



*Washington State Investment Board*

*Twenty-First Annual Investment Report*  
*June 30, 2002*





STATE OF WASHINGTON

**STATE INVESTMENT BOARD**

2424 Heritage Court SW - P.O. Box 40916 - Olympia, Washington 98504-0916  
(360) 664-8900 - FAX (360) 664-8912

June 30, 2002

To All Stakeholders:

I am pleased to submit the Washington State Investment Board's (WSIB) Annual Report for fiscal year 2002. This is our twenty-first annual report.

As of June 30, 2002, retirement fund assets totaled almost \$40 billion, including \$944 million in self-directed defined contribution funds. After a decade in which the retirement funds consistently posted double-digit investment gains, fiscal year 2002 marked the second consecutive year that the defined benefit retirement funds posted negative returns (-6.4 percent in fiscal year 2002). However, the silver-lining is that, as of June 30, 2002, the WSIB Retirement Funds have outperformed their public fund peers over the three-year and five-year time periods, as measured by the Trust Universe Comparison Service (TUUS) universe of public pension funds greater than \$1 billion in size.

The past two years have been a period of upheaval in equity markets world-wide, in which virtually all investors have experienced losses within their investment portfolios. In this past year alone, shaken by the attacks of September 11, 2001, and the discovery of a series of corporate accounting scandals, investors suffered through two of the worst quarters in the U.S. equity market since 1926. When compared with the returns of major stock indices like the S&P 500 (-18.0 percent) and the Wilshire 5000 (-16.6 percent), the WSIB's retirement fund performance highlights the benefits of a broadly diversified portfolio — a strategy which moderates extreme movements in any single investment market.

For the second consecutive year, portfolios with heavy emphasis on fixed income securities posted strong investment performance. The various Industrial Insurance funds posted positive returns of up to 9.2 percent, and the Permanent funds posted positive returns between 6.5 and 6.9 percent.

During this past year, the WSIB adopted new long-term asset allocation policy targets for the defined benefit retirement funds, increasing the target allocation to the Private Equity asset class from 15 to 17 percent and the allocation to Real Estate from nine to 12 percent. The target allocation to U.S. equities declines from 36 to 31 percent. Also this year, the third, and potentially largest, state hybrid defined contribution retirement plan, the Public Employees' Retirement System Plan 3 (PERS 3) began. The growth of defined contribution-type investment programs, such as PERS 3, and the more treacherous investment environment will present new challenges for the WSIB. However, I am certain that the hard-working and dedicated Board and its staff will continue to create and implement successful investment programs for the many and varied funds under the WSIB's management.

---

John F. Charles, Chair



## Twenty-First Annual Investment Report (Part 1)

### Contents

Highlights of Fiscal Year 2002	1
Washington State Investment Board Overview	2
Board-Established Committees	3
Board Members	4
Washington State Investment Board Staff	5
Investment Responsibility	7
Assets Under Management	8
Washington State Investment Board Budget	9
Annual Financial Report	10
Investing in Washington	11
Defined Benefit Retirement Funds	13
Retirement Plans	15
Asset Changes	16
Retirement Fund Performance	17
Investment Growth and Returns	18
Asset Allocation	19
U.S. Equity Program	20
Non-U.S. Equity Program	22
Fixed Income Program	24
Private Equity Program	28
Real Estate Program	29
Defined Contribution Retirement Plans	31
Public Employees' Retirement System Plan 3	33
School Employees' Retirement System Plan 3	34
Teachers' Retirement System Plan 3	35
Judicial Retirement Account	36
Deferred Compensation Fund	37
State Investment Board Daily-Valued Funds	41
Washington State Horizon Funds	43
Washington State Bond Fund	44
Savings Pool	45
Industrial Insurance Funds	47
Permanent Funds & Other Trust Funds	53
Permanent Funds	55
Other Trust Funds	56
Glossary	58

**Part 2 of the Annual Report, "Financial Statements and Schedules of Investments," is an integral part of this Annual Report. It contains detailed listings of WSIB's investment holdings.**

---

## *HIGHLIGHTS OF FISCAL YEAR 2002*

---

- Total assets managed by the Washington State Investment Board (WSIB) stood at \$50.9 billion on June 30, 2002, with 32 individual state funds managed by the WSIB. Fiscal year 2001 was the second consecutive year in which equity markets world-wide experienced precipitous declines. Shaken by the September 11, 2001, terrorist attacks and later by a series of corporate accounting scandals, the U.S. equity market suffered through two of the worst quarters since 1926 during this past fiscal year. Major U.S. stock market indices experienced double-digit declines, with the S&P 500 down 18 percent and the Wilshire 5000 off nearly 17 percent for the fiscal year.
- The defined benefit Retirement Funds returned -6.4 percent in fiscal year 2002. During the past fiscal year, the WSIB adopted new long-term asset allocation policy targets for the defined benefit retirement funds, increasing the target allocation to Private Equity from 15 to 17 percent and the target allocation to Real Estate from nine to 12 percent. The long-term target allocation to U.S. equities was decreased from 36 to 31 percent.
- As of June 30, 2002, the Retirement Funds have outperformed their public fund peers over the three-year and five-year time periods, as measured by the Trust Universe Comparison Service (TUCS) universe of public pension funds greater than \$1 billion in size.
- The four individual Industrial Insurance Funds each recorded positive returns in fiscal year 2002, with the highest being the 9.2% return of the Pension Reserve Fund.
- For the Permanent Funds, accrued earnings for distribution to beneficiaries totaled \$42.8 million in fiscal year 2002.
- Defined contribution-type assets stood at \$3.5 billion in five separate programs: the state Deferred Compensation Plan, the Judicial Retirement Account, the School Employees' Retirement System Plan 3, the Teachers' Retirement System Plan 3, and the new Public Employees' Retirement System Plan 3, which began on March 1, 2002.
- The WSIB received its tenth consecutive unqualified state audit (for fiscal year 2001).

---

# WASHINGTON STATE INVESTMENT BOARD

---

The WSIB was created by statute in 1981 to “. . . exercise all the powers and perform all duties prescribed by law with respect to the investment of public trust and retirement funds.” The law goes on to state “. . . the State Investment Board shall have full power to invest, reinvest, manage, contract, or sell or exchange investments acquired.”

As of June 30, 2002, the WSIB has management responsibility for 32 funds, which are categorized as either retirement funds (defined benefit and defined contribution), deferred compensation funds, industrial insurance funds, permanent funds, or other trust funds. The Board is composed of nine voting members and five non-voting members. A tenth voting Board member, representing active members of the School Employees’ Retirement System, will be added in September 2002.

Although governed by an independent board, the WSIB is part of the Executive branch of state government. As a state agency, Board members and staff are required to comply with all statutory requirements and rules established for all agencies, officials, and employees in the performance of their public duties.

In order to efficiently analyze investment issues, specific areas of responsibility have been assigned to Committees of the Board. The Committees consist of selected Board members and act as extensions of the Board. Their functions are to analyze investment issues under their jurisdiction in greater detail than would be possible for the full Board. Recommendations are brought to the Board at regular meeting dates for a full Board vote.

## Investment Principle

*“The State Investment Board shall invest and manage the assets entrusted to it with reasonable care, skill, prudence, and diligence under circumstances then prevailing which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an activity of like character and purpose.” (RCW 43.33A.140)*

*“The Board shall consider investments not in isolation, but in the context of the investment of the particular fund as a whole and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suited for that fund.” (RCW 43.33A.140)*

*“The Board shall establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk.” (RCW 43.33A.110)*

## Mission Statement

*To invest and to manage the entrusted funds in a manner consistent with statutes, regulations, Board policies and the highest standard of professional conduct for the exclusive benefit of fund beneficiaries.*

---

# WASHINGTON STATE INVESTMENT BOARD

---

## BOARD-ESTABLISHED COMMITTEES

The Board has established four Committees which are appointed by the Chair and approved by the Board as follows:

### Administrative

This Committee is responsible for organizational, personnel, budget, legal issues, and legislative issues, as well as strategic asset allocation matters.

### Audit

This Committee oversees audit activities and operations, and nominates candidates for the non-voting positions on the Board. In addition, the Audit Committee develops and monitors the Code of Conduct for the Board, reviews performance reporting requirements, and deals with corporate governance policies and issues.

### Private Markets

This Committee is responsible for development of policy and structure for private market investments (real estate, venture capital, leveraged buyouts, etc.), and reviews real estate and private equity investments for recommendations to the Board.

### Public Markets

This Committee is responsible for the development of policy and structure for public market investments (fixed income, domestic equity, international equity), and reviews individual equity managers for recommendation to the Board.

## OUTSIDE HELP AND ADVICE

Even with a highly skilled, professional staff, the Board also relies on a variety of outside experts to provide advice and counsel, as well as specific investment services. The following list includes the consultants and advisors currently utilized by the Board.

Money management firms hired by the Board to manage specific portions of the equity portfolio, and other assets managed by general partners in private equity and real estate, are listed on the pages describing those specific investment programs.

### Legal Services

- Attorney General of Washington
- Foster, Pepper & Shefelman - Seattle, WA
- Goodwin Procter - Boston, MA
- Orrick, Herrington & Sutcliffe - New York, NY
- Preston, Gates & Ellis - Seattle, WA
- Song & Mondress - Seattle, WA
- Testa Hurwitz & Thibault- Boston, MA
- Paul, Hastings, Janofsky & Walker - Los Angeles, CA

### Master Custodian Bank

- State Street Bank - Boston, MA

### Private Equity Consultant

- Pacific Corporate Group - La Jolla, CA

### Real Estate Consultant

- Courtland Partners - Cleveland, OH

### Insurance Portfolio Consultant

- Conning Asset Management - Hartford, CT

### Investment Accounting Data System

- Financial Control Systems - Chadds Ford, PA

### General Investment Consultants

- Pension Consulting Alliance - Encino, CA
- Callan Associates - Denver, CO
- R.V. Kuhns & Associates - San Francisco, CA
- Watson-Wyatt Investment Consulting - San Francisco, CA

---

## ***BOARD MEMBERS***

---

### **Ex-Officio Board Members**

Michael J. Murphy	State Treasurer
John F. Charles, Chair	Director, Department of Retirement Systems
Gary Moore	Director, Department of Labor and Industries

### **Board Members Appointed by the Governor**

Vacant	Representative - Active Member, Public Employees' Retirement System
George Masten	Representative - Retired Member of a State Retirement System
Patrick McElligott	Representative - Active Member, Law Enforcement Officers' and Fire Fighters' Retirement System

### **Board Member Appointed by the Superintendent of Public Instruction**

Lee Ann Prielipp, Vice-Chair	Representative - Active Member, Teachers' Retirement System
------------------------------	---

### **Board Member Appointed by the Speaker of the House**

Helen Sommers	State Representative
---------------	----------------------

### **Board Member Appointed by the President of the Senate**

Sid Snyder	State Senator
------------	---------------

### **Non-Voting Board Members Appointed by Voting Board Members**

Jeffrey Hanna	Investment Professional
Charles Kaminski	Investment Professional
John Magnuson	Investment Professional
Robert S. Nakahara	Investment Professional
Jeffrey Seely	Investment Professional

---

# STATE INVESTMENT BOARD STAFF

---

## EXECUTIVE STAFF

### **Gary Bruebaker, CFA, CPA**

*Chief Investment Officer, and Acting Executive Director*

Twenty-four years in executive management and public finance. Formerly Deputy State Treasurer of Oregon. Served as the President of the Government Finance Officers Association of the United States and Canada. Graduate of the University of Oregon with an MBA and a graduate of Oregon State University with honors in business administration. Chartered Financial Analyst, Certified Cash Manager and Certified Public Accountant.

### **Beth Vandehey, CPA**

*Internal Auditor*

### **Melanie Watness**

*Human Resources Administrator*

### **Les Brodie, CGFM**

*Acting Deputy Director for Operations*

Twenty years of experience in federal, state and county government. Prior positions include: Comptroller, Deputy Auditor of Finance, Senior Fiscal Analyst with the Washington House of Representatives and Auditor with the U.S. General Accounting Office. MPA graduate from California State University at Los Angeles and a Bachelor of Arts graduate from the University of Southern California. Certified Government Financial Manager.

### **Executive Support**

Sheila Geisler,

*Executive Assistant*

Kristi Bromley,

*Administrative Assistant for Investments*

Kristi Walters,

*Administrative Assistant for Operations*

Geri Uhlmeyer,

*Office Assistant*

## SENIOR INVESTMENT OFFICERS

### **William P. Kennett, CFA**

*Fixed Income*

Formerly a securities analyst at the Montana Board of Investments. Graduate of the University of Montana with an MBA and a BS in Business Administration.

### **Thomas E. Ruggels**

*Private Equity*

Formerly an Investment Officer in both public and private equity and Investment Accounting Controller for the SIB. Graduate of the University of Kansas in Accounting with an MBA from the University of Washington.

### **Nancy Calkins, CIMA**

*Public Equity*

Formerly Investment Officer for CALPERS, domestic and international external equity manager relations. Graduate with honors Master of Arts in Economics and Business Administration from California State University, Sacramento.

### **Jeffrey A. Habersetzer**

*Real Estate*

Formerly worked in the real estate related fields of fee appraisal and title insurance, and as a commercial sales and leasing associate. Graduate of University of Washington in Business Administration.



---

# STATE INVESTMENT BOARD STAFF

---

## INVESTMENT STAFF

### Asset Allocation

Diana Will, CFA

### Fixed Income

Thomas E. Bosworth  
Linda Esau  
Donna May Ong, CFA  
Ralph Ripple  
Maria S. Tosteson Rosen  
Judy Yu

### Private Equity

Isabelle Fowler  
Sam Green, CPA  
Gary R. Holt

### Public Equity

Linda L. Lester, CPA

### Real Estate

Steven M. Draper  
Gary G. Gallinger

### Investment Support

Linda Buchanan, Secretary Administrative  
Elizabeth Hyde, Office Assistant Senior  
Brian Shrader, Office Assistant Senior

## OPERATIONS STAFF

### Portfolio Administration

Alicia Markoff, Portfolio Administrator  
Mike Donovan, Assistant Portfolio Administrator  
Nelly Haun, Trade Settlement Specialist  
Barbara Schoenthal, Trade Settlement Specialist

### Investment Accounting

Steven C. Verschoor, Investment Accounting Controller  
Sandra Machado, Investment Accounting Supervisor  
Tami Clark, Investment Accountant  
Mimi French, Investment Accountant  
Vikki Gigstead, Investment Accountant  
Kae Schmidt, Investment Accountant

### Legislative and Communications

Scott Huntley

### Operations Support

E. Renée Wicklund, Office Assistant Senior

### Business Services

Sandra Joudrey, CPA, Financial Manager  
David Thatcher, Contract Specialist  
Kathy Butler, Administrative Assistant  
Jack Coleman, Chief Accountant  
Regina Cuccia, Secretary Senior  
Wendy Harris, Financial Analyst  
Meenu Kushan, Fiscal Technician  
Renee Long, Financial Specialist

### Systems and Office Services

Jim Lee, Systems and Office Services Manager  
Tom Edwards, LAN Administrator  
Bill Duris, Systems Analyst  
Brad Christoffer, PC Support Specialist  
Patricia Sheridan, Office Manager  
Tish Day, Office Assistant Senior  
Shauna Raphael, Office Assistant Senior

---

# **INVESTMENT RESPONSIBILITY**

---

As of June 30, 2002, the WSIB has investment responsibility for the following 32 funds:

## **RETIREMENT FUNDS**

### **DEFINED BENEFIT**

Public Employees' Retirement System (PERS) Plan 1  
Public Employees' Retirement System (PERS) Plan 2/3  
School Employees' Retirement System (SERS) Plan 2/3  
Teachers' Retirement System (TRS) Plan 1  
Teachers' Retirement System (TRS) Plan 2/3  
Law Enforcement Officers' & Fire Fighters' (LEOFF) Plan 1  
Law Enforcement Officers' & Fire Fighters' (LEOFF) Plan 2  
Judicial Retirement System  
Washington State Patrol Retirement System (WSPRS)  
Volunteer Fire Fighters' Relief & Pension Fund

### **DEFINED CONTRIBUTION**

Public Employees' Retirement System Plan 3 (Self-Directed)  
School Employees' Retirement System Plan 3 (Self-Directed)  
Teachers' Retirement System Plan 3 (Self-Directed)  
Judicial Retirement Account

### **DEFERRED COMPENSATION PROGRAM FUNDS**

State Deferred Compensation Program

### **INSURANCE (LABOR & INDUSTRIES) FUNDS**

Accident Fund  
Medical Aid Fund  
Pension Reserve Fund  
Supplemental Pension Fund

### **PERMANENT FUNDS**

Agricultural Permanent Fund  
Common School Permanent Fund  
Millersylvania Park Trust Fund  
Normal School Permanent Fund  
Scientific Permanent Fund  
State University Permanent Fund

### **OTHER TRUSTS**

Developmental Disabilities Endowment Trust Fund  
Game and Special Wildlife Fund  
Guaranteed Education Tuition Fund  
Radiation Perpetual Fund  
Reclamation Revolving Fund  
State Emergency Reserve Fund  
State Employees Insurance Reserve

