

Investment Section

DELAWARE
PUBLIC
EMPLOYEES'
RETIREMENT
SYSTEM

- a component unit of the State of Delaware

Five-Year Investment Comparison



(expressed in millions)

	Fiscal Years ending June 30,				
	2002	2001	2000	1999	1998
U.S. Equities	\$ 2,340.5	\$ 2,371.0	\$ 2,197.6	\$ 2,248.2	\$ 2,199.3
Intl. Equities	577.1	607.3	702.3	519.2	520.9
U.S. Bonds	1,234.8	1,483.8	1,761.4	1,572.3	912.7
Intl. Bonds	132.1	147.8	152.9	102.9	71.2
Real Estate	0.0	_*	_*	4.9	13.4
Private Investments	480.9	549.2	708.0	391.8	316.1
Cash & Equivalents	92.3	121.5	141.6	58.8	418.5
Totals	\$ 4,857.7	\$ 5,280.6	\$ 5,663.8	\$ 4,898.1	\$ 4,452.1

*less than 0.1% under management. Other real estate holdings in the form of Real Estate Investment Trusts are included in equities.

Note: For these asset classifications, the Pooled Equity and Fixed Income Accounts are included in their respective equity and fixed income asset classes; and, therefore, are different from the categories used in the financial section on pages 24-25.



**STATE OF DELAWARE
STATE BOARD OF PENSION TRUSTEES
AND**

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August 20, 2002

Dear Board Members, Participants, and Beneficiaries:

The Board of Pension Trustees Investment Committee (Committee) oversees the investment of the retirement funds of the Delaware Public Employees' Retirement System (System). The Committee's investment oversight includes the nine retirement plans [State Employees', Special, New State Police, Judiciary, County & Municipal Police/Firefighters', County & Municipal Other Employees', Volunteer Firemen's, Diamond State Port Corporation, and Closed State Police] that the Board of Pension Trustees (Board) administers and the four commingled pension funds [County & Municipal Police/Firefighters' COLA, Post-Retirement Increase (PRI), Delaware Local Government Retirement Investment Pool (DELRIP), and State Employees' Post-Retirement Health Insurance Premium] that the Board manages.

The Committee consists of six members appointed by the Board. The Committee operates within the following investment objectives established by the Board:

- To realize a real return of 3% per year over long periods.
- To control portfolio risk so as to limit downside price fluctuation of the total System.
- To realize as high a rate of total return as possible consistent with all of the above.

Investment decisions are further dictated by the Board's internal investment policy which requires a minimum of 20 - 25% of the total assets of the System to be invested in fixed income investments, such as bonds, cash equivalents, and certain real estate investments. The Committee monitors this policy with the assistance of the Investment Advisor. Also, the Committee reviews prospective risk levels and rates of return of all classes of assets. Hence, the Committee assures investment diversification by

Board Members, Participants, and Beneficiaries

Page 2

August 20, 2002

selecting managers whose demonstrated performance reflects different management styles and asset class expertise. Most importantly, the Committee closely monitors the performance of all investment managers, not only in relation to specific absolute objectives, but also in relation to other fund managers following the same investment objectives.

The System returned (6.3%) for fiscal year 2002. The total System's annualized rate of return over the last five, ten, and fifteen years was 6.4%, 10.6%, and 10.0%, respectively. As reported by a major performance ranking comparison service, the System's investment performance ranks slightly below the median for this fiscal year and in the top decile of public funds for the five and ten year periods. For the period ending June 30, 2002, the System market value totaled \$4.9 billion representing a decrease in assets of \$422.9 million.

The investment climate during this fiscal year was unusually difficult. The events of September 11 had a negative impact on stock markets around the world. In the following months, the threat of further attacks and the continued impact of a slowing U.S. economy made investors cautious. In recent months, signs of an economic recovery have been overshadowed by evidence of corporate malfeasance by companies, such as Enron and WorldCom. Although the System was affected by the general market impact, estimated losses incurred by directly held assets in these two companies were \$5,755,000, representing approximately 0.1% of total fund assets. Reflecting these conditions, the S&P 500 stock market index declined 18.0% during the fiscal year.

