

**STATE OF WISCONSIN
DEPARTMENT OF EMPLOYEE TRUST FUNDS
801 West Badger Road
Madison, WI 53702**

CORRESPONDENCE MEMORANDUM

DATE: April 30, 2003

TO: Deferred Compensation Board

FROM: Pam Henning, Director
Office of Strategic Services

SUBJECT: 2002 Annual Investment Performance Report Review and Recommendations

The **2002 Annual Investment Performance Report** is presented to the Deferred Compensation Board (Board) to monitor the investment options that are made available to participants of the Wisconsin Deferred Compensation (WDC) program. The Investment Committee met on April 22, 2003, to review a draft of the 2002 report. Staff and committee members concur that further review of the T. Rowe Price International Stock Fund and the Janus Fund is warranted because of their failure to meet performance benchmarks and concern with changes in management of the funds.

A portfolio manager from each of the above funds has been asked to attend the May 13, 2003 Board meeting (in person or via conference call) to provide an explanation of the fund's recent performance and its future outlook. Staff recommends that no action be taken on closing or removing these funds from the WDC program until further review has occurred and additional analysis is completed on possible alternative options for the core spectrum.

Overview of 2002

The WDC program assets totaled \$1.12 billion on January 1, 2002, and ended the year at \$1.03 billion, with new participant contributions for 2002 totaling \$101 million.

During 2002, one significant change took place within the WDC program's core investment spectrum. Effective December 31, 2002, the Vanguard Wellington Fund experienced a portfolio manager change. Ernst von Metzsch retired after being the lead portfolio manager for the equity portion of the fund since 1995. Edward P. Bousa, who has been a value-stock manager for most of his career, has assumed the lead role. Paul Kaplan continues to manage the 35% of the portfolio that is devoted to high-quality fixed income. He has been in this lead role since 1994.

Funds Failing To Meet Benchmarks

The report indicated that 10 of the 16 core investment options offered through the Wisconsin Deferred Compensation (WDC) program experienced a negative return for the year. However, only three funds have failed to meet performance benchmarks for the five-year period. These

three funds include the two International Stock Funds, T. Rowe Price International Stock Fund and Barclays EAFE Equity Index Fund, as well as Dreyfus Premier Third Century Fund.

T. Rowe Price International Stock Fund –

The T. Rowe Price International Stock Fund has failed to meet all of its performance benchmarks for the one, three and five-year periods. The quartile ranking illustrates that this fund is slightly below the median when compared to the Morningstar Foreign Stock Universe. As the report reflects, this fund has consistently fallen below the median.

T. Rowe Price presented an explanation of the fund's performance at last year's Board meeting. Since that meeting, no significant changes have occurred in the fund's practices or in its performance relative to other foreign stock funds.

Barclays EAFE (Europe Australia Far East) Equity Index Fund –

The EAFE Equity Index Fund failed to meet all of its performance benchmarks for the one-year period and failed to meet one of its benchmarks for the three-year period. This fund was added to the WDC Program in February 2001.

Barclays indicated that failure to meet the performance benchmarks was a direct result of the excessive trading that occurred in the EAFE Equity Index Fund in 2002. Recent corrective action by the Board should reduce these costs and associated tracking errors.

Dreyfus Premier Third Century Fund –

The Dreyfus Premier Third Century Fund failed to meet all performance benchmarks for the one, three, and five-year periods of time. Its quartile ranking was also below the median.

Based on last year's performance review, the Dreyfus Premier Third Century Fund was placed on a watch list and is currently closed to any new deferral elections. Participants have been informed that this fund has underperformed its benchmarks and that action may be taken by the Board to remove this fund from the program based on this year's review.

Janus Fund –

The Janus Fund exceeded one of two performance benchmarks for the one, five and ten-year periods but failed to meet both benchmarks for the three-year period. The fund's performance has been hindered recently due to one of its top holdings coming under scrutiny for some of its business practices. The fund has since dramatically reduced its position in this stock and has been a top half performer for three of the last five calendar years.

However, the management of this fund (as well as the Janus family of funds) has experienced many changes over the last three years, including, most recently, the departure of Helen Young Hayes, Chief Investment Officer of Janus worldwide. Concerns have been raised regarding how this may affect the fund's investment management and long-term performance opportunities.

Recommendations

Staff and Investment Committee members concurred that additional review of the T. Rowe Price International Stock Fund and the Janus Fund is necessary to ensure these options continue to be acceptable long-term investment opportunities for WDC participants. Specific recommendations for actions to close or remove any option from the WDC core spectrum should be deferred until information presented by the fund managers at the May 2003 Board meeting has been considered.

In addition, staff and the Investment Committee concur that based upon this year's review of the Dreyfus Premier Third Century Fund's investment performance, Dreyfus will continue on the watch list. The Investment Committee will review its performance this summer and report to the Board at the November 2003 Board meeting.

Attachment