# ASSETS UNDER MANAGEMENT

## TOTAL ASSETS BY FUND

*June 30, 2002*

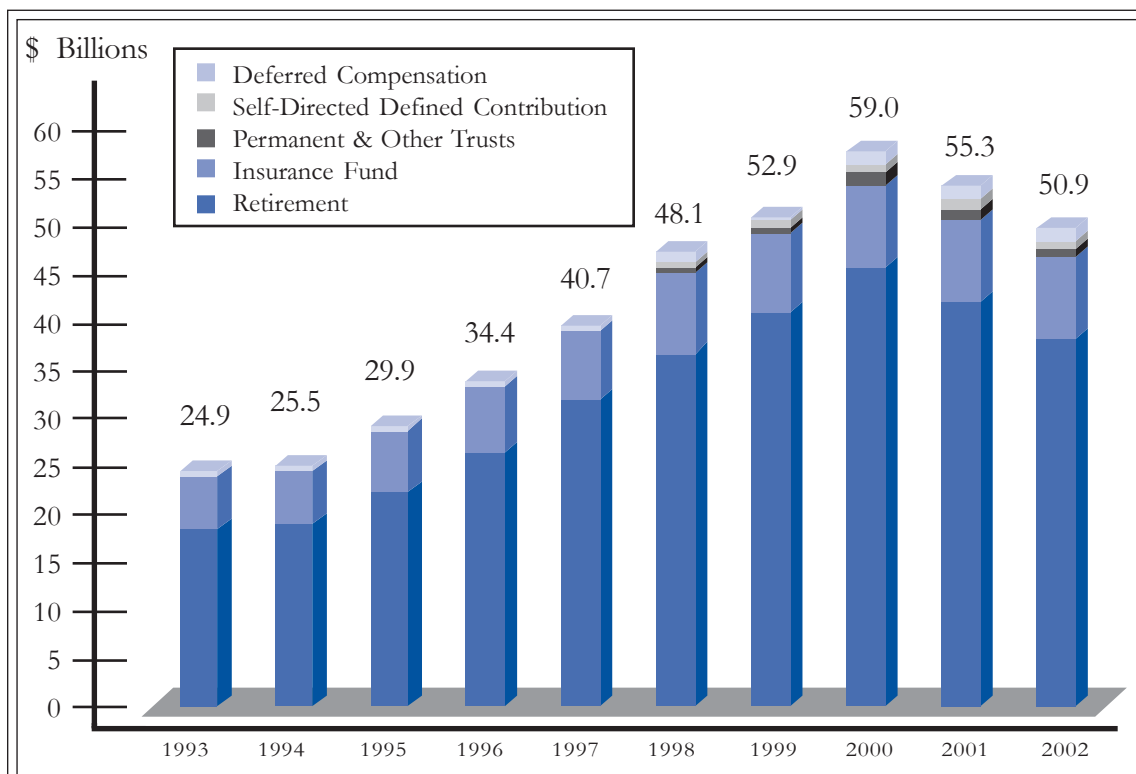
*(Millions)*

Retirement	\$ 39,026
Self-Directed Defined Contribution	944
Deferred Compensation	1,353
Industrial Insurance Funds	8,636
Permanent Funds	684
Other Trusts	289
	<b>\$ 50,932</b>

## GROWTH OF ASSETS

*Past Ten Years*

*Fiscal Year Ending June 30, 2002*



# **STATE INVESTMENT BOARD BUDGET**

The WSIB is referred to as a “non-general fund” agency for budgetary purposes. The WSIB receives no state general fund moneys; its funding comes from charges on the invested funds. These charges are spent on appropriated and non-appropriated expenses.

## **THE BIENNIAL BUDGET (Appropriated Expenses)**

The WSIB follows the same budget process as any other state agency. The Board receives a biennial (two-year) appropriation from the legislature, which covers normal department operations, including staff, facilities, equipment, supplies, etc.

The biennial budget is approved by the state legislature every odd-numbered year. The biennial budget funds the WSIB from July 1 of the odd-numbered year, following passage of the state budget, to June 30 of the next odd-numbered year.

Like any other state agency, the WSIB cannot operate in a deficit. The appropriated operating expenses are funded based on a formula established by statute whereby each fund invested by the WSIB pays a share proportional to the value of the assets of the fund. The WSIB’s operating budget is tiny in comparison to the assets managed. Currently, the two-year operating budget is 0.026 percent of the total assets managed (\$50.9 billion). For fiscal year 2002, the appropriated operating expenditures were \$6,062,400, or 0.012 percent of the total assets managed.

## **INVESTMENT EXPENSES (Non-Appropriated)**

Fees and expenses associated with the management of investments typically include money manager, custodial bank, consultant, and legal fees specifically related to an investment or group of investments. These expenses are classified as non-appropriated expenditures which do not require specific legislative appropriation.

Statutory authority for these expenditures is codified in RCW 43.84.160, Investment counseling fees payable from earnings: “Investment counseling fees established by contract shall be payable from the investment earnings derived from those assets being managed by investment counsel.”

For fiscal year 2002, total non-appropriated expenditures were \$205,547,766, or 0.4 percent of the total assets managed.

Investment expenses in fiscal year 2002 grew due to increased private equity and real estate commitments, and the inclusion of netted investment management fees.

### **WSIB Cost of Management ((\$000))**

Fiscal Year	Total Assets	Investment Expenses		Operating Expenses		Total Expenses	
			% of total assets		% of total assets		% of total assets
1997	\$40,654,325	\$53,288	0.131%	\$4,008	0.010%	\$57,296	0.141%
1998	\$48,060,437	\$51,715	0.107%	\$4,251	0.009%	\$55,966	0.116%
1999	\$52,870,990	\$100,002	0.189%	\$4,922	0.009%	\$104,925	0.198%
2000	\$58,868,551	\$138,573	0.235%	\$4,626	0.008%	\$143,199	0.243%
2001	\$55,298,357	\$170,228	0.308%	\$5,569	0.010%	\$175,797	0.318%
2002	\$50,931,946	\$205,548	0.403%	\$6,062	0.012%	\$211,610	0.415%



# ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2002  
Accrual Basis

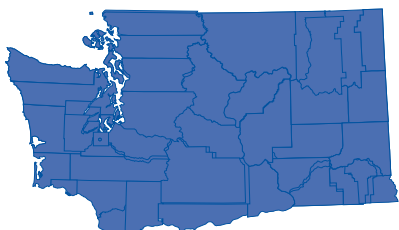
OBJECTS OF EXPENDITURE	BUDGET TO DATE	EXPENDITURES TO DATE	BUDGET VARIANCE
<b>Appropriated</b>			
Salaries	\$ 3,572,356	\$ 3,296,209	\$ 276,147
Benefits	686,106	614,132	71,974
Personal Services	829,640	803,096	26,544
Goods & Services	984,485	1,154,165	(169,680)
Travel	178,030	209,848	(31,818)
Fixed Assets	14,228	-	14,228
Interagency Reimbursements	-	(15,050)	15,050
	<u>\$ 6,264,845</u>	<u>\$ 6,062,400</u>	<u>\$ 202,445</u>
<b>Non-Appropriated</b>			
<b>Retirement Funds</b>			
U.S. Equity-Passive		\$ 417,025	
Non-U.S. Equity - Active		8,064,360	
Non-U.S. Emerging Markets - Passive		528,355	
Non-U.S. Emerging Markets - Active		3,288,594	
Non-U.S. Equity - Passive		2,380,797	
Private Equity		147,252,361	
Real Estate		24,814,648	
Commercial Mortgages (Fixed Income)		132,521	
General Pension Consultants		1,777,347	
Legal Fees		208,267	
Custodian Bank Fees		946,034	
Securities Lending and Other Fees		7,356,076	
<i>Total Retirement</i>		<u>\$ 197,166,385</u>	
<b>Self-Directed Defined Contribution Funds</b>			
Self-Directed Managers - Non U.S. Equity		\$ 48,235	
Self-Directed Managers - U.S. Equity		57,912	
U.S. Fixed Income		116,166	
Provident Liquidity Fees		59,147	
Securities Lending and Other Fees		83,905	
<i>Total Self-Directed Defined Contribution*</i>		<u>\$ 365,366</u>	
<b>Industrial Insurance Funds</b>			
Consultants		\$ 150,000	
U.S. Equity - Passive		23,885	
Non-U.S. Equity - Passive		187,081	
Custodian Bank Fees		165,139	
Securities Lending		795,361	
Provident Liquidity Fees		282,653	
<i>Total Industrial Insurance</i>		<u>\$ 1,604,119</u>	
<b>Deferred Compensation Funds</b>			
Fixed Income - Active		\$ 1,108	
U.S. Equity - Active		5,121,954	
Non-U.S. Equity - Active		191,886	
U.S. Equity - Passive		3,833	
Securities Lending		6,795	
<i>Total Deferred Compensation Funds*</i>		<u>\$ 5,325,576</u>	
<b>Permanent/Other Funds</b>			
U.S. Equity - Passive		\$ 850	
Non-U.S. Equity - Passive		14,987	
Custodian Bank Fees		27,491	
Securities Lending		60,515	
Provident Liquidity Fees		982,477	
<i>Total Permanent/Other Funds</i>		<u>\$ 1,086,320</u>	
<b>Subtotal Non-Appropriated</b>		<b>205,547,766</b>	
<b>TOTAL</b>		<b><u>\$ 211,610,166</u></b>	

\*Expenses are paid by participants. Department of Retirement Systems (DRS) administrative costs borne by participants are not included.

---

## INVESTING IN WASHINGTON

---



While the WSIB continually seeks the best investment opportunities no matter where they might be located worldwide, the state of Washington is home to many tremendous companies that offer the WSIB excellent investment opportunities. Many Washington investments can be found in all of the WSIB's investment portfolios.

### Washington Investments in the WSIB Portfolio

<b>Investment Class</b>	<b>Value (\$Millions)</b>
Public Equity	\$491.4
Fixed Income	\$465.6
Private Equity*	\$61.4
Real Estate*	\$667.3
<b>Total</b>	<b>\$1,685.7</b>

\*The private equity total shown is the amount invested in Washington-based companies by the WSIB. The real estate total shown is the estimated fair market value of Washington properties held by real estate partnerships in which the WSIB participates.

Washington investments represent 3.3 percent of the total investments of the WSIB (all funds). This figure compares favorably to the 2.2 percent figure that is the Washington economy's share of the total U.S. economy (Gross Domestic Product), as calculated by the U.S. Department of Commerce, Bureau of Economic Analysis.

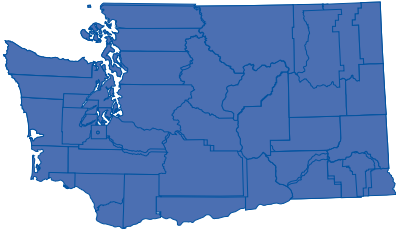
In the public markets (public equity and fixed income), the WSIB portfolio contains equity share ownership in and/or holds debt instruments issued by 118 publicly-held companies headquartered in the state of Washington (as well as holding in-state mortgages and debt instruments issued by the state and various local government units). The market value of these investments exceeds \$950 million as of June 30, 2002. Among the many Washington companies represented in the WSIB public equity and fixed income portfolios are:

- Airborne Inc.
- Amazon.Com Inc.
- Cascade Natural Gas Corp.
- Cell Therapeutics Inc.
- Costco Wholesale Corp.
- Cutter & Buck Inc.
- Expedia, Inc.
- Expeditors International
- Fisher Companies
- Getty Images Inc.
- Icos Corp.
- Immunex Corp.
- Longview Fibre Co.
- Microsoft Corp.
- Nautilus Group Inc.
- Nordstrom Inc.
- Paccar Inc.
- Plum Creek Timber Co.
- Puget Energy Inc.
- Safeco Corp.
- Seattle Genetics, Inc.
- Shurgood Storage Centers
- Sonosite, Inc.
- Spacelabs Medical
- Starbucks Corp.
- Todd Shipyards, Corp.
- Washington Federal Inc.
- Washington Mutual Inc.
- Weyerhaeuser Co.
- Zymogenetics Inc.

---

## INVESTING IN WASHINGTON

---



Several of the WSIB's real estate partners and managers have acquired or manage assets located in Washington. As of June 30, 2002, the WSIB portfolio includes whole or partial ownership of 30 office, retail or industrial properties located in Washington. The fair market value of these properties is estimated at over \$667 million. The following are some examples:

- 1551 Eastlake Avenue - Seattle
- 1616 Eastlake Avenue - Seattle
- 2100 Evergreen Parkway - Olympia
- Bellevue Galleria - Bellevue
- Burke & Phinney Buildings - Seattle
- Columbia Technology Center - Vancouver
- Covington Square - Covington
- Fairwood Shopping Center - Renton
- One & Two Union Square - Seattle
- Pacific Business Park North - Kent
- Southcenter Corporate Square - Seattle

Perhaps the most direct impact the WSIB investments might have on the Washington economy is in private equity ownership. As of June 30, 2002, the WSIB has over \$61 million invested in 69 Washington companies through its private equity partnerships. Some of the private equity portfolio companies headquartered in Washington include:

- Airspan Networks
- Apar Holding Corp.
- Asterion.com
- Aventail Corp.
- Avenue A
- Broadstream Corp.
- Calypso Medical Tech
- Captura Software
- Cobalt Group, Inc.
- Cybersafe Corp.
- edge2net, Inc.
- F5 Networks, Inc.
- iCopyright.com
- InterNAP Network Services
- Lizard Tech, Inc.
- Merrill Gardens
- Metawave Communications
- nLight Photonics Corp.
- Phycom Corp.
- Reflex Communications
- Rendition Networks
- Restaurants Unlimited
- SkeleTech, Inc.
- Spiration, Inc.
- Talisma Corp.
- Tera Beam
- Tidewater Holdings
- Vivato
- Western Inst. Review Board
- Your Pet's Choice

## ***DEFINED BENEFIT RETIREMENT FUNDS***

- **Retirement Plans**
- **Asset Changes**
- **Fund Performance**
- **Investment Growth and Returns**
- **Asset Allocation**
  
- **U.S. Equity Program**
- **Non-U.S. Equity Program**
- **Fixed Income Program**
- **Private Equity Program**
- **Real Estate Program**





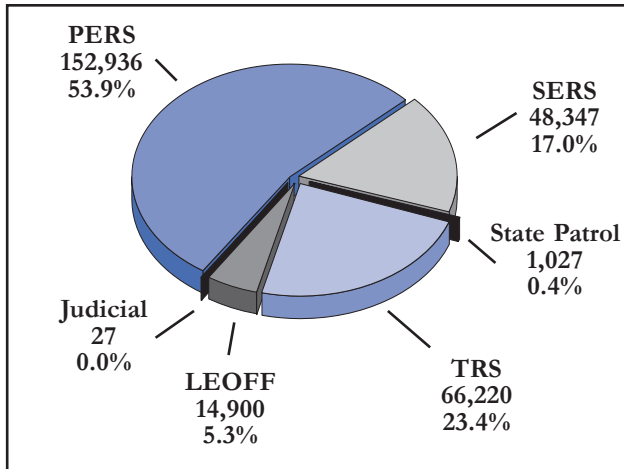
# RETIREMENT PLANS

The Department of Retirement Systems (DRS) is the administrative arm of the state's multiple-employer retirement systems. Headed by a cabinet-level director, who also serves as a voting member of the WSIB, DRS administers the pension plans for state employees, teachers and classified educational employees; law enforcement officers and fire fighters; and other employees of participating local political subdivisions.

The retirement system membership has grown to 414,417 members as of June 30, 2002, including 26,469 inactive members.

In fiscal year 2002, the sum of trust fund contributions, fees and investment returns was -\$2,114 million (including Plan 3 Self-Directed Defined Contribution). This includes positive revenues of \$410 million in member contributions and restorations, \$262 million in employer contributions, \$22 million in General Fund contributions, and \$28 million in fees and other revenue, countered by -\$2,836 million in investment losses.

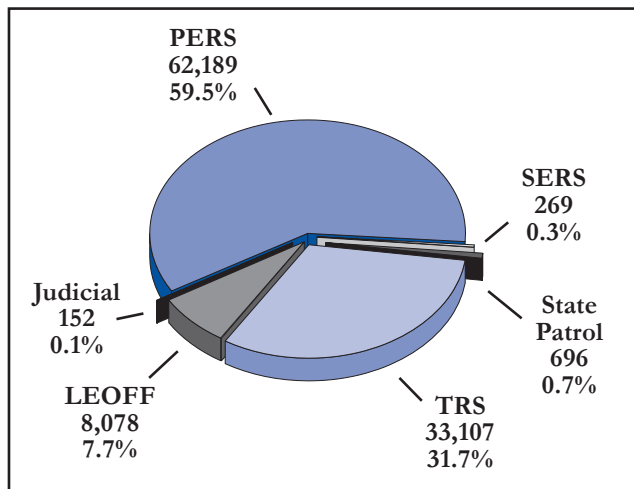
## ACTIVE MEMBERS BY SYSTEM



## MARKET VALUE AS OF JUNE 30, 2002 (In \$000's)

PERS 1	\$ 8,992,176
PERS 2/3	9,482,252
SERS 2/3	1,564,986
TRS 1	7,679,311
TRS 2/3	3,918,704
LEOFF 1	4,418,004
LEOFF 2	2,266,534
WSP	595,580
Vol FF	100,312
JUDICIAL	8,177
<b>TOTAL</b>	<b>\$ 39,026,036</b>

