

Board of Trustees  
**WISCONSIN RETIREMENT SYSTEM  
INVESTMENT POLICY**

Updated

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## I. INTRODUCTION

The State of Wisconsin Investment Board (“SWIB”) is an independent state agency responsible for the management and investment of all funds entrusted to it, including assets of the Wisconsin Retirement System (“WRS”), the State Investment Fund, and the assets of various other state agencies and programs.

SWIB was created by the Wisconsin Legislature for the sole purpose of providing professional investment management of trusts and public funds under its control. In its role as investment manager for these funds, SWIB is held to the “prudent expert” standard of fiduciary duty outlined in Section 25.15(2) of the Wisconsin Statutes, which requires SWIB to (i) manage the money and property with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity, with the same resources, and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims; (ii) diversify investments in order to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so, considering each trust’s or fund’s portfolio as a whole at any point in time; and (iii) administer assets of each trust or fund solely for the purpose of ensuring the fulfillment of the purpose of each trust or fund at a reasonable cost and not for any other purpose.

SWIB’s Board of Trustees (the “Board” or “Trustees”) has established the investment policy set forth herein for the WRS, pursuant to a comprehensive and ongoing evaluation of the appropriate risk and return standards for the WRS.

This Board of Trustees WRS Investment Policy (“WRS Investment Policy”) is intended to assist in development of a diversified portfolio of investments, tailored to accomplish the purpose of the WRS within acceptable risk parameters. This WRS Investment Policy represents a delegation of standing authority to SWIB staff to promote efficient and cost-effective operations of the two WRS trust funds. In addition to the WRS funds managed internally by SWIB staff, external managers are used for certain active and passive investment strategies. This document will be reviewed periodically and updated as necessary by the Board to reflect changes in SWIB’s investment strategy and to reflect best industry practices.

Accordingly, the Trustees hereby delegate to the Executive Director/Chief Investment Officer (“ED/CIO”) and SWIB investment staff standing authority to make prudent investments pursuant to this WRS Investment Policy, Sections 15.02(4) and 25.15(2) of the Wisconsin Statutes, and relevant provisions of the Wisconsin Administrative Code. The ED/CIO shall identify and delegate in writing the individual SWIB investment staff members who have authority to manage each of the specific asset classes and internal portfolios and who have authority to direct, hire, and terminate external managers.

In addition to this WRS Investment Policy, the Trustees have also adopted the State Investment Fund and Separately Managed Funds Investment Policy and Guidelines (“SIF & SMF Investment Policy”) to govern the administration of the other funds that SWIB manages pursuant to the Wisconsin Statutes. Further, the Trustees have delegated to SWIB’s Investment Committee the establishment and maintenance of guidelines for the management of internal WRS portfolios and for external managers of WRS assets pursuant to the SWIB Investment Committee WRS Investment Guidelines (“IC Guidelines”).

Administration of such IC Guidelines is hereby delegated to SWIB's Investment Committee or SWIB investment staff, as applicable, as part of the standing authority delegated pursuant to this WRS Investment Policy and the Investment Committee's charter approved by the Trustees.

## **II. WISCONSIN RETIREMENT SYSTEM**

The assets of the WRS constitute a large majority of the total funds invested by SWIB. These funds are invested globally in both long-term and short-term investments, across a wide range of asset types and classes. Pursuant to the Wisconsin Statutes, WRS assets are divided into two funds: a Core Retirement Investment Trust (the "Core Fund") and a Variable Retirement Investment Trust (the "Variable Fund"). The Core Fund is a broadly diversified portfolio of stocks, bonds, non-public securities, real estate and other holdings. The Variable Fund is an equity-focused portfolio primarily invested in global stocks.

### **A. The Core Fund**

The Core Fund is a pooled fund consisting of the retirement contributions made by and on behalf of participants in the WRS. Participants include state, school, and local government employees (with the exception of the City and County of Milwaukee). All participant contributions are invested in the Core Fund unless the participant has elected to contribute to the Variable Fund. (Wis. Stat. § 40.04(7))

### **B. The Variable Fund**

The Variable Fund, like the Core Fund, is a pooled fund consisting of retirement contributions made by or on behalf of the participants of the WRS. An active participant can elect to credit 50% of the total future monthly retirement contributions made by or on behalf of the participant to the Variable Fund, with the balance going to the Core Fund. The purpose of the Variable Fund is to permit participants to increase their exposure to the public equity markets beyond the allocation to public equities in the Core Fund. However, unlike the Core Fund, the Variable Fund does not pursue diversification across a variety of different asset classes and could be subject to greater volatility of earnings. (Wis. Stat. § 25.17(5))

## **III. STATEMENT OF PURPOSE AND INVESTMENT PHILOSOPHY**

This WRS Investment Policy is intended to summarize the fundamental investment objectives, philosophies, and directives relative to the implementation and oversight of the investment of the WRS assets managed by SWIB and to provide an outline of the common and critical components of successful administration of a large pool of public assets. Supplemental policies and guidelines pertaining to derivatives use, rebalancing assets, and portfolio-specific guidelines are set forth within the IC Guidelines that are maintained and approved by SWIB's Investment Committee.

