



The SWIB Report

Published by the State of Wisconsin Investment Board for WRS participants

May 2007

Calendar Year-to-date Preliminary Returns

As of 3/31/07

Core Fund2.0%

Variable Fund1.4%

Need Information?

Want to know more about SWIB and the investments of the retirement trust funds? Please visit our website at www.swib.state.wi.us for monthly performance updates, newsletters and other helpful information. To register for an email notification about our quarterly newsletter or other occasional alerts contact us at info@swib.state.wi.us. If you have registered for the electronic updates, but have not received one, check with your email provider to make sure your spam filter will permit delivery. You can also contact SWIB at:

Box 7842
Madison, WI 53707
Hotline: (800) 424-7942
(Madison) 267-0957

2007 Board Meetings

- June 13
- August 8
- September 19
- October 17/18
- November 14
- December 12 (tentative)

Agendas are posted on our website. Dates may change.

First quarter performance slows following strong finish in 2006

Following the solid fourth quarter of 2006, stocks again saw some volatility during the first three months of 2007. After two months of growth, there was a significant decline in the markets of more than 7% at the beginning of March. Much of the ground had been recovered by the end of the quarter, however.



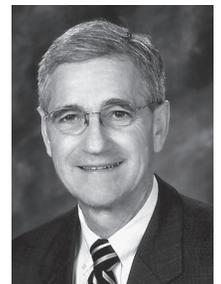
Source: Dow Jones

Stock market returns are expected by most observers to be positive for 2007. However, many expect returns to be single digits due to continuing concerns about consumer spending and a major slowdown in the housing market. Federal Reserve Chairman Ben Bernanke has indicated that inflation is still a concern. Bond yields might have to rise to compensate for the possibility of somewhat higher inflation.

From the executive director “Looking forward” or “forward looking”?

Ever since my announcement in January that I would be retiring as executive director later in 2007, I’ve been regularly asked why I’m departing and what I **look forward** to after leaving SWIB. More time with family? Sailing? Golf? Perhaps, some part-time work? The truth is it’s a little of each.

But my decision to retire this year was made for another reason: before announcing I engaged in some **“forward looking”** about SWIB and what I found makes me very optimistic. I asked myself: Have we got the right people in the right places to bring success? Do we have the resources to compete in an ever more efficient – and competitive – investment marketplace? Do we have the flexibility for our investment professionals to nimbly respond to opportunities presented by the markets?



Dave Mills

Continued on page 4

Core versus Variable

Overview

The Wisconsin Retirement System is comprised of two funds.

The Core Fund is the largest of the two trust funds. It includes a mixture of holdings. All participants have at least 50% of their pension fund account contributions made to this fund. Core Fund returns are smoothed over five years, lessening the impact of market volatility on contribution rates and annuitant dividends.

The smaller of the two trust funds is the Variable Fund. By law, the Variable Fund is a stock fund. 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 potential of greater long-run returns.

The WRS is the only public pension system that has an option such as the Variable Fund. About 20% of WRS participants and 8% of the WRS assets are in this fund.

Participants who choose the Variable Fund have half of their annual pension fund contributions invested in this fund. (Election to participate or cancel participation in the Variable Fund must be done through the Department of Employee Trust Funds.)

Investment Objectives

The basic objective of the Core Fund is to earn an optimum net rate of return while taking an acceptable level of risk. SWIB strives to earn at least an average 7.8% annual return over the long term. Contributions from public employers and employees can be reduced when investment earnings are higher than the assumed rate of return if wage inflation matches projections. The ten-year annualized return as of December 31, 2006, was 9.2%.

A second goal is to exceed the benchmark established by the Board of Trustees. The benchmark measures SWIB's performance against the markets. The Core Fund benchmark is mainly a composite of several market indexes, such as the Russell 3000, rolled up and weighted to reflect the Board's asset allocation.

By way of comparison, the investment objective for the Variable Fund is to achieve returns equal to or above that of similar stock portfolios over a market cycle.

2007 Core Fund Asset Targets

Domestic Stocks.....	36%
International Stocks	22%
Fixed Income.....	30%
Real Estate.....	5%
Private Equity/Debt.....	5%
Multi-Asset.....	2%

Types of Investments

Diversification is an important strategy for investing the pension system funds. The Core Fund is invested in stocks, bonds, business loans, real estate and private equity. In addition, diversity comes from company size and from investments in the US and other countries.

While the Variable Fund includes only stocks, it is also diversified among countries and by company size. The stocks in the Variable Fund are the same as the Core Fund.

The Board of Trustees regularly reviews the asset allocation to consider adjustments and new initiatives.

Public Equities (Stocks)

Domestic stocks: primarily common stock in US companies diversified among small-, medium- and large-sized companies.

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

Emerging market equities: stocks in developing countries as defined by the World Bank.

Public Fixed Income (Bonds)

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

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

Emerging markets: fixed income securities 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.

Private equity/debt: includes leveraged buyouts and venture capital and direct, long-term loans to Wisconsin companies. Investments may carry greater risk, but offer the prospect of greater return.

Annualized Return

December 31, 2006

Fund	5-year	Rank	
		risk-adjusted	not risk-adjusted
SWIB Core Trust Fund	9.9%	4	5
Washington State Investment Board*	10.9%	1	2
Pennsylvania Public Schools	11.7%	2	1
California Public Employees	10.3%	3	3
Virginia Retirement System*	10.2%	5	4
Minnesota State Board of Investments*	9.2%	6	6
New York State Teachers*	9.1%	7	7
Texas Teachers Retirement System	8.8%	8	8
Florida Retirement System	8.7%	9	9
New Jersey Division of Investments	7.8%	10	10

*Returns reported net of fees

The chart above shows SWIB's investment performance compared to other large pension funds. The risk-adjusted rank is based on tolerance for year-to-year volatility. The return rank is based on annualized returns. Liabilities and investment objectives vary from fund to fund and may contribute to differing performance results.

