



The SWIB Report

Published by The State of Wisconsin Investment Board For WRS Participants

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About SWIB

The State of Wisconsin Investment Board (SWIB) is the state agency responsible for investing the Wisconsin Retirement System assets.

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2004 Board Meetings

Meetings are held at the SWIB office, 121 E. Wilson St., second floor. Dates are:

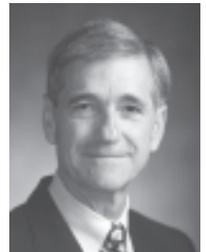
May 12 October 13
June 9 November 10
August 11 December 8
September 8

Decisions made in Fund's interest

By Dave Mills
SWIB Executive Director

Since joining the Investment Board staff as Executive Director last December, I have been impressed by the wide range of responsibilities that are involved in managing some \$65 billion in assets for the Wisconsin Retirement System (WRS). All of this work for the WRS

is driven by a single goal. That is, to make every investment based on our judgment of what is in the long term best interest of the members of the System.



Dave Mills

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SWIB returns among best in 20 years

Annualized Performance Ending 12/31/03

Retirement Funds	1-Year Return	5-Year Return	10-Year Return
Fixed Fund	24.2%	4.9%	9.1%
<i>Benchmark</i>	22.9	4.0	8.7
Variable Fund	32.7%	2.4%	9.4%
<i>Benchmark</i>	32.1	0.7	8.8
<i>S&P 500</i>	28.7	-0.6	11.1

A surge in the stock market – especially small company stocks – in 2003 helped push the State of Wisconsin Investment Board (SWIB) to a 24.2% return for the Fixed Retirement Fund, the second highest fund return in 20 years.

The Fixed Fund, the larger of the two trust funds of the Wisconsin Retirement System (WRS), has diversified holdings in domestic and international stocks, bonds, real estate and private equity. Market value of the Fixed Fund on December 31, 2003, was \$56.8 billion. The ten-year return is ahead of the 7.8% 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 32.7% for the year, matching its highest return in 20 years. The Variable Fund topped its one-year benchmark of 32.1% and the S&P 500 return of 28.7%. Market value of the Fund on December 31, 2003, was \$5.9 billion. Portfolio highlights for both funds were as follows:

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Calendar year-to-date Preliminary Returns

As of 3/31/04

Fixed Fund ----- 3.0%
Variable Fund ---- 2.8%

Trust Funds Investment Strategy

Fixed Fund

The Fixed Fund is the largest of the two trust funds that make up the Wisconsin Retirement System (WRS). All participants have at least 50% of their initial deposits in the Fixed Fund.

Investment Goals: The basic investment objective is to earn an average 7.8% annual return over the long term, which is 3.7% above the expected average increase of wages. The 7.8% return is the assumption recommended by the WRS actuary and set by the ETF Boards to ensure sufficient funding for current and projected benefits to participants. The ten-year annualized return as of December 31, 2003, was 9.1%.

A second goal is to exceed the benchmark established by the Board of Trustees. The benchmark measures SWIB's performance against the markets. The Fixed Fund benchmark is mainly a composite of several industry indices rolled up and weighted to reflect the Board's asset allocation decisions.

Investment Strategy: In keeping with the extended time horizon of the Fund's obligations to provide pensions for all participants, this fully diversified, balanced fund seeks long-term growth. Market trends and asset allocation are reviewed annually.

Investment Guidelines: Guidelines are established for each asset class by the Trustees. State law permits investments in stock, bonds, loans, securities, real estate and other investments not specifically prohibited by law.

Variable Fund

About 9% of the WRS assets are managed in the Variable Fund. Participants who choose the Variable Fund can place half of future pension fund contributions in this Fund. Participants in the Variable Fund option also accept a greater degree of risk, in part, because it is a stock fund, for the potential of greater long-term returns.

Investment Goal: The investment objective is to achieve returns that equal or exceed that of similar equity portfolios over a full market cycle. The Standard & Poor's Index of 500 stocks, which features large company stocks, is also used as a performance measure, however, about 53% of the Fixed Fund is diversified into smaller growth stocks and international markets not represented in the S&P 500.

Investment Strategy: Assets are in equities only with 80% in domestic stocks and 20% in international stocks. Investments are well diversified across large, mid-size and small capitalization companies in the US and by region internationally. The stocks are the same as in the Fixed Fund.