### **A. Broad Investment Objectives**

SWIB's overall objectives in managing WRS assets are:

1. To maximize long-term investment returns with a prudent level of risk to ensure that sufficient funds are available to meet pension fund obligations;
2. To seek aggregate returns in excess of the Core Fund's and Variable Fund's benchmarks over all cumulative time periods constructed with a prudent level of risk; and
3. To comply with all applicable fiduciary and legal standards.

#### **B. Key Investment Philosophies**

1. Investment returns are a function of risk. SWIB should take risk where it expects to be compensated for doing so and should acknowledge the potential for both short- and long-term losses that comes with taking risk.
2. If SWIB chooses to accept an uncompensated secondary risk to achieve a desired exposure, it should only do so knowingly after considering the costs and benefits.
3. SWIB's strategic asset allocation is the dominant driver of portfolio risk and return and should be aimed toward maintaining the stability of the WRS over the long run, which includes an awareness of WRS liabilities.
4. Diversification enhances risk-adjusted returns. Strategic use of leverage can improve returns without raising total risk (or maintain returns at lower risk) while providing capital to expand and diversify active strategies.
5. SWIB's relatively long-term investment horizon and predictability of capital provide an opportunity for improved returns including the capture of illiquidity risk premia.
6. Active management is an important means to supplement passive management and capitalize on areas of inefficiency in markets to enhance risk-adjusted returns.
7. Internal management and external management of assets are complementary valuable approaches to generate attractive net returns.
8. Managing costs effectively is important and should be considered in the context of maximizing net investment performance and meeting SWIB's overall fiduciary obligation.

#### **C. Other Key Philosophies**

The Board has adopted additional philosophies covering critical areas, including: (1) benchmarking, (2) compensation, (3) recruitment, and (4) others from time to time.

#### **IV. RESPONSIBILITIES**

SWIB's investment responsibilities break down into these primary areas:

- A. Setting the Asset Allocation and Investment Strategy
- B. Asset Allocation Rebalancing
- C. Establishing the Active Risk Target
- D. Risk Monitoring and Compliance; Waivers
- E. Investment Performance Monitoring and Benchmarking
- F. Cost Management and Optimization

The roles for each of SWIB's fiduciaries with respect to these responsibilities are outlined in Section V.

#### **A. Setting the Asset Allocation and Investment Strategy**

Together with the Asset & Risk Allocation ("ARA") division and the Board's asset allocation consultant, Trustees undertake an in-depth review of the strategic asset allocation plan for the WRS every other year to determine a suitable target allocation for each asset class included in the Core Fund and the Variable Fund (subject to the statutory restrictions of the Variable Fund). The Wisconsin Department of Employee Trust Funds' independent actuaries provide information with respect to asset/liability modeling. These reviews contemplate a long-term time horizon over which potential results are evaluated. This exercise is not an attempt to predict short-term market movements, but to better understand the long-term impacts of poor, normal, and above average market results. In the "off year" of the two-year cycle, structural asset allocation adjustments and other funding initiatives are considered. In addition to the potential future market impact, Trustees also contemplate the impact of actuarial analysis, the soundness of investment return and risk expectations, and the asset allocation policies of SWIB's peers. The Board will periodically consider and evaluate the cadence of asset allocation reviews and make adjustments as needed, without amendment to this WRS Investment Policy.

The recommended asset allocation targets are approved on an annual basis in the asset allocation memorandum attached to this WRS Investment Policy as *Appendix 1*. Each year upon approval by the Board, *Appendix 1* shall be updated without amendment to this WRS Investment Policy. The recommended asset allocation targets and Trustee-approved policy leverage (for the Core Fund) constitute the policy portfolio for each of the Core Fund and Variable Fund (each, the "Policy Portfolio").

Portfolios within each of the approved asset classes will be structured in a manner that attempts to effectively cover the universe represented by appropriate benchmarks and provide adequate flexibility to deviate from the benchmarks to generate active returns by taking active risk. This is accomplished through the active risk budgeting process approved by the Investment Committee for each asset class. Index funds and actively managed portfolios will be combined in a manner that attempts to accomplish desired performance objectives within acceptable risk parameters.

#### **B. Asset Allocation Rebalancing**

When a major liquid asset class (i.e., Total Public Equities, Total Public Fixed Income, or Inflation-Sensitive Assets) falls outside of a rebalance range approved annually by the Board,

as reflected in *Appendix 1*, as of a month end, a mandatory rebalancing will be initiated. In a mandatory rebalancing, an asset class in excess of its target will be adjusted to a level recommended by the Asset & Risk Allocation CIO, in consultation with the head of Liquidity Management and Beta Implementation (“LMBI”) as needed and approved by the ED/CIO, so that the asset class is returned to a level within its target allocation range. A discretionary rebalancing may also be initiated pursuant to procedures described in the IC Guidelines to use or reduce active risk or to minimize asset allocation drift from the Policy Portfolio, as recommended by the Asset & Risk Allocation CIO, in consultation with the head of LMBI as needed and approved by the ED/CIO.

Whenever a rebalancing is triggered (mandatory or discretionary), the ARA division, in consultation with the LMBI division as needed, will develop and recommend a rebalancing plan, subject to approval by the ED/CIO, whereby specific dollar amounts will be considered for movement based on the degree of the over/underweight, liquidity characteristics, and current market conditions. The LMBI division will then implement the rebalancing plan.

