

State of Wisconsin Investment Board

Annual Report

Fiscal Year 2009



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Introduction

Message from the Chair



After the worst stock market downturn since the 1930s, global equity markets rose 33% from the end of February to the end of the fiscal year at June 30. The Wisconsin Retirement System (WRS) Trust Funds were well positioned and took full advantage of the rebound.

Although several economic measures remained weak, the markets anticipated recovery as companies reported better than expected earnings in the first half of 2009. Government fiscal and monetary stimulus worldwide reached unprecedented levels, contributing to the market rise. However, many observers remain guarded in their market outlook due to the significant ongoing challenges that the global economy continues to face.

Core Fund investment returns for periods ending June 30, 2009, reflected the market downturn that began in October 2007 and persisted through most of the fiscal year. The Fund matched its performance benchmark for the one- and five- year periods and surpassed the ten-year benchmark.

A major long-term focus for SWIB is to reduce the risk to the Core Fund from the volatility the stock market has experienced for much of the last decade. Although the risk of inflation in the short term is low, the potential for greater inflation longer term is also a concern.

SWIB is considering several strategies that could enable the Core Fund to perform more consistently across all types of economic conditions. These strategies should help contribution rates for employers and employees remain stable and payments to retirees keep pace with the cost of living. We have already implemented some initial strategy changes and more are under consideration for 2010 and beyond.

SWIB is also focused on reducing the cost of investment management. In fiscal year 2009, the share of Core Fund assets managed by SWIB's professional staff increased from 23% to 39%, reducing reliance on more expensive outside money management firms. An independent evaluation by CEM Benchmarking, Inc. found that SWIB's total costs in 2008 (agency operating expenses plus payments to vendors) were less than those of other large public funds that managed a similar mix of assets. The ability to attract and retain experienced staff is essential to achieving these savings.

The design of the WRS will help the trust funds weather this period of unprecedented stress in the financial markets. SWIB trustees and staff are committed to pursuing long term investment strategies that ensure the retirement system remains strong.

A handwritten signature in black ink, appearing to read "James A. Senty", with a stylized flourish at the end.

James A. Senty, Chair



“Sustainability” is a word used a lot these days by public pension systems. Following the financial market collapse of 2008, public pension plans around the country are carefully considering how promised benefits can be supported without significant changes to the benefit, investment or funding structures.

A recent report by the actuary confirmed that the Wisconsin Retirement System (WRS) is in sound financial condition and in much better shape than many other pension systems. The WRS incorporates some uncommon features that contribute to its sustainability through periods of severe market stress.

By law, any change in contribution rates must be divided evenly between the employee and employer rates. This means that employees and employers are at equal risk for higher costs during periods of investment market declines. In addition, annual post-retirement adjustments to the monthly annuity benefit are based solely on investment returns.

These features act as a “braking mechanism” on liability increases during periods when asset values fall. Of equal importance, they distribute risk and reward among all plan participants and employers.

The 2008 financial market meltdown provided a significant “stress test” for the WRS that resulted in a “negative dividend” of 2.1% to Core Fund annuities and a small contribution rate increase of 0.6% beginning in 2010. Because investment returns are smoothed over a five-year rolling period losses from 2008 will be recognized over five years and offset by past and future investment gains.

Because of its structure, market volatility has different consequences for the WRS than for many other pension systems. The degree of reliance on stock market gains must be carefully considered. For the same reason, the value of investment diversification in lowering risk is increased. I encourage you to read the message from the Board Chair for more insight into how SWIB is approaching these factors in its future investment strategy.

Even in one of the most challenging investment environments in recent history, it is evident that the WRS contains built-in features that will help maintain a viable pension plan with fewer dislocations and inequities than other plans are likely to experience.

A handwritten signature in black ink, consisting of a stylized 'K' followed by a cursive 'Bozarth'.

Keith Bozarth, Executive Director

Overview

The State of Wisconsin Investment Board (SWIB) is a state agency responsible for investing the assets of the Wisconsin Retirement System (WRS), the State Investment Fund (SIF) and five smaller trust funds established by the State. Investments are made according to the purpose and risk profile of each trust. The WRS includes the Core Retirement Investment Trust Fund (Core Fund) and the Variable Retirement Investment Trust Fund (Variable Fund).

The Investment Board was created under section 15.76 of the statutes. The Board's duties as manager of the State's trust funds are provided in chapter 25 of the statutes. SWIB staff and Trustees are fiduciaries of the pension funds and are governed by the "prudent investor" standard, which requires them to use the

diligence, skill and care that a prudent person acting in a similar capacity and with the same resources would use in managing a large public pension fund.

The law also requires SWIB to make investment decisions and conduct every aspect of its operations in the best financial interest of the trust funds.

SWIB is directed by a nine-person, independent Board of Trustees and staffed with professional money managers and support personnel. The Board of Trustees appoints the executive director of the Investment Board. The executive director oversees the staff, develops and recommends agency and investment policies for Board adoption, and ensures adherence to state law and policies.

Assets Under Management - June 30, 2009

Fund	in Millions	% of Total
<i>Core Retirement Investment Trust Fund</i>	59,214	86%
<i>Variable Retirement Investment Trust Fund</i>	<u>4,126</u>	<u>6</u>
Wisconsin Retirement System	\$ 63,340	92
State Investment Fund*	4,574	7
Various Funds		
Injured Patients and Families Compensation Fund	568	1
State Life Insurance Fund	88	0
Local Gov't Property Insurance Fund	53	0
Historical Society Trust Fund	9	0
Tuition Trust Fund	<u>9</u>	<u>0</u>
	<u>\$ 68,641</u>	<u>100 %</u>

*Excludes deposits from Core Retirement Investment Trust Fund, Variable Retirement Investment Trust Fund and Various Funds.

Note: Values and percentages may not add due to rounding.

VISION

SWIB strives to be a premier public investment organization, a place where professional excellence and public service thrive. Superior investment returns, the highest ethical and professional standards, teamwork and a rewarding work environment will make SWIB the investment management organization of choice.

MISSION

To provide prudent and cost-effective management of funds held in trust by the State. This is achieved with solid investment returns, consistent with the purpose and risk profile of each fund.

Management costs of the State of Wisconsin Investment Board include external management and advisory fees, investment support services as well as expenses incurred to manage agency operations. The majority of expenses are fees paid to outside advisors and fund managers. Costs of other support services include custodial banking services, investment research, and legal services.

Agency operating expenses for staff compensation, overhead and equipment were \$26.5 million in calendar year 2008 and represented about 12% of total costs. Expenses are paid from investment earnings of the funds SWIB manages.

SWIB participates in an annual independent review of costs which compares SWIB to other investment managers and public pension fund peers. The 2008 analysis provided by CEM Benchmarking, Inc.¹ concluded that SWIB's total cost to manage the Core Fund was 35¢ per \$100 managed. The CEM report indicated that this amount was less than the costs incurred by peers with a similar mix of assets.

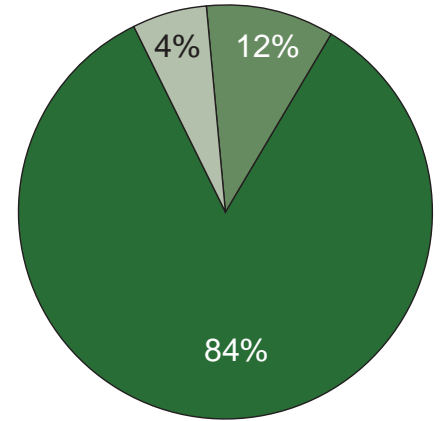
The cost to manage the Core Fund was \$219.2 million in 2008. This represents 96% of SWIB's total cost of management.

In addition to the Core Fund, SWIB manages seven other funds. SWIB's costs to manage all funds were \$227.4 million, or 28¢ per \$100 managed in 2008.

Management Costs

Calendar Year Ended 12/31/08

External Support Services Agency Operations



External Management & Advisory Fees

- Costs for managing all funds were 28¢ per \$100 under management.
- All management costs are funded with earnings from the funds.
- Total costs for managing all funds for the calendar year ending December 31, 2008 were \$227.4 million.
- According to CEM¹, SWIB's costs for the Core Fund in calendar year 2008 were considered low cost compared to its peers based on the mix of assets managed.

Total Management Costs

Calendar Year Ended 12/31/08

External Management & Advisory	\$191,823,700
Agency Operations	26,492,200
Consulting	3,939,000
Custodial Banking	651,900
Investment Research	4,470,700
Total	<u>\$227,377,500</u>

¹ CEM Benchmarking, Inc. is a Toronto-based firm that provides cost measurement and analysis of corporate and public pension funds.

Board of Trustees

The Board of Trustees is responsible for setting long-term investment policies, asset allocation, benchmarks, Fund level risk, and monitoring investment performance. The Board is comprised of the following:

- Six public members appointed by the Governor and confirmed by the State Senate including:
 - Four with at least 10 years investment experience.
 - One with at least 10 years financial experience and who works for a local government in the Local Government Investment Pool.
- Educator participant in the Wisconsin Retirement System (WRS) appointed by the Teachers Retirement Board.
- Non-educator participant in the WRS appointed by the Wisconsin Retirement Board.
- Secretary of the Department of Administration or designee.



James Senty



Thomas Boldt



Bruce Colburn



David Geertsen



David Kruger



William Levit, Jr.



Wayne McCaffery



Michael Morgan



David Stella

Public Members*

James Senty, Board Chair, President of Midwest Gas Companies, La Crosse

Thomas Boldt, Board Vice Chair, President of The Boldt Group, Inc./CEO, The Boldt Co., Appleton

Bruce Colburn, Director, Central States Property Services Division, Services Employees International Union (Confirmed in September)

David Geertsen, Local Government, Finance Director, Kenosha County

David Kruger, CEO/Owner, The Fiore Companies, Madison

William Levit, Jr., Attorney, Godfrey & Kahn S.C., Milwaukee

WRS Participant Members*

Wayne McCaffery, Educator, Retired Teacher, Stevens Point

David Stella, Board Secretary, Non-educator, Secretary, Department of Employee Trust Funds

Department of Administration

Michael Morgan, Department Secretary

*Appointed Board members serve six-year terms.

SWIB has 124.25 authorized positions. The executive director oversees the staff. Portfolio managers, analysts and traders are responsible for daily investment decisions made within the parameters of the investment policy. Investment managers are supported by a well-trained staff with legal, technical, accounting and administrative expertise.

There are three investment groups — public equities (stocks), public fixed income, and private markets.

Domestic stocks primarily consist of investments in US companies. International stocks encompass investments in markets for developed and emerging countries.

Fixed income investments include US government bonds and corporate bonds purchased in public markets, corporate securities, US Treasury and agency securities and global bonds.

Private markets investments include real estate, private equity and private debt investments. Real estate investments are commercial real estate with SWIB as a sole direct owner, or in joint ventures and partnerships. The portfolio is diversified by region and by property type. Private equity/debt investments primarily focus on leveraged buyouts (LBOs), venture capital, partnerships and structured investments.

Senior Management

Keith S. Bozarth
Executive Director

David C. Villa
Chief Investment Officer

Gail L. Hanson
Deputy Executive Director

Brandon Duck
Internal Audit Director

Chuck Carpenter
Managing Director Private
Markets

Kenneth W. Johnson
Chief Operating Officer/
Chief Financial Officer

L. Jane Hamblen
Chief Legal Counsel

Ronald A. Mensink
Managing Director Analytics
& Fund Management

Ledell Zellers
Human Resources Director

A majority of the investment staff holds or is pursuing the Chartered Financial Analyst (CFA) designation and the Board adheres to CFA standards. Senior investment staff experience ranges between 9 and 33 years.

Wisconsin Retirement System

- WRS includes current and former employees of state agencies, the university system, school districts and most local governments.
- 9th largest public pension fund in the US.
- 28th largest pension fund in the world.
- Comprised of the Core Fund, a balanced fund, and the Variable Fund, a stock fund.
- Core Fund gains and losses are spread over five years to smooth the effect on participants' accounts.
- Variable Fund annuities fully reflect prior year gains and losses of the investments.
- About 111,000 people participate in the Variable Fund.

The Wisconsin Retirement System (WRS) makes up 92% of the assets managed by SWIB. As a fiduciary for the funds, SWIB is dedicated to earning the best possible rate of return within acceptable risk parameters consistent with “prudent investor” standards. As of June 30, 2009, the total assets of the WRS were \$63.3 billion.

The WRS includes the pension funds available through most public employers in Wisconsin other than the City of Milwaukee and Milwaukee County. Contributions made to the WRS by participating employees and their employers are invested by the Investment Board to finance retirement benefits.

More than 557,000 people participate in the WRS. Investment earnings account for the majority of the annuities paid, thus lowering the costs paid by taxpayers. Over \$3.8 billion in benefits were paid in 2008 to 144,000 annuitants in the WRS.

The WRS is comprised of two trust funds. The larger of the two is the Core Fund, which is a broadly diversified portfolio of stocks, bonds, real estate and other holdings. The second fund is the Variable Fund, which is invested in stocks.

The process for determining the effect of investment returns on employee accounts (“effective rate”) and changes in benefits for retirees differs between the Variable and Core Funds.

The Department of Employee Trust Funds (ETF) is responsible for administering the benefits of the WRS. Most employees who retire receive a pension annuity initially determined by a formula (calculated by ETF) using years of service, salary and job type.

ETF computes benefit changes based on the December 31 rate of return for each of the two trust funds to determine the impact on participants.

Annualized Performance Ending 6/30/09			
Retirement Funds	1-Year Return	5-Year Return	10-Year Return
Core Fund	-17.7%	2.9%	3.6%
Benchmark	-17.7%	2.9%	3.2%
Variable Fund	-25.8%	-0.8%	0.1%
Benchmark	-27.1%	-0.5%	-0.5%
S&P 500	-26.2%	-2.2%	-2.2%

The State Investment Fund (SIF) is a pool of cash balances of various state and local governmental units. The objectives of this fund are to provide safety of principal, liquidity and a reasonable rate of return. SWIB's Fixed Income Group manages the State Investment Fund.

The State Investment Fund includes retirement trust funds' cash balances pending longer-term investment by SWIB's other investment groups. This fund also functions as the State's cash management fund. By pooling the idle cash balances of all 60 state funds, it provides the State's general fund with the needed liquidity for operating expenses.

Over 1,000 local units of government also deposit revenues in the SIF until they are needed. These funds are commingled in the Local Government Investment Pool (LGIP).

The cash balances available for investment vary daily as cash is accumulated or withdrawn from the agency funds. The SIF is invested primarily in obligations of the US government and its agencies, and high quality commercial bank and corporate debt obligations. Net assets of the State Investment Fund as of June 30, 2009, were \$6.4 billion.

