

Two Decades, One Mission

Annual Report of the Pension Reserves Investment Trust Fund
for the fiscal year ended June 30, 2004

Table of Contents:

Message from the PRIM Board Chair	2
Message from the Executive Director	4
PRIT Fund Charts: Growth in Net Assets and Growth of One Dollar	5
PRIT Core Charts: TUCS Rankings & Investment Performance.	6
PRIT Core Performance Summary & Performance Comparison	7
Annual Report of PRIT Fund, for the fiscal year ended June 30, 2004	8-29

Pension Reserves Investment Trust Fund Financial Statements,
for the fiscal year ended June 30, 2004

Message from the PRIM Board Chair

Dear Participants and Beneficiaries:

It is my great privilege to release the 2004 Annual Report of the Pension Reserves Investment Trust ("PRIT") Fund. In my second year as Chair of the PRIM Board, there have been a great number of challenges and accomplishments. I am very proud of the hard work that has been done by the Board, the staff and all of its advisors during the 2004 Fiscal Year. I would like to take a moment and review some of the endeavors of the past year and outline our goals going forward.

I am extremely proud of the performance of the PRIT Fund during fiscal 2004. For the twelve-month period ending June 30, 2004 the PRIT Core Fund returned 19.50%, putting PRIM in the top 8% of Public funds over \$1 billion in size, nationwide. At the time that this report was printed the fund had surpassed the \$34 billion level, a high point for the twenty-year history of PRIM.

In a continuing effort to achieve our core mission, the PRIM staff has diligently executed the asset allocation that was dictated by the Board in June of 2003. Working very closely with the Trustees of the PRIM Board and the members of the Investment and Real Estate Committees, staff has identified, and hired, 24 new quality managers. In addition to adding three Emerging Market Debt managers, the final piece of the implementation was the hiring of five new Hedge Fund of Funds, or Absolute Return managers. This marked the culmination of almost two years of rigorous due diligence into the use of Hedge funds as a vehicle to achieve greater diversification while reducing risk at the same time.

As a part of the ongoing vigilance to protect the pension assets, the PRIM Board and staff have joined me in making hard decisions regarding some long-term relationships that were no longer performing in the best interest of the PRIT Fund. In the process of rebalancing the PRIT Fund and hiring managers it was necessary to terminate a number of investment managers. Ending the tenure of a manager is one of the most difficult decisions a trustee is faced with in their role as a fiduciary. However, I will not hesitate to exercise this responsibility when the assets of the Fund are at risk.

One of my goals in the prior year was to evaluate and execute an Economically Targeted Investments (ETI) initiative. PRIM staff has evaluated dozens of proposals and presentations, applying a very stringent set of criteria for investment. PRIM made its first ETI investment by funding Access Capital in March of 2004. The investment in Access

Capital fills a funding gap by providing 203 mortgages to residents of 115 towns in Massachusetts. The performance of this investment has exceeded its benchmark thus far, fulfilling the 'double bottom line' that we strive for in the ETI program. There are currently several real estate and private equity ETI proposals under review, some of which we hope to fund in 2005.

The fiscal year brought many new faces to the PRIM Board and staff. There were three new Gubernatorial appointments in Peter Schwarzenbach, Paul Cesan and Greg White as well as my re-appointment of Alex Aikens, formerly a Governor's appointee. Sadly, the board lost State Board appointed member Bob Cawley in April of 2004 when he passed away. Bob's seat on the Board has been filled by Theresa McGoldrick by way of a special election. PRIM concluded its search for a new Executive Director in February of 2004 and hired former Deputy Treasurer of the Commonwealth, Michael Travaglini. Michael has brought a wealth of experience to the Board having served as a trustee of the PRIM Board and as the Executive Director of the City of Boston Retirement Board. PRIM also added five new talented analysts and administrators during the year, due to the creation of a new position and the replacement of other fine individuals moving on to new opportunities. The staff will miss its CIO of three and a half years, Dr. Jerry Mitchell, who retired in October of 2004. Jerry played a key role in directing staff through the recent asset allocation study and implementation. Although Jerry will be enjoying a well-deserved retirement, he has graciously agreed to serve on the investment committee. A search for his replacement is underway and in the meantime the highly capable Deputy CIO Stanley Mavromates will be overseeing the investment staff.

I hope that you enjoy this year's report and join me in congratulating the individuals who have perpetuated PRIM's "Mission" that began two decades ago as a vision.

Sincerely,

Timothy P. Cahill,
Chair, Pension Reserves Investment Management Board
Treasurer and Receiver-General, Commonwealth of Massachusetts

Message from the Executive Director

Dear Participants and Beneficiaries:

I am pleased to present the 2004 Annual report of the Pension Reserves Investment Trust Fund, my first as Executive Director. Previously, during my four years as Deputy Treasurer, I served as the Treasurer's designee to the PRIM Board as well as a member of the Investment Committee. As Executive Director, I am responsible for managing a highly competent staff that interfaces with a dedicated and engaged Board and three advisory committees, all with the express purpose of prudently investing the assets of our participants and beneficiaries.

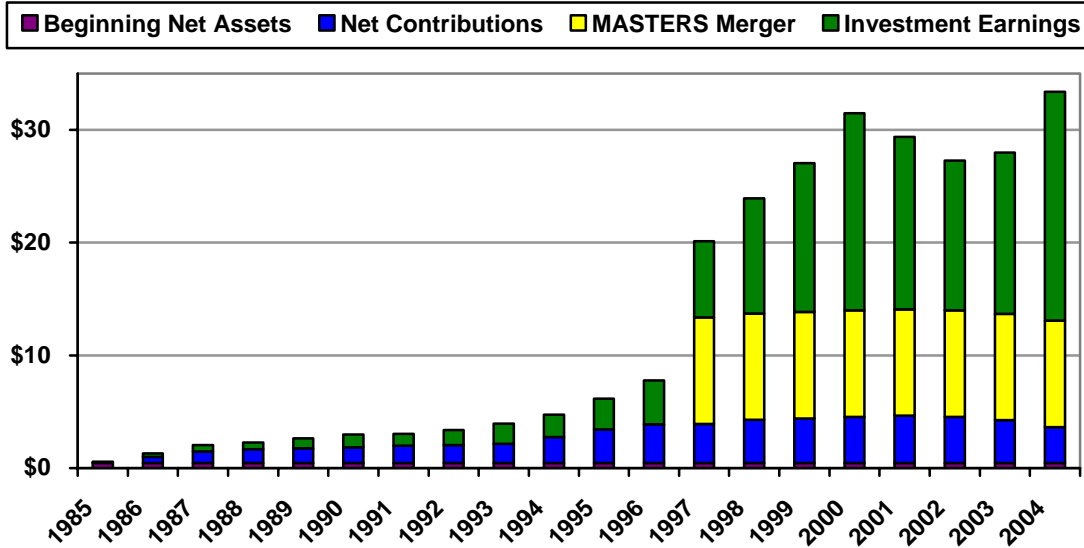
The mission at PRIM has not changed during its twenty-year history: responsibly investing the Commonwealth's pension assets so that the economic security of state employees and teachers is preserved at retirement. During that time, PRIM has successfully completed its "mission" as evidenced by solid performance, returning 10.84% per year since inception. Nevertheless, our challenge today is to continue that legacy of success in the face of bearish capital market return assumptions. You have my commitment that everyone at PRIM is singularly focused on this task.

