

Investment Section



State Police Retirement System

The General Assembly added a third benefit system, the State Police Retirement System, in 1949. Membership in the police system is restricted to uniformed employees of the Maryland State Police. The mission of the Maryland State Police is to fulfill its role as the state's lead coordinating law enforcement organization with commitment to pride, equality, respect and dignity. More than 1,500 officers throughout 23 counties strive to improve the quality of life for the citizens of Maryland by ensuring public safety.

Chief Investment Officer's Report

Investment Objectives

The Board of Trustees (the "Board") is charged with the responsibility of managing the assets of the State Retirement and Pension System. The Board is required to discharge its fiduciary duties solely in the interest of the participants, with the care, skill and diligence, which a prudent person would ordinarily exercise under similar circumstances. This standard of care not only permits but encourages diversifying investments across various asset classes.

Investment objectives are designed to support fulfillment of the Agency's mission - to optimize risk-adjusted returns in order to ensure timely payment of benefits to members and beneficiaries.

Investment objectives are implemented according to investment policies developed by the Board. The prudent person standard allows the Board to establish investment policies based on investment criteria that it defines, and it allows the Board to delegate investment authority to investment professionals.

System assets are managed by internal portfolio managers and external investment management firms, who employ both active and passive strategies. Investment management firms are selected and retained based on rigorous performance and organizational factors. Firms engaged must have a demonstrated track record and a clearly defined and applied investment process.

The System is a long-term investor, and consequently, long-term results are emphasized over short-term gains. The long-term investment objectives established by the Board are to achieve a real rate of return of at least 3.0% and to achieve a nominal rate of return, which equals or exceeds the 8.0% actuarial return assumption.

Asset allocation is a key determinant of a successful investment program, and it is credited with being responsible for determining as much as 90% of a pension plan's total return in a given year. Asset allocation is the process, which results in the weightings assigned to each asset class. The Board takes both asset and liability side considerations into account when reviewing asset allocation.

From an asset side perspective, the Board reviews and approves the CAPM assumptions (Capital Asset Pricing Model), including the risk and return projections for each asset class as well as

the correlations among the asset classes. Diversification is achieved by combining asset classes, which are not perfectly correlated with each other. This may result in offsetting a market decline in one asset class with appreciation in another asset class. The benefit of this diversification is a reduction in the volatility of the total portfolio's investment performance.

From the liability side perspective, the Board works closely with its actuary and incorporates its funded status when determining its risk posture. Avoiding adverse contribution experience is an important consideration.

Multiple scenarios for possible asset mixes are reviewed. This process results in ranges, which are approved by the Board for each asset class, and the targets are typically the mid-points of the ranges. As of June 30, 2001, the approved ranges for each asset class were:

Asset Class	Allowable Ranges
Equity	up to 80%
Domestic Equity	40-60%
International Equity	15-30%
Alternative Investments	0-1%
Real Estate	2-7%
Fixed Income	
Domestic Investment Grade	10-30%
Domestic High Yield	0-5%
Cash Reserves	0-5%

Capital Market Overview

As of the end of the fiscal year, bonds and real estate outperformed stocks. The capital markets continued to experience volatility throughout the year, and the U.S. dollar remained strong against major currencies.

Stocks suffered as the technology sector experienced significant declines, and bonds rose as the FOMC (Federal Open Market Committee) cut rates 275 basis points to a level of 3.75%, on concerns of a weakening economy. Inflation remained moderate, with the CPI (the Consumer Price Index, an inflation indicator) rising 3.2% for the 12-month period.

The following chart displays the fiscal year performance for some of the System's key benchmarks:

Benchmarks	FY 2001 Performance
Equity Markets	
U.S. Equities	
S&P 500	-14.83%
Russell 3000	-13.93%
Russell 2000	0.57%
CSFB Convertible Securities	-11.83%
International Equities	
MSCI EAFE	-23.61%
SSBI Extended Market	-8.07%
Bond Markets	
SSBI Broad Investment Grade	11.26%
ML High Yield Master II	-0.92%
Real Estate	
Russell NCREIF (1 quarter lag)	11.88%
Wilshire Real Estate Securities	24.60%
Short-Term Markets	
Three-month Treasury Bill	5.9%

U.S. equity market declines were led by information technology, which experienced a 52.3% drop for the fiscal year. Financial stocks were up 23.1%, and utility stocks were up 21.1%. Value outperformed growth, and the international markets followed the lead of the U.S. markets. In fact, only three developed markets turned in positive results. New Zealand was up 5%, Australia was up 2.9%, and Ireland was up 2.9%. When the international equity results were translated into U.S. dollar terms, the results appear worse than the U.S. equity markets due to the strength of the U.S. dollar versus the Euro and the yen.

With regard to fixed income, the yield curve returned to a normal slope, having been inverted during most of the prior fiscal year. Five and ten year U.S. Treasury yields fell 123 and 62 basis points, respectively. And high yield bonds under performed, falling about 1% over the fiscal year.

Investment Performance

Investment performance is calculated using time-weighted rates of return in compliance with AIMR standards. Total return includes interest and dividends as well as capital appreciation.

The investment program experienced a decline of 9.4% for the fiscal year. This decline was less than that of the broad equity markets, thanks to the benefits of a well-diversified portfolio. Rolling total returns for 3, 5, and 10-year period were 3.1%, 8.7% and 10.3%, respectively. Both the 5 and the 10-year results exceeded both the actuarial target of 8% and the real return tar-

get of 3.0%. Again, it is important to note that the System is a long-term investor.