While the System was impacted by all of these events, as evidenced by the disappointing (6.3%) return for the System, the continuing and consistent emphasis on diversification and risk control resulted in a System return that was significantly better than the (18.0%) return of the U.S. stock market.

On behalf of our Trustees, we thank our dedicated professional staff at the Office of Pensions, our investment advisor, and our money managers, who all work diligently to assure the successful operation of the Board of Pension Trustees Investment Committee.

Respectfully submitted,



Elva B. Ferrari, Chair
Board of Pension Trustees Investment Committee

Investment Activity

The bond markets performed well, but the U.S. stock markets continued to be weak during the fiscal year ending June 30, 2002. For the fiscal year, the S&P 500 stock index returned (18.0%) while the Lehman Aggregate bond index returned 8.2%.

For the fiscal year, the Delaware Public Employees' Retirement System (System) had a (6.3%) rate of return. This performance ranks the System slightly below the median of public funds for this fiscal year and in the top decile of public funds for the five and ten year periods.

Return data for the total System was calculated on a time-weighted basis in accordance with the standards of the Association for Investment Management & Research (AIMR). Valuations, where available, are based on published national securities exchanges prices.

Investment Philosophy and Objectives

In the investment of public funds, adequate funding of employee pensions is a paramount concern. Excessive risk taking could jeopardize that funding. An appropriate balance must be struck between risks taken and returns sought to ensure the long-term health and affordability of the plans involved. For over 20 years, the System has been managed to control the extent of downside risk to which assets are exposed while maximizing the potential for long-term gain.

Specific investment objectives are:

- To realize a real return (System return less CPI) of 3% per year over long periods (about 15 years).
- To control portfolio risk so as to limit downside price fluctuation of the total System in any 12-month period.
- To realize as high a rate of total return as possible, consistent with all of the above.

To achieve these objectives, these investment policies are employed:

- Allocate a minimum of 20% - 25% of assets to fixed income investments such as bonds, cash equivalents, and certain real estate investments.
- Maintain a widely diversified portfolio, so as to minimize the risk of overexposure to any one market sector or investment style.
- Closely monitor the performance of all investment managers against specific absolute objectives and in relation to other managers following the same investment objectives.

Investment Process

While the objectives and policies have been repeatedly reaffirmed, the implementation process undergoes continuous evolution. The increasing volume of investment information and the complexities of the global marketplace necessitate the ongoing development and use of advanced information systems. Computer technology is now used as a tool in every aspect of investment management, from asset allocation decisions to manager selection and performance measurement.

General Management

During each year, the Committee with Board of Pension Trustees (Board) oversight carries out a number of general management practices to assure that the appropriate policies, controls, and resources are in place. Areas that are reviewed at least annually include:

- Investment objectives and policies based on an analysis of cash flow and liabilities.
- Management tools for decision making.
- Long-term risk and return levels for various investment options.
- Manager organizations, performance, transaction costs, fees and expenses, proxy voting procedures, and adherence to investment philosophy.
- System performance versus externally measured universes of similar funds.
- Internal and external audits.
- Contacts with other leading state investment funds to compare management practices.
- Policy objectives and performance of the Private Program (including venture capital, limited partnerships, and private convertible bonds).

Investment Results

In Fiscal 2002, the investment process experienced:

- A time-weighted total return of (6.3%) based on market values.
- Benefit and expense payments exceeded net employer and member contributions by \$109.1 million.
- Net interest and dividend income of \$134.9 million.
- Net decrease in fair value of \$448.4 million.
- Decrease in total Fund assets from \$5.3 billion to \$4.9 billion.
- Overall volatility well below that of an all common stock portfolio.

The System is invested for long-term results and each single year’s returns must be viewed in relation to longer periods.

