



The SWIB Report

Published by The State of Wisconsin Investment Board For WRS Participants

May 2002

SWIB Manages WRS Trust Funds

Welcome to the 2002 annual SWIB Report, published by the State of Wisconsin Investment Board (SWIB). SWIB is responsible for investing the assets of the Wisconsin Retirement System (WRS). All other aspects of the WRS, such as managing individual accounts and benefits, fall under the responsibilities of the Department of Employee Trust Funds.

SWIB is a state agency directed by an independent Board of Trustees. Daily operations are carried out by professional money managers and administrative, legal and operations support staff.

In this issue, you will find information on how the Fixed and Variable Trust Funds are invested and other aspects of the Investment Board's operations.

SWIB Ahead of Benchmarks After One of Worst Markets on Record

Annualized Performance Ending 12/31/01

Retirement Funds	1-Year Return	5-Year Return	10-Year Return
Fixed Fund	-2.3%	8.5%	10.3%
<i>Benchmark</i>	-4.5	7.8	9.2
Variable Fund	-8.3%	9.2%	11.8%
<i>Equity Benchmark</i>	-12.9	7.1	10.5
<i>S&P 500</i>	-11.9	10.7	12.9

At the end of 2001, three leading US stock market indices were down for the second consecutive year, the first time since 1973/1974. Even in one of the most difficult markets on record, the Wisconsin Retirement System (WRS) Trust Funds remained ahead of their performance benchmark. The Fixed Fund ended the year with a return of -2.3%, outperforming its benchmark by about 2.2%. The benchmark represents the combined performance of the markets in which the Fixed Fund invests.

The Variable Fund, a stock fund that was reopened to actively employed WRS participants in 2001, was ahead of its benchmark by about 4.5%. Its benchmark reflects the Fund's investment in various domestic and international stocks. Both Funds remain ahead of their respective benchmarks for the five- and ten-year annual average return.

A 32.1% return for SWIB's small company stock portfolio and the continuing strength of the bond markets were two bright points in 2001.

Portfolio Performance:

SWIB's domestic stock portfolios returned -5.6%, exceeding the -11.5% return
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WRS Trust Funds Strategy Review

2002 Overall Investment Strategy

SWIB is implementing several strategic changes in 2002 that:

- Combine Private Equity and Opportunity Portfolios and staff into a single portfolio (Alternative Investments) under the Private Equity Managing Director. (See page 3 for details on this portfolio.)
- Focus Private Equity Portfolio on investments in developed markets.
- Retain 2001 Asset Allocation Targets as shown at right.
- Establish a new internally managed portfolio invested in broadly diversified mix of large cap stocks.
- Establish \$500 million domestic stock health care portfolio.

2002 Asset Targets

- Fixed Trust Fund
 - 39% US Stocks
 - 34% Fixed Income
 - 18% International Stocks
 - 4% Real Estate
 - 5% Alternative Investments
- Variable Trust Fund
 - 80% Domestic Stocks
 - 20% International Stocks

Fixed Fund

The Fixed (or balanced) Fund is the largest of the two trust funds that make up the Wisconsin Retirement System (WRS). All participants have at least 50% of their pension money in the Fixed Fund.

Investment Goals: The basic investment objective is to earn an average 8% annual return over the long-term, which includes an annual rate of return of 3.5% above the expected average increase of wages. The 8% return is the minimum requirement set by the WRS actuary, an outside consultant, to accumulate funds to pay projected benefits to participants over time. It is based on how much is needed to ensure that a person who retires will receive a benefit that will keep pace with inflation. The ten-year annualized return as of December 31, 2001 was 10.3%, 2.3% above the 8% goal. A second goal is to exceed the “benchmark” established by the Board of Trustees. The Fixed Fund benchmark is mainly a composite of several industry indices rolled up and weighted to the asset allocation target.

Investment Strategy: In keeping with the extended time horizon of the Fund’s obligations to provide pensions for all participants, this fully diversified, balanced fund seeks long-term growth. The strategy and asset allocation are reviewed annually.

