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☞ Details: Audit Report 04-13, An Evaluation: State of Wisconsin Investment Board

(FORM UPDATED: 08/11/2010)

## WISCONSIN STATE LEGISLATURE ... PUBLIC HEARING - COMMITTEE RECORDS

### 2005-06

(session year)

### Joint

(Assembly, Senate or Joint)

### Committee on Audit...

## COMMITTEE NOTICES ...

- Committee Reports ... **CR**
- Executive Sessions ... **ES**
- Public Hearings ... **PH**

## INFORMATION COLLECTED BY COMMITTEE FOR AND AGAINST PROPOSAL

- Appointments ... **Appt** (w/Record of Comm. Proceedings)
- Clearinghouse Rules ... **CRule** (w/Record of Comm. Proceedings)
- Hearing Records ... bills and resolutions (w/Record of Comm. Proceedings)
  - (**ab** = Assembly Bill)                      (**ar** = Assembly Resolution)                      (**ajr** = Assembly Joint Resolution)
  - (**sb** = Senate Bill)                              (**sr** = Senate Resolution)                              (**sjr** = Senate Joint Resolution)
- Miscellaneous ... **Misc**

\* Contents organized for archiving by: Stefanie Rose (LRB) (September 2012)

## Chapter 4 State Investment Fund

The State Investment Fund (SIF) invests the cash balances of the state, its agencies, local governments and the Wisconsin Retirement System (WRS) on a commingled basis. The investment goals for SIF are: first and foremost, safety of principal; second, liquidity; and finally, rate of return. These goals are reflected in its shorter-term, cash management objectives.

State agencies deposit tax revenues, fees, federal aid payments and other revenues from over 50 state funds with SIF until needed for state operating expenditures. WRS cash assets are invested in SIF until longer-term investment opportunities with more favorable rates of return become

available. Over 1,100 local units of government deposit funds until needed for local operating expenditures. These commingled local funds are referred to as the Local Government Investment Pool (LGIP).

Earnings for SIF are calculated and distributed monthly, based on the participant's average daily balance as a percent of the fund. Participants may deposit and withdraw their funds on a daily basis. SIF assets were valued at \$4.8 billion on December 31, 2004, which included \$433 million of WRS funds. The following table shows the average month-end SIF balance and participation in 2004 compared to 2003.

<b>State Investment Fund Average Month-End Balances</b>				
<b>Source</b>	<b>2003</b>		<b>2004</b>	
	<b>Amount (in millions)</b>	<b>Percent Of Total</b>	<b>Amount (in millions)</b>	<b>Percent Of Total</b>
Local Government Investment Pool (LGIP)	\$3,515	55%	\$3,118	54%
State Funds	2,203	35	1,957	34
WRS Trust Funds	<u>612</u>	<u>10</u>	<u>695</u>	<u>12</u>
<b>TOTAL</b>	<b>\$6,330</b>	<b>100%</b>	<b>\$5,769</b>	<b>100%</b>

The benchmark for measuring SIF investment performance consists of:

1. The 90-day US Treasury Bill rate (70%).
2. The 30-day Federal Reserve Certificate of Deposit Composite Index rate (30%).

## Investment Strategy/Asset Allocation

SIF achieves its investment goals by adhering to rigorous quality standards, careful attention to maturity schedules and emphasis on high marketability of securities in the portfolio. Enhanced return is sought through intensive portfolio management, which considers probable changes in the general structure of interest rates.

SIF is authorized to invest in direct obligations of the US government and its agencies, commercial paper of financial and industrial corporations, bank certificates of deposit, banker's acceptances, asset-backed securities,

mortgage-backed securities and repurchase agreements backed by securities of the US government or its agencies, and other instruments authorized by the Board of Trustees that are within state law restrictions.

Low interest rates coupled with inflation expectations and lower cash balances faced by the state and local governments influenced SIF's decisions to increase its holdings in shorter term securities. Investment guidelines for SIF include the following asset allocation limits. **Appendix I** provides a description of each category.

<b>State Investment Fund Asset Allocation Limits</b>	
<b>Asset Type</b>	<b>Limit as a Percent of Portfolio Par Value</b>
US Treasuries, Agencies and Repurchase Agreements	50-100%
Commercial Paper and Corporate Notes	0-30%
Certificates of Deposit and Banker's Acceptances	0-30%
Asset-Backed Securities	0-30%
Mortgage-Backed Securities	0-30%
Canadian (fully hedged)	0-20%
Yankee/Euro Dollar Issues (fully hedged)	0-10%

As shown on the following table, assets under management dropped over \$2 billion from year-end 2003 to year-end 2004. This drop reflects the economic conditions and tight budgets faced by state and local governments, resulting in

less cash available for short term investment. Because of the success of the Wisconsin Certificate of Deposit Program, the Board increased its allocation to \$500 million.

<b>State Investment Fund Holdings</b>				
<b>Asset Type</b>	<b>12/31/03</b>		<b>12/31/04</b>	
	<b>Amount*</b> <b>(In Millions)</b>	<b>Percent of Total</b>	<b>Amount*</b> <b>(In Millions)</b>	<b>Percent of Total</b>
Cash	\$0	0%	\$0	0%
US Government:				
Treasury Bills	0	0%	0	0%
Notes and Bonds	140	2%	140	3%
Agencies	4,934	71%	1,072	22%
Open Repurchase Agreements	1,006	15%	1,568	33%
Asset-Backed Securities	0	0%	0	0%
Mortgage-Backed Securities	1	0%	1	0%
Yankee/Euro Dollar Issues	0	0%	0	0%
Certificates of Deposit and Banker's Acceptances	500	7%	700	15%
Commercial Paper and Corporate Notes	345	5%	1,301	27%
<b>TOTAL</b>	<b>\$6,926</b>	<b>100%</b>	<b>\$4,782</b>	<b>100%</b>

\*Total value exceeds participant holdings due to check float and timing of postings

### Performance

<b>State Investment Fund Performance</b>			
<b>Annualized For Period Ending December 31, 2004</b>			
	<u><b>One Year</b></u>	<u><b>Five Years</b></u>	<u><b>Ten Years</b></u>
<b>State Investment Fund Return</b>	<b>1.3%</b>	<b>2.9%</b>	<b>4.1%</b>
<b>Investment Benchmark</b>	<b>1.4</b>	<b>2.7</b>	<b>4.0</b>

- SIF trailed the one-year benchmark but outperformed its benchmark for the five- and ten-year periods.
- For the year ending December 31, 2004, SIF's 1.3% return ranked 1<sup>st</sup> out of 225 government funds in the iMoneyNet Government Fund Index and 33<sup>rd</sup> out of 1,276 money market funds in the iMoneyNet All Taxable Money Market Index (top 3%). It was the third consecutive year that SIF topped the iMoneyNet Government Fund Index.
- In March 1995, SWIB neutralized 12 SIF derivative investments whose returns were determined by the spread between US and foreign currency and interest rates. The Board concluded these investments were inappropriate and outside policy guidelines. This action resulted in a \$95 million loss that was paid with interest over a ten-year period.

- Payments made to amortize the derivatives loss resulted in a reduction of 0.28% in the first five years ending March 2000 versus the projected 0.329%. At the end of 2004, the charge was approximately 0.09% compared to the projection of 0.091%. As of December 31, 2004, the remaining non-amortized balance on the \$95 million was approximately \$2.0 million. The balance was completely paid as of March 16, 2005. There were no other derivatives in SIF during 2004.

## Risk Management

Risk management for SIF places particular emphasis on three factors: (1) safety of principal; (2) the need for adequate liquidity to meet withdrawals; and (3) sensitivity of the portfolio to changes in interest rates. As previously

mentioned, interest rates and the increased need for liquidity affected investment decisions and are reflected below in the year-to-year fluctuations. These risks are measured in the following ways:

1. **Safety of Principal.** Approximately 58% of the fund was invested in US government securities as of December 31, 2004, dropping from 88% at the end of 2003. The Fund does contain certain investments that are subject to market risks, including default by the issuer. Although SIF has never experienced a credit default, in certain economic cycles the Fund could potentially incur losses in certain investments. SIF has insurance coverage for credit losses incurred by LGIP participants.
2. **Liquidity.** The combination of funds from the state, local governments and WRS provides a high degree of flexibility and liquidity. The average maturity for portfolio investments as of December 31, 2004 was 28 days, compared to 72 days at the end of 2003. The ability to withdraw any amount of funds on a daily basis creates the risk that a significant number of local government participants could make simultaneous withdrawals from SIF. As of December 31, 2004, 92% of the fund was invested in securities maturing within 90 days to meet this contingency compared to 77% at the end of 2003.
3. **Interest Rate Sensitivity.** Interest rates for 92% of portfolio assets reset within three months or less compared to 79% in 2003; while 44% of the portfolio changes rate overnight, compared to 18% in 2003. This strategy is designed to ensure that the rate of return is sensitive to changes in the general level of interest rates.

## Chapter 5 Investments in Wisconsin

SWIB makes investments in Wisconsin within the context of its fiduciary responsibility to participants in the funds under management. Some of the investments in Wisconsin occur as part of our everyday investment activity in the national and global markets, since Wisconsin businesses are participants in these markets. In other instances, SWIB staff makes special efforts to explore investment opportunities that exist within the State.