	Fiscal Years Ending June 30,					Five	Ten	Fifteen
	2002	2001	2000	1999	1998	Years Ending 6/30/02*	Years Ending 6/30/02*	Years Ending 6/30/02*
Total System Return	(6.3%)	(5.1%)	16.8%	11.1%	18.0%	6.4%	10.6%	10.0%
Consumer Price Index (CPI)	1.0%	3.3%	3.7%	2.0%	1.7%	2.3%	2.5%	3.1%
System Real Return	(7.3%)	(8.4%)	13.1%	9.1%	16.3%	4.1%	8.1%	6.9%

**(All returns Greater Than One Year Are Annualized)*

Chart I on page 58 summarizes the cash flows and total System returns for each of the last five fiscal years and the cumulative results for 5-year and 10-year periods ending June 30, 2002.

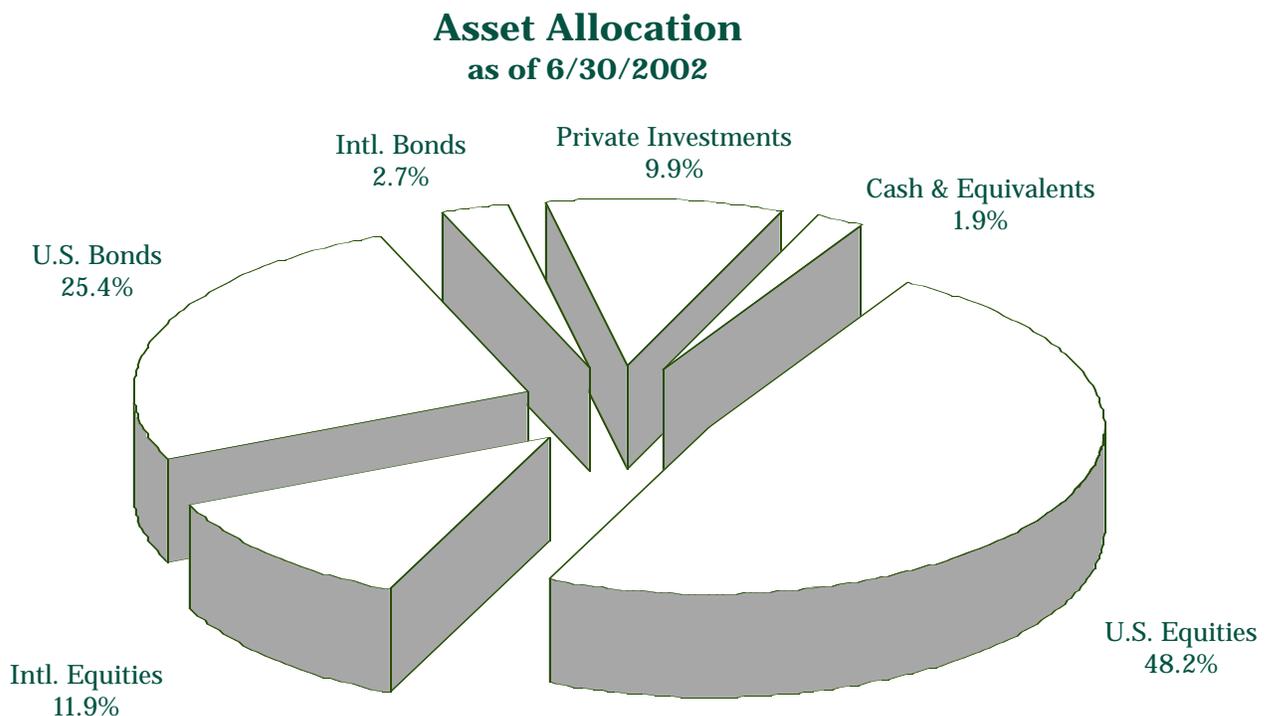
Chart II on page 58 summarizes the total System and asset class segment returns for each of the last five fiscal years and the annualized returns for the 3-year and 5-year periods ending June 30, 2002.



Charts III and IV on page 59 show the quarterly cumulative total System performance for the 5-year and 10-year periods ending June 30, 2002 compared to indices representative of some of the asset classes in which the System invests.

One investment objective is to achieve an annualized rate of total return over any 15-year period that is at least 3 percentage points greater than inflation. The most recent 15-year result is a real rate of return of 6.9% (10.0% System return less 3.1% CPI) measured on a time-weighted basis. During this period, risk as measured by relative volatility, was approximately 51% of the level that would have been experienced by a fund invested 100% in the S&P 500. The real rate of return from such a 100% stock portfolio would have been 7.8% (10.9% S&P 500 less 3.1% CPI). These are not typical real rates of return and should not be expected going forward. The last 15 years encompassed periods of exceptional returns in both the bond and stock markets which are unlikely to be repeated.