State Investment Fund Annualized Time-Weighted Returns

<u>Fiscal Year</u>	<u>Return</u>
2000	5.5%
2001	6.0
2002	2.5
2003	1.5
2004	1.0
2005	2.1
2006	4.2
2007	5.4
2008	4.0
2009	1.3

SIF Portfolio Characteristics as of June 30, 2009

- 84% of Fund invested in U.S. government securities and U.S. government agency securities.
- Average maturity 69 days versus iMoneyNet* at 50 days.
- Short-term liquidity (0 - 3 months) equal to 150% of LGIP and 77% of SIF.
- 38% of portfolio assets change rates overnight, 64% in three months.

Portfolio Rankings

- SIF provided a superior rate of return, ranking 1st out of 199 government money market funds.
- SIF also ranked 110th out of 1,175 money market funds (top 10%).*

* iMoneyNet All Taxable Money Market Index

Source: The iMoneyNet financial company money fund statistics.

To achieve its objectives, the SIF adheres to rigorous quality standards, pays careful attention to maturity schedules and places emphasis on high marketability. Enhanced return is sought through intensive portfolio management, which considers probable changes in the general structure of interest rates.

Earnings for the SIF are calculated and distributed monthly based on the participant's average daily balance as a percent of the total pool.

Contact Information

Injured Patients and Families Compensation Fund

(608) 266-6830 (Madison)
<http://oci.wi.gov/pcf.htm>

State Life Insurance Fund

(608) 266-0107 (Madison)
(800) 562-5558 (toll-free)
<http://oci.wi.gov/slif.htm>

Local Government Property Insurance Fund

(608) 266-3585 (Madison)
(800) 236-8517 (toll-free)
<http://oci.wi.gov/lgpif.htm>

State Historical Society

(608) 264-6400
<http://www.wisconsinhistory.org/>

EdVest

(608) 264-7899 (Madison)
(888) 338-3789 (toll-free)
<http://www.wellsfargoadvantagefunds.com/wfweb/wf/ev/index.jsp>

SWIB manages five funds for various state agencies. These funds represent about 1% of the total assets managed. Each is invested to meet specific objectives.

INJURED PATIENTS AND FAMILIES COMPENSATION FUND

The Fund was created by statute in 1975 to provide excess medical malpractice coverage for Wisconsin health care providers. Health care providers obtain primary medical malpractice insurance from private insurance companies in an amount required by law. Coverage in excess of the primary insurance is purchased by the Fund. The program is administered by the Office of the Commissioner of Insurance.

STATE LIFE INSURANCE FUND

The Fund is a state-sponsored life insurance program for the residents of Wisconsin. The applicant must be a state resident at the time of application for coverage through the Fund. The Fund operates on a nonprofit basis and receives no subsidies from the state.

LOCAL GOVERNMENT PROPERTY INSURANCE FUND

The purpose of the Fund is to make reasonably priced property insurance available for tax-supported local government property such as government buildings, schools, libraries, and motor vehicles. The Fund provides policy and claim service to the policyholders.

HISTORICAL SOCIETY TRUST FUND

The State Historical Society of Wisconsin is both a state agency and a private membership organization. SWIB is responsible for investing the endowment funds of the Historical Society to help with its goal to promote a wider appreciation of the American heritage, with an emphasis on the collection, advancement, and dissemination of knowledge of the history of Wisconsin and the region.

TUITION TRUST FUND

The Tuition Trust Fund was created to invest the funds for EdVest Wisconsin, a state-sponsored way to save for the cost of college expenses. This Fund is currently closed to new participants. Other options are administered through the Office of the State Treasurer.

SWIB's Corporate Governance Program has two primary goals: (a) to protect and increase SWIB's long-term returns and (b) to meet SWIB's fiduciary obligation to manage shareholder rights as an asset of the trust funds.

The primary focus is working with directors and management of a company with a goal of increasing economic value. It is one way SWIB works to fulfill its fiduciary obligation to the WRS beneficiaries. The program incorporates traditional corporate governance practices, corporate citizenship and litigation. Its strategy is developed by SWIB's governance and investment staff working together within parameters approved by Trustees.

Corporate governance — the relationship between the shareholders, directors and management of a company, as defined by the corporate charter, bylaws, formal policy and rule of law — makes up the largest part of our program. Governance issues are considered when voting our proxies and evaluating investments. Each year SWIB identifies key issues based on staff recommendations and national trends.

Then SWIB monitors companies within its portfolios that could benefit from improvements in the identified areas. SWIB determines ways to work with company management, corporate boards and shareholders to make positive changes. Initially, we contact company management and company directors to resolve concerns. If companies are not responsive, SWIB may vote against

Key Corporate Governance Issues

1. **Improve Integrity of Proxy Voting Process.** Over 85,000 company meetings take place annually with thousands of shareholders vote on various issues. Counting votes are complex due to the volume of votes, manual processing and lack of transparency. SWIB is working to improve the proxy voting process so that investors can ensure each vote counts.
2. **Improve Shareholder Rights.** In addition to market regulation, shareholders need ways to protect and monitor their investments and to ensure that companies are well-governed. Current laws limit shareholders' ability to oust poorly performing directors or to block excessive compensation plans. SWIB is communicating with federal officials to improve shareholder rights.
3. **Strengthen Market Oversight and Regulation.** SWIB is seeking a critical review of the roles and responsibilities of federal oversight agencies, such as the Securities and Exchange Commission (SEC), to ensure investors' rights are better protected. SWIB is involved in efforts to reform U.S. financial markets.
4. **Unify Global Financial Reporting.** Globalization of world markets is driving the demand for uniform financial reporting standards. Analysts and portfolio managers must evaluate the performance and financial viability of those companies in a manner that is consistent with domestic companies. SWIB is participating on an international advisory group to address these issues.

proposals or choose to withhold its proxy votes from certain director candidates. We may also seek adoption of a shareholder resolution or decide to sell the stock.

Policies for voting corporate citizenship resolutions also reinforce investment goals to enhance returns. SWIB considers sustainability issues when initially investing in a company. Making investments or using proxy votes solely for promoting social or political causes or goals is contrary to our fiduciary duties. We believe the social acceptability of products and practices is an economic consideration that should be part of the investment decision.

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Financial Section



STATE OF WISCONSIN

Legislative Audit Bureau

22 East Mifflin Street, Suite 500
Madison, Wisconsin 53703
(608) 266-2818
Fax (608) 267-0410
www.legis.wisconsin.gov/lab

Janice Mueller
State Auditor

INDEPENDENT AUDITOR'S REPORT

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Trustees and
Mr. Keith Bozarth, Executive Director
State of Wisconsin Investment Board

We have audited the accompanying Statement of Net Investment Assets for the Retirement Investment Trust Funds (Core Retirement Investment Trust Fund and Variable Retirement Investment Trust Fund) of the State of Wisconsin as of June 30, 2009, and the related Statement of Changes in Net Investment Assets for the year then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

The financial statements for the year ended June 30, 2008, are being presented for informational purposes only. These financial statements were audited by us and we expressed an unqualified opinion on them in our report dated December 2, 2008, but we have not performed any auditing procedures since that date.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to in the first paragraph present only the investment activity of the Retirement Investment Trust Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Retirement Investment Trust Funds attributable to the Department of Employee Trust Funds. Further, they do not purport to, and do not, present fairly the financial position and the changes in financial position of the Investment Board or of the State of Wisconsin in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective net investment assets of each of the Retirement Investment Trust Funds as of June 30, 2009, and the respective changes in net investment assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 2, the financial statements include investments that do not have readily ascertainable market prices and are valued based on a variety of third-party pricing methods. We have reviewed the procedures used by the Investment Board in arriving at estimates of the values of such investments and have inspected underlying documentation, and, given the circumstances, we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ from the values that would have been used had a ready market for the investments existed.

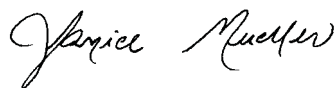
Our audit was conducted for the purpose of forming an opinion on the financial statements of the Retirement Investment Trust Funds. The supplementary information included as Management's Discussion and Analysis, which precedes the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 24, 2009, on our consideration of the Investment Board's internal control over financial reporting for the Retirement Investment Trust Funds; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which is included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU

November 24, 2009

by



Janice Mueller
State Auditor

Retirement Funds

Management Discussion and Analysis

The State of Wisconsin Retirement Funds' narrative discussion and analysis of the financial activities for the fiscal year ended June 30, 2009 is presented by management as an introduction to the financial statements. It is meant to assist the reader in understanding the financial statements by providing an overall review of the financial activities during the year as well as to provide a comparison of the prior year's activity and results.

Overview of Basic Financial Statements

Following this section are the financial statements and footnotes which reflect only the investment activity of the funds. Retirement reserves, contribution revenue and benefit expense are specifically excluded from presentation in these statements although contribution revenue and benefit expenses are reflected in "Net Receipts (Disbursements)" in the Statement of Changes in Net Investment Assets.

The **Statement of Net Investment Assets** provides information on the financial position of the funds at year-end. It indicates the investment assets available for payment of future benefits and any current liabilities related to the investments.

The **Statement of Changes in Net Investment Assets** presents the results of the investing activities during the year. The changes reflected on this statement support the overall change that has occurred to the prior year's net assets on the Statement of Net Investment Assets.

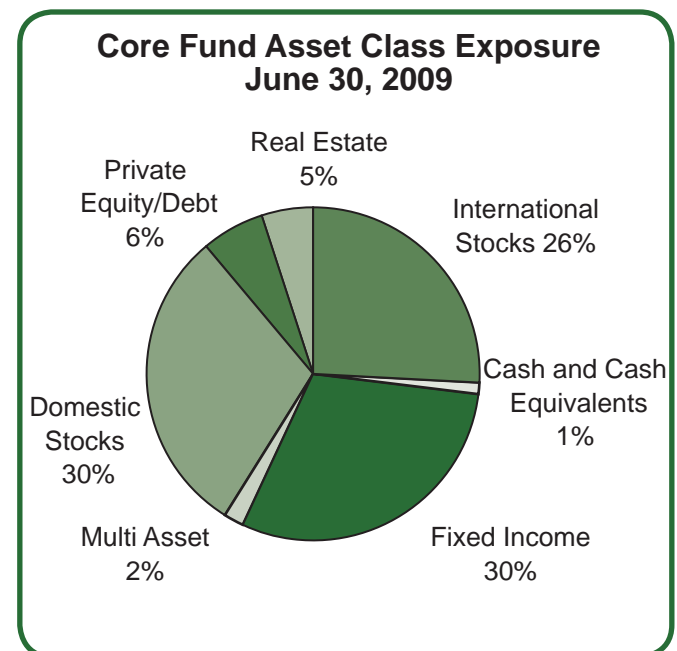
The **Notes to the Financial Statements** offer additional discussion that is essential to the full

understanding of the data presented in the financial statements. The notes give more detail about accounting policies, significant account balances and activities, material risks, obligations, contingencies and subsequent events, if any.

The financial statements and related notes are prepared in accordance with Governmental Accounting Standards Board Pronouncements.

Retirement Trust Funds

Approximately 557,000 people participate in the Wisconsin Retirement System (WRS), including current and former employees of Wisconsin's state agencies and most local governments in Wisconsin. Contributions made to the WRS by these employees and their employers are invested by the State of Wisconsin Investment Board to finance retirement and other benefits. The WRS is comprised of the Core Retirement Investment Trust Fund (Core Fund) and the Variable Retirement Investment Trust Fund (Variable



Core Retirement Investment Trust Fund Condensed Financial Information

Fiscal Year Ended:	2009	2008	% Change
Cash and Cash Equivalents	\$ 2,307,969,784	\$ 1,034,655,661	123.1
Receivables	1,234,336,561	1,626,781,781	(24.1)
Invested Securities Lending Collateral	4,679,615,874	5,834,263,422	(19.8)
Other Assets	9,863,837	6,052,355	63.0
Investments	56,625,273,794	73,960,805,192	(23.4)
Total Investment Assets	\$ 64,857,059,850	\$ 82,462,558,411	(21.3)
Payables	\$ 943,772,207	\$ 1,567,645,602	(39.8)
Securities Lending Collateral Liability	4,679,615,874	5,834,263,422	(19.8)
Other Liabilities	19,188,983	10,920,628	75.7
Total Investment Liabilities	\$ 5,642,577,064	\$ 7,412,829,652	(23.9)
Net Investment Assets	<u>\$ 59,214,482,786</u>	<u>\$ 75,049,728,759</u>	(21.1)
Investment Income (Loss)	\$ (13,321,373,780)	\$ (3,561,688,076)	274.0
Investment Expense	(219,389,072)	(213,023,596)	3.0
Net Investment Income (Loss)	\$ (13,540,762,852)	\$ (3,774,711,672)	258.7
Net Disbursements	(2,294,483,121)	(1,642,539,697)	39.7
Net Increase (Decrease) in Net Investment Assets	<u>\$ (15,835,245,973)</u>	<u>\$ (5,417,251,369)</u>	192.3

Fund) collectively, whose combined net investment assets total \$63.3 billion as of June 30, 2009.

Core Retirement Investment Trust Fund

The larger of the two trust funds comprising the Wisconsin Retirement System is the Core Fund with \$59.2 billion of net assets. All WRS members have invested at least half — if not all — of their pension account in the Core Fund. It is a fully diversified, balanced fund invested for the long-term needs of the WRS. Diversification helps to stabilize the effects of market changes. The basic investment objective of this trust fund is to achieve an average 7.8% annual return over the long-term, which consists of an annual rate of return of 3.7% above an estimated 4.1% wage-rate

growth. This objective is based on market rate of return and actuarial assumptions needed to meet obligations of the pension system.

The Core Fund net investment assets decreased approximately \$15.8 billion, or 21.1%, net of payments to beneficiaries for the year ended June 30, 2009. This was primarily due to total investment returns of -17.7%. Core Fund asset class returns for fiscal year 2009 were: public equities -27.4%, fixed income 4.1%, real estate -32.3%, private equity -25.2% and multi-asset strategies -11.3%. Net investment assets were decreased by net disbursements made by the Department of Employee Trust Funds mainly for net benefit payments.

Management Discussion and Analysis

The statements presented here reflect the investment activity of these funds, as well as net cash flows related to the Department of Employee Trust Funds which include benefit payments, contribution receipts and transfers to/from the Variable Retirement Investment Trust Fund. Retirement reserves, contribution revenue, and benefit expense are excluded from presentation in these statements.

The global economic recession experienced in fiscal year 2009 brought about a net investment loss of \$13.5 billion, driven by a 23.4% reduction in the market value of Core Fund investments. During this time, capital markets experienced unprecedented adverse events including a worldwide credit crisis triggered by the write down of mortgage related assets.

Cash and cash equivalents increased by 123.1% over the previous fiscal year end balance. Nearly all of this increase can be attributed to securitized cash positions within the Core Fund that were the result of rebalancing multiple asset classes whereby futures contracts were used to gain equity market exposure.

