

# *Washington State Investment Board*

## *Twenty ~Second Annual Investment Report*



*June 30, 2003*



STATE OF WASHINGTON

**STATE INVESTMENT BOARD**

2100 Evergreen Park Drive SW - P.O. Box 40916 - Olympia, Washington 98504-0916  
(360) 956-4600 - FAX (360) 956-4780

June 30, 2003

To all stakeholders,

It is my pleasure to present the Washington State Investment Board's (WSIB) Annual Report for fiscal year ended June 30, 2003. I'm also pleased to point out that, for the first time in three years, investment performance for retirement funds managed by the WSIB are back in positive territory. This is good news for state and local pension fund members, their beneficiaries, and all we serve.

As of June 30, 2003, total assets under management were just over \$52 billion. Assets for state retirement funds totaled nearly \$39 billion, an increase of \$2.9 billion from the previous quarter ending March 31, 2003, when the momentum of the negative to positive turnaround began. For the third consecutive year, the various Industrial Insurance Funds and Permanent Funds posted positive returns of up to 19.1 percent and 1.7 percent, respectively.

While there are numerous encouraging signs of improvement, only time will tell if this uphill climb will continue. The economy rarely comes out of a recession in a V-shaped pattern and, as recovery begins, it's not unusual for today's top performing sectors to become tomorrow's worst. That's why the WSIB adheres to the theory of diversification as a fundamental building block for long-term investment success. Our goal is to stay the course with a strategy that maintains a world-class, well-diversified portfolio to ensure steady, persistent growth over time.

There were several changes in Board membership and in senior staff management at the WSIB during the past year. After 17 excellent years on the Board, both as a public employee representative and as the Labor and Industries ex-officio member, Gary Moore resigned to pursue a new endeavor in public service. Joe Dear, former Board member and Board chair, and government relations officer for the Frank Russell Company, was appointed WSIB Executive Director. To strengthen and improve Board Governance and our effectiveness as a fiduciary body, the Board adopted several significant policy changes including a new Economically Targeted Investment Policy to facilitate the exchange of information between WSIB's general partners and appropriate parties with knowledge of quality, in-state investment opportunities that could help Washington-based companies.

Although last year's annual report is available on the WSIB's website, this year marks the first time it's been specifically designed for primary distribution via the Internet. That means more color can be infused into the document to make the financial content and graphics more inviting and user-friendly to read without incurring the traditionally high costs of paper, printing, and postage. For those who do not have Internet or printer access, copies will be provided upon request.

Overall, it's been an ambitious and positive year for the WSIB. Looking ahead to future challenges and initiatives, I can assure you the Board and the WSIB staff will continue to meet our fiduciary responsibilities and pursue new opportunities to enhance and improve the services we provide.

A handwritten signature in dark ink, appearing to read 'John F. Charles'.

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John F. Charles, Chair



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

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*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.*

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## ***FISCAL YEAR 2003 HIGHLIGHTS***

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- Total assets within the 33 individual funds managed by the WSIB were \$51.9 billion as of June 30, 2003. Fiscal year 2003 was the first since fiscal year 2000 to show positive investment returns for domestic equity investments. The Wilshire 5000 index, after starting off fiscal year 2003 with one of the worst quarters since the inception of the index in 1971, finished the fiscal year with a “top ten” quarter return of 16.51 percent, allowing the index to post a small positive return of 1.3 percent for the fiscal year. International equity markets, as measured by the Morgan Stanley Capital International (MSCI) All World Country Index (AWCI) Free ex U.S. index, continued to have a difficult year with a fiscal year return of negative 4.19 percent.
  
- The defined benefit Retirement Fund returned 3.1 percent in 2003 fiscal year. As of June 30, 2003, the retirement funds outperformed their public fund peers over both the five-and ten-year periods, as measured by the Trust Universe Comparison Service (TUCS) Universe of public pensions funds with assets greater than \$1 billion in size.
  
- Washington’s four individual Industrial Insurance Funds each recorded positive returns in fiscal year 2003, with the highest being the 19.1 percent return of the Pension Reserve Fund.
  
- Permanent and Other Trust Funds accrued earnings of \$36.4 million in fiscal year 2003 for distribution to beneficiaries.
  
- Defined contribution assets stood at \$4.2 billion in five separate programs: the state Deferred Compensation Program, 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.
  
- The WSIB received its 11th consecutive state audit (for fiscal year 2003) with no findings.

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# WSIB AGENCY OVERVIEW

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## Our Role

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

## Investment Principles

*“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)*

## Background

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 that, “. . . the State Investment Board shall have full power to invest, reinvest, manage, contract, or sell or exchange investments acquired.”

The WSIB has management responsibility for 33 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 ten voting members and five non-voting members.

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

To efficiently analyze investment issues, specific areas of responsibility have been assigned to Committees of the Board. Individual Board members are selected to serve on the Committees to analyze investment issues under their jurisdiction in greater detail than would be possible for the entire Board. Recommendations are brought to the Board at regular meeting dates for full discussion, consideration, and a vote.

