



State Investment Fund

# ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2018







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## *Message from the* Portfolio Manager

The State Investment Fund (SIF) is a pool of cash balances of various state and local governmental units that is managed by the State of Wisconsin Investment Board. The SIF includes retirement trust funds, state funds, and funds from over 1,300 Wisconsin municipal units that have accounts with the Local Government Investment Pool (LGIP). The LGIP was created in 1975 to give local governments an additional investment option providing them with liquidity, active management, and returns offered by larger investments. The investment objectives of the SIF are to provide safety, liquidity, and competitive rates of return. To meet these objectives, the fund primarily invests in obligations of the U.S. government and its agencies, with a smaller number of investments in bank and corporate debt.

Over the past year, the economy has continued to strengthen. Inflation and unemployment remained close to the Federal Reserve's target rates. In December 2017, the president signed into law his tax reform act. The new tax law has led to some companies bringing back a portion of their overseas cash to the U.S. The tax law changes also decreased the corporate tax rate, serving as a potential stimulus to the economy. Meanwhile, the U.S. Treasury bill supply increased significantly over the past fiscal year, putting upward pressure on short rates.

With the strengthening domestic economy, the Federal Reserve increased the federal funds target rate range by 25 basis points for three consecutive quarters in fiscal year 2018. After the Federal Reserve's meeting in September 2018, the Federal Reserve indicated that they anticipated further federal funds rate increases this year and next, so long as their expectations for inflation and the U.S. economy's ability to withstand shocks remain in line.

The investment strategy of the SIF over the past year has included a short average maturity which allowed the SIF to quickly capture the steadily rising interest rates over that period. We will continue to position the SIF to best capture the interest rate increases this year and next, while maintaining the SIF's investment objectives of safety, liquidity, and competitive rates of return.

Andrea Ruiz, CFA, CPA  
Portfolio Manager



# STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman  
State Auditor

## **Independent Auditor's Report on the Financial Statements and Other Reporting Required by *Government Auditing Standards***

Senator Robert Cowles and  
Representative Samantha Kerman, Co-chairpersons  
Joint Legislative Audit Committee

Mr. David Villa, Executive Director/Chief Investment Officer and  
Members of the Board of Trustees  
State of Wisconsin Investment Board

### **Report on the Financial Statements**

We have audited the accompanying financial statements and the related notes of the State Investment Fund of the State of Wisconsin as of and for the year ended June 30, 2018, as listed in the table of contents.

#### **Management's Responsibility for the Financial Statements**

Management of the State of Wisconsin Investment Board (SWIB) is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. 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*, which is 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the

financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on these financial statements.

## **Opinion**

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the State Investment Fund as of June 30, 2018, and the respective changes in its financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Emphases of Matter**

As discussed in Note 1 to the financial statements, 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 of the State of Wisconsin as of June 30, 2018, or the changes in its financial position, or where applicable, its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

As discussed in Note 5B to the financial statements, during the fiscal year the State Investment Fund entered into significant repurchase agreement transactions with the Core Retirement Investment Trust Fund. The State Investment Fund and the Core Retirement Investment Trust Fund are both administered by the State of Wisconsin Investment Board.

Our opinion is not modified with respect to these matters.

## **Other Matter**

*Required Supplementary Information*—Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis, which precedes the financial statements, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, which considers it to be essential for placing the financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information that included inquiries of management about the methods of preparing the information. We further compared the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Accompanying Information*—Our audit was conducted for the purpose of forming an opinion on the financial statements of the State Investment Fund. The Message from the Portfolio Manager and the Schedule of Investments as listed in the table of contents are presented for purposes of

additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued a report dated November 29, 2018, on our consideration of SWIB's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and contracts; and other matters. The purpose of that report is solely 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 effectiveness of SWIB's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering SWIB's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU

A handwritten signature in black ink, appearing to read "Joe Chrisman", with a stylized flourish extending from the end.

Joe Chrisman  
State Auditor

November 29, 2018



# Management Discussion & Analysis

The State Investment Fund's (SIF) discussion and analysis of the financial activities for the fiscal year (FY) ended June 30, 2018, is presented by management to assist the reader in understanding the financial statements by providing an overall review of the financial activities during the year and a comparison of the prior year's activity. The SIF temporarily invests the operating funds of the State of Wisconsin and agencies, the Wisconsin Retirement System (WRS), and various local government units (Local Government Investment Pool – LGIP).

Following this section are the financial statements and notes to the financial statements. The **Statement of Net Position** provides information on the financial position of the SIF at June 30, 2018. It reflects the investment assets available for use and any liabilities related to the investments.

The **Statement of Operations and Changes in Net Position** presents the results of the investing activities for the twelve months ending June 30, 2018. 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. Condensed SIF financial information for the FYs ending June 30, 2018 and June 30, 2017 is included in the table entitled **SIF Condensed Financial Information**.