WRS asset allocations will be reviewed at least monthly for potential rebalancing. When feasible, index funds may also be used to facilitate rebalancing to minimize opportunity and trading costs. Derivative securities may be used to implement adjustments. When active portfolios are used in a rebalance, applicable SWIB investment staff will be consulted and included in the process.

### **C. Establishing the Active Risk Target**

As part of the strategic asset allocation, the Trustees approve a fund-level active risk target for the WRS. Active risk represents a measurement of the added risk of actively investing assets, rather than replicating the benchmark, to achieve returns beyond market returns. Guidelines for individual portfolios will be constructed so that the aggregate risk of the portfolios is within the range established for the fund-level risk objective. The Investment Committee approves an active risk budget that allocates the active risk target to the Core Fund’s portfolios and monitors the allocation of active risk.

### **D. Risk Monitoring and Compliance; Waivers**

Investment risk is a consideration and factor in the management of the WRS assets, and such risk is considered throughout the investment process from asset allocation to performance evaluation. SWIB’s approach to investment risk management is detailed in Section VI.

The Investment Risk Management division will also measure soft risk parameters established by the IC Guidelines for asset classes and portfolios. Soft risk parameters refer to desired characteristics and/or risk exposures. SWIB investment staff are permitted to deviate from soft risk parameters in pursuit of excess return. However, anything outside of the soft risk parameters will be discussed with the Investment Committee to determine whether the exposure should be maintained. All such Investment Committee discussions will be documented in the Investment Committee’s meeting minutes.

Portfolio Managers are responsible for the compliance of their portfolios with this WRS Investment Policy, IC Guidelines, and the Wisconsin Statutes. SWIB’s Compliance division will review portfolios and asset classes on a daily and monthly basis for compliance with the IC Guidelines and other applicable regulatory requirements. Portfolios out of compliance

with IC Guidelines will be brought into compliance immediately, or a plan for doing so or a waiver will be discussed and approved by the ED/CIO pursuant to the IC Guidelines. Violations and the status of any remediation plans or waivers will be discussed at the next scheduled Enterprise Risk and Compliance Committee meeting and reported to the Investment Committee, and documented in the minutes for such meetings.

#### **E. Investment Performance Monitoring and Benchmarking**

The Trustees will review investment performance at least quarterly. Performance reviews will be conducted compared to the benchmarks approved by the Trustees. Quarterly results will be evaluated to review progress toward longer-term objectives. It is understood that there are likely to be intermittent periods when portfolio performance deviates from market indexes. During such times, comparisons with specific peer groups also will be considered. A third-party performance benchmarking consultant analyzes SWIB's performance in comparison to its peers, and the Trustees shall review such analysis quarterly.

#### **F. Cost Management and Optimization**

Costs reduce investment returns. SWIB is committed to managing the WRS in a prudent and cost-efficient manner. Retaining internal investment management when appropriate is one tool to manage costs efficiently. Economic arrangements with external managers are negotiated to ensure that manager interests are aligned with SWIB's interests and that SWIB's net performance is optimized. Fees for all individual vendors and external managers are reported to Trustees for their review by SWIB management on a quarterly basis. A third-party cost benchmarking consultant is retained by SWIB management to analyze SWIB's costs in comparison to peers.

### **V. ROLES AND RESPONSIBILITIES OF SWIB FIDUCIARIES**

The following section provides the delineation of roles and responsibilities among SWIB's fiduciaries. Each employee of SWIB has a definitive job description which describes all of the employee's specific job responsibilities, and the Trustees have a "SWIB Trustee Manual" that outlines all responsibilities for Trustees. This section supplements both. Below, the primary investment management responsibilities as they relate to each person's fiduciary obligations are highlighted for purposes of defining those fiduciary obligations and where the roles are distinctive and where they overlap.

#### Trustees

Trustees are fiduciaries of the WRS. Trustees are responsible for the overall professional investment management of the assets entrusted to them under Wisconsin state law. Trustees must manage the investment of assets pursuant to the prudent expert standard as set forth in Section 25.15(2) of the Wisconsin Statutes. Trustees have the following investment responsibilities:

- Establish and approve this WRS Investment Policy
- Review and approve:

- asset allocation for the Policy Portfolio as recommended by the Board’s Asset Allocation Consultant, Investment Committee, ED/CIO, and Asset & Risk Allocation CIO
- sub-asset class allocation policy for public equities and public fixed income asset classes, as well as any other sub-asset classes set forth in the asset allocation memorandum attached to this WRS Investment Policy as *Appendix 1*
- mandatory rebalancing ranges for major asset classes
- total fund absolute risk exposure through approving the asset allocation policy and active risk targets
- total fund policy-level leverage (as established by the asset allocation)
- total fund active risk targets and ranges
- total fund, asset class and portfolio performance benchmarks, as recommended by the Board’s Benchmark and Performance Committee (the “Benchmark Committee”) and Benchmark Consultant
- incentive compensation payments based on investment performance, as recommended by the Board’s Compensation and Workforce Development Committee (the “Compensation Committee”)
- SWIB’s total cost of management budget, as recommended by the Board’s Audit and Finance Committee (the “Audit Committee”)
- Delegate the establishment and approval of portfolio-specific investment guidelines to the Investment Committee through the IC Guidelines
- Through updates and reports provided at Board meetings, monitor and be informed of:
  - investment performance and risk metrics of the WRS
  - investment performance against a simplified reference portfolio used to evaluate the efficacy of the Policy Portfolio’s complexity and diversification
  - significant investment strategy and processes and infrastructure implemented to enable them
  - spending on investment activities
  - approved actions and recommendations arising out of Board Committees and the Investment Committee
- Approve the Investment Committee charter