The market value of System assets under management declined from \$32.9 billion on June 30, 2000 to \$29.4 billion on June 30, 2001. The System's equity investments declined by 17.3%, with U.S. equities returning -15.4% and international equities returning -21.0%. Convertible bonds declined by 16.2%, giving up some of their gains from the prior year, which closed ahead by 41.7%. This category is included under the equity allocation. The System's fixed income securities returned 10.2%, with the investment grade portfolios aggregating to 11.5%, and high yield bonds declining but not yet having a full year's worth of results. Real estate investments returned 18.5% for the fiscal year, with REITs (Real Estate Investment Trusts) reported as of June 30, 2001 and the remaining properties reported as of March 31, 2001.

The Trust's investment performance exceeded that of its benchmarks for all asset classes except domestic equity. This was due to the under performance of growth stocks.

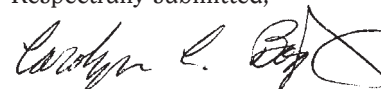
Investment Activity

Fiscal 2001 was a busy year for the System. The Board reviewed and revised its asset allocation policy. The current policy is reflected under the Investment Objectives section of this report. This led to the reduction of the System's international equity exposure, with a revised target of 20%. The proceeds will go to increasing the System's exposure to mid and small-to-mid cap domestic equity value managers.

Additional changes included modifying the System's brokerage policy and revising the Equity Real Estate Master Plan. The amended real estate document now allows for expansion of the System's investment activities beyond core real estate and into the value added and opportunistic categories. The amended brokerage policy increases the targets for the System's investment managers to trade with brokerage firms located in Maryland as well as with nationwide minority brokerage firms.

With regard to proxy voting, Agency staff voted an estimated 1500 ballots for approximately 1200 U.S. companies. Votes for shares of commingled funds and international investments are typically delegated to the managers of those respective funds.

Respectfully submitted,



Carol Boykin, CFA
Chief Investment Officer and
Secretary to the Investment Committee

Investment Portfolios by Manager

as of June 30, 2001

(Expressed in Thousands)

	Fair Value	Investment Advisory Fees		Fair Value	Investment Advisory Fees
Equity Managers			Fixed Income Managers		
State Street Global Advisors	\$ 5,048,493	\$ 475	Internally Managed	\$ 4,723,160	\$ N/A
Internally Managed	4,792,928	N/A	Pacific Investment		
Bank of Ireland Asset			Management Company	1,294,494	2,726
Management Limited	2,092,746	4,881	Standish, Ayer & Wood, Inc.	1,151,946	1,603
Capital Guardian Trust Company	995,941	3,611	W.R. Huff Asset		
Credit Suisse Asset			Management Co., LLC	561,054	2,535
Management, LLC	933,921	3,104	Morgan Stanley Dean Witter		
Zurich Scudder Investments	929,948	4,681	Investment Management	182,888	567
Templeton Investment Counsel, Inc.	865,311	2,675	Lazard Asset Management	103,062	345
Dimensional Fund Advisors, Inc.	792,013	837	Fountain Capital Management, LLC	100,692	341
Legg Mason Capital Management, Inc.	537,563	1,577		<u>\$ 8,117,296</u>	<u>\$ 8,117</u>
Harbor International Fund	467,632	3,840			
GEM Capital Management, Inc.	300,004	1,534	Real Estate Managers		
Advent Capital Management	242,248	1,210	LaSalle Investment		
J. & W. Seligman & Co., Inc.	220,838	563	Management Securities, L.P.	\$ 573,959	\$ 1,236
Robert W. Torray & Co., Inc.	210,353	1,049	LaSalle Investment Management, Inc.	327,369	2,651
The Edgar Lomax Company	210,345	515	J.P. Morgan Investment		
Chapman Capital Management, Inc.	190,250	1,738	Management, Inc.	186,161	1,464
Trust Company of the West	172,255	1,339	TimesSquare Real Estate Investors	166,329	1,602
Relational Investors, LLC	162,500	8,410	Internally Managed	152,918	N/A
Brown Investment			Sentinel Real Estate Corporation	61,041	674
Advisory & Trust Company	157,401	911	Lubert-Adler Management, Inc.	6,563	92
Greenway Partners, L.P.	149,070	1,620	AEW Capital Management, L.P.	93	29
Brown Capital Management, Inc.	115,253	1,084		<u>\$ 1,474,433</u>	<u>\$ 7,748</u>
Progress Investment					
Management Company	99,505	686	* Investment managers no longer under contract as of 6/30/01.		
T. Rowe Price Associates, Inc.	90,564	511			
Harbour Vest Partners, LLC	25,868	746			
Adams Street Partners, LLC	18,501	850			
Abbott Capital Management, LLC	9,348	330			
Other *	1,797	92			
	<u>\$ 19,832,596</u>	<u>\$ 48,869</u>			