Receivables and payables decreased significantly over the previous fiscal year due to a reduction in pending investment sales and purchases. The 2008 balances were largely the result of a transition of equity assets from externally managed funds to internal portfolios which took place over the 2008 fiscal year-end.

The invested securities lending collateral and the securities lending collateral liability decreased

19.8% when compared to the previous year-end. A drop-off in borrowing demand for Treasury securities significantly contributed to the year-over-year decline in Core Fund collateral. This change is also consistent with the decline in Total Investment Assets and represents an overall decline in the market value of SWIB's lendable securities. However, the decline in asset values was offset by an increase in securities available to loan as SWIB migrated assets from external to internal management during the year.

Expenses increased by roughly 3.0% when comparing fiscal year 2009 to 2008. The majority of the change can be attributed to fees incurred on private market assets, which increased by \$22.4 million over the prior fiscal year. This asset type generally has higher fees at the beginning of the investment's life because management fees are based on committed assets, rather than assets under management. During the fiscal year, SWIB committed to funding an additional \$1.1 billion, contributing to the increase in fees.

Total external manager fees decreased by \$22.6 million when compared to the prior fiscal year. The primary cause was a reduction in the amount of assets managed externally due to the general market decline experienced in fiscal year 2009 and a transition of assets from externally managed accounts to internal portfolios. Since the majority of fees paid to external managers are based on a percentage of the market value of assets under management, the reduction in value of those assets also results in lower fees.

Performance based fees increased by \$3.5 million when comparing fiscal year 2009 to 2008. This is due to several externally managed accounts surpassing their benchmark returns during the 2009 fiscal year while their returns for fiscal year 2008 lagged their benchmarks.

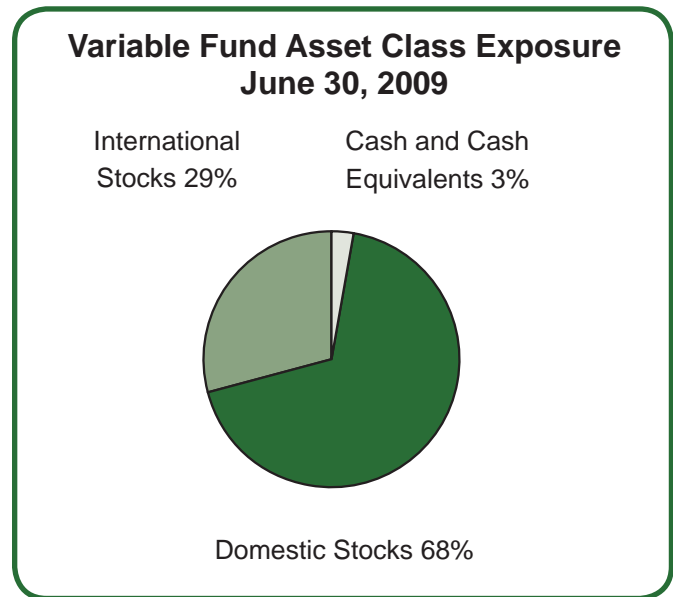
The Investment Board’s operating expenses increased by \$3.6 million, when compared to the previous fiscal year. The increase includes the cost of additional positions granted by the Legislature to manage assets moved from external managers to internal staff. At the end of fiscal year 2009, 38.8% of the Core Fund assets were managed internally, compared to 22.5% the prior year.

Transaction costs increased by \$1.3 million in fiscal year 2009, also contributing to the overall increase in expenses. This change can be explained by an increase in the use of futures contracts, which carry transaction fees.

Net disbursements increased by 39.7% when compared to fiscal year 2008. This line item represents the net cash flows of non-investment related activity such as net benefit payments/receipts, and expenses related to administering the benefit programs. While a portion of the change can be explained by increased annuity payments and the timing of cash flows associated with participants exiting the Variable Fund, the bulk of the decrease in net outflows can be explained by a one-time transfer of the health insurance program into the Core Fund in fiscal year 2008.

Variable Retirement Investment Trust Fund

The Variable Fund allows active employees participating in the WRS to put half of their pension fund contributions into this stock fund. Approximately 20% of WRS members participate in the Fund, which totaled \$4.1 billion at the end of fiscal year 2009. Employees who choose this fund accept a higher degree of market risk for the potential of greater long-run returns. The investment objective of the Variable Fund is to exceed similar equity-oriented portfolios over a full market cycle.



Variable Retirement Investment Trust Fund Condensed Financial Information

Fiscal Year Ended:	2009	2008	% Change
Cash and Cash Equivalents	\$ 113,039,587	\$ 83,114,986	36.0
Receivables	218,304,304	324,672,618	(32.8)
Invested Securities Lending Collateral	359,212,985	275,187,385	30.5
Investments	<u>4,010,407,859</u>	<u>5,877,870,138</u>	(31.8)
Total Investment Assets	\$ 4,700,964,735	\$ 6,560,845,127	(28.3)
Payables	\$ 216,119,772	\$ 324,631,608	(33.4)
Securities Lending Collateral Liability	359,212,985	275,187,385	30.5
Total Investment Liabilities	\$ 575,332,757	\$ 599,818,993	(4.1)
Net Investment Assets	<u>\$ 4,125,631,978</u>	<u>\$ 5,961,026,134</u>	(30.8)
Investment Income (Loss)	\$ (1,548,312,489)	\$ (913,863,020)	69.4
Investment Expense	<u>(6,298,102)</u>	<u>(7,663,684)</u>	(17.8)
Net Investment Income (Loss)	\$ (1,554,610,591)	\$ (921,526,704)	68.7
Net Disbursements	<u>(280,783,565)</u>	<u>(472,075,846)</u>	(40.5)
Net Increase (Decrease) in Net Investment Assets	<u>\$ (1,835,394,156)</u>	<u>\$ (1,393,602,550)</u>	31.7

The Variable Fund net investment assets decreased \$1.8 billion over the fiscal year. The decrease stemmed from the equity portfolios returning -26.0% for the fiscal year ended June 30, 2009. Employee and employer contributions were offset by disbursements out of the Fund and negative investment returns. Disbursements include annuity payments to retirees and active participants opting out of the Variable Fund. At the end of each calendar year, individual participants in the Variable Fund may elect to terminate their variable participation and transfer their account to the Core Fund.

As was the case with the Core Fund, the global economic recession experienced in fiscal year 2009

brought about a net investment loss of nearly \$1.6 billion, driven by a reduction in the market value of Variable Fund investments by 31.8%.

Cash and cash equivalents balances increased by 36.0% over the prior fiscal year end. The majority of this increase can be attributed to securitized cash positions within the Variable Fund.

The significant percentage change between fiscal years for receivables and payables can be explained by a decrease in investment purchases and sales pending over year end. The 2008 balances were largely the result of a transition of equity assets between externally managed funds to internal portfolios which took place over the 2008 fiscal year-end.

The Variable Fund's invested securities lending collateral increased by 30.5% over the prior fiscal year-end. The majority of the increase in collateral balance was due to the migration of equity index funds from external to internal management, causing the amount of reportable securities available for lending in the Variable Fund to increase.

Expenses for the Variable Fund decreased by 17.8% when comparing fiscal year 2009 to the previous fiscal year. The primary cause of this decrease was a reduction in the fees paid to external managers. The general declines experienced in the equity markets and the transition of assets from externally managed accounts to internally managed portfolios caused a reduction in management fees charged. At the end of fiscal year 2009, 54.2% of Variable Fund assets were managed internally, compared to 32.4% the prior year.

Net disbursements decreased when compared to fiscal year 2008. This line item represents the net cash flows of non-investment related activity such as net benefit payments/receipts, participants choosing to enter into or exit out of the Variable Fund and expenses related to administering the benefit programs. The -40.5% change over the prior fiscal year is largely explained by the timing of cash flows associated with participants exiting the Variable Fund.

RETIREMENT FUNDS
Statement of Net Investment Assets
as of June 30, 2009

	<u>Core Retirement Investment Trust Fund</u>	<u>Variable Retirement Investment Trust Fund</u>
Assets		
Cash and Cash Equivalents	\$ 2,307,969,784	\$ 113,039,587
Due from Other Funds	0	160
Receivables:		
Interest & Dividends	182,402,853	6,114,491
Securities Lending Income	5,535,742	547,535
Investment Sales	1,017,852,971	210,243,333
Foreign Currency Contracts	28,544,995	1,398,785
Invested Securities Lending Collateral	4,679,615,874	359,212,985
Other Assets	9,863,837	0
Investments (at fair value):		
Fixed Income	17,758,300,013	69
Preferred Securities	117,819,371	7,950,599
Convertible Securities	27,453,980	0
Stocks	31,663,015,752	4,002,457,191
Limited Partnerships	5,323,131,440	0
Commercial Mortgages	51,523,759	0
Real Estate	390,887,893	0
Multi Asset	1,293,141,586	0
Total Investment Assets	\$ 64,857,059,850	\$ 4,700,964,735
 Liabilities		
Payable for Investments Purchased	896,838,810	213,902,622
Financial Futures Contracts	6,501,904	65,182
Accounts Payable	40,431,493	2,151,968
Due to Other Funds	19,188,983	0
Securities Lending Collateral Liability	4,679,615,874	359,212,985
Total Investment Liabilities	\$ 5,642,577,064	\$ 575,332,757
Net Investment Assets Held in Trust	<u>\$ 59,214,482,786</u>	<u>\$ 4,125,631,978</u>

The accompanying notes are an integral part of this statement.

RETIREMENT FUNDS
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2009

	<u>Core Retirement Investment Trust Fund</u>	<u>Variable Retirement Investment Trust Fund</u>
Additions:		
Investment Income:		
Net Increase (Decrease) in the Fair Value of Investments	\$ (14,515,011,871)	\$ (1,619,955,880)
Interest	525,814,319	857,289
Dividends	550,097,281	67,630,160
Securities Lending Commissions	102,274,907	4,266,359
Other Income	69,511,061	0
Less:		
Investment Expense	(219,389,072)	(6,298,102)
Securities Lending Rebates	(49,970,948)	(837,668)
Securities Lending Fees	<u>(4,088,529)</u>	<u>(272,749)</u>
Total Investment Income (Loss)	\$ (13,540,762,852)	\$ (1,554,610,591)
Deductions:		
Net Receipts (Disbursements)		
Department of Employee Trust Funds	<u>(2,294,483,121)</u>	<u>(280,783,565)</u>
Net Increase (Decrease)	\$ (15,835,245,973)	\$ (1,835,394,156)
Net Investment Assets Held in Trust:		
Beginning of Year	<u>75,049,728,759</u>	<u>5,961,026,134</u>
End of Year	<u>\$ 59,214,482,786</u>	<u>\$ 4,125,631,978</u>

The accompanying notes are an integral part of this statement.

RETIREMENT FUNDS
Statement of Net Investment Assets
Comparative Amounts as of June 30, 2008

	Core Retirement Investment Trust Fund	Variable Retirement Investment Trust Fund
Assets		
Cash and Cash Equivalents	\$ 1,034,655,661	\$ 83,114,986
Receivables:		
Interest & Dividends	208,987,276	5,284,622
Securities Lending Income	7,913,904	465,202
Investment Sales	1,409,880,601	318,922,794
Invested Securities Lending Collateral	5,834,263,422	275,187,385
Other Assets	6,052,355	0
Investments (at fair value):		
Fixed Income	22,279,066,395	0
Preferred Securities	209,766,932	18,109,577
Convertible Securities	35,606,851	0
Stocks	43,829,944,551	5,859,760,561
Limited Partnerships	6,169,329,865	0
Commercial Mortgages	129,004,755	0
Real Estate	467,910,227	0
Multi Asset	840,175,616	0
Total Investment Assets	\$ 82,462,558,411	\$ 6,560,845,127
Liabilities		
Payable for Investments Purchased	1,523,703,573	322,376,158
Foreign Currency Contracts	4,209,517	529,379
Financial Futures Contracts	75,677	0
Accounts Payable	39,656,835	1,726,071
Due to Other Funds	10,920,628	0
Securities Lending Collateral Liability	5,834,263,422	275,187,385
Total Investment Liabilities	\$ 7,412,829,652	\$ 599,818,993
Net Investment Assets Held in Trust	\$ 75,049,728,759	\$ 5,961,026,134

The accompanying notes are an integral part of this statement.

RETIREMENT FUNDS Statement of Changes in Net Investment Assets Comparative Amounts For the Fiscal Year Ended June 30, 2008

	<u>Core Retirement Investment Trust Fund</u>	<u>Variable Retirement Investment Trust Fund</u>
Additions:		
Investment Income:		
Net Increase (Decrease) in the Fair Value of Investments	\$ (4,884,186,727)	\$ (981,567,101)
Interest	672,932,054	2,473,710
Dividends	529,195,172	62,903,900
Securities Lending Commissions	303,965,053	11,220,507
Other Income	71,908,265	0
Less:		
Investment Expense	(213,023,596)	(7,663,684)
Securities Lending Rebates	(251,210,057)	(8,690,810)
Securities Lending Fees	(4,291,836)	(203,226)
	<hr/>	<hr/>
Total Investment Income (Loss)	\$ (3,774,711,672)	\$ (921,526,704)
Deductions:		
Net Receipts (Disbursements) - Department of Employee Trust Funds	(1,642,539,697)	(472,075,846)
	<hr/>	<hr/>
Net Increase (Decrease)	\$ (5,417,251,369)	\$ (1,393,602,550)
Net Investment Assets Held in Trust:		
Beginning of Year	<hr/> 80,466,980,128	<hr/> 7,354,628,684
End of Year	<hr/> \$ 75,049,728,759	<hr/> \$ 5,961,026,134

The accompanying notes are an integral part of this statement.

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Notes to the Financial Statements

1 Description of Funds

The State of Wisconsin Investment Board (SWIB) has control of the investment and collection of principal, interest, and dividends of all monies invested by the Core Retirement Investment Trust Fund (Core Fund) and the Variable Retirement Investment Trust Fund (Variable Fund). The statements presented here reflect only the investment activity of these funds. Excluded from presentation in the statements are, for example, retirement reserves, contribution revenue, and benefit expense.

All of the Retirement Fund's administrative expenses are funded through employer/employee contributions and investment earnings. The administrative expenses are reflected in the "Investment Expense" account included in the Statement of Changes in Net Investment Assets. This account represents SWIB's operating expenses as well as expenses directly related to the investment function such as external management fees, legal fees, custodial bank fees, and investment consulting fees.

A. Core Retirement Investment Trust Fund

The Core Fund is managed by SWIB with oversight by a Board of Trustees as authorized in Wisconsin Statutes ss. 25.14 and 25.17. The Core Fund and SWIB are not registered with the Securities and Exchange Commission as an investment company. The investments of the Core Fund consist of a highly diversified portfolio of securities. SWIB is required to make investment management decisions for the trust funds solely for the benefit of the members of

the WRS. Wisconsin Statutes s. 25.182 authorizes SWIB to manage the Core Fund in accordance with the "prudent investor" standard of responsibility as described in Wisconsin Statutes s. 25.15(2) which requires that SWIB manage the trust funds with the diligence, skill and care that a prudent person acting in a similar capacity and with the same resources would use in managing a large public pension fund.

