CalPERS
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
Telecommunications Device for the Deaf - (916) 795-3240
(916) 795-3400

September 19, 2005

AGENDA ITEM 8c

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Domestic Equity Manager Annual Review

II. PROGRAM: Global Equity

III. RECOMMENDATION: Renew the contracts for CalPERS' six external active domestic equity managers and seven enhanced index external domestic equity managers. These managers are listed below. Wilshire's opinion letter is shown in Attachment 1. Wilshire's disclosure letter is shown in Attachment 2.

Active Managers	**Enhanced Index Managers**
AllianceBernstein	Atlantic Asset Management
The Boston Company	Franklin Portfolio Associates
Franklin Advisors	Goldman Sachs Asset Mgmt.
Geewax, Terker & Company	Intech
J.P. Morgan Investment Management	Quantitative Mgmt. Associates
Pzena Investment Management	Smith Breeden
	Western Asset Management Co.

IV. ANALYSIS:

Executive Summary

The performance of the external domestic equity manager program for the fiscal year ending June 30, 2005 was disappointing. Total program performance was 2.7% below benchmark, as shown in Table 4 of the report. That table also shows that the worst performance was in the first half of the fiscal year, with calendar year 2005 to date performance just 97 basis points below benchmark.

A number of actions have been taken to improve performance. First, two underperforming active managers resigned during the fiscal year with another two resigning in July 2005. Second, CalPERS' enhanced indexing managers received initial

funding in September 2004, with additional funding in subsequent months. As of May 2005, the assets allocated to the better performing enhanced indexing manager group exceeded the assets allocated the remaining active managers. Within the enhanced indexing group, more money was allocated to the stock-based managers as staff anticipated that a rising interest rate environment would prove challenging to the managers using a synthetic strategy. This assessment proved to be correct.

For the current fiscal year, staff plans to continue to allocate funds to the enhanced indexing managers, including at least one manager in the pool who has not yet been funded. Staff will also seek Investment Committee approval to add additional managers to this pool. Finally, staff is actively working on a number of additional ideas to improve performance of this part of the portfolio. We believe that, like the recommendation on enhanced indexing managers, a more innovative approach is needed than simply searching for different active managers. One of these ideas is to relax the long-only constraint on enhanced indexing portfolios and is an agenda item scheduled for presentation to the Investment Committee at its October or November meeting.

Background

CalPERS' external active domestic equity program consists of six active managers and seven enhanced index managers. The active managers were funded over the period from May 31, 1998 through October 2002, while the enhanced index managers were funded this fiscal year from September 2004 through February 2005.

On July 31, 1998, CalPERS implemented the internally managed Dynamic Completion Fund (DCF) to complement the portfolios of the active and enhanced domestic equity managers. The objective of the DCF is to mitigate style and capitalization biases within the equity portfolio relative to the CalPERS Custom Wilshire 2500 benchmark.

All of these managers have one year renewable contracts contingent upon the Investment Committee's annual approval as presented in this agenda item. Each contract contains a provision allowing for termination upon 30 days' notice.

During the fiscal year, two managers resigned from CalPERS' active manager lineup. An additional two managers resigned in July 2005.

Assets Under Management

As of July 31, 2005, total assets under management for CalPERS' active domestic equity program (including the DCF) were approximately $16.7 billion. Table 1, next page, shows the assets managed by each manager as of July 31, 2005.

Table 1

Manager	Portfolio Value (in millions)	Percent of Portfolio
Active Managers		
AllianceBernstein	$644.7	3.9%
The Boston Company	$799.8	4.8%
Franklin Advisors	$560.6	3.4%
Geewax, Terker & Company	$493.2	3.0%
J.P. Morgan Investment Mgmt.	$566.2	3.4%
Pzena Investment Mgmt.	$758.9	4.5%
Total Active	**$3,823.4**	**23.0%**
Enhanced Managers		
Atlantic Asset Mgt	$328.5	2.0%
Franklin Portfolio Associates	$889.3	5.3%
Goldman Sachs Asset Mgmt.	$441.7	2.6%
Intech	$905.9	5.4%
Quantitative Mgt Associates	$891.7	5.3%
Smith Breeden	$553.5	3.3%
Western Asset Mgmt. Co.	$559.7	3.4%
Total Enhanced	**$4,570.3**	**27.3%**
Dynamic Completion Fund	$8,296.7	49.7%
Total	**$16,690.4**	**100.0%**

Source: State Street Bank.

Market Environment

U.S. stocks posted positive returns for the trailing 12 months ending June 30, 2005. Over this period, oil prices where high and volatile moving from just over $40/barrel to almost $61/barrel in June 2005. Hurricane Ivan's path through the Gulf of Mexico contributed to these high and volatile oil prices as did concerns over emerging market growth and demand, such as in China, lack of adequate supply and reserves, as well as suspected increase in speculative investing. However, consumer confidence continued trending up as the economy supported more jobs and strong GDP growth continued. Also, during these past 12 months, the Federal Reserve has raised the Federal Funds interest rate from 1.25% to 3.25% at the end of June 2005. Historically, a period of rising interest rates does not preclude rising equity valuations as long as economic growth is sustained and earnings continue to advance. However, current price/earnings ratio valuation spreads, the range between the highest priced stocks and the lowest priced stocks relative to earnings, are very narrow and significantly below the long-term average, representing a challenging investment environment.

For the 12 month period ending June 30, 2005, the Custom Wilshire 2500 had the highest performance of the indices, which reflect a spectrum of possible investment

opportunities in the US market, listed in Table 2. Higher weights in consumer discretionary and health care stocks that outperformed, and better performance in industrial stocks, pulled the performance of the Custom Wilshire 2500 ahead of the S&P 500 for this period. The Dow Jones Industrials were particularly hurt by absolute performance in materials, health care, and information technology while the NASDAQ Composite really suffered from a large weight in poorly performing information technology stocks.

Table 2

Index	Return for the Year Ending June 30, 2005
S&P 500	6.32%
DJIA	0.66%
NASDAQ	1.11%
Custom Wilshire 2500	7.55%

As shown in Table 3, below, over the 12 month period, the Russell 2000 (Small Cap Value) Index performed the strongest, finishing up 14.39%. Growth (both large and small cap) indices posted positive returns over the same period, but both underperformed the value indices. Table 3 shows the disparity of returns between style and size indices for the one-year period.

Table 3

Index	July 2004 - June 2005	
	Growth	Value
CalPERS Wilshire Large	1.15%	13.25%
CalPERS Wilshire Small	7.07%	13.97%
Russell 1000 (Large)	1.68%	14.06%
Russell 2000 (Small)	4.29%	14.39%

In the CalPERS Custom Wilshire 2500 Index, for the 12 months ending June 2005, the best performing sectors were: energy, utilities, telecommunication services, and consumer discretionary. The worst performing sectors were: information technology, consumer staples, health care, and materials.

Program Performance Objective

Each active and enhanced portfolio is expected to exceed its customized benchmark over a full market cycle, which is three to five years. The objective of the Dynamic Completion Fund is to match the benchmark, filling in any gaps (reducing style bias) between the active and enhanced managers' composite benchmark and the CalPERS Custom Wilshire 2500 Index.

Program Performance

The active domestic equity program is expected to outperform, over a full market cycle, the aggregate custom benchmark comprised of the four Wilshire style indices, net of management fees. Over the trailing 12 months ending June 30, 2005, the active managers underperformed their custom benchmark by 2.13%. From inception through June 30, 2005, the active managers have outperformed their custom benchmarks by 0.13% net of fees. Table 4, below, shows the fiscal year returns along with the annualized since inception return.

Program performance includes partial year performance of managers whose performance was poor and whose contracts were resigned during the fiscal year and performance of managers who resigned in July 2005.

Table 4

	Fiscal Year 00/01	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Calendr YTD 2005	Annualized Since Inception*
External Active Managers	-20.92%	-18.34%	1.04%	22.39%	**7.15%**	-0.41%	4.41%
Composite Benchmark	-23.62%	-16.46%	1.27%	23.23%	**9.85%**	0.56%	4.36%
Active Return	**2.70%**	**-1.88%**	**-0.23%**	**-0.84%**	**-2.70%**	**-0.97%**	**0.05%**
Enhanced Index Managrs					**9.55%**	0.29%	9.55%
Composite Benchmark					**8.75%**	-0.48%	8.75%
Active Return					**0.80%**	**0.77%**	**0.80%**
Active & Enhnd Managers	-20.92%	-18.34%	1.04%	22.39%	**6.81%**	-0.29%	11.78%
Composite Benchmark	-23.62%	-16.46%	1.27%	23.23%	**8.94%**	0.06%	11.65%
Active Return	**2.70%**	**-1.88%**	**-0.23%**	**-0.84%**	**-2.13%**	**-0.35%**	**0.13%**

*Inception Date: 05/31/98. Source: State Street Bank, returns are net of fees.

The objective of the Total Program (Active Domestic Equity + DCF) portfolio is to exceed the return of the CalPERS Custom Wilshire 2500 Index, net of all management fees. Over the trailing 12 month period ending June 30, 2005, the Total Program underperformed its custom benchmark by 1.28%. Since the inception of the DCF through June 30, 2005, the Total Program has outperformed the Wilshire Custom 2500 by 0.56%. Table 5, below, shows the fiscal year returns along with the annualized since inception return.

Table 5

	Fiscal Year 00/01	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Calendr YTD 2005	Annualized Since Inception*
Total Program	-13.13%	-17.77%	1.14%	19.85%	**6.27%**	-0.32%	3.46%
Custom Wilshire 2500	-15.38%	-17.37%	1.13%	20.58%	**7.55%**	-0.03%	2.90%
Active Return	**2.25%**	**-0.40%**	**0.01%**	**-0.73%**	**-1.28%**	**-0.29%**	**0.56%**

*Inception Date: 07/31/98. Source: State Street Bank, returns are net of fees.

Program Attribution

Table 6, below, illustrates each manager's performance relative to its custom benchmark since its initial funding date. Although a few of the managers have a negative active return since inception, large positive active returns by three of the managers enabled the total group to outperform their custom benchmark by 0.56%.

Overall, CalPERS' slight bias in allocations to value strategies contributed positively to performance as the growth managers have generally underperformed their benchmark. In addition, the recently funded enhanced index managers have outperformed their benchmark by 0.80% and contributed positively to the overall active program return.