Investment Portfolio Summary

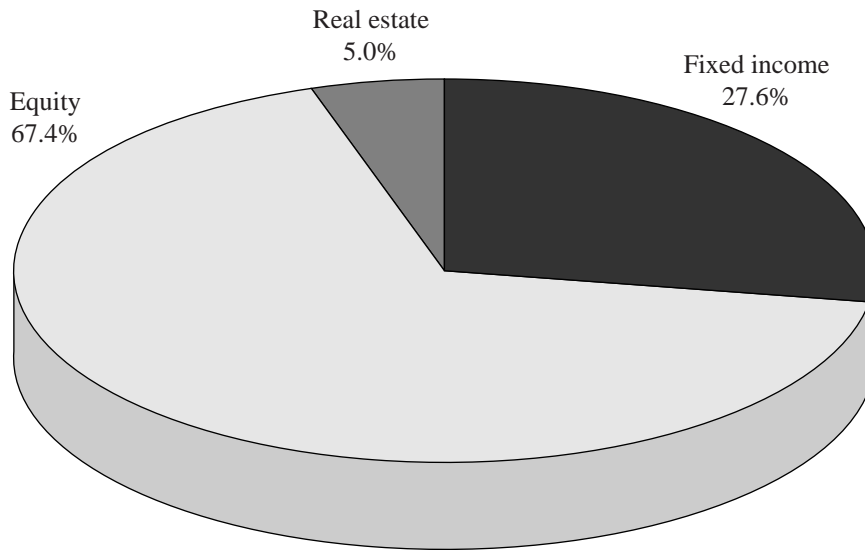
as of June 30, 2001 and 2000

(Expressed in Thousands)

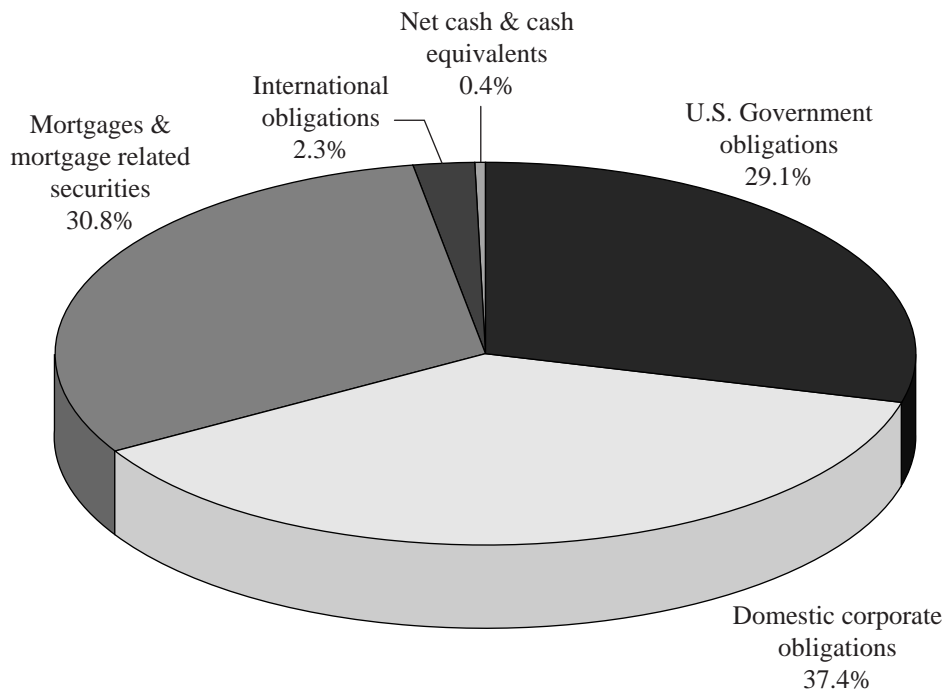
	2001		2000	
	Fair Value	% of Fair Value	Fair Value	% of Fair Value
Fixed Income				
Domestic corporate obligations	\$ 3,036,115	10.3%	\$ 2,503,630	7.6%
Mortgages & mortgage related securities	2,503,790	8.5	2,326,361	7.1
U.S. Government obligations	2,361,828	8.0	2,330,615	7.0
International obligations	185,519	0.7	144,240	0.4
Net cash & cash equivalents	30,044	0.1	695,704	2.1
*Total Fixed Income	<u>8,117,296</u>	<u>27.6</u>	<u>8,000,550</u>	<u>24.2</u>
Equity				
Domestic stocks	13,702,468	46.6	15,937,278	48.3
International stocks	5,632,416	19.1	6,867,162	20.8
Alternative investments	53,717	0.2	34,848	0.1
Net cash & cash equivalents	443,995	1.5	893,007	2.8
Total Equity	<u>19,832,596</u>	<u>67.4</u>	<u>23,732,295</u>	<u>72.0</u>
Real Estate				
Real Estate Investment Trusts	689,320	2.3	566,680	1.7
Pooled funds	413,624	1.3	376,690	1.1
Directly owned real estate	354,673	1.2	284,452	0.9
Alternative investments	6,563	0.1	0	0.0
Net cash & cash equivalents	10,253	0.1	21,650	0.1
Total Real Estate	<u>1,474,433</u>	<u>5.0</u>	<u>1,249,472</u>	<u>3.8</u>
Total Portfolio	<u>\$ 29,424,325</u>	<u>100.0%</u>	<u>\$ 32,982,317</u>	<u>100.0%</u>

* Security lending collateral payable has been netted against the actual collateral. The amounts net to zero.