## RETIRED MEMBERS BY SYSTEM



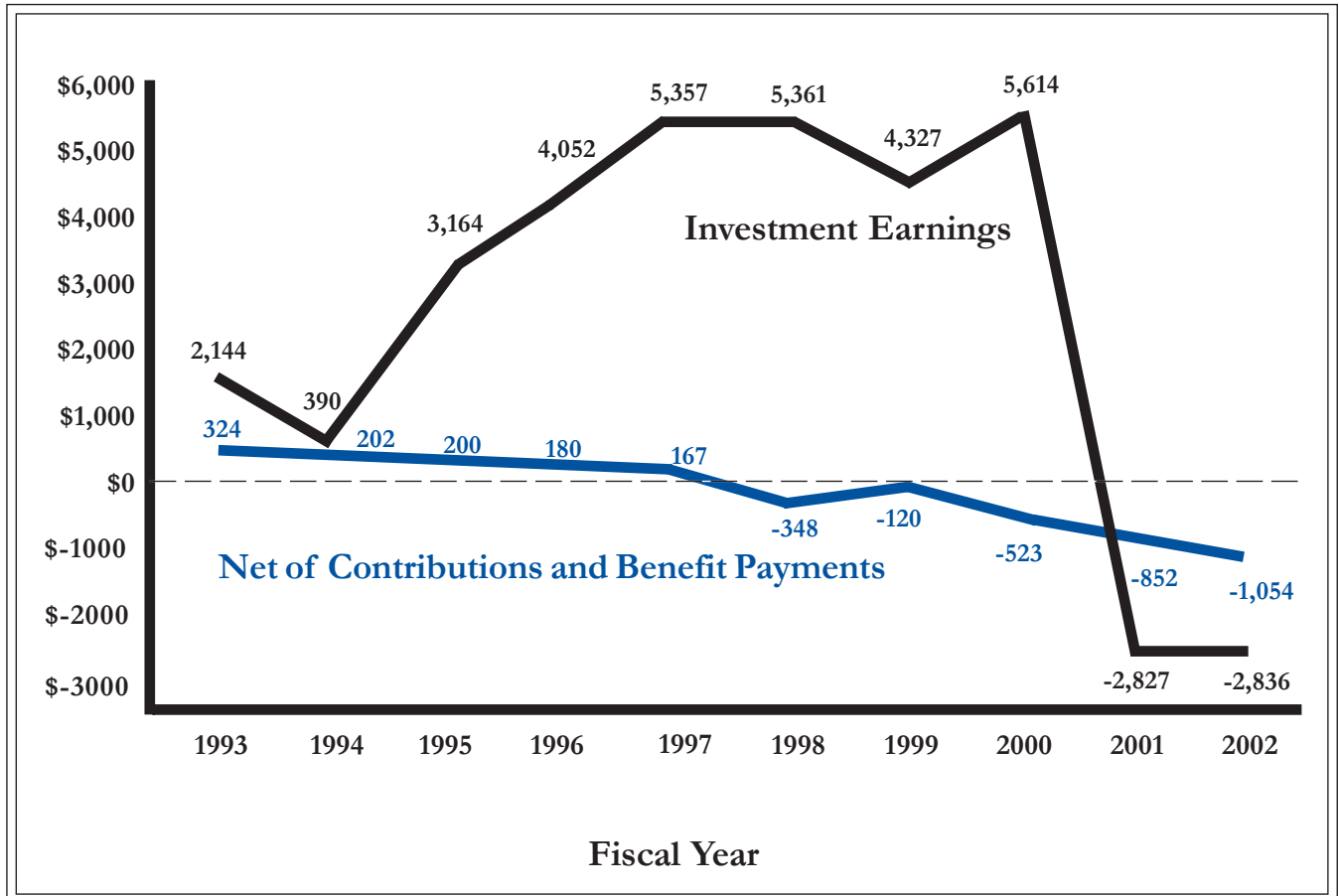
## *ASSET CHANGES*

Over the past ten years, the assets of the Retirement Funds have grown from \$16.4 billion to \$39.0 billion (as of June 30, 2002), not including Plan 3 Self-Directed Defined Contribution. This growth is comprised of employer and employee contributions, net investment returns, less benefit payments and fund transfers.

Employer contributions are driven by the obligation of the employer to fund the plan in a systematic and deliberate manner consistent with actuarial projections, existing statutes and availability of funds. The employee contributions are the most predictable component since they are statutory and less likely to change. Benefit payments are withdrawn from the funds to provide monthly stipends to retired members.

Investment returns are primarily the result of asset allocation and capital market returns. The WSIB has no control over capital market returns; it does, however, have control over the Retirement Fund's asset allocation, investment strategies, risk-return objectives, and certain investment decisions. The asset allocation policy is reviewed regularly and revised when appropriate. (See the Asset Allocation section on page 19).

### Factors Affecting Trust Fund Balances (in Millions)



Note: Investment earnings include Plan 3 Self-Directed investments. Source of data: WSIB and DRS.

## **RETIREMENT FUND PERFORMANCE**

The WSIB measures its performance by the achievement of expected returns on the assets under management, and comparisons to appropriate benchmarks.

An important part of the asset allocation policy process is to set an expectation for performance of the individual asset classes, as well as the Retirement Fund as a whole. Although returns will vary quarterly and annually, the long-term expectation should exceed the actuarially assumed rate over time.

Assets differ in their behavior and volatility. For example, since most public market investments can be priced instantaneously, fair market value can be determined with certainty. However, the real estate and private equity investments are very illiquid, are not easily priced, and may take years before offering the expected return to the investor. These characteristics must be kept in mind when reviewing quarterly and annual returns.

The nine largest defined benefit retirement funds are invested through the Retirement Commingled Trust Fund (CTF). The CTF serves to pool the assets of the nine separate funds in order to provide for more efficient management and reduce administrative costs and investment fees.

### **RETIREMENT COMMINGLED TRUST FUND** *Time-Weighted Returns - Restated* *Periods Ending June 30, 2002*

	-----Annualized-----		
	<u>One Year</u>	<u>Three Years</u>	<u>Five Years</u>
<b>TOTAL FUND</b>	-6.4%	0.2%	5.5%
<i>TUCS Public Fund &gt; \$1 Billion Median*</i>	-6.2	-0.6	4.9
<b>LIQUIDITY</b>	1.9%	1.8%	3.3%
<i>90 Day Treasury Bill</i>	2.6	4.6	4.8
<b>FIXED INCOME</b>	6.6%	7.7%	7.3%
<i>Lehman Aggregate Bond Index</i>	8.6	8.1	7.6
<b>U.S. EQUITY</b>	-16.9%	-7.7%	3.9%
<i>Wilshire 5000 Index</i>	-16.6	-8.2	3.6
<b>NON-U.S. EQUITY</b>	-7.4%	-3.7%	-1.8%
<i>MSCI ACWI Free (ex. U.S.) Index</i>	-8.2	-6.2	-1.7
<b>REAL ESTATE</b>	9.8%	11.6%	11.2%
<i>NCREIF Property Index + 200 basis points</i>	8.6	12.0	14.5
<b>PRIVATE EQUITY</b>	-12.9%	4.4%	8.9%
<i>S&amp;P 500 + 500 basis points</i>	-13.0	-4.2	8.7

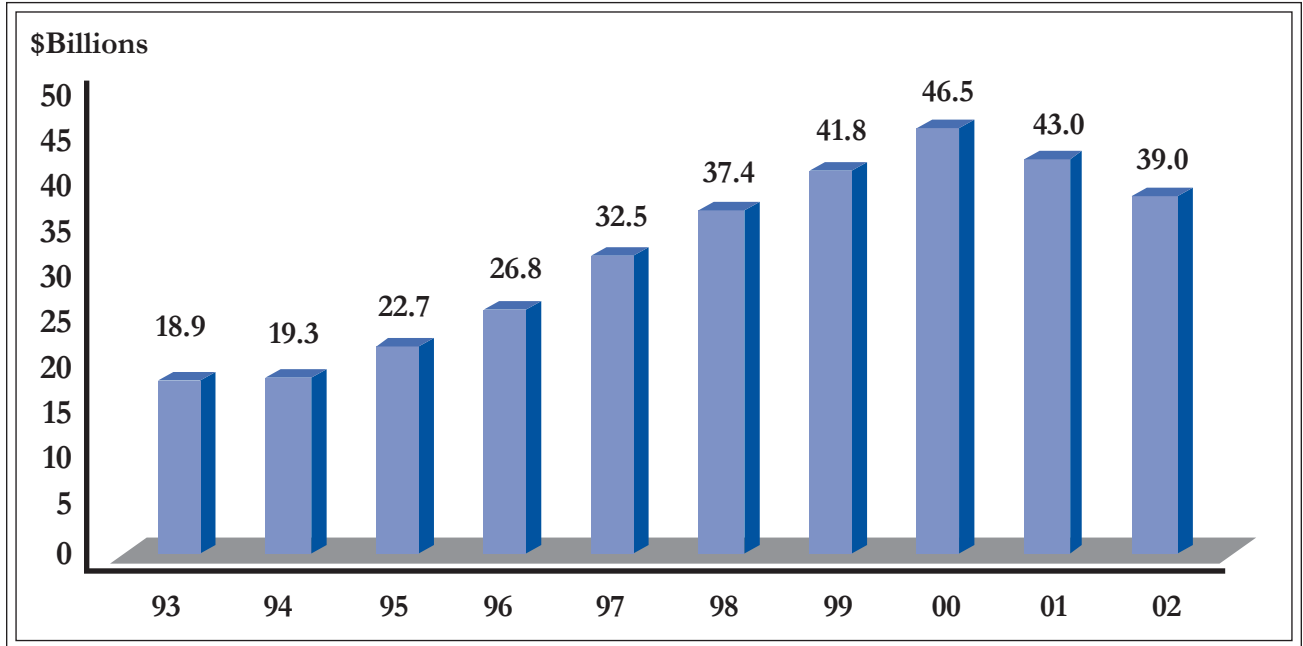
\* TUCS returns have been adjusted to reflect fees equivalent to those incurred by WSIB.



# INVESTMENT GROWTH AND RETURNS

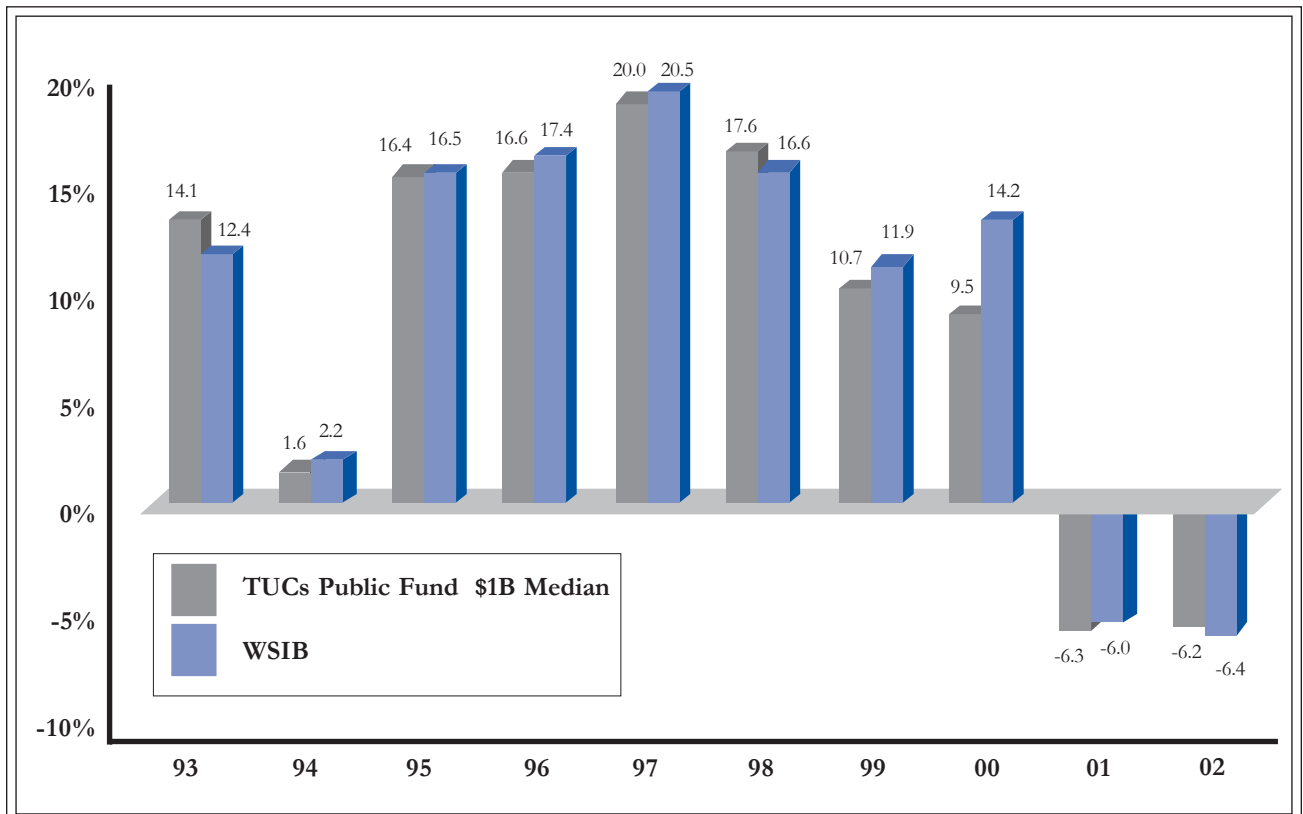
## RETIREMENT FUND HISTORICAL MARKET VALUES

*Fiscal years ending June 1993 to June 2002*



## RETIREMENT FUND HISTORICAL RATES OF RETURN

*Fiscal years ending June 1993 to June 2002*



## **ASSET ALLOCATION**

Asset allocation is the driver of investment performance. Research consistently shows that a plan's asset allocation explains over 90 percent of the variation in investment return. Accordingly, the WSIB spends considerable time and effort developing, monitoring, and adjusting the asset allocation of the retirement fund portfolio. To control the risk of the asset mix, the Board has established tight policy ranges around each asset class. By placing the fund's assets in several investment areas, the Board reduces the overall investment risk. The retirement fund is spread across five basic asset types. The following pages outline how each asset type is further diversified in line with the Board's mandate of a maximum rate of return at a prudent level of risk.

The Board has established a long-term plan based, in part, upon historical average investment returns. The Board formally reviews the plan every four years. The most recent asset allocation study was completed in the fourth quarter of 2001.

The actual asset mix is monitored continuously by staff and is reported monthly to the Board. The investment staff has directed several shifts during the fiscal year to move back toward the policy targets. This resulted in the fund taking profits at key times in the fixed income and non-U.S. equity markets. Both real estate and private equity have open contractual commitments to top tier investment partners that will move them toward their long-term targets over the next three to four years. As of June 30, 2002, private equity had open commitments of \$5.7 billion and real estate had open commitments of \$917 million. It is expected that these commitments will be called over the next three to four years. The capital to fund these commitments will most likely come from distributions received from previous investments, and then from U.S. and non-U.S. equity and the fixed income portfolio.

### **RETIREMENT COMMINGLED TRUST FUND**

*June 30, 2002*

<b>ASSET CLASS</b>		<b>ALLOCATION</b>		<b>LONG-TERM</b>	
		<b>IN 000'S</b>	<b>PERCENT</b>	<b>POLICY</b>	<b>POLICY</b>
				<b>TARGET</b>	<b>RANGE</b>
U.S. Equity	\$	12,970,632	33.3	31%	+/- 5%
Fixed Income		10,924,047	28.0	25%	+/- 4%
Non-U.S. Equity		5,848,133	15.0	15%	+/- 3%
Private Equity		5,124,981	13.1	17%	+/- 4%
Real Estate		3,610,785	9.3	12%	+/- 2%
Liquidity		498,488	1.3	0%	0-2%
<b>Total CTF</b>	<b>\$</b>	<b>38,977,066</b>			
<b>Plan Specific Investments*</b>	<b>\$</b>	<b>48,970</b>			
<b>Total Retirement Funds</b>	<b>\$</b>	<b>39,026,036</b>			

Unallocated funds targeted for Private Equity and Real Estate are invested in U.S. Equities and Fixed Income, respectively.

\* Plan-Specific Investments are short-term investment funds for each of the separate retirement plans.

---

## ***U.S. EQUITY PROGRAM***

---

### **THE PROGRAM**

The U.S. equity portfolio is structured to capture the returns of the broad U.S. equity market. The WSIB uses a passively-managed U.S. Equity Market Index Fund to provide broad market exposure similar to the Wilshire 5000 index. The index measures the performance of all U.S. headquartered equity securities with readily available price data. Over 5,800 capitalization-weighted security returns are used to calculate the index.

As of June 30, 2002, the defined benefit retirement funds had almost \$13 billion invested in the U.S. Equity Market Index Fund. Just over 78 percent of the portfolio consisted of large-capitalization (large-cap), S&P companies. The remaining 22 percent of the index was comprised of mid-capitalization and small-capitalization companies. Accordingly, the large-cap component of the WSIB U.S. equity portfolio totaled \$10.1 billion, while the small-/mid-cap component represented \$2.8 billion.

### **FISCAL YEAR HIGHLIGHTS**

Equity markets remained sluggish in the final half of 2001, as the market struggled to try to convince investors that the economy would recover by year-end. Consumer confidence, unemployment and Gross Domestic Product (GDP) reports pointed to weakness throughout third quarter 2001. Just when investors thought the damage couldn't get any worse, terrorist attacks knocked the already fragile U.S. economy down even further. The U.S. equity markets were closed for four consecutive days following the attacks, the longest trading disruption since the Great Depression. The S&P 500 fell 11.6 percent in the week the markets re-opened, which was the largest weekly decline since the Great Depression.

Some bargain-hunting took place in the final quarter of 2001, helping equities recover some of the losses. Investors started to see the initial stages of an economic recovery as durable goods orders and positive earnings announcements by select companies suggested the likelihood of a recovery in early 2002. However, investor confidence was further shaken when Enron shocked the market in December by filing the largest bankruptcy in U.S. history after revealing that it had vastly overstated its financial results by hiding losses.

The landscape briefly shifted early in 2002, as positive economic news signaled the potential end of the recession. However, corporate governance issues shattered investor confidence and pushed share prices even lower after several accounting scandals surfaced. First quarter GDP growth of 6.1 percent was not enough to accelerate the recovery. Consumer confidence and retail sales both turned negative, further jeopardizing prospects for a quick recovery. The Wilshire 5000 index ended the fiscal year down 16.6 percent. The Wilshire 4500 returned -13.3 percent during the last 12 months, while the S&P 500 declined 18 percent. The overall return of the WSIB's U.S. equity portfolio was -16.9 percent for the fiscal year.