Executive Director/Chief Investment Officer

The ED/CIO assists the Trustees in meeting their fiduciary and statutory duties by monitoring issues and trends and making recommendations to the Trustees. The ED/CIO is also responsible for establishing investment strategy, investment priorities, achieving

investment performance targets and managing the associated investment risks. In addition to the overall management of the agency and duties prescribed by statute, the ED/CIO has the following responsibilities:

- Implements the investment strategy approved by the Board
- Develops, identifies and leads strategic initiatives to enable SWIB's investment strategy
- Identifies and reports to the Board material issues or risks related to the investment policy or strategy
- Manages and monitors investment risk at both the total fund and asset class level
- Approves the implementation of new internal leverage strategies
- Leads the organization and evaluates its performance against its annual objectives
- Leads the SWIB Management Council and evaluates their performance
- Leads SWIB staff and evaluates their performance
- Serves as Chair of the Investment Committee and sets the Investment Committee agenda
- Reports the business of the Investment Committee to the Board and presents quarterly market trends and other macroeconomic conditions
- Recommends, with the Asset & Risk Allocation CIO, the Policy Portfolio to the Investment Committee and the Board
- Designs and approves the implementation of the Policy Portfolio approved by the Board and by doing so sets overall investment direction, strategies and priorities for each asset class
- Determines the implementation of the Policy Portfolio set by the Board by approving the allocation between:
  - active versus passive management, and
  - internal versus external management
- Approves the portfolios established or eliminated in each internal asset class
- Reviews and approves annual scorecards for each investment division
- Approves the monthly asset allocation memo which details the movement of assets across all portfolios
- Approves the implementation of mandatory and discretionary rebalancing
- Approves certain investments, as required by the IC Guidelines, for the private markets and funds alpha ("PMFA") division and exposure management portfolios
- Develops, in consultation with the Investment Division Leaders, the appropriate active risk target for each asset class and the active risk budget prior to its presentation to, and approval by, the Investment Committee

- Approves all new derivatives counterparties
- Collaborates with the Deputy Executive Director and Human Resources division regarding talent acquisition, development and retention
- Ensures the appropriate implementation of the incentive compensation program approved by the Board
- Ensures that prudent investment processes are implemented and works with the Section 25.167 CIO to monitor SWIB investment staff compliance with investment policies and guidelines
- Ensures, with the Section 25.167 CIO, that operating procedures have been developed and implemented that are intended to ensure that investment policies and guidelines are followed
- Ensures, with the Section 25.167 CIO, that investments are completely and accurately reported on all management and financial reports and that any information requested by the Board is provided on a timely basis

As permitted by the Wisconsin Statutes, the ED/CIO may delegate any of the responsibilities described above to SWIB staff, as appropriate.

#### Management Council

The Management Council was established by the Board as an advisory council to assist the ED/CIO in leading the organization. It consists of the ED/CIO and other senior leaders from investment management and investment services. The membership of the Management Council (including the number of members) will be set by the ED/CIO, and the ED/CIO will provide notice to the Board any time a change is made to the membership of the Management Council.

- Assists the ED/CIO in implementing SWIB's investment strategy
- Assists the ED/CIO in developing, identifying and leading key initiatives to enable SWIB's investment strategy
- Assists the ED/CIO in identifying and reporting to the Board any issues or risks related to SWIB's investment policy or strategy

#### Section 25.167 CIO

The Section 25.167 CIO is a SWIB investment staff member designated by the ED/CIO to assist with the fulfillment of certain statutory duties. The ED/CIO retains oversight of those responsibilities delegated to the Section 25.167 CIO, which include the following:

- Monitors activities of SWIB investment staff for compliance with investment policies and guidelines
- Develops and implements operating procedures that are intended to ensure that investment policies and guidelines are followed

- Ensures that investments are completely and accurately reported on all management and financial reports and that any information requested by the Board is provided on a timely basis

### Investment Committee

The Investment Committee provides oversight of SWIB's investments within the parameters established by the Board. The Investment Committee is chaired by the ED/CIO and has eleven additional voting members drawn from SWIB investment staff as well as three non-voting members. The Investment Committee has the following investment responsibilities which are also outlined in its charter approved by the Board:

- Establishes and approves the IC Guidelines, which includes portfolio-level guidelines for all internally managed portfolios
- Fulfills the duties and purposes set forth in its charter approved by the Trustees
- Reviews annual scorecards for each investment division
- Reviews and approves:
  - the active risk budget, and the Net Excess Value Added ("EVA") target, for the Core Fund and Variable Fund
  - the use of new investment instruments or initiatives, including derivatives and leverage, in all SWIB portfolios
- Reviews and monitors:
  - implementation of active risk budget
  - soft risk parameters for all internal portfolios
  - strategies and trades in the exposure management portfolios and the over and underweights to asset and sub-asset classes
  - sources of absolute and active risk through regular review of monthly risk reports
- Reviews and recommends to the Trustees:
  - any proposed changes to this WRS Investment Policy
  - the annual asset allocation plan and strategies and any proposed changes during the year
  - annual benchmark recommendations, and any provisional benchmark recommendations, from the Board's Benchmark Consultant
- Sets the procedures for rebalancing included in the IC Guidelines
- Delegates approval for external managers' guidelines to SWIB investment staff, as applicable