The Core Fund consists primarily of assets invested for the Wisconsin Retirement System (WRS) which is administered by the Department of Employee Trust Funds (ETF) in accordance with Chapter 40 of the Wisconsin Statutes. All retirement fund contributions are invested in this trust fund unless participants have elected to have half of their contributions invested in the Variable Fund. In addition to the retirement contributions, the assets of various other benefit programs are invested as part of the Core Fund as listed in the table entitled **Other Benefit Programs Within the Core Fund**.

Other Benefit Programs Within the Core Fund June 30, 2009 (Dollars in Millions)

<u>Program</u>	
Accumulated Sick Leave	\$1,657.5
Duty Disability	283.1
Long Term Disability Insurance	213.0
Active Employee Health Insurance	181.3
Milwaukee Retirement System	96.6
Income Continuation Insurance	72.4
Police and Firefighters Pension Group	36.4
State Retiree Health Insurance	8.9
Local Retiree Health Insurance	0.4
Total	<u>\$2,549.6</u>

B. Variable Retirement Investment Trust Fund

The Variable Fund is managed by SWIB with oversight by a Board of Trustees as authorized by Wisconsin Statutes ss. 25.14 and 25.17. The Variable Fund and SWIB are not registered with the Securities and Exchange Commission as an investment company. Wisconsin Statutes s. 25.17(5) states assets of the Variable Fund shall be invested primarily in equity securities which shall include common stocks, real estate or other recognized forms of equities whether or not subject to indebtedness, including securities convertible into common stocks and securities of corporations in the venture capital stage. Subject to that requirement, SWIB may invest the Variable Fund in any manner consistent with the “prudent investor” standard of responsibility in Wisconsin Statutes s. 25.15(2).

The Variable Fund also consists primarily of the assets invested for the WRS. In addition, the Milwaukee Retirement Systems had \$19.0 million invested in the Variable Fund as of June 30, 2009.

Participation in the Variable Fund is at the option of the employee. Participants have elected to invest one half of their retirement contributions and matching amounts of employer contributions in this fund, and have the remainder invested in the Core Fund. Individual participants in the Variable Fund program have a one-time option to terminate their Variable Fund participation and transfer their account to the Core Fund.

2 Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements were prepared in conformity with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

B. Basis of Accounting

The financial statements are prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred, if measurable. Security transactions and the related gains and losses are recorded on a trade date basis. Dividend income is recorded on the ex-dividend date, and interest income is accrued as earned.

SWIB applies all applicable GASB pronouncements and those Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 which do not conflict with or contradict GASB pronouncements.

C. Valuation of Securities

The investments of the Core Fund and the Variable Fund are valued at fair value, per Wisconsin Statutes s. 25.17(14). Monthly, the investments are adjusted to fair value, with unrealized gains and losses reflected in the Statement of Changes in Net

Investment Assets as “Net Increase (Decrease) in Fair Value of Investments.”

Generally, fair value information represents actual bid prices or the quoted yield equivalent for securities of comparable maturity, quality and type as obtained from one or more major investment brokers. If quoted market prices are not available, a variety of third party pricing methods are used, including appraisals, certifications, pricing models and other methods deemed acceptable by industry standards.

Commercial mortgages are priced via a matrix pricing system. The traditional discounted cash flow methodology is employed, where discount rates are developed based on market derived spreads over a base Treasury or London inter-bank offering rate yield. Spreads incorporate such factors as coupon rates, term to maturity, agency ratings, and sector/industry information.

Private placements are priced using a multi-tiered approach that prices each holding based on the best available information using the following hierarchy of pricing sources:

1. Custodian supplied prices for assets that are in the Barclays Capital U.S. Aggregate Bond Index
2. Prices provided by a third party with expertise in the bond market
3. Modeled prices utilizing CMS BondEdge where spreads are supplied by a contracted third party

In a few instances private placements cannot be priced by one of the above three sources. In these circumstances the investment is priced using an alternative bond index price or, if no independent

quotation exists, the investment is priced by SWIB management, usually at cost.

Limited partnerships’ fair value is estimated based on periodic reports from the limited partnerships’ management. Annually, the reports are audited by independent auditors.

Real estate valuations are based on generally accepted industry standards and are most typically based on discounted cash flow and comparable sales methodologies. The basis for valuing direct real estate holdings are independent appraisals, which are prepared once every three years. In years when appraisals are not performed, the asset managers are responsible for providing market valuations. Annually, direct real estate holdings are audited by independent auditors.

A limited number of securities are carried at cost. Certain non-public or closely held stocks are not reported at fair value, but are carried at cost since no independent quotation is available to estimate fair value for these securities.

All derivative financial instruments are reported at fair value in the Statement of Net Investment Assets. The instruments are marked to fair value at least monthly, with valuation changes recognized in income. Gains and losses are recorded in the Statement of Changes in Net Investment Assets as “Net Increase (Decrease) in the Fair Value of Investments” during the period the instruments are held and when the instrument is sold or expires. The nature and use of derivative instruments is discussed in Note 5.

Notes to the Financial Statements

D. Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates that affect amounts reported herein. Due to the inherent uncertainty involved, actual results could differ from those estimates.

3 Deposit and Investment Risk

A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to SWIB. Fixed income credit risk investment guidelines spell out the minimum ratings required at the time of purchase by individual portfolios, or groups of portfolios, based on the portfolios' investment objectives. In addition,

some fixed income portfolios are required to carry a minimum weighted average rating at all times. Information regarding SWIB's credit risk related to derivatives is found in Note 5.

The table entitled **Credit Quality Distribution** displays the lowest credit rating assigned by several nationally recognized statistical rating organizations on debt securities held by the Core Fund and the Variable Fund as of June 30, 2009. Included in this schedule are fixed income securities including certain short term securities classified as cash equivalents on the Statement of Net Investment Assets. Obligations of the United States and obligations explicitly guaranteed by the U.S. government have been included in the AAA rating although they are considered to be without credit risk. The table also includes investments in externally managed commingled or pooled funds which have not been rated by an independent rating agency. Although the funds themselves do not carry ratings, external management investment guidelines govern minimum credit quality standards for the investments within each portfolio. These standards are determined based on the investment objectives and risk parameters of each fund.

Credit Quality Distribution
June 30, 2009

Ratings	Fair Value	% of Total
P-1 or A-1	\$ 885,198,497	4
Aaa or AAA	5,533,231,103	22
Aa3 to Aa1 or AA- to AA+	2,083,188,180	8
A3 to A1 or A- to A+	2,344,092,900	9
Baa3 to Baa1 or BBB- to BBB+	1,046,263,014	4
Ba3 to Ba1 or BB- to BB+	415,297,670	2
B3 to B1 or B- to B+	271,469,284	1
Caa1 to Caa3 or CCC- to CCC+	103,001,369	1
Ca1 to Ca3 or CC- to CC+	16,115,359	0
C	10,723,409	0
D	7,521,011	0
Collective Trust Funds	10,567,893,672	42
Not Rated	1,677,484,904	7
Total	<u>\$ 24,961,480,372</u>	<u>100%</u>

B. Custodial Credit Risk

The Retirement Funds do not have a deposit or investment policy specifically related to custodial credit risk.

Deposits — Custodial credit risk related to deposits is the risk that, in the event of the failure of a depository financial institution,

SWIB will not be able to recover deposits that are in possession of an outside party. Bank deposits as of June 30, 2009 were \$243.1 million. A portion of the deposits, totaling \$809,467, are covered by federal depository insurance. The remaining uninsured and uncollateralized deposits, totaling \$242.3 million, were held in foreign currencies or margin accounts in SWIB's custodian's nominee name. In addition, SWIB held time deposits with foreign financial institutions with a fair value of \$26.0 million, all of which were uncollateralized and uninsured.

Investments — Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, SWIB will not be able to recover the value of investments that are in the possession of an outside party. As of June 30, 2009 the Retirement Funds held 12 tri-party repurchase agreements totaling \$1.25 billion. SWIB's securities lending collateral portfolio and cash management portfolio participate in repurchase agreement pools, purchasing only a portion of a repurchase agreement in which the manager of these accounts, acting as agent on behalf of SWIB and other clients, is the buyer-lender. Since the manager that purchased the repurchase agreement is the counterparty, the securities are not held in SWIB's name. They are held in the counterparty's name and held by the counterparty's agent.

C. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. SWIB limits concentrations of credit risk by establishing

investment guidelines for individual portfolios or groups of portfolios that generally restrict issuer concentrations in any one company or Rule 144A securities to less than 5% of assets.

D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SWIB uses a number of different methods to manage interest rate risk.

Generally, SWIB analyzes long or intermediate term portfolios' interest rate risk using various duration calculations. Modified duration, which is stated in years, is the measure of price sensitivity of a fixed income security to an interest rate change of 100 basis points. The calculation is based on the weighted average of the present values for all cash flows. Some pooled investments are analyzed using an option adjusted duration calculation which is similar to the modified duration method. Option adjusted duration incorporates the duration shortening effect of any embedded call provisions in the securities.

Short-term portfolios use the weighted average maturity (to next reset) to analyze interest rate risk. Weighted average maturity is the maturity of each position in a portfolio weighted by the dollar value of the position to compute an average maturity for the portfolio as a whole. This measure indicates a portfolio's sensitivity to interest rate changes: a longer weighted average maturity implies greater volatility in response to interest rate changes.

SWIB's investment guidelines related to interest rate risk vary by portfolio. Some fixed income portfolios are required to be managed within a range

Interest Rate Sensitivity by Investment Type
June 30, 2009

Investment Type	Fair Value	Modified Duration (years)
Asset Backed Securities	\$ 72,222,917	3.263
Commercial Paper	44,312,077	0.246
Corporate Bonds	3,332,876,265	4.624
Corporate Bonds	10,935,985	N/A
Government Agency	352,669,705	4.520
Commercial Mortgages	51,523,759	2.701
Municipal Bonds	4,192,392	8.342
Private Placements	437,511,096	4.937
Private Placements	8,916,349	N/A
Repurchase Agreements	36,000,000	N/A
Sovereign Debt	2,880,337,061	6.825
Sovereign Debt	1,613,213	N/A
United States Treasury Securities	3,238,995,310	7.657
	\$ 10,472,106,129	
 Intermediate and Long Term Collective Trust Funds		
Emerging Market Fixed Income	\$ 314,181,507	4.981
Global Fixed Income	429,132,142	4.870
Domestic Fixed Income	6,839,107,478	5.249
Total Intermediate and Long Term Collective Trust Funds	\$ 7,582,421,127	
		Weighted Average Maturity (days)
Short Term Pooled Investments	\$ 1,957,372,030	68
 Securities Lending Collateral Pool		
Asset Backed Securities	\$ 337,000,706	20
Certificates of Deposit	567,025,803	83
Commercial Paper	185,312,240	61
Corporate Bonds	1,486,781,755	35
Repurchase Agreements	1,212,499,612	4
Pooled Investments	1,028,100,516	14
United States Treasury Securities	132,860,454	153
Total Securities Lending Pool Investments	\$ 4,949,581,086	
 Total Fair Value	 \$ 24,961,480,372	
N/A = data not available		

of a targeted duration, while others are required to maintain a weighted average maturity at or below a specified number of days or years.

The table entitled **Interest Rate Sensitivity by Investment Type** presents the interest rate exposure for the Core and Variable Fund assets. Weighted average maturity where reset dates are assumed to be the effective maturity date for the security is presented for the securities lending collateral reinvestment pool and short-term pooled investments. Longer term instruments held by the Retirement Funds are presented using modified duration, as this measure more accurately states the interest rate sensitivity of these investments.

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. It includes the risk that currencies in which a portfolio's investments are denominated, or currencies in which a portfolio has taken on an active position, will decline in value relative to the U.S. dollar.

Foreign currency exchange rates may fluctuate significantly for a number of reasons, including the forces of supply and demand in the foreign exchange markets, actual or perceived changes in interest rates, intervention by U.S. or foreign governments or central banks, currency controls, or political developments in the U.S. or abroad. The Retirement Funds hold foreign currency denominated cash and securities invested directly in designated actively managed portfolios and indirectly through their investment in certain collective trust investment funds.

SWIB's policies include foreign currency risk management objectives relating to each individual portfolio. These guidelines address the foreign currency management activities permitted for each portfolio based on the portfolios mandates, risk tolerances and objectives. SWIB also employs discretionary currency overlay strategies at the total fund level when currency market conditions suggest such strategies are warranted.

As of June 30, 2009 the Core Fund and the Variable Fund assets were denominated in the currencies shown in the table entitled **Currency Exposures by Investment Type**.