Because the SIF is used to temporarily invest participants' operating cash flows, investments are in highly liquid, short-term fixed income securities. As of June 30, 2018, the SIF Net Position had decreased by \$533.9 million or 5.4% from the prior year primarily due to the decrease in the WRS pool shares, which was partly offset by increases in the shares of the State of Wisconsin and agencies

| SIF Condensed Financial Information |                 |                  |         | SIF Annualized Returns (as of June 30) |         |            |
|-------------------------------------|-----------------|------------------|---------|--|---------|------------|
| Fiscal Year Ended:                  | 2018            | 2017             | Change% | Year(s)                                | Return% | Benchmark% |
| Total Assets                        | \$9,482,004,407 | \$10,140,419,912 | (6.5)   | One Year:                              |         |            |
| Total Liabilities                   | 174,917,781     | 299,438,808      | (41.6)  | 2009                                   | 1.33    | 0.81       |
| Net Position                        | \$9,307,086,626 | \$ 9,840,981,104 | (5.4)   | 2010                                   | 0.25    | 0.15       |
|                                     |                 |                  |         | 2011                                   | 0.19    | 0.15       |
| Investment Income                   | \$130,196,193   | \$ 58,933,341    | 120.9   | 2012                                   | 0.14    | 0.09       |
| Investment Expenses                 | 1,412,874       | 1,865,993        | (24.3)  | 2013                                   | 0.15    | 0.10       |
| State Working Bank Charges          | 2,914,068       | 2,855,560        | 2.0     | 2014                                   | 0.09    | 0.06       |
| Net Income                          | \$125,869,251   | \$ 54,211,788    | 132.2   | 2015                                   | 0.11    | 0.05       |
|                                     |                 |                  |         | 2016                                   | 0.28    | 0.19       |
| Average Monthly Balance             | \$9,818,329,570 | \$11,039,423,973 | (11.1)  | 2017                                   | 0.54    | 0.57       |
| Weighted Avg. Maturity (WAM)        | 20              | 29               |         | 2018                                   | 1.34    | 1.42       |
| SIF Ownership:                      |                 |                  |         | Multi-Year:                            |         |            |
| State of Wisconsin & Agencies       | 39%             | 34%              |         | Three Year                             | 0.72    | 0.73       |
| Wisconsin Retirement System         | 23%             | 34%              |         | Five Year                              | 0.47    | 0.46       |
| Local Govt Investment Pool          | 38%             | 32%              |         | Ten Year                               | 0.44    | 0.36       |
| Total                               | 100%            | 100%             |         |  |         |            |

## Management Discussion & Analysis

and the LGIP. The SIF Average Monthly Balance decreased by \$1.2 billion in FY 2018 compared to FY 2017. During the FY, the monthly balance peaked at \$11.3 billion in January 2018.

Investment Income increased by \$71.3 million, or 120.9%, from the previous FY largely due to an increase in the return on investments resulting from an increase in the federal funds rate. During FY 2018, the Federal Reserve increased the federal funds “target range” from between 1.00% and 1.25% to between 1.75% and 2.00%. As a result, the average federal funds effective rate increased to 1.39% in FY 2018 compared to 0.63% in FY 2017. Accordingly, the one-year SIF return increased from 0.54% in the prior FY to 1.34%. Investment Expenses decreased by \$453,119, or 24.3%, from the prior FY for SWIB’s investment expenses allocated to SIF participants. Most of the decrease can be attributed to lower management operating

expenses charged to the SIF for investing activities. The decrease in management operating expenses was partially offset by an increase in investment operating services.

The weighted average maturity decreased from 29 to 20 days when comparing FY 2018 to the prior year-end. The largest contributor to the decrease was the SIF’s increased investment in overnight repurchase agreements. At June 30, 2018, the SIF held \$3.7 billion in repurchase agreements compared to \$1.4 billion at the end of the previous year, an increase of \$2.3 billion or 171.2%. Repurchase agreements represented 39.3% of the SIF’s total investments as of June 30, 2018 compared to 13.6% at June 30, 2017. The decrease in the weighted average maturity put the SIF in a position to quickly take advantage of the anticipated increases in the federal funds rate and to meet the cash flow needs of the participants.

