



Office of State Treasurer Highlights of the Fiscal Year 2004

PREPARED FOR THE INVESTMENT ADVISORY COUNCIL

This summary, prepared for the members of the Investment Advisory Council, highlights material included in the Annual Report of the Office of State Treasurer and related information for fiscal year 2004. The Annual Report was submitted in draft form to the Office of the Governor in October, 2004. Featured below are key financial achievements of the Connecticut Retirement Plans and Trust Funds, including recoveries from class action claims and litigation and activity in the CRPTF's proxy voting program, as well as performance highlights for the Short-Term Investment Fund (STIF).

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS OVERVIEW OF FINANCIAL HIGHLIGHTS & ACTIVITIES- FISCAL 2004

- Fiscal Year 2004 performance produced a net (after all expenses) return of 15.23% resulting in a gross operating increase to the fund of \$2.715 billion. The return is the highest achieved by the fund during the past four years. After deducting \$827 million of operating cash flow for pension benefits and distributions paid to beneficiaries, the Connecticut Retirement Plans and Trust Funds net assets grew to \$20.189 billion from the previous year balance of \$18.300 billion - an increase of \$1.889 billion.
- Positive returns were realized in each of the components of the Combined Investment Funds. Fueled by strong international markets and a weakening dollar, total return realized in the International Stock Fund in 2004 was 29.69% compared to a return of negative 6.39% in 2003. Beneficial risk factors and positive industry selection were the main contributors to fiscal 2004 performance for the Mutual Equity Fund, which realized a return of 20.84%, compared to 0.48% in 2003. Fixed income markets were not as favorable in fiscal 2004 as in the prior year, but positive manager performance produced a return of 2.79% for the Mutual Fixed Income Fund, compared with a 12.03% return in 2003. Expansion of the U.S. economy and a revived IPO market provided a boost to the Private Investment Fund, which realized a return of 20.21% in 2004, compared to a negative 11.94% return in 2003. Underexposure to core real estate strategies and traditional property types, coupled with overexposure to opportunistic strategies, hotels and non-traditional property types caused the Real Estate Fund to lag real estate industry returns, turning in a modest return of 0.67%, from a 3.30% return in the prior year. Other returns included the Commercial Mortgage Fund at 7.87% and the Cash Reserve Fund at 1.30%.
- In the Trust Universe Comparison survey (TUCs) of public funds with assets greater than \$1 billion, the CRPTF ranked in the 38th percentile of similar funds over a 5-year period with an annualized return gross of fees of 3.97% in 2004, compared to a 37th percentile in 2003 with a return of 3.12% over a 5-year period. The annual total return of 15.23% was 104 basis points under the benchmark return of 16.27%, largely attributable to asset allocation differences relative to the total Fund benchmark.
- The International Stock Fund (ISF) transition and funding were completed, with the hiring of 10 new managers and increased funding of approximately \$1.2 billion, and the ISF's two currency overlay managers were brought on board.

- During the fiscal year, there were 27 new money managers hired or attaining preferred vendor status during the fiscal year, including twelve firms that were finalists for the CRPTF's international stock fund or currency overlay mandates. All of the firms hired during the year were brought on board following successful completion of contract negotiations.
- The Private Equity portfolio was quite active in fiscal 2004, with \$110 million in commitments to two new partnerships and \$115 million pending for two other partnerships. The last of the Triumph Capital assets were sold effective June 30, following through on the Treasurer's commitment to sever all ties with this General Partner.
- The Real Estate Fund Asset Guidelines and Strategic Plan were endorsed by the IAC. The CRPTF then re-entered the real estate market as an active investor, after nearly 5 1/2 years of no new commitments, with a first commitment to Rockwood Capital Real Estate Partners Fund V LP.
- The Pension Fund Management Division instituted a quarterly cashflow report to the IAC, showing the flows in and out of the Pension Funds, and initiated a search for a Master Custodian during the year.
- FY 2004 saw development and initial implementation of the Connecticut Horizon Fund (CHF). Four finalist fund-of-funds managers were selected to administer the CHF.
- The new fiscal year brought a change in leadership of the IAC, with Steve Hart having concluded his 8 year term as Chairman and Dick Roberts being appointed by the Governor to succeed him. The year also saw the additions of David Roth and Jim Larkin to the IAC, following the departures of George Mason, Roslyn Schoonmaker and Clare Barnett.