Under s. 25.17 (70), Wis. Statutes, SWIB provides a biennial report to the Governor and Legislature on the investments it has made in Wisconsin

during the past biennium and its plans for future investment. The last report was submitted on June 30, 2003. In addition to the biennial report, SWIB presented its five-year plan for investing in the state. At that time, SWIB indicated that it planned to make new investments in the state between \$2.7 billion and \$4.5 billion for the five-year period ending June 30, 2007.

New investments made in Wisconsin companies for the year ending June 30, 2004 totaled \$684.3 million. See **Appendix K** for a list of the individual investments, which include:

- \$36.3 million of new investments in stocks of publicly held Wisconsin companies;
- \$188.6 million of new investments in high quality commercial paper issued by public utilities and Wisconsin companies;
- \$420.7 million in certificates of deposit from Wisconsin banks and thrifts;
- \$37.3 million in private equity and loans to Wisconsin companies; and
- \$1.4 million in real estate

The companies included in the totals are either headquartered in Wisconsin or easily identified as having a significant portion of their business activities in Wisconsin. As shown in the table on the following page, new and existing investments in companies headquartered in Wisconsin totaled nearly \$1.4 billion. An additional \$8.2 billion was invested in companies with 20 or more Wisconsin employees, bringing the total investments in companies with economic ties to Wisconsin to over \$9.6 billion at the end of fiscal year 2004.

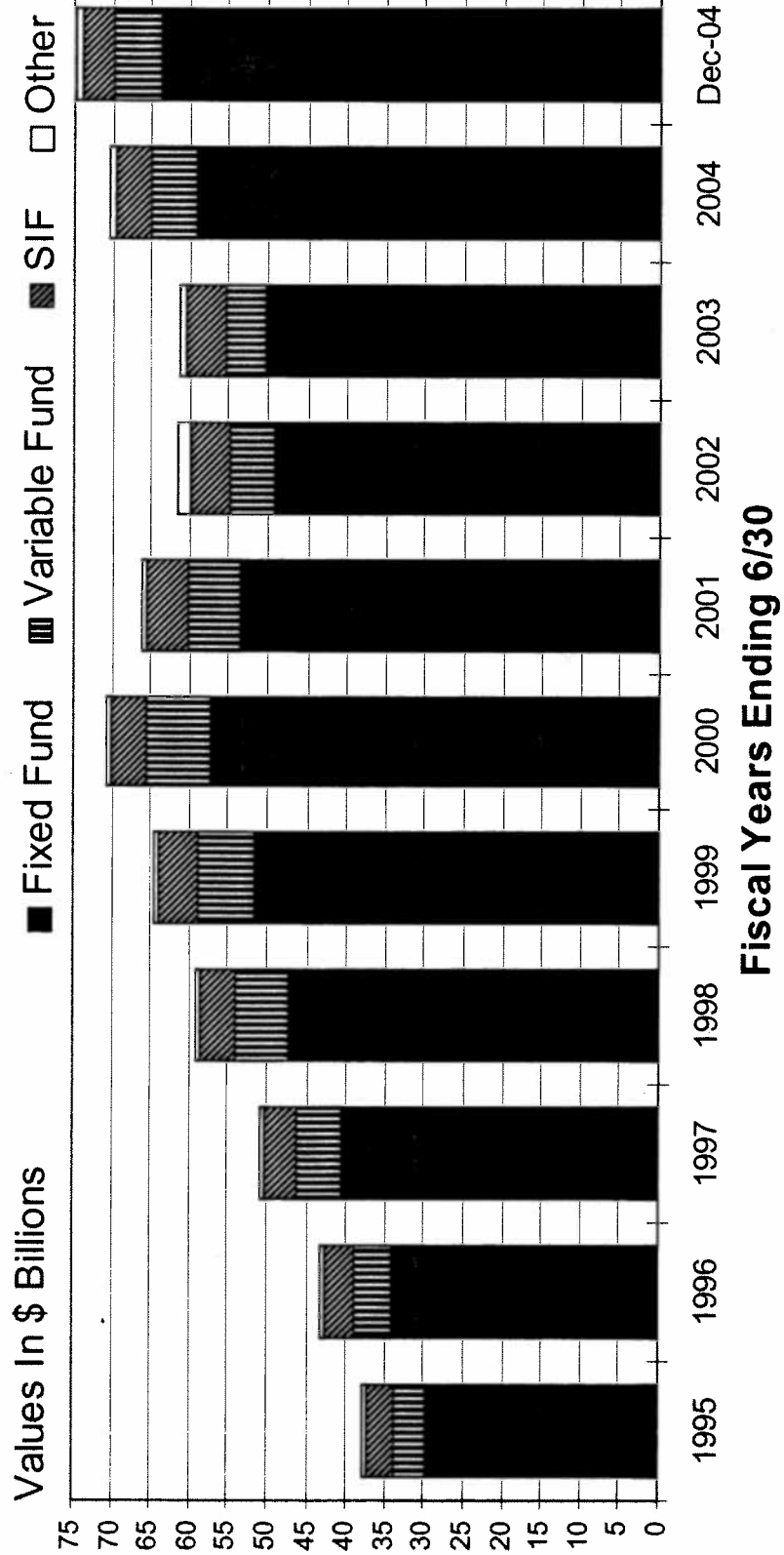
Section 25.186, Wis. Statutes, directs that SWIB pay at least 5% of brokerage commissions to broker-dealers headquartered in Wisconsin and whose principal business operations are located in the state. Currently, only one company meets that definition. On the advice of the Department of Justice, SWIB has attempted to comply with the statute to the extent that it is able to do so while still complying with its fiduciary responsibility to trust fund participants. In fiscal year 2004, SWIB directed \$481,353 or 3.15% of the \$15,262,683 total listed commissions to the one eligible Wisconsin broker.

**Total Wisconsin Investments by Asset Class  
June 30, 2004**

<b>Asset Class</b>	<b>Headquartered or Significant Presence in WI</b>	<b>Not Headquartered in WI - But 20+ WI Employees</b>	<b>Total Investment in WI</b>
Private Equity/Private Debt	\$ 475,060,024	\$ -	\$ 475,060,024
Fixed Income	60,553,685	1,444,147,602	1,504,701,287
Public Equities	225,411,340	6,148,032,244	6,373,443,584
Real Estate	15,722,501	-	15,722,501
State Investment Fund (1)	<u>609,330,000</u>	<u>625,000,000</u>	<u>1,234,330,000</u>
<b>Total</b>	<b>\$ 1,386,077,550</b>	<b>\$ 8,217,179,846</b>	<b>\$ 9,603,257,396</b>

(1) Includes commercial paper, certificates of deposit, and bankers' acceptances valued at par. Reflects maximum outstanding value per issue during the fiscal year.

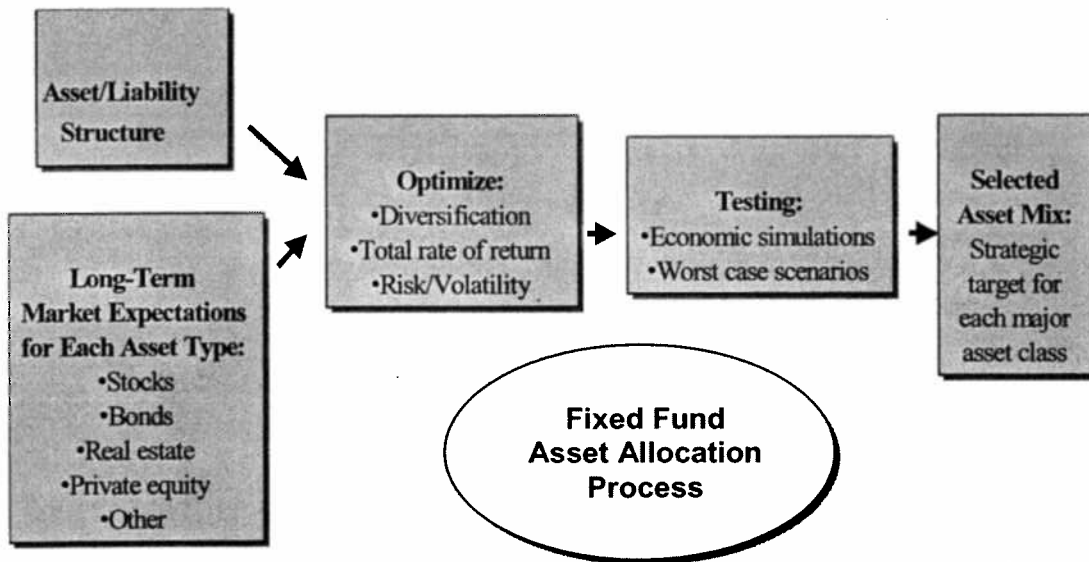
# Assets Under Management





## Appendix B Allocating Assets – The Process

When making asset allocation decisions, SWIB staff and the Board of Trustees follow a comprehensive formal process in year one of a two year cycle. The individual steps in this process are described below:



- ▶ **Asset/Liability Structure.** Assumptions made by the actuary for the WRS and adopted by the Employee Trust Funds Board are factored into the asset allocation model. Cash flow projections show that benefit payments currently exceed contributions to the WRS. Investment income, however, approximately equals the difference. This means that SWIB is not forced to liquidate significant assets in order for Employee Trust Funds to pay benefits.
- ▶ **Market Expectations.** SWIB's investment staff and asset allocation consultant develop long-term market return expectations for each asset class (stocks, bonds, real estate and others). They consider past experience, forecasts by key investment strategists and the judgment of SWIB's professional staff to develop the expected returns.
- ▶ **Optimize.** Models are run using expected results for each asset class to create "optimal portfolios". In addition to optimizing the total rate of return, SWIB evaluates the volatility (risk) of the expected return and the impact on the funded status of the WRS benefit plan.
- ▶ **Testing.** Optimal portfolios are "stress-tested" under a variety of potential economic scenarios, including the possibility that all markets decrease sharply at the same time ("worst case scenario"). This helps to identify an asset mix that is the best long-term performer under different economic conditions.
- ▶ **Selected Asset Mix.** In addition to approving the asset classes in which the Fixed Fund invests, the Board of Trustees also approves ranges and strategic targets. The rebalancing range defines the minimum and maximum fund share that may be allocated to each asset class, and the strategic target is the specific allocation target within the policy range. For example, the rebalancing range for a given asset may be 27-33% of the Fund's total assets, but the strategic or ideal target is 30%. Allocation targets are designed to meet the long-term obligations of the system with an optimal risk/return tradeoff.