# Financial Statements

| State Investment Fund<br>Statement of Net Position<br>As of June 30, 2018 |    | 2018          |
|---|----|---------------|
| <b>Assets</b>   |    |               |
| Investments   |    |               |
| Repurchase Agreements   | \$ | 3,725,714,130 |
| Government & Agencies   |    | 5,246,238,502 |
| Commercial Paper  |    | 364,595,490   |
| Certificates of Deposit   |    | 122,453,450   |
| Banker's Acceptances  |    | 19,819,555    |
| Total Investments   |    | 9,478,821,127 |
| Other Assets  |    |               |
| Accrued Interest Receivable   |    | 3,183,280     |
| Total Assets  |    | 9,482,004,407 |
| <b>Liabilities</b>  |    |               |
| Check Float Invested  |    | 159,580,369   |
| Earnings Distribution Payable   |    | 14,993,003    |
| Accounts Payable  |    | 344,409       |
| Total Liabilities   |    | 174,917,781   |
| <b>NET POSITION</b>   | \$ | 9,307,086,626 |
| Net Position consists of:   |    |               |
| Participating Shares  | \$ | 9,307,500,000 |
| Undistributed Unrealized Gains (Losses)                                   |    | (413,374)     |
| <b>NET POSITION</b>   | \$ | 9,307,086,626 |
| The accompanying notes are an integral part of this statement.            |    |               |

## Financial Statements

| <b>State Investment Fund</b><br><b>Statement of Operations and Changes in Net Position</b><br><b>For the Fiscal Year Ended June 30, 2018</b> |                         |
|--|-------------------------|
|  | 2018                    |
| <b>Additions</b>   |                         |
| <b>Investment Income</b>   |                         |
| Net Increase (Decrease) in the Fair Value of Investments   | \$ 88,039,676           |
| Interest   | 42,156,517              |
| Total Investment Income  | 130,196,193             |
| <b>Less</b>  |                         |
| <b>Investment Expenses</b>   |                         |
| Management Operating Expenses  | 737,028                 |
| Custodial Bank Charges   | 209,526                 |
| Research and Data Services   | 96,000                  |
| Legal and Consulting Fees  | 18,350                  |
| Investment Operating Services  | 351,970                 |
| Total Investment Expenses  | 1,412,874               |
| <b>Net Investment Income</b>   | 128,783,319             |
| <b>Less</b>  |                         |
| State Working Bank Charges   | 2,914,068               |
| Net Income   | 125,869,251             |
| Distributions Paid and Payable   | 125,076,729             |
| Change in Undistributed Unrealized Gains (Losses)  | 792,522                 |
| Beginning Undistributed Unrealized Gains (Losses)  | (1,205,896)             |
| Ending Undistributed Unrealized Gains (Losses)   | (413,374)               |
| Net Change in Participating Shares   | (534,687,000)           |
| Beginning of Period Participating Shares   | 9,842,187,000           |
| End of Period Participating Shares   | 9,307,500,000           |
| <b>NET POSITION</b>  | <b>\$ 9,307,086,626</b> |
| The accompanying notes are an integral part of this statement.   |                         |

# Notes to the Financial Statements

## 1. Description of Funds

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. The statements are not intended to present the financial activity for the State of Wisconsin as a whole.

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 including solvent financial institutions in Wisconsin and banker's 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

conformity with accounting principles generally accepted in the United States 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.

### C. Valuation of Securities

For financial statement purposes, the fair value of securities depends on asset class. Repurchase Agreements and non-negotiable Certificates of Deposit are carried at cost, because they are non-participating contracts that do not capture interest rate changes in their value.

All remaining short-term debt investments (U.S. Government/Agency securities, Banker's Acceptances, Commercial Paper, and negotiable Certificates of Deposit) are carried at fair value. Because quoted market prices for SIF securities are often not available at month end, BNY Mellon, as SWIB's custodial bank, compiles fair values from third party pricing services which use matrix pricing models to estimate a security's fair value.

The table entitled **Summary of Information by Investment Classification** contains summarized SIF information by investment type as of June 30, 2018.

### D. Investment Expenses

Investment Expenses are SWIB's administrative and investment costs that are allocated to the SIF participants which consist of management operating expenses, custodial bank charges, research and data services, legal and consulting fees, and investment operating services.



## Notes to the Financial Statements

### E. State Working Bank Charges

State Working Bank Charges represent charges for various state banking services such as lockbox, ePay, 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 Income.

### 3. SIF Investment Income and Pool Shares

For reporting purposes, as noted in Note 2C, investments are valued at fair value. 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. Distributions include 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 expenses. This method does not distribute to participants any unrealized gains or losses generated by the pool's investments.

Unrealized gains and losses are reflected in the Statement of Operations and Changes in Net Position as "Net Increase (Decrease) in the Fair Value of Investments." The cumulative difference between net income (fair value) and distributions paid (amortized cost) is reported in the Statement of Net Position as "Undistributed Unrealized Gains (Losses)."