The most useful tool available to us as custodians of the PRIT Fund is a well-designed and prudently executed asset allocation. The benefits of diversifying our investment portfolio have served as the foundation of PRIM's long-term success. The staff at PRIM continuously strives to select first class asset management firms and closely monitor their performance to ensure that expectations are met. While it may become increasingly more difficult for the PRIM portfolio to return 8.25% annually, my pledge as Executive Director is to utilize all of the available resources and direct all efforts toward that goal. Together, I am confident we can fulfill our fiduciary obligations and preserve the economic security of our beneficiaries.

Sincerely,

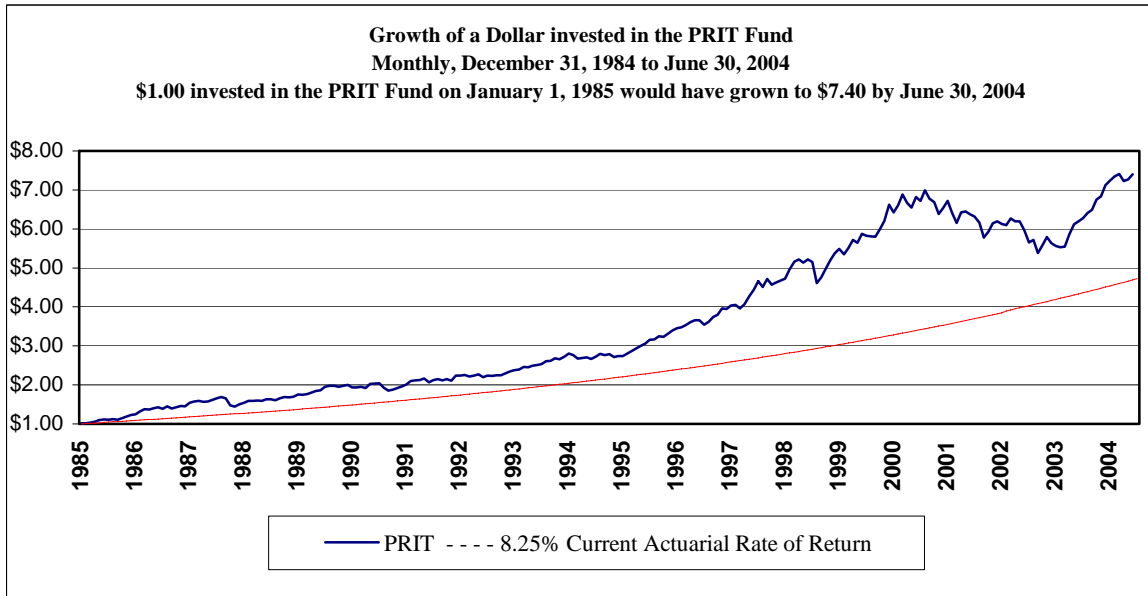
Michael Travaglini
Executive Director

TABLE 1
PRIT Fund Growth in Net Assets
Fiscal Years 1985 to 2004
(in billions)



The PRIT Fund's net assets have grown from \$597 million on June 30, 1985, to \$32 billion as of June 30, 2004, primarily as a result of strong investment performance.

TABLE 2
PRIT Fund Growth of One Dollar



Through June 30, 2004 the PRIT Fund has returned an average of 10.81%¹ annually since inception (1/1/85).

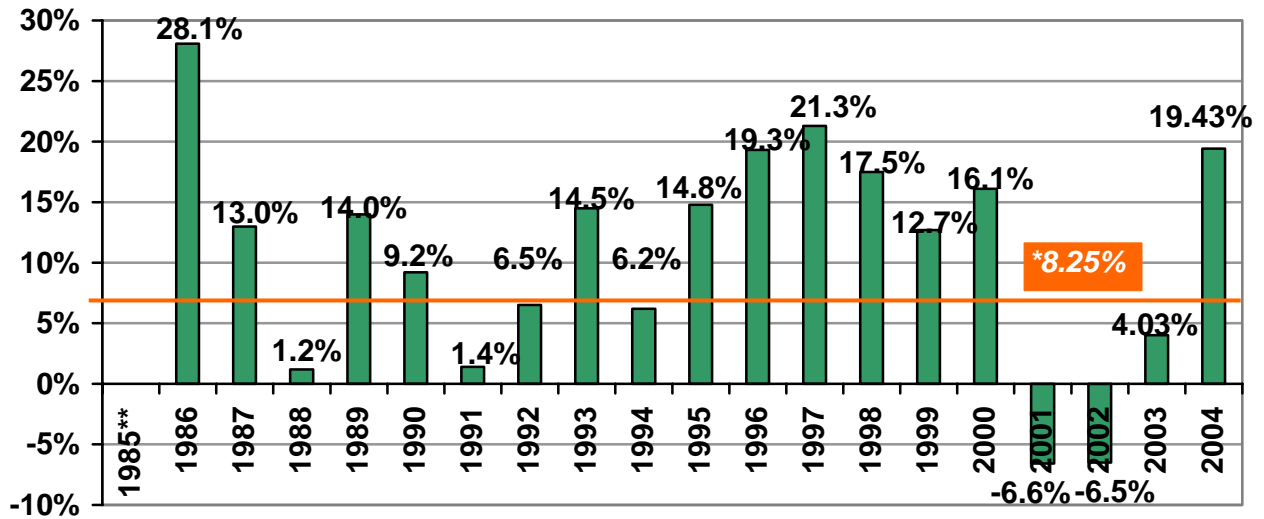
¹ All investment performance figures presented in this report are gross of expenses.

TABLE 3
PRIT Core² Rankings Relative to U.S. Public Funds
Plans over \$1 Billion in Assets
For Periods Ending June 30, 2004

	<i>YTD</i>	<i>One Year</i>	<i>Three-Years</i>	<i>Five-Years</i>	<i>Ten-Years</i>
PRIT Core Return	3.97%	19.49%	5.15%	4.74%	10.79%
PRIT Percentile Ranking	6th	3rd	25th	23rd	8th
Median Public Fund Return	2.95%	15.88%	4.22%	3.66%	9.80%

Source: Trust Universe Comparison Report, the most widely recognized benchmark for comparing the investment performance of pension funds nationwide.

TABLE 4
PRIT Total Fund Investment Performance
For Fiscal Years Ending June 30



*The Legislature has set 8.25% as the PRIT Fund's long-term rate of return target.

** The one-year rate of return for fiscal year 1985 is not applicable as PRIT's first full fiscal year of operation was fiscal year 1986.

