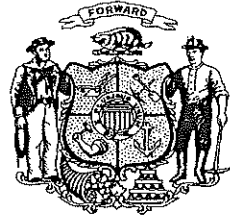


STATE OF WISCONSIN

SENATE CHAIR
Howard Marklein

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Madison, WI 53707-7882
Phone: (608) 266-0703



ASSEMBLY CHAIR
Mark Born

308 East, State Capitol
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JOINT COMMITTEE ON FINANCE

MEMORANDUM

To: Members
Joint Committee on Finance

From: Senator Howard Marklein
Representative Mark Born

Date: April 1, 2024

Re: SWIB Report to JFC

Attached is a report on goals, strategies and performance from the State of Wisconsin Investment Board, pursuant to s. 25.17(14m), Stats.

This report is being provided for your information only. No action by the Committee is required. Please feel free to contact us if you have any questions.

Attachments

HM:MB:jm



IB STATE OF WISCONSIN
INVESTMENT BOARD

APR 01 2024

St. Finance

2024

Goals, Strategies & Performance Report

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Our Mission

To be a trusted and skilled global investment organization contributing to a strong financial future for the beneficiaries of the funds entrusted to us.

Our Vision

SWIB will be an innovative, agile, integrated organization that optimizes investment returns while managing risk and cost over the long term.

Our Values

Values are the fundamental beliefs of our organization. They are guiding principles that explain our desired behaviors in the workplace and ensure we are on the right path. We believe in these values and will uphold them.

People - We believe people are the core of SWIB's mission. We value our people beyond their work, and encourage intellectual curiosity, transparency, candor, and respect. We're passionate about recruiting, developing, and retaining our talent. We respect, appreciate, and accept all SWIB employees and are committed to cultivating and preserving a diverse and inclusive workplace.

Excellence - We strive to exceed expectations and take pride in the quality of our work. We are motivated to continually improve and expand our viewpoints. We are results focused and process driven.

Integrity - We hold ourselves to the highest ethical standards in meeting our fiduciary duty. We maintain our internal and external relationships on a solid foundation of trust, dependability, accountability, and openness.

Innovation - We believe innovation is critical to SWIB's success and requires each person to have a genuine interest in creativity, prudently embrace change, and challenge the norm.

Collaboration - We operate as one team, seeking ways to contribute our individual talents toward achieving our shared mission. We value diverse ideas and recognize that thoughtful collaboration requires commitment, openness, preparation, and hard work.

Financial Performance

Just when it looked like many of the same issues that investors faced in 2022 would hold down returns, 2023 finished strong. Like 2022, 2023 was another tumultuous period marked by geopolitical uncertainties and the Federal Reserve's continued efforts to control the highest inflation in decades through aggressive interest rate hikes. The financial markets experienced significant volatility with a challenging landscape for generating positive returns. Unlike 2022, the end of the year saw a confluence of favorable market developments, including a downward trend in inflation, continued strong economic growth, and signals from the Federal Reserve that further interest rate hikes are unlikely.



Despite the challenges of the past year, the State of Wisconsin Investment Board (SWIB) remained committed to its long-term investment strategy that aims to keep annuity adjustments and contribution rates stable and meet the benefits promised to over 677,000 Wisconsin Retirement System (WRS) participants. Strong absolute investment returns in four of the past five years means positive annuity adjustment for beneficiaries in 2024 and continued stable employer and employee contribution rates for 2025.

I am very proud of the work that SWIB staff does on behalf of the WRS participants. The WRS continues to be a model pension system. A recently published report on public sector retirement systems by the Pew Charitable Trust found that Wisconsin has demonstrated that fiscal discipline and sound policy together can help states keep pension promises by maintaining full funding and stable costs. As we build on our past success and look to the future, we remain focused on our goals to increase active return through improved investment strategies, optimize our operations and technology infrastructure, and enhance our talent acquisition, retention, and management. Our work toward achieving these goals will keep the WRS well-positioned to confront whatever challenges may be in store for investors in the year ahead.

A handwritten signature in cursive script that reads "Edwin Denson".

Edwin Denson
Executive Director/Chief Investment Officer

About SWIB

SWIB is a trusted and skilled investment organization contributing to the strong financial future of the beneficiaries of the funds entrusted to it. An independent state agency governed by Chapter 25 of state statutes, SWIB is responsible for managing the assets of the fully funded Wisconsin Retirement System (WRS), the State Investment Fund (SIF), and other separately managed funds. The SIF is a pool of invested cash balances of the WRS and various state and local government units. Other funds managed by SWIB include the State Life Insurance Fund, Historical Society Trust Fund, Injured Patients and Families Compensation Fund, and University of Wisconsin System Trust Funds.

As of Dec. 31, 2023, SWIB managed more than \$155 billion in net assets. The Core Fund, the larger of the two WRS trust funds, had net assets of more than \$122 billion, and the Variable Fund, an optional stock-only fund, ended 2023 with net assets of over \$9 billion. The WRS consistently ranks among the 10 largest public pension funds in the U.S. More than 677,000 current and former state and local government employees and their families count on the WRS for some portion of their retirement security.