Table 6

External Manager	Fiscal Year 01/02 Active Return	Fiscal Year 02/03 Active Return	Fiscal Year 03/04 Active Return	Fiscal Year 04/05 Active Return	Since Inception Annualized Active Return through June 30, 2005	Inception
Active Managers						
Alliance Bernstein	5.45%	-1.24%	-1.69%	-0.57%	3.65%	Sept 2000
Boston Company	-5.31%	3.99%	2.97%	0.05%	0.58%	June 1998
Franklin Advisors	--	1.92%	-0.61%	-4.16%	-1.25%	Oct 2002
Geewax, Terker &	4.16%	-4.62%	-1.04%	3.31%	0.05%	June 1998
J.P. Morgan	-3.74%	-0.53%	0.63%	0.64%	-0.73%	Sept 2000
Pzena Investment	7.96%	5.89%	4.31%	-2.09%	6.77%	Sept 2000
Enhanced Mgrs						
Atlantic Asset Mgt				-1.00%	-1.00%	Nov 2004
Franklin Portfolio A				0.00%	0.00%	Oct 2004
Goldman Sachs SC				1.15%	1.15%	Feb 2005
Intech				2.87%	2.87%	Oct 2004
Quantitative Mgt A				1.84%	1.84%	Oct 2004
Smith Breeden				-0.21%	-0.21%	Nov 2004
Wamco				0.05%	0.05%	Oct 2004

* Manager resigned during the fiscal year, performance is reflected through this date
** Manager resigned after the fiscal year end, performance is reflected through June 30, 2005

Figure 1, on the next page, illustrates the annual and cumulative performance of the Total Program, which includes the DCF, relative to its CalPERS' Custom Wilshire 2500 benchmark. Figure 2, on the next page, reflects the risk and performance since September 2000, for the longer-term managers, of the domestic equity program. The added risk and underperformance currently associated with growth strategies is apparent.

Figure 1

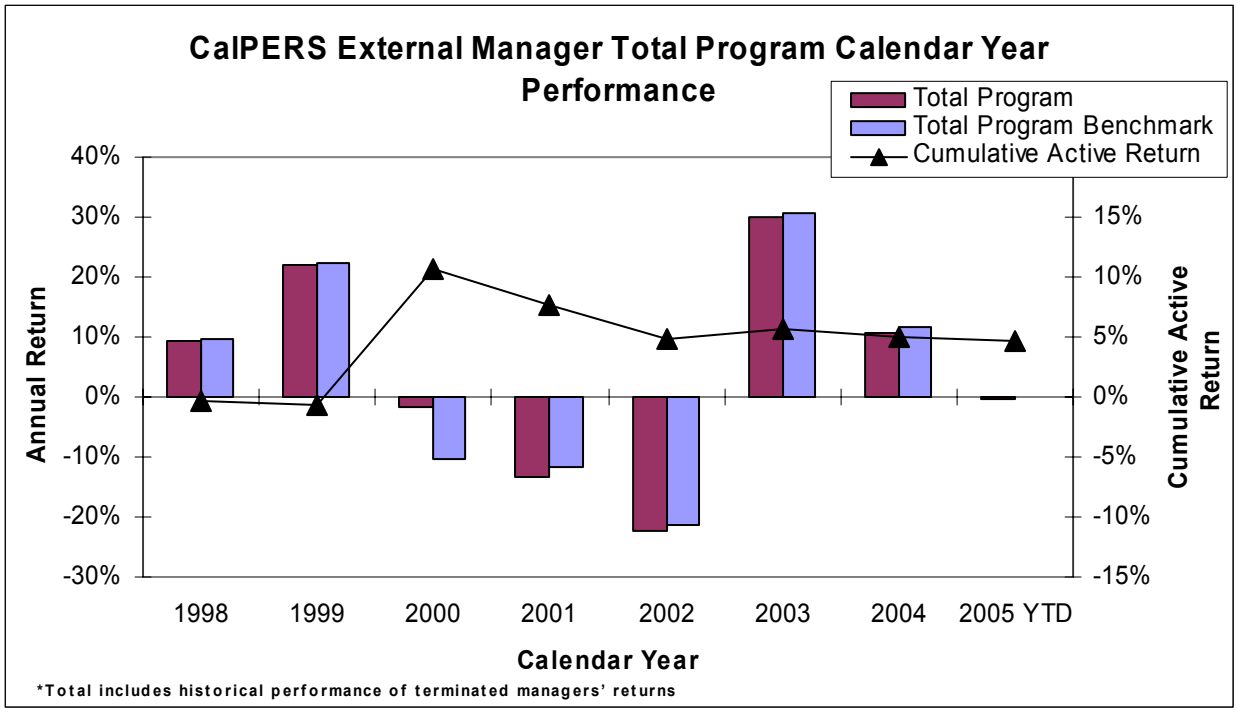
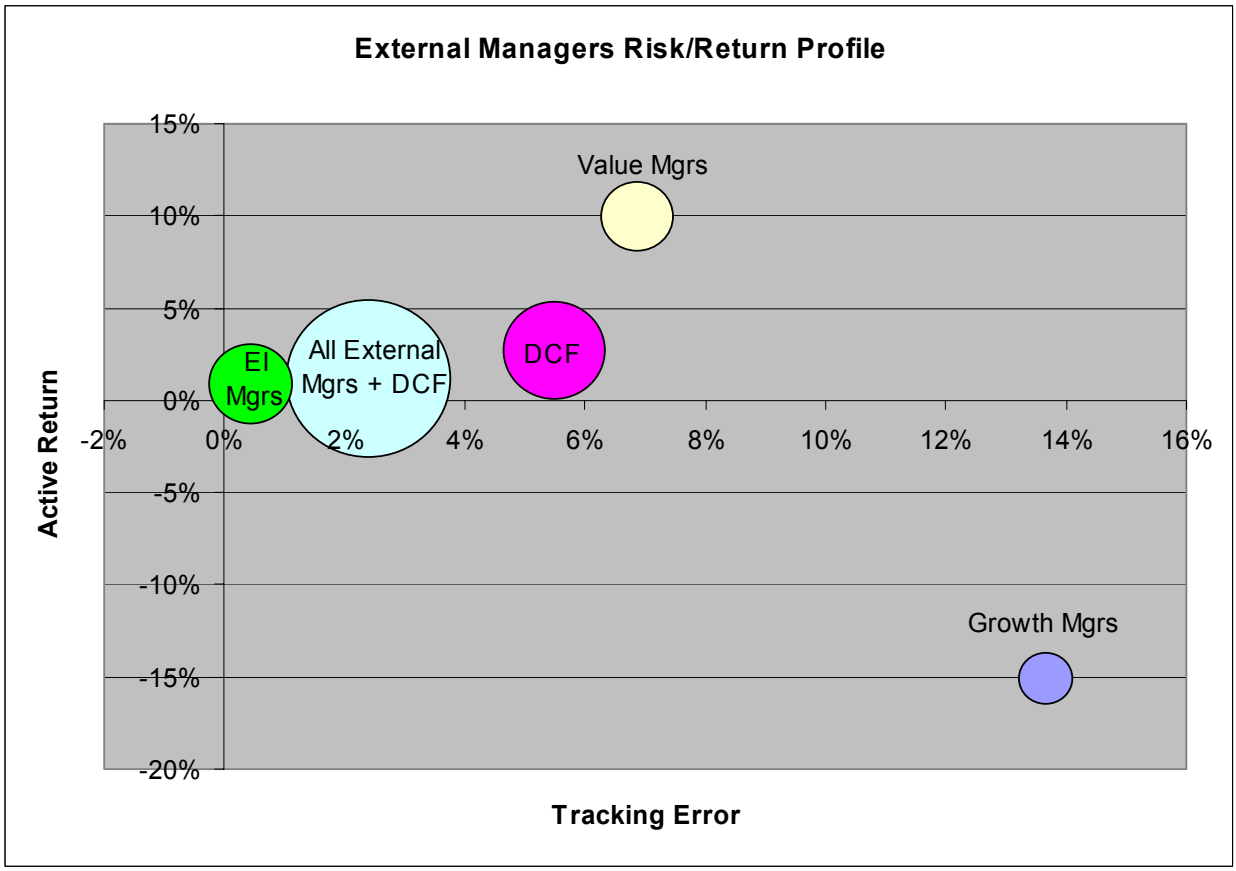


Figure 2 (Period reflected for managers' risk/return profile is September 2000 to June 2005 for all managers except the enhanced index managers, which is October 2004 to June 2005)



Managers' Style

Figure 3 illustrates how the composites for growth, value, enhanced index, total external equity and the Dynamic Completion Fund each compare to the CalPERS Custom Wilshire 2500 benchmark.