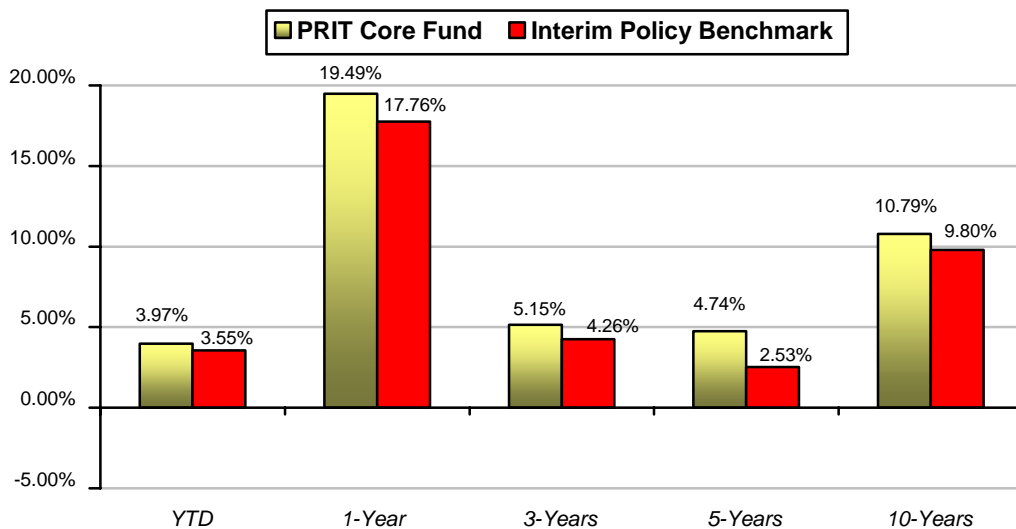
² PRIT Core does not include the State Employees and Teachers' Separate Cash Account.

TABLE 5 - PRIT Core Performance Summary, Periods Ending June 30, 2004

Component of Portfolio	PRIT 1 Year	Index 1 Year	PRIT 5Year	Index 5 Year	PRIT 10 Year	Index 10 Year	Index
Domestic Equity	22.36%	21.17%	1.04%	-1.05%	12.35%	11.52%	Wilshire 5000
Fixed Income	1.63%	1.11%	7.63%	7.35%	8.40%	7.59%	78% LB Aggregate 22% LB US TIPS
High Yield Debt ³	13.56%	13.92%					46% each MLHYM & JPM EMBI Global 8% Actual Distr. Debt
International Equity	32.60%	32.37%	4.06%	0.06%	7.63%	4.06%	MSCI EAFE
Emerging Markets	35.12%	33.51%	4.51%	3.27%	4.02%	1.21%	MSCI EMF Gross Div.
Real Estate	19.94%	12.47%	11.45%	9.84%	11.58%	10.46%	NCREIF Property Index (qtr. lagged)
Alternative Investments:	24.97%	N/A	6.81%	N/A	13.93%	N/A	No Benchmark
Special Equity	29.40%	N/A	8.75%	N/A	14.21%	N/A	No Benchmark
Venture Capital	15.35%	N/A	1.26%	N/A	14.00%	N/A	No Benchmark
Timber ⁴	12.68%	8.18%					NCREIF Timber Index
Total PRIT Core	19.49%	17.76%	4.74%	2.53%	10.79%	9.80%	Interim Policy Benchmark

TABLE 6 - PRIT Core Performance Comparison

For periods ending June 30, 2004



³ Since July 1, 2001

Annual Report

The PRIT Fund

The PRIT Fund is a pooled investment fund established to invest the assets of the Massachusetts State Teachers' and Employees' Retirement Systems, and the assets of county, authority, district, and municipal retirement systems that choose to invest in the Fund. The PRIT Fund was created by the Legislature in December 1983 (Chapter 661 of the Acts 1983) with a mandate to build up assets through investment earnings and other revenue sources to reduce the Commonwealth's unfunded pension liability, and to assist local participating retirement systems in meeting their future pension obligations. The PRIT Fund merged with the Massachusetts State Teachers' and Employees' Retirement Systems ("MASTERS") Trust on January 1, 1997, in accordance with Chapter 315 of the Acts of 1996. As of June 30, 2004, the net assets of the PRIT Fund totaled \$32.6 billion.

The PRIM Board is charged with the general oversight of the PRIT Fund. PRIM's mission is to maximize the return on investments within acceptable levels of risk by broadly diversifying its investment portfolio, capitalizing on economies of scale to achieve cost-effective operations, and providing access to high quality, innovative investment management firms, all under the management of a professional staff and members of the Board.

The PRIT Fund consists of two investment funds: the Capital Fund and the Cash Fund. Cash, deposited and invested on a temporary basis, is transferred from the Cash Fund to the Capital Fund at the discretion of the retirement systems on the first business day of each month. The Capital Fund serves as the long-term asset portfolio and currently consists of 14 accounts: General Allocation Account (holds units across all asset classes under PRIM's asset allocation plan), Domestic Equity, Fixed Income, High Yield Debt (including Emerging and Distressed Debt), International Equity, Emerging Markets, Real Estate, Timber, Alternative Investments, and Alternative Investments "Vintage Years" 2000, 2001, 2002, 2003 and 2004. ("Vintage Year" refers to the calendar year in which the PRIT Fund made a commitment to invest in Alternative Investments). In addition, as of July 2004, there is also an Absolute Return Hedge Fund of Funds Portfolio as well.

⁴ Since December 31, 2001

Asset Allocation Review

The Investment Policy statement adopted by the PRIM Board in September 1998 requires that the Trustees conduct an annual evaluation of the PRIT Fund's asset allocation. The purpose is to determine whether adjustments to the Fund's structure are necessary due to any changes in the capital market assumptions, the plan's liability assumptions, the Board's risk tolerances, or in the Fund's investment objectives. Experts from both the world of academics and the investment arena agree that asset allocation decisions are the major drivers in determining a portfolio's performance. In most cases, "where" and "how much" to invest, are more critical questions to ask than "with whom" to invest.

A major review of the PRIT Fund asset allocation was conducted during the later half of fiscal year 2003 with the following objectives: first, the Board sought to increase the forecasted return of the PRIT Fund and second, to decrease the risk by reducing volatility through greater diversification. The expected return, standard deviation, and correlation numbers used for existing and potential asset classes in the optimization process were thoroughly reviewed and formally agreed upon. After months of detailed analysis, a new asset allocation was devised. It included modifications of the current asset classes and the addition of two new asset classes - absolute return funds and emerging market debt. In June of 2003 the PRIM Board voted to implement the recommended changes (see Table 7 below for details). As detailed in the asset allocation table, the long-term expected rate of return of the PRIT Fund was revised upward to 8.33% from the former long-term expected rate of 8.16%. The revision was made in conjunction with a decrease in the overall expected risk of the portfolio from 12.75% to 11.60%, thus also achieving the goal of significantly reducing the volatility of the overall portfolio.