Variable Fund

About 12% of the WRS assets are managed in the Variable Fund, which was closed by law to new participants in 1980 and reopened to active employees in 2001. Participants who choose the Variable Fund, can place half of their future pension fund contributions in this Fund. Participants in the Variable Fund option also accept a greater degree of risk, in part, because it is a stock fund, for the potential of greater long-term returns.

Investment Goal: The investment objective is to achieve returns that equal or exceed that of similar equity portfolios. The Standard & Poor’s Index of 500 stocks, which features large company stocks, is also used as a performance measure. About 55% of the Fund is diversified into international markets and smaller growth stocks that are not represented in the S&P 500.

Investment Strategy: According to Wisconsin Statutes the “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...”

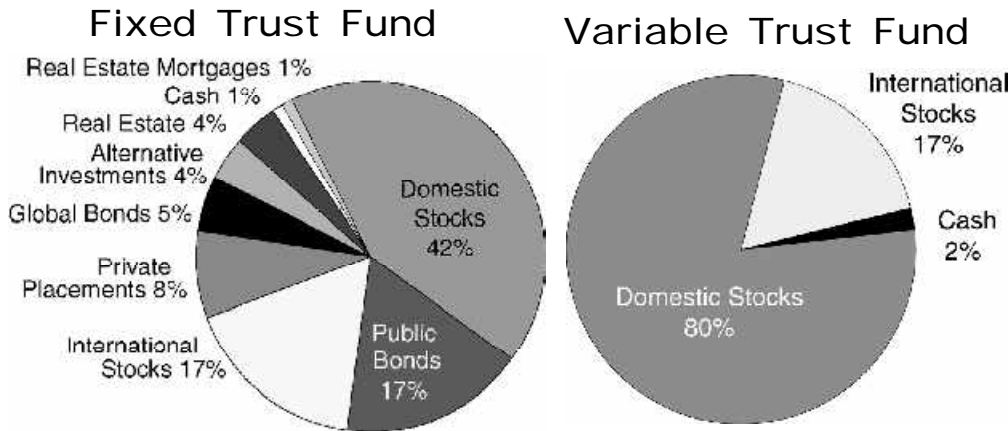
Stock Exposure

WRS participants who remain only in the Fixed Fund have about 54% of their current pension contributions invested in stocks. The stock exposure for those who participate in the Variable Fund will depend on the amount of the individual account and the length of time in the WRS and in the Variable Fund. It is estimated that participants generally will have between 56% to 77% stock exposure if they are in both funds.

Asset Allocation

2001 Performance

continued from page 1



As of December 31, 2001. Totals may not add to 100% due to rounding

Portfolios in the WRS Trust Funds

Domestic Stocks primarily consist of common stock in US companies. Holdings are diversified among small, medium and large companies. Five portfolios are managed internally and four externally. SWIB invests 39% of the equities in index funds.

International Stocks are divided among an internally managed portfolio, externally managed portfolios and an index fund. SWIB limits investments to countries rated "free" or "partly free" by the Freedom House Index.

Public Bonds include US government bonds and corporate bonds purchased in public markets, corporate securities and US Treasury, and agency securities. Two portfolios are actively managed by SWIB staff and two are index funds.

Global Bonds include US or foreign bonds. Securities must meet minimum credit quality requirements. Outside advisors manage about 45% of the holdings.

Real Estate Mortgages consist of private commercial mortgages in partnership with Northwestern Mutual Life.

Private Placements are direct, long-term loans to companies located throughout the United States. In many cases, SWIB is a co-lender with other public or private investors. Loans are made at fixed rates of interest.

Real Estate includes commercial real estate with SWIB as a sole direct owner, or in joint ventures and partnerships. The portfolio is diversified by region of the United States and by property type.

Alternative Investments are private equity investments, which includes leveraged buyouts and venture capital, and the Opportunity Portfolio, structured to invest opportunistically across asset classes in domestic and foreign markets. These investments carry greater risk, but offer the prospect of greater return.