SIF 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;

### Summary of Information by Investment Classification June 30, 2018

| Investment Type         | Maturity Dates      | Fair Value              |
|-------------------------|---------------------|-------------------------|
| Repurchase Agreements   | 07/02/18            | \$ 3,725,714,130        |
| Government & Agencies   | 07/02/18 - 04/30/20 | 5,246,238,502           |
| Certificates of Deposit | 07/09/18 - 06/17/19 | 122,453,450             |
| Banker's Acceptances    | 07/09/18 - 12/17/18 | 19,819,555              |
| Commercial Paper        | 07/02/18 - 08/16/18 | 364,595,490             |
| Total Investments       |                     | <u>\$ 9,478,821,127</u> |

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 Investment Committee 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 Board established SIF investment guidelines with maximum exposure limits by security type based on the minimum credit ratings as issued by Nationally Recognized Statistical Rating Organizations (NRSROs). The table entitled **Credit Quality Distribution for Securities** displays the credit ratings and aggregate exposures by investment type for the securities held by the SIF as of June 30, 2018.

### 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. As of June 30, 2018, the SIF held Certificates of Deposit (CDs) with a value of \$42,450,000 invested pursuant to the Wisconsin Certificate of Deposit Program (administered by Bankers' Bank) established in July 1987. Investment guidelines provide that to be accepted into this program, banks must accept deposits

## Notes to the Financial Statements

in Wisconsin and meet credit-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. As of June 30, 2018, \$42,450,000 is insured through FDIC insurance and the State of Wisconsin appropriation for losses on public deposits. The actual coverage of these deposits can fluctuate daily based on the allocable share of participants' accounts.

Investments — Custodial credit risk for investments is the risk that, in the event of 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. The

SIF held six repurchase agreements totaling \$3.7 billion as of June 30, 2018. Five of the repurchase agreements, totaling \$2.1 billion, were tri-party agreements. The underlying securities (collateral) for these repurchase agreements were held by the tri-party's agent, not in SWIB's name. The remaining repurchase agreement, totaling \$1.6 billion, was a related-party, bilateral agreement. The underlying securities for this repurchase agreement were held by SWIB's custodian, in SWIB's name. The related party transaction is discussed in Note 5B.

SWIB requires the execution of a Master Repurchase Agreement (MRA) prior to engaging in repurchase agreements with a counterparty. MRAs are negotiated contracts containing terms in which SWIB seeks to minimize counterparty credit risk. The counterparty credit exposure is managed through the transfer of margin, in the form of cash or securities, between SWIB and the counterparty. The market value of securities utilized as collateral

for repurchase agreements must be at least 102% of the value of the repurchase agreement. SWIB also controls credit exposures by performing a credit analysis on each counterparty and by establishing maximum exposure limits with any one counterparty based on their creditworthiness.

SWIB's custodial credit risk policy addresses the primary risks associated with safekeeping and custody. It requires that SWIB's custodial institution be

### Credit Quality Distribution for Securities June 30, 2018

| Investment Type                              | Rating | Fair Value       | %     |
|--|--------|------------------|-------|
| Repurchase Agreements (Collateral):          |        |                  |       |
| U.S. Government and Agencies Debt            | AA     | \$ 3,725,714,130 | 39.3  |
| U.S. Treasury:                               |        |                  |       |
| Short-Term (Bills and Notes)                 | A-1+   | 867,727,127      | 9.1   |
| Long-Term (Note)                             | AA     | 179,343,641      | 1.9   |
| Government Sponsored Entity U.S. Agency:     |        |                  |       |
| Federal Home Loan Bank (FHLB)                | A-1+   | 1,673,799,034    | 17.6  |
| Federal Home Loan Mortgage Corp (FHLMC)      | A-1+   | 1,024,720,143    | 10.8  |
| Federal Home Loan Mortgage Corp (FHLMC)      | AA     | 25,003,250       | 0.3   |
| Federal National Mortgage Association (FNMA) | A-1+   | 1,475,645,307    | 15.6  |
| Certificates of Deposit:                     |        |                  |       |
| Negotiable                                   | A-1+   | 55,003,700       | 0.6   |
| Negotiable                                   | A-1    | 24,999,750       | 0.3   |
| Non-Negotiable (Wisconsin CD Program)        | NR     | 42,450,000       | 0.4   |
| Banker's Acceptances                         | A-1+   | 19,819,555       | 0.2   |
| Commercial Paper                             | A-1+   | 310,676,494      | 3.3   |
| Commercial Paper                             | A-1    | 53,918,996       | 0.6   |
| Total Investments                            |        | \$ 9,478,821,127 | 100.0 |

## Notes to the Financial Statements

selected through a competitive bid process and that the institution be designated a “Systematically Important Financial Institution” by the U.S. Federal Reserve. The policy also requires that SWIB be reflected as beneficial owner on all securities entrusted to the custodian and that SWIB have access to safekeeping and custody accounts. The custodian is also required to be insured for errors and omissions and must provide SWIB with an annual report on internal controls, prepared in accordance with the Statement on Standards for Attestation Engagements. Furthermore, SWIB management has established a system of controls for the oversight of services and related processes of the custodian. SWIB’s current custodial bank was selected in accordance with these guidelines and meets all requirements stipulated in the custodial credit risk policy.