# U.S. EQUITY PROGRAM

## U.S. EQUITY MARKET INDEX FUND DETAIL

*June 30, 2002*

### Top Ten Holdings

Issue Name	Fund (%)	Wilshire 5000 (%)
Microsoft Corporation	2.54	2.62
General Electric Company	2.48	2.55
Exxon Mobil Corporation	2.38	2.45
Wal-Mart Stores Inc.	2.10	2.16
Pfizer Inc.	1.87	1.93
Citigroup Inc.	1.71	1.76
American International Group Inc.	1.53	1.57
Johnson & Johnson	1.35	1.39
The Coca-Cola Company	1.19	1.23
International Business Machines Corporation	1.06	1.09

### Sector Diversification

Sector Type	Fund (%)	Wilshire 5000 (%)
Basic Materials	3.0	2.8
Communications	10.1	10.3
Consumer, Cyclical	11.3	11.4
Consumer, Non-cyclical	22.7	22.9
Diversified	0.0	0.0
Energy	7.1	6.3
Financial	21.5	21.7
Industrial	9.8	9.8
Technology	11.6	11.9
Utilities	2.9	2.9
Other	0.0	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>

### Fund Summary Statistics

Description	Statistic
Beta versus S&P 500	0.9
Fund yield (%)	1.49
Number of issues in fund	3,639

### Fund Makeup by Exchange

Exchange	Number of Companies	% of Fund Market Value
NYSE	1,694	81.3
Amex	464	0.5
NASDAQ	3,682	18.2



---

## ***NON-U.S. EQUITY PROGRAM***

---



### **THE PROGRAM**

As of June 30, 2002, the non-U.S. equity program totaled \$5.8 billion and represented 15.0 percent of the total retirement fund.

The non-U.S. equity program includes investments in both international developed and emerging markets. The program is benchmarked against the market value weighted, Morgan Stanley Capital International (MSCI) All Country World Free Index (ACWI), excluding the United States.

For the developed markets, the program has a 50 percent active/50 percent passive target mix. The program structure integrates all the developed markets international markets, using investment firms that manage money in Europe, Australia, and the Far East (EAFE), as well as Canada. The actively-managed portion of the developed markets program consists of six active international equity investment firms, which were hired in mid-1999: Artisan Partners, Delaware International Advisers, Dresdner RCM Global Investors, Nicholas Applegate Capital Management, Putnam Investments and Pyrford International. On an opportunistic basis, these firms also are allowed to invest up to ten percent of the assets in emerging markets. The other half of the developed markets program is invested passively by State Street Global Advisors, which replicates the MSCI EAFE + Canada index.

As of June 30, 2002, the emerging markets component was 9.2 percent of the Non-U.S. Equity Program and totaled approximately \$537 million. Four firms actively manage 78 percent of the emerging markets component: Capital International, F & C Emerging Markets, Grantam Mayo van Otterloo & Company, and Schroder Capital Management. State Street Global Advisors manages the remaining 22 percent of the emerging markets program, using a liquidity tier index strategy.

### **FISCAL YEAR HIGHLIGHTS**

Non-U.S. equity portfolio returns for fiscal year 2002 were a negative 7.3 percent, outperforming the MSCI ACWI ex U.S. index return of negative 8.3 percent. The WSIB's developed market portfolio's return of negative 7.9 percent outperformed the MSCI EAFE + Canada Index return of negative 9.4 percent. Strength in the Pacific region and the decline in the U.S. dollar helped to support returns from these markets, relative to domestic market returns.

Emerging markets performed better than developed markets during the fiscal year ending June 30, 2002. However, the WSIB's total emerging market portfolio return of negative 1.1 percent under-performed the IFC Investable Index of positive 3.7 percent. The Board has approved a change in the emerging markets benchmark, for fiscal year 2003, to the MSCI Emerging Markets Free Index. This will standardize the international benchmarks to the MSCI family of indexes.

---

# NON-U.S. EQUITY PROGRAM

---

## ALLOCATION TO NON-U.S. EQUITY

June 30, 2002

DEVELOPED MARKETS	MARKET VALUE (IN 000'S)
<b>Active Managers</b>	
Artisan Partners	\$ 357,768
Delaware International Advisors	747,129
Dresdner RCM Global Investors	449,168
Nicholas Applegate Capital Management	226,013
Putnam Investments	569,718
Pyrford International PLC	<u>289,061</u>
Total Active	\$ 2,638,857
<b>Passive Manager</b>	
State Street Global Advisors	<u>\$ 2,672,374</u>
<b>Total Developed Markets</b>	<u>\$ 5,311,231</u>
<b>EMERGING MARKETS</b>	
<b>Active Emerging Markets Managers</b>	
Capital International Inc.	\$ 130,974
F & C Emerging Markets, Ltd.	90,481
Grantham Mayo van Otterloo & Co.	113,486
Schroder Capital Management	<u>86,509</u>
Total Active Emerging Markets	\$ 421,450
<b>Passive Manager</b>	
State Street Global Advisors	<u>\$ 115,452</u>
<b>Total Emerging Markets</b>	<u>\$ 536,902</u>
<b>TOTAL NON-U.S. EQUITY</b>	<u><u>\$ 5,848,133</u></u>

---

## ***FIXED INCOME PROGRAM***

---

### **THE PROGRAM**

Fixed income securities constitute an important component of the portfolios of most institutional investors. Several factors make these instruments attractive in a pension portfolio. Fixed income securities offer diversification from a pure equity portfolio and represent an excellent source of liquidity. Less risky than equities, fixed income securities help control the overall portfolio volatility.

The domestic fixed income program is internally managed by WSIB staff with the Lehman Aggregate Index as the performance benchmark (the performance benchmark will be changed to the Lehman Universal Index effective July 1, 2002). The WSIB may invest in the following fixed income instruments:

- U.S. treasuries (TSY) and government agencies (Agency)
- Treasury inflation protection securities (TIPS)
- Investment-grade and high-yield credit bonds
- Publicly traded mortgage-backed securities (MTG)
- Commercial mortgage-backed securities (CMBS)
- Privately-placed mortgages
- Private placements of corporate debt
- Convertible securities
- Non-dollar bonds
- Asset-backed securities (ABS)
- Real estate mortgages

The fixed income management strategy is primarily one of sector selection. The portfolio is structured to be overweighted or underweighted relative to the index's major sectors: Treasuries, Agencies, Credits, MTG and ABS. As of June 30, 2002, the portfolio was underweighted relative to the index in Governments and Mortgages, and overweighted in Credits and CMBS.

Not only is the total mortgage allocation lower than that of the index, about 70 percent of the mortgages are comprised of collateralized mortgage obligations (CMOs), whose structure provides more stable cash flows than standard pass-through mortgages.

Individual sector structures may also be overweighted or underweighted relative to that of the index. For example, the corporate portfolio's allocation to industry and credit rating differs from the index, as do the mortgage portfolio's allocation to coupon and maturity.

Treasury and Agency debt have the highest credit rating since they are backed by either the U.S. Treasury or governmental agencies. Most mortgage debt has agency equivalent ratings, but some structured product held may be Aaa or Aa. Investment grade corporate debt ranges from Aaa (the highest) to Baa (the lowest). More than 40 percent of all investment-grade corporate debt issued is A rated. The portfolio's overall credit allocation reflects its large allocation to corporates, its corporate concentration in Baa-rated companies, and the mortgage allocation to Agency and Aaa-rated structured mortgage product.

---

## ***FIXED INCOME PROGRAM***

---

### **FISCAL YEAR HIGHLIGHTS**

Fixed income markets were plagued by uncertainty during fiscal year 2002. The questions regarding terrorism, the macro economy, earnings, accounting fraud and management ethics compelled a flight to quality. As a result, U.S. Treasury securities dramatically outperformed credit bonds.

The WSIB's fixed income portfolio under-performed its benchmark, the Lehman Aggregate Index, by two percent for the fiscal year, returning 6.6 percent to the index's return of 8.6 percent. Credit bonds, which were the portfolio's largest allocation, returned 3.1 percent, compared to the 7.5 percent for the index's credit allocation.

The portfolio's allocation to credit bonds started the year at 58 percent, but was reduced to 44 percent by the end of the fiscal year in reaction to the turbulent credit market. The portfolio's allocation shifted to TIPS and to treasuries. TIPS started the fiscal year with an allocation of just four percent, but ended at about 12 percent. Treasuries started the fiscal year with an allocation of seven percent and ended at about 14 percent. TIPS posted a return for the fiscal year of 9.8 percent, while Treasuries returned 7.2 percent. WSIB's mortgage allocation returned 10.5 percent, while the index's mortgage allocation returned nine percent.

During the fiscal year, the WSIB portfolio's duration averaged about ten percent longer than the duration of the Lehman Aggregate Index, and finished the fiscal year with a duration eight percent longer than that of the index.

### **ALLOCATION TO FIXED INCOME**

*June 30, 2002*

<b>SECTOR</b>	<b>MARKET VALUE (In \$000's)</b>
<b>Cash</b>	<u>\$ 172,760</u>
<b>Long - Term</b>	
U.S. Treasuries	1,498,309
TIPS	1,256,563
Agencies	376,359
Credit	4,808,165
Asset-Backed	137,830
CMBS	768,581
Mortgages	<u>1,905,481</u>
<b>Total Long - Term</b>	<u>\$ 10,751,287</u>
<b>Total Fixed Income</b>	<u><u>\$ 10,924,047</u></u>

# FIXED INCOME PROGRAM

## CHARACTERISTICS OF THE FIXED INCOME PORTFOLIO

*June 30, 2002*

Sector Distribution	WSIB Portfolio	Lehman Aggregate Index
Cash	1.6%	0.0%
Treasury	13.7%	21.0%
TIPS	11.5%	0.0%
Agency	3.4%	12.4%
Credit	44.0%	26.3%
Asset-Backed	1.3%	1.7%
CMBS	7.0%	2.2%
Mortgages	17.4%	36.4%
	<u>100.0%</u>	<u>100.0%</u>

Top Ten Issuers	
Market Value – June 30, 2002	
\$000	
United States Treasury	\$ 2,755,423
FNMA Structured Mortgages	\$ 594,463
FHLMC Structured Mortgages	\$ 450,931
FNMA Agency Bonds	\$ 250,802
Morgan Stanley CMBS	\$ 172,450
General Electric Capital CMO	\$ 160,144
Pemex & Pemex Finance	\$ 157,054
GMAC	\$ 149,814
First Union CMBS	\$ 140,575
RFMSI CMO	\$ 139,009

Credit Distribution	WSIB Portfolio	Lehman Aggregate Index
TSY	25.2%	21.2%
AGY	14.4%	48.5%
Aaa	17.0%	5.8%
Aa	4.2%	4.8%
A	11.2%	9.9%
Baa	23.5%	9.8%
Other	4.5%	0.0%
	<u>100.0%</u>	<u>100.0%</u>

*Moody's credit ratings*

Coupon Distribution	WSIB Portfolio	Lehman Aggregate Index
0 – 4.9%	16.7%	9.8%
5 – 6.9%	44.4%	54.5%
7 – 7.9%	24.0%	23.9%
8 – 8.9%	8.2%	8.0%
9 – 9.9%	3.4%	1.9%
10+%	3.4%	1.9%
	<u>100.0%</u>	<u>100.0%</u>

Maturity Distribution	WSIB Portfolio	Lehman Aggregate Index
0 – 1 Year	3.8%	0.1%
1 – 3 Years	14.7%	21.0%
3 – 5 Years	15.7%	25.7%
5 – 7 Years	20.0%	23.2%
7 – 10 Years	24.1%	14.9%
10 – 15 Years	5.1%	2.6%
15 – 20 Years	3.3%	4.0%
20 – 25 Years	3.6%	3.3%
25+ Years	9.8%	5.2%
	<u>100.0%</u>	<u>100.0%</u>

Effective Duration	WSIB Portfolio	Lehman Aggregate Index
	4.4%	1.8%
0 – 1 Years	25.0%	33.7%
1 – 3 Years	20.1%	24.8%
3 – 4 Years	22.6%	18.2%
4 – 6 Years	17.3%	8.5%
6 – 8 Years	10.6%	13.0%
8+ Years	100.0%	100.0%

# FIXED INCOME PROGRAM

## CREDIT SECTOR DETAIL

*June 30, 2002*

<b>Top Ten Credit Holdings</b>	
Market Value – June 30, 2002	
\$000	
Albertson's Inc. – 8/01/09	\$79,386
GMAC – 7/15/05	\$56,341
U.S. Bank – 7/15/08	\$54,177
Pemex – 10/13/10	\$53,489
Washington Mutual – 4/01/10	\$51,811
Vale Overseas – 3/08/07	\$48,289
Pemex Finance – 8/15/17	\$48,158
Household Finance – 1/30/07	\$47,555
Petrobras Int'l. Finance – 7/06/11	\$47,379
Utilicorp United – 7/15/04	\$47,057

<b>Top Ten Credit Issuers</b>	
Market Value – June 30, 2002	
\$000	
Pemex & Pemex Finance	\$157,054
GMAC	\$149,814
Norfolk Southern	\$126,083
Williams Companies	\$125,209
Republic of Brazil	\$117,216
Union Pacific Corporation	\$102,069
Albertson's Inc.	\$89,961
Sprint Capital Corporation	\$85,080
El Paso Energy Corporation	\$82,759
CSX Corporation	\$78,642

Sector Distribution	WSIB Credit	Lehman Agg Credit
Industrial	48.4%	9.7%
Utilities	15.5%	18.1%
Financial	24.4%	36.7%
Non-Corporate	11.7%	35.5%
	<u>100.0%</u>	<u>100.0%</u>

Coupon Distribution	WSIB Credit	Lehman Agg Credit
0 - 4.9%	16.7%	9.8%
5 - 6.9%	44.4%	54.5%
7 - 7.9%	24.0%	23.9%
8 - 8.9%	8.2%	8.0%
9 - 9.9%	3.4%	1.9%
10+%	3.4%	1.9%
	<u>100.0%</u>	<u>100.0%</u>

Credit Distribution	WSIB Credit	Lehman Agg Credit
Aaa	1.3%	9.7%
Aa	9.5%	18.1%
A	25.6%	36.7%
Baa	53.4%	35.5%
Other	10.2%	0.0%
	<u>100.0%</u>	<u>100.0%</u>

*Moody's credit ratings*

Maturity Distribution	WSIB Credit	Lehman Agg Credit
0 – 1 Year	2.6%	14.1%
1 – 3 Years	11.5%	24.3%
3 – 5 Years	24.3%	11.9%
5 – 7 Years	11.9%	25.8%
7 – 10 Years	25.8%	3.6%
10 – 15 Years	3.6%	6.2%
15 – 20 Years	6.2%	4.9%
20 – 25 Years	4.9%	9.2%
25+ Years	9.2%	0.0%
	<u>100.0%</u>	<u>100.0%</u>

Effective Duration	WSIB Credit	Lehman Agg Credit
0 – 1 Years	2.6%	0.1%
1 – 3 Years	17.7%	22.4%
3 – 4 Years	18.2%	16.7%
4 – 6 Years	25.9%	22.2%
6 – 8 Years	18.8%	19.8%
8+ Years	16.8%	18.8%
	<u>100.0%</u>	<u>100.0%</u>



---

# PRIVATE EQUITY PROGRAM

---

## THE PROGRAM

Private equity investments range from leveraged buyouts of corporations to the investment of initial capital in start-up enterprises. These investments are illiquid and very long-term in nature (up to 12 years or more). They are attractive to long-term institutional investors, because over long time horizons private equity investment can offer higher returns than traditional public equity investments.

The objective of the WSIB's private equity portfolio is to achieve, over the long term, annualized returns of 400 to 600 basis points (or four to six percent) above the S&P 500 index. The WSIB's asset allocation target for private equity is 17 percent of the total retirement fund. Over the past fiscal year, the Board committed nearly \$2.2 billion to private equity partnerships. The portfolio decreased in value from \$5.73 billion to \$5.12 billion during the past fiscal year, representing 13.1 percent of the retirement fund at fiscal year-end.

The portfolio is well-diversified by stage of investment, company size, and geographic location. Due to the long-term and private nature of these investments, the valuations of these investments are based on conservative estimates. The true return on investment can only be accurately measured upon liquidation of the investment. Many investments are carried at original cost for considerable periods, until some event allows for the estimation of a market value. Such events would include an initial public offering, a subsequent round of financing or a commitment to purchase the investment. The valuations contained in this report are made by the general partners, and reviewed by the WSIB consultants and staff in accordance with currently accepted accounting practices.

Since the inception of the program in 1981, the fund has achieved an annual 14.1 percent internal rate of return (IRR), which is net of partnership fees and expenses. The IRR calculation is the industry standard method for investment performance. Time weighted returns, which represent performance independent of the timing of cash flows, are also calculated for the asset class. The time-weighted return for fiscal year 2001 was -12.9 percent.

## ALLOCATION TO PRIVATE EQUITY

*June 30, 2002*

SUB-ASSET CLASS	MARKET VALUE (In \$000's)	% of Private Equity
Large Corporate Finance	\$2,038,773	39.8%
Venture Capital	810,174	15.8%
International	731,972	14.3%
Distressed	480,657	9.4%
Small/Medium Corporate Finance	397,677	7.7%
Mezzanine	291,589	5.7%
Other	374,139	7.3%
<b>Total Private Equity</b>	<b>\$5,124,981</b>	<b>100.0%</b>

---

## ***REAL ESTATE PROGRAM***

---

### **THE PROGRAM**

The WSIB's real estate program is an externally managed pool of select partnership investments, intended to provide alternative portfolio characteristics when compared to traditional stock and bond investments. The majority of the WSIB's partnerships invest in institutional-quality real estate assets that are leased to third parties. The combination of income generated from bond-like lease payments, coupled with the hard asset qualities of commercial real estate, combine to generate returns that are expected to fall between the return expectations for fixed income and equities. The real estate portfolio is managed to deliver risk-adjusted returns that are consistent with the Board's long-term return expectations for the asset class. The WSIB's real estate partnerships typically invest in private real estate assets that are held for long-term income and appreciation. Many of the WSIB's investment partnerships do not involve co-investment with other financial entities, thereby providing the WSIB with control provisions related to liquidation, acquisition, and ongoing operational decisions such as annual capital expenditures.