Cash (temporary balances awaiting permanent investment) is invested in short-term and intermediate-term investments. They include obligations of the US government and its agencies and high quality commercial bank and corporate debt obligations.

for the Russell 3000, a broad market indicator that represents about 98% of the US stock market. SWIB invests in a diversified mix of small, mid-size and large companies.

The small company stock portfolio, which beat its benchmark three years in a row, was the major contributor to higher returns. SWIB's internally managed portfolio had a heavy emphasis on technology and health care stocks and has a long-term outlook.



SWIB's developed international stock portfolios returned -18.5% compared to -21.4% for the Morgan Stanley Capital International (MSCI) World Index that represents 21 developed foreign markets.

A recession, 11 interest-rate cuts and falling stock market pushed bond returns ahead of stocks. It was one of the few times on record bonds beat stocks two years in a row. The 9.2% total return for domestic fixed income holdings surpassed the 8.7% benchmark.

SWIB's global and emerging bond portfolios returned 0.3% compared to -1.0% for the benchmark. Private Placements (business loans) returned 10.5% compared to 9.5% for the benchmark.

Real Estate earned an 8.7% return compared to 10.1 for the benchmark.

Alternative Investments returned a -4.9% against a 15% absolute return benchmark.

The Role of Investment Board Trustees

BOARD OVERVIEW

- ◆ 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 or a local government participating in the Local Government Investment Pool.
- ◆ WRS participant appointed by the Teacher Retirement Board.
- ◆ Non teacher participant in WRS appointed by the Wisconsin Retirement Board.
- ◆ Secretary of the Department of Administration or designee.
- ◆ All appointed members of the Board of Trustees serve six-year terms.

WRS AT A GLANCE

- ◆ As of December 31, 2001, the WRS market value was \$58.4 billion.
- ◆ The WRS is the 10th largest US public pension fund.
- ◆ The WRS is the 19th largest pension fund in the world.
- ◆ Fixed & Variable Funds holdings include over 2,000 investments.

By Jon Hammes, Board Chairman



John Hammes

Nine people with diverse backgrounds and experience share a common responsibility as Trustees of the Investment Board. That is to ensure that the assets of the Wisconsin Retirement System (WRS) are prudently managed.

Surveys of pension funds show that there is a strong relationship between investment success and good organizational governance. Those funds that perform the best are also funds where the division of responsibility between Trustees and

staff is appropriate and clear. Trustees delegate certain responsibilities to staff, while maintaining the right level of oversight. This helps Trustees focus attention on the major strategic challenges for which investment organizations must be prepared in the years ahead.

In Wisconsin, the Board of Trustees appoints the Executive Director, who oversees the business planning needed to manage WRS assets. Investment strategy, risk management, human resources planning, cost management, and communications with fund participants are all part of the business planning that is reviewed by the Trustees. Day-to-day execution is delegated to staff.

The Board reviews and approves the allocation of assets among investment classes, with the assistance of staff and outside experts. This is one of our most important responsibilities. Research shows that the decision as to how assets are divided among stocks, bonds, real estate and other types of investment accounts for as much as 90% of the investment return. Once the asset allocation has been approved, day-to-day buy and sell decisions are made by investment staff.

On an ongoing basis, the Board monitors the performance of the staff against strategic objectives and investment benchmarks. An Internal Auditor, appointed by the Trustees, reviews each area of SWIB operations on a regular cycle. The Auditor reports directly to the Board on staff and outside vendor compliance with Board policies.

A Strategic Planning Committee of Trustees has begun to assess a number of critical issues that will be important to SWIB's ability to do the best possible job managing your WRS funds. Barriers to making the most cost effective choices in our operations, succession planning, and trends that may affect WRS funding are a few of the topics we are considering. Our governance structure will also continue to be reviewed.

Our goal as Trustees is to apply good business practices in what we do today and how we prepare for tomorrow.