## Appendix C Strategic Targets

The following tables show the strategic targets for 2004 and 2005 for the Fixed and Variable Funds, the target ranges for 2005 and how the assets were actually allocated at the end of 2003 and 2004.

<b>Fixed Trust Fund Asset Allocation</b>					
Asset Class	Target Range 2005	2003	2004		2005
		Actual 12/31/03	Strategic Target	Actual 12/31/04	Strategic Target
Stocks	53-65%	<u>63%</u>	<u>59%</u>	<u>63%</u>	<u>59%</u>
<i>Domestic</i>	35-43%	<u>42%</u>	<u>39%</u>	<u>41%</u>	<u>39%</u>
<i>International</i>	18-22%	<u>21%</u>	<u>20%</u>	<u>22%</u>	<u>20%</u>
Fixed Income	26-32%	<u>27%</u>	<u>31%</u>	<u>29%</u>	<u>29%</u>
<i>Public</i>		<u>19%</u>		<u>28%</u>	
<i>Private</i>		<u>8%</u>		<u>1%</u>	
Private Markets		<u>7%</u>	<u>10%</u>	<u>6%</u>	<u>10%</u>
<i>Real Estate</i>		<u>4%</u>	<u>4%</u>	<u>3%</u>	<u>5%</u>
<i>Equity/Debt</i>		<u>3%</u>	<u>6%</u>	<u>3%</u>	<u>5%</u>
Multi-Asset		<u>1%</u>	<u>0%</u>	<u>2%</u>	<u>2%</u>
Cash		<u>2%</u>	<u>0%</u>	<u>0%</u>	<u>0%</u>
<b>TOTAL</b>		<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

<b>Variable Trust Fund Asset Allocation</b>					
Asset Class	Target Range 2005	2003	2004		2005
		Actual 12/31/03	Strategic Target	Actual 12/31/04	Strategic Target
Stocks		<u>98%</u>	<u>100%</u>	<u>98%</u>	<u>99%</u>
<i>Domestic</i>	75-85%	<u>78%</u>	<u>80%</u>	<u>77%</u>	<u>79%</u>
<i>International</i>	15-25%	<u>20%</u>	<u>20%</u>	<u>21%</u>	<u>20%</u>
Multi-Asset				<u>1%</u>	<u>1%</u>
Cash		<u>2%</u>	<u>0%</u>	<u>1%</u>	<u>0%</u>
<b>TOTAL</b>		<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## Appendix D Holdings By Asset Class

The following tables compare, by portfolio type, how the various categories of investments for the Fixed and Variable Funds were managed within each asset class as of December 31, 2003 and 2004. Totals may not add correctly due to rounding.

<b>Fixed Trust Fund Holdings By Portfolio</b>				
	12/31/03		12/31/04	
	\$ in Millions	% of Total	\$ in Millions	% of Total
<b><u>Equities</u></b>				
Domestic				
Active Portfolios	\$9,564	17%	\$8,088	13%
Quantitative/Enhanced	6,714	12%	8,422	13%
Passive Index Funds	7,377	13%	9,361	15%
International				
Active Portfolios	3,595	6%	4,186	7%
Quantitative/Enhanced	4,002	7%	4,823	7%
Passive Index Fund	3,986	7%	4,377	7%
Emerging Markets	375	1%	739	1%
<b>Total Equities</b>	<b>\$35,613</b>	<b>63%</b>	<b>\$39,996</b>	<b>63%</b>
<b><u>Fixed Income</u></b>				
Public Bonds				
Active Portfolios	\$ 3,723	7%	\$3,558	6%
Quantitative/Enhanced	2,094	4%	2,722	3%
Passive Index Funds	2,781	5%	2,827	4%
TIPS			1,520	2%
High Yield				
Active Portfolios	187	0%	330	1%
Quantitative/Enhanced	303	1%	328	1%
Index Funds	339	1%	0	
Private Placements				
Nat'l Private Placements	159	0%	0	
WI Private Debt	401	1%	376	1%
Global Bonds				
Active Portfolios	3,649	6%	4,327	7%
Passive Index Fund	436	1%	405	1%
Real Estate Mortgages	579	1%	518	1%
Emerging Markets	319	1%	470	1%
High Yield/Emerging Markets	365	1%	686	1%
<b>Total Fixed Income</b>	<b>\$15,333</b>	<b>27%</b>	<b>\$18,066</b>	<b>29%</b>
<b><u>Private Markets</u></b>				
Real Estate	\$2009	4%		
Fund Investments			556	1%
Separate Accounts			657	1%
Transition Assets			625	1%
Private Equity				
Private Equity Legacy	477	0%	1,312	3%
Private Equity	1,480	3%	307	0%
WI Private Equity	20	0%	34	0%
<b>Total Private Markets</b>	<b>3,986</b>	<b>7%</b>	<b>\$3,491</b>	<b>6%</b>
<b><u>Multi-Asset</u></b>				
Active Portfolio	\$328	1%	\$380	1%
Passive Index Funds			624	1%
<b>Total Multi-Asset</b>	<b>\$328</b>	<b>1%</b>	<b>\$1,003</b>	<b>2%</b>
<b><u>Cash</u></b>				
	<b>\$1,638</b>	<b>2%</b>	<b>\$1,202</b>	<b>0%</b>
<b>Total</b>	<b>\$56,899</b>	<b>100%</b>	<b>\$63,759</b>	<b>100%</b>

Appendix D (continued)

<b>Variable Trust Fund Holdings By Portfolio</b>				
	<b>12/31/03</b>		<b>12/31/04</b>	
	\$ in Millions	% of Total	\$ in Millions	% of Total
<b><u>Equities</u></b>				
Domestic				
Active Portfolios	\$2,388	40%	\$2,048	33%
Quantitative/Enhanced	947	16%	1,208	19%
Passive Index Funds	1,307	22%	1,572	25%
International				
Active Portfolios	444	8%	419	7%
Quantitative/Enhanced	352	6%	429	7%
Passive Index Fund	355	6%	401	6%
Emerging Markets	<u>34</u>	<u>0%</u>	<u>76</u>	<u>1%</u>
Total Equities	\$5,827	98%	\$6,155	98%
<b>Multi-Asset</b>			32	1%
<b>Cash</b>	103	2%	62	1%
<b>TOTAL</b>	<b>\$5,930</b>	<b>100%</b>	<b>\$6,248</b>	<b>100%</b>

Appendix E  
WRS Equity Portfolios  
12/31/2004

Domestic Equities	Value (\$ Mil)	Active Internal	% of Total	Active/Enhanced External	% of Total	Passive External	% of Total
SWIB Large Cap	3,583	3,583	11.6%				
SWIB Large Cap Diversified	3,642	3,642	11.8%				
SWIB Mid Cap	806	806	2.6%				
SWIB Small Cap	862	862	2.8%				
SWIB Small Cap Diversified	563	563	1.8%				
SWIB Healthcare Sector	790	790	2.6%				
GMO Quantitative	1,072			1,072	3.5%		
BGI Alpha Tilts Russell 1000	4,786			4,786	15.5%		
BGI Alpha Tilts Small Cap	748			748	2.4%		
BGI Alpha Tilts Russell 3000	3,028			3,028	9.8%		
BGI Russell 3000 Index	10,933					10,933	35.5%
<b>Total Domestic Equities</b>	<b>30,814</b>	<b>10,248</b>	<b>33.3%</b>	<b>9,634</b>	<b>31.3%</b>	<b>10,933</b>	<b>35.5%</b>

Active/Passive	Internal/External					
Total Active/Enhanced	19,881	64.1%	Total Internal	10,248	33.3%	
Total Passive	10,933	35.9%	Total External	20,567	66.7%	

International Equities	Value (\$ Mil)	Active Internal	% of Total	Active/Enhanced External	% of Total	Passive External	% of Total
SWIB Internal	896	896	5.8%				
Acadian	127			127	0.8%		
Alliance Bernstein	1,339			1,339	8.6%		
American Century	120			120	0.8%		
Baillie Gifford	417			417	2.7%		
Capital Guardian	237			237	1.5%		
Fidelity	603			603	3.9%		
LSV Asset Management	1,212			1,212	7.8%		
Morgan Stanley	968			968	6.2%		
BGI Alpha Tilts International	4,048			4,048	26.0%		
BGI International Index Fund	4,778					4,778	30.7%
The Boston Company – EM*	279			279	1.8%		
GMO - EM	132			132	0.8%		
T. Rowe Price - EM	04			04	2.6%		
<b>Total International Equities</b>	<b>15,559</b>	<b>896</b>	<b>5.8%</b>	<b>9,885</b>	<b>63.5%</b>	<b>4,778</b>	<b>30.7%</b>