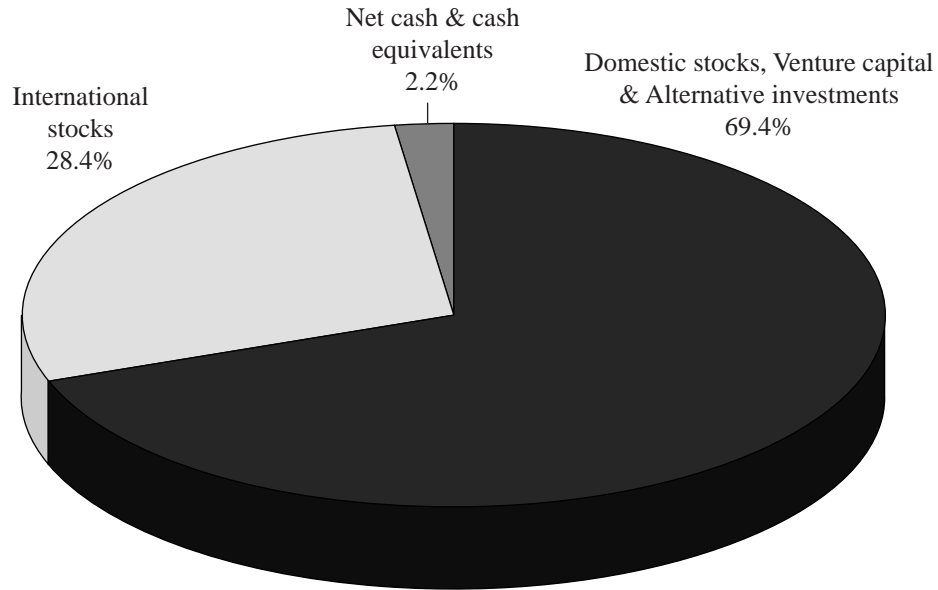
Investment Portfolio Allocation as of June 30, 2001



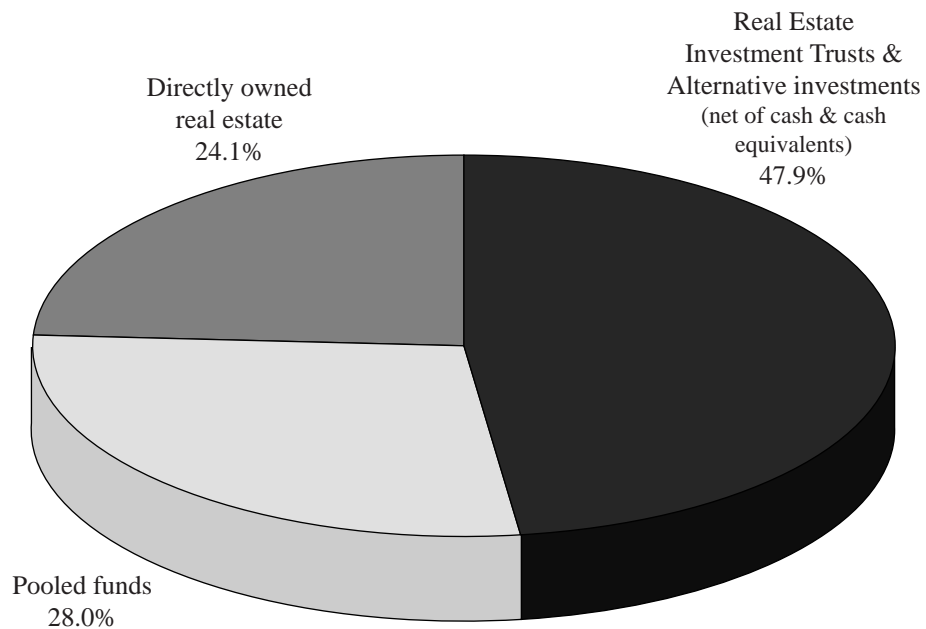
Fixed Income Distribution by Type as of June 30, 2001