### 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 U.S. Treasury bills or Agency discount notes. As of June 30, 2018, the SIF had more than five percent of its investments in FNMA (15.6%), FHLB (17.6%), FHLMC (11.1%), U.S. Treasury (11.0%), and Repurchase Agreement collateral (39.3%) consisting of various securities issued by these same U.S. Agencies. Since the Repurchase Agreements generally mature each day, new collateral, consisting of a different blend of U.S. Treasury and Agency securities, is assigned each day.

### 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.

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. Depending on the types of securities held in a fund, certain maturity shortening devices (e.g., interest rate resets, call options, and demand features) are taken into account when calculating the weighted average maturity.

The table entitled **Weighted Average Maturities (WAM) for Securities** presents the aggregated weighted average maturity by investment type for securities held by the SIF at June 30, 2018.

| Weighted Average Maturities (WAM) for Securities<br>June 30, 2018 |                         |            |
|---|-------------------------|------------|
| Investment Type   | Fair Value              | WAM (Days) |
| Repurchase Agreements   | \$ 3,725,714,130        | 2          |
| Government & Agencies   | 5,246,238,502           | 32         |
| Certificates of Deposit   | 122,453,450             | 70         |
| Banker’s Acceptances  | 19,819,555              | 67         |
| Commercial Paper  | 364,595,490             | 19         |
| Total Investments   | <u>\$ 9,478,821,127</u> |            |
| Portfolio Weighted Average Maturity (Days)                        |                         | 20         |

### 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 do not permit investment in foreign denominated securities.

## Notes to the Financial Statements

### 5. Related Party Transactions

#### A. Inter-Fund Loans

Wisconsin Statutes 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 2018, Section 20.002 (11) (b) 2 provides that General Fund borrowings may not exceed 9% of defined revenues (estimated borrowing cap of \$1.519 billion). Section 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 total borrowing cap of \$2.025 billion). Further, Section 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, 2018, the amount of inter-fund borrowings between statutory funds invested in the SIF is listed in the table entitled **Inter-Fund Loans**.

#### B. Inter-Fund Transactions

The Wisconsin Legislature created the SWIB for the sole purpose of providing professional investment management for the funds entrusted to it, including the assets of the SIF and the Core Retirement Investment Trust Fund (Core Fund). During the fiscal year, the SIF entered into repurchase agreement transactions with the Core Fund as a counterparty. As of June 30, 2018, the SIF held \$1.6 billion in a bilateral repurchase agreement with the Core Fund. The repurchase agreement was an overnight agreement collateralized with U.S. Treasury securities. The Core Fund is also a participant in the SIF, with an investment totaling \$2.0 billion at June 30, 2018.

### 6. Fair Value Reporting

Fair value measurements of the investments held by the SIF are categorized by the hierarchy established by generally accepted accounting principles. The hierarchy, which has three levels, is based on the valuation inputs used to measure the fair value of the asset.

Level 1 – Investments reflect unadjusted quoted

prices in active markets for identical assets.

Level 2 – Investments reflect prices that are based on inputs that are either directly or indirectly observable for an asset (including quoted prices for similar assets), which may include inputs in markets that are not considered to be active.

Level 3 – Investments reflect prices based upon valuation techniques in which significant inputs or significant value drivers are unobservable.

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3. When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to fair value. The categorization of investments within the hierarchy is based upon the pricing transparency of the instrument and does not represent the investment's overall risk.

The fair value measurements of investments held by the SIF as of June 30, 2018 are found in the table titled **Investments Measured at Fair Value**.

Securities classified in Level 1 are generally valued at the official closing price (usually the last trade prices) or the last bid price on the security's primary exchange. Such investments include U.S. Treasury bills and only the most recently-issued U.S. Treasury notes and bonds are classified as Level 1 because available pricing for these securities is similarly reliable to exchange-traded securities.

| Inter-Fund Loans<br>June 30, 2018          |                       |
|--|-----------------------|
| Fund                                       | Loan Amount           |
| Industrial Building Construction Loan Fund | \$ 1,000              |
| Medical Assistance Trust Fund              | 162,934,000           |
| Police and Fire Protection Fund            | 1,669,000             |
| Recycling & Renewable Energy Fund          | 1,000                 |
| Total Loans                                | <u>\$ 164,605,000</u> |

## Notes to the Financial Statements

Securities classified as Level 2 are valued using observable inputs, by third-party pricing services using a matrix-pricing technique. Matrix-pricing is used to value securities based on their relationship to quoted market prices for securities with similar interest rates, maturities, and credit ratings. The majority of debt securities are classified as Level 2 because they are generally traded using a dealer market, with lower trading volumes than Level 1 securities.