### Asset & Risk Allocation CIO

The Asset & Risk Allocation CIO maintains the quantitative analysis and research that supports the policy allocation of capital and risk. The Asset & Risk Allocation CIO has the following investment responsibilities:

- Recommends, with the ED/CIO and the Board's Asset Allocation Consultant, the Policy Portfolio to the Trustees and Investment Committee
- Considers and recommends mandatory and discretionary rebalancing, in consultation with the LMBI division
- Formulates, and recommends for IC approval, the active risk budget for the Core Fund and the Variable Fund
- Develops, recommends, and approves exposure management strategies pursuant to the IC Guidelines
- Determines appropriate contingency plans and risk mitigation actions for stressed market environments or when Core Fund or Variable Fund risk levels exceed expectations
- Recommends to the Trustees, with the ED/CIO and with analysis and verification from the Board's RPM Consultant, the Relative Performance Maximums

### Head of Liquidity Management and Beta Implementation

The head of LMBI is responsible for managing SWIB's passive public markets and short-term cash strategies as well as its trading, securities lending, financing, and collateral and liquidity management activities. The head of LMBI has the following primary responsibilities:

- Manages and monitors liquidity risk and oversees the implementation of internal leverage strategies
- Consults with the ARA division regarding rebalancing plans and, once approved by the ED/CIO, implements rebalancing plans and coordinates monthly cash flow activities
- Manages the passive external manager relationships, including review and approval of passive external manager guidelines and waivers therefrom
- Manages, and collaborates with SWIB investment risk management staff to monitor, SWIB's counterparties

### Investment Division Leaders

In addition to any other responsibilities such person may have under this WRS Investment Policy, the primary responsibility of each Investment Division Leader is to set the direction for the division and assure that the portfolios within the division are successfully managed. Investment Division Leaders have the following responsibilities:

- Reports quarterly to the Investment Committee, and to the Board when requested, regarding performance and market trends

- Sets the division’s annual scorecard, with approval by the ED/CIO
- Implements and monitors the division’s annual scorecard, and, as applicable, approves investment recommendations
- Manages and monitors investment risk and performance of the division
- Assures compliance with all investment policies, guidelines and risk controls, including the IC Guidelines
- Manages and evaluates performance of employees within the division
- Manages and implements improvements to the investment analysis process for, and asset management within, each portfolio within the division

#### Investment Portfolio Managers (“Portfolio Managers”)

The primary responsibility of each Portfolio Manager is to invest assets in accordance with the IC Guidelines and in accordance with the policies and guidelines established by the Trustees. Portfolio Managers have the following responsibilities:

- Manage portfolios in accordance with the guidelines and objectives contained within IC Guidelines
- Exercise full investment discretion with respect to the purchase, sale and ongoing management of assets within their respective portfolios to achieve established objectives subject to applicable IC Guidelines and direction from the ED/CIO and Asset & Risk Allocation CIO regarding appropriate risk levels
- Implement active risk budgets
- Manage and monitor drawdown levels and implement risk drawdown controls

#### Head of Risk Management

The Investment Risk Management division exercises oversight of the organization’s investment risk monitoring and investment risk management functions. The head of Risk Management has the following responsibilities:

- Oversees investment risk monitoring for the WRS and ensures investment risk management measures are implemented
- Monitors and reviews sources of investment risk, including, without limitation, market risk, valuation risk, event risk, liquidity risk, and counterparty risk
- Monitors relative performance drawdowns for active portfolios and participates, with the ED/CIO and the Asset & Risk Allocation CIO, in discussions regarding such drawdowns and the responses thereto
- Conducts stress testing analysis
- Identifies, measures, and monitors the risks affecting SWIB’s investments

#### Board Consultants with Investment Responsibilities

### Asset Allocation Consultant

- Annually, conduct analysis and evaluation of SWIB's asset allocation plan and, together with the ARA division, provide Trustees with any recommendations for adjustments.
- Every two years, together with the ARA division, present results and recommendations for strategic asset allocation targets for the Core Fund and Variable Fund to Trustees. The Wisconsin Department of Employee Trust Funds' independent actuaries provide information with respect to asset/liability modeling.
- The Board may decide to adjust the cadence of the two preceding items as needed, without amendment to this WRS Investment Policy.

### Benchmark Consultant

- Annually, and throughout the year as necessary, review proposed benchmark changes or retentions, as well as benchmark changes resulting from updates to the asset allocation or investment strategy modifications. Make a recommendation to the Investment Committee and the Benchmark Committee regarding any modifications or updates to any existing benchmarks, adoption of new provisional benchmarks, or retention of existing benchmarks.
- Every three to five years, conduct a comprehensive benchmark review to evaluate all Board-approved benchmarks, align benchmarks to the investment strategies and asset allocation, and make a recommendation to the Investment Committee and the Benchmark Committee regarding any proposed benchmark modifications, updates, or retentions.

### SWIB Staff Consultants

- SWIB investment staff may engage consultants in accordance with the Board Consultant Services Policy.
- Staff consultants may provide updates to SWIB investment staff and, as requested by the Board, to Trustees regarding developments involving SWIB's investments and provide commentary regarding the impacts of such developments.