SWIB and its governing body, the Board of Trustees, have a fiduciary responsibility to invest this money in the best interest of the trust funds as a prudent expert. To help it meet this responsibility, SWIB needs to attract and retain qualified investment professionals and to invest in its technology and systems. Over the years, the Legislature has helped ensure that SWIB can meet its fiduciary duty by providing SWIB flexibility, independence, and authority that are different from those of other state agencies, including investment, budget, position, and compensation setting authority.

SWIB's budget differs from that of other state agencies. SWIB receives no direct general purpose revenues from the state. All costs to manage assets in the trust funds are paid from those trust funds. 2011 Wisconsin Act 32 gave SWIB's independent Board of Trustees the authority to establish SWIB's operating budget and staffing level. This law change has given SWIB the flexibility to adapt to swiftly changing market conditions while increasing its internal management of assets in a cost-effective manner. Since SWIB's inception in 1951, forward-thinking state legislators and governors have given SWIB the tools to allow the agency to evolve into the premier money manager it is today.

Annually, SWIB is required to report its long-term strategies, investment goals, and the status of goals and investment performance for the previous year. This report is submitted to the Legislature pursuant to section 25.17(14m) of the Wisconsin State Statutes. More information about SWIB and the funds it manages can be found at swib.state.wi.us.

Management



Edwin Denson
Executive Director/
Chief Investment Officer



Rochelle Klaskin
Deputy Executive Director/
Chief Operating Officer



Todd Mattina
Head Economist,
Asset & Risk
Allocation Chief
Investment Officer



Anne-Marie Fink
Private Markets &
Funds Alpha Chief
Investment Officer



Head of Multi-Asset
Strategies



Head of Fixed Income
Strategies

Performance

2023 performance was volatile. Through the first half of the year, returns were attractive, with the Core Fund up 6.5% through June. Then came the four-month period from the end of June to the end of October, when interest rates rose significantly, and asset returns reacted downward. At the end of October, the Core Fund return had significantly declined to just over 2%. The return on equity securities was roughly cut in half, and the general surge in interest rates pushed fixed income securities into negative return territory. The last two months of the year saw a confluence of favorable market developments, including a downward trend in inflation, continued strong economic growth, and signals from the Federal Reserve that further interest rate hikes are unlikely. The impact was decisive and significant, pushing the Core Fund up from 2% at the end of October to over 11% at year-end. A solid outcome that was in no way guaranteed.

- The Core Fund, the larger of the two WRS trust funds with more than \$122 billion in net assets, ended the year with a net of all fees and costs return of 11.40% and a 5-year net of all fees and costs return of 9.29%. The Core Fund's 10- and 20-year returns net of external manager fees were 7.09%, and 7.12%, respectively.
- SWIB's returns for the Core Fund exceeded its performance benchmarks for all these periods. Performance benchmarks are market references that the Board of Trustees uses to compare and evaluate SWIB's performance. Benchmarks are set by the Board of Trustees with the guidance of an independent benchmarking consultant.
- SWIB's 5-, 10- and 20-year returns for the Core Fund exceeded the long-term WRS investment target of 6.8%.
- The Variable Fund, an optional stock-only fund with over \$9 billion in assets, ended the year with a net return of 22.24% and 5-, 10-, and 20-year returns net of external manager fees of 12.76%, 9.25%, and 8.39%, respectively.
- When looking over the last 20 years, SWIB's active management and diversified holdings generated \$29.5 billion for the Core Fund above what SWIB would have earned by simply investing in a low-cost passive portfolio consisting of 60% global equities and 40% domestic bonds.

Wisconsin, Inc.

The WRS is a risk-sharing defined benefit plan. It is a hybrid model in that it contains elements of a defined benefit plan and a defined contribution plan, like a 401(k). Contributions made to the WRS by state and local government employees, and their employers, are invested by SWIB to finance retirement benefits. SWIB has helped fuel one of the only fully funded pension systems in the U.S. during a time when many public pension plans are struggling with underfunding. Investment earnings generated by SWIB comprise about 78% of the revenues needed to fund the WRS, reducing the burden on public employers and employees.

WRS Annualized Returns				
As of December 31, 2023				
	Net of All Fees and Costs		Net of External Manager Fees	
	One Year	Five Years	Ten Years	Twenty Years
Core Fund	11.40%	9.29%	7.09%	7.12%
Core Fund Benchmark	11.00%	8.72%	6.69%	6.79%
Variable Fund	22.24%	12.71%	9.25%	8.39%
Variable Fund Benchmark	23.14%	12.90%	9.32%	8.42%

Investment performance for both the Core Fund and Variable Fund is included in the table entitled **WRS Annualized Returns**.