4 Securities Lending Transactions

State statutes and Board policies permit SWIB to use investments of the Core and Variable Funds to enter into securities lending transactions. These transactions involve the lending of securities to broker-dealers and other entities in exchange for collateral, in the form of cash or securities, with the simultaneous agreement to return the collateral for identical securities in the future. SWIB's securities custodian is an agent in lending the Retirement Funds' directly held domestic and international securities. When the Retirement Funds' securities are delivered to a borrower as part of a securities lending agreement, the borrower is required to place collateral equal to 102 percent of the loaned securities' fair value, including interest accrued, as of the delivery date with the lending agent so long as the securities and the collateral are denominated in the same currency. In the event that foreign securities are loaned against collateral denominated in a different

Currency Exposures by Investment Type
June 30, 2009

Currency	Cash and Cash Equivalents	Commercial Mortgages	Convertible Securities	Stocks	Fixed Income
Australian Dollar	6,225,413	0	0	297,731,878	121,257,513
Brazil Real	2,569,128	0	0	26,713,159	22,453,704
British Pound Sterling	4,035,230	0	111,866	1,300,410,110	226,116,672
Canadian Dollar	4,434,055	0	0	419,278,013	102,760,322
Colombian Peso	0	0	0	0	9,666,664
Czech Koruna	235,471	0	0	9,253,869	0
Danish Krone	1,659,743	0	0	61,627,017	25,354,677
Euro Currency Unit	12,689,183	0	0	2,318,829,223	1,182,112,940
German Mark	0	0	0	0	87,855
Hong Kong Dollar	3,714,507	0	0	309,807,959	0
Hungarian Forint	66,212	0	0	7,132,378	3,843,200
Iceland Krona	139,633	0	0	0	1,475,225
Indian Rupee	2,945,359	0	0	123,280,876	0
Indonesian Rupian	246,144	0	0	9,376,887	13,673,891
Israeli Shekel	303,135	0	0	8,221,765	0
Italian Lira	0	0	0	0	559,823
Japanese Yen	24,282,957	0	0	1,418,364,229	860,334,744
Malaysian Ringgit	2,321,865	0	0	18,579,419	38,612,333
Mexican New Peso	272,578	0	0	48,000,896	17,500,897
Moroccan Dirham	61,382	0	0	2,046,211	0
New Taiwan Dollar	9,116,198	0	0	164,240,362	0
New Turkish Lira	202,789	0	0	34,833,224	1,843,774
New Zealand Dollar	364,576	0	0	662,001	8,074,352
Norwegian Krone	514,614	0	0	97,060,826	5,845,610
Philippines Peso	298,872	0	0	5,251,954	0
Polish Zloty	220,394	0	0	11,684,608	24,771,259
S. African Comm Rand	720,941	0	0	41,392,544	5,744,683
Singapore Dollar	2,840,127	0	0	84,152,163	0
South Korean Won	994,224	0	0	165,632,281	0
Swedish Krona	1,272,076	0	0	88,914,979	27,111,573
Swiss Franc	1,478,821	0	0	379,169,977	0
Thailand Baht	743,491	0	0	40,378,511	0
United States Dollar	2,336,040,253	51,523,759	27,342,114	28,173,445,624	15,053,833,670
Uruguayan Peso	0	0	0	0	5,264,701
Grand Total	<u>\$ 2,421,009,371</u>	<u>\$ 51,523,759</u>	<u>\$ 27,453,980</u>	<u>\$ 35,665,472,943</u>	<u>\$ 17,758,300,082</u>

Currency Exposures by Investment Type
June 30, 2009

Currency	Financial Futures Contracts	Multi-Asset	Preferred Securities	Limited Partnerships	Real Estate	Grand Total
Australian Dollar	240,254	0	0	0	0	425,455,058
Brazil Real	0	0	94,671,242	0	0	146,407,233
British Pound Sterling	73,306	0	0	97,401,150	0	1,628,148,334
Canadian Dollar	(19,084)	0	0	24,176,094	0	550,629,400
Colombian Peso	0	0	0	0	0	9,666,664
Czech Koruna	0	0	0	0	0	9,489,340
Danish Krone	0	0	0	0	0	88,641,437
Euro Currency Unit	1,156,155	0	20,082,716	452,924,704	0	3,987,794,921
German Mark	0	0	0	0	0	87,855
Hong Kong Dollar	0	0	0	0	0	313,522,466
Hungarian Forint	0	0	0	0	0	11,041,790
Iceland Krona	0	0	0	0	0	1,614,858
Indian Rupee	0	0	0	0	0	126,226,235
Indonesian Rupian	0	0	0	0	0	23,296,922
Israeli Shekel	0	0	0	0	0	8,524,900
Italian Lira	0	0	0	0	0	559,823
Japanese Yen	414,592	0	0	0	0	2,303,396,522
Malaysian Ringgit	0	0	0	0	0	59,513,617
Mexican New Peso	0	0	0	0	0	65,774,371
Moroccan Dirham	0	0	0	0	0	2,107,593
New Taiwan Dollar	0	0	0	0	0	173,356,560
New Turkish Lira	0	0	0	0	0	36,879,787
New Zealand Dollar	0	0	0	0	0	9,100,929
Norwegian Krone	0	0	0	0	0	103,421,050
Philippines Peso	0	0	0	0	0	5,550,826
Polish Zloty	0	0	0	0	0	36,676,261
S. African Comm Rand	0	0	0	0	0	47,858,168
Singapore Dollar	0	0	0	0	0	86,992,290
South Korean Won	0	0	3,725,804	0	0	170,352,309
Swedish Krona	0	0	0	947,027	0	118,245,655
Swiss Franc	0	0	0	0	0	380,648,798
Thailand Baht	0	0	0	0	0	41,122,002
United States Dollar	(8,432,309)	1,293,141,586	7,290,208	4,747,682,465	390,887,893	52,072,755,263
Uruguayan Peso	0	0	0	0	0	5,264,701
	<u>\$ (6,567,086)</u>	<u>\$ 1,293,141,586</u>	<u>\$ 125,769,970</u>	<u>\$ 5,323,131,440</u>	<u>\$ 390,887,893</u>	<u>\$ 63,050,123,938</u>

Notes to the Financial Statements

currency, the borrower is required to place collateral totaling 105 percent of the loaned securities' fair value, including interest accrued, as of the delivery date with the lending agent. Collateral is marked to market daily and adjusted as needed to maintain the required minimum level.

Cash collateral is reinvested by the lending agent or its affiliate in accordance with contractual investment guidelines which are designed to minimize the risk of principal loss and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also require a portion of the collateral investments to be invested in short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers and fees paid to agents, results in the gross earnings from lending activities, which are then split on a percentage basis with the lending agent.

In accordance with money market mutual fund industry standards, the cash collateral reinvestment pools are valued at amortized cost. The amortized or book value of a fund's assets and underlying fair market value of the assets may differ based on market conditions. The pool's market value relative to its amortized cost is expressed as net asset value (NAV) and is derived by dividing total market value by amortized cost. In fiscal year 2009, the securities lending reinvestment pools' NAVs were below the typical money market fund market floor value of 99.50%. As of June 30, 2009, the U.S. dollar cash collateral reinvestment pool's NAV was 98.43% while the foreign reinvestment pool had an NAV of 97.63%.

At fiscal year-end, the Retirement Funds had no credit risk exposure to borrowers because the amounts the Retirement Funds owed the borrowers exceeded the amounts the borrowers owed the Retirement Funds. The contract with the lending agent requires it to indemnify the Retirement Funds if the borrowers fail to return the loaned securities and the collateral margin is inadequate to replace the securities lent. The Retirement Funds are also indemnified against losses resulting from violations of investment guidelines.

The majority of security loans can be terminated on demand by the Retirement Funds or the borrower. The average term of the loans is approximately three days which is shorter than the weighted average maturity/days to reset of 35 days for investments made with the U.S. dollar cash collateral and the weighted average maturity/days to reset of 14 days for investments made with foreign cash collateral at June 30, 2009.

Pledging or selling collateral securities cannot be done without a borrower default. The quantity or dollar value of securities lending contracts that the Retirement Funds may enter into is not restricted by statute.

The Retirement Funds also earn securities lending income as part of total net earnings from the investment in several collective trust funds. These earnings are automatically reinvested in the collective trust fund, and as a result the earnings are combined with all other earnings and gains and losses for these funds, and reported in the Statement of Changes in Net Investment Assets as "Net Increase (Decrease) in the Fair Value of Investments".

5 Derivative Financial Instruments

Derivatives may be used as part of a portfolio's or fund's investment strategy. All derivative instruments are subjected to risk analysis and monitoring processes at the portfolio, asset class and fund levels.

Investment guidelines define allowable derivative activity for each portfolio and are based on the investment objectives which have been approved by the Board. Where derivatives are permitted, guidelines stipulate allowable instruments and the manner in which they are to be used. In general, derivative issuers or counterparties used must be a recognized exchange or a bank or broker dealer with a credit rating of no less than: (1) "A1/P1" on short term debt from S&P or Moody's; and/or (2) "A" on long term debt from S&P or Moody's. These counterparty credit rating requirements may be modified on a case-by-case basis, with the approval of the Investment Committee.

Below are the types of derivatives that SWIB uses in its dedicated account portfolios. SWIB also invests in derivative instruments indirectly through several collective trust funds. These derivatives have not been included in the following narrative.

A. Foreign Currency Forwards and Options

Currency exposure management is permitted through the use of exchange traded currency instruments, and through the use of over-the-counter spot and forward contracts in foreign currencies. Losses may arise from future changes in the value of the underlying currency, or if the counterparties do not perform under the terms of the contract.

SWIB may employ discretionary currency overlay strategies at the total fund level when currency market conditions suggest such strategies are warranted. Direct hedging of currency exposure back to the U. S. dollar is permitted when consistent with the strategy of the portfolio. Cross-currency exposure management to transfer out of an exposed currency and into a benchmark currency is permitted in some portfolios. Currencies of non-benchmark countries may be held through the use of forward contracts, provided that the notional value of any single non-benchmark currency does not exceed 5% of the market value of the portfolio.

During the fiscal year presented in these financial statements SWIB's currency exposure management involved the use of foreign currency spot and forward contracts. The table entitled **Foreign**

Foreign Currency Spot and Forward Contracts
June 30, 2009

	Core Fund	Variable Fund
Pending Receivable	\$ 3,086,336,026	\$ 168,669,266
Pending Payable	(3,057,791,031)	(167,270,481)
Net Foreign Currency Contract Asset	<u>\$ 28,544,995</u>	<u>\$ 1,398,785</u>

Notes to the Financial Statements

Currency Spot and Forward Contracts presents the fair value of foreign currency forward contract assets and liabilities held by the Core and Variable Funds as of June 30, 2009.

B. Futures Contracts

A financial futures contract is an exchange traded agreement to buy or sell a financial instrument at an agreed upon price and time in the future. Upon entering into a futures contract, collateral is deposited with the broker, in SWIB's name, in accordance with the initial margin requirements of the broker. Futures contracts are marked to market daily by the board of trade or exchange on which they are traded. The resulting gain/loss is received/paid the following day until the contract expires. The frequency of cash flows depends upon specified collateral and margin limits mutually agreed upon by the manager and third-party broker.

Futures contracts involve, to varying degrees, risk of loss in excess of the variation margin disclosed in the Statement of Net Investment Assets. Losses may arise from future changes in the value of the underlying instrument.

Financial futures contracts and financial options contracts may be entered into for the following objectives: to facilitate asset class rebalancing, protect portfolios against the risk of changing asset values or interest rates, enhance liquidity, aid in cash flow management, manage interest rate exposure, adjust duration, equitize cash and receivable positions or as a substitute for cash market transactions.

The Retirement Funds were invested in exchange-traded interest rate futures contracts and

equity futures contracts with a net notional value of \$2.65 billion as of June 30, 2009. These contracts are secured by collateral deposited with brokers which can be in the form of cash, U.S. Treasuries and equity securities.

C. Asset Backed Securities

The Core Fund holds asset backed securities, which are reported at fair market value in the Statement of Net Investment Assets.

Asset backed securities are debt securities whose value is derived from payments and prepayments of principal and interest generated from whole loan mortgages, mortgage pass-through securities, credit card receivables, car loan and leases receivables, insurance proceeds receivable, as well as, airline and railroad car loan receivables. In some cases, cash flows are distributed to different investment classes or tranches in accordance with the security's established payment order. Some tranches have more stable cash flows relative to changes in interest rates while others are significantly more sensitive to interest rate fluctuations.

In a declining interest rate environment, some asset backed securities may be subject to a reduction in interest payments as a result of prepayments of underlying mortgages, leases, or loans which make up the collateral pool. A reduction in interest payments may cause a decline in cash flows and thus a decline in the fair value of the security. Rising interest rates may cause an increase in anticipated interest payments, thus an increase in fair value of the security.

The Core Fund holds primarily high quality, senior tranches, resulting in low to moderate risk of

default and prepayment. However, given the current credit market environment, some potential price volatility should be expected in these securities. The degree of prepayment risk varies with the type of underlying assets. Mortgage backed securities tend to have a higher degree of prepayment risk due to the long term nature of the security. The WRS directly held mortgage backed securities with a fair value totaling \$65.4 million at June 30, 2009.

D. Options

Option contracts give the purchaser of the contract the right to buy (call) or sell (put) the security or index underlying the contract at an agreed upon price on or before the expiration of the option contract. The seller of the contract is subject to market risk, while the purchaser is subject to credit risk and market risk to the extent of the premium paid to enter into the contract.

Trust fund rebalancing policies permit the use of exchange traded options. Call options may be purchased or put options sold on investments that could be held in the portfolio if the options were exercised. Domestic fixed income portfolios are permitted to enter into option contracts for the purposes of adjusting duration, taking or modifying credit positions, or investing anticipated cash flows.

The Retirement Funds held no options during fiscal year 2009.

6 Summary of Investments

The tables entitled **Core Retirement Investment Trust Fund** and **Variable Retirement Investment Trust Fund** provide summary information by investment classification for the Core Fund and Variable Fund at June 30, 2009.

Core Retirement Investment Trust Fund
June 30, 2009

Classification	Coupon Rate (%)	Maturity Dates	Cost	Fair Value
Fixed Income	Variable & 0.00 - 18.00	7/2009 - 12/2049	\$ 16,291,512,711	\$ 17,758,300,013
Preferred Securities	N/A	N/A	105,606,040	117,819,371
Convertible Securities	Variable & 0.00 - 10.00	6/2010 - 12/2049	30,387,154	27,453,980
Stocks	N/A	N/A	34,357,297,406	31,663,015,752
Limited Partnerships	N/A	N/A	7,232,909,694	5,323,131,440
Commercial Mortgages	7.00 - 7.36	2/2010 - 12/2014	49,823,009	51,523,759
Real Estate	N/A	N/A	284,091,970	390,887,893
Multi Asset	N/A	N/A	1,022,873,404	1,293,141,586
Financial Futures Contracts	N/A	N/A	0	(6,501,904)
			<u>\$ 59,374,501,388</u>	<u>\$ 56,618,771,890</u>

Variable Retirement Investment Trust Fund
June 30, 2009

Classification	Coupon Rate (%)	Maturity Dates	Cost	Fair Value
Fixed Income*	Variable	N/A	\$ 692,877	\$ 69
Preferred Securities	N/A	N/A	7,730,948	7,950,599
Stocks	N/A	N/A	4,558,634,730	4,002,457,191
Financial Futures Contracts	N/A	N/A	0	(65,182)
			<u>\$ 4,567,058,555</u>	<u>\$ 4,010,342,677</u>

* The Variable fund held one defaulted fixed income investment as of 6/30/09

7 Milwaukee Retirement System

The Milwaukee Retirement System (MRS), consisting of several funds within the Milwaukee Public School Retirement System, invests in the Core Fund and Variable Fund through the WRS. Since the MRS is a separate legal entity from the WRS, both the Core Fund and the Variable Fund qualify as external investment trust funds. Participation by the MRS in the Core Fund and Variable Fund is described in the ETF Administrative Code, Chapter 10.12. MRS provides assets to ETF for investment in the Core Fund and Variable Fund which are managed by SWIB. Each month the ETF distributes to the MRS their pro-rata share of the total Core Fund's earnings less administrative expenses, as well as the Variable Fund's earnings less administrative expenses. The

MRS accounts are adjusted to fair value and gains/losses are recorded directly in the accounts per ETF Administrative Code 10.12(2). No State statute, legal provision, or legally binding guarantee exists to support the value of MRS's portion of the Core Fund or the Variable Fund.

8 Unfunded Capital Commitments

The Core Fund has committed to fund various limited partnerships and side-by-side agreements related to its private equity and real estate holdings. Commitments that have not been funded totaled \$5.3 billion as of June 30, 2009. Unfunded commitments are not included in the financial statements since the amount and timing of the funding is not certain.