Equity Distribution by Strategy as of June 30, 2001

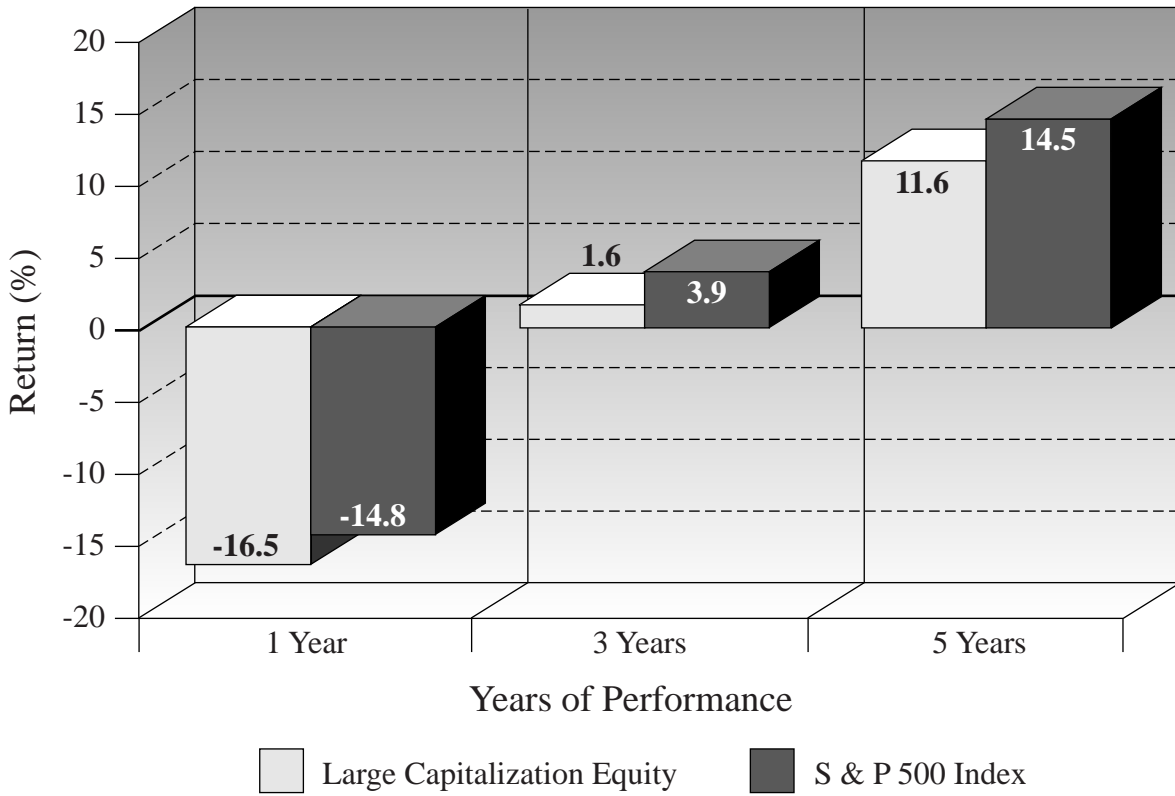


Real Estate Distribution by Strategy as of June 30, 2001

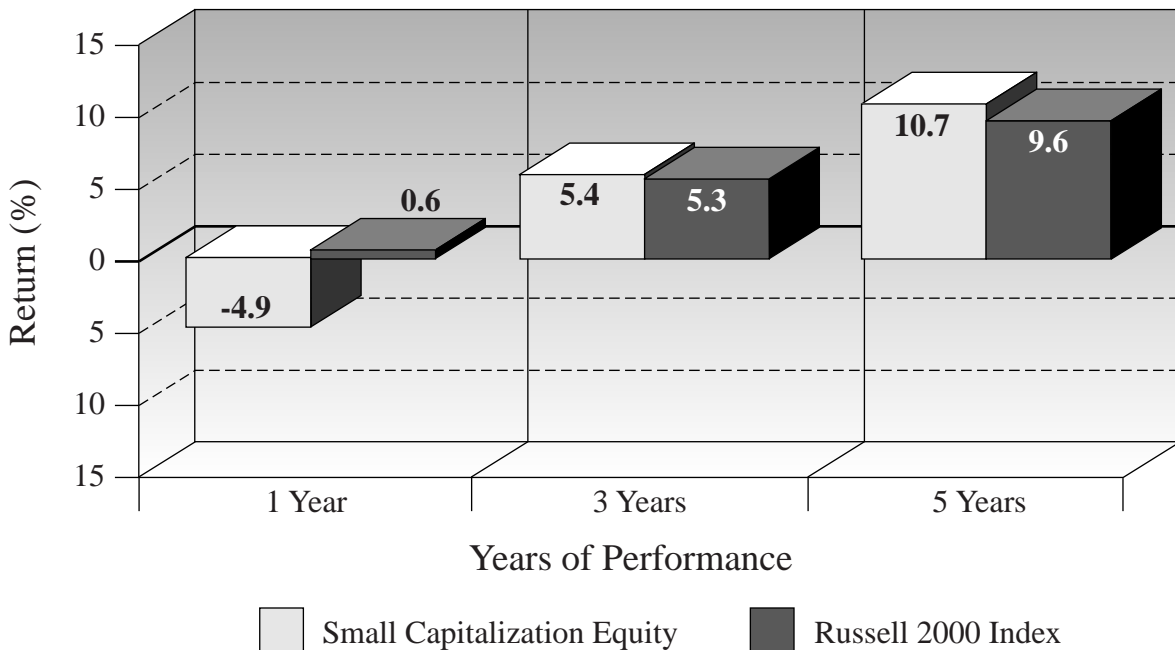


Comparative Investment Returns Ending June 30, 2001

Large Capitalization Equity

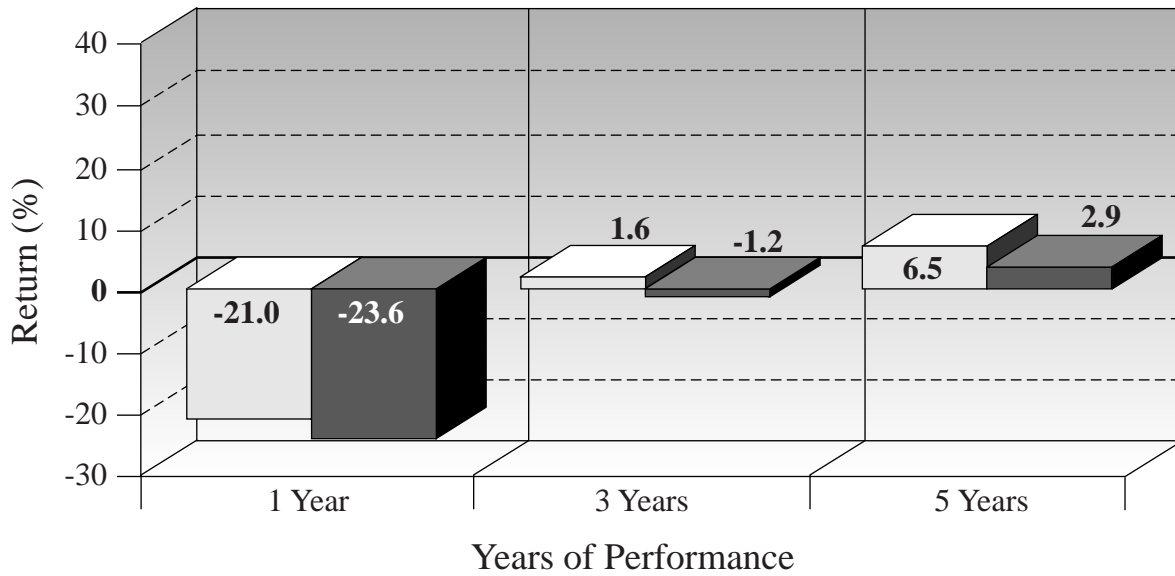