## **VI TOTAL FUND INVESTMENT RISK MANAGEMENT POLICY**

### **A. Introduction**

Investment risk is a consideration and factor in the management of the WRS assets, and such risk is considered throughout the investment process from asset allocation to performance evaluation. Risk management is integral to SWIB's investment processes and is guided by this WRS Investment Policy. However, investment risk evolves through time as markets and investment strategies change. SWIB also strives to evolve its investment risk monitoring to better analyze, measure, quantify, and report such risks over time.

## **B. Risk Management Philosophy**

Risk must be taken to achieve sufficient returns to meet financial obligations for the various funds under the purview of SWIB. Risk is viewed from multiple perspectives. It is most commonly viewed as the loss of capital or of not meeting objectives within the designated time frame. It is deconstructed between systematic (i.e., market) and unsystematic, or specific risk, at the total fund, asset class and portfolio levels. The sources and types of risk inherent in any strategy are evaluated and acknowledged prior to implementation. However, even with the most sophisticated risk measurement techniques, extreme events cannot easily be measured in advance. Accordingly, risk models may only provide limited predictive qualities but should provide investment professionals opportunities to test and challenge investment strategies and assumptions prior to implementation. Post implementation, investment risks are managed, measured, and monitored at all relevant levels. Benchmarking is employed to determine whether risks taken achieve expected rewards.

## **C. Risk Management Objectives**

The primary investment risk SWIB seeks to manage is drawdowns to the Core Fund and Variable Fund that could cause reduction in participant dividends, create volatility in contributions from both employers and employees, or cause the WRS to be less than fully funded. SWIB's investment strategy is designed to take intentional risk, called active risk, and achieve investment results commensurate with the levels of risk taken. Expectations for active return earned per unit of active risk taken are set and monitored for all portfolios. A risk budgeting approach will be employed to set active risk targets for each asset class. Unintended risk due to asset allocation drift or other factors is to be minimized where feasible from an implementation and cost perspective. Risk will be managed through implementation of IC Guidelines, soft risk parameters, multiple approaches to diversification, and investment risk analyses and measurement. Pursuant to SWIB's statutory fiduciary standard under Section 25.15(2)(b) of the Wisconsin Statutes, SWIB shall "diversify investments in order to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. . . ." Diversification is a significant tool to manage risk.

Risks that are assessed generally will include (but are not limited to):

1. Market risk: risk of drawdowns or swings in volatility
2. Valuation risk: trending towards or reaching extremes (e.g., historically wide credit spreads), pricing integrity
3. Event risk: e.g., sovereign downgrade, Lehman bankruptcy, Asian currency crisis, etc.
4. Liquidity risk: ability to quickly raise funds to support leveraged and synthetic exposures, asset/liability mismatch
5. Counterparty risk: risk of counterparty defaulting or otherwise not meeting their obligation to SWIB
6. Other investment risk: risk of failure in investment risk measurement/monitoring processes, systems or personnel responsible for managing and/or monitoring investment risk exposures

#### **D. Risk Measurement**

The Investment Risk Management division will measure investment risk using multiple metrics on both an absolute and relative basis at all relevant levels (i.e. total fund, asset class and portfolio level). In addition, downside risk metrics identified through stress testing and scenario analyses will be employed. Financial and economic analysis will also be undertaken to better understand the current and potential risks of non-public markets.

#### **E. Risk Monitoring and Reporting**

The Investment Committee will, at each meeting, receive reporting from the Investment Risk Management division regarding investment risk to evaluate sources of risk, and changes to sources of risk. In particular, regular stress testing and scenario analysis by the Investment Risk Management division enables SWIB to identify potential weaknesses, or 'tail risks', in the investment program given extreme market environments that have occurred in the past. Risk monitoring will be conducted on both an absolute and relative risk basis. Assets that cannot be readily modeled will be subject to other review processes to better ascertain the risks. Reports will be reviewed by the Board and the Investment Committee at their respective meetings and will generally include summaries of key risk exposures and risk attribution and summaries of stress test and scenario analyses results.

#### **F. Risk Mitigation**

SWIB's strategic asset allocation reflects SWIB's philosophy that market risks must be taken to ensure sufficient asset growth to meet SWIB's financial obligations. However, SWIB is cognizant of the fact that large drawdowns can significantly negatively impact funded status and future contributions. Thus, SWIB has adopted drawdown risk controls for active strategies, which require holding discussions and, as applicable, formulating plans to mitigate the risk of a portfolio if the portfolio's benchmark relative returns fall below a pre-specified downside threshold. Potential mitigating actions may be deployed at either the portfolio level or the Core Fund level.

#### **G. Risk Resources**

SWIB is committed to conducting periodic assessments of its analytic and personnel risk resources to ensure that SWIB maintains adequate tools and skills to sufficiently support a robust risk management framework.

### **VII. GENERAL INVESTMENT GUIDELINES**

The following compulsory guidelines are applicable to all internally managed portfolios. Individual portfolio guidelines are included in the IC Guidelines.

1. All investment decisions are subject to all applicable federal and state statutes and administrative rules and are subject to the prudent expert fiduciary standard as set forth in Wis. Stat. § 25.15(2).
2. SWIB will exercise its fiduciary duty to vote all proxies pursuant to its ownership in publicly held companies in accordance with the Board's Corporate Governance Policy and SWIB's Corporate Governance Proxy Voting Guidelines.

