

MINNESOTA  
STATE  
BOARD OF  
INVESTMENT

08 - 0056



Board Members:

Governor  
Tim Pawlenty

State Auditor  
Rebecca Otto

Secretary of State  
Mark Ritchie

Attorney General  
Lori Swanson

Executive Director:

Howard J. Bicker

60 Empire Drive

Suite 355

St. Paul, MN 55103

(651) 296-3328

FAX (651) 296-9572

E-mail:

[minn.sbi@state.mn.us](mailto:minn.sbi@state.mn.us)

[www.sbi.state.mn.us](http://www.sbi.state.mn.us)

DATE: January 7, 2008

TO: The Honorable Tim Pawlenty  
Members of the Minnesota Legislature

FROM: Howard J. Bicker, Executive Director

**SUBJECT: External Money Manager Report Pursuant to Minnesota Statutes Section 11A.04, clause (12)**

*Minnesota Statutes*, Section 11A.04, clause (12) requires the State Board of Investment (SBI) to report annually to the Governor and Legislature the cost and investment performance of external investment managers employed by the Board.

On June 30, 2007, the SBI utilized 29 domestic stock managers, 15 international stock managers and 8 bond managers for the retirement assets under its control. As a matter of policy, the SBI allocates approximately one third of domestic stock to active management, one third to semi-passive management and one third to passive management; and approximately one half of all bonds to active management and one half to semi-passive management. As a matter of policy, the SBI allocated approximately 56 percent of international stock assets to active management, approximately one-third to passive management, and about 12 percent to semi-passive management.

The investment performance of each manager, as well as the fees paid to each, are reported in the charts on the following pages. This information is also included in the Board's annual report for FY07. Please note that the SBI terminated three domestic stock managers during the fiscal year.

It is important to note that all performance data reported by the SBI is *net* of fees and transactions costs associated with the various portfolios. The SBI's FY 2007 Annual Report contains additional detail on manager performance and may be accessed online at [www.sbi.state.mn.us](http://www.sbi.state.mn.us).

### **Domestic Stock Managers**

The SBI evaluates domestic stock manager returns against the performance of Russell style indices which reflect the managers' specific investment approaches. The benchmark portfolios take into account the market forces that at times favorably or unfavorably impact certain investment styles. The aggregate domestic stock program is designed to outperform the Russell 3000 Index. Assets are allocated to managers within each Russell style index in the same proportion as in the Russell 3000 Index.

As a group, the managers underperformed the broad market by 0.4 percentage point for the fiscal year. The active, semi-passive and passive components each underperformed the respective benchmark. Eleven active managers outperformed; thirteen active managers underperformed. One semi-passive manager outperformed; two underperformed. The passive manager underperformed by 0.1 percentage point the Russell 3000 benchmark.

### **International Stock Managers**

The SBI evaluates international stock managers against market indices published by Morgan Stanley Capital International (MSCI). Two indices are used: the World ex U.S. (net) and the Emerging Markets Free (EMF). As a group, the international stock managers outperformed the MSCI Country World Index (ACWI) ex U.S. (net) index by 0.7 percentage point for the fiscal year. Three of the eight EAFE managers outperformed the index; two of the three emerging markets managers outperformed EMF. All three semi-passive EAFE managers outperformed the benchmark. The passive manager outperformed the MSCI World ex U.S. index by 0.2 percentage point.

### **Bond Managers**

The SBI evaluates the performance of its bond managers against the Lehman Brothers Aggregate bond index. Four of the five active managers exceeded the benchmark. Two of the three semi-passive bond managers outperformed the index for the year. As a group, the bond managers outperformed the broad bond market by 0.2 percentage point for the year.

Figure 16. Domestic Stock Manager Performance FY 2007

	Actual Return	Benchmark Return
<b><u>Active Managers</u></b>		
<b>Large Cap Core (Russell 1000)</b>		
Franklin Portfolio Associates	21.2%	20.4%
New Amsterdam Partners	15.8	20.4
UBS Global Asset Management	22.1	20.4
<b>Large Cap Growth (Russell 1000 Growth)</b>		
Alliance Capital Management	14.7	19.0
Cohen Klingenstein & Marks	22.0	19.0
INTECH	14.8	19.0
Jacobs Levy Equity Mgmt.	14.9	19.0
Lazard Asset Mgmt.	21.2	19.0
Sands Capital Mgmt.	11.1	19.0
Voyageur-Chicago Equity	10.6	19.0
Winslow Capital Mgmt.	19.3	19.0
Zevenbergen Capital	21.2	19.0
<b>Large Cap Value (Russell 1000 Value)</b>		
Barrow, Hanley	21.9	21.9
Earnest Partners	18.6	21.9
Lord Abbett & Co.	19.0	21.9
LSV Asset Mgmt.	22.6	21.9
Systematic Financial Mgmt.	22.7	21.9
<b>Small Cap Growth (Russell 2000 Growth)</b>		
McKinley Capital	16.0	16.8
Next Century Growth	17.9	16.8
Turner Investment Partners	18.4	16.8
<b>Small Cap Value (Russell 2000 Value)</b>		
Goldman Sachs	17.4	16.1
Hotchkis & Wiley	14.1	16.1
Martingale Asset Mgmt.	9.1	16.1
Peregrine Capital Mgmt.	14.6	16.1
RiverSource/Kenwood	11.2	16.1
<b><u>Semi-Passive Managers (Russell 1000)</u></b>		
Barclays Global Investors	19.3	20.4
Franklin Portfolio Associates	19.2	20.4
J.P. Morgan Investment Mgmt.	22.2	20.4
<b><u>Passive Manager (Russell 3000)</u></b>		
Barclays Global Investors	20.0	20.1
<b>Historical Aggregate</b>	19.7	20.1
<b>SBI Domestic Equity Asset Class Target</b>		20.1