Small Capitalization Equity



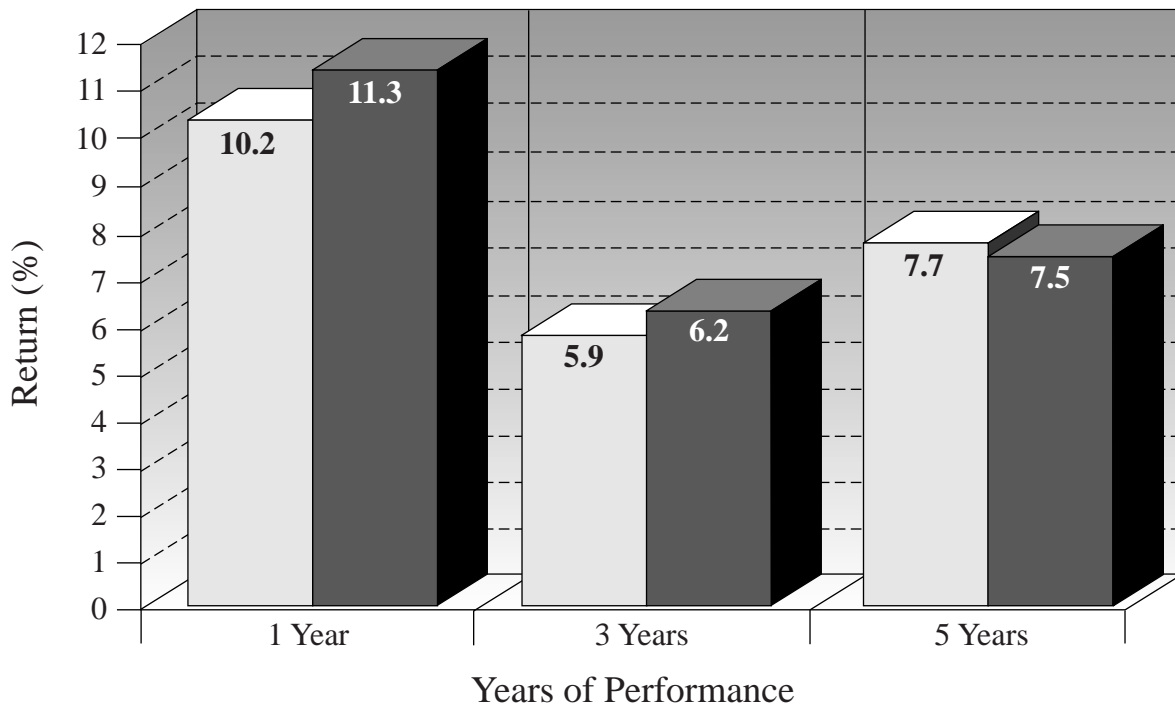
Comparative Investment Returns Ending June 30, 2001

International / Global / Emerging Equity



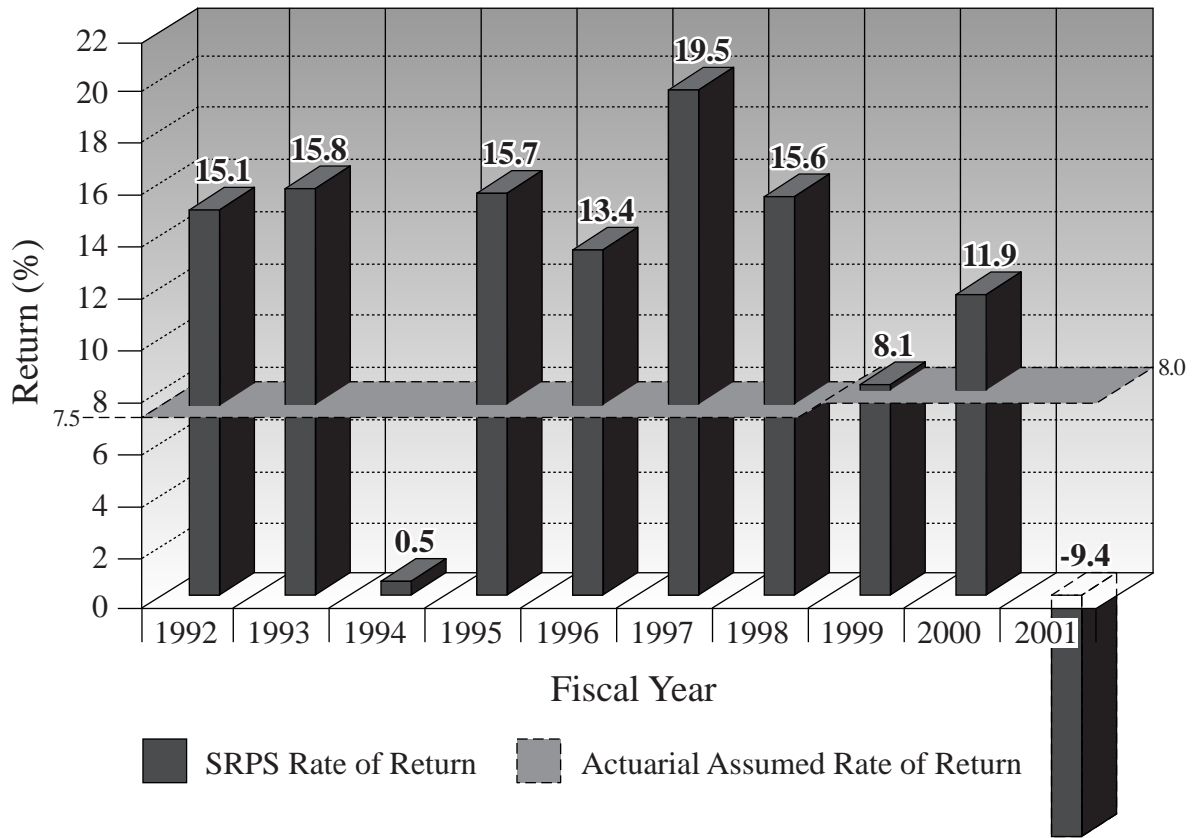
International / Global / Emerging Equity Portfolio Performance
 International / MSCI EAFE Index

