

## STATE OF WISCONSIN INVESTMENT BOARD

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September 20, 1996

Members, Joint Committee on Audit  
Members, Joint Committee on Finance  
Mr. Donald Schneider, Senate Chief Clerk  
Mr. Charles Sanders, Assembly Chief Clerk

Members of the Legislature:

Section 25.17(14r) of the Statutes, as created by 1995 Wisconsin Act 274, requires that the State of Wisconsin Investment Board (SWIB) submit a report to the Joint Committee on Audit, Joint Committee on Finance, and Chief Clerks of each House summarizing any change in the Board's investment policies, upon adoption of the change.

On September 12, 1996, the Board of Trustees approved a change to the investment guidelines for our domestic equities portfolios. The change is highlighted on the attached copy of the guidelines.

Our domestic equity investments are managed in three portfolios:

- The LARGE-CAP portfolio primarily invests in stocks with market capitalization of at least \$5.0 billion. Up to 20% of the portfolio value may be invested in stocks with a market capitalization of between \$1.0 and \$5.0 billion.
- The MID-CAP portfolio primarily invests in stocks with market capitalization between \$1.0 and \$5.0 billion. Up to 50% of the value of the portfolio may be invested in stocks with market capitalization over \$5.0 billion.
- The SMALL-CAP portfolio primarily invests in stocks with market capitalization of less than \$1.0 billion. Up to 10% of the value of the portfolio may be invested in stocks with a market capitalization between \$1.0 billion to \$5.0 billion.

### Guideline Change

The change in the guidelines delegates authority to the Chief Investment Officer (CIO) to approve variations from these market capitalization limits, up to a maximum of 5% of the asset value for each portfolio. For example, with the approval of the CIO, the portion of the

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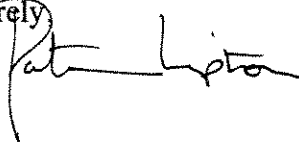
LARGE-CAP portfolio invested in stocks between \$1.0 billion and \$5.0 billion could be increased from the current 20% to up to 25% of the value of the portfolio.

The purpose of this change is to allow for some modest amount of additional flexibility in managing the portfolios. The flexibility is needed because our investment strategies periodically cross the capitalization limits for each portfolio. As the overall market moves up and down, the definition of "large" or "small" might be expected to move commensurately. Even in a stable market, individual stocks will move back and forth across the market cap limits.

With this guideline change the overall emphasis of each portfolio will be retained and the additional flexibility will be under the oversight of the CIO.

Please feel free to contact me if you have any questions about this item.

Sincerely,

A handwritten signature in black ink that reads "Patricia Lipton". The signature is written in a cursive style with a large initial "P" and "L".

Patricia Lipton  
Executive Director

**STATE OF WISCONSIN INVESTMENT BOARD**

**INVESTMENT GUIDELINES**

**As of ~~September~~ May 1996**

## 1. THE DOMESTIC EQUITIES PORTFOLIOS

**DESCRIPTION.** The Domestic Equities Portfolios are constructed of publicly traded equities, using primarily common stocks and convertible bonds. The portfolios are broadly diversified. Stock partnership interests and other publicly traded equity securities are purchased over-the-counter or on stock exchanges. These portfolios include the LARGE CAP, MID-CAP and SMALL-CAP.

**Portfolio Purpose and Objectives.** The general objectives and purpose of each portfolio are as follows:

The **LARGE-CAP** portfolio seeks diversification across a universe of primarily larger cap equities, combining both "value" (e.g. low price-to-earning or price-to-book ratios) and "growth"(e.g. high earnings growth) companies depending on market and economic conditions, with the bias ( at least 80%) being toward large market capitalization stocks of \$5 billion and over, primarily S&P 500 stocks. The LARGE-CAP portfolio may also invest up to 20% of its value in middle capitalization stocks ranging from \$1 billion to \$5 billion in market capitalization. Risk and return of the LARGE-CAP portfolio are compared regularly with a benchmark comprised of appropriate components as established by the SWIB Benchmark Committee.