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# WASHINGTON STATE INVESTMENT BOARD

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## BOARD-ESTABLISHED COMMITTEES

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

### Administrative

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

### Audit

The Audit 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 Conflict of Interest Policy for the Board, reviews performance reporting requirements, and deals with corporate governance policies and issues.

### Private Markets

The Private Markets Committee is responsible for developing 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

The Public Markets Committee is responsible for developing policy and structure for public market investments (fixed income, domestic equity, international equity), and reviewing individual equity managers to recommend to the Board.

## OUTSIDE HELP AND ADVICE

In addition to 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

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## **BOARD MEMBERS**

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

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

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

George Masten, Vice Chair <i>(Elected Chair September 2003)</i>	Representative - Retired Member of a State Retirement System
Patrick McElligott <i>(Elected Vice-Chair September 2003)</i>	Representative - Active Member, Law Enforcement Officers' and Fire Fighters' Retirement System
Deborah Brookman	Representative - Active Member, Public Employees' Retirement System

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

Glenn Gorton	Representative - Active Member, School Employees' Retirement System
David Scott	Representative - Active Member, Teachers' Retirement System

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

Helen Sommers	State Representative
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### **Board Member Appointed by the President of the Senate**

Joseph Zarelli	State Senator
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### **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

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## WSIB STAFF

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### EXECUTIVE TEAM

#### **Joseph A. Dear, Executive Director**

Appointed WSIB Executive Director on November 12, 2002. Formerly government relations officer for Frank Russell Company. Served as chief of staff for Governor Gary Locke; assistant secretary of labor for the Occupational Safety and Health Administration (OSHA), and director of the Washington State Department of Labor and Industries. Member of the Washington State Investment Board from 1987 to 1992 and served as Board chair from 1989 to 1991. Bachelor of Arts from The Evergreen State College.

#### **Theresa J. Whitmarsh**

*Deputy Director for Operations*

Eighteen years in insurance, finance, and technology management. Formerly assistant and deputy director for the Washington State Department of Labor and Industries; vice president for leading data management company serving large, self-funded employers; and communications director for an insurance trade association. MBA graduate of Pacific Lutheran University and Bachelor of Arts from Seattle Pacific University.

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

*Chief Investment Officer*

Twenty-five 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 (Oregon).

#### **Sue Hedrick**

*Executive Assistant*

#### **Beth Vandehey**

*Internal Auditor*

#### **Liz Mendizabal**

*Communications/Legislative Coordinator*

### 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 WSIB. Graduate of the University of Kansas in Accounting with an MBA from the University of Washington.

#### **Nancy Calkins, CIMA**

*Public Equity*

Formerly an 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.

#### **Steven M. Draper**

*Real Estate*

Formerly a real estate investment officer for the WSIB. Worked in the analysis, strategic planning, and management of real estate investment portfolios and projects, primarily as a consultant to institutional investors. Graduate of Brigham Young University in Business Management/Finance.



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# WSIB STAFF

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## INVESTMENT STAFF

### Asset Allocation

Diana Will, CFA

### Fixed Income

Thomas E. Bosworth

Donna May Ong, CFA

Ralph Ripple

Maria S. Tosteson Rosen

Judy Yu, CFA

Lisa Harrison

### Real Estate

Steve Draper

### Private Equity

Isabelle Fowler

Sam Green, CPA

Gary R. Holt

Janet Kruzal

### Public Equity

Linda L. Lester, CPA

### Investment Support

Kristi Bromley, Administrative Assistant

Linda Buchanan, Secretary Administrative

Elizabeth Hyde, Office Assistant Senior

Brian Shrader, Office Assistant Senior

## OPERATIONS

### 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

### Operations Support

Kristi Walters, Administrative Assistant

E. Reneé Wicklund, Office Assistant Senior

### Business and Office Services

Erwin Vidallon, Finance and Budget 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

Patricia Sheridan, Office Manager

Tish Day, Office Assistant Senior

Geri Uhlmeier, Office Assistant

### Information Systems

Jim Lee, Systems and Office Services Manager

Tom Edwards, LAN Administrator

Bill Duris, Systems Analyst

Brad Christoffer, PC Support Specialist

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# **INVESTMENT RESPONSIBILITY**

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As of June 30, 2003, the WSIB has investment responsibility for the following 33 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' & Firefighters' (LEOFF) Plan 1  
Law Enforcement Officers' & Firefighters' (LEOFF) Plan 2  
Judicial Retirement Account (JRA)  
Washington State Patrol Retirement System (WSPRS) Plan 1  
Washington State Patrol Retirement System (WSPRS) Plan 2  
Volunteer Firefighters' Relief & Pension Fund (VFF)

### **DEFINED CONTRIBUTION**

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

## **DEFERRED COMPENSATION FUNDS**

Deferred Compensation Program (DCP)

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

Accident Fund  
Medical Aid Fund  
Pension Reserve Fund  
Supplemental Pension Fund

## **PERMANENT FUNDS**

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

## **OTHER TRUSTS**

Guaranteed Education Tuition Program (GET)  
Developmental Disabilities Endowment Trust Fund (DDEF)  
State Emergency Reserve Fund  
Game and Special Wildlife Fund  
State Employees' Insurance Reserve Fund  
Radiation Perpetual Fund  
Reclamation Revolving Fund