2002 Board Members



Front (left to right) John Petersen, Jon Hammes, Eric Stanchfield. Back (left to right) George Lightbourn, James Senty, Wayne McCaffery, Andrea Steen Crawford, William Sauey, James Nelsen.

Jon D. Hammes - Chair (Public Member)

President, Hammes Company, Brookfield

John Petersen III - Vice- Chair (Public Member)

President, Inland Investment Co., Madison

Eric O. Stanchfield - Secretary (Wisconsin Retirement Board Member)

Secretary, Department of Employee Trust Funds

Andrea Steen Crawford (Local Government Public Member)

Village Manager, Village of Elm Grove

George Lightbourn Secretary, Department of Administration

Wayne McCaffery (Teacher Retirement Board Member); Teacher, Stevens Point

James R. Nelsen (Public Member)

Investment Advisor, Loomis, Sayles & Company, Milwaukee

William R. Sauey (Public Member)

Chairman/President, Nordic Group of Companies, Ltd., Baraboo

James A. Senty (Public Member)

President, Midwest Gas Companies, La Crosse

20-Year Returns

There has been greater annual fluctuation in Variable Fund returns, reflecting the volatility of the stock market.

In addition, the composition of the Fixed Fund has changed, moving from an average 32% in stocks in the early 1980s to over 58% in January 2002.

Investment Returns		
Year	Fixed Fund	Variable Fund
2001	-2.3%	-8.3%
2000	-0.8%	-7.2%
1999	15.7%	27.8%
1998	14.6%	17.5%
1997	17.2%	21.6%
1996	14.4%	19.8%
1995	23.1%	25.6%
1994	-0.6%	0.8%
1993	15.0%	16.5%
1992	9.7%	10.7%
1991	20.4%	27.1%
1990	-1.5%	-11.3%
1989	19.2%	22.6%
1988	14.4%	21.7%
1987	2.2%	-1.1%
1986	14.5%	11.5%
1985	27.5%	32.7%
1984	12.8%	5.8%
1983	12.5%	24.7%
1982	27.3%	22.2%
Average Annual Return	12.4%	13.3%

2001 LARGEST TEN DOMESTIC STOCK HOLDINGS

Exxon Mobil Corp.
General Electric Co.
Merck & Co.

Pfizer
American Intl Group
Fannie Mae

Matsushita Electric Works
STERIS Corp.
Cisco Systems
Procter & Gamble

Impact of Investment Returns Can Vary

The work of the Investment Board impacts every corner of the state. However, many people often ask, "What does it mean to me?"

First and foremost, SWIB's goal is to produce the long-term stable asset growth needed to meet the pension obligations of the Wisconsin Retirement System's (WRS) current and future retirees. The annual investment returns of the WRS Funds on December 31 are provided to the Department of Employee Trust Funds (ETF) to determine the impact on more than 478,000 participants in the WRS.

Changes made by 1999 Act 11 has affected a number of active WRS participants. Those hired after 1981 previously received 5% interest credited to their account, regardless of the interest return. Now they receive an amount that reflects actual earnings credited to their retirement accounts.

In addition, the Variable Fund, an all-stock fund, has been reopened to active participants for the first time since 1981, giving them more choice in how their WRS funds

are invested.

The impact of SWIB's returns depends on whether participants are active or retired and if they have put 50% of their retirement account in the Fixed Fund only or also in the Variable Fund.

For more information regarding the impact of investments on WRS accounts, see the article entitled "What effect will market declines have on future fixed annuity dividends," page 1 of the Trust Fund News produced by ETF and included in this mailing.

Investment earnings account for more than 85% of the cost of benefits paid to retirees. Over \$2.4 billion in benefits is paid to WRS participants each year. Because nearly 90% of retirees remain in Wisconsin, the benefits they receive strengthen local economies across the state.

Taxpayers also benefit when investment earnings are higher than the amount needed to fund the system because contributions from public employers can be reduced.

