

Investment Committee Memorandum
Board of Regents, State of Iowa

Subject: Selection of Small Cap Fund Manager

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Recommended Actions:

Recommend the Board approve for the institutional endowment portfolios:

1. The termination of Seneca Capital Management.
2. The selection of Artisan Partners as the new small capitalization domestic fund manager.

Executive Summary:

Previous Board Actions At its December 2003 meeting, the Board moved to sever the investment relationships its international equity, domestic equity, and fixed income fund managers.

In February 2004, the Board approved:

- Selection of a new international equity fund manager.
- Selection of a new fixed income fund manager.
- Temporary transfer of Invesco's domestic equity portfolio to Vanguard, the Board's large capitalization index fund manager.

In September 2004, the Board approved:

- Termination of the Board's current large capitalization index fund manager.
- Selection of a new large capitalization domestic equity fund manager with an enhanced index philosophy.
- Selection of a large capitalization domestic equity fund manager with an active, fundamental, bottom-up philosophy.
- Modification to the fund manager allocation section of the Board's investment policy.

Portfolio Considerations Institutional officials and Board Office staff worked with representatives from Wilshire Associates, the Board's investment advisor, to develop a diversification strategy for the endowment portfolios utilizing an equity fund manager with a small capitalization growth-oriented focus.

Search Criteria Wilshire delineated search specifications for small or small/mid cap growth equity managers, which included typical characteristics, benchmarked to the Russell 2000 Growth or Russell 2500 Growth Indices, and three- to five-year performance expectations of at least 2% above the benchmark.

Wilshire Associates identified and provided evaluation summaries for a small group of qualified managers. A Regent fund manager selection group conducted interviews of the top three domestic equity fund managers.

Group Recommendation	<p>The interview group recommends the selection of Artisan Partners as the new small capitalization fund manager with a growth-oriented, fundamental bottom-up approach.</p> <p>To implement this recommendation, the relationship with Seneca Capital Management, a mid-capitalization growth fund manager, will need to be terminated. Seneca, as of September 30, 2004, managed \$30.4 million (7.7%) of the institutional combined endowment portfolios.</p> <p>The transition of these funds to the new manager would take place as soon as practical after Board approval.</p>
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Background and Analysis:

Previous Board Actions	<p>At its December 2003 meeting, the Board moved to sever the investment relationships with two of its investment fund managers.</p> <ul style="list-style-type: none">• Alliance Bernstein managed the Board's international equity component of the endowment portfolio valued at \$24.1 million at the end of the calendar year.• Invesco managed both a domestic equity portfolio of \$109.1 million and a fixed income portfolio of \$88.9 million as of December 31, 2003. <p>In February 2004, the Board:</p> <ul style="list-style-type: none">• Selected Grantham, Mayo, Van Otterloo & Co. as the new international equity fund manager.• Selected Dodge and Cox as a new fixed income fund manager.• Transferred Invesco's domestic equity portfolio to Vanguard, the Board's large capitalization index fund manager. (This action maintained compliance with the Board's investment policies. The portfolio would then be evaluated in several months, with an emphasis on the domestic equity component.)• Provided the institutions with an option of splitting its fixed income portfolios between the two managers, given the relative size and risk of the portfolios.• Selected BlackRock as a contingent fixed income manager, should a new fixed income manager be necessary within the next year, with the utilization of this manager subject to further approvals. <p>In September 2004, the Board:</p> <ul style="list-style-type: none">• Terminated Vanguard, the Board's large capitalization index fund manager.• Selected Goldman Sachs Asset Management and Lotsoff Capital Management as the large capitalization domestic fund managers with an equal share of the equity portfolio.• Modified the manager allocation section of the Board's investment policy.
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Process	<p>Wilshire Associates was asked to identify and provide evaluation summaries for a small group of qualified active small capitalization domestic equity fund managers.</p> <ul style="list-style-type: none"> • Wilshire's manager selection process: <ul style="list-style-type: none"> • Uses extensive technology and both qualitative and quantitative measures to identify managers who will successfully execute the fund's investment structure. • Incorporates ongoing research as well as focused analysis. Wilshire maintains comprehensive databases on managers in all asset classes and has staff dedicated to researching investment managers. • Careful monitoring of managers by Wilshire at all times is essential to having reliable information to help locate suitable managers. • Wilshire consultants have experience in meeting new managers and viewing first hand manager relationships with Wilshire's existing clients. <p>Wilshire also calculates and audits performance for client accounts on over 900 managers.</p> <hr/>
Selection Group	<p>On Friday, November 19, 2004, a Regent selection group conducted interviews of the top three small capitalization domestic equity fund managers. The selection group consisted of representatives from the Investment Committee, the universities, the Board Office, and Wilshire Associates.</p> <p>The group interviewed the following managers:</p> <ul style="list-style-type: none"> • Chartwell Investment Partners • Mazama Capital Management • Artisan Partners <hr/>
Group Recommendation	<p>Based on the evaluation data and the interview process, the group recommends the selection of Artisan Partners as the Board's new small capitalization domestic equity fund manager.</p> <p>Artisan was founded in 1995 and is an independent, privately owned partnership located in Milwaukee, Wisconsin. It has approximately \$35 billion under management with approximately \$1.2 billion under management in the small-cap growth strategy.</p> <p>It has a fundamental bottom-up small cap investment philosophy with a focus on intrinsic value and return on invested capital.</p> <hr/>