Figure 3

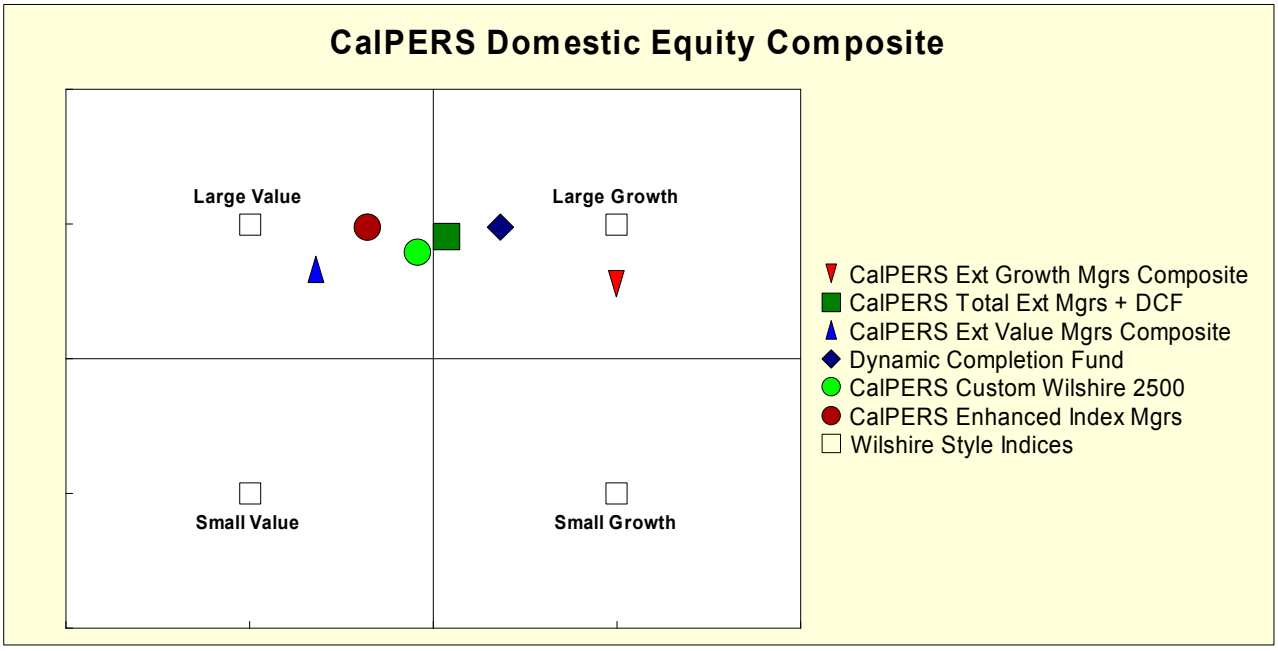
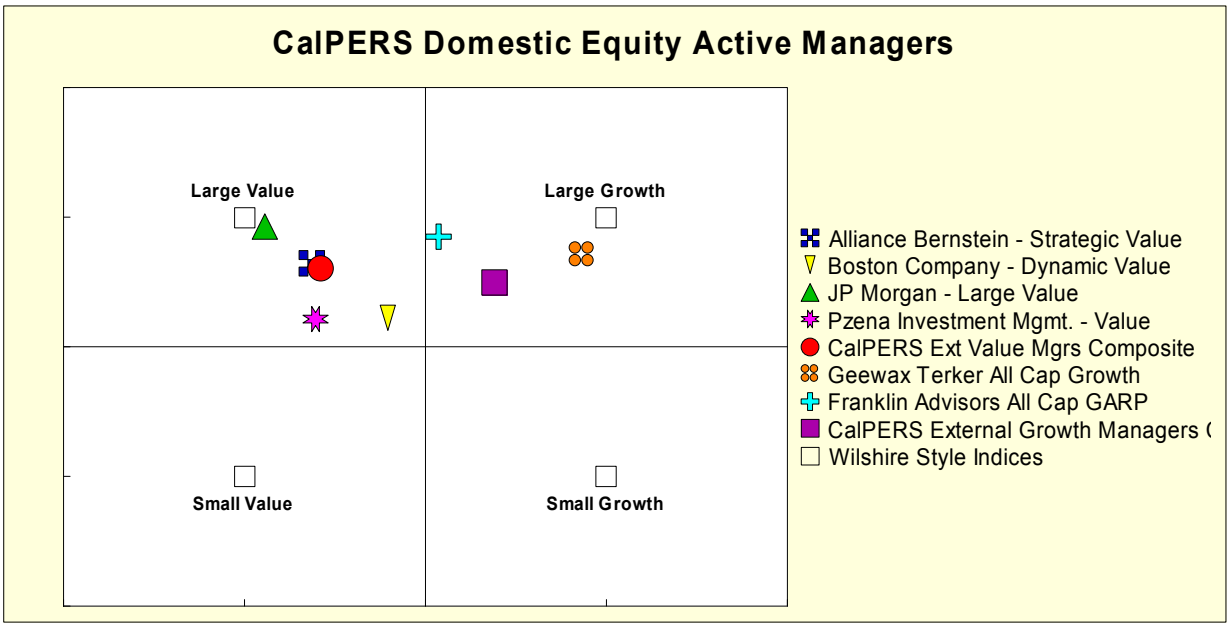


Figure 4, next page, shows how the active portfolios plot on a manager style chart. The style chart plots CalPERS' external growth and value managers along with their respective composite. The style (value to growth) is measured on the horizontal axis, and size (large capitalization to small capitalization) is measured on the vertical axis. Each quadrant represents a style box. Please note, the recently funded enhanced index managers are not reflected here due to insufficient data points to complete this analysis.

The four value managers reside in the large cap value quadrant. Pzena Investment Management, which invests in an all cap value strategy, resides in the lower part of the large value quadrant as does The Boston Co., whose investment strategy also provides exposure to both large and mid cap stocks. The remaining value managers plot higher in the large cap value quadrant.

The two growth managers reside in the large cap growth quadrant. However, Franklin Advisors resides near the mid-point as its growth at a reasonable price strategy reflects their increased focus on identifying undervalued growth stocks. Also, as reflected in the chart, Geewax primarily invests in more core growth companies.

Figure 4



The following pages provide information on the managers in the active domestic equity program. The managers and manager composite performance numbers shown above and individually for each manager on the next pages are net of fees and are CFA Institute compliant.

Individual Managers Performance and Evaluation

AllianceBernstein – Active Manager

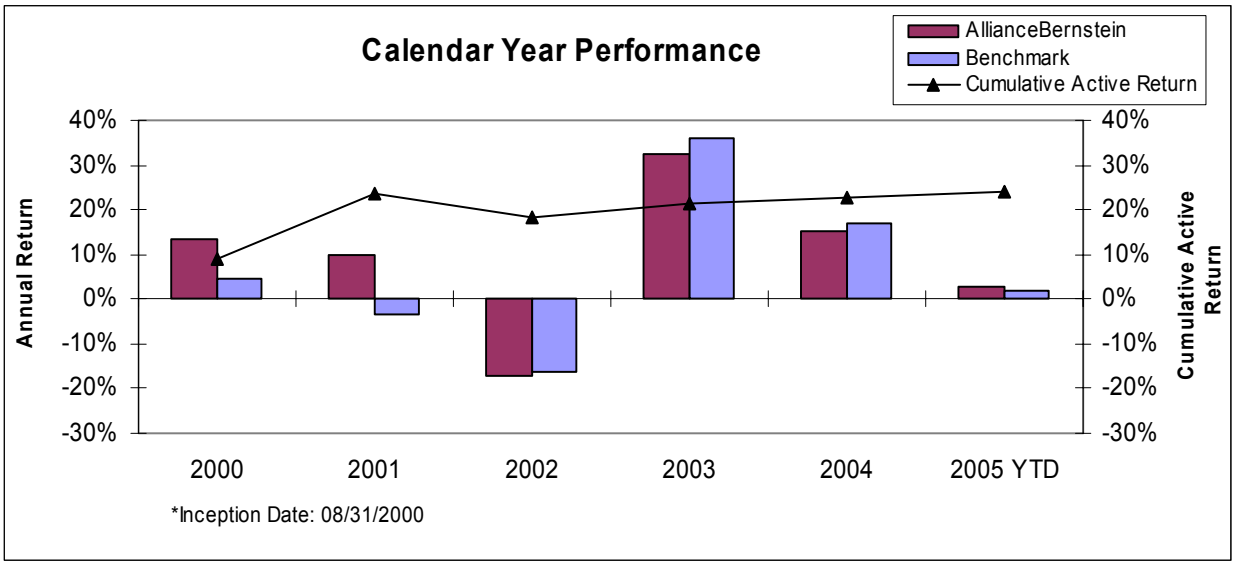
AllianceBernstein, funded on August 31, 2000, takes a bottom-up approach to security selection. The firm compares the present value of each company's future cash flow, as forecasted by their analysts, to the current price of the stock. Companies are ranked from the highest expected return to the lowest. Once the expected return is calculated for each stock, an adjustment is made for timing risk and concentration risk. Securities from the top two quintiles of their valuation universe are selected with an optimal trade off of risk and return.

While more recent relative performance has been negative, since inception, this manager has outperformed their benchmark. They have also outperformed in calendar year 2005 to date. In part, their strategy has been negatively affected by the narrow range in valuations. In addition, stock selection in the consumer discretionary and materials sectors particularly hurt this last year's performance. Annualized outperformance from inception represents $3.65 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $617.6 million. During the fiscal year, staff reduced the assets under management with AllianceBernstein by $254.7 million.

	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Inception* Annualized
AllianceBernstein.	(2.59)%	(0.70)%	23.19%	12.84%	10.35%
Benchmark	(8.04)%	0.54%	24.88%	13.41%	6.70%
Active Return	5.45%	(1.24)%	(1.69)%	(0.57)	3.65%

*Inception Date: 08/31/2000. Source: State Street Bank, returns are net of fees.

The chart below shows AllianceBernstein's performance versus its benchmark. The axis on the left measures the manager's annual performance against its benchmark. The right axis measures AllianceBernstein's cumulative performance relative to the benchmark.



The Boston Company – Active Manager

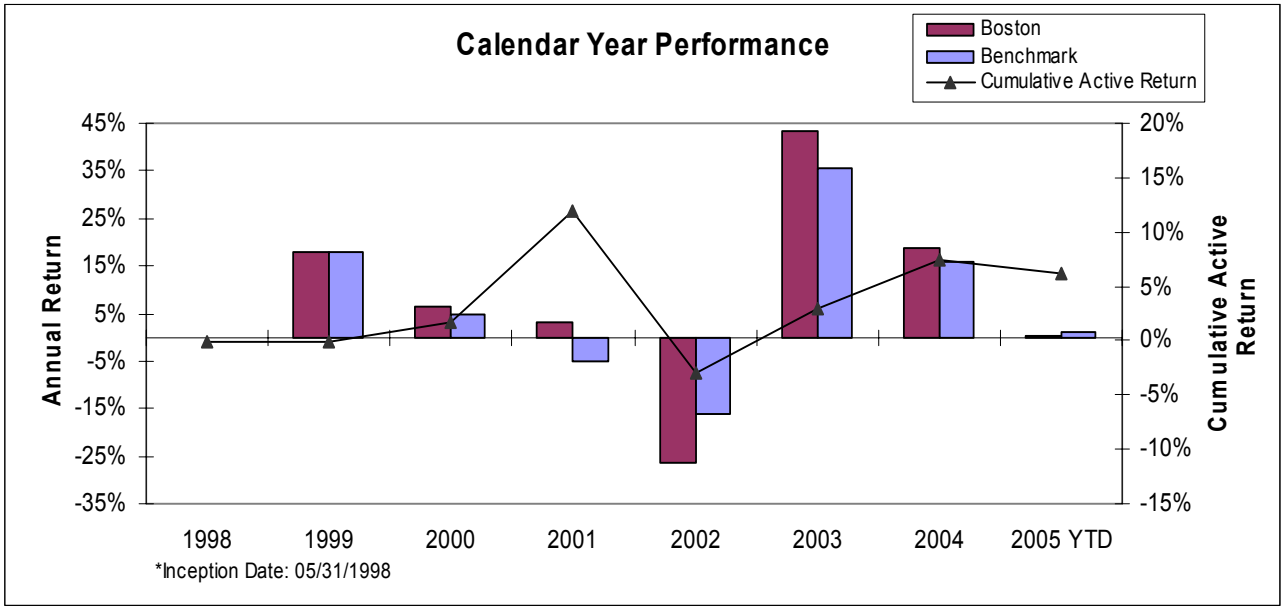
The Boston Company (TBC) was funded on May 31, 1998 as an active domestic equity value manager. TBC's Dynamic Value Equity Management product utilizes a bottom-up, value-oriented investment approach rooted in detailed fundamental analysis. The three-step analysis includes: 1) quantitative and fundamental business analysis of the individual companies, 2) valuation of the market as a whole, and 3) valuation of broadly defined segments of the market. Once the analysis is complete, the portfolio manager overweights the market segments with the best value characteristics and chooses companies within each market segment with the best fundamentals.