Figure 18. Bond Manager Performance FY 2007

	Actual Return	Benchmark Return
<b>Active Managers</b>		
Aberdeen Asset Mgmt.	6.5%	6.1%
Dodge & Cox Investment Mgmt.	6.7	6.1
Morgan Stanley Investment Mgmt.	6.1	6.1
RiverSource Investments	6.3	6.1
Western Asset Mgmt.	6.9	6.1
<b>Semi-Passive Managers</b>		
BlackRock Financial Mgmt.	5.7	6.1
Goldman Sachs Asset Mgmt.	6.2	6.1
Lehman Brothers Asset Mgmt.	6.2	6.1
<b>Aggregate Bond Pool</b>	<b>6.3</b>	<b>6.1</b>
<b>Asset Class Target</b>		
Lehman Aggregate		6.1

Figure 20. International Manager Performance FY 2007

	Actual Return	Benchmark
<b>Active Managers: Developed Markets</b>		
Acadian Asset Management	34.1%	27.1%
Invesco Global Asset Mgmt.	24.8	27.1
J.P. Morgan Investment Mgmt. Co.	22.5	27.1
Marathon Asset Management	29.7	27.1
McKinley Capital Management	30.9	27.1
Pyramis Global Advisors Trust Co.	25.5	27.1
RiverSource Investments, LLC	23.0	27.1
UBS Global Asset Management	24.7	27.1
<b>Semi-Passive Managers: Developed Markets</b>		
AQR Capital Management	28.2	27.1
Pyramis Global Advisors Trust Co.	29.6	27.1
State Street Global Advisors	27.5	27.1
<b>Active Managers: Emerging Markets</b>		
AllianceBernstein L.P.	44.9	45.0
Capital International, Inc.	51.9	45.0
Morgan Stanley Investment Mgmt.	48.7	45.0
<b>Passive EAFE Manager: Developed Markets</b>		
State Street Global Advisors	27.3	27.1
<b>Aggregate International Pool</b>	<b>30.3</b>	
<b>Asset Class Target</b>		<b>29.6</b>

## External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2007

### Active Domestic Stock Managers

Alliance Bernstein L.P.	\$	291,419
Barrow, Hanley, Mewhinney & Stauss, Inc.		1,083,767
Cohen, Klingenstein & Marks, Inc.		580,290
EARNEST Partners, LLC		506,680
Enhanced Investment Technologies, LLC		1,288,015
Franklin Portfolio Associates, LLC		605,251
Goldman Sachs Asset Management, LP		931,273
Holt-Smith & Yates Advisors*		390,912
Hotchkis and Wiley Capital Management, LLC		1,180,089
Jacobs Levy Equity Management, Inc.		1,131,198
Lazard Asset Management Group, LLC		322,408
Lord, Abbet, & Co., LLC		838,471
LVS Asset Management		1,573,872
Martingale Asset Management L.P.		962,617
McKinley Capital Management Inc.		1,326,250
New Amsterdam Partners, LLC		1,043,507
Next Century Growth Investors, LLC		1,829,946
Oppenheimer Capital, LLC*		870,557
Peregrine Capital Management		1,549,045
RiverSource Investments		426,160
Sands Capital Management, LLC		582,497
Summit Creek Advisors, LLC (Winslow-Small Cap.)*		278,243
Systematic Financial Management, LP		993,166
Turner Investment Partners, Inc.		1,379,758
UBS Global Asset Management (Americas) Inc.		1,361,701
Voyageur Asset Management, Inc.		265,317
Winslow Capital Management, Inc. (Large Cap.)		540,308
Zevenbergen Capital Investments, LLC		1,185,722

### Passive Domestic Stock Managers

Barclays Global Investors		850,587
---------------------------	--	---------

### Semi-Passive Domestic Stock Managers

Barclays Global Investors, N.A.		3,473,789
Franklin Portfolio Associates, LLC		2,189,696
JPMorgan Investment Management, Inc.		2,618,831

cont.

## External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2007

### Active Domestic Bond Managers (2)

Aberdeen Asset Management (Deutsche)	\$	1,746,048
Dodge & Cox		1,166,514
Morgan Stanley		1,321,297
RiverSource Investments (American Express)		993,106
Western Asset Management		1,429,083

### Semi-Passive Domestic Bond Managers (2)

BlackRock Inc.		1,060,638
Goldman Sachs		1,425,902
Lehman Brothers Asset Management, LLC (Lincoln)		603,211

### International Stock Managers

Acadian Asset Management		1,562,331
Alliance Bernstein L.P.		2,065,534
AQR Capital Management		1,557,477
Capital International		3,124,482
Invesco Global Asset Management		1,232,641
JP Morgan Flemming		1,465,764
Marathon Asset Management		1,875,420
McKinley Capital Management		1,544,325
Morgan Stanley Investment Management		3,436,856
Pyramis Global Advisors Trust Co.- Active (Fidelity)		875,096
Pyramis Global Advisors Trust Co. - Semi Passive (Fidelity)		1,189,030
RiverSource Investments(American Express )		1,140,954
State Street Global Advisors - Semi Passive		1,363,451
State Street Global Advisors - Passive		435,631
UBS Global Asset Management (Brinson)		1,127,678

### Assigned Risk Plan

GE Investment Management		293,418
Voyager Asset Management		257,818

\* Manager Terminated in Fiscal '07

- (1) Most active stock managers, with the exception of those managing small portfolios, are compensated on a performance-based fee formula. Four fee options are available and fees earned range from zero to twice the manager's base fee, depending on the manager's performance relative to an established benchmark.
- (2) Active bond managers and semi-passive bond managers are compensated based on a specified percentage of assets under management.