Fixed Income

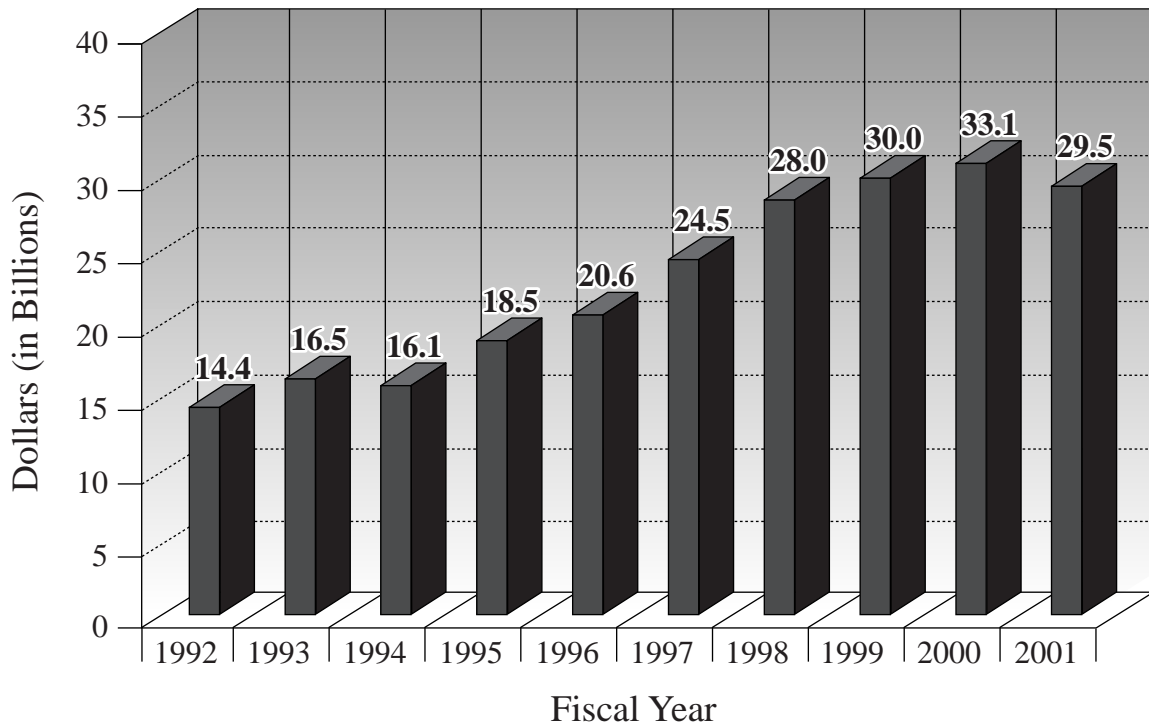


Fixed Income Portfolio Performance
 Salomon Broad Investment Grade Index

Ten-Year History of Time-Weighted Annual Returns



Ten-Year Growth of Investment Portfolio



Largest 25 Holdings as of June 30, 2001

EQUITY INCOME SECURITIES:	No. of Shares	Fair Value
General Electric Company	8,206,485	\$ 400,066,144
Microsoft Corporation	4,430,682	323,439,786
Pfizer, Inc.	5,210,897	208,696,425
International Business Machines Corporation	1,692,014	191,197,582
Wal-Mart Stores, Inc.	3,772,590	184,102,392
Intel Corporation	5,589,387	163,489,570
Citigroup, Inc.	2,863,350	151,299,414
Exxon Corporation	1,611,850	140,795,098
America Online, Inc. Del.	2,614,484	138,567,652
Johnson & Johnson	2,735,731	136,786,550
Merck & Co., Inc.	1,911,463	122,161,600
ING Groep NV	1,823,958	119,204,565
SBC Communications Inc.	2,853,966	114,329,878
Cisco Systems, Inc.	5,938,716	108,084,631
Vodafone Airtouch	48,561,421	107,567,473
Shell Transport & Trading Co.	12,929,983	107,471,783
Philip Morris Companies, Inc.	2,074,600	105,285,950
Federal National Mortgage Association	1,122,206	95,555,841
Coca-Cola Company	2,070,226	93,160,170
GlaxoSmithKline	3,308,991	93,075,334
Oracle Corporation	4,769,865	90,627,435
Bristol-Myers Squibb Co.	1,726,929	90,318,387
Tyco International Ltd.	1,645,818	89,697,081
Home Depot, Inc.	1,922,789	89,505,828
American International Group, Inc.	1,038,672	89,325,792
TOTAL		<u>\$3,553,812,361</u>