For the fiscal year ending June 30, 2005, the portfolio performed inline with its custom benchmark. Stock selection for the portfolio was positive while TBC's sector weighting decisions negatively impacted the performance. Annualized performance from inception was 0.58% above the benchmark, representing $0.58 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $774.0 million.

	Fiscal Year 00/01	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Inception* Annualized
The Boston Co.	11.71%	(14.37)%	5.08%	27.81%	11.61%	7.10%
Benchmark	9.35%	(9.06)%	1.09%	24.84%	11.56%	6.52%
Active Return	2.36%	(5.31)%	3.99%	2.97%	0.05%	0.58%

*Inception Date: 05/31/1998. Source: State Street Bank, returns are net of fees.

The chart below shows TBC's performance versus its benchmark. The axis on the left measures the manager's annual performance against its benchmark. The right axis measures TBC's cumulative performance relative to the benchmark.



Franklin Advisors – Active Manager

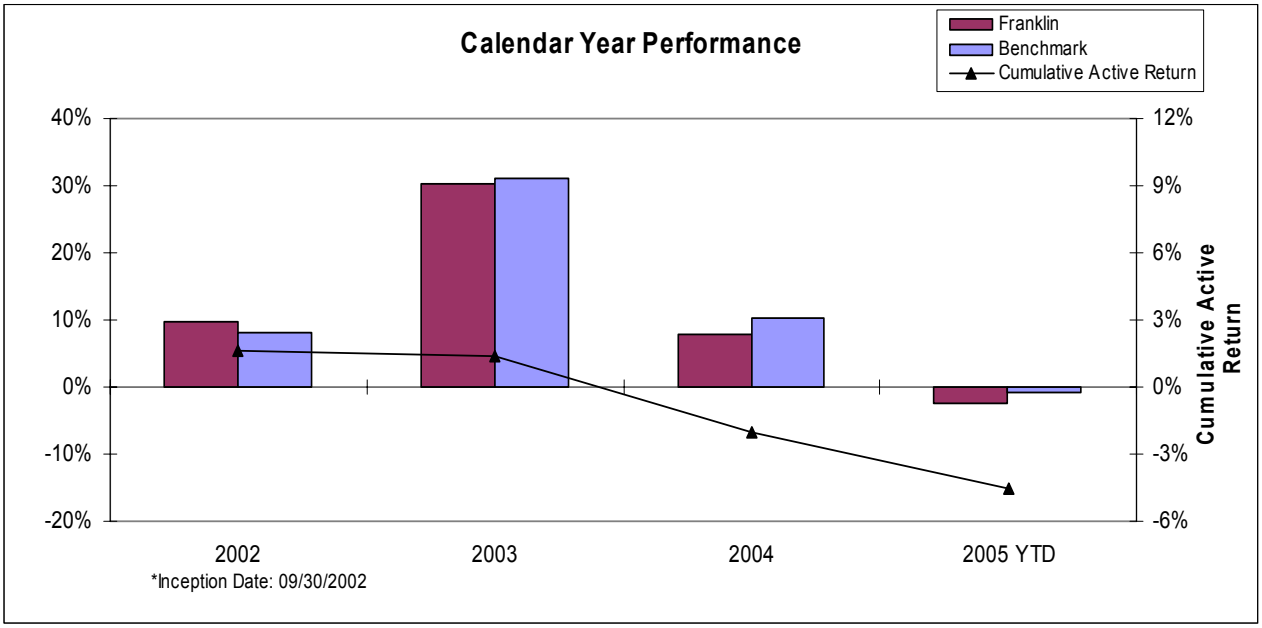
Franklin Advisors was funded on September 30, 2002 as an active domestic equity growth manager. Franklin builds its portfolio from a foundation of fundamental research coupled with insight on investment themes and sector outlook. Through a combination of qualitative research and proprietary quantitative screening, analysts create a buy list of 75-125 securities that offer: 1) strong growth characteristics, 2) compelling valuations, 3) a strong balance sheet, and 4) sustainable competitive advantages. Investment themes are developed based upon secular trends developed for multiple sectors. They then use their bottom-up security selection process to identify the best opportunities that participate in these themes.

Franklin Advisors' poor performance during the period was driven by an underweight to the energy sector and poor stock selection in the consumer discretionary and financial sectors. Annualized performance from inception was 1.25% below the benchmark, representing $1.25 million of underperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $793.4 million. In July 2005, staff reduced the assets under management with Franklin Advisors' by 257.5 million.

	Inception through June 30, 2003	Fiscal Year 03/04	Fiscal Year 04/05	Inception* Annualized
Franklin	**23.85%**	**19.52%**	**1.78%**	**16.07%**
Benchmark	**21.93%**	**20.13%**	**5.94%**	**17.32%**
Active Return	**1.92%**	**(0.61)%**	**(4.16)%**	**(1.25)%**

*Inception Date: 09/30/2002. Source: State Street Bank, returns are net of fees.

The chart below shows Franklin's performance versus its benchmark. The axis on the left measures the manager's annual performance against its benchmark. The right axis measures Franklin's cumulative performance relative to the benchmark.



Geewax, Terker & Co. – Active Manager

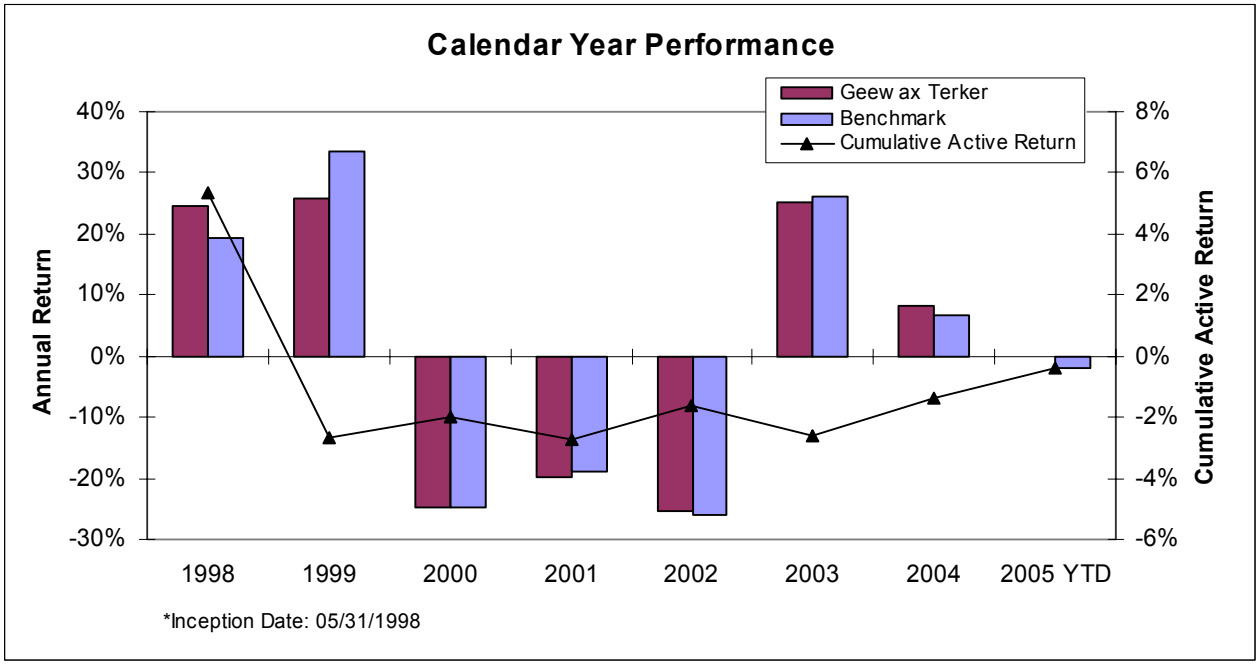
Geewax Terker was funded on May 31, 1998 as an active domestic equity growth manager. The firm utilizes a fundamentally driven, bottom-up growth investment style. Geewax seeks to capitalize on the overly optimistic expectations of other investors in the growth equity market by avoiding stocks likely to underperform based on a variety of valuation factors. A quantitative screening process is utilized that eliminates companies that have poor financial quality, missed earnings projections, or significant insider selling.

Following two consecutive years of disappointing performance, Geewax's performance rebounded strongly in the recent fiscal year. Driving the performance was strong stock selection, particularly in the consumer discretionary and energy sectors. Annualized performance from inception is 0.05% above the benchmark, representing $0.05 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $477.0 million. During the fiscal year, staff reduced the assets under management with Geewax by $200.7 million.

	Fiscal Year 00/01	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Inception* Annualized
Geewax Terker	(35.16)%	(21.23)%	(2.38)%	15.61%	4.83%	(0.65)%
Benchmark	(34.71)%	(25.39)%	2.24%	16.65%	1.52%	(0.70)%
Active Return	(0.45)%	4.16%	(4.62)%	(1.04)%	3.31%	0.05%

*Inception Date: 05/31/1998. Source: State Street Bank, returns are net of fees.

The chart below shows Geewax's performance versus its benchmark. The axis on the left measures the manager's annual performance against its benchmark. The right axis measures Geewax's cumulative performance relative to the benchmark.