As predicted, this shift in strategy did not take place overnight; in fact, it took approximately 12 months to approach the Interim Target Allocations. While it may take as much as 2 to 3 years more to reach the Long-Term Target Allocations, PRIM staff has made significant strides towards the portfolio's ultimate structure. Specifically, the staff continues to employ great patience and prudence in increasing its stakes in real estate, timber, and alternative investments (private equity). In these somewhat illiquid asset classes the staff has made the quality of the portfolio's investments a priority over the speed with which the funds are re-allocated. On July 1, 2004 PRIM staff transferred the first installments of a \$1.6 billion allocation to the Absolute Return portfolio, marking another significant milestone in both the implementation of the new asset allocation and the increased diversification of the portfolio.

TABLE 7 - PRIT Core Asset Allocation Policy

As of June 30,2004

Asset Class	6/30/2004 Allocation %	Policy Interim Target %	Policy Long- Term Target%
U.S. Stocks	39.0	32	26
Non-U.S. Stocks	16.3	15	15
Emerging Markets	5.5	5	5
U.S. Bonds	13.0	13	10
TIPS	5.0	5	5
High Yield	7.0	8	9
Real Estate	5.6	7	10
Alternatives	5.7	7	10
Timber	2.9	4	5
Absolute Return	0.0	4	5
Expected Return	8.00%	8.12%	8.33%
Expected Risk	12.30%	11.68%	11.60%
Return/Risk Ratio	0.65	0.70	0.72

The PRIT Fund Portfolio

The Year in Review – The World Markets

What a difference a year makes! Fiscal 2004 began on a positive note as the stellar gains from the June quarter rolled into the summer months. After the torrid markets of the spring of 2003 the slow down in the markets seemed to point to a “soft landing” of sorts. A weak September across most domestic equity markets was tempered by a small rally in the bond markets and the fiscal year began with solid gains. During the 1st fiscal quarter of 2004 (ending September 30, 2003), the broad U.S. stock market, as represented by the Wilshire 5000 Index, returned 3.70%. On the whole, small cap stocks beat large cap stocks and growth generally beat value stocks. Large capitalization stocks, as measured by the S&P 500 Index, rose 2.65% during the quarter. Small capitalization stocks, as measured by the Russell 2000 Index, grew by 9.08% during the quarter. International developed markets also posted solid returns for the quarter ended September 30, 2003. The Morgan Stanley Capital International Europe, Australasia, Far East (MSCI EAFE) Index surged 8.13% for the 1st fiscal quarter. Emerging markets were even stronger, and the Morgan Stanley Capital International Emerging Markets Free (MSCI EMF) Index returned 14.21%. Fixed income posted small losses as investors flocked to the equity markets. The Lehman Brothers Aggregate (LB Agg) Index, the broad fixed income benchmark, lost -0.15% for the 1st fiscal quarter. Treasuries weakened further with the yield on the 10-year bond rising to 3.96% at the end of September, up from 3.51% at the end of June (the yield moves in the opposite direction of the price). The high yield market, as measured by the Merrill Lynch High Yield Master II indices, rose 2.62% for the 1st fiscal quarter.

The December quarter of 2003 was the perfect ending to a great year for the equity markets worldwide. The expanding U.S. economy was driven partly by improving earnings from many companies. Years of cost cutting paired with better revenues aided a sustained rally. For many investors there was also a psychological boost during the quarter from crossing the 2,000 and 10,000 levels on the Nasdaq and Dow respectively. The Wilshire 5000 Index jumped 12.43% during the 2nd fiscal quarter of 2003. Large capitalization stocks, in the S&P 500 Index, surged 12.18% during the quarter. Small capitalization stocks in the Russell 2000 Index gained 14.51% during the quarter. International developed markets also skyrocketed in the quarter.

The MSCI EAFE Index marked a gain of 17.08% for the 2nd fiscal quarter despite positive, but lagging performance in the MSCI Japan Index (8.38%) and the MSCI Pacific Index (9.77%). Emerging markets posted an impressive gain for the quarter as the MSCI EMF Index returned 17.81%. Treasuries continued to struggle with the yield on the 10-year bond rising to 4.25% at the end of December, up from 3.96% at the end of September. The LB Agg Index returned 0.32% for the 2nd fiscal quarter and in the high yield market the ML HY Master II Index returned 5.94% for the quarter.

Although the first calendar quarter of 2004 was generally positive, March started to show signs of negativity sparked by the bombings in Madrid, fears of rising interest rates and setbacks in the Iraq campaign. Corporate earnings continued to trend upward after the year-end and the markets responded positively in January and February. In March however, there was evidence that investors were taking profits on the realization that the economic recovery may be priced into the markets and that uncertain geopolitical events were creating more risk. The broad U.S. stock market Wilshire 5000 Index returned 2.60% during the 3rd fiscal quarter of 2003. Large capitalization stocks in the S&P 500 Index were also up 1.70% during the quarter. Small capitalization stocks in the Russell 2000 Index were a bit stronger, up 6.26% during the quarter. The late March losses (Wilshire 5000 down -1.07%) did not derail the positive quarter, but the Nasdaq and Dow were both down -0.46% and -0.43% respectively. Developed international markets eked out a small gain during the 3rd fiscal quarter. The MSCI EAFE Index was up 4.34% in a quarter that featured a reversal of fortunes for Europe and Asia. MSCI Europe lagged, up 0.89% while Japan led the charge up 15.14% for the quarter. Emerging markets posted a fourth consecutive stellar quarter as the MSCI EMF Index gained 9.72%. Treasuries reversed the recent trend with the yield on the 10-year bond dropping to 3.88% at the end of March, down from 4.25% at the end of December. The LB Agg index rebounded strongly with a return of 2.66% for 3rd fiscal quarter and the high yield market index, ML HY Master II, returned 2.18% for the quarter.

In the final quarter of the 2004 fiscal year, ending June 30, 2004, the markets limped across the finish line. As the ten-year treasuries rose steadily, the bond markets and the emerging equity markets slumped badly. The equity markets did manage to salvage a positive quarter after having fallen off in April, largely due to better than expected corporate earnings and continued positive economic news in the face of escalating oil prices and regular inflammations in Iraq. The broad market indices, S&P 500 and new 'Dow Jones Wilshire 5000' posted returns of 1.72% and 1.28% respectively. The narrow market benchmarks, Dow Jones

Industrials and NASDAQ, also posted positive returns of 1.28% and 2.69%, respectively and the small cap Russell 2000 Index rose a meager 0.47%. International equities posted small gains for the 4th fiscal quarter with the MSCI EAFE Index gaining only 0.22%. Emerging markets equities dropped precipitously for the 4th fiscal quarter with the MSCI EMF index down -9.57%. Bond markets experienced a correction, posting significant losses for the quarter with the LB Agg Index sliding -2.44%. Within the broad LB Agg Index, treasuries experienced weakness during the quarter amid expectations that the Fed would be raising rates in the months to come. The yield on the 10-year treasury moved up to 4.84%, but ended the quarter at 4.59%, still well above March's ending level of 3.88%. High yield markets finally showed signs of weakness with the ML HY Master II Index down -0.80% for the quarter ended June 30, 2004.