Core Fund Returns*		
As of December 31, 2023		
Asset Class	Benchmark	One Year
Stocks	22.6%	21.7%
Fixed Income	8.5%	8.9%
Inflation Sensitive	3.9%	3.9%
Real Estate	-12.9%	-7.1%
Private Equity/Debt	6.4%	6.4%
Alpha Pool Overlay	0.0%	0.7%
Total	11.0%	11.4%

*One year total returns presented net of all fees and costs. Asset class returns presented net of external manager fee.

The Core Fund includes diversified holdings in stocks, bonds, private equity, real estate, hedge funds, and other investments. SWIB has designed and built the Core Fund investment strategy to strike an efficient balance between protecting the WRS and growing its assets. Asset class returns as of Dec. 31, 2023 are presented in the table entitled Core Fund Returns.

SWIB diversifies its assets among many types of public and private investments. This investment management strategy is designed to weather a variety of economic environments over the long term and help ensure the WRS can meet its obligations today and in the future. It also allows SWIB to meet its standards of responsibility outlined in state statutes. That statute, s. 25.15 (2), requires that SWIB manage the funds as a prudent expert, diversify investments in order to minimize the risk of large losses, and administer assets of each trust or fund solely for its purpose and at a reasonable cost. The investment goal of the Core Fund is to earn an optimal rate of return while taking an acceptable level of risk and meeting or exceeding the actuarially assumed rate of return of 6.8%. The

table entitled **Core Fund Asset Allocation Targets** shows policy targets for the Core Fund asset classes for each of the last three years. SWIB's actual asset allocation may vary from the targets shown in the table in ranges approved by the Board.

WRS participants may elect to have 50% of their contributions invested in the all-stock Variable Fund instead of 100% in the Core Fund. The Variable Fund provides participants the potential for higher returns in exchange for higher investment risk. By choosing this option, participants also forego part of the formula benefit guarantee. The Variable Fund's gains and losses are not smoothed and are recognized in the year in which they occur. This results in greater volatility in investment gains or losses.

By law, the Variable Fund invests only in stocks, as shown in the chart entitled **Variable Fund Asset Allocation**. When setting the Variable Fund asset allocation, Trustees evaluate the risk/return tradeoff of U.S. and non-U.S. exposures. The benchmark is a weighted blend of U.S., international, and emerging market stock indices. The investment strategy for the Variable Fund is to achieve returns equal to or above that of similar stock portfolios over a market cycle.

Core Fund Asset Allocation Targets			
As of December 31, 2023			
Asset Class	2021	2022	2023
Stocks	52.0%	48.0%	40.0%
Fixed Income	25.0%	25.0%	27.0%
Inflation Sensitive	19.0%	19.0%	19.0%
Private Equity	12.0%	15.0%	18.0%
Real Estate	7.0%	8.0%	8.0%
Multi-Asset	0.0%	0.0%	0.0%
Cash & Overlays*	-15.0%	-15.0%	-12.0%
Total	100%	100%	100%

*Negative percentages reflect SWIB's leverage strategy.

Variable Fund Asset Allocation	
U.S. Stock	70%
International Stock	30%
Total	100%

Long-Term Strategies

SWIB has been, and continues to be, a long-term investor, which means it can be more patient than many other investors. Historically, markets tend to be cyclical and decline after a few years of strong performance. Success is measured by the overall long-term health of the system rather than individual peaks and valleys. For that reason, managing investment risk is a constant consideration for the trust funds.

SWIB's long-term goal is to provide prudent and cost-effective management of funds held in trust. This is achieved through people, policies, and processes for setting the asset allocation in a diversified portfolio, estimating expected investment returns and risk, and evaluating investment performance. SWIB has developed a disciplined, prudent, and innovative investment strategy designed to help keep contribution rates stable while generating reasonable returns to help the WRS remain fully funded. Asset allocation – the distribution of investments across stocks, bonds, and other assets to maximize returns and minimize risk – is a primary driver of long-term investment returns and is approved by the Board of Trustees in consultation with SWIB's asset and risk allocation investment staff and an independent asset allocation consultant.

SWIB has continued to diversify its portfolio by investing in multi-asset strategies. These strategies are not constrained by asset class, but can hold securities of many different asset types in the same portfolio. These strategies take advantage of market opportunities that cannot be done through a single asset class.

SWIB uses investment performance targets that are tied to benchmarks – usually market indices against which portfolio and fund returns are evaluated. The Core Fund is measured against a blend of benchmarks representing broader markets for stocks, bonds, and other asset classes that reflect the blend of the Core Fund’s individual portfolios.

Peer Comparison

Numerous differences in plan structure should be considered when reviewing peer comparisons including asset allocation, cash flow needs, investment styles, funding levels, return assumptions, risk tolerance levels, and statutory or other restrictions on allowable investments. In short, differences in plan structure often result in different goals, which result in different asset allocations that then drive overall returns. When a plan is not fully funded, its effective rate of return will decrease because a portion of the assets are not available to earn investment returns. Given the WRS’s fully funded status and unique risk-sharing design, SWIB invests differently than its peers, who are often underfunded, generally have higher investment targets, and may need to have greater risk tolerances.