3. Portfolios may utilize cash instruments or derivatives in their investment strategy. All investments used will be subjected to the risk analysis and monitoring processes at the portfolio, asset class and fund levels and remain subject to the IC Guidelines.

# **ASSET ALLOCATION**

## **Overview and Recommendations for 2026**

**December 17, 2025**

Edwin Denson  
Executive Director/Chief Investment Officer

Todd Mattina  
Head Economist & Asset and Risk Allocation CIO

*In Consultation with NEPC and the Investment Committee*

## 2026 RECOMMENDATIONS SUMMARY

### Strategic Asset Allocation Targets and Ranges

#### 2026 Core Trust Fund recommendation and expectations:

	<u>Policy Targets*</u>	<u>Ranges*</u>
Public Equity	36%	30% - 42%
Public Fixed Income	27%	21% - 33%
Inflation Sensitive Assets	19%	14% - 24%
Private Equity/Debt	20%	12% - 28%
Real Estate	8%	4% - 12%
Leverage	<u>-10%</u>	-2% <sup>†</sup> to -18%
<b>Total (Including Leverage)</b>	<b>100%</b>	
<i>10 Yr. Expected Return</i>	<i>6.5%</i>	
<i>30 Yr. Expected Return</i>	<i>7.7%</i>	
<i>Expected Standard Deviation</i>	<i>12.2%</i>	
<i>10 Yr. Expected Sharpe Ratio</i>	<i>0.22</i>	
<i>30 Yr. Expected Sharpe Ratio</i>	<i>0.34</i>	
<b>Target Active Risk</b>	<b>120bps +/- 60bps</b>	

The Board of Trustees' external asset allocation consultant, NEPC, provided the following capital market assumptions used to develop the asset allocation recommendation and expectations:

<u>Asset Class</u>	<u>Long Term Expected Return</u>	<u>10 Year Expected Return</u>	<u>Standard Deviation</u>
Public Equity	7.4%	5.7%	18.1%
Public Fixed Income	6.2%	5.7%	6.3%
Inflation Sensitive Assets	5.0%	4.6%	6.0%
Private Equity/Debt	9.5%	8.2%	21.3%
Real Estate	6.2%	5.4%	14.7%

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\* Policy Targets and Ranges will vary from the above table. This is due to the Asset Allocation Corridor Treatment which requires that Private Equity/Debt and Real Estate asset class Policy Targets be derived from actual AUM, and then corresponding Policy Targets and Ranges for Public Equities and Public Fixed Income are adjusted. Mandatory rebalancing for Public Equities and Public Fixed Income as set forth in the Board of Trustees WRS Investment Policy is not triggered by the ranges in the above table, but by these adjusted ranges.

<sup>†</sup> SWIB Staff allowed to eliminate leverage (i.e., 0%).

- The recommended 2026 Policy Target for Public Equity (36%) is 2% lower than the 2024 target, reducing the volatility impact on the Core Trust Fund.
- The recommended 2026 Policy Targets for Public Fixed Income (27%) and Inflation Sensitive Assets (19%) remain unchanged.
- The recommended 2026 Policy Target for Private Equity/Debt (20%) remains unchanged as cash flows and commitments have tracked closely with SWIB’s multi-year pacing model. The recommended Policy Target for Real Estate (8%) also remains unchanged.
- The recommended 2026 Policy Target for Policy Leverage (-10%) declines by 2% in absolute terms, reflecting a reduced risk-adjusted expected return from leverage primarily due to increased volatility in individual asset classes and a reduced diversification benefit from elevated stock-bond correlations in the most recent capital market assumptions.
- The Target Active Risk of 120 basis points  $\pm$  60 basis points will be maintained for the Core Trust Fund in 2026.

The recommended 2026 Policy Targets may be implemented at any time after approval by the Board of Trustees as determined and approved by the ED/CIO, subject to market conditions and operational readiness.

**2026 Variable Trust Fund recommendation and expectations:**

	<u>Policy Targets</u>	<u>Ranges</u>
<b>U.S. Equities</b>	<b>70.0%</b>	<b>65.0-75.0%</b>
<b>International Equities</b>	<b>30.0%</b>	<b>25.0-35.0%</b>
	<b>100.0%</b>	
 <i>10 Yr. Expected Return</i>	 <i>5.7%</i>	
<i>30 Yr. Expected Return</i>	<i>7.4%</i>	
<i>Expected Standard Deviation</i>	<i>17.2%</i>	
<i>10 Yr. Expected Sharpe Ratio</i>	<i>0.09</i>	
<i>30 Yr. Expected Sharpe Ratio</i>	<i>0.22</i>	
 <b>Target Active Risk</b>	 <b>0bps to 90bps</b>	

- The recommended 2026 Policy Targets and Ranges are unchanged from 2025.
- Recommended Target Active Risk shifts to a range of 0 to 90 basis points compared to 60 basis points  $\pm$  30 basis points last year, allowing for greater passive investment flexibility.