# ASSETS UNDER MANAGEMENT

## TOTAL ASSETS BY FUND

*June 30, 2003*

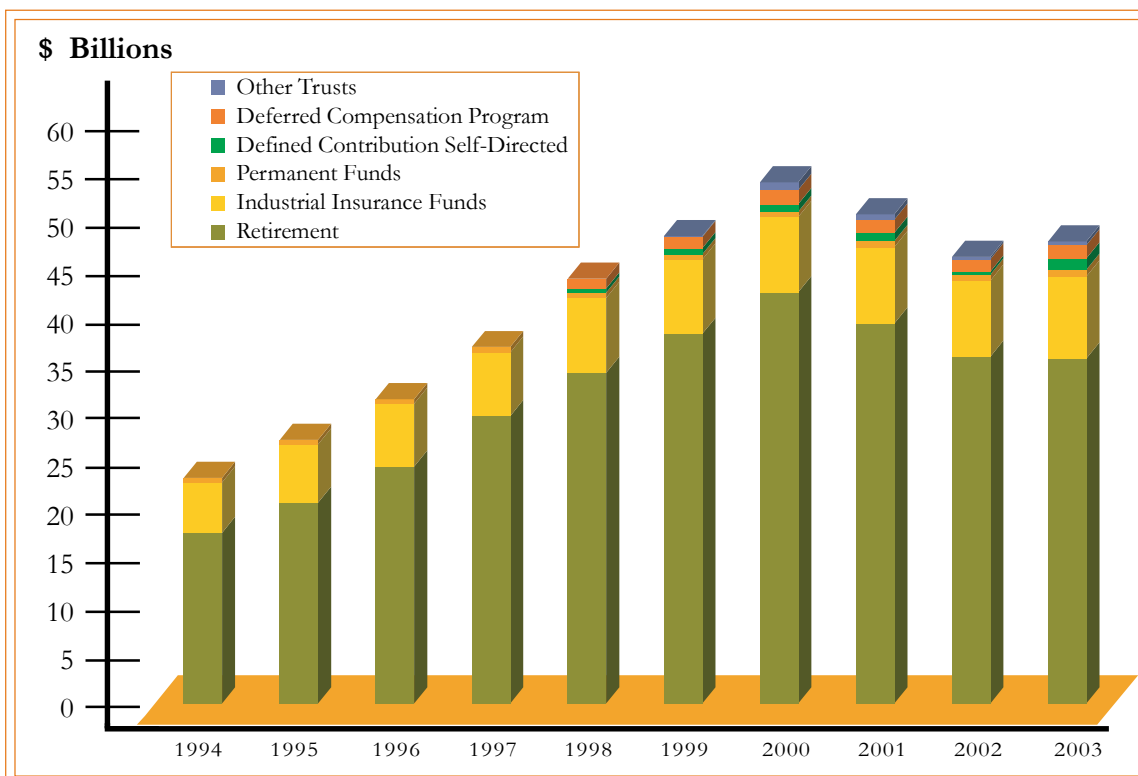
*(In millions)*

Retirement Funds	\$ 38,819
Self-Directed Defined Contribution (Includes Plan 3's & JRA)	1,388
Deferred Compensation Program	1,461
Industrial Insurance Funds	9,342
Permanent Funds	731
Other Trusts	396
<b>TOTAL</b>	<b><u><u>\$ 52,137</u></u></b>

## Assets Under Management

*Past Ten Years*

*Fiscal Year Ended June 30, 2003*



# WSIB BUDGET

The WSIB receives no state general fund monies. Funding comes from charges on the invested funds, which 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 agency operations, including staff, facilities, equipment, supplies, etc.

The biennial budget is approved by the state Legislature every odd-numbered year. The two-year budget funds the WSIB from July 1 of the odd-numbered year 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 (\$52.1 billion). For fiscal year 2003, the appropriated operating expenditures were \$7,747,742, or 0.014 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 and 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 2003, total non-appropriated expenditures were \$195,160,883, or 0.4 percent of the total assets managed.

## WSIB Cost of Management (000s)

Fiscal Year	Total Assets	Investment Expenses		Operating Expenses		Total Expenses	
			% of total assets		% of total assets		% of total assets
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%
2003	\$52,132,415	\$195,161	0.374%	\$7,448	0.014%	\$202,609	0.388%

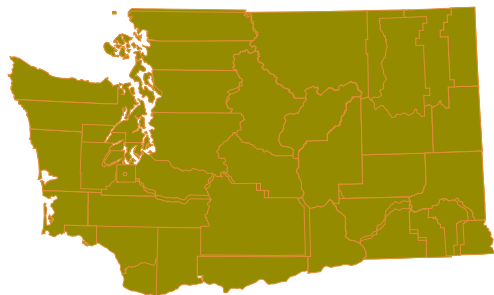
# ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2003  
Accrual Basis