Volatility within the real estate portfolio is minimized through a combination of factors. First, the majority of the WSIB's partners own commercial real estate assets in a private investment form, which is not subject to public market volatility. Second, real estate capital is diversified among a host of partners with varying investment styles. Third, partnership assets are invested in numerous economic regions, including international markets, and in various property types. Fourth, WSIB partners invest at different points within the asset's capital structure and life cycle.

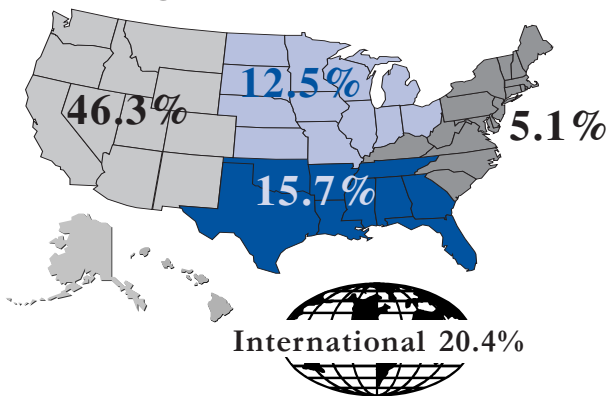
The WSIB's current return objective for real estate calls for a target benchmark return of 100 to 300 basis points (or one to three percent) above the NCREIF index. The portfolio's value remained constant at \$3.6 billion during the past fiscal year, and represented 9.3 percent of the total retirement fund. In November, 2001, the board completed an asset allocation study for the retirement fund which raised the long-term target allocation to real estate from nine percent to 12 percent. It is anticipated that this new allocation target will be met by the end of 2005.

### **FISCAL YEAR HIGHLIGHTS**

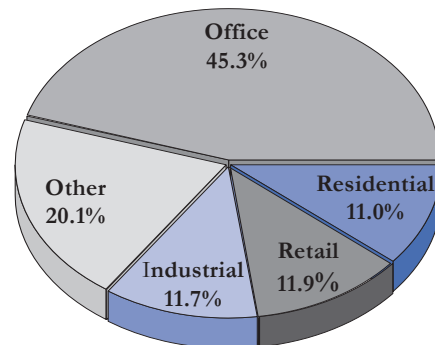
Despite a slowing domestic economy, real estate performance posted attractive risk-adjusted returns. For the one-year period ending June 30, 2002, the WSIB's real estate portfolio significantly outperformed the NCREIF Index, 9.8 percent to 6.6 percent.

# REAL ESTATE PROGRAM

**Regional Distribution**



**Asset Type Distribution**



## ESTIMATED REAL ESTATE VALUE

*June 30, 2002*

ADVISOR / PARTNER	INVESTMENT	MARKET VALUE (In \$000's)
PM Realty Advisors	America West II	\$ 192
Pacific Realty Associates	Pactrust	296,315
Pacific Realty Associates	Pac-SIB	185,175
Lowe Enterprises	Union Square	393,509
Lowe Enterprises	Lowe NW	314,007
JE Robert Companies	JER Fund I	75,365
Sentinel Realty Advisors	SREF	6,345
Security Capital	Security Capital Group	53,264
TA Associates	Olympia Properties	382,304
Morgan Stanley	MSREF III International	106,590
Morgan Stanley	MSREF IV International	95,063
Morgan Stanley	MSSS	1,468
Taylor Simpson Group	MCPI	99,762
Hudson Advisors	Lonestar I	18,252
Hudson Advisors	Lonestar II	69,078
Hudson Advisors	Lonestar III	287,439
Hudson Advisors	Lonestar IV	7,194
Hancock Nat. Res. Group	ForesTree Washington	76,549
Hearthstone	Hearthstone Olympia Homebuilding Partners	-3,872
Hearthstone	MSII	21,496
Transwestern	Home Town America	41,554
PRICOA	European Investor Properties	198,693
Cherokee Investment Services	Cherokee Investment Partners II	58,033
ING Realty Associates	ING Realty Partners	84,423
Principal Financial	Principal Enterprise Capital	427,050
Campbell Group	Hawthorne Timber Company	306,282
<b>Total Investment Holdings</b>		<b>\$ 3,601,530</b>
<b>Net Accruals</b>		<b>\$ 9,255</b>
<b>Total Real Estate Equity</b>		<b>\$ 3,610,785</b>

## ***DEFINED CONTRIBUTION RETIREMENT FUNDS***

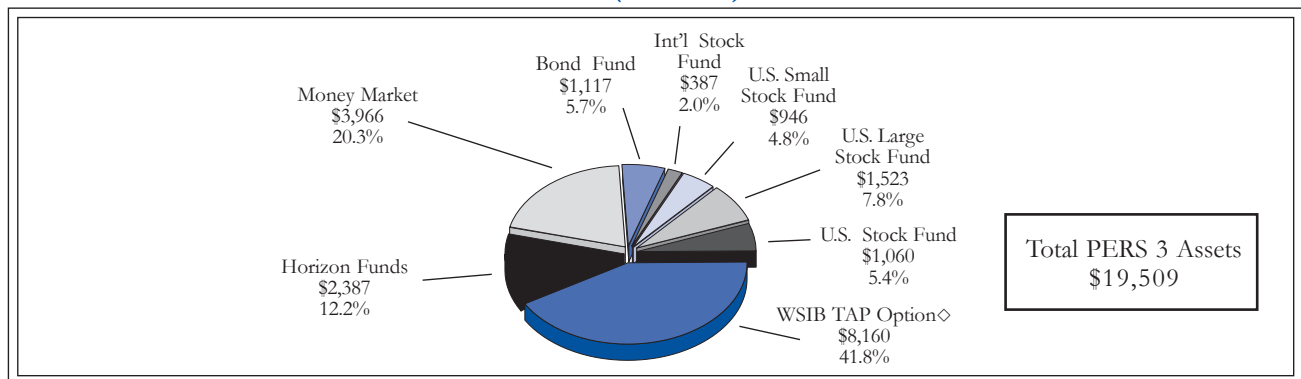
- **Public Employees' Retirement System Plan 3**
- **School Employees' Retirement System Plan 3**
- **Teachers' Retirement System Plan 3**
- **Judicial Retirement Account**



## PUBLIC EMPLOYEES' RETIREMENT SYSTEM PLAN 3

The WSIB is Trustee of the Public Employees' Retirement System (PERS) Plan 3. The WSIB is responsible for the investment of PERS Plan 3 assets and for the provision of self-directed investment options to members of the plan. The DRS is responsible for plan administration, accounting, and record-keeping. PERS Plan 3 is the newest of the state's hybrid defined contribution retirement plans. PERS Plan 3 began March 1, 2002, with the first transfer period (for state and higher education employees) running from March 1 through August 31, 2002. The transfer period for local government employees will run from September 1, 2002, through May 31, 2003.

### PERS Plan 3 Defined Contribution Assets and Performance June 30, 2002 (In \$000's)



◇ The WSIB Total Allocation Portfolio (TAP) option, the statutory default option for PERS Plan 3, is invested in the Retirement Commingled Trust Fund. These moneys are included in the total for Retirement Funds shown elsewhere in this report. The remaining options are shown elsewhere in this report as self-directed defined contribution funds.

FUND PERFORMANCE	ONE-YEAR	THREE-YEAR	FIVE-YEAR
<b>WSIB TAP Option</b> <i>Custom Benchmark*</i>	-5.2% -9.2%	0.1% -4.0%	5.6% 3.5%
<b>Short-Horizon Fund</b> <i>Custom Benchmark‡</i>	-0.2% -0.1%	** 2.7%	** 5.5%
<b>Mid-Horizon Fund</b> <i>Custom Benchmark‡</i>	-4.6% -4.5%	** -0.4%	** 4.9%
<b>Long-Horizon Fund</b> <i>Custom Benchmark‡</i>	-10.4% -10.2%	** -4.5%	** 3.6%
<b>U.S. Stock Fund</b> <i>Russell 3000 Index</i>	-17.4% -17.2%	** -7.9%	** 3.8%
<b>U.S. Large Stock Fund</b> <i>S &amp; P 500 Index</i>	-18.0% -18.0%	-9.2% -9.2%	3.7% 3.7%
<b>U.S. Small Stock Fund</b> <i>Russell 2000 Index</i>	-8.4% -8.6%	1.9% 1.7%	** 4.4%
<b>International Stock Fund</b> <i>MSCI EAFE Index</i>	-10.1% -9.5%	-7.4% -6.8%	-1.8% -1.6%
<b>Bond Fund</b> <i>Lehman Intermediate Credit</i>	7.6% 7.7%	** 7.7%	** 7.1%
<b>Money Market</b> <i>90 Day T-Bill</i>	3.0% 2.6%	5.1% 4.6%	5.3% 4.8%

\* TAP Custom Benchmark: 60% Wilshire 5000 + 25% Lehman Aggregate + 15% MSCI ACWI Free ex U.S.

‡ Horizon Fund Custom Benchmarks: **Short** - 46% Lehman Intermediate Credit + 25% London Interbank Offered Rate + 19% Wilshire 5000 + 10% MSCI EAFE; **Mid** - 46% Lehman Intermediate Credit + 38% Wilshire 5000 + 16% MSCI EAFE; **Long** - 58% Wilshire 5000 + 22% MSCI EAFE + 20% Lehman Intermediate Credit.

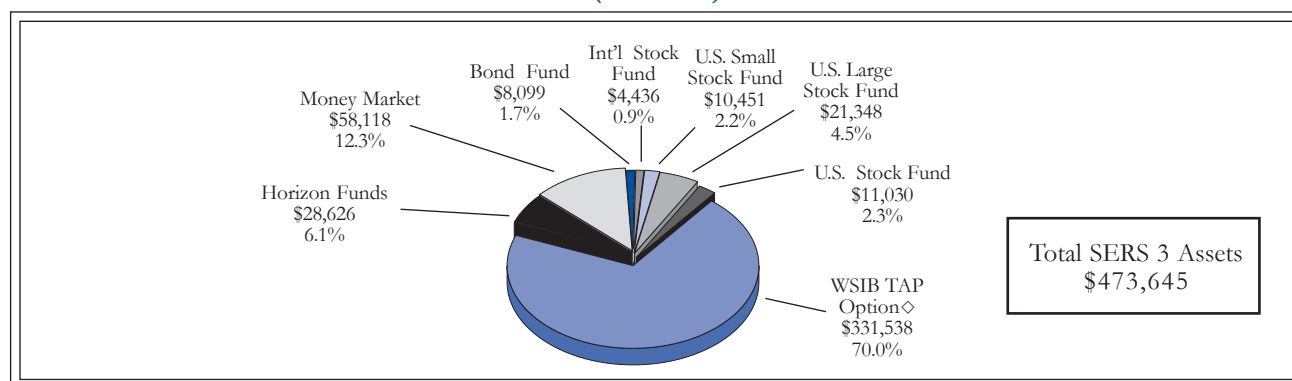
\*\* Fund has not been in existence long enough to provide performance figures for these dates.



## SCHOOL EMPLOYEES' RETIREMENT SYSTEM PLAN 3

The WSIB is Trustee of the School Employees' Retirement System (SERS) Plan 3. The WSIB is responsible for the investment of SERS Plan 3 assets and for the provision of self-directed investment options to members of the plan. The DRS is responsible for plan administration, accounting, and record-keeping.

### SERS Plan 3 Defined Contribution Assets and Performance June 30, 2002 (In \$000's)



◇ The WSIB Total Allocation Portfolio (TAP) option, the statutory default option for SERS Plan 3, is invested in the Retirement Commingled Trust Fund. These moneys are included in the total for Retirement Funds shown elsewhere in this report. The remaining options are shown elsewhere in this report as self-directed defined contribution funds.

FUND PERFORMANCE	ONE-YEAR	THREE-YEAR	FIVE-YEAR
<b>WSIB TAP Option</b> <i>Custom Benchmark*</i>	-5.2% -9.2%	0.1% -4.0%	5.6% 3.5%
<b>Short-Horizon Fund</b> <i>Custom Benchmark‡</i>	-0.2% -0.1%	** 2.7%	** 5.5%
<b>Mid-Horizon Fund</b> <i>Custom Benchmark‡</i>	-4.6% -4.5%	** -0.4%	** 4.9%
<b>Long-Horizon Fund</b> <i>Custom Benchmark‡</i>	-10.4% -10.2%	** -4.5%	** 3.6%
<b>U.S. Stock Fund</b> <i>Russell 3000 Index</i>	-17.4% -17.2%	** -7.9%	** 3.8%
<b>U.S. Large Stock Fund</b> <i>S &amp; P 500 Index</i>	-18.0% -18.0%	-9.2% -9.2%	3.7% 3.7%
<b>U.S. Small Stock Fund</b> <i>Russell 2000 Index</i>	-8.4% -8.6%	1.9% 1.7%	** 4.4%
<b>International Stock Fund</b> <i>MSCI EAFE Index</i>	-10.1% -9.5%	-7.4% -6.8%	-1.8% -1.6%
<b>Bond Fund</b> <i>Lehman Intermediate Credit</i>	7.6% 7.7%	** 7.7%	** 7.1%
<b>Money Market</b> <i>90 Day T-Bill</i>	3.0% 2.6%	5.1% 4.6%	5.3% 4.8%

\* TAP Custom Benchmark: 60% Wilshire 5000 + 25% Lehman Aggregate + 15% MSCI ACWI Free ex U.S.

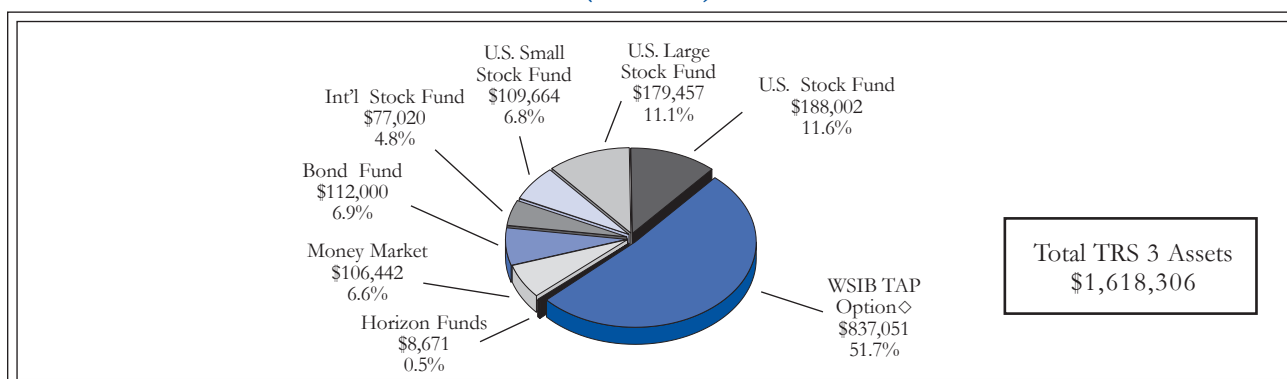
‡ Horizon Fund Custom Benchmarks: **Short** - 46% Lehman Intermediate Credit + 25% London Interbank Offered Rate + 19% Wilshire 5000 + 10% MSCI EAFE; **Mid** - 46% Lehman Intermediate Credit + 38% Wilshire 5000 + 16% MSCI EAFE; **Long** - 58% Wilshire 5000 + 22% MSCI EAFE + 20% Lehman Intermediate Credit.

\*\* Fund has not been in existence long enough to provide performance figures for these dates.

# TEACHERS' RETIREMENT SYSTEM PLAN 3

The WSIB is Trustee of the Teachers' Retirement System (TRS) Plan 3. The WSIB is responsible for the investment of TRS Plan 3 assets and for the provision of self-directed investment options to members of the plan. The DRS is responsible for plan administration, accounting, and record-keeping.

## TRS Plan 3 Defined Contribution Assets and Performance June 30, 2002 (In \$000's)



◇ The WSIB Total Allocation Portfolio (TAP) option, the statutory default option for TRS Plan 3, is invested in the Retirement Commingled Trust Fund. These moneys are included in the total for Retirement Funds shown elsewhere in this report. The remaining options are shown elsewhere in this report as self-directed defined contribution funds.

FUND PERFORMANCE	ONE-YEAR	THREE-YEAR	FIVE-YEAR
<b>WSIB TAP Option</b> <i>Custom Benchmark*</i>	-5.2% -9.2%	0.1% -4.0%	5.6% 3.5%
<b>Short-Horizon Fund</b> <i>Custom Benchmark‡</i>	-0.2% -0.1%	** 2.7%	** 5.5%
<b>Mid-Horizon Fund</b> <i>Custom Benchmark‡</i>	-4.6% -4.5%	** -0.4%	** 4.9%
<b>Long-Horizon Fund</b> <i>Custom Benchmark‡</i>	-10.4% -10.2%	** -4.5%	** 3.6%
<b>U.S. Stock Fund</b> <i>Russell 3000 Index</i>	-17.4% -17.2%	** -7.9%	** 3.8%
<b>U.S. Large Stock Fund</b> <i>S &amp; P 500 Index</i>	-18.0% -18.0%	-9.2% -9.2%	3.7% 3.7%
<b>U.S. Small Stock Fund</b> <i>Russell 2000 Index</i>	-8.4% -8.6%	1.9% 1.7%	** 4.4%
<b>International Stock Fund</b> <i>MSCI EAFE Index</i>	-10.1% -9.5%	-7.4% -6.8%	-1.8% -1.6%
<b>Bond Fund</b> <i>Lehman Intermediate Credit</i>	7.6% 7.7%	** 7.7%	** 7.1%
<b>Money Market</b> <i>90 Day T-Bill</i>	3.0% 2.6%	5.1% 4.6%	5.3% 4.8%

\* TAP Custom Benchmark: 60% Wilshire 5000 + 25% Lehman Aggregate + 15% MSCI ACWI Free ex U.S.