J.P. Morgan – Active Manager

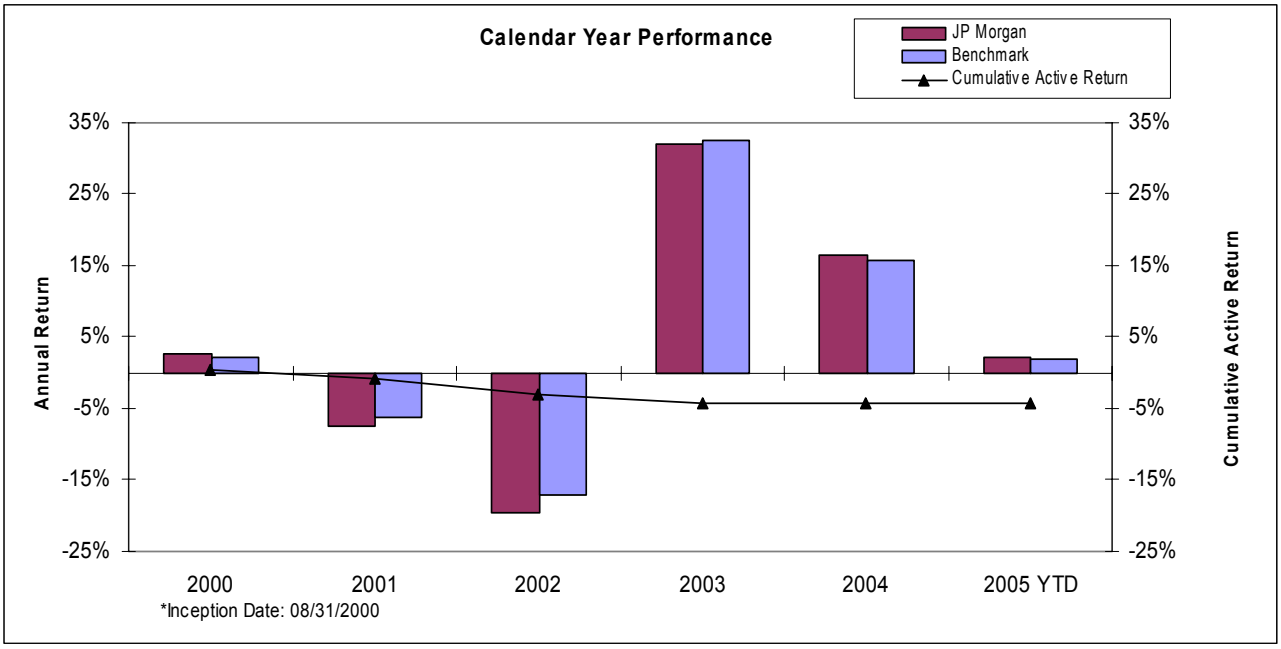
J.P. Morgan (JPM) was funded on August 31, 2000 as an active domestic equity value manager. JPM utilizes a structured stock selection process to construct a large cap value portfolio where risk is controlled by limiting active weights to 1%. JPM utilizes the proprietary fundamental research of their analysts to select those value securities with the highest expected returns within their respective sectors.

The manager's risk managed process invests in 225 to 300 names thereby avoiding large impacts from individual stocks. During the last fiscal year, stock selection in the financials and health care sectors contributed significantly to their outperformance. Annualized performance from inception is 0.73% below the benchmark, representing $0.73 million of underperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $552.0 million. During the fiscal year, staff reduced the assets under management with JPM by $200.2 million.

	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Inception* Annualized
JPM	(14.20)%	(0.52)%	22.73%	13.89%	3.83%
Benchmark	(10.46)%	0.01%	22.10%	13.25%	4.56%
Active Return	(3.74)%	(0.53)%	0.63%	0.64%	(0.73)%

*Inception Date: 08/31/2000. Source: State Street Bank, returns are net of fees.

The chart below shows JPM's performance versus its benchmark. The axis on the left measures the manager's annual performance against its benchmark. The right axis measures JPM's cumulative performance relative to the benchmark.



Pzena Investment Management – Active Manager

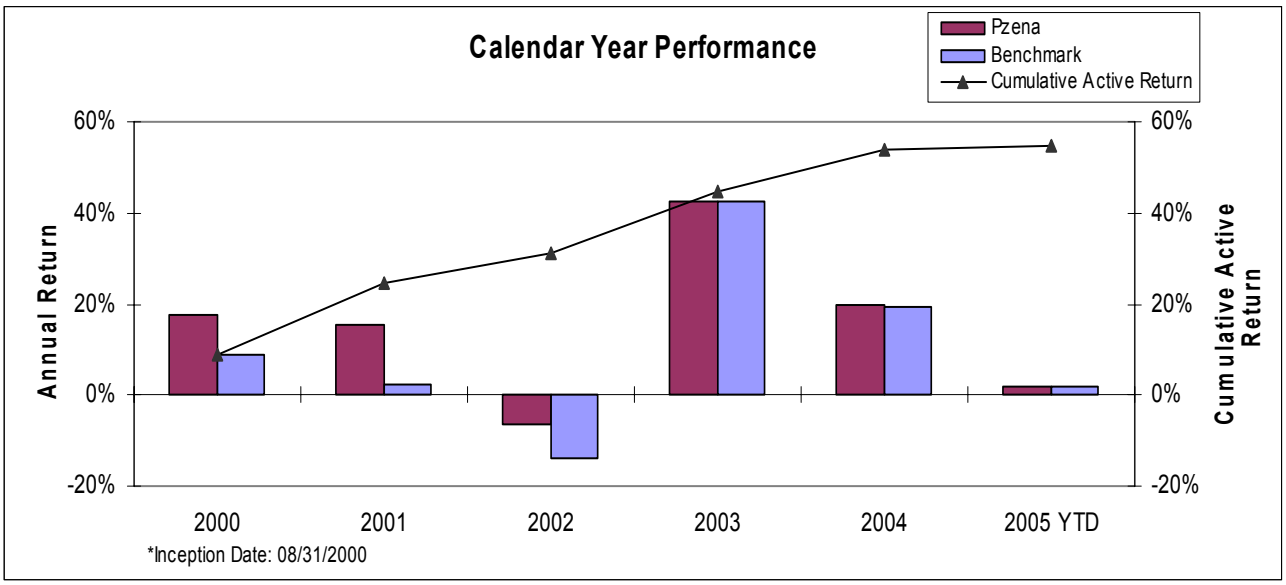
Pzena was funded on August 31, 2000 as an active domestic equity value manager. Pzena adheres to a classic value investment process in which it seeks stocks whose prices are low relative to their long-term normal earnings power. A consistent and disciplined value approach is used to develop an estimate of normalized earnings over the next five years. This includes evaluating a company's position within its industry and incorporating Pzena's judgment as to the company's ability to successfully implement its strategic business plan.

Pzena had its first fiscal year of underperformance since inception. The portfolio's weak performance relative to its benchmark was driven by poor stock selection and allocation weighting decisions primarily in two sectors, the consumer discretionary and energy sectors. Annualized performance from inception is 6.77% above the benchmark, representing $6.77 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $734.6 million. During the fiscal year, staff reduced the assets under management with Pzena by $248.0 million.

	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Inception* Annualized
Pzena	5.77%	7.04%	34.85%	11.57%	17.70%
Benchmark	(2.19)%	1.15%	30.54%	13.66%	10.93%
Active Return	7.96%	5.89%	4.31%	(2.09)%	6.77%

*Inception Date: 08/31/2000. Source: State Street Bank, returns are net of fees.

The chart below shows Pzena's performance versus its benchmark. The axis on the left measures the manager's annual performance against its benchmark. The right axis measures Pzena's cumulative performance relative to the benchmark.



Atlantic Asset Management – Enhanced Index Manager

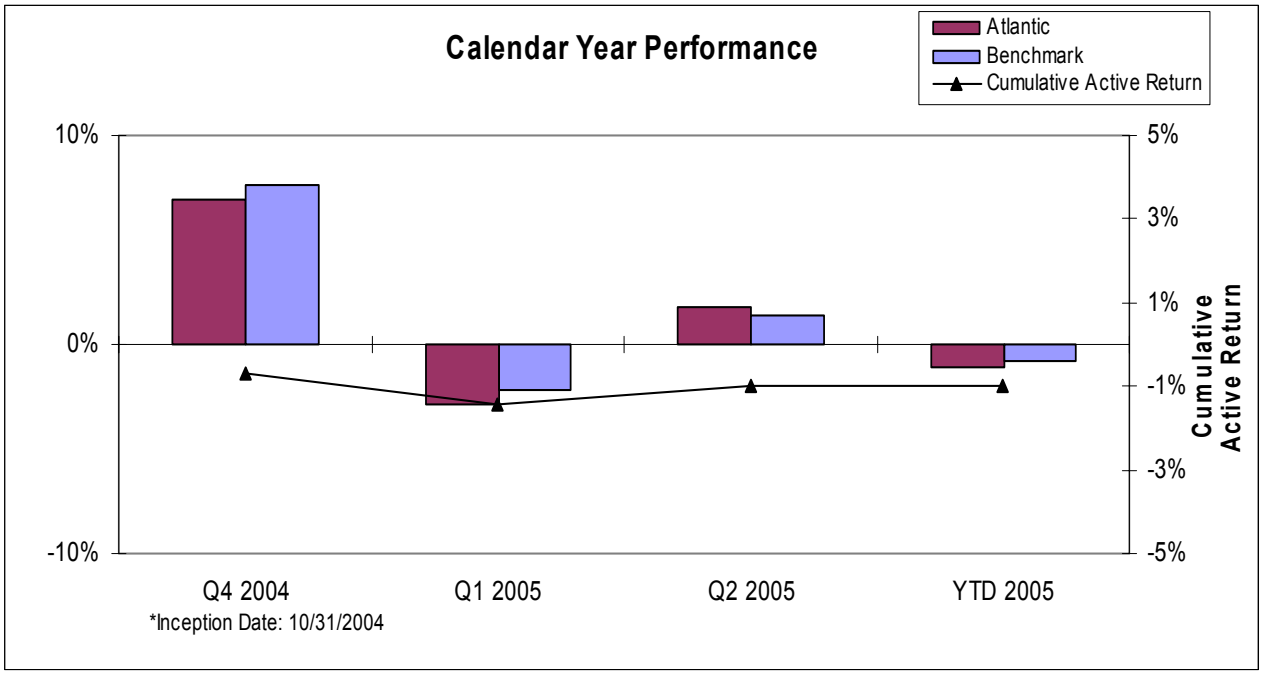
This is a synthetic enhanced index strategy. Enhanced cash and S&P 500 futures (or swaps) are managed together with the objective to synthetically replicate and exceed the S&P 500 index return. The goal of the enhanced cash portfolio is to obtain higher yields and returns than LIBOR by modestly extending maturities and diversifying the portfolio into various sectors of the bond market. Risk is controlled by managing the average duration of the enhanced cash portfolio to a maximum of two years and diversifying the portfolio by bond market sector and issuer concentration.