Active/Passive	Internal/External					
Total Active/Enhanced	10,781	69.3%	Total Internal	896	5.8%	
Total Passive	4,778	30.7%	Total External	14,663	94.2%	

\* Emerging Markets

Appendix F  
WRS Fixed Income Portfolios  
12/31/2004

Domestic Fixed Income	Value (\$Mil)	Active Internal	% of Total	Active/Enhanced External	% of Total	Passive External	% of Total
Government Credit	3,620	3,620	28.7%				
BGI Alpha Tilts Credit	2,206			2,206	17.5%		
BGI Alpha Tilts Government	516			516	4.1%		
BGI Lehman Index Fund	2,827					2,827	22.4%
TIPS Portfolio	1,137	1,137	9.0%				
Bridgewater TIPS	524			524	4.2%		
SWIB Transition	199	199	1.6%				
Loomis Sayles US High Yield	332			332	2.6%		
BGI Alpha Tilts US High Yield	328			328	2.6%		
Wisconsin Private Debt	386	386	3.1%				
NML Real Estate Mortgages	519	519	4.1%				
<b>Total Domestic Fixed Income</b>	<b>12,593</b>	<b>5,859</b>	<b>46.5%</b>	<b>3,907</b>	<b>31.0%</b>	<b>2,827</b>	<b>22.4%</b>
<b>Active/Passive</b>		<b>Internal/External</b>					
Total Active/Enhanced		9,766	77.6%	Total Internal		5,859	46.5%
Total Passive		2,827	22.4%	Total External		6,734	53.4%

Global Fixed Income	Value (\$Mil)	Active Internal	% of Total	Active/Enhanced External	% of Total	Passive External	% of Total
SWIB Internal Global	2,705	2,705	44.0%				
Brandywine Global	405			405	6.6%		
Bridgewater Global	393			393	6.4%		
Deutsche Morgan Grenfell	523			523	8.5%		
UBS Global	538			538	8.8%		
BGI Global Index Fund	405					405	6.6%
Deutsche Morgan Grenfell - EM	146			146	2.4%		
GMO - EM	337			337	5.5%		
Salomon Brothers - EM	361			361	5.9%		
Capital Guardian - EM/HY*	338			338	5.5%		
<b>Total Global Fixed Income</b>	<b>6,151</b>	<b>2,705</b>	<b>44.0%</b>	<b>3,041</b>	<b>49.4%</b>	<b>405</b>	<b>6.6%</b>
<b>Active/Passive</b>		<b>Internal/External</b>					
Total Active/Enhanced	5,746	93.4%		Total Internal		2,705	44.0%
Total Passive	405	6.6%		Total External		3,445	56.0%

\* Emerging Market/High Yield

## Appendix G Portfolio Highlights

The following provides the performance and certain highlights for the individual portfolios within the Fixed and Variable Funds. The Variable Fund is only invested in equities and cash.

### DOMESTIC EQUITIES

#### Large Cap

Created March 31, 1997  
 Description This Large Cap Equities portfolio focuses on companies with market capitalization of approximately \$5 billion or more, such as those found in the S&P 500 Index. In particular, the manager seeks companies with solid business fundamentals and above-average, long-term growth prospects.  
 Managed Active internal management  
 Market Value \$3.6 Billion  
 Benchmark S&P 500 Index

			One-Year	Five-Year	Inception - 12/31/04
Performance	--	Fund	4.1%	-2.4%	2.0%
	--	Benchmark	10.9	-2.3	1.2

#### Large Cap Diversified Equities

Created April 30, 2002  
 Description The Large Cap Diversified Equities portfolio invests in a broadly diversified set of companies with market capitalization that normally exceed \$5 billion, such as those found in the S&P 500 Index. The investment process includes quantitative selection and risk control measures.  
 Managed Active internal management  
 Market Value \$3.6 Billion  
 Benchmark S&P 500 Index

			One-Year	Inception - 12/31/04
Performance	--	Fund	9.2%	6.3%
	--	Benchmark	10.9	6.4

#### Mid Cap

Created July 31, 1990; modified July 1996; modified January 1, 2004  
 Description The Mid Cap Equities portfolio focuses on domestic companies with a market capitalization that range from approximately \$1 billion to \$10 billion. The portfolio is broadly diversified without a particular value or growth orientation.  
 Managed Active internal management  
 Market Value \$806 Million  
 Benchmark Russell Mid Cap Index (since 1/1/04)

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	15.7%	6.3%	14.0%
	--	Benchmark	20.2	10.3	16.0

#### Small Cap

Created December 31, 1982, modified July 1996  
 Description The Small Cap Equities portfolio invests in a focused set of small company stocks, convertibles and cash. It focuses on domestic technology and healthcare companies with a market capitalization of approximately \$1.5 billion and less.

Managed Active internal management  
 Market Value \$862 Million  
 Benchmark Russell 2000 Index

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	8.5%	8.9%	14.1%
	--	Benchmark	18.3	6.6	12.4

**Small Cap Diversified**

Created March 31, 2003  
 Description The Small Cap Diversified Equities Portfolio invests in a broadly diversified set of small-cap companies with market capitalization of \$1.5 billion or less, similar to those found in the Russell 2000 Index.  
 Managed Active internal management  
 Market Value \$563 Million  
 Benchmark Russell 2000 Index

			One-Year	Inception – 12-31-04
Performance	--	Fund	23.7%	38.2%
	--	Benchmark	18.3	37.4

**Healthcare Sector Equities**

Created December 31, 2001  
 Description The Healthcare Sector Portfolio focuses on healthcare stocks across the entire domestic market capitalization spectrum.  
 Managed Active internal management  
 Market Value \$790 Million  
 Benchmark Russell 3000 Healthcare Sector Index

			One-Year	Inception – 12/31/04
Performance	--	Fund	4.5%	3.4%
	--	Benchmark	3.9	-.05

**GMO Quantitative Large Cap**

Created June 30, 1998  
 Description Managed by Grantham, Mayo, Van Otterloo and Company (GMO), this portfolio uses risk-controlled strategies that attempt to earn excess return over the S&P 500 Index using primarily quantitative strategies. The strategy employed by GMO also uses some subjective inputs and does not have a predefined expected tracking error relative to the benchmark.  
 Managed Quantitative/Enhanced  
 Market Value \$1.1 Billion  
 Benchmark S&P 500 Index

			One-Year	Five-Year	Inception – 12/31/04
Performance	--	Fund	10.2%	1.1%	5.0%
	--	Benchmark	10.9	-2.3	2.5

**BGI Alpha Tilts Russell 1000 - Commingled**

Created August 31, 2003  
 Description Constructed by Barclays Global Investors (BGI), this portfolio uses a risk-controlled strategy that attempts to track the Russell 1000 fairly closely, while earning excess returns by controlled variations from the index. The enhanced strategies that BGI utilizes for its alpha tilts portfolios are tightly constrained to their benchmarks with an expected tracking error of 2% or less.  
 Managed Quantitative/Enhanced



Market Value \$4.8 Billion  
 Benchmark Russell 1000 Index

		One-Year	Inception-12/31/04
Performance	-- Fund	11.9%	17.4%
	-- Benchmark	11.4	17.4

**BGI Alpha Tilts Small Cap - Commingled**

Created April 30, 2001  
 Description Constructed by Barclays Global Investors, this portfolio uses a risk-controlled strategy that attempts to track the Russell 2000 Index fairly closely, while earning excess returns by controlled variations from the index. The enhanced strategies that BGI utilizes for its alpha tilts portfolios are tightly constrained to the benchmarks with an expected tracking error of 2% or less.  
 Managed Quantitative/Enhanced  
 Market Value \$748 Million  
 Benchmark Russell 2000 Index

		One-Year	Inception – 12/31/04
Performance	-- Fund	18.3%	12.9%
	-- Benchmark	18.3	9.8

**BGI Alpha Tilts Russell 3000 - Commingled**

Created October 31, 2002  
 Description Constructed by Barclays Global Investors, this portfolio uses a risk-controlled strategy that attempts to track the Russell 3000 Index fairly closely, while earning excess returns by controlled variations from the index. The enhanced strategies that BGI utilizes for its alpha tilts portfolios are tightly constrained to the benchmarks with an expected tracking error of 2% or less.  
 Managed Quantitative/Enhanced  
 Market Value \$3.0 Billion  
 Benchmark Russell 3000 Index

		One-Year	Inception – 12/31/04
Performance	-- Fund	12.4%	19.7%
	-- Benchmark	11.9	19.4

**BGI Russell 3000 Index Fund - Commingled**

Created June 30, 2002  
 Description This fund tracks the Russell 3000 Index. In 2002, SWIB closed the small, mid and large company index portfolios it had with BGI and moved those assets to this BGI fund, which represents a broad cross section of domestic equities. The investment objectives are to add diversity to equity portfolios, facilitate asset allocation and complement SWIB's active investment style.  
 Managed Passive Index Fund  
 Market Value \$10.9 Billion  
 Benchmark Russell 3000 Index

		One-Year	Inception – 12/31/04
Performance	-- Fund	12.0%	11.5%
	-- Benchmark	11.9	11.5