OVERVIEW OF COMBINED INVESTMENT FUNDS, AS OF JUNE 30, 2004

Total Value of Assets Under Management	\$20,650,115,902
Net Assets Under Management	\$20,189,389,780
Total Investment Returns for the Fiscal Year	\$2,715,406,286
Total Management Fees for the Fiscal Year	\$73,902,059
Total Number of Advisors	74
Increase in Total Advisors from Prior Year	9
One-Year Total Return	15.23%
Five-Year Compounded Annual Total Return	3.79%
Ten-Year Compounded Annual Total Return	9.20%

NET ASSETS AND CHANGES IN NET ASSETS

Listed in Table 1, below, is a summary of the key components of net assets. Listed in Table 2, below, is a summary of the key components of investment income and expenses, and changes in net assets.

TABLE 1
CRPTF NET ASSETS
(IN MILLIONS)

	<u>FY2004</u>	<u>Net Assets</u>	<u>FY2003</u>	<u>Net Assets</u>	<u>FY2002</u>
		<u>Inc/(Dec)</u>		<u>Inc/(Dec)</u>	
Investments in Securities, at Fair Value	\$20,650	\$1,661	\$18,989	\$(569)	\$19,558
Cash, Receivables and Other Assets	<u>\$10,456</u>	<u>\$6,202</u>	<u>\$ 4,254</u>	<u>\$400</u>	<u>\$ 3,854</u>
Total Assets	\$31,106	\$7,863	\$23,243	\$(169)	\$23,412
Payables	<u>\$10,917</u>	<u>\$5,974</u>	<u>\$ 4,943</u>	<u>\$(237)</u>	<u>\$ 4,706</u>
Total Net Assets	<u>\$20,189</u>	<u>\$1,889</u>	<u>\$18,300</u>	<u>\$(406)</u>	<u>\$18,706</u>

TABLE 2
CRPTF CHANGES IN NET ASSETS
(IN MILLIONS)

	<u>FY2004</u>	<u>Net Assets</u> <u>Inc/(Dec)</u>	<u>FY2003</u>	<u>Net Assets</u> <u>Inc/(Dec)</u>	<u>FY2002</u>
Total Investment Income	\$ 963	\$ 97	\$ 866	\$ 92	\$ 774
Total Investment Expenses	\$ 66	\$ 2	\$ 68	\$ 25	\$ 93
Net Realized Gain (Loss)	\$ 881	\$1,448	\$ (567)	\$ (121)	\$ (446)
Net Change in Unrealized Gain (Loss) on Investments	<u>\$ 937</u>	<u>\$ 813</u>	<u>\$ 124</u>	<u>\$ 1,691</u>	<u>\$(1,567)</u>
Change in Net Assets from Operations	\$ 2,715	\$2,360	\$ 355	\$1,687	\$(1,332)
Net Change from Paid Pension Benefits and Unit Transactions	<u>\$ (826)</u>	<u>\$ (65)</u>	<u>\$ (761)</u>	<u>\$ (206)</u>	<u>\$ (555)</u>
Total Change in Net Assets	\$ 1,889	\$ 2,295	\$ (406)	\$ 1,481	\$(1,887)
Total Net Assets – Beginning	<u>\$18,300</u>	<u>\$ (406)</u>	<u>\$18,706</u>	<u>\$ (1,887)</u>	<u>\$20,593</u>
Total Net Assets - Ending	<u>\$20,189</u>	<u>\$ 1,889</u>	<u>\$18,300</u>	<u>\$ (406)</u>	<u>\$18,706</u>

OVERVIEW OF ASSET RECOVERY AND CLASS ACTION LITIGATION

- The pension funds recovered a record \$2.8 million in fiscal year 2004 in claims filed in class action lawsuits. Nearly \$6 million has been brought into the funds since this program was initiated four years ago.
- The pension fund received \$850,000 from the convicted chairman of Triumph Capital, representing the first money recovered directly attributable to federal convictions flowing from the kickback and bribery scandal involving former Treasurer Paul Silvester. The payment, by former Triumph Capital founder and Chairman Frederick W. McCarthy, was made as part of his plea agreement with the U.S. Justice Department.

