545</u>	<u>3,981,185</u>
Subtotal	5,258,767	137,569,514	195,144,356

**SECURITIES TRADED ON NON-US MARKETS**

Security Name	Shares	Total Cost	Market Value
COMPAGNIE FINANCIERE	80,000	2,751,015	1,080,000
EMPRESAS LA MODERNA	94,500	438,914	548,952
PT GUDANG GARAM	150,000	598,736	88,176
REMBRANDT GROUP	385,000	3,450,237	2,418,497
SHANGHAI INDUSTRIAL HLDGS	410,000	1,430,989	965,661
SOUZA CRUZ SA	<u>137,000</u>	<u>1,139,595</u>	<u>1,018,668</u>
Subtotal	1,256,500	9,809,485	6,119,954
TOTAL	6,515,267	147,378,999	201,264,311