PRIT Core Performance - Fiscal Year 2004

In the Fiscal year 2004 the PRIT Fund posted its second consecutive positive fiscal year return. At one point during the year the Fund had a string of 13 positive months in a row. For fiscal year 2004, the PRIT Core returned 19.49%, surpassing the interim policy benchmark return of 17.76%, by an astounding 173 basis points. The PRIT Fund's fiscal year return is once again proof of the tremendous benefits of diversification and superior manager selection and oversight. It also speaks volumes of the importance of effective management of the asset allocation planning process and adherence to a long-term investment policy, regardless of short-term market trends.

The PRIT Fund began fiscal year 2004 with a net asset value of \$27.84 billion and ended with \$32.64 billion. On a gross basis the fund was up approximately \$6.5 billion, a net increase of \$4.75 billion less \$1.6 billion in redemptions from the State Employees and State-Teachers' accounts to make up in part for a shortfall in the pension appropriation. The quarterly returns of the PRIT Core in fiscal year 2004 were as follows:

- 4.73% for September 30, 2003
- 9.75% for December 31, 2003
- 4.11% for March 31, 2004
- -0.14% for June 30, 2004

On an absolute basis, all asset classes were positive for the fiscal year with Emerging Markets and International Equity leading the pack, returning 35.12% and 32.60%, respectively. The asset class with the lowest return was Fixed Income up 1.63%. The remaining five asset classes had positive returns in fiscal year 2004 as follows: Alternative Investments - Private Equity 24.97%, Domestic Equity 22.36%, Real Estate 19.94%, High Yield Debt 13.56%, and Timber 12.68%.

Active management makes up approximately 60% of the PRIT Core, which means that the investment committee and the PRIM staff are responsible for selecting and recommending managers to the Board that are expected to beat their respective contractual benchmarks. During fiscal year 2004, 81% of PRIM's active managers outperformed their individual indices. Over the past three years, 78% of PRIM's active managers outperformed their benchmarks. A trademark of a successful pension fund is its ability to select managers that outperform their benchmarks in both bull and bear markets. We are proud to declare that the PRIM Board and

staff have achieved this goal with remarkable results. Over both short and long periods of time, the PRIT Fund's relative performance continues to compare favorably to the policy benchmark. It is also important to note that the Fund has outperformed its benchmark with incredible consistency. For the three-year period ending June 30, 2004, PRIT Core had an annualized return of 5.15%, exceeding the interim policy benchmark by 89 basis points. During the five-year period ending June 30, 2004 the PRIT Core return of 4.74% outperformed the policy benchmark by 221 basis points per year and over ten years the PRIT Core returned 10.79%, 99 basis points above the benchmark. (See TABLE 3 on page 5 for TUCS rankings, comparing the PRIT Core performance to public pension peers).

The PRIT Fund Public Markets Portfolios

Domestic Equity. As of June 30, 2004, PRIT's Domestic Equity portfolio represented 39.0% of the PRIT Core's net asset value. For the fiscal year, the portfolio produced a 22.36% return compared to 21.17% for the portfolio benchmark, the Wilshire 5000 index. PRIT's large cap managers outperformed the large cap benchmark S&P 500 index (ex-tobacco), returning 19.15% compared to 19.11%. However, the bulk of the outperformance versus the benchmark for fiscal 2004 came from the small cap managers returning 31.11% for the year versus 29.52% in the Wilshire 4500 benchmark. PRIM's investment strategy for Domestic Equity is to be neutral to the market with respect to capitalization weightings. The large cap component of the Domestic Equity portfolio was approximately 72% of the total Domestic Equity portfolio at fiscal year-end, with the small capitalization composite representing the remaining 28%. On a three- five- and ten-year basis through June 30, 2004, PRIT's Domestic Equity portfolio has beaten its benchmarks, returning 1.54%, 1.04%, and 12.35%, respectively, compared to the Wilshire 5000 index, which returned 0.77%, -1.05%, and 11.52%, respectively.

International Equity. International Equity has been reduced to 16.3% of the PRIT Core's net assets as of June 30, 2004. For the fiscal year, the International Equity portfolio returned 32.60% (with core managers up 33.11%) compared to the MSCI EAFE index return of 32.37%. PRIT's best performing international equity manager was the London-based, value-oriented, Marathon Asset Management. Marathon's return of 40.28% added 791 basis points above the benchmark. Over the longer-term, PRIT's international equity managers continue to add significant value over the benchmark. On a three- five- and ten-year basis, PRIT's international equity managers posted returns of 4.47%, 4.06%, and 7.63%, respectively, outperforming the MSCI EAFE index, which returned 3.87%, 0.06%, and 4.06% over the same

periods. PRIM has selected two new managers to be funded on July 1, 2004; Baillie Gifford, a growth manager from Edinburgh, Scotland and The Boston Company, a local value manager will be funded \$600 million each.

Emerging Markets. The Emerging Markets portfolio grew to \$1.8 billion or 5.5% of the PRIT Core's net assets by the end of fiscal 2004. PRIT's emerging markets managers returned a portfolio best of 35.12% for the fiscal year versus a return of 33.51% for the MSCI EMF index. The outperformance compared to the index was due to the performance of GMO (hired in September of 2002) and Emerging Markets Management ("EMM"). GMO returned 38.35% for the fiscal year, 484 basis points above the benchmark. EMM returned 37.32% for the 12-month period ended June 30, 2004, adding 381 basis points above the benchmark. Longer term, PRIT's emerging markets portfolio has returned 12.29% versus the benchmark return of 13.10% on a three-year basis, 4.51% compared to 3.27% for the index on a five-year basis, and 4.02% relative to the benchmark return of 1.21% for the ten-year period ended June 30, 2004.

Fixed Income. In July of 2001 the Fixed Income portfolio was split into two separate portfolios: Fixed Income "Core" (investment grade bonds only, including TIPS) and High Yield Debt (high yield grade bonds and distressed debt). As of June 30, 2004, 18.0% of the PRIT Core's net asset value was invested in domestic investment grade Fixed Income "core" securities. For the fiscal year 2004, the Fixed Income composite return of 1.63% beat the benchmark (78% LB Agg/22% Lehman US TIPS index), which was 1.11%. PRIT's TIPS manager, Barclays, achieved a 3.97% return versus the Lehman US TIPS benchmark return of 3.87%.

High Yield Debt. High Yield Debt has been increased to 7.0% of the PRIT Core's net assets on June 30, 2004. In fiscal year 2004, the High Yield composite returned 13.56% compared to 13.92% for the asset class benchmark. PRIT Core's high yield bond managers returned 10.98%, while the ML HY Master II index returned 10.19%. Distressed debt investments are limited partnerships and PRIT Core has invested a total of \$128 million with three different managers; Oaktree Capital Management, Angelo, Gordon & Co. and TCW Asset Management. In fiscal year 2004, the Distressed Debt portfolio returned 49.58%. As there are no readily available, relevant indices for this class of assets, the benchmark for Distressed Debt is the actual performance of that portion of the portfolio. In January of 2004, a new sub-class of Emerging Market Debt was added to the High Yield portfolio. This portfolio is managed by Ashmore, GMO and PIMCO and has returned -2.20% in its first six months, just slightly ahead of JP Morgan Emerging Markets Bond Index (JPM EMBI Global Index) by 7 basis points.

