

Frequently Asked Questions

State of Wisconsin Investment Board 2010 Asset Allocation Strategy

As part of an ongoing review of Wisconsin Retirement System (WRS) investment strategies, trustees of the State of Wisconsin Investment Board (SWIB) approved new strategic asset allocation targets for the Core Retirement Fund. The new asset allocation targets will be initiated in 2010, subject to the Board's approval of specific implementation plans.

By taking such proactive actions, SWIB is positioned to implement an investment strategy to help keep the Core Fund in strong financial condition and better protect it against severe market downturns. One of the primary goals is to help the WRS – ranked in two recent national studies as one of the best-funded public pension systems in the national – maintain its strong financial position.

The strategy adopted at the January 2010 Board meeting is intended to:

- reduce risk through less exposure to public equities (stocks);
- provide better diversification with increased allocation to lower-return and lower-risk assets (fixed income); and
- continue to achieve the actuarial expected rate of return over the long term.

The development and review of possible implementation plans will take place over a number of months with discussion and decision in public meetings.

SWIB has produced the following series of questions and answers to provide additional information about the actions being considered in 2010.

Q1. Why are you considering a “new” strategy now?

A. Actually, SWIB has been discussing and assessing the strategy for more than two years. The strategy particularly considers “lessons learned” from the market collapse of 2008, one of the worst downturns since the 1930s. Thus, we are implementing a strategy that addresses market volatility. The sharp decline in public equities markets has caused many large institutional investors to consider ways to protect portfolios from extreme swings in the market and, most important, precipitous declines. SWIB has analyzed and evaluated a range of investment instruments and strategies. This strategy is the result of extensive modeling and research by the SWIB staff and its consultants.

Q2. What strategies will SWIB consider using?

A. Trustees approved a strategic investment direction that will consider a trade off of a reduction in high-volatility stocks held in the portfolio against the modest use of leveraging low-volatility fixed income assets to help manage risk in the Core Fund. While it is premature to detail the process, timing and methods, those aspects will be discussed openly as part of a public agenda. Meanwhile, staff will be taking a cautious approach to changes using modeling and analysis prior to implementation. In addition, the amount of leverage will be reexamined and reassessed annually by trustees.

Q3. Why is SWIB using a strategy that includes leverage?

A. We wish to emphasize that this strategy is intended to help stabilize contribution rates and benefit adjustments in the Core Fund rather than increase returns. In fact, the strategy knowingly trades a very slight reduction in expected returns for better performance in down markets by reducing the allocation to stocks and increasing the allocation to fixed income. This strategy acts as an insurance premium against declines in the market value of equities, which comprise roughly half of the Core Fund assets, but 90% of the total Fund volatility.

This strategy has been implemented successfully by some institutional investors and is being considered by others. Leverage frightens many people today because of misuse and overuse. In reality, it is like any other investment tool that provides great benefit when properly used, but can be harmful when misused.

Q4. Isn't leverage what caused certain companies to fail during the recent financial crisis?

A. Yes. However, those widely reported cases involved extreme amounts and forms of leverage as well as degrees of risk far beyond the bounds of sound investment principles or anything SWIB is considering. It is unfortunate that leverage as an investment term should have this current connotation. That said, leverage has been and will be an appropriate investment tool when used with caution. There are many forms and degrees of leverage that can be done with the use of various financial instruments, such as options and futures, not necessarily borrowing cash. The risk-reducing nature of the SWIB strategy will conservatively use leverage to improve returns in down markets. There are many ways to implement the strategy and SWIB has not settled on the precise steps it will take. One common and productive use of leverage is borrowing to buy a home. For a home purchased with a 20% down payment, the leverage multiple is 5 to 1. The leverage multiple of SWIB's 2010 proposal is significantly smaller at 1.04 to 1.

Q5. How will the use of leverage affect funding of the Wisconsin Retirement System?

A. Some observers have incorrectly assumed the strategy is tied to an effort to address problems with the current financial condition of the WRS. However, with a market ratio funding status estimated between 90% and 100% by the Department of Employee Trust Funds, the WRS is sound. In fact, it has a long history of being one of the top funded public systems in the nation.

Under the proposed strategy, the expected Core Fund return will be slightly lower; however, the Fund is still projected to achieve the assumed actuarial rate of return (7.8%) over the long term. Moreover, this strategy seeks to stabilize the impact on employers (taxpayers), employees and retirees, which is a growing challenge in the current market environment. To achieve this, we expect SWIB's returns will be slightly lower when equities have a strong performance, but the Core Fund will perform better during extreme economic environments.

Please contact SWIB at info@swib.state.wi.us.

April 2010