OBJECTS OF EXPENDITURE	BUDGET TO DATE	EXPENDITURES TO DATE	BUDGET VARIANCE
<b>Appropriated</b>			
Salaries	\$ 3,928,197	\$ 3,523,688	\$ 404,509
Benefits	751,784	659,516	92,268
Personal Services	599,640	832,219	(232,579)
Goods & Services	1,498,406	1,376,125	122,280
Travel	159,926	154,879	5,047
Fixed Assets	461,724	901,315	(439,591)
Interagency Reimbursements	-	-	-
<b>Subtotal Appropriated</b>	<b>\$ 7,399,677</b>	<b>\$ 7,447,743</b>	<b>\$ (48,066)</b>
<b>Non-Appropriated</b>			
<b>Retirement Funds</b>			
U.S. Equity - Passive		\$ 451,115	
International Equity - Active		7,301,140	
International Emerging Markets - Passive		526,765	
International Emerging Markets - Active		3,099,685	
International Equity - Passive		1,381,567	
Private Equity		134,636,694	
Real Estate		30,459,460	
General Pension Consultants		2,148,817	
Legal Fees		179,996	
Custodian Bank Fees		1,181,891	
Securities Lending and Other Fees		5,938,239	
<b>Total Retirement</b>		<b>\$ 187,305,369</b>	
<b>Self-Directed Defined Contribution Funds</b>			
Self-Directed Managers - International Equity		43,354	
Self-Directed Managers - U.S. Equity		44,813	
U.S. Fixed Income		167,666	
Securities Lending and Other Fees		126,302	
<b>Total Self-Directed Defined Contribution*</b>		<b>\$ 382,135</b>	
<b>Industrial Insurance Funds</b>			
Consultants		118,750	
U.S. Equity - Passive		29,193	
International Equity - Passive		841,263	
Custodian Bank Fees		114,454	
Securities Lending		777,162	
Provident Liquidity Fees		249,898	
<b>Total Industrial Insurance</b>		<b>\$ 2,130,720</b>	
<b>Deferred Compensation Funds</b>			
Fixed Income - Active		2,464	
U.S. Equity - Active		4,500,723	
International Equity - Active		172,741	
U.S. Equity - Passive		4,493	
Securities Lending		10,251	
<b>Total Deferred Compensation Funds*</b>		<b>\$ 4,690,672</b>	
<b>Permanent/Other Funds</b>			
U.S. Equity - Passive		2,024	
International Equity - Passive		91,821	
Custodian Bank Fees		17,832	
Securities Lending		104,302	
Blackrock Liquidity Fees		436,009	
<b>Total Permanent/Other Funds</b>		<b>\$ 651,988</b>	
<b>Subtotal Non-Appropriated</b>		<b>195,160,884</b>	
<b>TOTAL</b>		<b>\$ 202,608,626</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

Investment Class	Value (In millions)
Public Equity	\$594.2
Fixed Income	\$317.8
Private Equity*	\$59.4
Real Estate*	\$343.0
<b>Total</b>	<b>\$1,314.4</b>

\* The private equity total shown is the amount invested in Washington-based companies by the WSIB. The real estate total represents the equity that the WSIB has invested in Washington properties.

## Public Equity and Fixed Income

As of June 30, 2003, the market value of WSIB public equity and fixed income investments in companies headquartered in Washington was \$912 million. Among the 81 companies represented in these portfolios are:

- Airborne Inc.
- Amazon.com Inc.
- AT&T Wireless
- Cascade Natural Gas Corp.
- Cell Therapeutics Inc.
- Costco Wholesale Corp.
- Cutter & Buck Inc.
- Eden Bioscience Corp.
- Expedia Inc.
- Expeditors International
- Fisher Companies
- Getty Images Inc.
- Icos Corp.
- Immunex Corp.
- Infospace Inc.
- Longview Fibre Co.
- Microsoft Corp.
- Nautilus Group Inc.
- Nextel Partners Inc.
- Nordstrom Inc.
- Onyx Software Corp
- Paccar Inc.
- Plum Creek Timber Co.
- Potlatch Corp.
- Puget Energy Inc.
- Real Networks Inc
- Safeco Corp.
- Seattle Genetics Inc.
- Shurguard Storage Centers
- Sonosite Inc.
- Spacelabs Medical
- Starbucks Corp.
- Todd Shipyards Corp.
- Washington Federal Inc.
- Washington Mutual Inc.
- Weyerhaeuser Co.
- Zymogenetics Inc.

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# *INVESTING IN WASHINGTON*

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## **Real Estate**

Several of the WSIB's real estate partners have property investments located in Washington. As of June 30, 2003, the WSIB portfolio includes whole or partial ownership of over 25 office, retail, or industrial properties located in Washington. The WSIB's equity investment in these properties is estimated at approximately \$343 million. The following are some examples:

- 1551 Eastlake Avenue - Seattle
- 2100 Evergreen Parkway - Olympia
- Bellevue Galleria - Bellevue
- Burke Building - 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

## **Private Equity**

Perhaps the most direct impact the WSIB investments might have on the Washington economy is in private equity ownership. As of June 30, 2003, the WSIB has over \$59 million invested in 46 Washington companies through its private equity partnerships. Some of the private equity portfolio companies headquartered in Washington include:

- Action Engine Corp.
- Apar Holding Corp.
- APEX Learning, Inc.
- AskMe, Corp.
- Aventail Corp.
- Broadstorm Telecom., Corp.
- Calypso Medical Tech.
- Car Toys, Inc.
- Cobalt Group, Inc.
- DSD Communications
- GeneCraft
- Intelligent Results, Inc.
- Loudeye Technologies, Inc.
- nLight Photonics Corp.
- Pacific Northwest Bancorp.
- PlayNetwork, Inc.
- Restaurants Unlimited
- SafeHarbour Tech., Corp.
- SkeleTech, Inc.
- Smooth, Corp.
- Spiration, Inc.
- Talisma Corp.
- Tera Beam
- Tidewater Holdings
- vCustomer, Corp.
- Vivato
- WatchGuard Tech., Inc.
- Western Inst. Review Board
- XCYTE Therapies
- Your Pet's Choice

## ***RETIREMENT FUNDS***

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



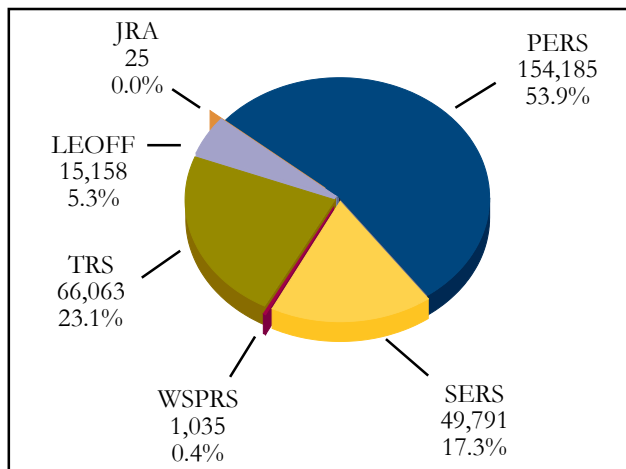
## **RETIREMENT PLANS**

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 (PERS), teachers (TRS) and classified educational employees (SERS); law enforcement officers and fire fighters (LEOFF); and other employees of participating local political subdivisions (JRA, WSPRS). The Volunteer Fire Fighters Relief & Pension Fund (VFF) is not managed by DRS, but the investment assets are managed by the WSIB.

The retirement system membership has grown to 422,640 members as of June 30, 2003, including 28,653 inactive members.

In fiscal year 2003, the sum of trust fund contributions, fees, and investment returns was \$2,155 million (including Plan 3 Self-Directed Defined Contribution). This includes positive revenues of \$427 million in member contributions and restorations, \$166 million in employer contributions, \$23 million in general fund contributions, and \$28 million in fees and other revenue, countered by \$1,512 million in investment gains.

### **ACTIVE MEMBERS BY SYSTEM**

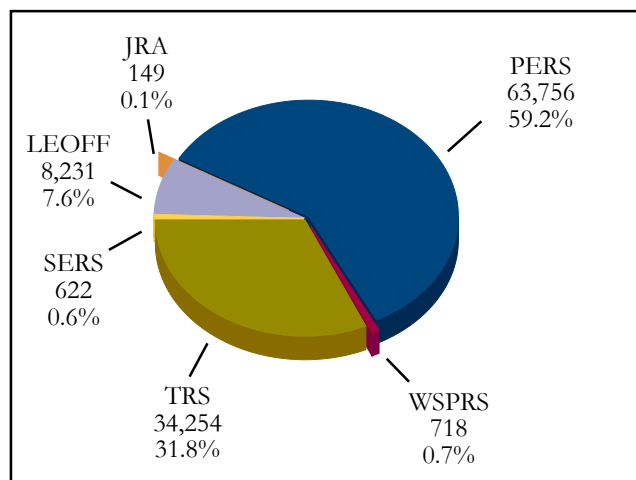


### **MARKET VALUE**

*June 30, 2003*  
(000s)

PERS 1	\$ 8,642,953
PERS 2/3	9,571,708
SERS 2/3	1,656,135
TRS 1	7,330,639
TRS 2/3	4,164,394
LEOFF 1	4,315,472
LEOFF 2	2,439,634
WSPRS	595,554
JRA	6,487
VFF	<u>96,697</u>
<b>TOTAL</b>	<b><u><u>\$ 38,819,673</u></u></b>

### **RETIRED MEMBERS BY SYSTEM**



## ***ASSET CHANGES***

Over the past ten years, the assets of the Retirement Fund have grown from \$16.4 to \$38.8 billion (as of June 30, 2003), not including the Plan 3 Self-Directed Defined Contribution Funds. This growth is comprised of employer and employee contributions, plus net investment returns, less benefit payments and fund transfers.

