



# The SWIB Report

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## Allocation key to performance

Asset allocation is an important part of the investment process. Each year, the Board of Trustees reviews how the assets of the retirement funds are allocated among stocks, bonds, real estate and other types of investments and establish the policy for the next year.

The asset allocation plays an important role in helping to earn an 8% average annual rate of return or better over the long term. Studies have shown that asset allocation accounts for 80% to 90% of the ultimate performance of the funds. Selection of individual securities within each asset class accounts for the rest.

With the help of outside experts, SWIB reviewed the trust fund allocations earlier this year and has made some changes. These changes should help with the challenges we are expecting to face in 2003 to continue to meet our long-term investment goals.

The changes are found in the Fixed Fund. SWIB increased the allocation to

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### Annualized Performance Ending 12/31/02

Retirement Funds	1-Year Return	5-Year Return	10-Year Return
<b>Fixed Fund</b>	<b>-8.8%</b>	<b>3.2%</b>	<b>8.3%</b>
<i>Benchmark</i>	-7.7	2.7	7.7
<b>Variable Fund</b>	<b>-21.9%</b>	<b>0.0%</b>	<b>7.9%</b>
<i>Equity Benchmark</i>	-19.9	-1.6	7.3
<i>S&amp;P 500</i>	-22.1	-0.6	9.3

## Fixed Fund Returns -8.8%; No Cut for Fixed Pension

The State of Wisconsin Investment Board (SWIB) reported a -8.8% return for the Fixed Retirement Fund in 2002. "It has been a very difficult market, but the good news is that annuitants will not see a reduction in their Fixed Fund benefits," said Executive Director Patricia Lipton.

The Fixed (or balanced) Fund is the larger of the two trust funds of the Wisconsin Retirement System (WRS). It has diversified holdings in domestic and international stocks, bonds, loans, real estate and private equity. The market value of the Fixed Fund on December 31, 2002, was \$46.2 billion.

The Fixed Fund return beat the -10.7% return for the Lipper Index of Balanced Mutual Funds, but was behind SWIB's one-year benchmark of -7.7%. The Fixed Fund's five-year annual average return of 3.2% and ten-year annual average return of 8.3% are ahead of their performance benchmarks. The ten-year return is also ahead of the 8.0%

average annual return needed to meet pension obligations to current and future retirees over the long term.

The Variable Fund, an all-stock fund, returned -21.9% for the year, behind its benchmark of -19.9% but surpassed the S&P 500 return of -22.1%. The Fund's five-year annual average return, which shows no gain or loss, remains ahead of its benchmark. The ten-year annual average return of 7.9% was also ahead of its benchmark. The preliminary market value of the Variable Fund was \$4.7 billion on December 31.

"It was the worst December experienced by the Dow Jones Industrial Index in 70 years and the first time since 1939 through 1941 that we have seen three consecutive down markets," Lipton said.

Investment returns include changes in market value as well as

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# Q&A: Can SWIB returns be posted at the month's end ?

*A. SWIB updates performance numbers each month for the Fixed and Variable Trust Funds on the website at [www.swib.state.wi.us](http://www.swib.state.wi.us).*

*Performance numbers for the calendar year are what affects retirement system participants. These numbers are used to determine the credit that actively employed members receive in their pension accounts as well as changes in annuitants' benefits each year. However, we post monthly updates to give participants an indication of the performance trend as the year progresses.*

*Mutual funds determine performance each day to set their share price, since investors buy into and sell out of their funds daily. The WRS does not need to incur the extra expense of daily pricing.*

*The performance of the Fixed and Variable Funds are determined by the returns of many individual investments. Stocks and other investments traded on public markets are priced daily. However, performance figures for privately traded investments—such as business loans, real estate and private equity—are typically not available until two or three weeks after the end of the month. To avoid confusion, SWIB generally waits until final calculations are made on all investments before updating the monthly performance.*

*Performance information is updated quarterly in The SWIB Report. Our annual financial report provides annual performance information at the end of the fiscal year. These documents are available on our website or by request.*

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interest and dividend income. Investment returns differ from rates credited to WRS member accounts and adjustments to monthly annuities for retirees. The Department of Employee Trust Funds determines these percentages.

SWIB's international stocks outperformed their benchmark. The developed international stock portfolios returned -12.3% compared to -15.8% for the Morgan Stanley Capital International (MSCI) World (excluding US) Index that represents stocks in 22 developed foreign markets. SWIB's domestic stock portfolios returned -23.2% compared to the -21.5% for the

Russell 3000, a broad market indicator that represents about 98% of the US stock market.

SWIB's global and emerging market bond portfolios gave a strong performance and returned 19.4%, beating their combined benchmark of 18.8%. The domestic fixed income holdings saw a 7.2% aggregate return versus 10.5% for the benchmark.

The real estate portfolio return at 8.3% was ahead of the 5.6% return for its benchmark. Alternative Investments returned 2.8%, beating a -7.3% return for the benchmark.

The WRS is the 10th largest US public pension fund and 19th largest public or private pension fund in the world.

## Asset Targets

	2002	2003
<u>Fixed Trust Fund</u>		
Domestic Stocks	39%	40%
Fixed Income	34%	31%
International Stocks	18%	19%
Real Estate	4%	4%
Alternative Investments	5%	6%
<u>Variable Trust Fund</u>		
Domestic Stocks	80%	80%
International Stocks	20%	20%

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Alternative Investments from 5% to 6% of the \$46.3 billion in the Fixed Fund. Alternative investments include direct public equity deals, leveraged buyouts and venture capital.

SWIB has also increased the allocation to international stocks by 1%. Based on historical returns, international markets are overdue for a rebound. As a part of this strategy, we are considering increased investments in emerging markets as opposed to established markets, such as most European countries.

Research indicates that it is not practical for public pension funds to try and time the markets. The long-term nature of pension fund obligations helps the WRS weather difficult markets.

## What Is A Benchmark?

A benchmark is a standard that is used to measure the investment return on a portfolio. It is determined by the objectives of the portfolio and the types of investments that can be made. A benchmark is either an appropriate index for the asset class, such as the Russell 3000, or a peer group average.

To evaluate the performance of an investment manager, the actual return of the portfolio is compared to the return on the investment benchmark. Benchmarks are set by the Board of Trustees after a review by an outside expert.