9 Loss Contingency

On September 5, 2008, the Internal Revenue Service (IRS) provided SWIB with a “Notice of Transferee Liability.” This claim seeks taxes, penalties and interest relating to the sale of Shockley Communications Corporation (SCC) stock in 2001.

SWIB is classified as a tax exempt entity by the IRS. However, the IRS asserts that the shareholders’ sale of SCC stock in 2001 should have been characterized as a sale of assets by SCC, on which SCC should have paid income taxes. Based on the theory of transferee liability, the IRS asserts that the former SCC shareholders, including SWIB, would be liable for those taxes, plus penalties and interest. Transferee liability is limited to the amount actually received by the putative transferee, plus interest. As a result, SWIB’s liability, as a putative transferee of SCC assets, would be limited to \$28.3 million of SCC’s tax deficiency, plus interest.

SWIB is aggressively contesting the IRS’ assertions of SWIB’s tax liability. Furthermore, SWIB believes that the loss, if any, resulting from the claim will not have a material impact on SWIB’s net investment assets or net income in future years. As such, SWIB has not recognized a loss relating to this matter in the current year, nor does it appear as a contingent liability in the Statement of Net Investment Assets.



STATE OF WISCONSIN

Legislative Audit Bureau

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Janice Mueller
State Auditor

INDEPENDENT AUDITOR'S REPORT

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Trustees and
Mr. Keith Bozarth, Executive Director
State of Wisconsin Investment Board

We have audited the accompanying Statement of Net Assets for the State Investment Fund of the State of Wisconsin as of June 30, 2009, and the related Statement of Operations and Changes in Net Assets for the year then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

The financial statements for the year ended June 30, 2008, are being presented for informational purposes only. These financial statements were audited by us and we expressed an unqualified opinion on them in our report dated August 28, 2008, but we have not performed any auditing procedures since that date.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

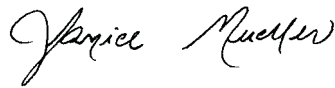
The financial statements referred to in the first paragraph present only the State Investment Fund and do not purport to, and do not, present fairly the financial position and results of operations of the Investment Board or of the State of Wisconsin in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the net assets of the State Investment Fund as of June 30, 2009, and the results of its operations and changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the State Investment Fund. The supplementary information included as Management's Discussion and Analysis, which precedes the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, accordingly, we express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 25, 2009, on our consideration of the Investment Board's internal control over financial reporting for the State Investment Fund; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which is included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU



by

Janice Mueller
State Auditor

August 25, 2009

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State Investment Fund

Management Discussion and Analysis

Management's Discussion and Analysis provides general information on the financial activities of the State Investment Fund (SIF). The SIF temporarily invests the operating funds of: 1) State of Wisconsin Agencies, 2) the Wisconsin Retirement System (WRS), and 3) the Wisconsin Local Government Investment Pool (LGIP). At June 30 the ownership of the SIF was as follows:

	2009	2008
1. State of Wisconsin Agencies	19%	25%
2. Wisconsin Retirement System	30%	9%
3. Local Gov't Investment Pool	51%	66%

Following this section are the Financial Statements and Notes to the Financial Statements. The Statement of Net Assets provides information on the types of assets and the liabilities of the SIF. The Statement of Operations and Changes in Net Assets provides information on the net investment income of the SIF and its net assets at year end. The Notes to the Financial Statements provide additional information that is essential to a full understanding of the

data provided in the SIF financial statements. The table entitled **Condensed SIF Financial Information** contains a summary for the fiscal years ended June 30, 2009 and 2008 (for comparison).

Because the SIF is used to temporarily invest participants' operating cash flows, investments are in highly liquid, short-term fixed income securities. At June 30, 2009, SIF Net Assets had increased by \$814,423,000 from the prior year due to the increase in the WRS (+\$1,401 million) balance greatly exceeding the decrease in both the Wisconsin agencies (-\$160 million) and the LGIP (-\$427 million) balances. The WRS held significantly more cash to cover the notional value of new positions in futures contracts. The Average Daily Portfolio Balance remained relatively unchanged in the current fiscal year compared to the prior year. The monthly average peaked at \$8.234 billion in February 2009.

The Net Investment Income decrease of 67.7% from the previous fiscal year was largely due to the Federal Open Markets Committee reducing the Federal Funds Rate three times during fiscal year 2009, from 2.00% to 0.25%. This also caused the Time Weighted Annual Yield to decrease from 4.02% to 1.33%.

SIF Condensed Financial Information

Fiscal Year Ended:	2009	2008	% Change
Total Assets	\$ 6,529,206,269	\$ 5,830,457,009	12.0
Total Liabilities	100,907,269	216,581,009	(53.4)
Net Assets	<u>\$ 6,428,299,000</u>	<u>\$ 5,613,876,000</u>	14.5
Investment Revenue	\$ 87,840,020	\$ 261,201,741	(66.4)
Expenses	1,943,880	2,203,590	(11.8)
State Working Bank Charges	3,343,029	3,326,292	0.5
Net Investment Income	<u>\$ 82,553,111</u>	<u>\$ 255,671,859</u>	(67.7)
Average Daily Cash Balance	\$ 6,646,028,448	\$ 6,576,691,453	1.1
Time Weighted Annual Yield	1.33%	4.02%	

STATE INVESTMENT FUND
Statement of Net Assets
As of June 30, 2009 (with Comparative Amounts for June 30, 2008)

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Assets		
Investments (at fair value):		
NOW Account Deposits	\$ 867,905,000	\$ 0
Repurchase Agreements	901,000,000	1,371,000,000
Government and Agency	4,557,665,170	3,851,263,560
Commercial Paper	0	0
Certificates of Deposit (CDs)	198,900,000	600,000,000
Asset Backed Securities	0	0
Mortgage Backed Securities	84,259	177,635
Yankee/Euro Issues	<u>0</u>	<u>0</u>
 Total Net Investments (at fair value)	 \$ 6,525,554,429	 \$ 5,822,441,195
 Other Assets:		
Accrued Interest Receivable	<u>3,651,840</u>	<u>8,015,814</u>
 Total Investment Assets	 <u>\$ 6,529,206,269</u>	 <u>\$ 5,830,457,009</u>
Liabilities		
Check Float Invested	\$ 99,062,276	\$ 205,687,832
Earnings Distribution Payable	1,736,961	10,664,619
Accrued Expenses	<u>108,032</u>	<u>228,558</u>
 Total Liabilities	 <u>\$ 100,907,269</u>	 <u>\$ 216,581,009</u>
 NET ASSETS	 <u><u>\$ 6,428,299,000</u></u>	 <u><u>\$ 5,613,876,000</u></u>
 Net Assets consist of:		
Participating Shares	\$ 6,428,299,000	\$ 5,613,876,000
Undistributed Unrealized Gains (Losses)	<u>0</u>	<u>0</u>
 NET ASSETS	 <u><u>\$ 6,428,299,000</u></u>	 <u><u>\$ 5,613,876,000</u></u>

The accompanying notes on pages 50 through 55 are an integral part of this statement.

STATE INVESTMENT FUND
Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2009 (with Comparative Amounts for 2008)

	<u>2009</u>	<u>2008</u>
Investment Revenue	\$ 87,840,020	\$ 261,201,741
Expenses		
Management Operating Expense	\$ 1,641,013	\$ 1,880,723
Custodial Bank Charges	106,384	109,108
Electronic Services	178,121	205,059
Legal and Consulting Fees	<u>18,362</u>	<u>8,700</u>
Total Expenses	<u>\$ 1,943,880</u>	<u>\$ 2,203,590</u>
Net Investment Revenue	\$ 85,896,140	\$ 258,998,151
State Working Bank Charges	<u>3,343,029</u>	<u>3,326,292</u>
Net Investment Income	\$ 82,553,111	\$ 255,671,859
Distributions Paid and Payable	<u>82,553,111</u>	<u>255,671,859</u>
Change in Undistributed Unrealized Gains (Losses)	\$ 0	\$ 0
Beginning of Period Undistributed Unrealized Gains (Losses)	<u>0</u>	<u>0</u>
End of Period Undistributed Unrealized Gains (Losses)	<u>\$ 0</u>	<u>\$ 0</u>
Participant Transactions		
Receipts by Transfer to Fund	\$ 32,404,364,000	\$ 28,231,258,000
Disbursements by Transfer from Fund	<u>(31,589,941,000)</u>	<u>(28,842,072,000)</u>
Net Change in Participating Shares	\$ 814,423,000	\$ (610,814,000)
Beginning of Period Participating Shares	<u>5,613,876,000</u>	<u>6,224,690,000</u>
End of Period Participating Shares	<u>\$ 6,428,299,000</u>	<u>\$ 5,613,876,000</u>
NET ASSETS	<u>\$ 6,428,299,000</u>	<u>\$ 5,613,876,000</u>

The accompanying notes on pages 50 through 55 are an integral part of this statement.

Notes to the Financial Statements

1 Description of Fund

The State Investment Fund (SIF) pools the cash of the State of Wisconsin and its agencies, the Wisconsin Retirement System (WRS), and various local government units (Local Government Investment Pool – LGIP) into a commingled fund with the investment objective of safety of principal and liquidity while earning a competitive money market rate of return. Only State of Wisconsin agencies are required to invest their operating cash in the SIF. In the State’s Comprehensive Annual Financial Report (CAFR), the SIF is not reported as a separate fund; rather, each State fund’s share in the “pool” is reported on the balance sheet as “Cash and Cash Equivalents.” Shares of the SIF belonging to other participating public institutions are presented in the Local Government Pooled Investment Fund, an investment trust fund. The staff of the State of Wisconsin Investment Board (SWIB) manages the SIF with oversight by the Board of Trustees as authorized in Wisconsin Statutes 25.14 and 25.17. The SWIB is not registered with the SEC as an investment company.

Wisconsin Statutes 25.17(3)(b), (ba), (bd), and (dg) enumerate the various types of securities in which the SIF can be invested, which include direct obligations of the United States or its agencies, corporations wholly owned by the United States or chartered by an act of Congress, securities guaranteed by the United States, the unsecured notes of financial and industrial issuers, direct obligations of or guaranteed by the government of Canada, certificates of deposit issued by banks in the United States and solvent financial institutions in Wisconsin and bankers acceptances. The Board of Trustees may specifically approve other prudent legal investments.

2 Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements of the investment activity of the SIF are prepared in accordance with Generally Accepted Accounting Principles for governments as prescribed by the Governmental Accounting Standards Board (GASB).

B. Basis of Accounting

The accompanying statements are prepared based upon the flow of economic resources measurement focus and the full accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized in the period incurred, if measurable. Security transactions and the related gains and losses are recorded on a trade date basis. Interest income is accrued as earned.

SWIB applies all applicable GASB pronouncements and those Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, which do not conflict with or contradict GASB pronouncements.

C. Valuation of Securities

Generally, investments are valued at fair value for financial statement purposes and amortized cost for purposes of calculating income to participants (See Footnote 3). BNY Mellon, as custodial bank, compiles fair value information for applicable securities by

utilizing third party pricing services. The fair value of investments is determined at the end of each month.

U.S. Government/Agency securities and Commercial Paper are priced using matrix pricing. This method estimates a security's fair value by using quoted market prices for securities with similar interest rates, maturities, and credit ratings. Further, short-term debt investments with remaining maturities of up to ninety days are valued using amortized cost to estimate fair value, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors.

Repurchase Agreements and Non-Negotiable Certificates of Deposit are valued at cost because they are nonparticipating contracts that do not capture interest rate changes in their value. In addition, a bond issued by a State of Wisconsin agency, having a par value at June 30, 2009 of \$84,259, is valued at

par, which management believes approximates fair value. The table entitled **Summary Information by Investment Classification** contains information on SIF holdings.

D. Management Operating Expenses

Management operating expenses are SWIB's investment and administrative costs that are allocated to the SIF participants.

E. State Working Bank Charges

State Working Bank Charges represent charges for various state banking services such as lockbox, e-pay, and depository services. These expenses are allocated to SIF participants based on their proportionate usage of banking services and, accordingly, reduce the participant's share of the Net Investment Revenue.

Summary Information by Investment Classification
June 30, 2009

	Interest Rates	Maturity Dates	Book Value (Amort. Cost)	Fair Value
Bank NOW Acct Deposits	0.35 - 0.40	Demand	\$ 867,905,000	\$ 867,905,000
Repurchase Agreements	0.01 - 0.10	07/01/09	901,000,000	901,000,000
Government and Agency	0.12 - 0.57	07/01/09 - 09/01/09	4,557,665,170	4,557,665,170
Commercial Paper	--	--	0	0
Certificates of Deposit	0.90 - 5.68	07/01/09 - 07/15/10	198,900,000	198,900,000
Asset Back Securities	--	--	0	0
Mortgage Backed Securities	1.31	05/27/10	84,259	84,259
Yankee/Euro Issues	--	--	0	0
Total Investments			<u>\$ 6,525,554,429</u>	<u>\$ 6,525,554,429</u>
Ratio of Fair Value to Book Value				<u>100%</u>

3 Pool Earnings and Pool Shares

For purposes of calculating earnings to each participant, all investments are valued at amortized cost. Specifically, the SIF distributes income to pool participants monthly, based on their average daily share balance. Distributed net income includes interest income based on stated rates (both paid and accrued), amortization of discounts and premiums on a straight-line basis, realized investment gains and losses calculated on an amortized cost basis, and investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements, because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair values of the pool's investments. The total difference between the fair values of the investments in the pool and the values distributed to the pool participants using the amortized cost method described above is reported in the equity section of the statement of net assets as "Undistributed Unrealized Gains (Losses)".

Pool shares are bought and redeemed at \$1.00 based on the amortized cost of the investments in the SIF. The State of Wisconsin does not provide any legally binding guarantees to support the value of pool shares.

4 Deposit and Investment Risk

SWIB recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation. SWIB monitors risk through multiple forms of analysis and reporting. For the SIF, evaluations of levels of diversification, nominal risk

exposures including sector, maturity, and interest rate exposures, and risk/return plots form the core of the monitoring process. In addition, the portfolio is reviewed daily for compliance with investment guidelines. At least quarterly, comprehensive reporting is presented to SWIB's Compliance and Investment Committees and the Board of Trustees.

A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the SIF. The SIF's investment guidelines establish very specific maximum exposure limits by security type based on the minimum credit ratings as issued by Nationally Recognized Statistical Rating Organizations (NRSROs). As of June 30, 2009, these credit ratings and aggregate exposures by investment type are found in the table entitled **Credit Quality Distribution for Securities**.