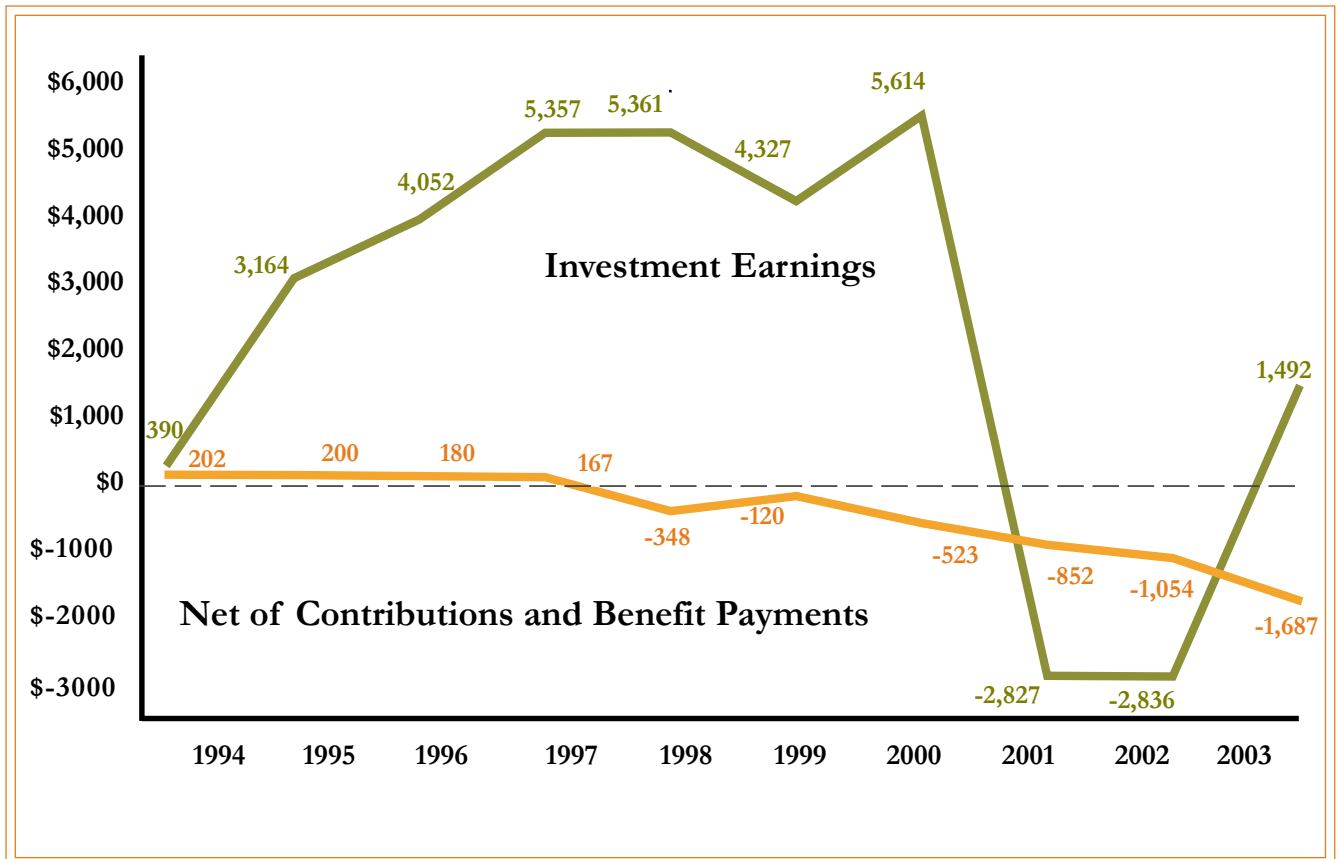
Employer contributions are driven by the obligation of the employer to fund the plan in a systematic and deliberate manner consistent with actuarial projections, existing statutes, and availability of funds. The employee contributions are the most predictable component since they are statutory and less 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 18.)

### **Factors Affecting Trust Fund Balances**

*Fiscal Year Ended June 30, 2003*

(000s)



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 defined benefit retirement funds are invested through the Retirement Commingled Trust Fund (CTF). The CTF serves to pool retirement fund assets to provide more efficient management and reduce administrative costs and investment fees.