According to Callan Associates, Inc., a firm that provides independent research, education, decision support, and advice to public pension plans and other institutional investors, the Core Fund’s gross investment returns as of Dec. 31, 2023 performed at or above the median of peer U.S. pension plans over the five- and ten-year periods. In addition, Callan states “SWIB maintains a cost effective mix of internal and external investment management that provides a material total fund cost advantage vs. peers.”

Callan comparison peer data is reviewed by the Board of Trustees every quarter. Reports are available on SWIB’s website.

Diversification Reduces Risk

Diversification of assets at the fund level is the primary tool for managing risk; because in a more diversified fund risks are often offset by one another. This is because market conditions generally affect different asset classes differently, so returns in one asset class may be positive while another asset class may be negative in the same market environment. SWIB continues to find ways to further diversify the Core Fund as a way to address market volatility. Every year, as part of the process in developing the Core Fund’s asset allocation, SWIB and its asset allocation consultant work together to target an asset mix that is appropriate for the Core Fund’s goals, with a focus on both the expected return of the asset allocation and its overall risk profile.

Managing risk becomes even more important in the WRS since its retirees’ annuity payments are directly impacted by returns because of the shared risks and rewards design. Lowering volatility helps stabilize contribution rates and benefit adjustments.

SWIB Manages Risk in Many Ways

In addition to diversification, SWIB monitors and manages risk through an enterprise-wide process. Each portfolio follows guidelines that specify the types of allowable investments and other requirements consistent with policies established by the Board of Trustees. Portfolio managers are responsible for complying with these guidelines, as well as Wisconsin Statutes and Administrative Code. In 2021, SWIB

Michael J. ...

...

built out a new standalone Risk Management Division that reports directly to the Executive Director/ Chief Investment Officer (ED/CIO). This division assesses, evaluates, and monitors investment risk for all strategies and portfolios.

As part of its risk management, SWIB has conducted robust investment stress testing since 2013 to evaluate and strengthen its investment strategy and make it more risk aware. The stress testing evaluates market downturns, liquidity risks, and multiple return environments. Routine testing and modeling are reviewed regularly by SWIB's Investment Committee, and biennially, in-depth stress testing is conducted with the WRS's actuaries and presented to the Board of Trustees. This information is publicly available at swib.state.wi.us/stresstesting.

SWIB's compliance staff continuously monitors investments and reports any exceptions and their resolution. Many monitoring tools are used to detect, and in some cases prevent, investment activities that would violate the investment guidelines. Portfolios out of compliance with guidelines will be brought into compliance immediately, or a plan for doing so or a waiver must be approved by the ED/ CIO.

SWIB's Internal Audit Division enhances and protects organizational value by providing risk-based and objective assurance, advice, and insight through regular audits, consulting, and other activities.

SWIB Optimizes Strategy Implementation

Staff is responsible for making investment decisions subject to its fiduciary duty, Board-approved asset allocation, and other restrictions. Assets can be managed passively as an index, which seeks to replicate the returns of the market or benchmark, or with active management, which attempts to exceed the performance of a particular market index using independent decisions. Active strategies are expected to produce higher returns than passive strategies over time; however, additional costs and risk associated with active management are considered when determining implementation strategies.

In 2023, SWIB launched a cross-functional implementation working group to advise the ED/CIO and the Asset & Risk Allocation CIO in making strategy implementation decisions.

Hedge Funds

SWIB's investment strategy includes investments in hedge funds. SWIB's use of hedge funds is different from many other public pension funds. Many other plans seek hedge fund returns similar to the stock market and are paying hedge fund managers for both stock market performance and additional returns from active management. SWIB looks to access general market returns in the lowest cost and most efficient manner possible, preferring to replicate market exposures internally. SWIB's hedge fund portfolio, which is generally designed to have minimal correlation with the stock market, is then combined with this exposure for a more efficient and cost-effective approach.

Leverage

The SWIB Board's recommended 2024 policy target for Core Fund leverage decreased from 15% to 12%. While the word "leverage" might imply additional risk, SWIB actually employs leverage to help reduce risk by enabling a higher allocation to lower-risk, fixed income securities while targeting the

Investments account for about **79%** of the total portfolio (including the WRS)

same performance return. Leverage is achieved through many passively implemented arrangements including reverse repurchase agreements and derivatives exposures.

Derivatives

All derivative instruments are subjected to risk analysis and monitoring processes at the portfolio, asset class, and fund levels. Investment guidelines define allowable derivative activity for each portfolio and are based on the investment policy objectives which have been approved by the Board of Trustees. The following are the types of derivatives that SWIB uses in its portfolios. SWIB also invests in derivative instruments indirectly through several commingled funds, which have not been included in the following narrative.