Level 3 investments are generally valued using significant inputs that are unobservable to the marketplace. Banker's Acceptances included in Level 3 represent securities that derive their fair value from cost. Typically, due to their short-term nature, cost approximates fair value for these investments.

Investments held at cost (Repurchase Agreements and non-negotiable Certificates of Deposit) are not reported within the fair value hierarchy.

| Investments Measured at Fair Value<br>June 30, 2018 |  |   |  |                         |
|---|--|---|--|-------------------------|
|   | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total                   |
| Investments by Fair Value Level:                    |  |   |  |                         |
| Government & Agencies                               | \$ 668,053,750   | \$4,578,184,752   |  | \$ 5,246,238,502        |
| Commercial Paper                                    |  | 364,595,490   |  | 364,595,490             |
| Certificates of Deposit (negotiable)                |  | 80,003,450  |  | 80,003,450              |
| Banker's Acceptances                                |  |   | \$ 19,819,555                                      | 19,819,555              |
| Total Investments by Fair Value Level               | <u>\$ 668,053,750</u>  | <u>\$5,022,783,692</u>                                    | <u>\$ 19,819,555</u>                               | <u>\$ 5,710,656,997</u> |
| Investments Reported at Cost                        |  |   |  |                         |
| Repurchase Agreements                               |  |   |  | \$ 3,725,714,130        |
| Certificates of Deposit (non-negotiable)            |  |   |  | 42,450,000              |
| Total Investments                                   |  |   |  | <u>\$ 9,478,821,127</u> |



State Investment Fund

# **SCHEDULE OF INVESTMENTS**

Fiscal Year Ended June 30, 2018

## Schedule of Investments

### REPURCHASE AGREEMENTS

| SECURITY NAME                           | COUPON RATE | MATURITY DATE | FAIR VALUE (\$)      |
|---|-------------|---------------|----------------------|
| DAIWA TRI GOVT REP                      | 2.05        | 7/2/2018      | 500,000,000          |
| MITSUBISHI TRI GOVT REPO                | 2.06        | 7/2/2018      | 662,000,000          |
| JEFFERIES TRI GOVT REP                  | 2.10        | 7/2/2018      | 460,000,000          |
| CREDIT AGRICOLE TRIPARTY                | 2.08        | 7/2/2018      | 400,000,000          |
| MIZUHO TRI GOVT REPO                    | 2.04        | 7/2/2018      | 150,000,000          |
| CORE FUND DVP                           | 2.30        | 7/2/2018      | 1,553,714,130        |
| <b>TOTAL REPURCHASE AGREEMENTS.....</b> |             |               | <b>3,725,714,130</b> |

### GOVERNMENT & AGENCIES

| SECURITY NAME | COUPON RATE   | MATURITY DATE | FAIR VALUE (\$) |
|---------------|---------------|---------------|-----------------|
| FHLB          | DISCOUNT      | 7/5/2018      | 9,808,430       |
| FHLB          | DISCOUNT      | 7/6/2018      | 86,201,894      |
| FHLB          | DISCOUNT      | 7/12/2018     | 26,686,116      |
| FHLB          | DISCOUNT      | 7/13/2018     | 199,686,114     |
| FHLB          | DISCOUNT      | 7/18/2018     | 90,524,802      |
| FHLB          | DISCOUNT      | 7/20/2018     | 249,767,500     |
| FHLB          | DISCOUNT      | 7/23/2018     | 26,970,570      |
| FHLB          | DISCOUNT      | 7/24/2018     | 49,943,000      |
| FHLB          | DISCOUNT      | 7/25/2018     | 77,208,013      |
| FHLB          | VARIABLE RATE | 7/25/2018     | 100,005,000     |
| FHLB          | DISCOUNT      | 7/27/2018     | 49,935,000      |
| FHLB          | DISCOUNT      | 8/1/2018      | 215,155,200     |
| FHLB          | VARIABLE RATE | 8/1/2018      | 24,999,000      |
| FHLB          | DISCOUNT      | 8/3/2018      | 102,224,896     |
| FHLB          | 0.63          | 8/7/2018      | 1,672,789       |
| FHLB          | DISCOUNT      | 8/8/2018      | 99,803,000      |
| FHLB          | DISCOUNT      | 8/10/2018     | 99,792,000      |
| FHLB          | DISCOUNT      | 9/14/2018     | 54,780,550      |
| FHLB          | DISCOUNT      | 9/19/2018     | 53,769,960      |
| FHLB          | DISCOUNT      | 9/21/2018     | 29,869,200      |
| FHLB          | VARIABLE RATE | 1/28/2019     | 24,996,000      |
| FHLMC         | DISCOUNT      | 7/2/2018      | 14,545,000      |
| FHLMC         | DISCOUNT      | 7/3/2018      | 53,247,338      |
| FHLMC         | DISCOUNT      | 7/5/2018      | 2,999,520       |
| FHLMC         | DISCOUNT      | 7/9/2018      | 49,982,000      |
| FHLMC         | VARIABLE RATE | 7/17/2018     | 25,002,500      |
| FHLMC         | DISCOUNT      | 7/18/2018     | 275,361,260     |
| FHLMC         | DISCOUNT      | 7/23/2018     | 145,341,405     |
| FHLMC         | VARIABLE RATE | 7/24/2018     | 17,012,041      |
| FHLMC         | DISCOUNT      | 7/26/2018     | 74,906,250      |
| FHLMC         | 0.85          | 7/27/2018     | 4,996,150       |