## INTERNATIONAL EQUITIES

### Internal

Created September 30, 1989  
 Description SWIB's Internal International Equities Portfolio takes advantage of expanding opportunities outside the US, which currently comprise a significant portion of all available investments. The manager may invest in countries that are rated "free" or "partly free" by the Freedom House Index or that are included in the manager's benchmark.  
 Managed Active internal management  
 Market Value \$896 Million  
 Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	23.2%	-1.9%	8.7%
	--	Benchmark	20.4	-0.8	7.6

### Alliance Bernstein

Created July 31, 2004  
 Description Managed by Alliance Bernstein, this portfolio is invested in non-US securities in "free" or "partly free" countries, as rated by the Freedom House Index or that are included in the manager's benchmark.  
 Managed Active external management  
 Market Value \$1.3 Billion  
 Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

			Inception - 12/31/04
Performance	--	Fund	22.1%
	--	Benchmark	19.0

### Baillie Gifford

Created June 30, 1993  
 Description Managed by Baillie Gifford Overseas Limited, this portfolio is invested in non-US securities in "free" or "partly free" countries, as rated by the Freedom House Index or that are included in the manager's benchmark. SWIB terminated its contract with Baillie Gifford in April 2005 due to performance and strategy considerations.  
 Managed Active external management  
 Market Value \$417 Million  
 Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	18.2%	-2.1%	8.7%
	--	Benchmark	20.4	-0.8	7.6

### Capital Guardian

Created September 30, 1989  
 Description This international portfolio is managed by the Capital Group, Inc., and is invested in non-US securities in "free" or "partly free" countries, as rated by the Freedom House Index or that are included in the manager's benchmark. SWIB closed this portfolio in April 2005 due to performance and strategy considerations.  
 Managed Active external management  
 Market Value \$237 Million  
 Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	12.5%	-2.2%	9.9%
	--	Benchmark	20.4	-0.8	7.6

#### **Fidelity**

Created July 31, 2004  
Description This international portfolio is managed by Fidelity and is invested in non-US securities in "free" or "partly free" countries, as rated by the Freedom House Index or that are included in the manager's benchmark.  
Managed Active external management  
Market Value \$603 Million  
Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

			Inception - 12/31/04
Performance	--	Fund	20.6%
	--	Benchmark	19.0

#### **Morgan Stanley**

Created September 30, 1989  
Description Managed by Morgan Stanley Investment Management, this portfolio is invested in non-US securities in "free or "partly free" countries, as rated by the Freedom House Index or that are included in the manager's benchmark.  
Managed Active external management  
Market Value \$968 Million  
Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	21.9%	10.3%	13.9%
	--	Benchmark	20.4	-0.8	7.6

#### **Acadian**

Created July 31, 2004  
Description This is a diversified portfolio invested in non-US equity instruments. Countries rated "Free" or "Partly Free" by the Freedom House Index or that are included in the manager's benchmark are eligible. The portfolio has a small-cap focus within developed markets. Investments in emerging market countries are permitted subject to specified limits.  
Managed Active external management  
Market Value \$127 Million  
Benchmark Morgan Stanley Capital International (MSCI) World ex US Small Cap (Net Taxes)

			Inception - 12/31/04
Performance	--	Fund	26.1%
	--	Benchmark	21.6

#### **American Century**

Created July 31, 2004  
Description This is a diversified portfolio invested in non-US equity instruments. Countries rated "Free" or "Partly Free" by the Freedom House Index or that are included in the manager's benchmark are eligible. The portfolio has a small-cap focus within developed markets. Investments in emerging market countries are permitted subject to specified limits.  
Managed Active external management  
Market Value \$120 Million  
Benchmark Morgan Stanley Capital International (MSCI) World ex US Small Cap (Net Taxes)

		<u>Inception - 12/31/04</u>
Performance	-- Fund	19.8%
	-- Benchmark	21.6

**BGI International Alpha Tilts Fund - Commingled**

Created October 5, 2001  
Description Constructed by Barclays Global Investors, the BGI International Alpha Tilts Fund invests in non-US equity instruments. The investment objectives are to add diversity to equity portfolios, facilitate asset allocation and complement SWIB's active investment style.  
Managed Quantitative/Enhanced  
Market Value \$4.0 Billion  
Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

		<u>One-Year</u>	<u>Inception - 12/31/04</u>
Performance	-- Fund	23.4%	15.3%
	-- Benchmark	20.4	12.6

**LSV Asset Management**

Created July 31, 2004  
Description Managed by LSV Asset Management, this fund is invested in non-US equity instruments. The investment objectives are to add diversity to equity portfolios, facilitate asset allocation and complement SWIB's active investment style.  
Managed Enhanced/quantitative management  
Market Value \$1.2 Billion  
Benchmark Morgan Stanley Capital International (MSCI) World ex US Index (Net Taxes)

		<u>Inception - 12/31/04</u>
Performance	-- Fund	21.0%
	-- Benchmark	19.0

**BGI International Index Fund - Commingled**

Created November 30, 1996  
Description This fund is managed by Barclays Global Investors and tracks the Morgan Stanley Capital International (MSCI) World Index of markets in 22 countries, excluding the US.  
Managed Passive index fund  
Market Value \$4.8 Billion  
Benchmark Morgan Stanley Capital International (MSCI) World Index ex US (Net Taxes)

		<u>One-Year</u>	<u>Five-Year</u>	<u>Inception - 12/31/04</u>
Performance	-- Fund	20.7%	-0.6%	5.8%
	-- Benchmark	20.4	-0.8	5.7

**The Boston Company Emerging Markets Portfolio - Commingled**

Created June 30, 2003  
Description The investments of this portfolio are limited to developing countries, as viewed by the manager.  
Managed Active external management  
Market Value \$279 Million  
Benchmark Morgan Stanley Capital International (MSCI) Emerging Markets Free Index

			One-Year	Inception – 12/31/04
Performance	--	Fund	29.0%	43.9%
	--	Benchmark	26.0	42.2

**GMO Emerging Markets Portfolio - Commingled**

Created June 30, 2003  
Description The investments in this portfolio are limited to developing countries, as viewed by the manager, Grantham, Mayo, Van Otterloo and Company (GMO).  
Managed Active external management  
Market Value \$132 Million  
Benchmark Morgan Stanley Capital International (MSCI) Emerging Markets Free Index

			One-Year	Inception – 12/31/04
Performance	--	Fund	27.9%	50.7%
	--	Benchmark	26.0	42.2

**T. Rowe Price Emerging Markets- Commingled**

Created June 30, 2003  
Description The investments in this portfolio are limited to developing countries, as viewed by the manager.  
Managed Active external management  
Market Value \$404 Million  
Benchmark Morgan Stanley Capital International (MSCI) Emerging Markets Free Index

			One-Year	Inception – 12/31/04
Performance	--	Fund	28.6%	45.2%
	--	Benchmark	26.0	42.2

**FIXED INCOME**

**Government Credit Bond**

Created December 31, 1988, revised in 2000 and further modified effective January 1, 2003  
Description This internally managed portfolio, originally the Market Evaluation Portfolio, consists of dollar denominated, primarily investment grade bonds purchased in public markets. The portfolio is broadly diversified across sectors including government, agency, corporate and Yankee. Diversification rules for the portfolio state that the manager may invest no more than 5% in any single corporate issuer rated BBB- and above and no more than 3% in any issuer rated BB+ and below.  
Managed Active internal management  
Market Value \$3.6 Billion  
Benchmark Lehman Government/Credit Index

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	4.1%	7.3%	7.7%
	--	Benchmark	4.2	7.8	8.0

**BGI Alpha Tilts Credit Bond- Commingled**

Created September 30, 2002  
Description Barclays Global Investors constructed the BGI Alpha Tilts Credit Portfolio, which invests in investment grade US fixed income instruments.  
Managed Quantitative/Enhanced  
Market Value \$2.2 Billion

Benchmark Lehman Credit Index

		<u>One-Year</u>	<u>Inception – 12/31/04</u>
Performance	-- Fund	5.4%	7.3%
	-- Benchmark	5.2%	7.2%

**BGI Lehman Index Fund- Commingled**

Created September 30, 1996  
Description This fund tracks the bond market return for the Lehman Government/Credit Index of the broad US public and corporate bond markets.  
Managed Passive index fund  
Market Value \$2.8 Billion  
Benchmark Lehman Custom Index

		<u>One-Year</u>	<u>Five-Year</u>	<u>Inception – 12/31/04</u>
Performance	-- Fund	4.2%	8.4%	7.5%
	-- Benchmark	4.0	8.4	7.5

**Treasury Inflation-Protected Securities (TIPS)**

Created December 31, 2003  
Description This portfolio invests in dollar denominated Treasury inflation-indexed securities.  
Managed Passive internal management  
Market Value \$1.1 Billion  
Benchmark Lehman TIPS Index

		<u>One-Year</u>	<u>Inception - 12/31/04</u>
Performance	-- Fund	7.7%	7.7%
	-- Benchmark	8.5	8.5

**Bridgewater TIPS**

Created March 31, 2004  
Description This portfolio invests in dollar denominated Treasury inflation-indexed securities.  
Managed Active external management  
Market Value \$524 Million  
Benchmark Lehman TIPS Index

		<u>Inception - 12/31/04</u>
Performance	-- Fund	5.3%
	-- Benchmark	3.2

**Loomis Sayles US High Yield**

Created December 31, 2003  
Description Managed by Loomis Sayles, this portfolio is invested in below investment grade US and Canadian fixed income instruments.  
Managed Active external management  
Market Value \$332 Million  
Benchmark CSFB High Yield Broad Index