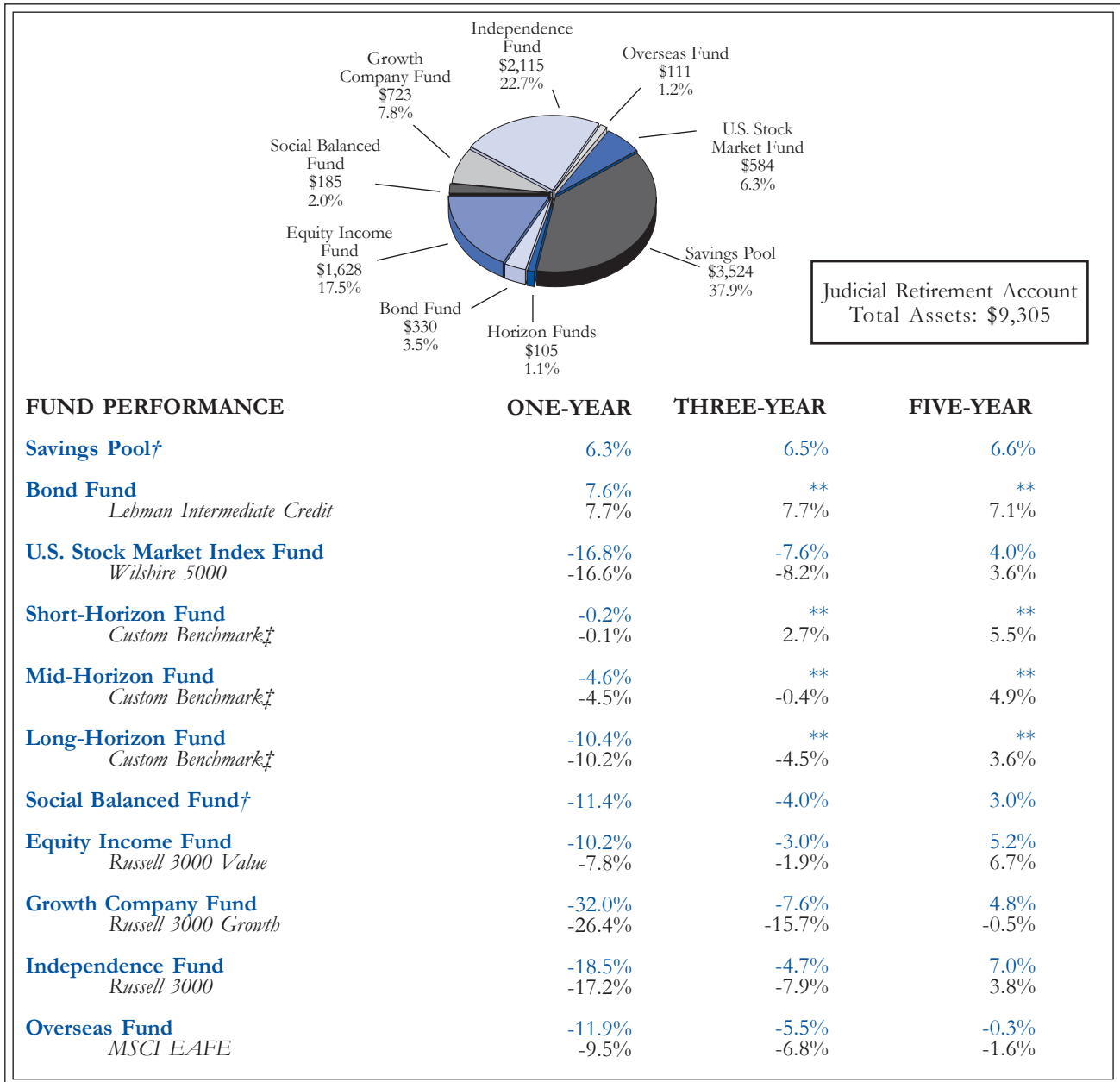
‡ Horizon Fund Custom Benchmarks: **Short** - 46% Lehman Intermediate Credit + 25% London Interbank Offered Rate + 19% Wilshire 5000 + 10% MSCI EAFE; **Mid** - 46% Lehman Intermediate Credit + 38% Wilshire 5000 + 16% MSCI EAFE; **Long** - 58% Wilshire 5000 + 22% MSCI EAFE + 20% Lehman Intermediate Credit.

\*\* Fund has not been in existence long enough to provide performance figures for these dates.

# JUDICIAL RETIREMENT ACCOUNT

The Judicial Retirement Account is a defined contribution supplemental retirement fund for state judges. Investments are self-directed by participants in the Judges' Supplemental Retirement Program, utilizing the Deferred Compensation Program investment options offered by the WSIB. The fund is administered by the Office of the Administrator for the Courts while the DRS is responsible for plan accounting and record-keeping.

## Judicial Retirement Account Assets and Performance June 30, 2002 (In \$000's)



FUND PERFORMANCE	ONE-YEAR	THREE-YEAR	FIVE-YEAR
<b>Savings Pool</b> <sup>†</sup>	6.3%	6.5%	6.6%
<b>Bond Fund</b> <i>Lehman Intermediate Credit</i>	7.6%	**	**
	7.7%	7.7%	7.1%
<b>U.S. Stock Market Index Fund</b> <i>Wilshire 5000</i>	-16.8%	-7.6%	4.0%
	-16.6%	-8.2%	3.6%
<b>Short-Horizon Fund</b> <i>Custom Benchmark</i> <sup>‡</sup>	-0.2%	**	**
	-0.1%	2.7%	5.5%
<b>Mid-Horizon Fund</b> <i>Custom Benchmark</i> <sup>‡</sup>	-4.6%	**	**
	-4.5%	-0.4%	4.9%
<b>Long-Horizon Fund</b> <i>Custom Benchmark</i> <sup>‡</sup>	-10.4%	**	**
	-10.2%	-4.5%	3.6%
<b>Social Balanced Fund</b> <sup>†</sup>	-11.4%	-4.0%	3.0%
<b>Equity Income Fund</b> <i>Russell 3000 Value</i>	-10.2%	-3.0%	5.2%
	-7.8%	-1.9%	6.7%
<b>Growth Company Fund</b> <i>Russell 3000 Growth</i>	-32.0%	-7.6%	4.8%
	-26.4%	-15.7%	-0.5%
<b>Independence Fund</b> <i>Russell 3000</i>	-18.5%	-4.7%	7.0%
	-17.2%	-7.9%	3.8%
<b>Overseas Fund</b> <i>MSCI EAFE</i>	-11.9%	-5.5%	-0.3%
	-9.5%	-6.8%	-1.6%

<sup>†</sup> Fund has no readily accessible comparative index to use as a benchmark.

<sup>‡</sup> Horizon Fund Custom Benchmarks: **Short** - 46% Lehman Intermediate Credit + 25% London Interbank Offered Rate + 19% Wilshire 5000 + 10% MSCI EAFE; **Mid** - 46% Lehman Intermediate Credit + 38% Wilshire 5000 + 16% MSCI EAFE; **Long** - 58% Wilshire 5000 + 22% MSCI EAFE + 20% Lehman Intermediate Credit.

\*\* Fund has not been in existence long enough to provide performance figures for these dates.

## ***DEFERRED COMPENSATION PROGRAM***

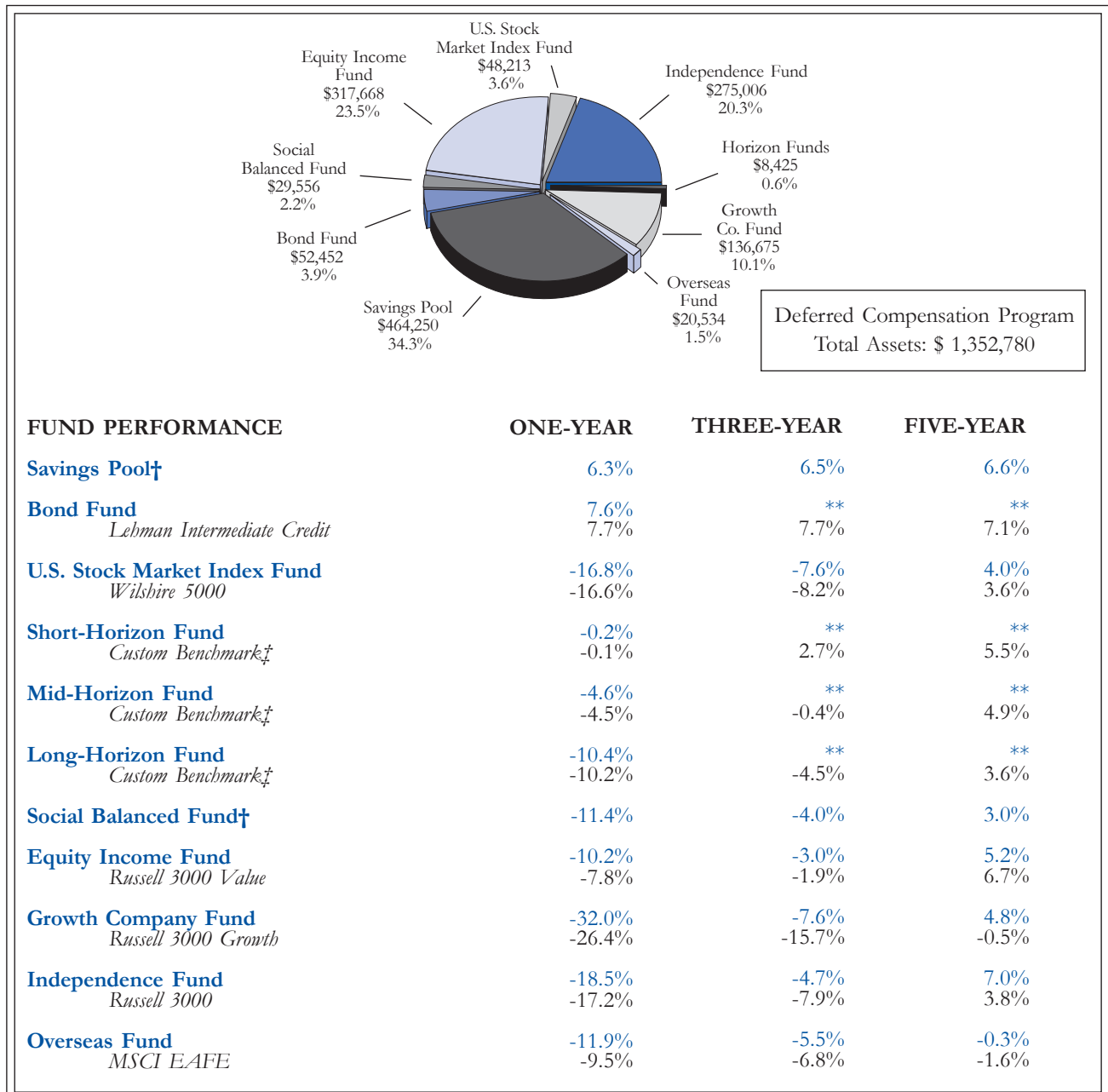
- **Savings Pool**
- **Bond Fund**
- **U.S. Stock Market Index Fund**
- **Horizon Funds**
- **Social Balanced Fund**
- **Equity Income Fund**
- **Growth Company Fund**
- **Independence Fund**
- **Overseas Fund**



# DEFERRED COMPENSATION PROGRAM

The WSIB is Trustee of State Deferred Compensation Program assets. The WSIB is responsible for the investment of State Deferred Compensation funds and for the provision of investment options to participants in the program. The DRS is responsible for Deferred Compensation Program administration, accounting, and record-keeping.

## Deferred Compensation Program Assets and Performance June 30, 2002 (In \$000's)



† Fund has no readily accessible comparative index to use as a benchmark.

‡ Horizon Fund Custom Benchmarks: **Short** - 46% Lehman Intermediate Credit + 25% London Interbank Offered Rate + 19% Wilshire 5000 + 10% MSCI EAFE; **Mid** - 46% Lehman Intermediate Credit + 38% Wilshire 5000 + 16% MSCI EAFE; **Long** - 58% Wilshire 5000 + 22% MSCI EAFE + 20% Lehman Intermediate Credit.

\*\* Fund has not been in existence long enough to provide performance figures for these dates.





***WSIB DAILY-MANAGED FUNDS  
FOR SELF-DIRECTED INVESTMENT PROGRAMS***

- **Washington State Horizon Funds**
- **Washington State Bond Fund**
- **Savings Pool**

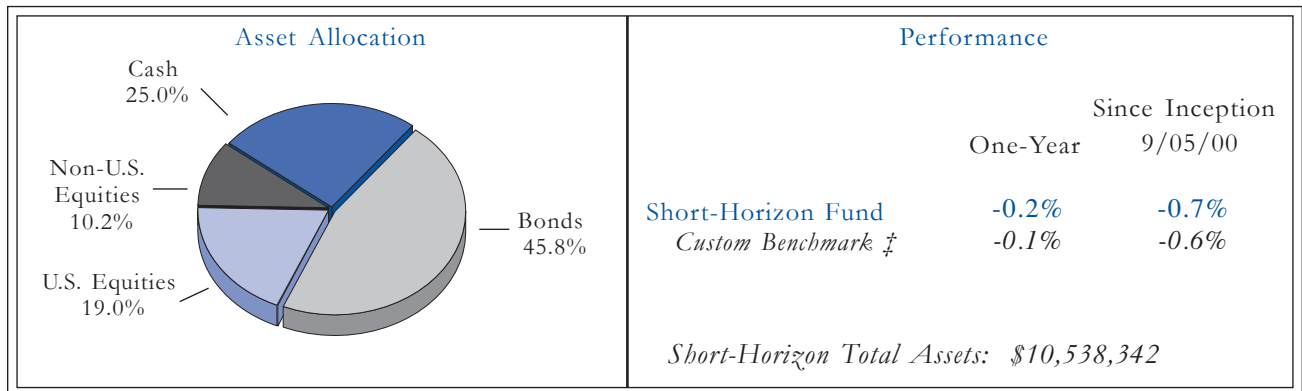


# WASHINGTON STATE HORIZON FUNDS

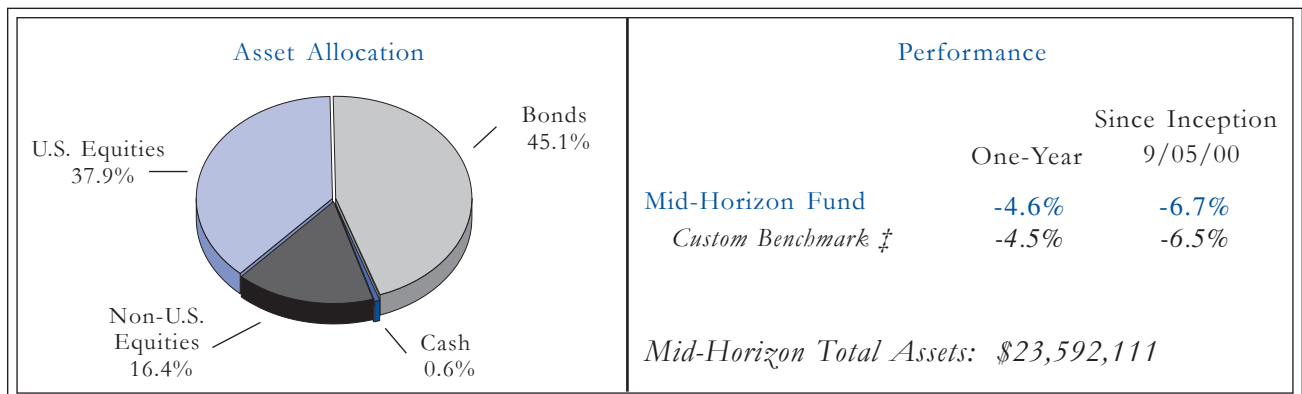
In September 2000, the WSIB introduced three new internally-managed, daily-valued balanced funds as self-directed options for participants in the defined contribution retirement plans (TRS 3, SERS 3, PERS 3, and the Judicial Retirement Account) and the state Deferred Compensation Program. The three Horizon Funds provide participants in these plans with the ability to choose a diversified asset allocation model that fits their personal risk and return objectives in a single investment decision. Each Horizon Fund is regularly and carefully rebalanced by WSIB investment professionals in order to preserve the proper asset allocation mix.

