The
SWIB Report
Published by the State of Wisconsin Investment Board for WRS participants

May 2006

Fixed Fund name changed

The name of the Fixed Fund has changed to Core Fund in this issue. The change is a result of a law passed in March renaming the fund.

Need Information?

Want to know more about SWIB and the investments of the retirement trust funds? Please visit our website, which includes monthly performance updates, newsletters and other helpful publications. Or, you can contact us to receive our informational brochure or sign up to receive a copy of our newsletter by mail. **For more information, contact SWIB at:**

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2006 Board Meetings

June 14
No meeting in July
August 9 (tentative)
September 13
October 18/19 (offsite location)
November 8
December 13

Agendas are posted on our website. Dates may change.

First quarter performance positive; Economic slowdown is possible

Calendar year-to-date Preliminary Returns As of 3/31/06
Core (Fixed) Fund .. 4.8%
Variable Fund..........6.1%

Stocks showed some volatility in the first quarter of 2006 with an upward trend in the US market helped by small company stocks. Market observers are optimistic that the markets will produce positive returns for 2006. However, there are concerns about an economic slowdown due to rising interest rates. Other factors include a slowing in consumer spending and a cooling down of the housing market.

Returns for bonds in the first quarter were flat with the outlook for the rest of the year to be the same or slightly positive. Major indices for US bond markets were flat or slightly negative for the first quarter while emerging market bonds were up slightly. Many believe that the Federal Reserve will continue to increase the Federal Funds rate; bond yields will move higher; and the dollar will be weaker relative to other currencies.

According to the Department of Employee Trust Funds, if the investment return for 2006 is above -2.8% for the Core (Fixed) Fund, annuitants are likely to see a dividend in 2007.

SWIB seeks corporate responsibility

While many executives receive fair pay for the difficult jobs set before them, there has been rising concern over extraordinary pay and benefits for some corporate heads, particularly when not tied to improved shareholder value. This is one of the top issues being addressed by SWIB and other institutional investors as part of corporate governance activities.

SWIB acts as shareholder on behalf of WRS participants through its corporate governance program. The primary focus of the program is to work with directors and management to improve company performance.

SWIB's emphasis for 2006 is to continue efforts to make boards more accountable in certain areas, including executive compensation and using a majority vote standard to elect board members.

SWIB supports compensation aligned with performance measured against a meaningful benchmark. SWIB submitted a letter to the Securities and Exchange Commission in support of its new proposal requiring companies to disclose a compensation committee's discussion and process

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Core (Fixed) versus Variable

Overview

The Wisconsin Retirement System is comprised of two funds.

The Core (Fixed) Fund is the largest of the two trust funds. It includes a mixture of holdings. All participants have at least 50% of their initial deposits in this fund. Core Fund returns are smoothed over five years, lessening the impact of market volatility.

The smaller of the two trust funds is the Variable Fund. By law, the Variable Fund is a stock fund. The returns of the Variable Fund are not smoothed and, therefore, fully reflect market changes. Participants in the Variable Fund are exposed to a higher degree of risk because of possible losses from unfavorable stock market performance in exchange for the potential of greater long-run returns.

The WRS is the only public pension system that has an option such as the Variable Fund. About 20% of WRS participants and 9% of the WRS assets are in this fund.

Participants who choose the Variable Fund have half of annual pension fund contributions in this fund. (Election to participate or cancel participation in the Variable Fund must be done through the Department of Employee Trust Funds.)

Investment Objectives

The basic objective of the Core Fund is to earn an optimum net rate of return while taking an acceptable level of risk. SWIB strives to earn at least an average 7.8% annual return over the long term. Contributions from public employers and employees can be reduced when investment earnings are higher than the assumed rate of return. The ten-year annualized return as of December 31, 2005, 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 Core Fund benchmark is mainly a composite of several market indexes, such as the Russell 3000, rolled up and weighted to reflect the Board's asset allocation.

By way of comparison, the investment objective for the Variable Fund is to achieve returns that equal or exceed that of similar stock portfolios over a market cycle.

Types of Investments

Diversification is an important strategy for investing the pension system funds. The Core (Fixed) Fund is invested in stocks, bonds, business loans, real estate and private equity. In addition, diversity comes from company size and from investments in the US and other countries.

While the Variable Fund includes only stocks, it is also diversified among countries and by company size. The stocks in the Variable Fund are the same as the Core Fund.

The Board of Trustees regularly reviews the asset allocation to consider adjustments and new initiatives.

Public Equities (Stocks)

Domestic stocks: primarily common stock in US companies diversified among small-, medium- and large-sized companies.

International stocks: primarily common stock in foreign companies in developed countries.

Emerging market equities: stocks in developing countries as defined by the World Bank.

Public Fixed Income (Bonds)

Public bonds: US government and corporate bonds purchased in public markets meeting minimum credit quality requirements.

Global bonds: Developed country bonds meeting minimum credit quality requirements.

Emerging markets: Fixed income securities in developing markets as defined by the World Bank.

Private Markets

Real estate: commercial real estate investments with SWIB as a sole direct owner, or in joint ventures and partnerships with outside managers and diversified by location and property types.

Private equity/debt: includes leveraged buyouts and venture capital and direct, long-term loans to Wisconsin companies. Investments may carry greater risk, but offer the prospect of greater return.

2006 Core Fund Asset Targets

Domestic Stocks	36%
International Stocks	22%
Fixed Income	30%
Real Estate	5%
Private Equity/Debt	5%
Multi-Asset	2%

SWIB's performance adds value

At the end of 2005, the return for the Core Fund, a diversified fund, was 8.6% and the return for the Variable Fund, an all-stock fund, was 8.3%.