The **MID-CAP** portfolio seeks diversification across a universe of primarily mid-cap equities, ranging from \$1 billion to \$5 billion in market capitalization. The portfolio combines both "value" (e.g. low price-to-earning or price-to-book ratios) and "growth"(e.g. high earnings growth) companies depending on market and economic conditions, with the bias (at least 50%) being toward mid-cap stocks. The MID-CAP portfolio may also invest up to 50% of its value in large capitalization stocks of \$5 billion or more in market capitalization. Risk and return of the MID-CAP portfolio are compared regularly with a benchmark comprised of appropriate components as established by the SWIB Benchmark Committee.

The **SMALL-CAP** portfolio seeks diversification over a broad class of small cap growth stocks with typical market capitalizations less than \$1 billion. The goal of the portfolio is to get well positioned in a number of attractively priced smaller company stocks which are not yet fully covered by the wall street analyst community for the purpose of achieving above average long-

term returns. These companies represent cutting edge products and technology, offering exceptional upside potential. The companies in this portfolio also carry higher risk/volatility profiles than those typically found in other SWIB equity portfolios. The portfolio is generally fully invested in a combination of both growth and value oriented stocks, across all major economic sectors. The SMALL-CAP portfolio may also invest up to 10% of its value in medium capitalization stocks of \$1 billion to \$5 billion in market capitalization. Risk and return of the SMALL-CAP portfolio are compared regularly with the benchmark comprised of appropriate components as established by the SWIB Benchmark Committee.

## APPROVED INVESTMENTS

Investments in the Domestic Equities Portfolios will be made within the following guidelines. The manager has the discretion to take the following actions:

1. Sell any investment purchased for the portfolio.
2. Purchase any legal, publicly-traded equity security (preferred or common stock, warrant, ADR or ADS, right or convertible issue) of any company which passes at the time of purchase a minimum of three (3) of the following tests:
  - a. The firm holds a significant position in its primary line of business;
  - b. A majority of the board consists of directors who are either independent (as defined by CII) or the board members in the aggregate own the lesser of 1% or \$5 million worth of the company's stock.
  - c. The most recent opinion of the auditors of the company is unqualified;
  - d. Return on total capital exceeds its industry average over past three (3) years (Value Line);<sup>1</sup>
  - e.
    - i. Financial strength is rated "B" or better by Value Line;  
or
    - ii. Retained earnings at least 50% of total share holders equity;  
or
    - iii. Total common shareholder's equity at least 50% of total assets. For financial and related companies, equity at least 6.0% of total assets.

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<sup>1</sup>Note: If Value Line numbers for the company are unavailable, use annual reports to compute net returns on total assets and compare with appropriate Value Line industry returns.

3. When aggregated with other portfolios, up to 10% of the issued and outstanding shares of common stock of a company may be purchased provided that the market value of the holding at the time of the last purchase does not exceed 5% of the sum of the market value of all publicly traded stocks owned by the Fixed and Variable Trust Funds and the dollars allocated to but not yet invested in stocks.
4. Privately placed equity securities of publicly held companies may be purchased provided the company has agreed to assist in the public sale of such securities at such time as SWIB shall reasonably request and the investment otherwise meets applicable criteria for purchase under delegated authority. No more than 5% of the assets in any portfolio may consist of securities that are restricted as to trading.
5. Make any other legal investment that is specifically approved by the Board.
6. Purchase units of limited partnerships which trade on an exchange or over-the-counter provided:

The units do not entail assuming materially more liability than a common stock in the form of ownership.
7. Up to 10% of the portfolio may be invested in U.S. equity securities of foreign companies (e.g. ADRs) or Canadian equities, including investments in companies located in countries defined as emerging markets by the International Finance Corporation (IFC), which are limited to no more than 1% of the portfolio.
8. Purchase shares in any initial public offering (IPO), regardless of the initial market capitalization of such company. Purchases must be made in the initial offering only and not through secondary market purchases.
9. Upon prior approval of the Chief Investment Officer, purchase equity securities which fall outside the prescribed capitalization limits for the portfolio, up to a maximum of 5% of the portfolio for each applicable limit.

#### DERIVATIVES AUTHORITY

Subject to review and approval of the SWIB Risk Management/Derivatives Committee, purchase or sell futures and options, provided that the stock equivalent value of the futures and options bought or sold shall not exceed 20% of the value of all domestic stocks and equity portfolio reserves. Put options may be purchased and call options may be sold only in connection with existing equity positions in the portfolio.