**2026 ASSET ALLOCATION OVERVIEW**

Since the late 1980s, SWIB has conducted an asset allocation exercise annually, leading to policy and funding recommendations at the beginning of each calendar year. In the late 1990s, the process was expanded to include several planning sessions with investment staff, senior staff, consultants, and Trustees. SWIB’s process includes a full asset/liability modeling process, stress testing, and discussion sessions with the Board every other year (an “on-year”), opening the schedule to

consideration of other strategic issues or structural asset allocation adjustments on an annual basis.

SWIB launched the current “on-year” process for the 2026 asset allocation during the first quarter of 2025 by collaborating with the Employee Trust Fund’s (ETF) actuarial consultant, Gabriel, Roeder, Smith and Company (GRS), and NEPC to execute an Actuarial Overview and Stress Testing Scenarios for the Wisconsin Retirement System (WRS). The results were presented by GRS during the 2025 October Workshop attended by Trustees, staff, and guest experts. GRS presented updated results of the stress testing executed in their 2023 study. The result of the stress testing of the WRS was a recommendation to continue to target an allocation that provides for a target return with appropriate downside protection. The above recommended asset allocation Policy Targets for the Core Trust Fund are consistent with this prescription.

The recommended 2% reduction in the target allocation to Public Equity reflects an effort to achieve similar long-term portfolio returns in the Core Trust Fund with lower overall volatility. Compared to last year, this adjustment results in modestly higher expected returns at key horizons: the 10-year expected return increases slightly to 6.5% from 6.4%, and the 30-year expected return rises to 7.7% from 7.5%. By modestly reducing exposure to Public Equity, the portfolio maintains a long-term expected return that exceeds the actuarial assumed rate of 6.8% while lowering downside risks such as the potential for higher contribution rates or plan underfunding. This recommendation is not a blanket move toward de-risking the plan but rather a balanced approach that supports long-term financial stability and the ability to meet actuarial objectives over time, including an appropriate rate of dividend adjustment. In the current environment, a modestly lower target allocation to Public Equity provides an appropriate balance between return and risk consistent with the plan’s long-term goals.

The recommended reduction in Policy Leverage aligns with the lower target allocation to Public Equity and reflects application of the Policy Leverage framework. Under this framework, leverage is reduced when the expected return net of financing costs declines (i.e., a lower expected “return to leverage”) or when portfolio volatility is expected to rise (i.e., a lower expected risk-adjusted return to leverage). In recent years, increased volatility in individual asset classes and reduced diversification benefits due to increasing equity–bond correlations resulted in higher overall portfolio volatility.

The 10-year pacing plan for private market allocations was reviewed to reflect updated cash flow projections and return assumptions relative to last year. Expected allocations in Private Equity/Debt and Real Estate were modeled using revised estimates for future returns, commitments, capital contributions, and distributions from general partners. Overall, private investment cash flows and commitments have evolved largely as anticipated, and current allocations remain within their target ranges. Given this stability and the consistency of long-term expectations, no changes in the target allocations for Private Equity/Debt and Real Estate are recommended at this time.

Another theme of the review is a recommended shift towards greater passive investment flexibility in the Variable Trust Fund. Developed market equities represent a large share of the Variable Trust Fund’s target allocations, and adding value through active management in these markets has become increasingly challenging. In recent years, active risk in the Variable Trust Fund has trended towards the lower end of its target range. Expanding the active risk range to 0-90 basis points provides additional flexibility to increase passive exposure, allowing for a further reduction in active risk while maintaining alignment with the fund’s investment objectives.

The 2026 asset allocation recommendations at the asset and sub-asset class levels are summarized below:

1. **Public Equity:** While the overall target allocation is lower, sub-asset class targets remain aligned with the global investable market across regions and market capitalizations, as represented by the MSCI ACWI IMI. The portfolio continues to maintain a half-weight allocation to China large-cap equities.
2. **Public Fixed Income:** The total target allocation remains unchanged at 27%. Within Public Fixed Income, the recommended sub-asset allocations shift modestly, with Long Treasuries reallocated to U.S. Treasuries.
3. **Private Markets:** Target allocations to Private Equity/Debt (20%) and Real Estate (8%) remain unchanged, as private investment pacing and cash flows continue to track closely with prior expectations.
4. **Active Risk:** Active return remains an important contributor to the Core Trust Fund's total return and diversification. The recommended Target Active Risk is 120 basis points ( $\pm 60$  bps). For the Variable Trust Fund, the range is widened to 0–90 basis points to support greater flexibility for passive investment management.

### Strategic Sub-Asset Class Allocation Targets

#### 2026 Core Trust Fund recommendation and expectations for information:

<b><u>Public Equity</u></b>	<b><u>Policy Target<sup>‡</sup></u></b>
Global	28.5%
US Small Cap	2.7%
Int'l Small Cap	1.3%
EME Large Cap China	0.5%
EME Large Cap ex China	2.5%
EME Small Cap	<u>0.6%</u>
	36.0%
<b><u>Public Fixed Income</u></b>	<b><u>Policy Target</u></b>
US Treasuries	7.6%
US Investment Grade Credit	6.5%
MBS	2.2%
Long Treasuries	0.0%
High Yield Bonds	5.4%
Levered Loans	2.7%
EMD (External)	1.35%
EMD (Local Currency)	<u>1.35%</u>
	27.0%

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<sup>‡</sup> Public Equity sub-asset class targets are informational and reflect the market capitalization of the MSCI ACWI Investable Market Index (IMI) with a 50% weight to the China large cap component as of 6/30/2025.