The PRIT Fund Private Markets Portfolios

Real Estate. On June 30, 2004, 5.6% of the PRIT Core's net assets were invested in Real Estate. For the one-year period, the portfolio returned 19.94%, well ahead of the asset class benchmark return of 12.47%.

To support PRIM's "Segmentation" program, the Real Estate portfolio was separated into "core" and "non-core" components on July 1, 1997. For the fiscal year ended June 30, 2004, the "core" portfolio (investments in real properties and publicly traded Real Estate Investment Trusts, or REITs) returned 20.02%.

PRIM's Real Estate returns were significantly enhanced by the use of debt. The investments in real property returned 17.68% for the twelve months ending June 30, 2004, beating the NCREIF Property Index (NPI), which returned 10.84% over the same period of time. In June 2003 the PRIM Board voted to increase its exposure to the REIT market, hiring four new managers and terminating one manager. For the one-year period the Fund's five REIT managers returned 31.59%, beating the NAREIT Equity index, which returned 27.08%.

The "core" real estate portfolio, which is composed of the directly owned properties and the REIT stock portfolio, has returned 12.06% over the past three years versus the asset class benchmark of 8.63%. On a five-year basis, returns were 11.44% compared to the benchmark return of 9.84%. These strong returns have been achieved with less risk than the benchmark. As of June 30, 2004, Real Estate was the PRIT Fund's best performing asset class over a five-year period during which U.S. equities endured substantial swings.

The total Real Estate portfolio was hurt somewhat by the "non-core" assets in fiscal 2003, despite the continued divestiture of these assets, which returned 2.26% for the fiscal year. Non-core assets represented less than one percent of PRIT Core and are principally commingled fund investments made in the late 1980's, of which approximately \$7 million remained as of June 30, 2004.

Timber. As of June 30, 2004, Timber represented 2.9% of the PRIT Core's net assets. PRIT added Timber as an asset class in 2001. Since that time, PRIM and its two managers have been building the Timber portfolio. As of June 30, 2004 PRIT owned over \$931 million of timber investments throughout the United States. As of June 30, 2004, the one-year return was 12.68% as compared to the NCREIF Timber Index of 8.32%. Since its inception, in December of 2001, the Timber portfolio has produced an annualized return of 13.19% versus a benchmark return of 1.37%, an out-performance of 1,182 basis points

Alternative Investments. As of June 30, 2004, alternative investments comprised 5.7% of the PRIT Core's net assets. The portfolio consists of special equities (buy-outs and expansion capital), which represents 73% of the portfolio and venture capital (start-ups and young growth companies), which represents the remaining 27%. After three difficult years for alternative investments, PRIT's alternative investments portfolio delivered both strong realized and unrealized appreciation, generating a one-year return of 24.97%. PRIT's alternative investments managers took advantage of the improved economic environment and healthy capital markets to sell assets generating \$518 million in realized proceeds during fiscal year 2004. While this short-term performance is encouraging, investors should remember that alternative investments are a long-term asset class. The recent short-term performance is a general indicator of the direction of the alternative investments market to date. However, short-term performance is not indicative of long term potential of the asset class.

While there is not currently a widely used or conventional benchmark in this asset class, the PRIM staff has generally targeted, over five to ten year periods, a 300 basis point margin over the S&P 500. Over the long term PRIT's alternative investments portfolio has performed well with a 10-year average annual return of 13.93%, exceeding the S&P 500 index return of 11.83% by 210 basis points. On a five-year basis, the portfolio exceeded the S&P 500 by 901 basis points, 6.81% compared to -2.20%. For the three-year period the alternative investments returned 1.57%, exceeding the S&P 500 index return of -0.70% by 227 basis points. For the fiscal year ended June 30, 2004, the alternative investments portfolio returned 24.97%, outperforming the S&P 500 index return of 19.11% by 586 basis points. Specifically during fiscal year 2004, the special equity portfolio generated a return of 29.40% and the venture capital portfolio returned 15.35%. As there is a one-quarter lag in reporting Alternative Investments portfolio returns, the year-end numbers actually reflect performance for the one-year ended March 31, 2004.

As of today, PRIT has committed over \$5.2 billion to 172 funds managed by 83 general partners, and has establish 47 "key relationships" with general partners in both venture capital and special equity.

Management Costs

Expenses incurred by the PRIM Board in overseeing the management of the PRIT Fund are charged to the PRIT Fund in the form of management fees. These costs include investment management fees, consultant fees, custodian fees as well as the professional fees, salaries and administrative expenses of PRIM.

PRIM employs professional investment managers and provides them discretion, consistent with specified objectives and guidelines, to manage the PRIT Fund's assets. Investment managers operate under formal contracts that delineate their responsibilities and performance expectations. Approximately 87% of PRIM's total budget for fiscal 2004 was allocated to investment management fees. PRIM also employs an outside custodian, investment consultants, and other professional services providers in managing the PRIT Fund. Approximately 9% of PRIM's operating budget for fiscal year 2004 was allocated to fees for these professional services.

The PRIT Fund also incurs indirect management costs as a result of investing in alternative investments, real estate and timber assets. Most investment management fees for alternative investments are charged by managing general partners to investment partnerships and not to the limited partner investors (e.g., PRIM) directly. Therefore, partnerships incur expenses and report income to the limited partners *net* of these fees. The majority of management fees for real estate and timber investments are charged in a similar manner, not to investors directly. Most pension funds do not disclose these indirect management fees as part of their overall costs. PRIM continues to report all investment management fees, including those charged at the partnership level, as part of the cost of managing the Fund.

The total cost of managing the PRIT Fund for fiscal year 2004, *inclusive* of all investment management, consulting, custodial and overhead charges was 42 basis points (0.42%) of the average net asset value of the PRIT Fund compared to 43 basis points in fiscal year 2003. *Excluding* indirect management fees (as most public pension funds report), the cost of managing the Fund was 23 basis points compared to 22 basis points in fiscal year 2003. As the PRIT Fund allocates more assets away from traditional equity and fixed income assets classes to higher fee asset classes such as alternative investments, absolute return, real estate and timber, we anticipate a slight increase in the total cost of managing the Fund in future years.