Foreign Currency Spot and Forward Contracts

Foreign currency spot and forward contracts are uncleared, over-the-counter agreements between two counterparties to exchange designated currencies at a specific time in the future. No cash is exchanged when a foreign currency exchange spot or forward contract is initiated. SWIB may employ discretionary currency overlay strategies at the total fund and asset class level when currency market conditions suggest such strategies are warranted. Only the currencies of developed market countries in the MSCI World Index may be used to implement a currency overlay. SWIB executes spot and forward contracts with various counterparties. Guidelines have been established which provide minimum credit ratings for counterparties. Additionally, policies have been established which seek to implement master netting arrangements with counterparties to over-the-counter derivative transactions.

Futures Contracts

A futures contract is an exchange traded agreement to buy or sell a financial instrument at an agreed upon price and time in the future. Upon entering into a futures contract, collateral is deposited with the broker, in SWIB's name, in accordance with the agreement. Collateral for futures contracts can be in the form of cash, U.S. Treasuries, and equity securities. Futures contracts are marked to market daily, based upon the closing market price of the contract at the board of trade or exchange on which they are traded. The resulting gain/loss is typically received/paid the following day until the contract expires. Futures contracts involve, to varying degrees, risk of loss in excess of the collateral deposited with the broker. Losses may arise from future changes in the value of the underlying instrument.

Options

An option contract gives the purchaser of the contract the right, but not the obligation, to buy (call) or sell (put) the security or index underlying the contract at an agreed upon price on or before the expiration of the option contract. The seller of the contract is subject to market risk, while the purchaser is subject to credit risk and market risk, to the extent of the premium paid to enter into the contract.

Swaps

A swap is a negotiated contractual agreement in which counterparties exchange cash flows of one party's financial instrument for those of the other party's financial instrument. Both parties to the swap contract are subject to market and credit risk of the underlying contract payments. Market risk results from the variability of payments and credit risk results from the parties' obligations to make payments. Collateralization of payments and market value variations mitigates the credit risk.

SWIB manages non-IBD and IBD investments in accordance with the investment objectives of the funds.

To Be Announced Securities

To Be Announced (TBA) mortgage-backed securities (MBS) are over-the-counter forward contracts on mortgage-backed securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae where the seller agrees to deliver the MBS for an agreed upon price on an agreed upon date. The TBA market provides mortgage lenders with a means of hedging interest rate risk between the time a loan rate is locked by a borrower and when the loan is funded. At settlement, TBA securities are exchanged for mortgage pools. However, SWIB's strategy is not typically expected to take in a mortgage pool. Instead, those TBA securities will usually be sold prior to that exchange occurring.

Internal Management Is Cost Effective

According to CEM Benchmarking, an independent provider of objective cost benchmarking for public pensions plans, SWIB does more internal management of assets than other pension plans. SWIB's cost for internal active management is considerably lower than the cost of external active management.

Qualified Staff and Systems Are Critical

SWIB competes for staff with investment firms in the private sector throughout the country. A successful internal management program requires experienced and qualified staff. Because SWIB manages so many assets internally, it must also invest in its people. With assistance from an independent compensation consultant, SWIB annually reviews the investment industry employment market to set compensation at appropriate levels. In addition to hiring and retaining qualified staff, SWIB seeks to develop the information technology, trading, accounting, and monitoring systems needed to accommodate its complex investment strategies. When considering whether to gain access to an investment strategy through internal or external management, SWIB considers many factors including the cost and return expectations associated with each option.

Maintaining a lower-cost internal management program requires the ability to attract, hire, and retain qualified staff. Over the past few years, the Board of Trustees has worked with its compensation consultant to maintain an incentive compensation program that motivates staff to earn the highest possible returns at reasonable costs and controlled levels of risk, aligning their interests with those of the WRS over the long term. SWIB's incentive compensation plan is explicitly authorized by section 25.16 of the Wisconsin Statutes. This statute was created in the 1987 session of the Legislature, after SWIB reported it was unable to attract and retain investment staff needed to manage the trust funds in a cost-effective manner. SWIB's compensation plan focuses on paying for performance and five-year returns. A competitive compensation plan is critical to SWIB's ability to attract and retain a talented and skilled workforce.

To adequately and efficiently process trades, measure risk, and manage investments, SWIB must continually enhance its systems and processes. Over the past several years, SWIB's team has worked diligently to implement new technology platforms to improve accounting,

Staff Qualifications (as of December 31, 2023)	
Total SWIB Staff*	263
Masters of Business Administration (MBA)	68
Masters Degree other than MBA	69
Juris Doctor Degree (JD)	9
Doctorate (PhD)	12
Chartered Financial Analyst (CFA)	57
Certified Public Accountant (CPA)	20
Chartered Alternative Investment Analyst (CAIA)	12
*Some SWIB Staff have more than one advanced degree or credential.	

trading, risk management, and portfolio management activities. Investments in SWIB's technology are ongoing, and these improvements will continue to provide staff better access to high quality and timely data while improving SWIB's ability to monitor and manage risk.