FIXED INCOME SECURITIES:	Par	Fair Value
Federal Home Loan Bank, 5.80% due Sept. 2, 2008	\$ 239,350,000	\$ 236,844,006
GNMA I TBA, 7.50% due Dec. 31, 2099	207,500,000	212,751,825
Federal National Mortgage Assn. Princ. Strip, 0.00% due Feb. 15, 2008	265,500,000	182,241,855
Federal National Mortgage Assn. Remic, 6.50% due Dec. 25, 2022	141,149,000	144,059,492
Grand Metro Investment Corp., 0.00% due Jan. 6, 2004	129,725,000	112,592,219
United States Treasury Notes, 6.50% due May 31, 2002	100,000,000	102,344,000
United States Treasury Bonds, 6.25% due May 15, 2030	93,370,000	98,709,830
United States Treasury Bonds, 12.00% due Aug. 15, 2013	70,550,000	97,667,304
Federal National Mortgage Assn., 7.25% due May 15, 2030	80,000,000	86,587,200
Citibank Credit Card Master Trust, 6.3231% due Aug. 15, 2006	101,500,000	85,827,101
United States Treasury Notes, 5.625% due Feb. 15, 2006	81,500,000	83,689,905
Federal Home Loan Mortgage Corp., 8.0714% due Nov. 15, 2021	71,565,000	75,948,356
Federal Home Loan Mortgage Corp., 5.125% due Oct. 15, 2008	79,500,000	75,699,105
United States Treasury Bonds, 5.50% due Aug. 15, 2028	80,000,000	75,612,800
Federal National Mortgage Assn. Remic, 6.50% due Nov. 18, 2023	63,711,000	64,686,415
Deutsche Ausgleichbk, 5.125% due Sept. 22, 2003	60,000,000	60,390,600
GNMA I TBA, 6.50% due Dec. 15, 2099	60,000,000	59,343,600
Federal Home Loan Mortgage Corp., 6.00% due May 15, 2017	46,200,000	46,041,072
United States Treasury Notes, 4.75% due Nov. 15, 2008	46,000,000	44,390,000
Prudential-Bache CMO Trust, 8.485% due Oct. 20, 2020	38,671,603	40,242,443
Federal Republic of Germany, 5.25% due Jan. 04, 2011	46,140,000	39,673,800
Government Backed Trust, 0.00% due May 15, 2007	55,000,000	39,328,300
GMNA II Pool, 6.50% due Aug. 20, 2029	38,615,896	38,133,198
Federal National Mortgage Assn., 7.125% due Mar. 15, 2007	35,000,000	37,477,300
Federal Home Loan Mortgage Corp., 6.45% due April 29, 2009	37,800,000	37,470,384
TOTAL		<u>\$2,177,752,110</u>

A complete list of portfolio holdings is available upon request.

Commissions to Brokers for the Fiscal Year Ended June 30, 2001

(Expressed in Thousands)

Brokers *	Total Shares	Total Commission	Commission Per Share
Merrill Lynch & Co., Inc.	126,930	\$ 1,428	\$ 0.011
Salomon Smith Barney, Inc.	77,007	985	0.013
Deutsche Bank AG	523,444	708	0.001
Goldman Sachs & Co.	18,424	659	0.036
Morgan Stanley Dean Witter & Co.	31,922	605	0.019
HSBC Securities	29,243	599	0.020
Bear Stearns & Co.	15,398	584	0.038
Lehman Brothers, Inc.	19,942	505	0.025
Kleinwort Benson	17,630	500	0.028
UBS AG	31,680	484	0.015
SBC Warburg	32,765	453	0.014
ABN Amro	16,724	434	0.026
Credit Suisse First Boston	31,431	371	0.012
J.P. Morgan Securities, Inc.	10,624	325	0.031
Credit Lyonnais Securities	9,479	178	0.019
Societe Generale	4,600	166	0.036
Ferris Baker Watts, Inc.	3,063	155	0.051
Jefferies & Co.	2,885	155	0.054
Legg Mason, Inc.	2,904	147	0.051
Exane S. A.	1,060	140	0.132
Warburg Dillon Read	7,243	136	0.019
Weiss Peck and Greer	2,852	134	0.047
Investment Technology Group, Inc.	4,352	117	0.027
SG Cowen Securities Corp.	1,863	111	0.060
Donaldson, Lufkin & Jenrette, Inc.	3,416	107	0.031
ING Baring Securities	3,793	100	0.026
First Union Corp.	1,909	95	0.050
Fox Pitt Kelton, Inc.	1,389	94	0.068
Commerzbank	3,767	91	0.024
Bankers Trust Co.	3,105	88	0.028
Paine Webber Group, Inc.	1,632	83	0.051
Prudential Securities, Inc.	1,719	80	0.047
Cazenove & Co.	12,192	77	0.006
Other broker fees	86,684	2,353	0.027
Total broker commissions	<u>1,143,071</u>	<u>\$ 13,247</u>	\$ 0.012

* Proceeds from the sale and disbursements for the purchase of securities are reported net of brokers' commissions. As such, brokers' commissions are not included as investment expenses on the Statements of Changes in Plan Net Assets. Other broker fees include 170 other brokers each receiving less than \$75,000 in total commissions.



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