

# SWIB REPORT

May 2010 :: Published For Wisconsin Retirement System Participants

## Trust Fund returns start slow, rebound in March

After a slow start to 2010, stock markets rebounded during March. Both the Core and Variable Funds ended January and February with slight negative returns. However, in March the economy began showing some momentum and stocks started to rebound. The Dow Jones Industrial Average gained 4.1% during the first quarter, the best first quarter performance since 1999.

A recovery is expected to take time. Several factors, including the job market and the housing market continue to be of concern. The outlook for the U.S. markets in 2010 is generally considered to be positive. However, global investors face significant uncertainty in the next year or two.

### **Calendar Year-to-Date Preliminary Returns As of 3/31/10**

**Core Fund ..... 2.7%**  
**Variable Fund ..... 4.8%**

### **2009 Final Returns**

**Core Fund ..... 22.4%**  
**Variable Fund ..... 33.7%**

## SWIB CIO honored

David Villa, SWIB chief investment officer, has been honored for his contribution to the financial industry and exceptional performance as a money manager. David was named 2010 U.S. Large Public Fund Investment Manager of the Year by Institutional Investor, an international financial magazine.

David was selected from among U.S. public pension funds managing assets of more than \$10 billion. The first-time award recognizes professionals in the industry for excellence based on performance, understanding of the market and recommendations by

*Villa continued on page 4*

## Pew's praise for WRS is no surprise

*By Keith Bozarth, SWIB, executive director and Dave Stella, ETF secretary*

A recent study by the Pew Center on the States is making news because of the poor scores given to most states for public pension management. In contrast, the study recognized Wisconsin as a "national leader" in managing its pension system. There are good reasons why Wisconsin is considered a "solid performer" by the Pew Center.

The Wisconsin Retirement System (WRS) and its members and employers are not immune to the pain of the financial market collapse of 2008. Rather, the system endured the pain because the WRS contains uncommon "risk and reward" features that help sustain a fair level of retirement security at a reasonable cost.

The risks and rewards of pension fund investing are shared among retirees, active employees and employers:

- ◆ The WRS substitutes a dividend process in lieu of guaranteed cost-of-living increases for

This article is in response to media coverage of the public pension fund report issued by the Pew Center. A link to the Pew Center report and the Wisconsin Factsheet is available at <http://www.swib.state.wi.us/Default.aspx>

retirees. If annual investment returns justify it, a dividend is declared. If investment returns are poor, retirees can and do see pension reductions, which happened for the first time in 2009 and again in 2010.

- ◆ The WRS is a hybrid plan that provides a modest percentage of final pay formula benefit. A higher benefit can be earned, but only if investment returns support it.
- ◆ Contributions to fund benefits are required from employees and employers, but an employer may agree to pay some or all of its

*Pew continued on page 4*

## Core Fund returns higher in 20-year comparison

The annualized investment rates of return (see chart below) compare the investment performance of the Core Fund and Variable Fund for a 20-year period. The annualized return calculation takes compounding into consideration.

Annual investment results are used to determine adjustments to annuity payments to WRS retirees and to the effective rates credited to active employee accounts. The calculation includes several factors.

Annual Investment Returns		
Year	Core Fund	Variable Fund
2009	22.4%	33.7%
2008	-26.2%	-39.0%
2007	8.7%	5.6%
2006	15.8%	17.6%
2005	8.6%	8.3%
2004	12.8%	12.7%
2003	24.2%	32.7%
2002	-8.8%	-21.9%
2001	-2.3%	-8.3%
2000	-0.8%	-7.2%
1999	15.7%	27.8%
1998	14.6%	17.5%
1997	17.2%	21.6%
1996	14.4%	19.8%
1995	23.1%	25.6%
1994	-0.6%	0.8%
1993	15.0%	16.5%
1992	9.7%	10.7%
1991	20.4%	27.1%
1990	-1.5%	-11.3%
20-year Annualized Return	8.3%	7.7%