Goals & Strategies

2023 Goals & Strategies

Goal: Increase Active Return Through Improved Investment Strategies

In 2023, SWIB launched new active strategies aimed at increasing active return in global equities and leveraged loans, as well as a new factor premia pilot focused on reducing overall fund risk. SWIB also provided existing portfolios with access to new markets with the implementation and support of new investment instruments, including total return swaps on single name leveraged loans.

Goal: Enhance and Optimize SWIB's Operations and Technology Infrastructure

In 2023, substantial progress was made in enhancing and optimizing SWIB's operations and technology infrastructure. New systems were implemented to replace the existing platforms that support compliance and travel and expenses. SWIB enhanced its reporting and analytics for its private markets teams within its portfolio management platform. Finally, SWIB made significant strides in testing and migrating investment portfolios and middle office support activities onto its new middle office technology platform.

Goal: Enhance Talent Acquisition, Retention, and Management

In 2023, efforts to bolster talent acquisition, retention, and management were fruitful. The relocation of SWIB headquarters to Madison Yards was completed, providing an environment with the space and technology to position the organization for continued success. An in-house leadership training program was developed and launched to nurture internal talent. Forty-six open positions were filled, including four internal transfers, indicating a successful recruitment and retention strategy.

2024 Goals & Strategies

Goal: Increase Active Return Through Improved Investment Strategies

In 2024, SWIB will consider enhancements to existing investment strategies to provide new opportunities for alpha generation. Additionally, SWIB will explore its requirements for a new strategic order management system to improve investment decision-making processes. Finally, SWIB will continue to explore opportunities for optimizing existing capabilities in setting its strategic asset allocation.

Goal: Enhance and Optimize SWIB's Operations and Technology Infrastructure

In 2024, SWIB will complete the testing and migration of investment portfolios and middle office support activities onto its new middle office technology platform, allowing for the insourcing of the investment book of record. Additionally, SWIB will ensure readiness to comply with various regulatory changes, including new SEC reporting requirements, and continue to keep its operating environment and infrastructure updated through the completion of planned application upgrades and infrastructure maintenance. Finally, SWIB will continue the ongoing project to provide an improved technology platform to support its Finance and Human Resources divisions.

Goal: Enhance Talent Acquisition, Retention, and Management

In 2024, SWIB will continue its efforts to recruit and retain top tier talent. SWIB will support the development of its staff in leadership roles through continuing sessions of its in-house leadership training program that will provide opportunities for enhanced growth and refinement of leadership competencies. Additionally, SWIB will provide interview training to relevant staff to support effective recruitment processes.

State Investment Fund

SWIB also manages the State Investment Fund (SIF), which consists of commingled cash balances of the state and its agencies, local governments, and the WRS. The SIF investment goals are safety of principal, liquidity, and competitive rates of return. The fund's shorter-term cash management objectives reflect these goals.

State agencies deposit tax revenues, fees, federal funds, and other revenues from over 50 state funds with the SIF until needed for state operating expenditures. WRS cash assets are invested in the SIF for transition and cash flow purposes, and in some cases, until longer-term investment opportunities with more favorable rates of return become available. Over 1,300 local government units deposit funds in the commingled Local Government Investment Pool until needed for operating expenditures. SIF earnings are calculated and distributed monthly based on the participant's average daily balance as a percent of the fund. Participants may deposit and withdraw funds daily. SIF assets were valued at about \$22.6 billion on Dec. 31, 2023.

Investment Strategy

To effectively achieve its objectives for safety of principal, liquidity, and then competitive money market returns, the investment strategy of the SIF positions the portfolio to earn additional returns by monitoring and analyzing market and economic expectations and the market return of short-term government securities. Investment staff constantly monitor global market and economic events and position the fund accordingly. The SIF ended 2023 with a one-year return of 5.15%, outperforming its one-year benchmark. The SIF continued to outperform its 5- and 10-year benchmarks.

Investment in Wisconsin

SWIB's fundamental responsibility is to generate strong investment returns and maintain the fiduciary duty it owes to the trust funds under management. However, SWIB welcomes opportunities that have the dual benefit of being both a good investment for the trust funds and good for Wisconsin's economy. For decades, SWIB has been making investments in Wisconsin and will continue to try and do so in the future. As of June 30, 2023, SWIB had more than \$635 million invested in companies either headquartered or with a significant presence in Wisconsin.

SWIB has two dedicated portfolios that focus on Wisconsin. The Wisconsin Private Debt Portfolio dates back to the 1960s and the Wisconsin Venture Capital Portfolio was launched in 1999.

Wisconsin Private Debt Portfolio

About 60% of the Private Debt Portfolio is invested in Wisconsin opportunities. As of June 30, 2023, the portfolio held 47 loans to 28 borrowers headquartered or having operations in Wisconsin totaling approximately \$319 million. The average outstanding balance for borrowers was about \$11 million.

SWIB can be a good partner with a company's banks, providing long-term loans that complement the banks' short-term financing while not competing with the banks to provide other financial services. The program offers flexibility with loans that mature in five to 15 years and feature a fixed interest rate for the life of the loan.