OVERVIEW OF PROXY SEASON

- The CRPTF engaged over 40 companies on corporate governance and other key shareholder issues, including letter writing, filing shareholder resolutions, appearing at annual meetings, holding discussions with management, and meeting with boards of directors.
- Two major highlights in 2004 were at American Electric Power (AEP) and at The Walt Disney Company. At AEP, the Treasurer, working with other institutional investors, reached an agreement with the company on reporting to shareholders on climate risk. At Disney, the CRPTF was one of a number of institutional investors actively involved in advocating responsible corporate governance policies in advance of the company's annual meeting, which ultimately led to a strong shareholder vote opposing the re-election of various Board members, and the Board's subsequent decision to have different individuals serve as Board Chair and CEO.
- On the issue of climate change, the success with AEP has been followed up with similar agreements between shareholders and investors for similar reports at a number of other companies. The CRPTF has been directly involved in some of these dialogues, and has consulted with other investors on the others.

- The Treasurer's Office co-sponsored the first-ever *Investor Summit on Climate Risk*, held at the United Nations and attended by 300 participants, including some of the nation's largest institutional investors, prominent Wall Street firms, and experts on the issue of financial risk posed by climate change.
- In the area of corporate governance, Reebok and SBC agreed to move to annual election of all members of the Board of Directors, and the CRPTF shareholder resolution on annual election of all directors received 72% support at the Stanley Works.
- In the area of board diversity, American Power Conversion (APCC) and EMC both added a woman to previously all-male, all-white boards and Gateway appointed an Asian man as Chairman and CEO - integrating that formally all white male board as well. APCC also agreed to strengthen its nominating committee guidelines on seeking out a diverse candidate pool for consideration for vacant board seats.
- In the areas of executive compensation, the shareholder resolution co-filed by the CRPTF at Peoplesoft asking for expensing of stock options received a majority vote.

SHORT-TERM INVESTMENT FUND

OVERVIEW OF FINANCIAL HIGHLIGHTS - FISCAL 2004

- The Short-Term Investment Fund invested an average of \$3.8 billion in short-term money market instruments during the fiscal year 2004, an increase of \$0.553 billion over the prior fiscal year, while maintaining the AAAM rating by Standard & Poor's and returning 1.16%.
- The 1.16% total annual return in STIF exceeded its primary benchmark by 41 basis points (an extraordinary 55%) resulting in \$16 million in additional interest income for Connecticut governments and their taxpayers.
- As of June 30, 2004, STIF had 1,154 active accounts for 60 State agencies and authorities and 258 municipalities and local entities. During the year, STIF added 17 new local accounts totaling \$47 million.

SHORT-TERM INVESTMENT FUND (STIF), AS OF JUNE 30, 2004

Total Net Assets of the Fund	\$3,829,256,007
One-Year Total Return	1.16%
Five-Year Compounded Annual Total Return	3.48%
Ten-Year Compounded Annual Total Return	4.58%
Weighted Average Maturity	35 days

2004 AWARDS & RECOGNITION

- The Government Finance Officers Association of the United States and Canada (GFOA) awarded a **Certificate of Achievement for Excellence in Financial Reporting** to each of the State of Connecticut Treasurer's Combined Investment Funds, and Short-Term Investment Fund Comprehensive Annual Financial Reports (CAFR's) for the fiscal year ended June 30, 2003.

In order to be awarded a Certificate of Achievement, the Treasurer's Office must publish easily readable and efficiently organized comprehensive annual financial reports and satisfy both accounting principles generally accepted in the United States and applicable requirements. While a certificate is valid for a period of one year only, we believe the current year report continues to meet the Program's requirements and we will be submitting them to GFOA for certification.