Investment Guidelines: According to Wisconsin Statutes, the "assets of the Variable Fund shall be invested primarily in equity securities, which shall include common stocks, real estate or other recognized forms of equities...". The fund may temporarily invest in other types of securities because of market conditions.

Stock Exposure

WRS participants who remain only in the Fixed Fund have about 59% of their current pension contributions invested in stocks. Stock exposure for those who participate in the Variable Fund will depend on the amount of the individual account and the length of time in the WRS and in the Variable Fund. Participants who decide to divide their current pension contributions between Fixed and Variable Funds have a stock exposure of about 80%. This proportion changes as stock values change in the market place relative to other types of investments. (These comments reflect only individual participant account balances; defined benefit calculations are not directly affected by these asset allocations except through participation in the Variable Fund.)

2004 Fixed Fund Asset Target Changes

Assets	2003 Target	2004 Target
US Stocks	40%	Decreased to 39%
International Stocks	19%	Increased to 20%
Fixed Income	31%	Remains at 31%
Real Estate	4%	Remains at 4%
Alternatives	6%	Remains at 6%

Fixed and Variable average annual returns for 20 years are equal

Over the long term, stocks have outperformed most other types of investments and as a result, Variable Fund returns exceeded Fixed Fund returns. However, for the 20-year period ending December 31, 2003, the average annual returns of the two funds are even at 11.1%. Market volatility has been extraordinary in recent years. Exceptionally strong returns of the 1990s were unprecedented, then were followed by a three-year stock-market decline for the first time since 1939 - 1941.

2003 portfolio performance highlights

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- SWIB's domestic stocks returned 31.7% exceeding a return of 31.1% for the Russell 3000, a broad market indicator for US stocks.
- SWIB's internally managed small company stock portfolio had an exceptional performance returning 89.9% compared to a 47.3% for the Russell 2000, a leading indicator for the small company market sector.
- SWIB's internally managed international portfolio earned 39.3% versus 39.4% for the benchmark.
- Two investment initiatives, emerging markets equities and multi-assets portfolio, performed well with returns of 37.6% against a benchmark of 34.6%, and 31.3% versus 25.2% respectively.
- Global bonds returned 15.8% against a benchmark of 14.9% and fixed income emerging markets returned 25.8%, beating its benchmark of 22.2%. US investment grade fixed income holdings saw a 6.1% total return versus 4.7% for the benchmark.
- SWIB's internally managed real estate portfolio returned 10.2% versus 7.8% for the benchmark.

Portfolios in the WRS Trust Funds

Domestic Stocks primarily consist of common stock in US companies. Holdings are diversified among small-, medium- and large-sized companies.

International Stocks are limited to countries rated "free" or "partly free" by the Freedom House Index.

Fixed Income

- *Public Bonds* include US government bonds and corporate bonds purchased in public markets.
- *Private debt* includes direct, long-term loans to Wisconsin companies.
- *Global bonds* include US or foreign bonds meeting minimum credit quality requirements.
- *Real estate mortgages* consist of private commercial mortgages in partnership with Northwestern Mutual Life.

Real Estate includes commercial real estate with SWIB as a sole direct owner, or in joint ventures and partnerships.

Alternative Investments are private equity investments, which include leveraged buyouts and venture capital. These investments carry greater risk, but offer the prospect of greater return.

Cash (temporary balances awaiting permanent investment) is invested in short-term and intermediate-term investments.

What will 2004 bring?

Last year returns for the Fixed and Variable Funds were exceptional. Positive indicators for 2004 include continued economic expansion and strong global growth. But there are also other concerns for the markets, including a growth in the budget deficit and increased risk of inflation and higher interest rates, and the ever present risk of global terrorist activities. Even with a solid return in 2004, it is possible that retirees may see no increase in their Fixed Fund annuity in 2005 based on three previous years of negative returns still working through the System.