In its first eight months since its October 31, 2004 initial funding, Atlantic's performance was negatively impacted by a flattening of the short-term yield curve. As the Federal Reserve pushed up the federal funds rate, the spread relative to other short-term securities narrowed, eliminating the performance pickup. Performance from inception is 1.00% below the benchmark, representing $1.00 million of underperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $317.9 million.

	Inception through Qtr Ending 12/31/04	Qtr Ending 03/05	Qtr Ending 06/05	Inception*
Atlantic	6.90%	(2.86)%	1.81%	5.72%
Benchmark	7.59%	(2.15)%	1.37%	6.72%
Active Return	(0.69)%	(0.71)%	0.44%	(1.00)%

*Inception Date: 10/31/2004. Source: State Street Bank, returns are net of fees.

The chart below shows Atlantic's performance versus its benchmark. The axis on the left measures the manager's quarterly performance against its benchmark. The right axis measures Atlantic's cumulative performance relative to the benchmark.



Franklin Portfolio Associates – Enhanced Index Manager

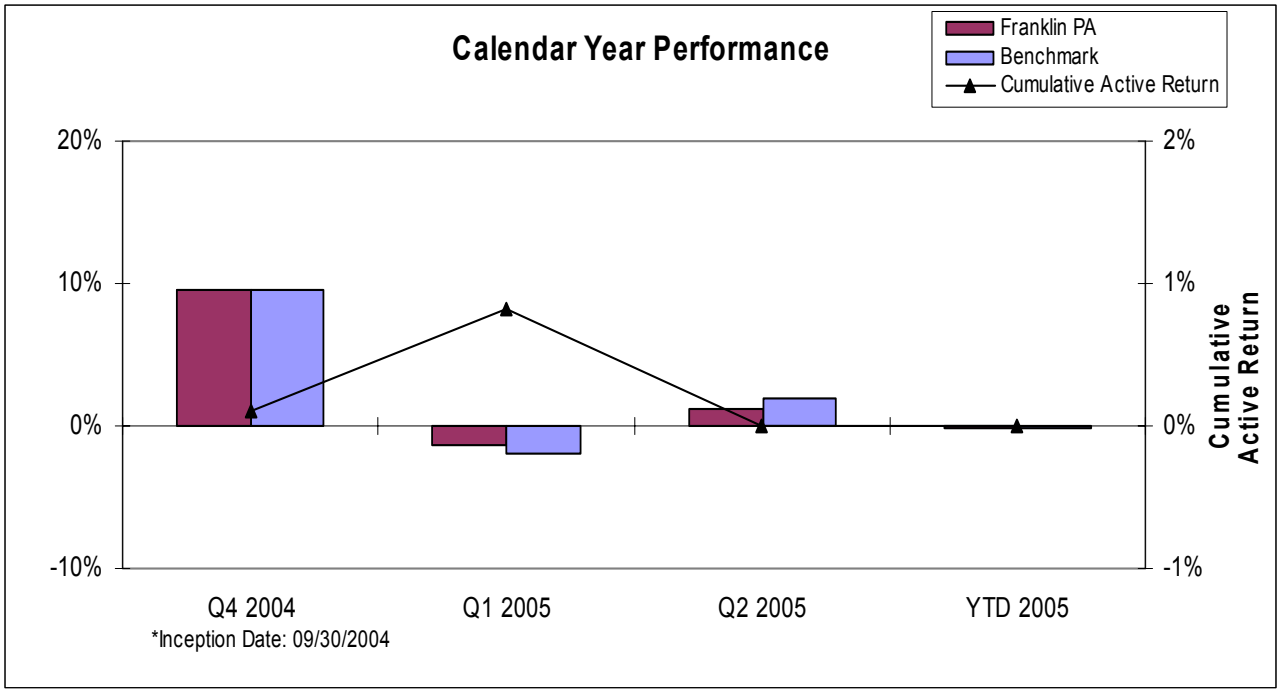
Franklin Portfolio Associates' (FPA) strategy emphasizes stock selection while limiting its over or under exposure to sectors and other factors. FPA currently uses over 40 variables to determine a stock's attractiveness. The individual variables are blended together using a proprietary approach to determine a single score of attractiveness. After the valuation process is complete, FPA uses an optimizer to build a portfolio that selects the top-ranked issues while satisfying the risk and diversification requirements.

Overall, performance is in line with expectations given the short time-horizon reflected and the quantitative nature of this strategy. Assets under management as of June 30, 2005 were $856.4 million.

	Inception through Qtr Ending 12/31/04	Qtr Ending 03/05	Qtr Ending 06/05	Inception*
Franklin PA	9.59%	(1.29)%	1.12%	9.39%
Benchmark	9.49%	(1.94)%	1.90%	9.39%
Active Return	0.10%	0.65%	(0.78)%	0.00%

*Inception Date: 09/30/2004. Source: State Street Bank, returns are net of fees.

The chart below shows FPA's performance versus its benchmark. The axis on the left measures the manager's quarterly performance against its benchmark. The right axis measures FPA's cumulative performance relative to the benchmark.



Goldman Sachs Small Cap – Enhanced Index Manager

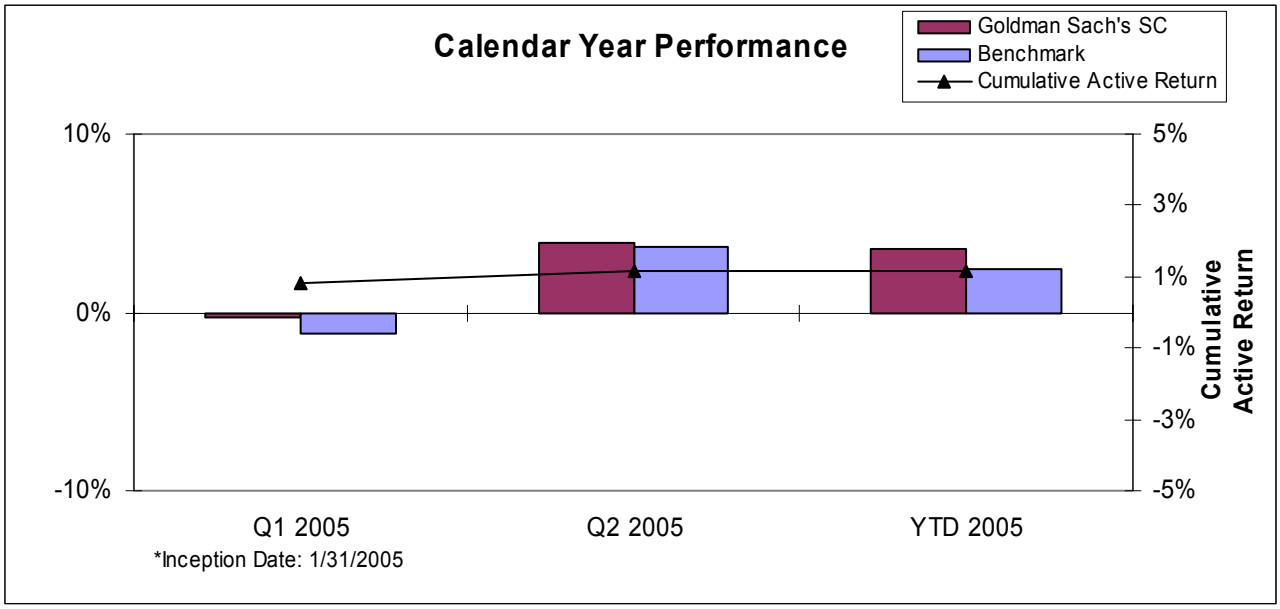
The CORE ("Computer-Optimized, Research-Enhanced") index strategy consists of a three step process. Step 1 is to forecast expected returns on approximately 3,000 stocks daily. Return forecasts are determined using proprietary models developed by the Quantitative Equity team. Models are based on six investment themes: Valuation, Momentum, Analyst Sentiment, Profitability, Earnings Quality, and Management Impact. Step 2 evaluates the risk associated with any stock due to changing market conditions using a daily updated proprietary optimizer. In step 3, transaction costs are considered.

GSAM has been able to add value by continually evaluating stock specific news events and making only those adjustments that would have a meaningful impact on portfolio performance. Performance from inception is 1.15% above the benchmark, representing $1.15 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $414.1 million.

	Inception through Qtr Ending 3/31/05	Qtr Ending 06/30/05	Inception*
Goldman Sachs SC	(0.32)%	3.94%	3.61%
Benchmark	(1.14)%	3.64%	2.46%
Active Return	0.82%	0.30%	1.15%

*Inception Date: 1/31/2005. Source: State Street Bank, returns are net of fees.

The chart below shows Goldman Sach's performance versus its benchmark. The axis on the left measures the manager's quarterly performance against its benchmark. The right axis measures Goldman Sach's cumulative performance relative to the benchmark.