		<u>One-Year</u>	<u>Inception - 12/31/04</u>
Performance	-- Fund	10.9%	10.9%
	-- Benchmark	11.1	11.1

**BGI Alpha Tilts US High Yield Bond - Commingled**

Created September 30, 2002  
 Description The BGI Alpha Tilts US High Yield portfolio invests in below investment grade US and Canadian fixed income instruments.  
 Managed Quantitative/Enhanced  
 Market Value \$328 Million  
 Benchmark CSFB High Yield Broad Index

		One-Year	Inception – 12/31/04
Performance	-- Fund	11.9%	18.3%
	-- Benchmark	11.1	20.4

**Internal Global Fixed Income**

Created December 31, 1996  
 Description This portfolio invests in any corporate, sovereign, agency or supra-national bond within countries rated "free" and "partly free" by the Freedom House Index.  
 Managed Active internal management  
 Market Value \$2.7 Billion  
 Benchmark Salomon World Government Bond Index Unhedged (WGBI) (Net Taxes)

		One-Year	Five-Year	Inception – 12/31/04
Performance	-- Fund	10.3%	9.4%	8.1%
	-- Benchmark	10.3	8.7	8.0

**Brandywine Global Fixed Income**

Created December 31, 2003  
 Description This portfolio invests in any corporate, sovereign, agency or supra-national bond within countries rated "free" and "partly free" by the Freedom House Index or that are included in the manager's benchmark.  
 Managed Active external management  
 Market Value \$405 Million  
 Benchmark Salomon World Government Bond Index Unhedged (WGBI) (Net Taxes)

		One-Year	Inception - 12/31/04
Performance	-- Fund	14.5%	14.5%
	-- Benchmark	10.3	10.3

**Bridgewater Global Fixed Income**

Created December 31, 2003  
 Description This portfolio invests in any corporate, sovereign, agency or supra-national bond within countries rated "free" and "partly free" by the Freedom House Index or that are included in the manager's benchmark.  
 Managed Active external management  
 Market Value \$393 Million  
 Benchmark Salomon World Government Bond Index Unhedged (Net Taxes)

		One-Year	Inception - 12/31/04
Performance	-- Fund	11.6%	11.6%
	-- Benchmark	10.3	10.3

**Deutsche Morgan Grenfell Global Fixed Income**

Created September 30, 1989  
 Description This portfolio invests in any corporate, sovereign, agency or supra-national bond within countries rated "free" and "partly free" by the Freedom House Index or that are included in the manager's benchmark.

Managed Active external management  
 Market Value \$523 Million  
 Benchmark Salomon World Government Bond Index Unhedged (Net Taxes)

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	10.3%	9.1%	10.1%
	--	Benchmark	10.3	8.7	9.9

**UBS Global Fixed Income**

Created September 30, 1989  
 Description This portfolio invests in any corporate, sovereign, agency or supra-national bond within countries rated "free" and "partly free" by the Freedom House Index or that are included in the manager's benchmark.  
 Managed Active external management  
 Market Value \$538 Million  
 Benchmark Salomon World Government Bond Index Unhedged (Net Taxes)

			One-Year	Five-Year	Ten-Year
Performance	--	Fund	10.5%	10.0%	10.6%
	--	Benchmark	10.3	8.7	9.9

**BGI Global Bond Index Fund- Commingled**

Created November 30, 1999  
 Description This fund tracks the Salomon World Government Bond Index (WGBI).  
 Managed Passive  
 Market Value \$405 Million  
 Benchmark Salomon WGBI Unhedged (Net Tax)

			One-Year	Five-Year	Inception – 12/31/04
Performance	--	Fund	10.3%	8.7%	8.4%
	--	Benchmark	10.3	8.7	8.5

**Deutsche Morgan Grenfell Emerging Markets**

Created December 31, 1994  
 Description Managed by Deutsche Morgan Grenfell, this fund may invest in public or private fixed income investments in developing countries as defined by the World Bank. This portfolio may also invest in developed countries that are rated "free" or "partly free" by the Freedom House Index or that are included in the manager's benchmark.  
 Managed Active external management  
 Market Value \$146 Million  
 Benchmark JP Morgan Emerging Market Bond Index Global Diversified Fund

			One-Year	Five-Year	Inception – 12/31/04
Performance	--	Fund	14.5%	15.0%	17.1%
	--	Benchmark	11.6	11.4	13.8

**GMO Emerging Markets Fixed Income - Commingled**

Created December 31, 2003  
 Description Managed by GMO, this fund may invest in public or private fixed income investments in developing countries as defined by the World Bank.  
 Managed Active external management  
 Market Value \$337 Million  
 Benchmark JP Morgan Emerging Market Bond Index Global Diversified Fund



		One-Year	Inception - 12/31/04
Performance	-- Fund	19.4%	19.4%
	-- Benchmark	11.6	11.6

**Capital Guardian Global High Yield - Emerging Markets - Commingled**

Created December 31, 2003  
 Description This portfolio is invested in below investment grade global fixed income securities.  
 Managed Active external management  
 Market Value \$338 Million  
 Benchmark 50% CSFB High Yield + 50% JP Morgan Emerging Markets Bond Global Diversified Index

		One-Year	Inception - 12/31/04
Performance	-- Fund	12.6%	12.6%
	-- Benchmark	11.4	11.4

**Salomon Brothers Emerging Markets Fund**

Created December 31, 1994  
 Description This portfolio is invested in below investment grade global fixed income securities. Salomon Brothers Asset Management, which manages this fund, may also invest in countries that are rated "free" or "partly free" by the Freedom House Index or that are included in the manager's benchmark. (Although owned by Citigroup, the manager maintained its former name.)  
 Managed Active external management  
 Market Value \$361 Million  
 Benchmark 50% CSFB High Yield + 50% JP Morgan Emerging Markets Bond Global Diversified Index

		One-Year	Five-Year	Inception - 12/31/04
Performance	-- Fund	12.0%	14.5%	16.5%
	-- Benchmark	11.4	11.3	13.8

**PRIVATE MARKETS**

**Real Estate Fund Investments**

Created March 31, 2004  
 Description The Real Estate Fund Investments Portfolio is dedicated to commercial real estate investments in joint ventures and partnerships. Emphasis is on lower-risk, value-added funds with strong current income and follow-on investments with the best managers. Objectives are to add diversification, long-term stability, inflation hedging and competitive returns over a complete economic cycle.  
 Managed Active internal  
 Market Value \$556 Million  
 Benchmark National Council of Real Estate Investment Fiduciaries' Index (NCREIF)

		Inception - 12/31/04
Performance	-- Fund	18.0%
	-- Benchmark	9.4

**Real Estate Separate Accounts**

Created March 31, 2004  
 Description The Real Estate Separate Accounts Portfolio is dedicated to domestic commercial real estate investments. Emphasis is on high quality assets in major markets with low to moderate risk and strong cash flow. Objectives are to add

diversification, long-term stability, inflation hedging and competitive returns over a complete economic cycle.

Managed Active internal  
 Market Value \$657 Million  
 Benchmark National Council of Real Estate Investment Fiduciaries' Index (NCREIF)

			<u>Inception - 12/31/04</u>
Performance	--	Fund	18.5%
	--	Benchmark	9.4

#### **Real Estate Transition Portfolio**

Created June 30, 1977; modified 7/1/99  
 Description The Real Estate Transition Portfolio consists of commercial real estate investments either with SWIB as a sole direct owner or in joint ventures and partnerships.  
 Managed Active internal management  
 Market Value \$625 Million  
 Benchmark National Council of Real Estate Investment Fiduciaries' Index (NCREIF)

			<u>One-Year</u>	<u>Five-Year</u>	<u>Ten-Year</u>
Performance	--	Fund	17.7%	11.4%	11.1%
	--	Benchmark	12.4	9.5	10.2

#### **NML Real Estate Mortgages**

Created June 30, 1999  
 Description This portfolio consists of private commercial mortgages invested in conjunction with Northwestern Mutual Life (NML) Insurance Company, the lead underwriter. SWIB's real estate staff collaborate regarding SWIB's participation in each investment.  
 Managed Active internal management  
 Market Value \$518 Million  
 Benchmark Duration-Adjusted Lehman BAA Credit Bond Index

			<u>One-Year</u>	<u>Five-Year</u>	<u>Inception - 12/31/04</u>
Performance	--	Fund	4.3%	8.8%	8.6%
	--	Benchmark	3.8	7.7	7.2

#### **Wisconsin Private Debt**

Created June 30, 1977  
 Description The Wisconsin Private Debt Portfolio targets intermediate corporate debt in Wisconsin companies and makes direct, long-term, market rate loans to those companies.  
 Managed Active internal management  
 Market Value \$376 Million  
 Benchmark Duration-Adjusted Lehman BAA Credit Bond + 20 basis points

			<u>One-Year</u>	<u>Five-Year</u>	<u>Ten-Year</u>
Performance	--	Fund	7.3%	9.2%	8.8%
	--	Benchmark	5.2	8.6	8.3

#### **Wisconsin Private Equity**

Created June 30, 2000  
 Description This portfolio is dedicated to investments in venture capital partnerships with a concentration of firms sited primarily in Wisconsin and the Midwest. Any investments made by the funds must meet the same due diligence as other

SWIB investments. As with other venture capital investments, it is typical for these investments to earn below benchmark returns for at least the first five years. They investments are subject to higher risks of failure but offer the prospect of higher returns.