WRS Stocks, Other Holdings Available

Some participants are interested in the list of stocks and other investments that SWIB has in the Fixed and Variable Trust Funds. All SWIB holdings as of June 30 are listed by Trust Fund in the Schedule of Investments, published at the end of the fiscal year. A copy is available on the Internet at www.swib.state.wi.us or by contacting SWIB.

A list of the domestic stocks in the Fixed and Variable Funds (the same stocks are held in both trust funds) are also available at the end of each quarter (March, June, September and December). SWIB files a complete list of domestic stock holdings with the US Securities and Exchange Commission (SEC) to be included in the commissions EDGAR database. Filings from the past few years are available on the SEC website.

There are two ways to access the list. The first is through a direct link from the SWIB website by clicking on the WRS Investment button. At the bottom of the page is a direct link to the SWIB holdings on the SEC site. To locate



the most current SWIB holdings, scan the alphabetized list and click on the first listing for "State of Wisconsin Investment Board 13F - HR." The holdings are generally listed in alphabetical order, but the user must first scroll past some basic legal information.

The list can also be accessed at the EDGAR search at www.sec.gov. Enter "wisconsin investment board and 13F-HR" as the keywords for the search at the top of the page. Several listings for SWIB are included because the site includes past quarterly reports. The most current date should be listed first. EDGAR, or Electronic Data Gathering, Analysis, and Retrieval system, performs automated collection, validation, indexing, acceptance, and forwarding of submissions by companies and others who are required by law to file forms with the SEC. Please note that EDGAR filings are posted at least 24 hours after the date of filing.

Contact SWIB by calling the toll-free hotline at 800-424-7942 or by email at info@swib.state.wi.us.



Sign-up for Electronic Updates

Want timely SWIB information delivered to you electronically? Send your email address to SWIB at info@swib.state.wi.us to be included on our email update list. You will receive occasional updates about the WRS Trust Fund investments and other related news.

2001 Annual Reports Are Available

The Financial Report and Schedule of Investments for the fiscal year ending June 30, 2001, are now available. To receive a printed copy of either document, contact SWIB at our email address, info@swib.state.wi.us, or call toll-free, (800) 424-7942, or 267-0957 in Madison. The Annual Report and Schedule of Investments can also be downloaded from the SWIB website at www.swib.state.wi.us.

SWIB Working for Auditor Reforms

The Investment Board has joined with the Council of Institutional Investors (CII) in seeking reforms in the US auditing and corporate governance systems designed to "ensure that another Enron won't happen." SWIB is a founding member of CII, an organization of 250 pension funds and investment-related firms responsible for \$2 trillion of pension assets. The campaign is a result of the problems discovered at Enron, a Houston energy and financial management company that filed bankruptcy last December and is currently under litigation. SWIB has also joined in lawsuits in an effort to recover losses. SWIB purchased \$46.3 million in bonds that now have a value of \$5 million. The paper loss is 0.06% of the total assets of the Fixed Fund. In a bankruptcy, bondholders are generally preferred creditors, but the amount will be determined by the bankruptcy process. Equity losses in Enron total \$40.1 million, or 0.07% of the total \$58.5 billion WRS assets. By themselves, these losses were not large enough to affect retirement dividends in 2002.

Surveys Help With Communications

Insights provided by two recent surveys are helping to provide expanded communications to WRS participants. Last fall, SWIB conducted 7 focus groups that reviewed SWIB information sources. A second survey, sent to the nearly 1,300 employers in the WRS, generated a huge return and lots of valuable information about reaching active members of the WRS. SWIB will be providing information to employer contacts and work to create better distribution networks to all participants. The information gathered will also be used to redesign some of the current publications and the website. Thank you to everyone who participated!

Glossary

Asset Allocation: The process of dividing investments among different types of assets - such as stocks, bonds, real estate and cash - in a combination expected to provide the return needed over time.

Benchmark: The performance of a predetermined set of securities or other target used for comparison purposes.