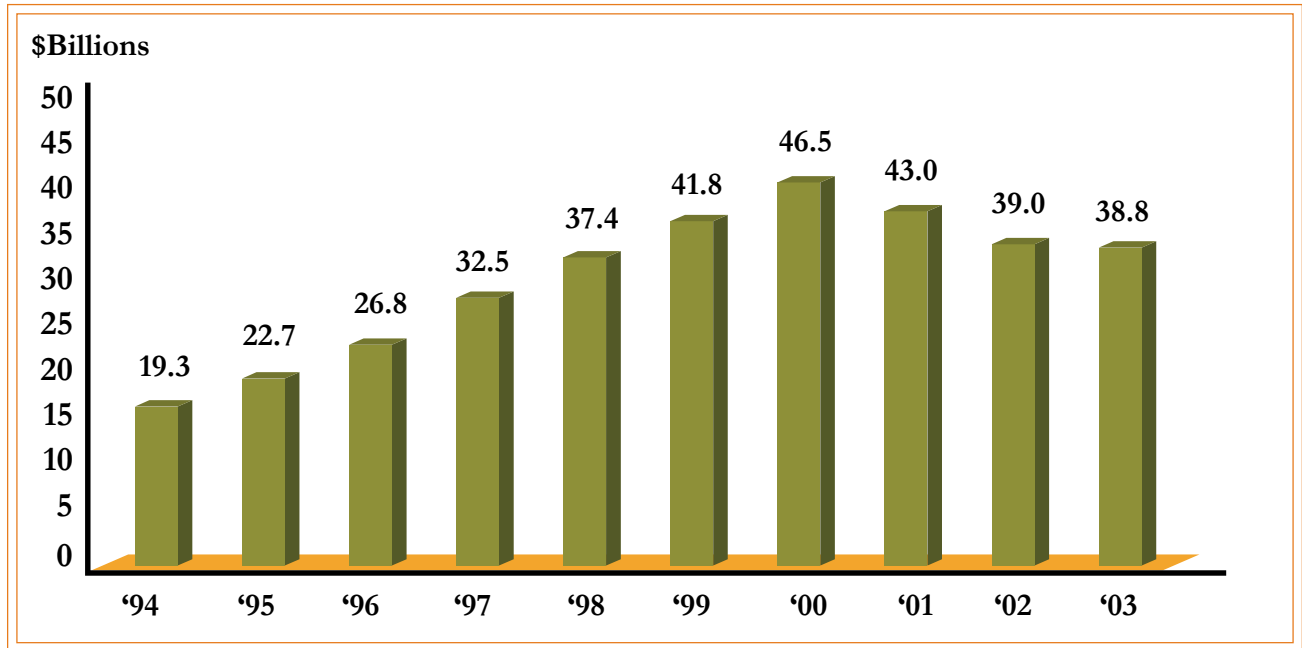
### **RETIREMENT COMMINGLED TRUST FUND** *Time-Weighted Returns - Non-Lagged* *Periods Ended June 30, 2003*

	————— Annualized —————		
	<u>One-Year</u>	<u>Three-Year</u>	<u>Five-Year</u>
<b>TOTAL FUND</b>	4.15%	-2.85%	3.17%
<i>Multi-Asset Portfolio (MAP) Benchmark</i>	3.67	-5.24	1.16
<b>CASH</b>	1.48%	1.84%	3.37%
<i>90-Day Treasury Bill</i>	1.53	3.34	4.02
<b>FIXED INCOME</b>	13.53%	10.79%	7.85%
<i>Lehman Universal Bond Index</i>	11.51	9.99	7.43
<b>U.S. EQUITY</b>	1.18%	-10.40%	-0.94%
<i>Wilshire 5000 Index</i>	1.29	-10.57	-1.30
<b>INTERNATIONAL EQUITY</b>	-4.56%	-11.51%	-1.33%
<i>MSCI ACWI Free (ex. U.S.) Index</i>	-4.19	-12.48	-2.81
<b>REAL ESTATE</b>	11.33%	11.48%	10.89%
<i>NCREIF Property Index + 100 basis points</i>	8.64	9.21%	10.79
<b>PRIVATE EQUITY</b>	-3.39%	-7.91%	2.75%
<i>S&amp;P 500 + 400 basis points</i>	4.26	-7.20%	2.39

# INVESTMENT GROWTH AND RETURNS

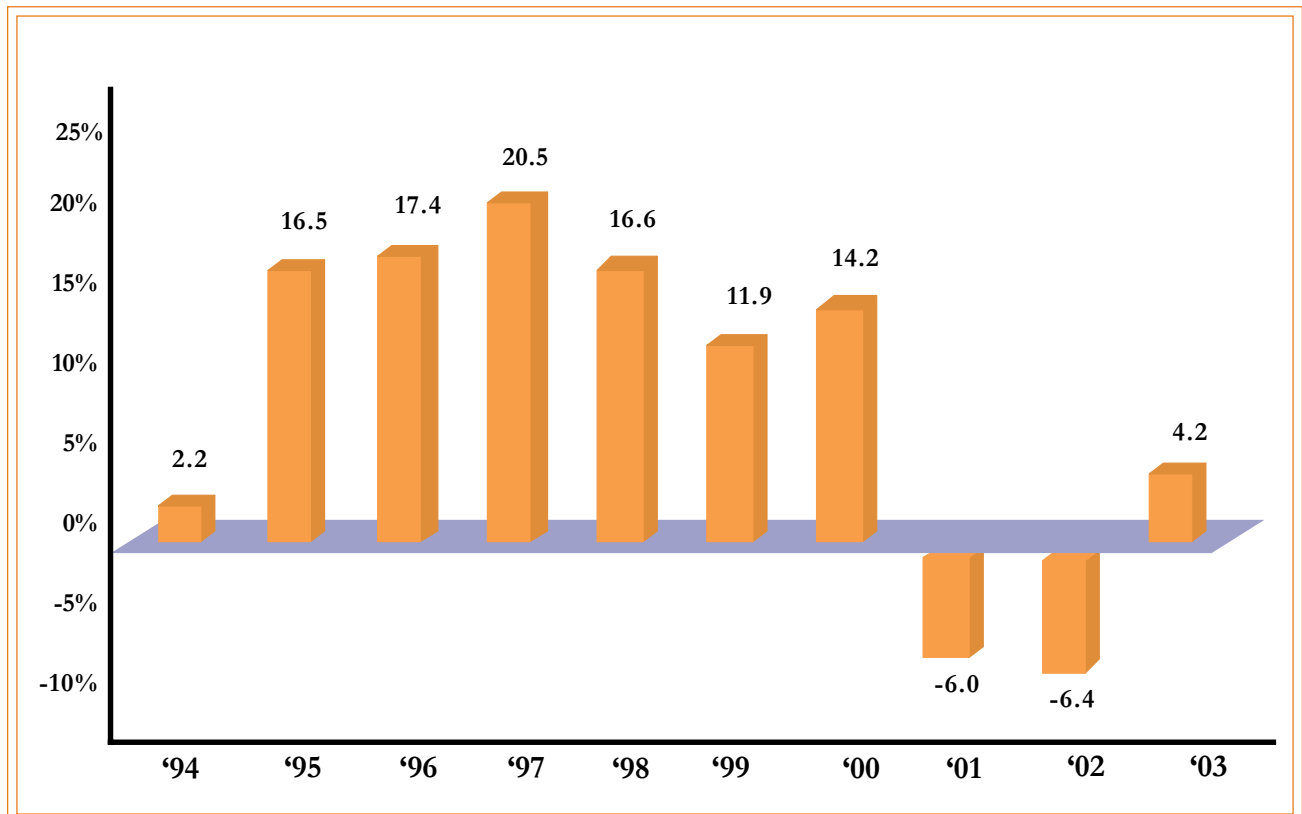
## COMMINGLED TRUST FUND HISTORICAL MARKET VALUES