Managed Active internal management  
 Market Value \$34 million  
 Benchmark Cash Flow Adjusted Russell 3000 + 250 basis points

		One-Year	Inception – 12/31/04
Performance	-- Fund	-11.6%	-11.6%
	-- Benchmark	0.8	4.9

**Private Equity**

Created: March 31, 2004  
 Description: The Private Equity Portfolio invests in and with selected leveraged buyout (LBO) and venture capital partnerships. The portfolio is well diversified across many different partnerships with different stages of development focuses. These investments are subject to higher risks of failure but offer the prospect of higher returns.

Managed: Active internal management  
 Market Value: \$307 Million  
 Benchmark: Venture Economics Buyout Index weighted by vintage year

		Inception - 12/31/04
Performance	-- Fund	27.2%
	-- Benchmark	5.6

**Private Equity Legacy**

Created December 31, 2001  
 Description: The investments in this portfolio were originally part of the Private Equity and Opportunity E portfolios. The investments, however, no longer conform to the strategies adopted for the new Private Markets asset class and will be phased out.

Managed Active internal management  
 Market Value \$1.3 Billion  
 Benchmark Cash Flow Adjusted 50% Russell 3000/50% MSCI ACWI +200 basis points

		One-Year	Inception – 12/31/04
Performance	-- Fund	17.4%	0.1%
	-- Benchmark	11.3	6.9

**MULTI-ASSET**

**UBS Multi-Asset-Commingled**

Created March 31, 2003  
 Description: The UBS Multi-Asset Portfolio is an actively managed, globally diversified portfolio that applies asset allocation strategies across world capital markets. The portfolio invests primarily in equity and debt instruments in developed and emerging markets, but it also includes investments in real estate, natural resources, private equity and money market instruments.

Managed Active external management  
 Market Value \$380 Million  
 Benchmark UBS Multiple Markets Index

			<u>One-Year</u>	<u>Inception - 12/31/04</u>
Performance	--	Fund	15.7%	27.0%
	--	Benchmark	13.2	22.3

**BGI Russell 3000 Liquidity - Commingled**

Created	June 30, 2004			
Description	This fund was established to provide a ready means to invest temporary excess cash and to provide a fund from which monies may be withdrawn easily to pay benefits. The assets are allocated to this portfolio and the two succeeding ones on a pro rata basis according to the targeted allocations for the particular asset classes.			
Managed	Passive external			
Market Value	\$294 Million			
Benchmark	Russell 3000 Index			

			<u>Inception - 12/31/04</u>
Performance	--	Fund	8.0%
	--	Benchmark	8.1

**BGI MSCI World ex US Liquidity - Commingled**

Created	June 30, 2004		
Description	This fund was established to provide a ready means to invest temporary excess cash and to provide a fund from which monies may be withdrawn easily to pay benefits.		
Managed	Passive external		
Market Value	\$162 Million		
Benchmark	Morgan Stanley Capital World ex US Index (Net Taxes)		

			<u>Inception - 12/31/04</u>
Performance	--	Fund	15.2%
	--	Benchmark	15.4

**BGI Lehman Government/Credit Liquidity - Commingled**

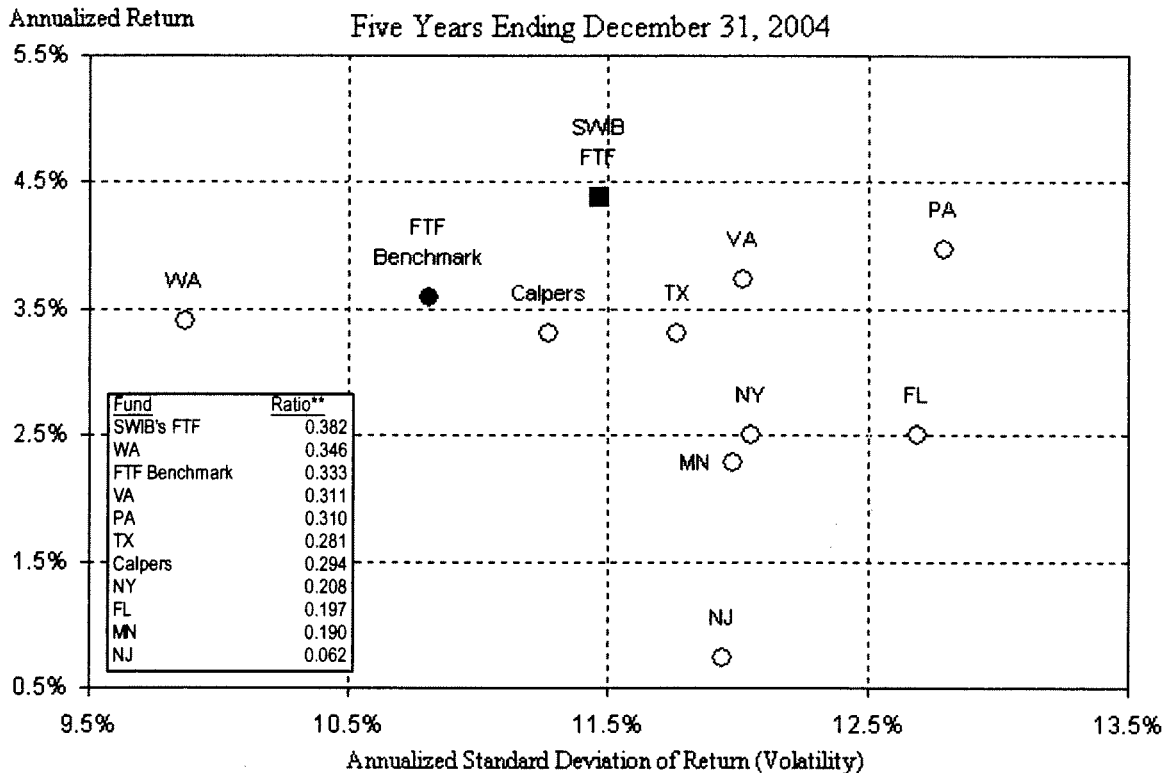
Created	June 30, 2004		
Description	This fund was established to provide a ready means to invest temporary excess cash and to provide a fund from which monies may be withdrawn easily to pay benefits.		
Managed	Passive external		
Market Value	\$200 Million		
Benchmark	Lehman Government/Credit Index		

			<u>Inception - 12/31/04</u>
Performance	--	Fund	4.4%
	--	Benchmark	4.4

**CASH**

Although the Board does not target assets for cash, the Fixed and Variable Funds will typically have 1%-2% in cash at any given time while awaiting permanent investment. The State Investment Fund invests the temporary cash balances in short-term and intermediate-term investments. These investments include obligations of the US government and its agencies as well as high quality commercial bank and corporate debt obligations. At the end of 2004, less than 1% of WRS assets was in cash, which earned 1.3% for the year compared to the 1.4% for the benchmark.

## Appendix H Return/Volatility Fixed Trust Fund and LAB Peers \*



\* Gross-of-Fees returns, except for MN, NY, VA, and WA which are Net-of- Fees.

\*\* Return/Risk Ratio is return divided by standard deviation. Higher ratios indicate more favorable return for the level of risk taken on.

This chart captures both return and risk, or volatility, and provides a more complete picture of investment results than looking solely at absolute returns. The return/risk ratio shown in the chart is the return divided by the volatility. This represents the level of reward achieved for the level of risk taken. The higher the return or risk ratio, the better the result. The most preferred position is in the upper left quadrant of the chart, which indicates higher returns but less volatility. The upper right quadrant shows those who also had high returns but incurred the highest volatility earning those returns.

The chart compares the Fixed Trust Fund's five-year return/risk ratio with nine public pension funds LAB used for comparison purposes in its 2001 and 2003 performance audits. The chart shows that the Fixed Trust Fund earned higher returns than its benchmark but had slightly higher volatility than the benchmark. Compared to the other public funds shown, SWIB is a higher-return, lower-risk fund for the five-year period. On a risk-adjusted basis, SWIB's return/risk ratio ranked first among the 10 funds for this five-year period.

## Appendix I Use of Derivative Financial Instruments

A derivative is a financial instrument whose value depends on, or is derived from, the value of another asset, index or rate. Investment guidelines prohibit the use of derivatives for speculative purposes or leveraging of the assets. Below are the types of derivatives that SWIB uses in its separately managed portfolios. SWIB also invests in derivative instruments indirectly through several commingled funds. Because SWIB has no direct control over commingled funds, they are excluded from the following totals.

The Board of Trustees determines the specific investment policies for each portfolio's use of derivative instruments. These policies are contained in the Investment Guidelines or external manager contracts.

Under the Board's investment guidelines, the Investment Committee reviews the strategies for the use of derivative investments in internal and external SWIB portfolios. Portfolio managers, managing directors, investment directors or chief investment officers develop derivative strategies in accordance with investment guidelines. The Committee reviews the use of derivatives as part of its overall strategy review and evaluates derivatives when analyzing the portfolio's risk.

At least annually, the chief operating officer reviews with the Committee the accounting treatment and required note disclosures for external reporting purposes used for derivative instruments based on the applicable fund, the characteristics of the instrument, and any underlying assets or liabilities.

The Compliance Committee oversees the use of derivative investments in all SWIB portfolios, pursuant to policies and procedures. The compliance officer reviews all derivative investment activity at least monthly and reports any significant compliance breaches to the Committee at its next meeting.