	Periods Ending June 30, 2002		
	Five Years	Ten Years	Fifteen Years
Total System Return	6.4%	10.6%	10.0%
S&P Index % Return	3.7%	11.4%	10.9%
Relative Return vs. S&P 500 Index	172.6%	92.9%	92.3%
Relative Risk vs. S&P 500 Index	53.6%	55.1%	50.8%



Asset Allocation

To achieve investment objectives, monies are deployed in diverse asset classes offering the risk and return characteristics desired. The following chart illustrates the diversification of assets at the end of the fiscal year. The accompanying table shows the five-year history and trends in asset allocation. For these asset classifications, the Pooled Equity and Fixed Income Accounts are included in their respective equity and fixed income asset classes; and, therefore, are different from the asset classes used in the financial section on pages 24-25.

	Fiscal Years Ending June 30,				
	2002	2001	2000	1999	1998
U.S. Equities	48.2%	44.9%	38.8%	45.3%	49.4%
Intl. Equities	11.9%	11.5%	12.4%	10.5%	11.7%
U.S. Bonds	25.4%	28.1%	31.1%	31.6%	20.5%
Intl. Bonds	2.7%	2.8%	2.7%	2.1%	1.6%
Real Estate	-	-*	-*	0.1%	0.3%
Private Investments	9.9%	10.4%	12.5%	9.2%	7.1%
Cash & Equivalents	1.9%	2.3%	2.5%	1.2%	9.4%

**less than 0.1% under management. Other real estate holdings in the form of Real Estate Investment Trusts are included in equities.*

Individual investment managers are selected for each asset class based on a rigorous set of performance and organizational criteria. In addition to a proven track record of managing a given class of assets, they must have a clearly stated and consistently applied investment policy and decision making process, continuity of personnel, and a well-defined plan for retaining key personnel and controlling growth.

All investment managers are expected to meet and maintain a number of organizational criteria in order to continue as managers. One manager was terminated during the fiscal year, four managers were hired, two venture capital funds reached their scheduled termination dates and distributed assets, the responsibilities of two managers were reduced, and an existing manager was given additional responsibilities in the area of private investments. At the end of the fiscal year, the money managers of the System and their responsibilities were:

Investment Manager	Responsibility	Calendar Year Retained
<u>U.S. Equities</u>		
Alliance Capital Management	Equities	2001
Armstrong Shaw	Equities	2002
Barclays Global Investors	Equities	1977
Fidelity Management Trust Co.	Real Estate Investment Trusts	1995
Froley, Revy Investment Co.	Convertible Securities	1984
Granahan Investment Management	Equities	2002
Lincoln Capital Management	Equities	1978
Mellon Capital Management	Equities	1984
Oaktree Capital Management	Convertible Securities	1995
T. Rowe Price Associates	Equities	1971
Trinity Investment Management	Equities	1982
<u>International Equities</u>		
Jarislowsky Fraser	International Equities	2002
Mellon Capital Management	International Equities	1996
Oaktree Capital Management	International Convertible Securities	1995
<u>U.S. Bonds</u>		
Lincoln Capital Management	Fixed Income	1995
Mellon Capital Management	Fixed Income	1984
T. Rowe Price Associates	Fixed Income	1996
Loomis Sayles & Company LP	Fixed Income	1998
<u>Private Investments</u>		
Accel Partners	Venture Capital	1984
Advanced Technology Ventures	Venture Capital	1990
Brentwood Associates	Venture Capital	1983
The Carlyle Group	Private Equity	1996
Cherry Tree Ventures	Venture Capital	1984
Coller Isnard Ltd.	Venture Capital	1994
MeriTech Capital Partners	Venture Capital	1999
Oaktree Capital Management	Distressed Debt	1997
Oaktree Capital Management	Emerging Markets	2000
One Liberty Ventures	Venture Capital	1982
ONSET Enterprise Associates	Venture Capital	1989
Pecks Partners	Private Equity	1986
Spectra Enterprise Associates	Venture Capital	1986
Summit Ventures	Venture Capital	1988
T. Rowe Price Recovery Fund	Distressed Debt	1988
T. Rowe Price Threshold Funds	Venture Capital	1984
Trident Management	Venture Capital	1999
TCW Asset Management	Distressed Debt	1990
Weston Presidio Capital	Venture Capital	1995
<u>Cash & Equivalents</u>		
T. Rowe Price Associates	Cash & Equivalents	1983