## Horizon Funds Asset Allocation and Performance June 30, 2002

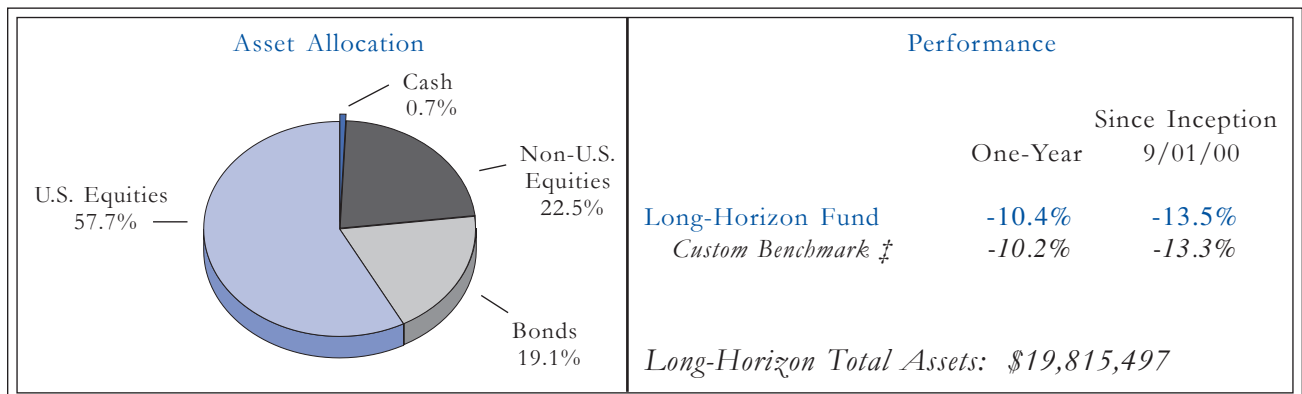
### Short-Horizon



### Mid-Horizon



### Long-Horizon



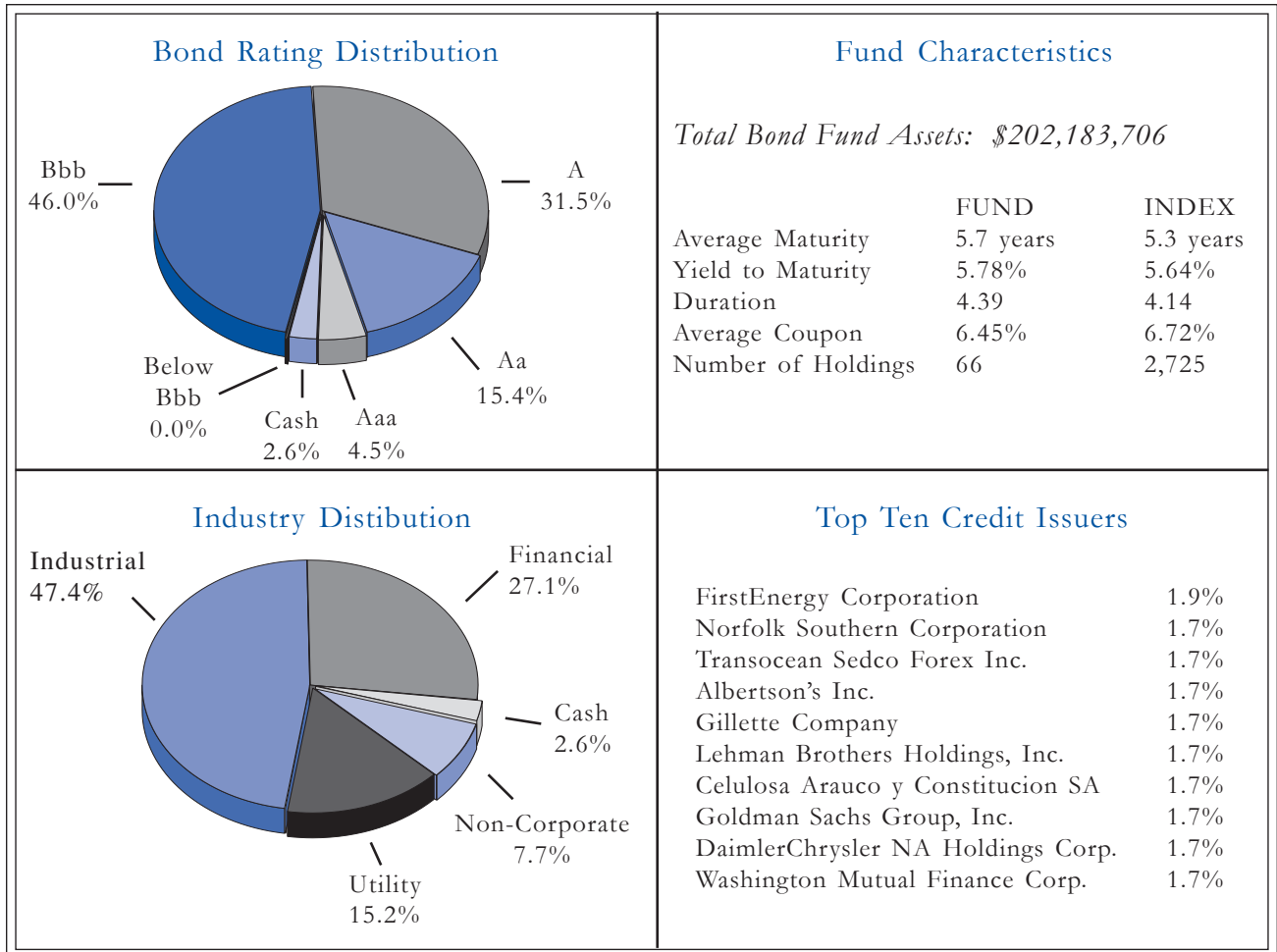
\*\* Fund has not been in existence long enough to provide performance figures for these dates.

‡ Horizon Fund Custom Benchmarks: **Short** - 46% Lehman Intermediate Credit + 25% London Interbank Offered Rate + 19% Wilshire 5000 + 10% MSCI EAFE; **Mid** - 46% Lehman Intermediate Credit + 38% Wilshire 5000 + 16% MSCI EAFE; **Long** - 58% Wilshire 5000 + 22% MSCI EAFE + 20% Lehman Intermediate Credit.

# WASHINGTON STATE BOND FUND

In late July 2000, the WSIB introduced the internally-managed Washington State Bond Fund as a daily-valued, self-directed investment option for participants in the defined contribution retirement plans (TRS 3, SERS 3, PERS 3, and the Judicial Retirement Account) and the state Deferred Compensation Program. This fund's goal is to provide attractive returns while controlling risk by investing in high quality corporate bonds. This fund is intended for participants who want an intermediate-term investment designed to match or moderately exceed the returns of the Lehman Intermediate Credit Index.

## Bond Fund Characteristics and Performance June 30, 2002



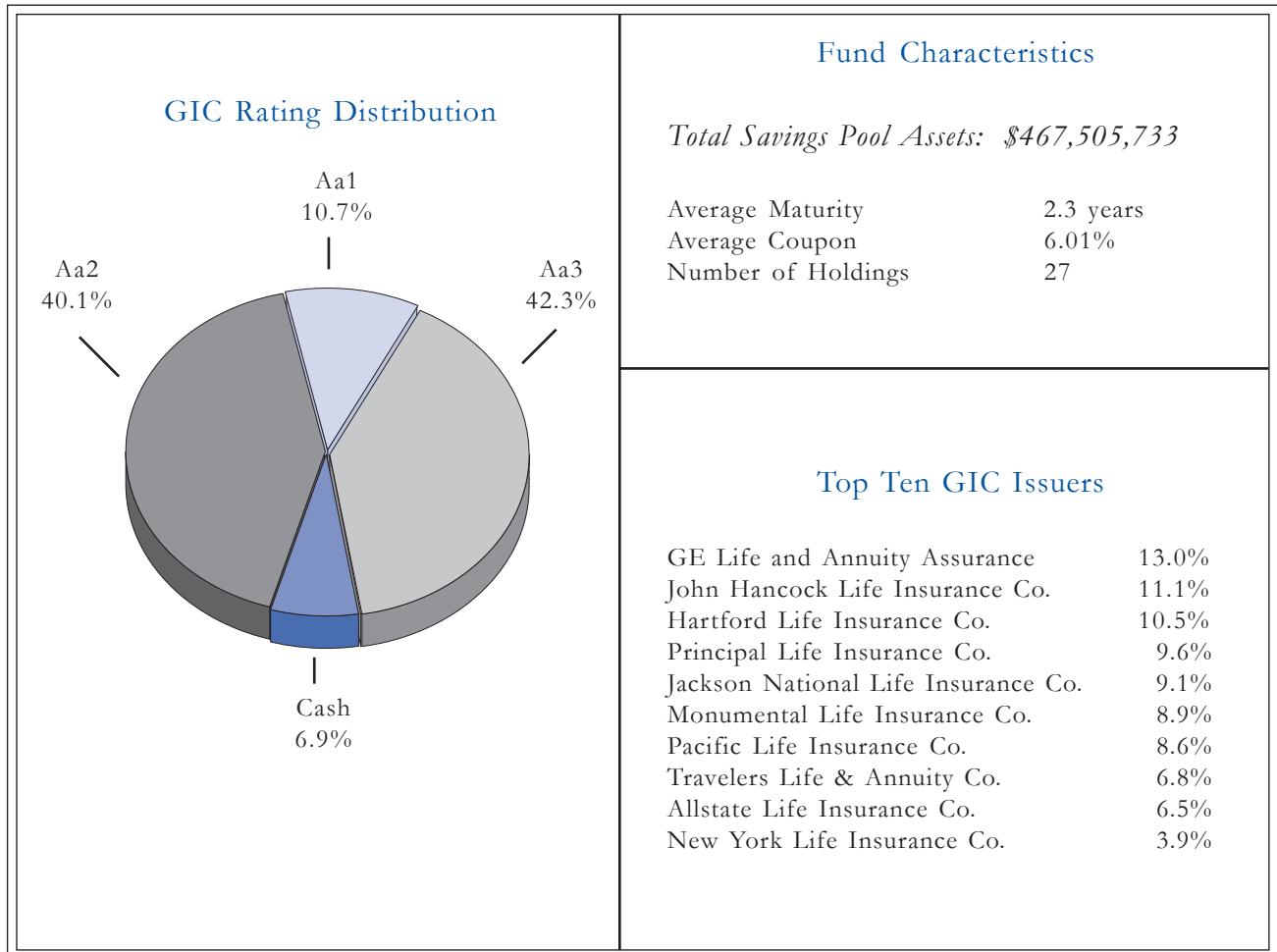
Fund Performance	One-Year	Since Inception 7/23/00
<b>Washington State Bond Fund</b>	7.6%	9.4%
<i>Lehman Intermediate Credit Index</i>	7.7%	9.6%

\*\* Fund has not been in existence long enough to provide performance figures for this date.

# SAVINGS POOL

The Savings Pool is internally-managed by the WSIB and is intended as a conservative short-term investment vehicle where current income and the preservation of capital is the primary objective. In addition to the Deferred Compensation Program, this investment option is also available to participants in the Judicial Retirement Account. The Savings Pool is a diversified portfolio of guaranteed investment contracts and short-term cash funds. It's investment goal is to preserve principal while earning a rate of return in excess of the current yield of U.S. Treasury securities of similar maturities.

## *Savings Pool Characteristics and Performance* June 30, 2002



Fund Performance	One-Year	Three-Year	Five-Year
Savings Pool †	6.3%	6.5%	6.6%

† Fund has no readily accessible comparative index to use as a benchmark.





## ***INDUSTRIAL INSURANCE FUNDS***

- **Accident Fund**
- **Medical Aid Fund**
- **Pension Reserve Fund**
- **Supplemental Pension Fund**



---

# ***INDUSTRIAL INSURANCE FUNDS***

---

The WSIB manages Industrial Insurance funds on behalf of the Department of Labor and Industries (L & I). The Industrial Insurance Portfolio consists of four separate funds that total \$8.6 billion.

## **ACCIDENT FUND**

This fund earns revenue from employer premiums for industrial insurance and investment earnings. The primary use is to pay disability benefits for injured workers, such as time loss compensation, permanent partial disability, certain travel and retraining expenses, burial awards, and administrative costs.

## **MEDICAL AID FUND**

The Medical Aid Fund earns income from premiums paid by both the employer and employee, as well as investment earnings. Payments are made for conservative medical care, hospital services, artificial appliances, physical and vocational rehabilitation, travel expenses, any other service required by the injured worker, and administrative costs.

## **PENSION RESERVE FUND**

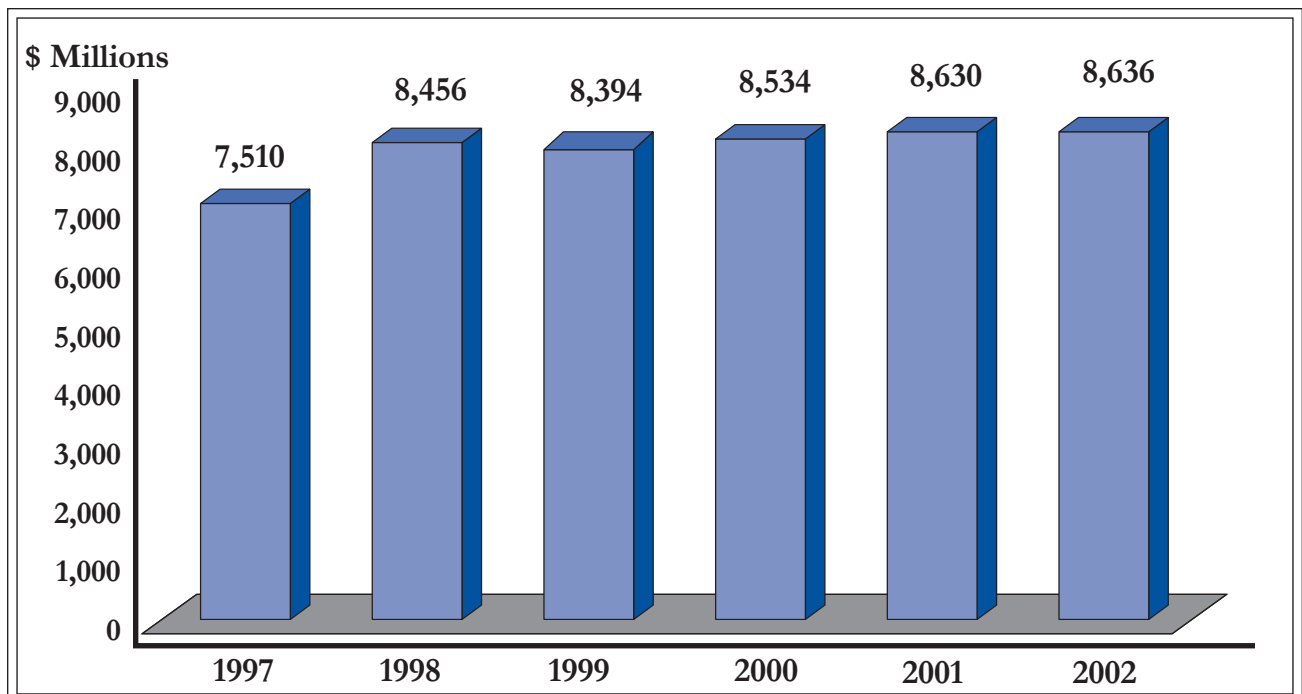
This fund is maintained by transfers of money from the Accident Fund at the time that a new pensioner is setup. This pays the permanently disabled worker and survivors of deceased injured workers.

## **SUPPLEMENTAL PENSION FUND**

The Supplemental Pension Fund receives income from employer and employee premiums and investment earnings. These funds are used to supplement time loss and pensions based on older, lower schedules and to compensate for cost of living increases.

### *HISTORICAL MARKET VALUES*

*June 30, 2002*



# INDUSTRIAL INSURANCE FUNDS

## ASSET ALLOCATION

*June 30, 2002*

The Industrial Insurance Fund portfolios are weighted strongly toward credit bonds with a meaningful allocation to equities. Credit bonds allow the funds to hold assets with higher yields than government bonds as a result of their credit risk. Most of this weighting lies in A and Baa rated companies. The equity allocation provides diversification from fixed income assets, with equities providing both higher return and greater volatility over the long term. This allocation also acts as an inflation hedge for the Medical Aid Fund, which has the largest equity holding of the four funds. At the end of the fiscal year, the total equity allocation was 15.2 percent.

Assets	Market Value (In 000's)	Percent
<b>Short-Term (Cash)</b>	\$ 125,381	1.4%
<b>Long-Term Fixed Income</b>		
U.S. Government Securities	\$ 1,397,223	16.2%
Credit Securities	3,888,198	45.0%
Asset-Backed Securities	156,307	1.8%
Mortgages and Mortgage-Backed Securities	1,655,786	19.2%
Total Short-Term and Fixed Income	<u>\$ 7,222,895</u>	<u>83.6%</u>
<b>Equities</b>		
U.S. Equity Market Index	\$ 1,102,621	12.8%
MSCI EAFE Index	209,906	2.4%
Total Equity	<u>\$ 1,312,527</u>	<u>15.2%</u>
<b>Total Accruals</b>	<u>100,297</u>	<u>1.2%</u>
<b>TOTAL</b>	<u><u>\$ 8,635,719</u></u>	<u><u>100%</u></u>

## TIME-WEIGHTED RETURNS

*June 30, 2002*

	— Annualized —		
	One Year	Three Years	Five Years
Accident Fund	5.2%	6.0%	7.1%
Medical Aid Fund	3.0%	4.5%	6.8%
Pension Reserve Fund	9.2%	8.5%	7.7%
Supplemental Pension Fund	3.7%	6.1%	6.3%

# INDUSTRIAL INSURANCE FUNDS

## BOND PORTFOLIO CHARACTERISTICS

*June 30, 2002*

### Sector Distribution

U.S. Treasuries	9.9%
Agency	9.8%
Credit	54.8%
Asset-Backed	2.2%
Mortgages	15.9%
CMBS	7.4%
	100.0%

### Top Ten Issuers

Market Value – June 30, 2002  
\$000

United State Treasury	\$709,431
FHLMC Structured Mortgages	\$358,160
FHLB Agency Bonds	\$324,556
FNMA Structured Mortgages	\$229,807
DLJMA CMBS	\$177,464
FNMA Agency Bonds	\$144,084
Tennessee Valley Authority	\$131,288
RFMSI - CMO	\$100,144
FHLMC Agency Bonds	\$92,815
Hydro Quebec	\$82,892

### Credit Distribution

TSY	9.9%
AGY	19.7%
Aaa	16.8%
Aa	4.8%
A	22.3%
Baa	24.9%
<Baa	1.6%
	100.0%

*Moody's credit ratings*

### Coupon Distribution

0 – 4.9%	6.6%
5 – 6.9%	50.4%
7 – 7.9%	30.2%
8 – 8.9%	10.0%
9 – 9.9%	2.6%
10+%	0.2%
	100.0%

### Maturity Distribution

0 – 1 Year	3.4%
1 – 3 Years	11.3%
3 – 5 Years	15.9%
5 – 7 Years	15.6%
7 – 10 Years	11.7%
10 – 15 Years	8.8%
15 – 20 Years	6.1%
20 – 25 Years	6.3%
25+ Years	20.9%
	100.0%