The Committee and Executive Director review and refer to the Board of Trustees:

- a. any identified situations where Investment Guideline policy limits have been exceeded;
- b. any suggested changes to standing policies or limits.

The following types of derivatives are being utilized by each Fund:

**The Fixed Fund** uses the following types of derivatives:

**Foreign Currency Forward Contracts.** Foreign currency forward contracts fix the exchange rate for the future delivery of a currency at an agreed upon date. SWIB generally uses these derivatives to protect against the risk of currency exchange rate fluctuation in our international investments. Market risk is controlled by holding substantially offsetting purchase and sell positions. Additionally, counterparty risk is mitigated by limiting the counterparty to a bank or broker-dealer with a credit rating of at least: (1) 'B/C' or better from Fitch; (2) 'A1/P1' or better on short-term debt from S&P or Moody's; or (3) 'A' or better on long-term debt from S&P or Moody's.

Investment guidelines allow currency exposure management through the use of exchange-traded currency instruments and through the use of forward contracts. Direct currency hedging is permitted to hedge currency directly back to the U.S. dollar. Cross currency exposure management to transfer out of an exposed currency and into a benchmark currency is permitted.

On December 31, 2004, the fair value of the foreign currency forward contract assets totaled \$2.208 billion, while the liabilities totaled \$2.221 billion.

**Futures Contracts.** Futures contracts are an obligation to purchase or sell an underlying security at a specified date. Upon entering into a futures contract, the fund is required to deposit with a custodian an amount of cash or US government obligations in accordance with the initial margin requirements of the broker or exchange. Futures contracts are marked to market daily based on the settlement price established by the exchange on which they trade. An appropriate payable or receivable for the change in value (variation margin) is recorded by the Fixed Fund. The payable or receivable is subsequently settled and the gain or loss is realized.

Futures contracts involve, to varying degrees, risk of loss in excess of the variation margin. Losses may arise from changes in the value of the underlying instrument if there is an illiquid market for the contracts or if counterparties do not perform under the contract terms. Counterparty risk is mitigated by limiting the counterparty to a bank or broker-dealer with a credit rating of at least: (1) 'B/C' or better from Fitch; (2) 'A1/P1' or better on short-term debt from S&P or Moody's; or (3) 'A' or better on long-term debt from S&P or Moody's.

Nearly all of the fixed income portfolios are permitted to manage their interest rate exposure through the use of exchange-traded interest rate instruments. As of December 31, 2004, SWIB was invested in interest rate futures contracts with base exposure totaling \$484.8 million. During the calendar year realized gains on futures contracts totaled \$7.7 million.

**Credit-Linked Trust Certificates.** Credit-linked trust certificates are investments in a limited purpose trust.

In December 2003 SWIB hired Loomis Sayles & Company, L.P. to manage a high yield fixed income portfolio. As part of their investment strategy, they invested in exchange-traded Dow Jones Trac-X North America High Yield Trusts-Credit Linked Trust Certificates (Trac-X securities). Investing in Trac-X securities gives the portfolio immediate, diversified exposure to the high yield fixed income market.

The Trac-X security's trustee uses the proceeds from the certificates and invests the funds in a securities lending agreement with JP Morgan. The trust also enters into a credit default swap with JP Morgan Chase Bank, referencing 100 high yield corporate bonds. (A credit default swap is a counterparty agreement that allows the transfer of credit risk from one party to the other.) If the issuer of one of the 100 high yield corporate bonds defaults, the trust will receive the current market value of the defaulted asset. In addition, the notional value is reduced with a corresponding loss of principal to the certificate holders. Holders of certificates in this trust receive a fixed interest payment based on the notional value of the credit default swap. Investment in these certificates involves risk of loss from credit rating downgrades,

illiquidity, and counterparty risk. Valuation of this security is calculated by the party marketing the security, not by an independent party.

Loomis Sayles & Company, L.P. purchased \$114 million of the Trac-X securities in December 2003 and January 2004 on SWIB's behalf. The securities were sold over the next six months, at a loss of \$425,000, as the new portfolio gained exposure to the high yield market through the purchase of high yield bonds. During the time the securities were held they earned \$1.172 million in interest income.

**The Variable Fund** only utilized **Foreign Currency Forward Contracts**. (See Fixed Fund for description.) On December 31, 2004, the fair value of the foreign currency spot and forward contract assets totaled \$4.386 million, while the liabilities totaled \$4.403 million.



## Appendix J

### State Investment Fund Investment Categories

**US Treasury Bills.** US Treasury short-term discount securities guaranteed by the full faith and credit of the US Government.

**US Treasury Notes and Bonds.** US Treasury coupon issues with original maturities of up to ten years guaranteed by the full faith and credit of the US Government.

**US Agencies.** An agency chartered by the US Government to serve the public purposes specified by the Congress. Payment of the principal and interest may or may not be guaranteed by the full faith and credit of the US Government itself.

**Repurchase Agreements.** The purchase of securities (collateral) from a bank or dealer with the simultaneous consent by the bank or dealer to repurchase the securities at the same price at a specified date and interest rate. Repurchase agreements must be US Treasury or Agency securities that meet other investment guidelines.

**Asset-Backed Securities.** Publicly traded notes backed by loans, leases or installment contracts on personal property. Cash flows generated from underlying assets are used to pay principal and interest to the shareholders.

**Mortgage-Backed Securities.** Ordinary bonds backed by an undivided interest in a pool of mortgages or trust deeds. Income from the underlying mortgages is used to pay off the securities.

**Yankee/Euro Dollar Issues.** Obligations of foreign issuers payable in US dollars and registered with the Securities and Exchange Commission.

**Certificates of Deposit.** Interest bearing, negotiable, time deposits of fixed maturity at commercial banks.

**Commercial Paper and Corporate Notes.** Unsecured promissory notes that meet maturity and credit quality standards specified in the investment guidelines.

**Canadian Government Bills and Notes.** Securities with original maturities up to two years guaranteed by the full faith and credit of the Canadian government.

**Banker's Acceptances.** Time drafts drawn on and accepted by a bank to pay a specified amount of money on a specified date.

Appendix K  
New Investments in Wisconsin Companies  
Fiscal Year Ended June 30, 2004

Asset Category	Amount	Location
<b>Liquid Asset Investments</b>		
JOHNSON CONTROLS	\$25,000,000	Milwaukee
M&I - MILWAUKEE	\$25,000,000	Milwaukee
MGIC INVT CORP WIS	\$25,000,000	Milwaukee
US BANCORP (Firststar)	\$50,000,000	Significant Wisconsin Presence
WISCONSIN CD PROGRAM	\$420,730,000	Madison
WISCONSIN CORP CENTRAL CREDIT UNION	\$50,000,000	Hales Corners
WISCONSIN PUBLIC SERVICE	\$13,600,000	Green Bay
<b>Total Liquid Asset Investments</b>	<b><u>\$609,330,000</u></b>	
<b>Loans and Private Equity</b>		
BAIRD VENTURE PARTNERS	\$2,430,467	Milwaukee
CITYFOREST CORP	\$6,250,000	Ladysmith
FRAZIER TECHNOLOGY VENTURES	\$7,038,055	Significant Wisconsin Presence
HK SYSTEMS	\$146,729	Brookfield
HORIZON CAP PARTNERS	\$399,127	Milwaukee
KOHL'S CORP	\$5,613,000	Menomonee Falls
M & I BANK	\$5,000,650	Milwaukee
MASON WELLS	\$2,325,581	Milwaukee
NAMEPROTECT	\$200,000	Madison
NIMBLEGEN	\$400,000	Madison
OPGEN INC	\$316,667	Madison
PROTEIN INGREDIENT INC	\$4,361,198	Significant Wisconsin Presence
TOMOTHERAPY INC	\$531,000	Middleton
VENTURE INVESTORS	\$750,000	Madison
WPB ACQUISITION	\$1,500,000	Jackson
<b>Total Loans and Private Equity</b>	<b><u>\$37,262,474</u></b>	
<b>Public Equities</b>		
ALTRIA GROUP INC	\$7,257,250	Significant Wisconsin Presence
ANCHOR BANCORP WIS INC	\$92,540	Madison
ASSOCIATED BANC CORP	\$296,300	Green Bay
BRIGGS & STRATTON CORP	\$424,080	Wauwatosa
CRAY INC	\$662,000	Significant Wisconsin Presence
HARLEY DAVIDSON INC	\$5,054,304	Milwaukee
JOHNSON CTLS INC	\$3,770,977	Milwaukee
JOURNAL COMMUNICATIONS INC	\$1,839,691	Milwaukee
KOHL'S CORP	\$7,399,000	Menomonee Falls
OSHKOSH TRUCK CORP	\$1,341,054	Oshkosh
QUINTON CARDIOLOGY SYSTEMS INC	\$302,887	Significant Wisconsin Presence
ROCKWELL INTL CORP	\$7,689,550	Milwaukee
A O SMITH CORP	\$206,635	Milwaukee
<b>Total Public Equities</b>	<b><u>\$36,336,268</u></b>	
<b>Real Estate</b>		
LAKE TERRACE BUILDING	\$1,376,613	Madison
<b>Total Real Estate</b>	<b><u>\$1,376,613</u></b>	
<b>Grand Total</b>	<b><u>\$684,305,355</u></b>	

*This report contains new investments with companies that are headquartered or have a significant presence in Wisconsin.*