Peer comparison is good management review tool

Public pension funds measure performance in different ways. One common way is to compare the rate of return against an investment standard, or benchmark. (See chart top of page 4.) Using this measure, SWIB seeks to exceed benchmarks set for the trust funds by Trustees with the help of a consultant.

The Legislative Audit Bureau (LAB) also compares SWIB's performance to nine other public pension funds (listed above) for management reviews. These comparisons with other funds consider gross returns, except where noted, and do not take into account asset allocation, risk, liabilities and other factors that vary from fund to fund and affect returns.

As of December 31, 2006, the Core Fund's five-year return

ranked fourth on a risk-adjusted basis. This approach considers the plan's tolerance for year-to-year fluctuations (volatility) in returns. Less volatility helps to stabilize employer contributions to the WRS and benefits available to retirees.

With no adjustment for risk, the Core Fund ranked fourth in a comparison of one-year gross returns and fifth for five-year returns compared to the public pension funds surveyed in the past by the LAB.

Another survey conducted by the Trust Universe Comparison Service (TUCS) ranks the Core Fund's one-year return in the top 20%. Of about 55 public pension funds with assets over \$1 billion, the five- and ten-year returns were ranked in the top 25%. TUCS returns are not on a risk-adjusted basis.

Changes are expected to improve returns

The investment environment is changing. So is SWIB. In late 2006, SWIB began strategic changes designed to enhance the long-term investment performance of the trust funds. These changes will further diversify assets, reduce costs of external management by bringing more assets in-house and take advantage of market opportunities.

The initial phase is to combine the assets of three large cap domestic equity (stock) portfolios to create portfolios that each focus on one of ten market sectors, such as consumer staples or technology. SWIB's stock analysts now each cover multiple sectors, and the US and overseas markets are covered by separate analysts. SWIB's goal is for each analyst to specialize in one sector on a global basis. That way an analyst covering energy, for example, will evaluate investment opportunities in large cap companies worldwide. This change will also involve merging the assets of the international and domestic large cap portfolios.

This "global sector" approach is used by a number of leading private investment firms. SWIB has successfully managed a healthcare sector portfolio since 2001. That portfolio is the model for this initiative.

Implementation of this plan depends upon final approval of additional resources included in the Governor's 2007-09 biennial budget recommendations. When fully implemented, our goal for this and other changes is to improve net returns to the WRS trust funds by over \$44 million annually.

Strong returns in 2006 add value to WRS funds

At the end of 2006, the return for the diversified Core Fund was 15.8% and the return for the all-stock Variable Fund was 17.6%.

The Core Fund return beat its one-year benchmark of 14.6% and the Lipper Index of Balanced Mutual Funds return of 11.9%. SWIB has beaten the Core Fund benchmark for four consecutive years for the first time since the WRS composite benchmark was implemented in 1982. The Core Funds's ten-year return is also well ahead of the 7.8% annual average return assumed

Annualized Returns			
Ending 12/31/06			
	1-Year	5-Year	10-Year
Core Fund	15.8%	9.9%	9.2%
Benchmark	14.6	9.5	8.6
Variable Fund	17.6%	8.3%	8.7%
Benchmark	17.6	8.8	8.0

in the actuarial projections for the WRS.

The Variable Fund return equaled its benchmark. (See chart above for five- and ten-year performance.) By beating benchmarks, SWIB added about \$737.5 million in returns. The additional investment earnings were

mainly the result of investment strategies in real estate, private equity and fixed income. The market value of the Core Fund on December 31, 2006, was \$76.0 billion and the Variable Fund was \$7.1 billion.

The WRS Trust Funds provide benefits to over 533,000 current and former employees of state agencies, the university system, school districts and most local governments. The WRS is the 9th largest US public pension fund and the 24th largest public or private pension fund in the world.

Forward *Continued from page 1*

The good news is the answers are positive. Our four most senior investment staff, new to their positions within the last two years, are eager, energetic and very capable. They will do a terrific job for SWIB. Surrounded by seasoned SWIB veterans and a large group of highly qualified newer staff, I expect great things from them. The other half of our organization, often referred to as our investment support staff, is truly exceptional in the contribution they make to SWIB's success.

On the resource front, before I leave I expect to be able to say that things have never been better. Governor Doyle has included our request for greater budget authority in the executive budget, and legislators seem responsive. If the bill passes this summer with our changes intact, SWIB should be able to improve net returns by bringing more assets in-house for a fraction of the cost that we now pay outside managers.

And when it comes to flexibility,

we are working aggressively to educate the Legislature on the importance of providing SWIB with the tools needed to compete in today's investment world. SWIB must have state of the art information technology and the authority to pursue new strategies to be the first class institutional investor our members and the State expect us to be. When I did my "**forward looking**," I saw a staff poised for great success, supported and challenged by a Board of Trustees committed to taking SWIB to the next level. These things made a difficult decision to retire a whole lot easier.

In closing, let me say it has been a great honor and privilege to serve as SWIB's leader. I have spent my entire professional career as an educator and public servant, which makes it very special to finish my career working **for** educators and public servants. And "**forward looking**," SWIB's future – your future – looks very bright.

Annual Investment Returns		
Year	Core Fund	Variable Fund
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%
1989	19.2%	22.6%
1988	14.4%	21.7%
1987	2.2%	-1.1%
20-year Annualized Return	10.3%	10.6%