The Core Fund return beat its one-year benchmark of 7.9% and the Lipper Index of Balanced Mutual Funds return of 5.2% in 2005. This is the third consecutive year the Core Fund has beaten its benchmark. The Variable Fund surpassed its benchmark of 8.0%. (See chart for below for five- and ten-year performance.)

By beating benchmarks, SWIB added about $432 million in returns in 2005. More than $2.7 billion in excess value has been added over the past five years.

Much of the added value from last year was a result of investments in private markets (which include real estate and private equities) and emerging markets. The return for real estate was 28.2% against a benchmark of 19.2%. The return for private equity was 44.2% against a benchmark of 30.4%.

Annualized Returns
Ending 12/31/05

	1-Year	5-Year	10-Year
Core (Fixed) Fund	**8.6%**	**6.3%**	**9.1%**
Benchmark	7.9	5.3	8.3
Variable Fund	**8.3%**	**3.0%**	**9.0%**
Benchmark	8.0	2.5	8.0

Annual Investment Returns

Year	Core Fund	Variable Fund
2005	8.6%	8.3%
2004	12.8%	12.7%
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%
20-year Average Annual Return	10.2%	10.3%

Responsibility continued from page 1

for determining CEO compensation levels, plan components and related performance measurements. This information will help shareholders better understand the logic behind compensation plans and how those plans relate to performance.

Specifically, we want companies to provide compensation that is not excessive. The only action that can be taken when a plan is excessive is to withhold a vote for a compensation committee director.

Majority voting is also a major concern. SWIB seeks to have a one share, one vote process for electing directors to the corporate board. As it stands now, SWIB can vote for or withhold its vote for a director. Current laws make it fairly easy for an uncontested director to be elected even with a majority of withhold votes.

In response to investor concerns, more companies are looking closely at the majority vote issue.

Other issues that we are looking at as a part of the program include:

- Holding directors accountable for long-term performance.
- Seeking electronic access to more proxy information.
- Establishing better ways for shareholders to communicate with directors.

2005 Proxy Voting Trends

To fulfill our responsibility to participants, we must vote our proxies. In 2005, SWIB cast 16,000 votes — 50% more than the previous year — with the help of our proxy service. It is the main focus of our corporate governance program. This includes discussing proxies with company management.

In 2005, SWIB supported management on more issues, a trend that indicates companies are working to address shareholder concerns. Other trends were:

- More items on the ballot,
- Over half were director related,
- Executive compensation and director issues most common.

Q & A

Q. What is SWIB doing to prepare for the expected increase in the number of retirees?

A. The number of retirees in the WRS is expected to more than double over the next 20 years. The pension system is designed to ensure that funds are available to provide benefits to both current and future retirees. SWIB must make investment decisions based on these objectives. SWIB's investment earnings play a significant role, funding between 80 to 85% of the cost of retirement benefits for the WRS. Employer and employee contributions make up the remaining amount.

SWIB's asset allocation and expected rate of return are reviewed annually. When making recommendations for future contribution rates, the WRS actuary assumes that the asset allocation for the Core (Fixed) Fund will earn an average 7.8% return over the long term. This is 3.7% more than the assumed 4.1% annual wage growth.

In 2005, Gabriel, Roeder, Smith & Company (GRS) — the WRS actuary — updated its 50-year financial projection for the pension fund. GRS said that the WRS is one of the best funded pension funds in the country. That takes into account the projected significant increase in future benefit payments due to the expected increase in participants who will retire. Net cash flow for the system (contributions + investment income - benefit payments) has declined in recent years and is now slightly negative. The reduced cash inflow was anticipated and, in fact, is on target with long-term actuarial projections for a mature retirement system, such as the WRS. The increase in benefit payments should not require changes in basic investment strategy for many years.

Performance compared to peers

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 chart on page 3.) The Legislative Audit Bureau (LAB) also compares SWIB's performance to nine other public pension funds listed below.

As of December 31, 2005, the Core (Fixed) Fund's five-year return ranked second on a risk adjusted basis. This approach considers the plan's tolerance for year-to-year fluctuations (volatility) in returns.

With no adjustment for risk, the Core Fund ranked sixth in a comparison of one-year gross returns, third for five-year and fifth for ten-year returns compared to nine other large public pension funds surveyed in the past by the LAB for performance evaluation.

Another survey conducted by the Trust Universe Comparison Service (TUCS) ranks the Core Fund's one-year return in the top 40%. The five-and ten-year returns were ranked in the top 25% of about 50 other public pension funds with assets over $1 billion. TUCS returns are not reported on a risk-adjusted basis.

Annualized Return versus Risk Adjusted Return

December 31, 2005

Fund	5-year	Rank risk adjusted	Rank not risk adjusted
SWIB Core (Fixed) Trust Fund	6.3%	2	3
Washington State Investment Board*	6.3%	1	2
Pennsylvania Public Schools	6.7%	3	1
California Public Employees	5.8%	4	4
Virginia Retirement System*	5.2%	5	5
Texas Teachers Retirement System	5.0%	6	6
Minnesota State Board of Investments*	4.9%	7	7
New York State Teachers*	4.6%	8	8
Florida Retirement System	4.5%	9	9
New Jersey Division of Investments	3.3%	10	10

*Returns reported net of fees

The chart above shows SWIB's investment performance compared to nine other large pension funds. The risk-adjusted rank is based the plan's tolerance for year-to-year volitility. The return rank is based on annualized returns. Liabilities and investment objectives vary from fund to fund and may contribute to differing performance results.