**Chart I
Calculated Returns**

*(Dollar values expressed in thousands)
(All Returns for Periods Greater Than One Year Are Annualized)*

	Fiscal Years Ending June 30,					Five Years	Ten Years
						Ending	Ending
	2002	2001	2000	1999	1998	6/30/02	6/30/02
Beginning Market Value	\$ 5,280.6	5,663.8	4,898.1	4,452.1	3,793.3	\$ 3,793.3	\$ 2,011.4
Net (Withdrawals)/Contributions	(109.1)	(96.1)	(58.7)	(43.6)	(30.4)	(337.9)	(471.5)
Net Investment Income	134.9	160.8	155.5	126.9	130.2	708.3	1,238.4
Net (Decrease)/Increase in fair value	(448.4)	(447.9)	668.9	362.7	559.0	694.3	2,079.7
Ending Market Value	\$ 4,858.0	5,280.6	5,663.8	4,898.1	4,452.1	\$ 4,858.0	\$ 4,858.0
Time-Weighted Total Return on Market Value	(6.3%)	(5.1%)	16.8%	11.1%	18.0%	6.4%	10.6%
Consumer Price Index	1.0%	3.3%	3.7%	2.0%	1.7%	4.1%	8.1%

**Chart II
Investment Performance Summary**

(All Returns for Periods Greater Than One Year Are Annualized)

	Fiscal Years Ending June 30,					Three	Five
						Years	Years
	2002	2001	2000	1999	1998	Ending	Ending
(1) Total System	(6.3%)	(5.1%)	16.8%	11.1%	18.0%	1.3%	6.4%
(2) Equity and Private Equity Segment**	(9.7%)	(8.7%)	33.6%	11.2%	16.0%	3.3%	7.3%
(3) Fixed Income and Cash Segment***	6.0%	8.5%	5.2%	6.1%	7.8%	6.6%	6.7%
(4) Tactical Asset Allocation Segment****	(7.3%)	(6.2%)	7.0%	13.4%	27.0%	(2.4%)	6.0%
Consumer Price Index*	1.0%	3.3%	3.7%	2.0%	1.7%	2.7%	2.3%
S&P 500 Index	(18.0%)	(14.8%)	7.4%	22.7%	30.2%	(9.1%)	3.7%
Russell 3000 Index	(17.2%)	(13.9%)	9.6%	20.1%	28.8%	(7.9%)	3.8%
MSCI EAFE Index	(9.5%)	(23.6%)	17.2%	7.6%	6.1%	(6.8%)	(1.6%)
Lehman Gov't Corp	8.2%	11.1%	4.3%	2.7%	11.3%	7.9%	7.5%
90-Day Treasury Bill	2.2%	5.0%	5.5%	4.5%	5.1%	4.2%	4.4%
60/40 S&P/Lehman Gov't Corp Mix	(7.4%)	(4.8%)	6.5%	15.2%	22.5%	(2.1%)	5.8%
60/40 MSCI World/Salomon WGBI	(4.0%)	(13.5%)	8.7%	11.5%	12.1%	(3.4%)	2.4%

* A benchmark for establishing the Total System return.

** Includes convertible securities and private equity; excludes equity portion of tactical asset allocation portfolios.

*** Excludes fixed income and cash segments of tactical asset allocation portfolios.

**** Comprises investment accounts which tactically rebalance among stocks, bonds and cash (including foreign stocks, bonds and cash) to optimize the risk/return characteristics of the mix. The underlying assets in these accounts are generally passively invested in index vehicles.