### Effective Duration

0 – 1 Year	3.8%
1 – 3 Years	15.4%
3 – 4 Years	10.4%
4 – 6 Years	1.6%
6 – 8 Years	12.0%
8+ Years	36.8%
	100.0%

# INDUSTRIAL INSURANCE FUNDS

## CREDIT SECTOR DETAIL

*June 30, 2002*

### Top Ten Credit Holdings

Market Value – June 30, 2002

\$000

GMAC – 7/15/05	\$44,189
Washington Mutual – 8/15/06	\$39,218
Bombardier Capital – 8/15/04	\$38,448
Norsk Hydro – 1/15/29	\$37,342
Hydro Quebec – 4/15/30	\$35,011
Albertson's Inc. – 2/23/28	\$32,397
Amerada Hess Corp. – 8/15/31	\$31,521
Sprint Capital Corp. – 11/15/28	\$29,729
FirstEnergy Corp. – 11/15/31	\$28,588
Cinergy Corp. – 12/16/08	\$28,139

### Top Ten Credit Issuers

Market Value – June 30, 2002

\$000

Hydro Quebec	\$82,892
Washington Mutual	\$80,608
Verizon	\$79,582
Ford Motor Company	\$75,770
Citigroup	\$73,880
Goldman Sachs	\$72,681
Burlington Northern	\$72,020
Boeing Company	\$67,339
Sprint Capital Corporation	\$65,282
Union Pacific Resources	\$64,819

### Sector Distribution

Industrial	50.3%
Utilitie	16.5%
Financial	28.0%
Non-Corporate	5.2%
	<u>100.0%</u>

### Coupon Distribution

0 – 4.9%	0.5%
5 – 6.9%	43.1%
7 – 7.9%	38.7%
8 – 8.9%	13.0%
9 – 9.9%	4.6%
10+%	0.1%
	<u>100.0%</u>

### Credit Distribution

Aaa	1.5%
Aa	8.8%
A	40.9%
Baa	45.8%
<Baa	3.0%
	<u>100.0%</u>

*Moody's credit ratings*

### Maturity Distribution

0 – 1 Year	2.4%
1 – 3 Years	12.7%
3 – 5 Years	18.9%
5 – 7 Years	11.7%
7 – 10 Years	11.8%
10 – 15 Years	3.2%
15 – 20 Years	5.1%
20 – 25 Years	5.8%
25+ Years	28.4%
	<u>100.0%</u>

### Effective Duration

0 – 1 Years	2.2%
1 – 3 Years	17.3%
3 – 4 Years	12.7%
4 – 6 Years	17.9%
6 – 8 Years	11.1%
8+ Years	38.8%
	<u>100.0%</u>

## *PERMANENT FUNDS & OTHER TRUST FUNDS*

- **Agriculture Permanent Fund**
- **Common School Permanent Fund**
- **Normal School Permanent Fund**
- **Scientific School Permanent Fund**
- **State University Permanent Fund**
- **Millersylvania Park Trust Fund**
  
- **Developmental Disabilities Endowment Trust Fund**
- **Game and Special Wildlife Fund**
- **Guaranteed Education Tuition Fund**
- **Radiation Perpetual Fund**
- **Reclamation Revolving Fund**
- **State Emergency Reserve Fund**
- **State Employees Insurance Reserve**





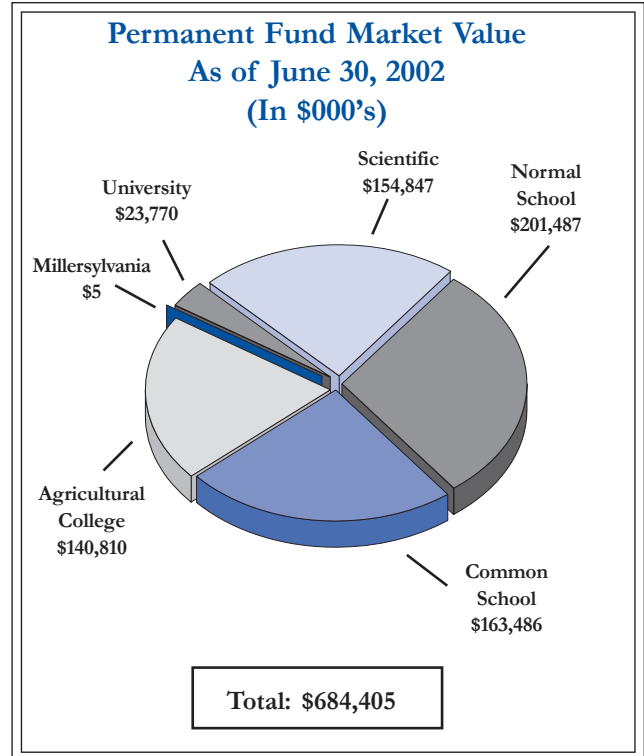
## PERMANENT FUNDS

The WSIB manages assets for six Permanent Funds, each with its own specific purpose and investment constraints. In aggregate, the assets of the Permanent Funds total \$684 million. Permanent Funds are non-expendable trust funds in which the investment principal (corpus) remains intact as required by the Washington State Constitution.

The Permanent Funds are invested in fixed income and short-term holdings with the exception of the Common School Permanent Fund, which is also invested in the U.S. Equity Market Index Fund. The State University Permanent Fund is invested in the WSIB Commingled Monthly Bond Fund and short-term holdings.

The five education Permanent Funds were established through land grants from the federal government to benefit the Washington State schools and colleges. Investment earnings are distributed to the schools, colleges and universities in the state for the purpose of bond repayment, capital development, and facilities maintenance.

The Millersylvania Park Trust fund was established from a gift of cash and securities. The earnings on investments are used for improvement, maintenance, and upkeep of the Millersylvania State Park.



Performance as of June 30, 2002	One-Year		Three-Year		Five-Year	
	Total Return	Distribution Return	Total Return	Distribution Return	Total Return	Distribution Return
Agricultural College Fund	8.4%	6.8%	7.9%	6.9%	7.3%	6.9%
Common School Fund	8.4%	6.5%	7.6%	6.6%	7.3%	6.6%
Normal School Fund	9.4%	6.6%	8.2%	6.8%	7.6%	6.7%
Scientific University Fund	10.1%	6.9%	8.2%	6.8%	7.5%	6.7%
State University Fund	10.2%	6.6%	8.5%	6.9%	7.7%	7.0%
<i>Lehman Aggregate Index</i>	8.6%		8.1%		7.6%	
Millersylvania Park Fund	2.5%	2.7%	4.7%	4.8%	5.0%	5.0%
<i>90 Day T-Bill</i>	2.6%		4.6%		4.8%	

*Distribution returns include coupon interest, realized gains and losses, and additional income less expenses and fees. Total return also includes unrealized market gains and losses on the investments held based on values captured at a point in time (June 30, 2002).*

Fiscal Year 2002 Distributions: Agricultural College Fund, \$8,978,510; Common School Fund, \$10,197,078; Normal School fund, \$12,358,504; Scientific University Fund, \$9,861,488; State University Fund, \$1,452,790; Millersylvania Park Fund, \$126.

## OTHER TRUST FUNDS

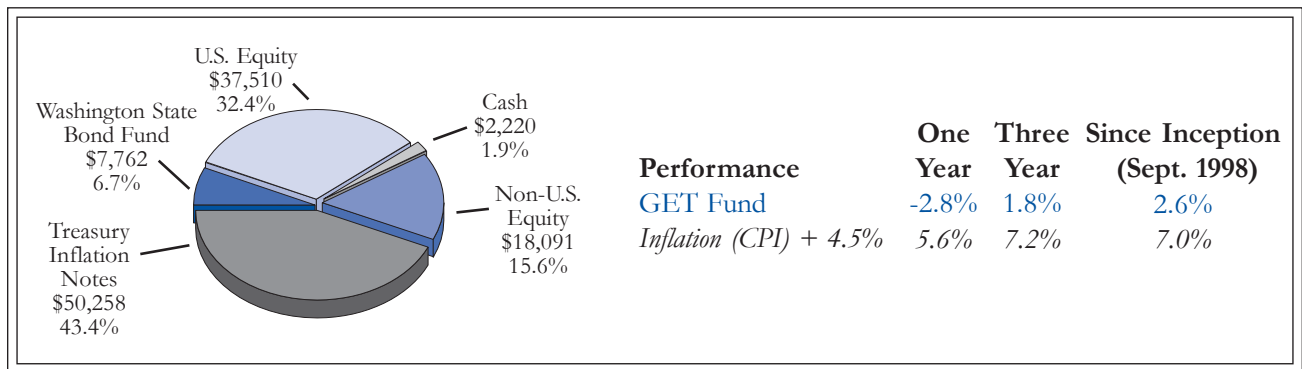
The WSIB manages assets for seven other trust funds that total about \$289 million in aggregate. Each fund has its own specific purpose and investment policy.

### ➤ **Guaranteed Education Tuition Fund (\$115.8 million)**

The Guaranteed Education Tuition (GET) Program allows individuals or groups to purchase state college and university tuition units for future use at current prices. Program administration is under the authority of the Committee on Advanced Tuition Payment. The WSIB serves as Trustee for and invests the funds from advance tuition purchases in a mix of short-term holdings, Treasury Inflation Notes, U.S. equity and non-U.S. equity.

#### GET Fund Asset Allocation and Fund Performance

*June 30, 2002*  
\$000

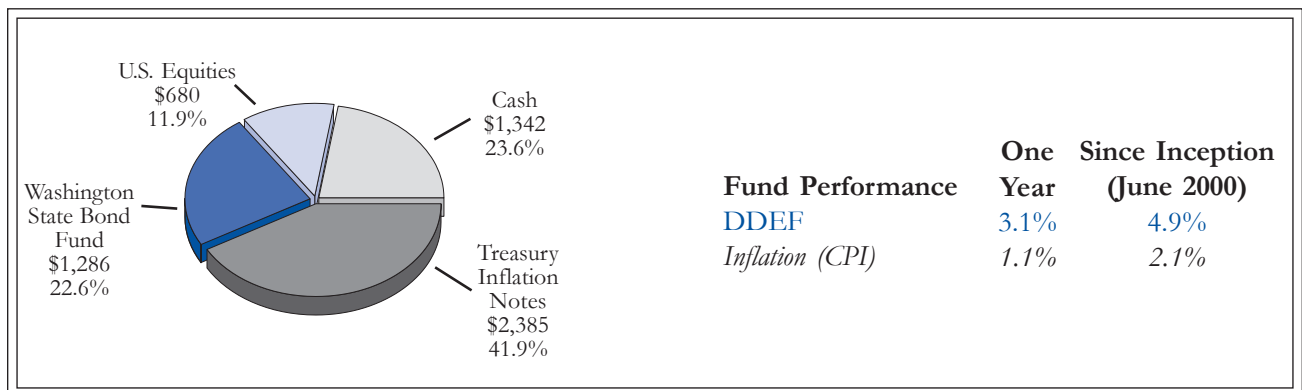


### ➤ **Developmental Disabilities Endowment Trust Fund (\$5.7 million)**

The Developmental Disabilities Endowment Trust Fund was established to support individuals with developmental disabilities through private contributions and public appropriations. The WSIB invests the fund in a mix of short-term holdings, Treasury Inflation Notes, fixed income, and U.S. equity.

#### Developmental Disabilities Endowment Asset Allocation and Fund Performance

*June 30, 2002*  
\$000



---

## ***OTHER TRUST FUNDS***

---

➤ **State Emergency Reserve Fund (\$116.1 million)**

The State Emergency Reserve Fund was created under the guidelines of State Proposition 601 to provide the state of Washington with a budget reserve fund. The moneys in the fund are managed by the Office of Financial Management and overseen by the budget committees of the state House of Representatives and Senate. The WSIB began investing the State Emergency Reserve Fund in July 1999. The fund is invested in short-term holdings.

➤ **Game and Special Wildlife Fund (\$11.6 million)**

This fund was created to hold moneys received as compensation for wildlife losses. The WSIB is authorized to invest surpluses in the Special Wildlife Fund. The program is under the authority of the State Fish and Wildlife Commission. The fund is invested in short-term holdings.

➤ **State Employees Insurance Reserve (\$38.3 million)**

This fund was created for the purpose of holding and investing reserves needed for the payment of claims in insurance programs under the Health Care Authority. The account is funded from the reserves of the public employees' and retirees' insurance account. The fund is invested in short-term holdings.

➤ **Radiation Perpetual Fund (\$275 thousand)**

This fund was created to provide moneys for the maintenance, monitoring, and other care of radioactive materials at sites no longer operating. Funding is from a charge imposed on each pound of uranium or thorium compound milled out of raw ore. The program is under the authority of the Department of Health. This fund is invested in short-term holdings.

➤ **Reclamation Revolving Fund (\$1.1 million)**

This fund was created to provide a source of funding for the reclamation and development of lands suitable, and economically available, for development as agricultural lands. This fund is invested in short-term holdings and municipal water district bonds.

<b>Performance as of June 30, 2002</b>	<b>One-Year</b>	<b>Three-Year</b>	<b>Five-Year</b>
State Emergency Reserve Fund	2.4%	4.7%	N/A
Game and Special Wildlife Fund	2.3%	4.6%	5.1%
State Employees Ins. Reserve	2.3%	4.6%	5.0%
Radiation Perpetual Fund	2.3%	4.6%	5.0%
Reclamation Revolving Fund	3.7%	5.1%	5.4%
<i>90 Day T-Bill</i>	<i>2.6%</i>	<i>4.6%</i>	<i>4.8%</i>

---

## **GLOSSARY**

---

**Acquisitions/Buyouts.** The purchase of a controlling interest in a corporation, or portion thereof, in order to take over assets and/or operations.

**Active Management.** An investment management approach with the objective of attaining excess risk-adjusted return versus the benchmark as a result of structuring a portfolio differently from the benchmark.

**Asset.** Anything owned that has value and is measurable in terms of money.

**Asset Class.** Categories of investments that share certain characteristics and exhibit similar patterns of return.

**Benchmark.** The performance objective or standard represented by a model portfolio used to define the return against which [another] portfolio is to be evaluated.

**Beneficiary.** The recipient of fund benefits.

**Cash Equivalents.** Highly liquid, very safe investments which can be easily converted into cash, such as Treasury Bills and money-market funds.

**Commingled Fund.** An investment fund in which the manager pools the assets of several accounts to permit more efficient management and to reduce administrative costs.

**Defined Benefit Plan.** A pension plan that promises to pay a specified amount to each person who retires, generally based upon a

formula combination of years of service, age at retirement, and salary history.

**Defined Contribution Plan.** A pension plan in which the retirement benefit is based solely on the amount contributed to an individual account plus net investment earnings. The employee bears the investment risk, as there is no guaranteed rate of return and the value of the member's account will increase or decrease based on fluctuations in the market.

**Distressed Entities.** The investment of equity or debt capital into an entity with various degrees of management assistance to help fix the underlying problems of the company.

**Diversification.** A strategy of reducing exposure to risk by combining a variety of investments among different asset classes, which are unlikely to move in the same direction.

**Efficient Market Theory.** The hypothesis that prices of securities fully reflect all available information.

**Ex-officio Member.** A member by virtue of office or position.

**Fiduciary.** An individual, corporation or association holding assets for another party, often with the legal authority and duty to make decisions regarding financial matters on behalf of the other party.

**Fixed Income.** Securities representing debt obligations and usually having fixed payments and maturities. Different types of fixed income

---

## GLOSSARY

---

securities include government and corporate bonds, mortgage-backed securities, asset-backed securities, convertible issues, and sometimes also includes money-market instruments.

**Index.** A group of securities that represents the universe of available investments in a specific class or subclass of assets.

**Liquidity.** Measures or describes the ease and time in which assets can be turned into cash without an impact on price.

**Nonvoting Members.** Members, typically experts in the investment and economics fields, who are appointed by the Board and act in an advisory capacity.

**Passive Management.** A money management strategy that seeks to match the return and risk characteristics of a market segment or index, by mirroring its composition.

**Private Equity.** The infusion of equity capital into a private company (one which is not available on the public markets).

**Risk (investment).** The degree of uncertainty and/or the amount of possible loss on an investment.

**Self-Directed Investment.** An investment program in which the individual members or participants choose the investment vehicles for their assets, usually from among a set of investment options provided by the trustee.

**Stock.** Ownership of a corporation represented by shares that are claim on the corporation's earnings and assets.

**Trustee.** An individual or organization which holds or manages and invests assets for the benefit of another.

**TUCS Public Fund Median.** Trust Universe Comparison Services Median return of other public funds.

**Venture Capital.** Equity financing of early, expansion, and later stage emerging small businesses. Companies grow from start-up to medium size businesses, and are then either sold to the public through an Initial Public Offering, or are sold to a strategic or financial buyer.

**Volatility.** In financial matters, volatility of returns is the measurement used to define risk. It describes the spread of annual returns from lowest to highest over a particular period. The greater the volatility, the higher the risk.

**Voting Members.** The nine voting members of the Board. They include four members which represent various stakeholders in the pension systems, three ex-officio members, and one legislator from each house. In September 2002, a tenth voting member will be added representing active members of the School Employees' Retirement System.

The WSIB is an equal opportunity and affirmative action employer. Every effort will be made to provide reasonable accommodation and accessibility to WSIB employees and the public we serve.

**Special thanks to the following people for their work in producing  
WSIB's 2002 Annual Report:**

**Scott Huntley - Project Supervisor**

**Patricia Sheridan - Project Coordinator**

**Shauna Raphael - Graphics and Page Design**

**Steve Verschoor - Financial Statements and Schedules**

**Tom Edwards and Brad Christoffer - Technical Support**

**Shauna Raphael - Cover Photograph**

**Cover Photo: Gig Harbor**



Washington State Investment Board  
2424 Heritage Court S.W.  
P.O. Box 40916  
Olympia, WA 98504-0916  
(360) 664-8900