## Schedule of Investments

### GOVERNMENT & AGENCIES

| SECURITY NAME                               | COUPON RATE   | MATURITY DATE | FAIR VALUE (\$)      |
|---|---------------|---------------|----------------------|
| FHLMC                                       | DISCOUNT      | 8/2/2018      | 101,831,700          |
| FHLMC                                       | DISCOUNT      | 8/3/2018      | 99,829               |
| FHLMC                                       | DISCOUNT      | 8/6/2018      | 54,897,150           |
| FHLMC                                       | DISCOUNT      | 8/10/2018     | 149,688,000          |
| FHLMC                                       | DISCOUNT      | 9/4/2018      | 49,827,500           |
| FHLMC                                       | DISCOUNT      | 9/5/2018      | 4,982,500            |
| FHLMC                                       | VARIABLE RATE | 8/8/2019      | 25,003,250           |
| FNMA  | DISCOUNT      | 7/2/2018      | 830,000,000          |
| FNMA  | DISCOUNT      | 7/5/2018      | 80,987,040           |
| FNMA  | DISCOUNT      | 7/9/2018      | 23,491,540           |
| FNMA  | DISCOUNT      | 7/11/2018     | 33,008,479           |
| FNMA  | DISCOUNT      | 7/18/2018     | 117,345,522          |
| FNMA  | 1.13          | 7/20/2018     | 21,333,677           |
| FNMA  | DISCOUNT      | 7/25/2018     | 170,252,159          |
| FNMA  | 0.88          | 7/27/2018     | 4,996,400            |
| FNMA  | DISCOUNT      | 7/30/2018     | 24,963,750           |
| FNMA  | DISCOUNT      | 8/1/2018      | 24,960,000           |
| FNMA  | DISCOUNT      | 8/15/2018     | 64,553,941           |
| FNMA  | DISCOUNT      | 8/29/2018     | 79,752,800           |
| TREASURY BILL                               | DISCOUNT      | 7/5/2018      | 224,968,500          |
| TREASURY BILL                               | DISCOUNT      | 7/26/2018     | 49,942,500           |
| TREASURY BILL                               | DISCOUNT      | 8/2/2018      | 39,937,600           |
| TREASURY BILL                               | DISCOUNT      | 8/9/2018      | 19,961,600           |
| TREASURY BILL                               | DISCOUNT      | 8/16/2018     | 74,829,000           |
| TREASURY BILL                               | DISCOUNT      | 8/23/2018     | 24,934,250           |
| TREASURY BILL                               | DISCOUNT      | 9/20/2018     | 74,687,250           |
| TREASURY BILL                               | DISCOUNT      | 9/27/2018     | 24,886,250           |
| TREASURY BILL                               | DISCOUNT      | 10/11/2018    | 44,756,550           |
| TREASURY BILL                               | DISCOUNT      | 12/6/2018     | 39,646,000           |
| TREASURY BILL                               | DISCOUNT      | 12/20/2018    | 24,759,000           |
| TREASURY BILL                               | DISCOUNT      | 12/27/2018    | 24,745,250           |
| TREASURY NOTE                               | 1.50          | 8/31/2018     | 124,912,110          |
| TREASURY NOTE                               | 0.88          | 10/15/2018    | 74,761,267           |
| TREASURY NOTE                               | 1.25          | 8/31/2019     | 49,335,541           |
| TREASURY NOTE                               | VARIABLE RATE | 10/31/2019    | 10,007,431           |
| TREASURY NOTE                               | VARIABLE RATE | 1/31/2020     | 29,995,821           |
| TREASURY NOTE                               | VARIABLE RATE | 4/30/2020     | 90,004,848           |
| <b>TOTAL GOVERNMENT &amp; AGENCIES.....</b> |               |               | <b>5,246,238,502</b> |

