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### Justification for selecting the Lazard Freres Asset Management to manage the International Equity Option

In 1999, Treasury concluded that international equities were warranted in portfolios with a long-term investment time horizon. Treasury reached this conclusion after considering the expected diversification, risk, and return benefits international equities would bring to an otherwise diversified portfolio. In making the recommendation Treasury carefully considered the likely costs of establishing the investment option and the anticipated need for the option.

Unlike the domestic equity common trust funds that are passively managed, Treasury concluded that active management was appropriate for the international equity fund. Active management of international equities has over all relevant historical time periods provided superior returns to the passive alternatives. The following table shows the median or average active international manager returns compared to the most widely used international equity index.

Time Period ending 12-31-99	Median Manager Return	MSCI EAFE Index Return
1 year	35.40%	26.96%
3 years	18.99%	15.75%
5 years	16.77%	12.83%
7 years	17.47%	14.71%
10 years	11.84%	7.02%

Source: Callan Associates

Indexing of international equities is not as efficient or cost effective as indexation of domestic equities. The cost of indexing international equities, while relatively low, does not present the compelling low cost option that passively managed domestic equities did. The combination of active management adding incremental returns and the lack of a compelling low cost option lead to Treasury's decision to pursue active international equity.

At the time Treasury was beginning its search for an active international equity investment option, the Municipality of Anchorage was concluding its search for an international equity institutional mutual fund. That search, conducted by Callan Associates, identified a number of firms offering attractive funds. The Municipality and Callan Associates agreed to allow Treasury access to the results of the search in the form of the analysis of the six finalists.

Treasury through its relationship with the Alaska State Pension Investment Board (ASPIB) was very familiar with two of the finalists, Lazard Freres Asset Management and Capital Guardian Trust Company. Lazard Freres Asset Management has a global equity mandate from the ASPIB. The international portion of that mandate is very similar to the Lazard International Equity Portfolio included in the finalist list.

Active management of international equities requires ongoing monitoring. The very high level of oversight and monitoring Treasury can provide on Lazard's management is based on the almost \$600,000,000 in international equities ASPIB entrusted to them. Selecting Lazard Freres allows Treasury to meet its monitoring responsibilities at very little cost to the fund participants. Based on the existing relationship Treasury has with Lazard and the recent third party review which identified them as a qualified firm, Treasury recommends Lazard Freres.

Treasury also negotiated a substantial reduction in the management fee Lazard Freres normally charges. Lazard Freres was willing to offer this reduction based largely on the existing relationship with ASPIB and Treasury.

While all six finalists in the Municipality of Anchorage search are fine firms with attractive products Treasury focused on the two firms with which they have ongoing relationships. This decision was based on cost and monitoring considerations. Of the two firms, Capital Guardian and Lazard Freres, Lazard Freres presented the most attractive option. Lazard Freres already managed significant assets for ASPIB with a very similar mandate, offered a relatively low cost option, and would be the simplest to monitor.

Treasury therefore recommends selection of the Lazard Freres Asset Management to manage the international equity option for any funds needing such an option.