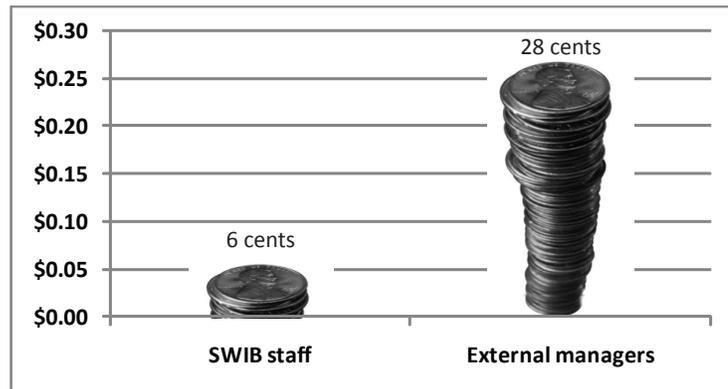
## Initiatives help cut costs

SWIB's management style, including the use of staff to manage WRS assets in house, is paying off. SWIB was ranked as a low cost manager compared to peer funds of a similar size and asset mix according to an annual review of Core Fund costs by CEM Benchmarking, Inc.

One reason, the study noted, was an increase in internal management, which costs considerably less than using external managers. Since December 31, 2007, the share of retirement fund assets managed internally has risen from 21% to 41% due to greater budget and position authority. SWIB has achieved approximately \$6.4 million in net annual cost savings as a result and has improved investment returns in a number of areas. In 2009, internal managers also contributed greatly to the \$1.2 billion value added by the Core Fund outperforming its benchmark. The total cost of management for all assets in the Core Fund -- including private and public markets -- is \$0.37 per \$100.

### 2009 Core Fund Cost

(per \$100 of public market assets)



## Core, Variable differ in impact, strategies

The Core and Variable Funds are two different funds with distinct investment strategies. More importantly, the end results and impact on your pension will also be very different.

The Core Fund is a fully diversified, balanced fund. The Fund is anchored with equities (stocks) and fixed income (bonds) and includes other types of investments. (See page 3.) One very important aspect of the Core Fund is the smoothing of returns over five years, lessening the impact of market volatility on adjustments to employee accounts and annuity payments.

State law requires that the Variable Fund be primarily invested in equities. The returns of the Variable Fund are not smoothed and, therefore, fully reflect market changes. Participants in the Variable Fund are exposed to a higher degree of risk because of possible losses from unfavorable stock market performance in exchange for the possibility of greater long-run returns. Variable Fund negative returns could cause annuities to decrease below the initial base amount.

Stock exposure for those who participate in the Variable Fund -- depending on the amount of the individual account and length of time in the WRS and in the Variable Fund -- is estimated to be an average of 77%.

# Core Fund changes would provide greater stability

At the January Board meeting, SWIB trustees approved new strategic asset allocation targets for the Core Fund subject to implementation decisions over the course of 2010. With this strategy, SWIB would trade a slight reduction in expected returns for better performance in down markets.

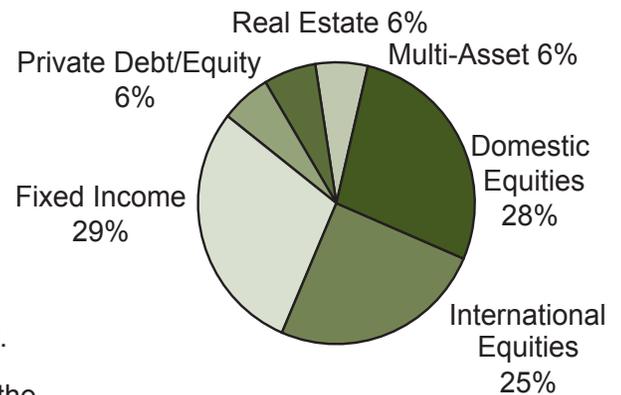
The change was a result of the Trustees' annual review of the asset allocation to consider adjustments and new initiatives. This year domestic equities (stocks) were reduced by 2% and multi-asset allocation was increased by 2%. The increase in the multi-asset allocation allows SWIB to consider new investment opportunities aimed at further reducing the volatility of the Core Fund.

Based on work done by SWIB's asset allocation consultant, the proposed changes could provide greater stability and predictability for members and employers. It also provides greater protection in extreme stock markets, such as the severe downturn in 2008.