Investment Returns		
Year	Fixed Fund	Variable Fund
2003	24.2%	32.7%
2002	-8.8%	-21.9%
2001	-2.3%	-8.3%
2000	-0.8%	-7.2%
1999	15.7%	27.8%
1998	14.6%	17.5%
1997	17.2%	21.6%
1996	14.4%	19.8%
1995	23.1%	25.6%
1994	-0.6%	0.8%
1993	15.0%	16.5%
1992	9.7%	10.7%
1991	20.4%	27.1%
1990	-1.5%	-11.3%
1989	19.2%	22.6%
1988	14.4%	21.7%
1987	2.2%	-1.1%
1986	14.5%	11.5%
1985	27.5%	32.7%
1984	12.8%	5.8%

Whitefish Bay attorney named to SWIB Board

Stephen E. Bablitch, former chairman of the Board and CEO of Cobalt Corporation, has been named by the Governor to the SWIB Board of Trustees.



Stephen Bablitch

He also served as Secretary of the Department of Corrections and was an attorney in private practice as well as the Dane County District Attorney's office. He is a graduate of the University of Wisconsin-Madison and its Law School.

Dave Mills: Focus remains on duty to participants

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In 2003, SWIB earned \$562 million in added value for the WRS by beating performance benchmarks. Staff must weigh potential risks and rewards for a great many investment decisions each day. In making those decisions the SWIB staff is guided by both professional knowledge and their duty to the more than 500,000 members of the WRS. This is only part of the work that goes into creating a strong investment program.

■ **Good organizational governance** is essential to strong financial performance. Many of our Trustees are relatively new to the Board. This is an opportune time for all the Trustees to consider how they are organized as a Board, their oversight role, and the division of responsibilities between Trustees and staff. A review of these topics is underway.

■ **Good planning discipline** is necessary to ensure that SWIB's investment program meets the long-term needs of the WRS as well as providing for those now receiving annuities. Staff and Trustees will be

reviewing the annual process SWIB currently uses to allocate WRS assets among stocks, bonds and other types of investments. We want to ensure that this process is as effective as possible.

■ **Effective partner/supplier relationships** are essential to our success. When selecting outside providers and services we closely review costs, value, and benefit to the System. In light of a number of troubling issues that have emerged in the financial services industry, we have reconfirmed that our key outside managers and consultants have strong ethical practices in place. We are also currently reviewing our contracting processes to determine if some could be strengthened.

To compete in a constantly changing investment world, SWIB must routinely question previous assumptions, examine new ideas and refocus strategic goals. However, one aspect never changes. We remain keenly aware that we must take every action solely in the interests of the members of the trust fund.

Performance compares well to public funds

Public pension funds measure performance in different ways. One common way is to compare the rate of return against an investment standard, or benchmark. (See page 1.) Another way SWIB reviews its performance is to compare its investment returns to other large pension funds. As of December 31, 2003, the Fixed Fund ranked third for one-year returns, first for five-year and eighth for ten-year returns compared to nine other large public

December 31, 2003 Gross Return Comparison

Fund	One-year	Rank	Five-year	Rank	Ten-year	Rank
SWIB (Fixed Trust Fund)	24.2%	3	4.9%	1	9.1%	8
New Jersey Division of Inv. Virginia*	21.2	9	2.6	10	9.3	5
Florida Retirement System	24.3	2	4.6	4	9.6	2
New York State Teachers*	23.4	4	3.4	7	9.4	4
Minnesota Combined *	22.8	8	2.9	9	9.7	1
California Public Employees	23.3	7	3.0	8	8.9	10
Pennsylvania Public Schools	23.3	6	3.8	5	9.1	9
Texas Teachers	25.3	1	4.6	3	9.3	7
Washington State Inv Board*	23.3	5	3.5	6	9.4	3
	19.8	10	4.7	2	9.3	6

**Returns for Minnesota, New York, Virginia, and Washington are net of fees.*

The chart above shows SWIB's investment performance compared to nine other large pension funds surveyed by the Legislative Audit Bureau in 2000. Returns are not adjusted for risk.

pension funds surveyed by the Legislative Audit Bureau for performance evaluation in the past. The Fixed Fund's five-year return ranked second on a risk adjusted basis. While returns varied significantly for the one- and five-year periods, the ten-year variance was less than 1%. Another survey conducted by the Trust Universe Comparison Service ranks the Fixed Fund one-year return in the top third and five- and ten-year returns above the median of about 40 other public pension funds with assets over \$1 billion. TUCS returns are not on a risk-adjusted basis.