Wisconsin Venture Capital Portfolio

SWIB's primary objective for investing in early-stage start-up companies through its Wisconsin Venture Capital Portfolio is to generate reasonable investment returns for the beneficiaries of the WRS on a risk-adjusted basis. A secondary benefit, many times, comes from potential jobs these investments can create.

Private equity consists of equity securities in companies not publicly traded on a stock exchange. These investments carry higher risks than publicly traded investments but offer the potential for higher rates of return. Venture capital is one form of private equity investment.

Active funds allocated to the Wisconsin Venture Capital Portfolio are committed to 16 venture capital funds as of June 30, 2023. The portfolio also has active direct investments in eight Wisconsin venture stage companies. As of June 30, 2023, the Wisconsin Venture Capital Portfolio had over \$316 million committed/invested in funds and directly into companies.

The portfolio capitalizes on the imbalance between the high amount of research and development in the Wisconsin region, entrepreneurial talent, low cost to operate a business within the state, and relatively low amount of venture capital dollars seeking investments here.

SWIB believes it can make money on this imbalance because venture capital investing requires time-intensive and hands-on attention to each company. The high costs can be prohibitive for long-distance investments giving an advantage both to local investors with established connections to the research conducted here and to business leaders with skills to build companies that can commercialize this research. The relative lack of competition gives local investors the opportunity to invest at attractive valuations and select the best opportunities.

SWIB is required by state statutes to report biennially to the Governor and the Legislature on its plans for making investments in Wisconsin. The Goals for Investing in Wisconsin Report for fiscal years 2023-2026 can be found on SWIB's website swib.state.wi.us under the Investing in Wisconsin tab.

Appendix A

CORE and VARIABLE FUND HOLDINGS BY ASSET CLASS

The following tables compare how the various categories of investments for the Core and Variable Funds were managed within each asset class as of Dec. 31, 2022 and 2023. Totals include exposure to futures and may not add correctly due to rounding.

Core Trust Fund				
Exposures by Sub Asset Class				
	12/31/2022		12/31/2023	
	<u>\$ in Millions</u>	<u>% of Total</u>	<u>\$ in Millions</u>	<u>% of Total</u>
<u>Equities</u>				
Developed Global ^{1,3}	\$ 38,772	34%	\$ 40,895	33%
U.S. Small Cap	3,322	3	3,010	3
International Small Cap ²	2,226	2	1,946	2
Emerging Market Equity ^{1,2}	5,274	5	4,912	4
Total Equities	\$ <u>49,594</u>	<u>43%</u>	\$ <u>50,763</u>	<u>41%</u>
<u>Fixed Income</u>				
U.S. Investment Grade ³	\$ 16,329	14%	\$ 17,617	14%
High Yield	5,369	5	5,856	5
Levered Loans	2,699	2	3,015	3
Emerging Market Debt	2,758	2	3,006	3
Total Fixed Income	\$ <u>27,155</u>	<u>24%</u>	\$ <u>29,494</u>	<u>24%</u>
<u>Inflation Sensitive</u>				
TIPS	\$ 21,641	19%	\$ 23,057	19%
Commodities	0	0	0	0
Total Inflation Sensitive	\$ <u>21,641</u>	<u>19%</u>	\$ <u>23,057</u>	<u>19%</u>
<u>Private Markets</u>				
Real Estate	\$ 12,003	11	\$ 12,037	10
Private Equity	12,726	11	14,227	12
Private Equity Co-Invest	2,285	2	2,886	2
Venture Capital	2,462	2	2,345	2
Private Equity Legacy	17	0	14	0
Current Return	2,799	2	3,498	3
Private Debt	554	1	694	1
Total Private Markets	\$ <u>32,847</u>	<u>29%</u>	\$ <u>35,702</u>	<u>29%</u>
<u>Multi-Asset</u>	\$ <u>0</u>	<u>0%</u>	\$ <u>0</u>	<u>0%</u>
<u>Cash/Leverage/Overlays</u>	\$ <u>(16,743)</u>	<u>(15%)</u>	\$ <u>(16,438)</u>	<u>(14%)</u>
<u>Total</u>	\$ <u>114,494</u>	<u>100%</u>	\$ <u>122,578</u>	<u>100%</u>

¹ MW TOPS split between US, Int'l, and EM using MSCI ACWI

² AB and Driehaus split using MSCI ACWI x US Small Cap

³ Factor Premia portfolios split 60% Developed Global and 40% US Investment Grade

Variable Trust Fund				
Exposures by Sub Asset Class				
	12/31/2022		12/31/2022	
	\$ in Millions	% of Total	\$ in Millions	% of Total
<u>Equities</u>				
Domestic Equity ^{1,4}	\$ 5,889	70%	\$ 6,851	70%
International Equity ^{1,4}	1,801	21	2,120	22
Emerging Market Equity ¹	716	9	824	8
Total Equities	\$ <u>8,406</u>	100%	\$ <u>9,796</u>	100%
<u>Multi-Asset</u>	\$ <u>0</u>	<u>0%</u>	\$ <u>0</u>	<u>0%</u>
<u>Cash</u>	\$ <u>33</u>	<u>0%</u>	\$ <u>35</u>	<u>0%</u>
<u>Total</u>	\$ <u>8,439</u>	100%	\$ <u>9,831</u>	100%

¹ MW TOPS split between US, Int'l, and EM using MSCI ACWI

⁴ Developed global equity portfolios split between US and Int'l using MSCI World

RISK MANAGEMENT

As part of SWIB's ongoing risk management activities, SWIB routinely monitors risk within the areas outlined below.