Index Fund: A fund that replicates a market index, such as the Standard & Poor's 500 Index (S&P 500). The rate of return on the fund is expected to be the same as the performance of the index.

International Equities: Investments in stocks traded on foreign markets.

Large Company (Large Cap) Stocks: Stocks of well established corporations that typically have market capitalizations (valuations) in excess of \$5 billion.

Mid-Size Company (Mid-Cap) Stocks: Stocks of mid-size corporations that typically have market capitalizations (valuations) between \$1 billion and \$5 billion.

Passive Management: Investing in a fund that replicates a market index, such as the S&P 500, that will allow an investment performance that is no worse, or better, than the market as a whole.

Portfolio: A group of investments generally in the same asset class, such as stocks, bonds, and real estate managed by an individual or institutional investor.

Rate of Return (also, Return): A measure of profitability for an asset which encompasses both dividend payments and price appreciation of the asset over a specific period of time.

Rebalancing: The process of adjusting the allocation of various assets in a fund (stocks, bonds, etc.) to achieve or maintain a desired mix.

Small Company (Small Cap) Stocks: Stocks of smaller corporations that typically have market capitalizations (valuations) of under \$1 billion. Traditionally, small company stocks have a greater growth potential, but are also more volatile.

Q & A

Q. How are Trust Fund benchmarks created?

A. Individual benchmarks are set for the Fixed Trust and Variable Trust Funds to determine the relative success of SWIB's investment strategy. Typically, the Investment Board reviews all benchmarks with the help of an outside consultant every two years, more often if necessary. Benchmarks also have been reviewed by the Legislative Audit Bureau to make sure they accurately reflect our portfolios. Trust Fund benchmarks are based on published indexes (that measures changes in financial markets) or are customized to reflect a specific investment strategy. The Fixed and Variable Trust Funds each consist of a composite of a number of indexes and other customized benchmarks that are rolled up and weighted to match SWIB's asset allocation target. Where possible SWIB uses published indexes to measure. For example, our domestic equities are measured against the Russell 3000 because it represents the mixture of large, medium and small companies held in the WRS domestic equities portfolios.

Q. What Are the Standards Set for Investment Staff and Trustees?

State law establishes a standard of responsibility for the Board in its investment activities. These standards require the Board invest with "skill, care and prudence," to diversity investments to minimize risk and to administer the assets solely to fulfill the purpose of each trust fund. Trustees and senior staff of the Investment Board are subject to the same State Ethics Code that affect all public officials. It prohibits public officials from taking official action substantially affecting a matter in which they have a personal financial interest. Trustees, senior staff members and portfolio managers must also file quarterly and annual ethics statements with the Ethics Board about investment holdings and transactions. These statements are open for inspection by the Legislative Audit Bureau (LAB). In addition to the standard state requirements, SWIB has a number of other procedures.

- ◆ Trustees may refer potential investment opportunities to SWIB, but the same process and criteria must be used to evaluate these referrals as is used for other investment opportunities.
- ◆ SWIB requires written confirmation from the counterparty in a private transaction that no SWIB Trustee or employee has personal interest in the transaction or is getting a kickback.

Recently, several changes were made to the SWIB procedures:

- ◆ Assigned responsibility to the staff Risk and Investment Committee to review and approve non-public alternative investment proposals of less than \$100 million, reducing the number of proposals that Trustees review. Trustees are then able to focus greater attention on topics related to agency governance.
- ◆ Requested that LAB increase the frequency of its in-depth review of filings with the Ethics Board from once a year to twice yearly.
- ◆ Amended investment guidelines to require each portfolio manager to report to the Board any referrals or contacts by Trustees with staff on privately negotiated investments, other than status requests.

ETF

Manages the WRS and individual accounts

Contact ETF if you have questions regarding:

- personal retirement account or health/life benefits
- changing addresses or tax withholding status
- annual fixed dividend & variable adjustment process

SWIB

Invests assets of WRS and other funds

Contact SWIB if you have questions regarding:

- investment performance
- types of investments in WRS
- general information about the Investment Board