B. Custodial Credit Risk

Deposits — Custodial credit risk related to deposits is the risk that, in the event of the failure of a depository financial institution, SWIB will not be able to recover deposits that are in possession of an outside party. SWIB does not have a deposit policy specifically for custodial credit risk. As of June 30, 2009, the SIF held Certificates of Deposit (CDs) with an estimated fair value of \$198.9 million invested pursuant to the Wisconsin Certificate of Deposit Program (administered by Bankers' Bank) established in July 1987. Investment guidelines provide that banks accepted into this program must accept deposits in Wisconsin and meet credit-

Credit Quality Distribution for Securities
June 30, 2009

	Rating	Fair Value	%
Bank NOW Account Deposits	NR	\$ 867,905,000	13.3
Repurchase Agreements (Collateral):			
US Government Debt	N/A	676,000,000	10.4
Govt Sponsored Entity US Agency	AAA/Aaa	225,000,000	3.4
FHLB (Federal Home Loan Bank)	A-1+/P-1	1,410,511,716	21.6
FHLMC (Federal Home Loan Mortgage Corp)	A-1+/P-1	1,650,363,808	25.3
FNMA (Federal National Mortgage Association)	A-1+/P-1	1,496,789,646	22.9
Certificates of Deposits:			
Non-Negotiable (Var. Wisc Banks)	NR	198,900,000	3.1
Mortgage Backed Securities	NR	84,259	0.0
Totals		<u>\$ 6,525,554,429</u>	<u>100%</u>

screening criteria designed to assure the safety of the deposits. The Federal Deposit Insurance Corporation (FDIC) insures the pro rata share of Certificates of Deposit held by the LGIP up to \$250,000, and the State of Wisconsin appropriation for losses on public deposits protects a depositing municipality up to \$400,000 if the local governing body has designated the LGIP as a public depository. Approximately \$198.9 million is insured through FDIC insurance and the State of Wisconsin appropriation for losses on public deposits. The actual coverage of these deposits fluctuates daily based on the allocable share of participants' accounts.

The SIF also had bank Negotiable Order of Withdrawal (NOW) accounts with various Wisconsin banks (\$268 million - administered by Bankers' Bank) and with Branch Banking & Trust (BB&T - \$600 million). Because these bank NOW accounts had interest rates no higher than 0.50%, these balances are fully guaranteed under the transaction account guarantee component (TAG) of the FDIC's Temporary Liquidity Guarantee Program (TLGP).

C. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. The SIF's investment guidelines limit concentrations of credit risk by establishing maximum issuer and/or issue exposure limits based on credit rating. These guidelines do not place a limit on maximum exposure for any U.S. Treasury or Agency securities. As of June 30, 2009 the SIF has more than five percent of its investments in a BB&T NOW Account Deposit (9.2%), FHLB (21.6%), FHLMC (25.3%), FNMA (22.9%), and Repurchase Agreement collateral consisting of various securities issued by these same three U.S. Agencies (3.4%). Since the Repurchase Agreements mature each day, new collateral, consisting of a different blend of U.S. Treasury and Agency securities, is assigned each night.

Notes to the Financial Statements

D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The SIF uses the Weighted Average Maturity (WAM) method to analyze interest rate risk and investment guidelines mandate that the Weighted Average Maturity for the entire portfolio will not exceed one year. SIF summary WAM analysis by investment type is found in the table entitled **Weighted Average Maturities (WAM) for Securities**.

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. SIF guidelines allow the investment in U.S. dollar denominated issues only. As of June 30,

2009 the SIF did not own any issues denominated in a foreign currency.

5 Related Party Transactions

The SIF held one bond issued by a State of Wisconsin agency, the Department of Veterans Affairs, with a remaining par and carrying value of \$84,259 as of June 30, 2009. SWIB management believes the rate of interest received is comparable to rates for bonds with similar characteristics issued by an unaffiliated third party.

Wisconsin Statutes Chap. 20.002 (11) provides for the short-term temporary reallocation of surplus moneys between statutory funds, provided that the borrowing fund anticipates receiving future revenues to pay back the temporary loan. For Fiscal Year 2009, Chapter 20.002 (11) (b) 2 provides that General Fund

Weighted Average Maturities (WAM) for Securities
June 30, 2009

	Fair Value	WAM (Days)
Bank NOW Acct Deposits	\$ 867,905,000	0
Repurchase Agreements	901,000,000	1
Government and Agencies	4,557,665,170	95
Commercial Paper	0	--
Certificates of Deposit	198,900,000	81
Asset Backed Securities	0	--
Mortgage Backed Securities	84,259	331
Yankee/Euro Issues	0	--
Total Fair Value	<u>\$ 6,525,554,429</u>	
Portfolio Weighted Average Maturity		<u>69</u>

borrowings may not exceed 7% of defined revenues (estimated borrowing cap of \$986 million). Chapter 20.002 (11) (b) 3 permits an additional temporary allocation not to exceed 3% of defined revenues for a period of up to 30 days (estimated borrowing cap of \$423 million). Further, Chapter 20.002 (11) (b) 1 limits the total amount of any temporary reallocations to a fund other than the General Fund to \$400 million. The borrowing fund is charged interest on the inter-fund loan at the SIF monthly interest rate. As of June 30, 2009 the amount of inter-fund borrowings between statutory funds invested in the SIF is listed in the table entitled **Inter-Fund Loans**.

<u>Fund</u>	<u>Amount</u>
General	\$ 147,352,000
Medical Assistance Trust	352,223,000
Utility Public Benefits	162,000
Injured Patients & Families Comp	77,151,000
Total	\$ 576,888,000



STATE OF WISCONSIN

Legislative Audit Bureau

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Janice Mueller
State Auditor

INDEPENDENT AUDITOR'S REPORT

Senator Kathleen Vinehout and
Representative Peter Barca, Co-chairpersons
Joint Legislative Audit Committee

Members of the Board of Trustees and
Mr. Keith Bozarth, Executive Director
State of Wisconsin Investment Board

We have audited the accompanying Statement of Net Investment Assets for the Various Funds (Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, EdVest Tuition Trust Fund, and Historical Society Trust Fund) of the State of Wisconsin as of June 30, 2009, and the related Statement of Changes in Net Investment Assets for the year then ended. These financial statements are the responsibility of the State of Wisconsin Investment Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

The financial statements for the year ended June 30, 2008, are being presented for informational purposes only. These financial statements were audited by us and we expressed an unqualified opinion on them in our report dated December 2, 2008, but we have not performed any auditing procedures since that date.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to in the first paragraph present only the investment activity of the Various Funds attributable to the transactions of the State of Wisconsin Investment Board. The financial statements do not purport to, and do not, present the financial activity of the Various Funds attributable to other state agencies. Further, they do not purport to, and do not, present fairly the financial position and results of operations of the Investment Board or of the State of Wisconsin in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective net investment assets of each of the Various Funds as of June 30, 2009, and the respective changes in net investment assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

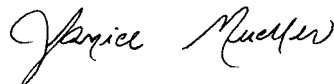
Our audit was conducted for the purpose of forming an opinion on the financial statements of the Various Funds. The supplementary information included as Management's Discussion and Analysis, which precedes the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it. The introduction section of the annual report has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 24, 2009, on our consideration of the Investment Board's internal control over financial reporting for the Various Funds; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report, which is included in a management letter to the Investment Board, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LEGISLATIVE AUDIT BUREAU

November 24, 2009

by



Janice Mueller
State Auditor

Various Funds

Management Discussion and Analysis

Management Discussion and Analysis provides general information on the investment financial activities of the Various Funds. The State of Wisconsin Investment Board (SWIB) has exclusive control of the investment and collection of principal, interest, and dividends of all monies invested of the Local Government Property Insurance Fund (LGPIF), State Life Insurance Fund (Life Fund), Injured Patients and Families Compensation Fund (IPFCF), EdVest Tuition Trust Fund (EdVest), and Historical Society Trust Fund (HSTF) (collectively known as the “Various Funds”).

Following this section are the financial statements and notes. The **Statement of Net Investment Assets** provides information on the types of investments and the liabilities of the Various Funds. The **Statement of Changes in Net Investment Assets** provides information on the in-

vestment income of the Various Funds and their net assets at year-end. The **Notes to the Financial Statements** provide additional information that is essential to a full understanding of the data provided in the funds’ financial statements. Condensed Various Funds financial information for the fiscal year ended June 30, 2009 (with comparable amounts for 2008) is in the table entitled **Various Funds Condensed Investment Financial Information**.

Percentage changes in the Net Investment Assets of the Various Funds were due to Net Investment Income and to program activities within the fund that were not investment related.

For Fiscal Year 2009, both equity markets and bond prices were generally significantly lower early in the year and improving at year end. The

Various Funds Condensed Investment Financial Information

Fiscal Year Ended:	2009	2008	% Change
<u>Net Investment Assets:</u>			
Local Govt Property Ins Fund	\$ 52,717,233	\$ 53,207,254	(0.9)
State Life Insurance Fund	87,883,468	85,197,190	3.2
Inj Patients & Families Comp	567,854,617	735,587,218	(22.8)
EdVest Tuition Trust Fund	8,894,696	9,330,777	(4.7)
Historical Society Trust Fund	8,790,182	11,232,081	(21.7)
<u>Net Investment Income:</u>			
Local Govt Property Ins Fund	\$ 737,289	\$ 2,331,699	(68.4)
State Life Insurance Fund	5,425,054	5,579,562	(2.8)
Inj Patients & Families Comp Fd	(5,123,893)	26,929,111	(119.0)
EdVest Tuition Trust Fund	386,135	848,992	(54.5)
Historical Society Trust Fund	(2,000,340)	(1,049,622)	(90.6)

Federal Open Markets Committee (FOMC) reduced the federal funds target rate three times, from 2.00% to 0.25%. Since the Local Government Property Insurance Fund was primarily invested in the State Investment Fund (SIF), the lower short-term interest rates resulted in a 68.4% decrease in net income.

It should be noted that Life Fund, IPFCF, and EdVest are primarily “buy and hold” portfolios. Highly rated bonds (at time of purchase) are acquired for each portfolio and held to maturity. As such, since the portfolios are marked to fair value, their annual Net Investment Income is subject to swings caused by the affect of interest rate changes on bond prices.

The 2.8% decrease in Net Investment Income of the Life Fund was due to lower bond prices and to the fund holding a \$500,000 par position in Lehman Brothers when the company entered bankruptcy.

In addition to lower bond prices, the 119.0% decrease in Net Investment Income for Injured Patients and Families Compensation Fund was also due to several other factors. At the end of FY 2009, the fund held four indexed stock funds,

representing 14.0% of investments, which experienced a \$33.1 million decrease in fair value during the current year as compared to a \$15.8 million decrease in fair value during the prior year. During FY 2009, the fund held \$5.0 million par positions in both Washington Mutual Bank, which entered receivership, and Lehman Brothers, which entered bankruptcy. Also, in July 2008, as provided by the 2007 Wisconsin Act 20, the State transferred \$128.5 million from IPFCF to the State’s General Fund.

The 54.5% decrease in Net Investment Income for EdVest was due to depreciation in the prices of government sponsored entity bonds it held as compared to significant appreciation in the prior year. The fund also held a \$100,000 par position in General Motors when the company entered bankruptcy.

The 90.6% increase in Net Investment Loss for the Historical Society Trust Fund was largely due to an indexed stock fund, representing 77.6% of Net Investment Assets, which experienced a \$2.1 million decrease in fair value during the current year as compared to a \$1.3 million decrease in fair value during the prior year.

VARIOUS FUNDS
Statement of Net Investment Assets
As of June 30, 2009

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	EdVest Tuition Trust Fund	Historical Society Trust Fund
Investment Assets					
Cash and Cash Equivalents	\$ 33,602,685	\$ 1,626,743	\$ 287	\$ 1,612,402	\$ 293,921
Receivables					
Investment Income	174,658	1,346,308	8,435,276	23,015	29,316
Investment Sales	0	0	750,000	0	7,201
Investments					
Fixed Income	18,939,890	84,910,417	547,121,817	7,259,279	1,898,830
Stocks	0	0	88,709,713	0	6,561,750
Total Investment Assets	<u>\$ 52,717,233</u>	<u>\$ 87,883,468</u>	<u>\$ 645,017,093</u>	<u>\$ 8,894,696</u>	<u>\$ 8,791,018</u>
Liabilities					
Investment Purchases Payable	0	0	6,656	0	371
Accounts Payable	0	0	4,820	0	465
Due to State Investment Fund	0	0	77,151,000	0	0
Total Liabilities	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 77,162,476</u>	<u>\$ 0</u>	<u>\$ 836</u>
Net Investment Assets	<u>\$ 52,717,233</u>	<u>\$ 87,883,468</u>	<u>\$ 567,854,617</u>	<u>\$ 8,894,696</u>	<u>\$ 8,790,182</u>

VARIOUS FUNDS
Statement of Changes in Net Investment Assets
For the Fiscal Year Ended June 30, 2009

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	EdVest Tuition Trust Fund	Historical Society Trust Fund
From Investment Activities:					
Investment Income					
Net Increase (Decrease) in Fair Value of Investments	\$ (21,181)	\$ 633,758	\$ (35,256,593)	\$ (32,740)	\$ (1,989,485)
Interest	759,304	4,796,784	30,176,790	418,875	3,034
Investment Expenses	(834)	(5,488)	(44,090)	0	(13,889)
Net Investment Income	\$ 737,289	\$ 5,425,054	\$ (5,123,893)	\$ 386,135	\$ (2,000,340)
From Participant Transactions:					
Net Receipts (Disbursements) - Non-Investment Activity	(1,227,310)	(2,738,776)	(162,608,708)	(822,216)	(441,559)
Net Increase (Decrease) in Net Investment Assets	\$ (490,021)	\$ 2,686,278	\$ (167,732,601)	\$ (436,081)	\$ (2,441,899)
Net Investment Assets					
Beginning of Year	53,207,254	85,197,190	735,587,218	9,330,777	11,232,081
End of Year	<u>\$ 52,717,233</u>	<u>\$ 87,883,468</u>	<u>\$ 567,854,617</u>	<u>\$ 8,894,696</u>	<u>\$ 8,790,182</u>

The accompanying notes on pages 62 through 67 are an integral part of this statement.