Funding WRS Liabilities: The most basic measure of risk for WRS trust funds under management is the ability to pay promised benefits. The WRS actuary and SWIB's asset allocation consultant both agree that the WRS is well-positioned to meet its current and future obligations.

Volatility: Minimizing year-to-year fluctuation in the Core Fund's returns helps to stabilize required contributions to the WRS and dividends paid to retirees. This is partly achieved through the smoothing mechanism in the Core Fund, whereby returns are smoothed over a five-year period, as well as investment strategies that temper the volatility of returns and take advantage of short-term displacements in prices.

Interest Rate Risk: Risk that changes in interest rates affect the value of a bond SWIB holds. SWIB uses multiple methods to monitor and mitigate interest rate risk. One example is an investment in Treasury Inflation Protected Securities (TIPS).

Currency Risk: Currency risk is the potential risk of loss from fluctuating foreign exchange rates. Foreign currency exposure in the trust funds occurs primarily in the international stock and bond holdings and, to a lesser extent, from private markets. International and global portfolio managers make currency hedging decisions. International currency risk is further managed by diversifying across international regions, economies, sectors, and individual investments.

Tracking Error/Active Risk: Tracking error measures the volatility of excess return versus the benchmark. It is an indication of how the fund or portfolio is positioned relative to the benchmark. This also helps measure the extent to which the performance of any one portfolio within the trust fund could affect the performance of the entire fund. The Trustees have adopted an active risk objective of 120 basis points, plus or minus 60 basis points, for the Core Fund. The active risk target for the Variable Fund is 60 basis points, plus or minus 30 basis points. SWIB staff monitor tracking error on an ongoing basis and perform attribution analysis to understand in detail where deviations from the benchmark are occurring.

Soft Risk Parameters: Investment guidelines include "soft risk parameters," supplementary guidelines within which a portfolio is expected to operate over time. The Investment Committee, composed of SWIB executive and investment staff, monitors portfolios on a regular basis for compliance with parameters. The Investment Committee discusses the rationale and outlook for any exceptions.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to SWIB. Fixed income credit risk investment guidelines outline the minimum ratings required at the time of purchase by individual portfolios, or groups of portfolios, based on the portfolios' investment objectives. In addition, some fixed income portfolios are required to carry a minimum weighted average rating at all times. SWIB's Credit Team reviews overall credit risks.

SEPARATELY MANAGED FUNDS

Goals and strategies for the following funds are set by the various fund administrators. SWIB takes guidance from the administrators of the funds on how the assets should be managed, and SWIB executes the investment strategies.

Injured Patients and Families Compensation Fund: The Injured Patients and Families Compensation Fund provides excess medical malpractice coverage for Wisconsin health care providers and to compensate injured claimants. SWIB is responsible for managing the fund's assets to meet the maturity and liquidity needs established by the Board of Governors. The investment objective of the fund includes a balance between capital appreciation, preservation of capital, and current income.

UW System Trust Funds: The University of Wisconsin System trust funds consist primarily of monies that have been gifted directly to a UW institution, rather than one of the separate, supporting foundations. The Trust Funds Office works externally with donors and other related parties, and internally with the benefiting campuses and colleges, to facilitate the receipt and proper use (compliant with donor terms and conditions) of all gifts and bequests. Most of the trust funds are invested by SWIB. The system's spending policy targets annual expenditures of 4% of the market value of the assets (calculated using a three-year rolling average) for payments to beneficiaries. The investment objective is to achieve, net of administrative and investment expenses, reasonable, attainable, and sustainable returns over and above the rate of inflation. SWIB seeks to achieve this objective through use of passive, externally-managed, public markets funds.

State Life Insurance Fund: The State Life Insurance Fund offers low-cost life insurance to Wisconsin residents. The investment objective of the fund is to maintain a diversified portfolio of high-quality public bonds which will preserve principal, maximize investment income, and minimize costs to policyholders. Liabilities from the fund's insurance contracts are factored into investment decisions.

Historical Society Trust Fund: The Historical Society Trust Fund supports current and anticipated initiatives and operations of the Wisconsin Historical Society. The investment objective of the Historical Society Trust Fund is to maintain a mix of equities and fixed income providing long-term growth in capital and income generation.



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