INTECH – Enhanced Index Manager

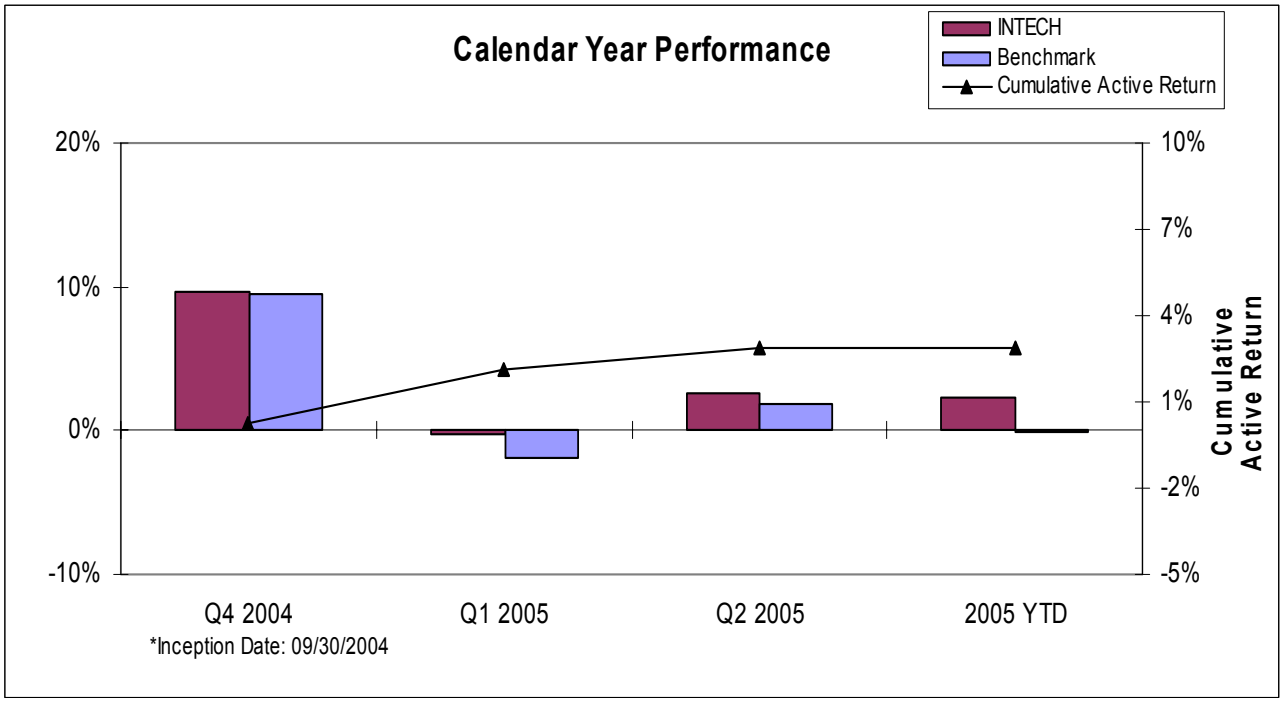
This enhanced index strategy employs a quantitative review of the covariance of markets and stock volatility to identify those companies expected to outperform the benchmark. Using additional bankruptcy and liquidity screens to eliminate these concerns, the portfolio construction process is then applied to the remaining eligible stocks to determine security position sizes that maximize the information ratio of the portfolio and maintain a constant beta equal to or less than the benchmark. Once established, the portfolio is then monitored frequently and rebalanced to maintain an optimum structure.

Superior sector selection along with solid stock picking skills drove the portfolio's relative outperformance. INTECH's performance from inception is 2.87% above the benchmark, representing $2.87 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $874.5 million.

	Inception through Qtr Ending 12/31/04	Qtr Ending 03/05	Qtr Ending 06/05	Inception*
INTECH	9.71%	(0.20)%	2.53%	12.26%
Benchmark	9.49%	(1.94)%	1.90%	9.39%
Active Return	0.22%	1.74%	0.63%	2.87%

*Inception Date: 09/30/2004. Source: State Street Bank, returns are net of fees.

The chart below shows INTECH's performance versus its benchmark. The axis on the left measures the manager's quarterly performance against its benchmark. The right axis measures INTECH's cumulative performance relative to the benchmark.



Quantitative Management Associates – (QMA) Enhanced Index Manager

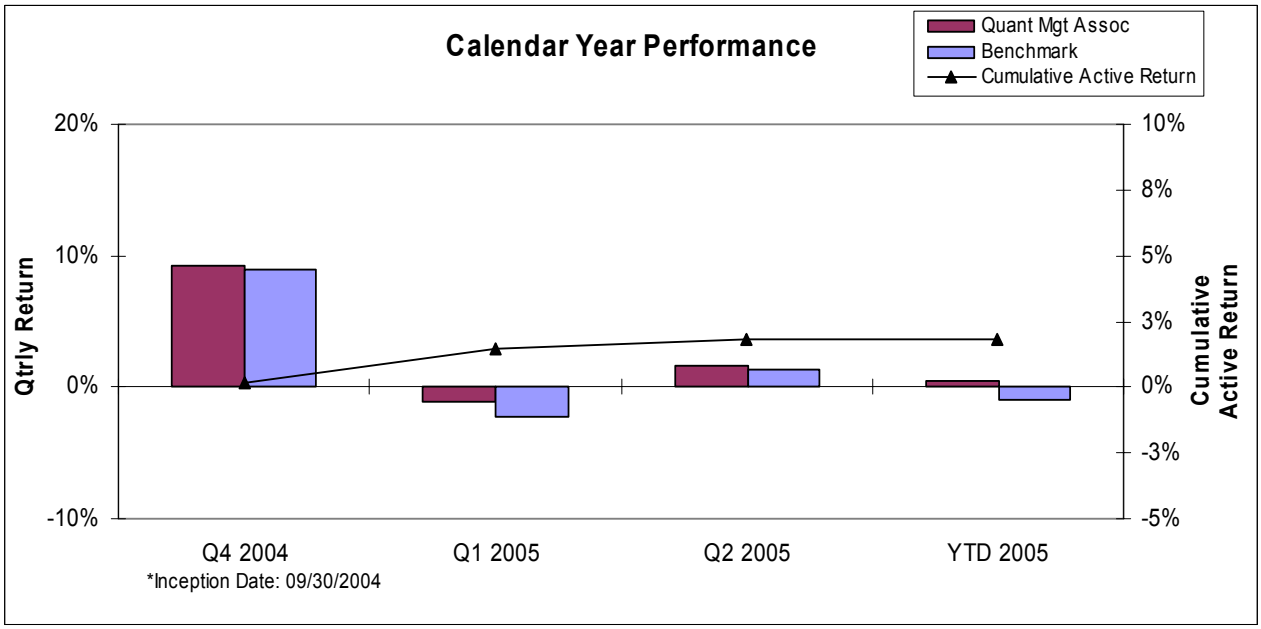
The Quantitative Core Equity investment process uses a quantitative approach to exploit persistent, predictable mispricings. The Strategy uses a three-step investment process: classify the universe of stocks by growth rate, calculate the expected alpha for each stock in the universe, and construct the optimal portfolio. The portfolio is constructed to maximize expected alpha subject to a targeted tracking error. The optimization program controls risk across multiple measures including size, value/growth, sector, industry, and individual security. Typically holdings range from 300 to 450 securities.

QMA outperformed its benchmark since its initial funding on September 30, 2004. Driving performance was good stock selection across almost all sectors. Performance from inception is 1.84% above the benchmark, representing $1.84 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $859.2 million.

	Inception through Qtr Ending 12/31/04	Qtr Ending 03/05	Qtr Ending 06/05	Inception*
Quant Mgt Assoc	9.19%	(1.11)%	1.66%	9.77%
Benchmark	8.99%	(2.27)%	1.33%	7.93%
Active Return	0.20%	1.16%	0.33%	1.84%

*Inception Date: 09/30/2004. Source: State Street Bank, returns are net of fees.

The chart below shows QMA's performance versus its benchmark. The axis on the left measures the manager's quarterly performance against its benchmark. The right axis measures QMA's cumulative performance relative to the benchmark.



Smith Breeden – Enhanced Index Manager

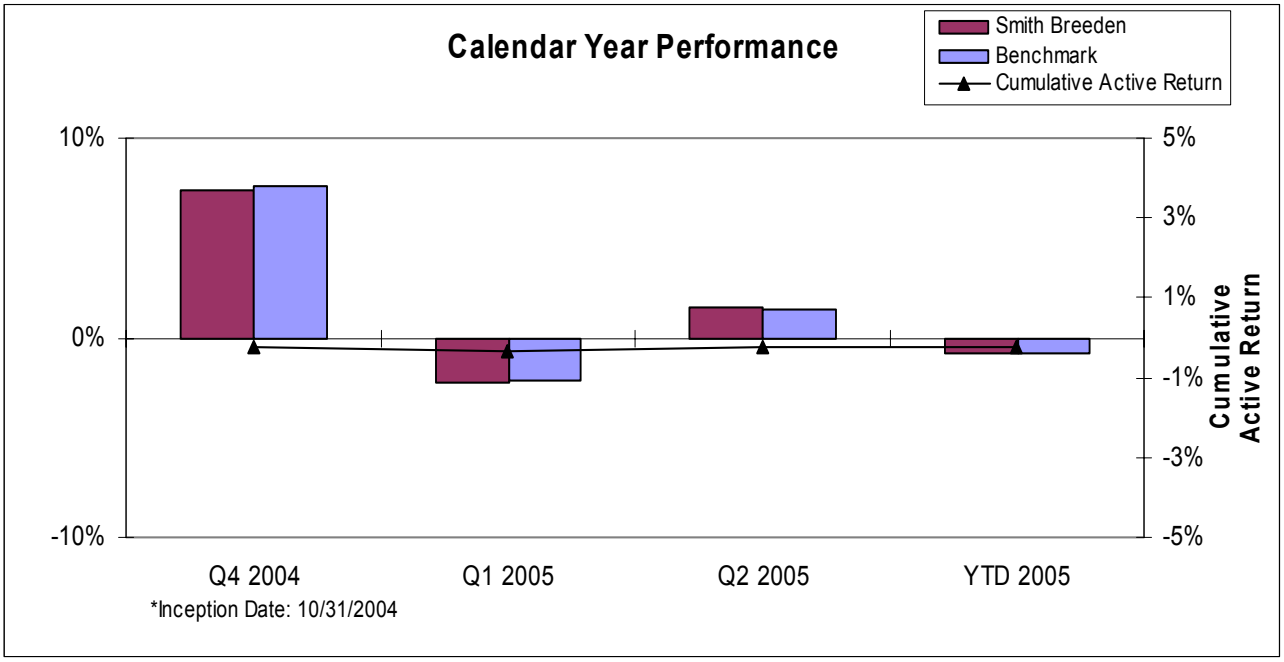
Smith Breeden's Equity Market Plus enhanced index investment strategy combines an active short duration cash management portfolio with an S&P 500 Index overlay. The S&P overlay is normally established through an appropriate long position in S&P 500 index futures. The key to the strategy is the short duration and focus on security selection and sector rotation within the mortgage-backed, asset-backed, and corporate sectors, while minimizing duration risk relative to the benchmark.