The PRIM Board

The PRIM Board acts as Trustee for each retirement system that invests in the PRIT Fund and is responsible for the control and management of the Fund. The PRIM Board's members are: the State Treasurer, ex officio, or designee, who serves as Chair of the Board; the Governor, ex officio, or designee; a private citizen experienced in the field of investment or financial management appointed by the State Treasurer; an employee or retiree who is a member of the State Teachers' Retirement System elected by the members of such system; an employee or retiree who is a member of the State Retirement System elected by the members of such system; the elected member of the State Retirement Board; one of the elected members of the Teachers' Retirement Board, chosen by the members of the Teachers' Retirement Board; a person who is not an employee or official of the Commonwealth appointed by the Governor; and a representative of a public safety union appointed by the Governor. The current PRIM Board members are:

Timothy P. Cahill, Chair, Ex Officio Member

State Treasurer & Receiver-General, Commonwealth of Massachusetts

Alexander E. Aikens III, Appointee of the State Treasurer, Private Citizen Experienced in the Field of Investment or Financial Management - Retired, Fleet Bank

Robert Brousseau, Elected Representative, State Teachers' Retirement System
Retired Teacher, Town of Wareham Public School System

Paul Cesan, Appointee of the Governor, Public Safety Union Representative (Sept. 2003)
Treasurer, State Police Association of Massachusetts

Theresa McGoldrick, State Retirement Board Member
President, SEIU/NAGE; Attorney Mass. DOR

George F. McSherry, Teachers' Retirement Board Member
Retired Teacher, City of Brockton Public School System

Peter Schwarzenbach, Designee of the Governor, Ex Officio Member
Chief Administrative Officer, A&F

Gregory White, Appointee of the Governor, Non-State Employee or Official

Ralph White, Elected Representative, State Employees' Retirement System
President, Retired State, County and Municipal Employees Association of Massachusetts

The PRIM Board Staff

The PRIM Board employs a professional staff to manage the day-to-day operations of the Fund and report to the Board. The current PRIM Board staff members are:

PRIM Staff - 2004



Michael Travaglini - Executive Director
Rupert Boyd - Financial Analyst
Eileen Coyne - Staff Accountant
Karen E. Gershman, CPA - COO & CFO
Hannah Gilligan - Investment Analyst,
Public Markets
Ian Haet - Investment Analyst,
Real Estate & Timber
Thomas A. Hanna, CPA - Director of Finance
Gregory Hegerich, CPA - Sr. Financial
Analyst
Cathy Hodges - Accounting Assistant
Jennifer Cole - Financial Analyst
Yisroel "Izzy" Markov, CPA - Manager of
Investment Reporting & System Admin.

Stanley P. Mavromates, Jr. - Deputy CIO,
Senior Investment officer - Public Markets
Zoë Niarchos - Investment Analyst,
Alternative Investments
Amy Prehn - Investment Officer,
Public Markets
Alyssa Profenna - Administrative Assistant
Michael Reardon - Sr. Client Service Officer
Maureen Roche - Executive Assistant
Wayne Smith, CFA - Sr. Investment Officer,
Alternative Investments
George Wilson, CPA - Sr. Investment Officer,
Real Estate & Timber
Grace Yang - Investment Analyst,
Public Markets

Advisory Committees of the PRIM Board

The PRIM Board uses advisory committees to provide expert advice to the Board. Committees include Board members, representatives from participating or purchasing retirement systems, and private citizens from the investment or business community. The current Investment, Real Estate and Administration & Audit Committee members are:

Investment Committee

David J. Grain, Chair
Former Board Member

Ralph White
Board Member

Gregory White
Board Member

Herman Daley
Deutsche Bank

Dr. Jerrold Mitchell
Former CIO, PRIM

Peter A. Brooke
Retired Investment Professional

Glenn P. Strehle
Treasurer MIT (retired)

Real Estate Committee

Alexander E. Aikens III, Co-Chair
Board Member

Ralph White, Co-Chair
Board Member

George McSherry
Board Member

Peter Schwarzenbach
Board Member

Michael Crowley
Crowley & Associates

William F. McCall, Jr.
McCall & Almy, Inc.

Peter O'Connell
Marina Bay Company

Perry Hagenstein
Timber Consultant

Administration & Audit Committee

Robert Brousseau, Chair
Board Member

Paul Cesan
Board Member

Ted C. Alexiades
Town Accountant & Chair, Hingham Retirement Board

Joseph D. Blair
Executive Vice President, Advest, Inc.

Richard P. Foley
Town Accountant, Reading Retirement Board

Robert Foy
Retired, City of Quincy Town Accountant

PRIT Segmentation Program

Chapter 84 of the Acts of 1996, signed into law on May 15, 1996, explicitly confirms retirement boards’ authority to invest in individual asset classes of the PRIT Fund as an alternative to investing in the General Allocation Account. The program, called “*Segmentation*”, gives local retirement boards the flexibility to select specific asset classes in whatever proportions they believe are best suited to their needs. Because of PRIM’s economies of scale, Segmentation provides an affordable means for retirement boards to make diversified investments in traditional and non-traditional asset classes. including: Domestic Equity, International Equity (EAFE), Emerging Markets, Fixed Income, Core Real Estate, and Alternative Investments “Vintage Year” accounts. Current list of Segmented systems:

Asset Class	Retirement System
Core Real Estate	Andover, Belmont, Braintree, Chelsea, Chicopee, Dukes County, Franklin County, Gloucester, Greenfield, Hampden County, Hampshire County, MassPort Authority, Medford, Plymouth, Shrewsbury, Webster & Weymouth
Alternative Investments	Barnstable, Belmont, MassPort, Quincy, Webster, Wellesley
International Equity	Dukes County, Franklin County & Woburn
Fixed Income	Leominster & Winchester
Domestic Equity	Barnstable County

Member State and Municipal Retirement Systems

A public retirement system within the Commonwealth may elect to invest in the PRIT Fund by vote of its board. The board may choose to invest as a *Participating System* or a *Purchasing System*. Participating systems invest all their retirement assets in PRIT for a minimum of five years, and qualify for funds appropriated by the Commonwealth⁵ to reduce the unfunded pension liability. A Purchasing System may invest in the PRIT Core (General Allocation Account) or in one or more of the separate investment accounts of PRIT Core available through “Segmentation”. Currently there are 51 systems invested with PRIM

Participating Systems (18)	Purchasing Systems (33)
<p>Berkshire County, Blue Hills Regional Vocational Technical School, Dedham, Easthampton, Fairhaven, Gardner, Hingham, Milton, Minuteman Technical Vocational High School, Montague, Needham, Northbridge, Reading, Saugus, State Employees, Mass. Teachers, Stoneham & Wakefield</p>	<p>Andover, Barnstable, Belmont, Braintree, Brookline, Chelsea, Chicopee, Concord, Dukes County, Framingham, Franklin County, Gloucester, Greenfield, Hampden County, Hampshire County, Hull, Leominster, Lowell, Marblehead, MassPort, Medford, MWRA, New Bedford, Newburyport, Quincy, Plymouth, Revere, Shrewsbury, Webster, Wellesley, Weymouth, Winchester & Woburn</p>

⁵No such funds were appropriated in FY 2004. M.G.L. Chapter 32, Section 22B requires, in part, that “In each fiscal year, the Governor shall recommend to the general court an appropriation to be set aside in the PRIT Fund to reduce the unfunded pension liability of retirement systems participating in said fund pursuant to section twenty-two”.