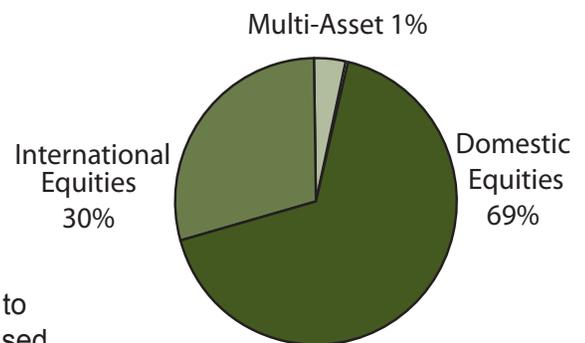
While the SWIB governing board has endorsed a proposed strategy, implementation of specific plans is subject to approval. Over the course of 2010, SWIB will review investment options, selecting appropriate investments to implement in small incremental steps. The process, timing and methods used will be discussed openly as part of a public agenda. Staff will be taking a cautious approach to changes using modeling and analysis conducted prior to implementation. In addition, changes will be reexamined and reassessed annually by Trustees.

Asset allocation is an important part of the diversification strategy for investing the pension system funds. This process is one of the ways that SWIB manages risk and helps stabilize returns. Diversification allows for more consistent performance under a wide range of economic conditions.

## 2010 Core Asset Targets



## 2010 Variable Asset Targets



## Types of investments in the asset allocation

### Public Equities (Stocks)

**Domestic:** primarily common stock in U.S. companies diversified among small-, medium- and large-sized companies.

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

**Emerging markets:** stocks in developing countries as defined by the World Bank.

### Public Fixed Income (Bonds)

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

**Global:** developed country bonds meeting minimum credit quality requirements.

**Emerging markets:** fixed income securities, mostly government debt, in developing markets as defined by the World Bank.

### Private Markets

**Real estate:** commercial real estate investments with SWIB as a sole direct owner, or in joint ventures and partnerships with outside managers and diversified by location and property types; and diversified sets of real estate investment trusts (REITs).

**Private equity/debt:** includes leveraged buyouts and venture capital; direct, long-term loans to Wisconsin companies; and private market investments.

### Multi-Asset

Globally diversified investments; applies asset allocation strategies across world capital markets.

## **Villa** (continued from page 1)

peers in the investor community.

“This is an honor that truly recognizes everyone at SWIB for their dedication and their extraordinary work,” said David. “The support from our Board and the resources we can draw on here are outstanding and as a result we can do things that other funds who depend on external managers cannot.”

“We have accomplished some great things, most notably was the work involved in bringing an additional 20% of the Wisconsin Retirement System funds inside to be managed by staff over the past two years.”



David Villa

It was no accident that the lifetime achievement award was being presented for the first time this year, said Mike Peltz, executive editor of Institutional Investor. “The timing is really good given what people have been through over the past 18 months,” he said, “we wanted to acknowledge the people who were able to do well by the people they represent.”

## **Pew** (continued from page 1)

employees’ contributions. Contributions and who pays for them can be adjusted over time.

Unlike Social Security, the WRS actually accumulates assets so that future generations of participants and taxpayers are not left with an IOU. In addition, unlike some other states, Wisconsin governments have paid the pension contributions necessary to keep up with long-term funding requirements.

Investment management is also an important part of the formula.

- ◆ Because the WRS includes almost all Wisconsin public employees, it has the advantage of size in the financial markets and scale in managing costs. A cost-effectiveness analysis by CEM Benchmarking, Inc. found that WRS investment costs are below normal.
- ◆ A high percentage of WRS assets are managed by the Investment Board’s own staff, rather than by higher-cost external asset management firms.
- ◆ State policymakers have given the WRS the resources and flexibility necessary to carry out a high quality investment program. That support is lacking in many states.

The Pew Center report provides insight into some of the problems that have plagued some public pension funds over the years. Wisconsin residents can take comfort that this state has been recognized as an exception.

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David Stella, Secretary

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Michael Morgan

### 2010 Board Meetings

Tuesday/Wednesday, May 11/12

Wednesday, June 9

No July Meeting

Wednesday, August 4

Tuesday/Wednesday, September 14/15

Tuesday/Wednesday October 6/7

Wednesday November 10

Wednesday December 8

Agendas are posted on our website.

Dates may change.

Keith Bozarth, Executive Director

David Villa, Chief Investment Officer

Gail Hanson, Dep. Exec. Director

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