The portfolio performed in line with its benchmark since its October 31, 2004 initial funding. As with all synthetic products, results have been affected by the yield curve flattening over this time period. Tight spreads on short-term securities and a decrease in market volatility constrained the portfolio's performance. Performance from inception is 0.21% below the benchmark, representing $0.21 million of underperformance per year for every $100 million managed. Assets under management as of April 30, 2005 were $533.9 million.

	Inception through Qtr Ending 12/31/04	Qtr Ending 03/05	Qtr Ending 06/05	Inception*
Smith Breeden	7.37%	(2.26)%	1.49%	6.51%
Benchmark	7.59%	(2.15)%	1.37%	6.72%
Active Return	(0.22)%	(0.11)%	0.12%	(0.21)%

*Inception Date: 10/31/2004. Source: State Street Bank, returns are net of fees.

The chart below shows Smith Breeden's performance versus its benchmark. The axis on the left measures the manager's quarterly performance against its benchmark. The right axis measures Smith Breeden's cumulative performance relative to the benchmark.



Western Asset Management Company (WAMCO) – Enhanced Index Manager

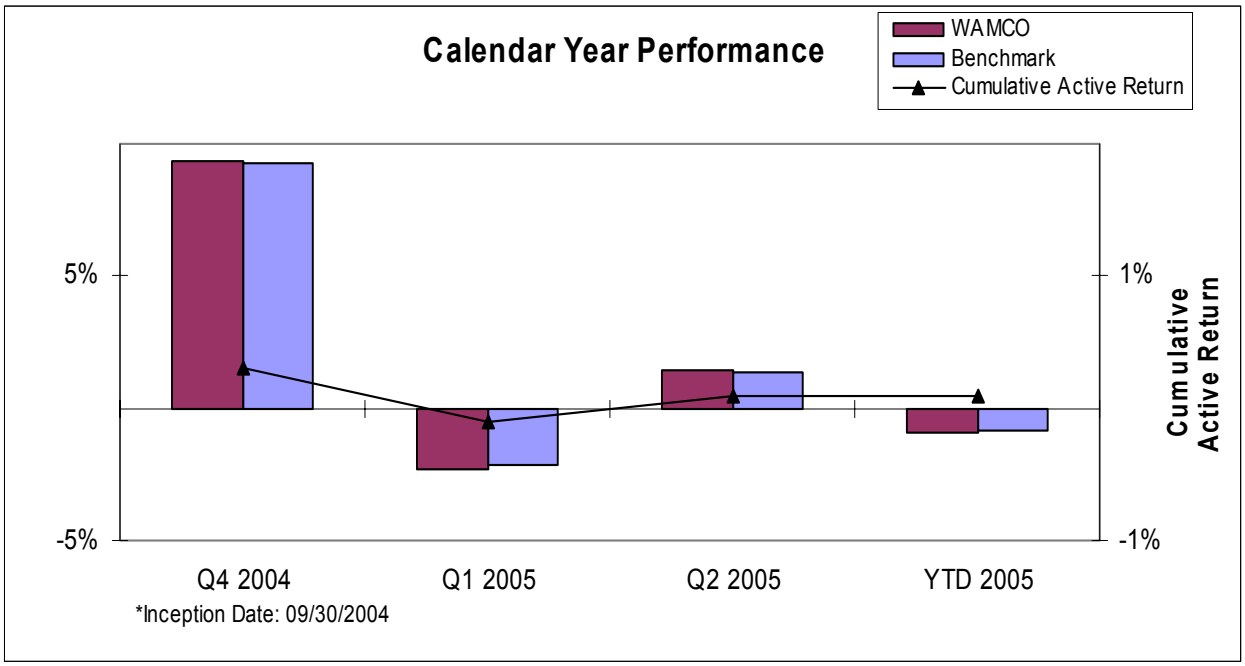
WAMCO's Index Plus synthetic enhanced equity product combines S&P 500 futures and S&P 500 total return swaps with a cash management portfolio. This strategy seeks to produce a return in excess of the S&P 500 Index while minimizing the risk of significant underperformance. The futures and swaps track the price movements of the S&P index with the excess return coming from the security and sector selection in the underlying short-duration bond portfolio.

WAMCO has outperformed the benchmark since inception. Performance is in line with expectations given the yield curve flattening over this time period making it challenging for short-duration cash management portfolios. Performance from inception outperformed the benchmark by 0.05%, representing $0.05 million of outperformance per year for every $100 million managed. Assets under management as of June 30, 2005 were $539.4 million.

	Inception through Qtr Ending 12/31/04	Qtr Ending 03/05	Qtr Ending 06/05	Inception*
WAMCO	9.38%	(2.33)%	1.47%	8.40%
Benchmark	9.23%	(2.15)%	1.37%	8.35%
Active Return	0.15%	(0.18)%	0.10%	0.05%

*Inception Date: 09/30/2004. Source: State Street Bank, returns are net of fees.

The chart below shows WAMCO's performance versus its benchmark. The axis on the left measures the manager's quarterly performance against its benchmark. The right axis measures WAMCO's cumulative performance relative to the benchmark.



Dynamic Completion Fund – Internal Index Fund

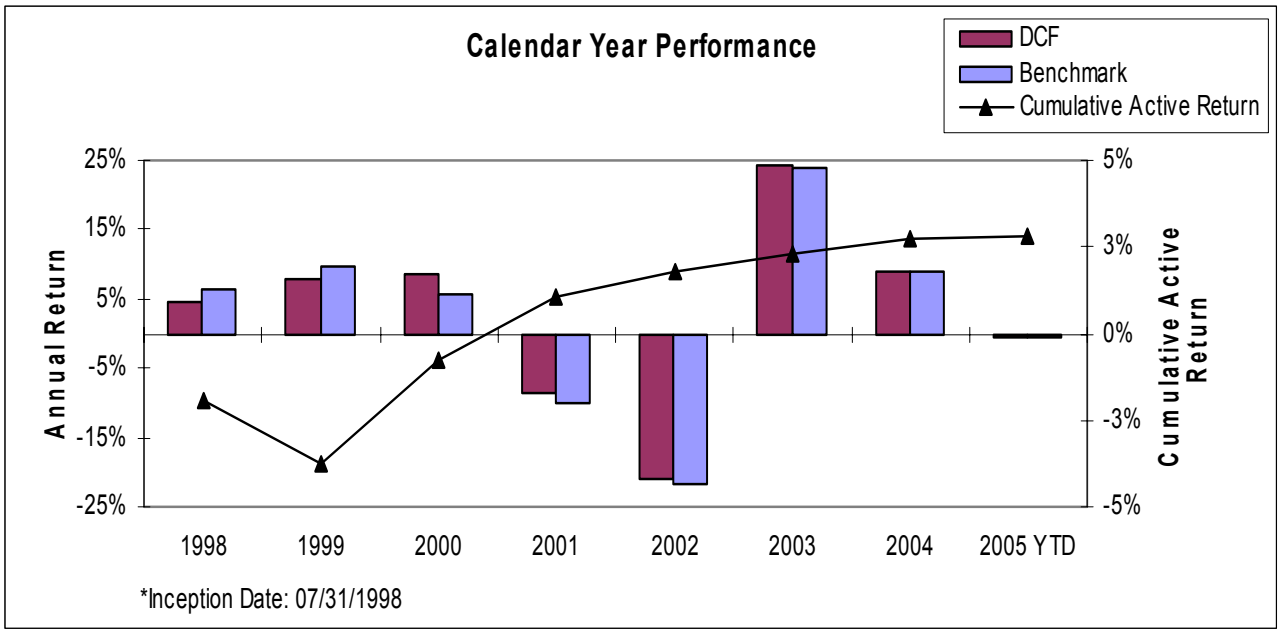
The Dynamic Completion Fund (DCF) is a specialized, passively managed internal domestic equity portfolio that is structured to complement the active domestic equity managers' portfolios. The strategic objective of the DCF is to reduce style bias caused by the active domestic equity managers' benchmarks relative to the CalPERS Custom Wilshire 2500 Index. The DCF also provides a vehicle to facilitate manager transitions while minimizing transaction costs. The portfolio is managed and constructed using an optimized sampled approach which produces an actual portfolio with risk characteristics closely resembling the benchmark. The optimization approach employs a fundamental risk model to define and decompose the portfolio's risk exposures relative to those of the benchmark.

During the 12 months ended June 30, 2005, the DCF returned 5.15% while the benchmark returned 4.97%. On average, the DCF accumulated one to two basis points of outperformance each month by holding a portfolio with a slight value bias relative to its benchmark. Annualized performance from inception is 0.36% above the benchmark, representing $3.6 million of outperformance per year for every $1 billion managed. Assets under management as of June 30, 2005 were $6.6 billion.

	Fiscal Year 00/01	Fiscal Year 01/02	Fiscal Year 02/03	Fiscal Year 03/04	Fiscal Year 04/05	Inception* Annualized
DCF	3.32%	(16.76)%	1.30%	16.08%	5.15%	2.55%
Benchmark	(0.24)%	(17.53)%	0.96%	15.86%	4.97%	2.19%
Active Return	3.56%	0.77%	0.34%	0.22%	0.18%	0.36%

*Inception Date: 07/31/1998. Source: State Street Bank, returns are net of fees.

The chart below shows DCF's performance versus its benchmark. The axis on the left measures the manager's annual performance against its benchmark. The right axis measures DCF's cumulative performance relative to the benchmark.



Recommendation

Staff recommends renewing the contracts of CalPERS' six active and seven enhanced index external domestic equity managers for a period of one year. Each contract contains a provision allowing for termination on 30 days' notice.

V. STRATEGIC PLAN:

External investment manager performance is monitored by staff and reported to the Investment Committee per CalPERS Strategic Plan, Goal IV: Assure that sufficient funds are available, first, to pay benefits and, second, to minimize and stabilize employer contributions.

VI. RESULTS/COSTS:

The purpose of this item is to keep the Investment Committee informed of staff's efforts to ensure that the external active domestic equity manager program is performing in line with expectations.

Prepared By:

Sheila Halousek
Investment Officer

Mary C. Cottrill
Senior Portfolio Manager

Christianna Wood
Senior Investment Officer

Mark Anson
Chief Investment Officer