Investment Managers

The PRIM Board retains outside managers to invest the PRIT Fund's assets according to the Fund's asset allocation and investment guidelines. Many of the Fund's managers are compensated under various base and/or performance fee agreements. The PRIM Board's current investment managers are:

Domestic, Emerging and International Equity Managers

Ariel Capital Management, Chicago, IL
AXA Rosenberg Investment Management, Orinda, CA
Baillie Gifford, Edinburgh, Scotland
Earnest Partners, Atlanta, GA
Emerging Markets Management, Arlington, VA
Fidelity Management Trust Company, Boston, MA
Grantham, Mayo, Van Otterloo, & Co., LLC, Boston, MA
Lazard Asset Management, New York, NY
Legg Mason Capital Management, Inc., Baltimore, MD
Marathon Asset Management, London, England
Mazama Capital Management, Portland, OR
Numeric Investors, LP, Cambridge, MA
Pareto Partners, London, England
Putnam Investments, Boston, MA
State Street Global Advisors, Boston, MA
The Boston Company, Boston, MA
Wellington Management Company, LLP, Boston, MA

Fixed Income Managers

Angelo Gordon & Co., LP, New York, NY
Ashmore Investment Management, Ltd., London, England
Barclays Global Advisors, San Francisco, CA
Blackrock Financial Management, Inc., New York, NY
Fidelity Management Trust Company, Boston, MA
Grantham, Mayo, Van Otterloo, & Co., LLC, Boston, MA
W.R. Huff Asset Management Co., LLC, Morristown, NJ
Loomis, Sayles & Co., Boston, MA
Oaktree Capital Management, LLC, Los Angeles, CA
Pacific Investment Management Co., Newport Beach, CA (2)
Seix Investment Advisors, Woodcliff Lake, NJ
Shenkman Capital Management, New York, NY
Standish Mellon Asset Management, Boston, MA
TCW Investment Management, Santa Monica, CA

Core and Non-Core Real Estate Managers

INVESCO Realty Advisors, Dallas, TX (Core)
J.P. Morgan Investment Management, New York, NY (Core)
LaSalle Investment Management, Chicago, IL (Core)
RREEF America, LLC, Chicago, IL (Core)
TA Associates Realty, Boston, MA (Core)
AEW Capital Management, LP, Boston, MA
Capital Associates Realty Partners, Chicago, IL
Heitman Capital Management Corp., Chicago, IL
L&B Real Estate Counsel, Dallas, TX

REIT Managers

INVESCO Realty Advisors, Dallas, TX
LaSalle Investment Management, Baltimore, MD
RREEF America, LLC, Chicago, IL
Urdang Advisors, Philadelphia, PA
Wellington, Boston, MA

Timber Managers

The Campbell Group LLC, Portland, OR
Forest Investment Associates, Atlanta GA

Venture Capital and Special Equity Partnerships

Advent International, Boston, MA
Alchemy Partners, London, England
Alta Communications, Boston, MA
APAX Partners & Co., London, England
Apollo Management Co., New York, NY
Austin Ventures, Austin, TX
Battery Ventures, Wellesley, MA
Belmont Capital Partners, Boston, MA
Berkshire Partners, LLC, Boston, MA
The Blackstone Group, New York, NY
Boston Ventures, Boston, MA
Brown Brothers Harriman & Co., New York, NY
Capital Resource Lenders, Boston, MA
Charlesbank Capital Partners, Boston, MA
Charles River Ventures, Waltham, MA
CVC Capital, London, England
Commonwealth Capital Ventures, Wellesley, MA
The Crossroads Group, Hartford, CT
Cypress Merchant Banking Partners, New York, NY
DLJ Merchant Banking Partners, New York, NY
El Dorado Ventures, Menlo Park, CA
Equitable Capital Management Corp., New York, NY
Exponent, London, UK
Essex Woodlands Health Ventures, Chicago, IL

Venture Capital and Special Equity Partnerships (Cont.)

First Reserve Corporation, Greenwich, CT
Flagship Ventures, Cambridge, MA
Forstmann, Little & Co., New York, NY
Freeman Spogli Equity Partners, Los Angeles, CA
Genstar Capital Partners, San Francisco, CA
GTCR Golder, Rauner, Chicago, IL
Harborvest Partners, Boston, MA
Hellman & Friedman Capital Partners, Los Angeles, CA
H.I.G. Capital, Miami, FL
Highland Capital Partners, Boston, MA
InterWest Partners, Menlo Park, CA / Dallas, TX
Joseph Littlejohn & Levy Fund, New York, NY
Kelso & Company, New York, NY
Kohlberg Kravis Roberts and Co., New York, NY
Landmark Equity Partners, Simsbury, CT
Lexington Partners, New York, NY
Madison Dearborn Capital Partners, Chicago, IL
M/C Venture Partners, Boston, MA
Menlo Ventures, Menlo Park, CA
Nautic Partners, Providence, RI
Narragansett Capital Inc., Providence, RI
New Enterprise Associates, Baltimore, MD
Nordic Capital, Stockholm, Sweden
Olympus Growth Fund, Stamford, CT
Onex Capital, Toronto, CAN & New York, NY
Permira, London, England
Polaris Venture Partners, Waltham, MA
Providence Equity Partners, Providence, RI
Quad-C Management, Inc., Charlottesville, VA
Richland Ventures, Nashville, TN
Sovereign Capital Limited, London, England
Spectrum Equity Partners, Boston, MA
Summit Ventures, Boston, MA
TA Associates/Advent, Boston, MA
Texas Pacific Group, San Francisco, CA / Fort Worth, TX
Thoma Cressey Fund, Chicago, IL
Thomas H. Lee Equity Partners, LP, Boston, MA
Trident Capital, Palo Alto, CA
VantagePoint Partners, San Bruno, CA
Venture Capital Fund of New England, Boston, MA
Vestar Capital Partners, New York, NY
Welsh Carson Anderson & Stowe, New York, NY
Weston Presidio Capital, Boston, MA / San Francisco, CA
Whitney & Company, Stamford, CT
William Blair Mezzanine Capital Fund, LP, Chicago, IL
Willis Stein, Chicago, IL

External Advisors

The PRIM Board retains independent professionals to assist in allocating the Fund's assets, monitoring current investments, evaluating new opportunities and operating the Fund. The PRIM Board's current external consultants, auditors and custodian are:

Consultants:

Public Markets

Wilshire Associates, Inc., Santa Monica, CA

Absolute Return

New England Pension Consultants, Boston, MA

Alternative Investments

Pathway Capital Management, Irvine, CA

Real Estate and Timber

The Townsend Group, Cleveland, OH
Morris and Morse Company, Inc., Boston, MA

Independent Auditors:

PRIT Fund and PRIM Board

KPMG LLP, Boston, MA

Real Estate and Timber Portfolios

Deloitte & Touche LLP, Chicago, IL

Custodian:

Mellon Trust, Everett, MA

Legal Counsel

Goodwin Procter LLC, Boston, MA
Mintz, Levin, Cohn, Ferris, Glovsky & Popeo, P.C.,
Boston, MA

Chapter 32, Section 22(8) of the Massachusetts General Laws establishes the PRIT Fund. The Fund is administered by the PRIM Board, which is established under Chapter 32, Section 23(2A) of the Massachusetts General Laws. The Board oversees the Fund under the terms of its operating trust, as most recently amended on September 22, 1998. The PRIM Board is an authority of the Commonwealth of Massachusetts. Its offices are located in Boston, Massachusetts.

All correspondence may be directed to:

B. Michael Reardon

Senior Client Service Officer

Pension Reserves Investment Management Board

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Website: <http://www.mapension.com>