## Schedule of Investments

### CERTIFICATES OF DEPOSIT (CDs)

| SECURITY NAME                             | COUPON RATE   | MATURITY DATE | FAIR VALUE (\$)    |
|---|---------------|---------------|--------------------|
| US BANK NA                                | 2.02          | 7/9/2018      | 30,001,200         |
| ROYAL BANK OF CANADA                      | VARIABLE RATE | 7/13/2018     | 25,002,500         |
| BANKERS' BANK                             | 1.80          | 7/16/2018     | 1,500,000          |
| BANKERS' BANK                             | 1.75          | 7/16/2018     | 400,000            |
| BANK OF MONTREAL                          | 2.07          | 7/30/2018     | 24,999,750         |
| BANKERS' BANK                             | 1.90          | 8/15/2018     | 500,000            |
| BANKERS' BANK                             | 1.95          | 8/15/2018     | 5,200,000          |
| BANKERS' BANK                             | 1.99          | 9/17/2018     | 1,000,000          |
| BANKERS' BANK                             | 2.05          | 9/17/2018     | 6,000,000          |
| BANKERS' BANK                             | 2.05          | 10/15/2018    | 600,000            |
| BANKERS' BANK                             | 1.60          | 10/15/2018    | 2,000,000          |
| BANKERS' BANK                             | 2.15          | 11/15/2018    | 500,000            |
| BANKERS' BANK                             | 2.15          | 12/17/2018    | 1,500,000          |
| BANKERS' BANK                             | 1.80          | 12/17/2018    | 9,250,000          |
| BANKERS' BANK                             | 2.00          | 1/15/2019     | 1,000,000          |
| BANKERS' BANK                             | 2.25          | 2/15/2019     | 1,000,000          |
| BANKERS' BANK                             | 2.30          | 3/15/2019     | 3,000,000          |
| BANKERS' BANK                             | 2.35          | 5/15/2019     | 4,500,000          |
| BANKERS' BANK                             | 2.40          | 6/17/2019     | 4,500,000          |
| <b>TOTAL CERTIFICATES OF DEPOSIT.....</b> |               |               | <b>122,453,450</b> |

### BANKER'S ACCEPTANCE (BA)

| SECURITY NAME                          | COUPON RATE | MATURITY DATE | FAIR VALUE (\$)   |
|--|-------------|---------------|-------------------|
| US BANK NA                             | DISCOUNT    | 7/9/2018      | 1,246,644         |
| US BANK NA                             | DISCOUNT    | 7/18/2018     | 1,741,692         |
| US BANK NA                             | DISCOUNT    | 8/1/2018      | 2,782,495         |
| US BANK NA                             | DISCOUNT    | 8/6/2018      | 1,099,638         |
| US BANK NA                             | DISCOUNT    | 8/9/2018      | 686,286           |
| US BANK NA                             | DISCOUNT    | 8/15/2018     | 1,981,485         |
| US BANK NA                             | DISCOUNT    | 8/16/2018     | 847,303           |
| US BANK NA                             | DISCOUNT    | 8/20/2018     | 1,260,092         |
| US BANK NA                             | DISCOUNT    | 8/27/2018     | 1,732,870         |
| US BANK NA                             | DISCOUNT    | 9/4/2018      | 870,352           |
| US BANK NA                             | DISCOUNT    | 10/4/2018     | 740,555           |
| US BANK NA                             | DISCOUNT    | 10/9/2018     | 791,212           |
| US BANK NA                             | DISCOUNT    | 11/15/2018    | 1,978,771         |
| US BANK NA                             | DISCOUNT    | 12/17/2018    | 2,060,159         |
| <b>TOTAL BANKER'S ACCEPTANCES.....</b> |             |               | <b>19,819,555</b> |

## Schedule of Investments

### COMMERCIAL PAPER

| SECURITY NAME                                 | COUPON RATE | MATURITY DATE | FAIR VALUE (\$)      |
|---|-------------|---------------|----------------------|
| ARMY & AIR FORCE                              | DISCOUNT    | 7/2/2018      | 35,994,300           |
| WALMART STORES INC                            | DISCOUNT    | 7/2/2018      | 49,991,875           |
| PROCTOR & GAMBLE COMPANY                      | DISCOUNT    | 7/5/2018      | 49,984,100           |
| WALMART STORES INC                            | DISCOUNT    | 7/16/2018     | 24,976,165           |
| BNY MELLON                                    | DISCOUNT    | 7/16/2018     | 74,930,654           |
| THE COCA-COLA COMPANY                         | DISCOUNT    | 7/20/2018     | 3,995,413            |
| TOYOTA MOTOR CREDIT CORP                      | DISCOUNT    | 7/27/2018     | 49,923,584           |
| APPLE INC                                     | DISCOUNT    | 8/16/2018     | 74,799,400           |
| <b>TOTAL COMMERCIAL PAPER.....</b>            |             |               | <b>364,595,490</b>   |
| <b>GRAND TOTAL STATE INVESTMENT FUND.....</b> |             |               | <b>9,478,821,127</b> |



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### **Agency Information**

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STATE OF WISCONSIN  
INVESTMENT BOARD





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