VARIOUS FUNDS
Statement of Net Investment Assets
Comparative Amounts as of June 30, 2008

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	EdVest Tuition Trust Fund	Historical Society Trust Fund
Investment Assets					
Cash and Cash Equivalents	\$ 53,099,808	\$ 1,929,401	\$ 252	\$ 882,629	\$ 230,468
Receivables:					
Investment Income Receivable	108,040	1,267,978	9,728,688	25,910	10,523
Investment Sales Receivable	0	0	0	0	47,855
Investments:					
Fixed Income	0	82,001,804	639,397,447	8,422,238	2,540,369
Stocks	0	0	121,761,814	0	8,404,933
Total Investment Assets	\$ 53,207,848	\$ 85,199,183	\$ 770,888,201	\$ 9,330,777	\$ 11,234,148
Liabilities					
Investment Purchases Payable	0	0	9,361	0	470
Accounts Payable	594	1,993	13,622	0	1,597
Due to State Investment Fund	0	0	35,278,000	0	0
Total Liabilities	\$ 594	\$ 1,993	\$ 35,300,983	\$ 0	\$ 2,067
Net Investment Assets	\$ 53,207,254	\$ 85,197,190	\$ 735,587,218	\$ 9,330,777	\$ 11,232,081

VARIOUS FUNDS
Statement of Changes in Net Investment Assets
Comparative Amounts for the Fiscal Year Ended June 30, 2008

	Local Gov't. Property Ins. Fund	State Life Insurance Fund	Injured Patients & Families Compensation Fund	EdVest Tuition Trust Fund	Historical Society Trust Fund
From Investment Activities:					
Investment Income:					
Net Increase (Decrease) in Fair Value of Investments	\$ 0	\$ 904,850	\$ (7,787,242)	\$ 345,813	\$ (1,034,902)
Interest	2,333,555	4,681,146	34,772,577	503,179	9,414
Investment Expenses	(1,856)	(6,434)	(56,224)	0	(24,134)
Net Investment Income	\$ 2,331,699	\$ 5,579,562	\$ 26,929,111	\$ 848,992	\$ (1,049,622)
From Participant Transactions:					
Net Receipts (Disbursements) - Non-Investment Activity	(3,859,183)	(2,617,955)	(89,392,543)	(1,127,771)	(435,575)
Net Increase (Decrease) in Net Investment Assets	\$ (1,527,484)	\$ 2,961,607	\$ (62,463,432)	\$ (278,779)	\$ (1,485,197)
Net Investment Assets					
Beginning of Year	54,734,738	82,235,583	798,050,650	9,609,556	12,717,278
End of Year	\$ 53,207,254	\$ 85,197,190	\$ 735,587,218	\$ 9,330,777	\$ 11,232,081

The accompanying notes on pages 62 through 67 are an integral part of this statement.

Notes to the Financial Statements

1 Description of Funds

The State of Wisconsin Investment Board (SWIB or the Investment Board) has control of the investment and collection of principal, interest, and dividends of all monies invested of the Local Government Property Insurance Fund, State Life Insurance Fund, Injured Patients and Families Compensation Fund, Historical Society Trust Fund, and EdVest Tuition Trust Fund (collectively known as the "Various Funds"). The statements presented herein reflect only the investment activity of the Various Funds. Excluded from the presentation in the statements are, for example, claim reserves, reserves for life policies and contracts, contribution revenue, premiums earned, benefit expense, and expenditures from endowment income. Also excluded from the statements are SWIB's administrative receipts and disbursements related to the investment function.

The State Investment Fund (SIF) is used to temporarily invest the operating cash flows of the Various Funds. SWIB manages the SIF with oversight by a Board of Trustees, as authorized in Wisconsin Statutes 25.14 and 25.17. SWIB is not registered with the Securities and Exchange Commission (SEC) as an investment company.

A. Local Government Property Insurance Fund

The Local Government Property Insurance Fund (LGPIF) provides property insurance protection to local government units on an optional basis. The Office of the Commissioner of Insurance (OCI) is responsible for administering the operations of the LGPIF, while SWIB performs the investment

activities for the fund. SWIB's investment objective is to ensure safety of principal and maximization of return within liquidity needs established by the OCI. Wisconsin Statute 25.17(3)(b) allows investments in direct obligations of the United States and Canada, securities guaranteed by the United States, unsecured notes of financial and industrial issuers, Yankee/Euro dollar issues, certificates of deposit issued by banks in the United States, and solvent financial institutions in Wisconsin.

B. State Life Insurance Fund

The State Life Insurance Fund (Life Fund) offers low cost life insurance protection to Wisconsin residents in amounts up to \$10,000 per person. The Office of the Commissioner of Insurance is responsible for administering the operations of the Life Fund. SWIB's investment objective is to maintain a diversified portfolio of high quality publicly issued fixed income obligations that will preserve principal, maximize income while minimizing costs to policyholders, and approximate the expected life of the fund's insurance contracts. Wisconsin Statute 25.17(3)(a) allows investments in loans, securities and any other investments as authorized by s. 620.22, Wis. Stats. Permitted classes of investments include bonds of government units or of corporations, loans secured by mortgages, preferred or common stocks, real property and other investments not specifically prohibited by statute.

C. Injured Patients and Families Compensation Fund

The Injured Patients and Families Compensation Fund (IPFCF) provides medical malpractice insurance

protection to health care providers permanently practicing or operating in Wisconsin. Management of the IPFCF is vested with a Board of Governors and administration of the operations of the fund is the responsibility of the Office of the Commissioner of Insurance. Since September 1990, SWIB has been responsible for investing the securities held by this fund. SWIB's investment objective is to maintain a diversified portfolio of investments to provide a balance between capital appreciation, preservation of capital, and current income consistent with the needs of the IPFCF. Wisconsin Statute 25.17(3)(a) allows investments in loans, securities and any other investments as authorized by s. 620.22, Wis. Stats. Permitted classes of investments include bonds of governmental units or of corporations, loans secured by mortgages, preferred or common stock, real property and other investments not specifically prohibited by statute.

D. Historical Society Trust Fund

The State Historical Society of Wisconsin collects and preserves historical and cultural resources relating to the history of Wisconsin and the western United States, conducts historical research, facilitates and encourages education in Wisconsin history, and serves as the Trustee of the State for the preservation and care of government records. In addition to state and federal funds, the Historical Society receives gifts, grants, and bequests to assist it in carrying out its mission. The gifts, grants and bequests are deposited into the Historical Society Trust Fund (HSTF). SWIB is responsible for managing and supervising the fund's investments with an

investment objective of maintaining a diversified portfolio of high quality publicly issued equities and fixed income obligations providing long-term growth in capital and income generation. Any income earned, except where reinvestment is required by the terms of the gift or bequest, may be expended by the Historical Society in accordance with provisions of the gift, grant or bequest. The Historical Society funds available for investment are authorized to be invested in "every kind of property, real, personal or mixed, and every kind of investment, specifically including but not by the way of limitation, bonds, debentures, and other corporate obligations, stocks, preferred or common, and shares of investment companies and investment trusts, which persons of prudence, discretion, and intelligence acquire or retain for their own account."

E. EdVest Tuition Trust Fund

The EdVest Wisconsin program offers families a way to prepare for future higher education costs. When the program was established in 1997, it offered a bond-based tuition unit investment option. These units, plus investment earnings, are expected to equal one percent of the projected average annual cost of tuition at University of Wisconsin campuses in the year of their use. The Office of State Treasurer is responsible for the administration of the EdVest Wisconsin program. Wisconsin Statute 14.63(10)(b) directs SWIB to invest moneys held in the Tuition Trust Fund in investments with maturities and liquidity that are appropriate for the needs of the fund as reported by the State Treasurer in his or her quarterly reports. All income derived from such investments shall be credited to the fund. The sale of tuition units was

discontinued in 2002. Other investment options are available under the EdVest program, but these are not managed by the Investment Board.

2 Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements of the investment activity of the Various Funds are prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America for governments as prescribed by the Governmental Accounting Standards Board (GASB).

The Local Government Property Insurance Fund, the State Life Insurance Fund, and the Injured Patients and Families Compensation Fund operate similar to insurance enterprises and are reported by the State as proprietary funds. In reporting the investment activity of proprietary funds, SWIB applies all applicable GASB pronouncements and those Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, which do not conflict with or contradict GASB pronouncements. The Historical Society Trust Fund is reported by the State as a governmental fund and the EdVest Tuition Trust Fund is reported by the State as a fiduciary fund.

B. Basis of Accounting

The accompanying statements are prepared based upon the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized in the accounting period

in which they are earned and become measurable, and expenses are recognized in the period incurred, if measurable. Security transactions and the related gains and losses are recorded on a trade date basis. Dividend income is recorded on the ex-dividend date and interest income is accrued as earned.

C. Valuation of Securities

As required by Governmental Accounting Standards Board Statement No. 31, the investments of the Various Funds are valued at fair value, with unrealized and realized gains and losses reflected in the **Statement of Changes in Net Investment Assets** as “Net Increase (Decrease) in Fair Value of Investments”.

Generally, fair value is based on quoted market prices. Private placements are priced via a multi-tiered method. This method prices each holding based on the best available information using a hierarchy of pricing sources.

D. Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates that affect amounts reported herein. Due to the inherent uncertainty involved, actual results could differ from those estimates.

E. Cash and Cash Equivalents

“Cash and Cash Equivalents” reported on the **Statement of Net Investment Assets** include bank deposits and the individual funds’ shares in the State Investment Fund.

3 Deposits and Investments

SWIB recognizes that risk issues permeate the entire investment process from asset allocation to performance evaluation. SWIB monitors risk through multiple forms of analysis and reporting. Inspection of levels of diversification, nominal risk exposures, risk/return plots, and matching liabilities with assets forms the core of the monitoring process. In addition, portfolios and asset classes are reviewed monthly for compliance with investment guidelines and exceptions, if any, are remedied in a prudent manner. On a quarterly basis, guideline exceptions, when identified, are reviewed by SWIB's Compliance Committee.

A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the Various Funds. The Various Funds' (except for EdVest) investment guidelines generally require that issues be rated "A-" or better at the time of purchase based on the minimum credit ratings as issued by Nationally Recognized Statistical Rating Organizations (NRSROs). IPFCF guidelines provide that, at the time of purchase, at least 80% of the bond portfolio must be rated "A3/A1-" or better, using the lower of split ratings. EdVest guidelines do not specifically list a minimum credit quality. As of June 30, 2009, these credit ratings and aggregate exposures by investment type can be found in the table entitled **Credit Quality Distribution for Fixed Income Securities**.

Credit Quality Distribution for Fixed Income Securities
June 30, 2009

	LGPIF		State Life		IPFCF		EdVest		Historical Society	
	Fair Value	%	Fair Value	%	Fair Value	%	Fair Value	%	Fair Value	%
AAA	\$ 18,939,890	36.0	\$ 34,567,895	39.8	\$ 230,492,952	42.1	\$ 6,408,187	72.3	\$ 0	0
AA	0	0	8,228,285	9.5	37,846,917	6.9	247,619	2.8	0	0
A	0	0	25,524,266	29.5	162,840,930	29.8	256,780	2.9	0	0
BBB	0	0	14,599,064	16.9	93,966,506	17.2	164,006	1.8	0	0
BB	0	0	1,349,657	1.6	19,172,012	3.5	170,687	1.9	0	0
B	0	0	567,500	0.7	2,800,000	0.5	0	0	0	0
CCC	0	0	0	0	0	0	0	0	0	0
D	0	0	0	0	0	0	12,000	0.1	0	0
Not Rated	0	0	73,750	0.1	2,500	0	0	0	1,898,830	86.7
Subtotals	\$ 18,939,890	36.0	\$ 84,910,417	98.1	\$ 547,121,817	100.0	\$ 7,259,279	81.8	\$ 1,898,830	86.7
SIF (unrated)	33,602,000	64.0	1,626,000	1.9	0	0	1,612,000	18.2	292,000	13.3
Totals	\$ 52,541,890	100%	\$ 86,536,417	100%	\$ 547,121,817	100%	\$ 8,871,279	100%	\$ 2,190,830	100%

Note: SIF shares are reported on the Statement of Net Investment Assets as Cash and Cash Equivalents.

B. Custodial Credit Risk

Deposits — Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Various Funds will not be able to recover deposits that are in possession of an outside party. The Various Funds do not have a deposit policy specifically for custodial credit risk. As of June 30, 2009, the Various Funds had \$4,038 deposited in a bank account covered by FDIC insurance.

Investments — Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Various Funds will not be able to recover the value of investments that are in the possession of an outside party. The Various Funds do not have an investment policy specifically for custodial credit risk. As of June 30, 2009 the Various Funds did not have any direct investment securities exposed to custodial credit risk.

C. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an organization's investment in a single issuer. With the exception of EdVest, the Various Funds investment guidelines limit concentrations of credit risk by establishing maximum issuer and/or sector exposure limits. Generally, the guidelines require that no single issuer may exceed 5% of the fund investments, with the exception of the U.S. Government and its Agencies, whose exposure is unlimited. The LGPIF further limits AAA-rated mortgage-backed, AAA-rated asset-backed, and individual corporate issuers to 3% of the market value of the fund investments.

Excluding investments issued or explicitly guaranteed by the U.S. government and pooled investments, as of June 30, 2009 none of the Various Fund had more than 5% of their total investments (including the SIF) in a single issuer.

D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Various Funds use the duration method to identify and manage interest rate risk. Three of the Various Funds have investment guidelines relating to interest rate risk. The LGPIF guidelines require that a bond's maturity must not exceed ten years. The Life Fund guidelines require the Weighted Average Maturity (WAM) of the portfolio, including cash, shall be a minimum of ten years. The IPFCF guidelines require that the average duration of the aggregate bond portfolio shall be less than ten years. Summary duration analysis is found in the table entitled **Duration or WAM for Fixed Income Securities**.

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment. The Various Fund investment guidelines do not specifically address foreign currency risk with the exception that the Life Fund only allows investments in U.S. dollar denominated instruments. As of June 30, 2009 the Various Funds did not directly own any issues denominated in a foreign currency.

**Duration or WAM (in years) for Fixed Income Securities
June 30, 2009**

	LGPIF		State Life		IPFCF		EdVest		Historical Society	
	Fair Value	Duration	Fair Value	WAM	Fair Value	Duration	Fair Value	Duration	Fair Value	Duration
Govt/Agcy	\$ 8,347,058	1.97	\$ 33,623,337	16.04	\$ 221,293,804	4.68	\$ 6,408,187	4.65	\$ 0	0.00
Corporate	10,592,832	2.52	51,287,080	17.06	325,828,013	5.02	851,092	4.07	0	0.00
Bond Funds	0		0		0		0		1,898,830	5.06
Subtotal/Ave	<u>\$ 18,939,890</u>	2.28	<u>\$ 84,910,417</u>	16.65	<u>\$ 547,121,817</u>	4.88	<u>\$ 7,259,279</u>	4.59	<u>\$ 1,898,830</u>	5.06
SIF	33,602,000	0.19	1,626,000	0.19	0		1,612,000	0.19	292,000	0.19
Total/Ave	<u>\$ 52,541,890</u>	0.94	<u>\$ 86,536,417</u>	16.34	<u>\$ 547,121,817</u>	4.88	<u>\$ 8,871,279</u>	3.79	<u>\$ 2,190,830</u>	4.41

4 Derivative Financial Instruments

Interest Only Strips — Interest only strips are securities that derive cash flow from the payment of interest on underlying debt securities. EdVest held several interest only strips for yield enhancement purposes. Because the underlying securities are United States Treasury obligations, the credit risk is low. On the other hand, interest only strips may be more sensitive to interest rate fluctuations, which

results in greater price volatility, and thus the market risk is higher than for traditional United States Treasury obligations.

As of June 30, 2009, the EdVest Tuition Trust Fund held interest only strips valued at \$6.25 million, representing approximately 70.5% of portfolio investments.

This publication is available on the Internet at:
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