*Fiscal years ended June 1994 to 2003*



## COMMINGLED TRUST FUND HISTORICAL RATES OF RETURN

*Fiscal years ended June 1994 to 2003*



## **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 CTF 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 invested 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 CTF taking profits at key times in the fixed income and international 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, 2003, private equity had open commitments of \$5.2 billion and real estate had open commitments of \$3.7 billion. 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 international equity and the fixed income portfolio.

### **RETIREMENT COMMINGLED TRUST FUND**

*June 30, 2003*

<b>ASSET CLASS</b>	<b>ALLOCATION</b>		<b>POLICY TARGET</b>	<b>POLICY RANGE</b>
	<b>(000s)</b>	<b>Percent</b>	<b>Long-Term</b>	
U.S. Equity	\$ 12,923,155	33.3%	31%	+/- 5%
Fixed Income	9,643,909	24.9%	25%	+/- 4%
International Equity	5,545,569	14.3%	15%	+/- 3%
Private Equity	5,583,673	14.4%	17%	+/- 4%
Real Estate	3,634,816	9.4%	12%	+/- 2%
Cash	1,447,652	3.7%	0%	0-2%
<b>Total CTF</b>	<b>\$ 38,778,774</b>			
<b>Plan Specific Investments*</b>	<b>\$ 40,899</b>			
<b>Total Retirement Funds</b>	<b>\$ 38,819,673</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.

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

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### **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 5,400 capitalization-weighted security returns are used to calculate the index.

As of June 30, 2003, the CTF had \$12.9 billion invested in the U.S. Equity Market Index Fund. Just over 78 percent of the portfolio consisted of large-capitalization (large-cap), Standard & Poors (S&P) companies. The remaining 22 percent of the index was comprised of mid-capitalization (mid-cap) and small-capitalization (small-cap) companies. Accordingly, the large-cap component of the WSIB U.S. equity portfolio totaled \$10.2 billion, while the small-plus mid-cap component represented \$2.7 billion.

### **FISCAL YEAR HIGHLIGHTS**

In November 2002, the Federal Reserve cut interest rates for the first time in 11 months in an attempt to boost the lackluster economy. Growth continued to remain dependent on household spending and the strength of the housing market. By calendar year-end, and for only the third time in its 106-year history, the Dow Jones Industrial Average had fallen for another successive year.

The war with Iraq began in the first quarter of 2003, and economists watched carefully to gauge its impact on the financial markets. While it was easy to blame the war for a soft global economy, the root of the problem remained that global growth was still being driven by U.S. household spending. Corporations seemed reluctant to expand while profitability remained under pressure, and the business environment remained uncertain. Investment in new equipment, factories, and offices fell for the second consecutive year.

During the second quarter of 2003, equity markets climbed with the S&P 500 Index rising 20 percent. In June 2003, the Federal Reserve decided to trim interest rates again to the present 1.00 percent. It was felt this adjustment was needed to support economic growth by maintaining U.S. consumer spending. The Wilshire 5000 Index ended the fiscal year up 1.3 percent. The Wilshire 5000 Index returned 5.2 percent during the last 12 months, while the S&P 500 Index was up 0.3 percent. The overall return of the WSIB's U.S. equity portfolio was 1.2 percent for the fiscal year.

# U.S. EQUITY PROGRAM

## U.S. EQUITY MARKET INDEX FUND DETAIL

*June 30, 2003*

### Top Ten Holdings

Issue Name	Fund (%)	Wilshire 5000 (%)
General Electric Company	2.51	2.53
Microsoft Corporation	2.41	2.43
Pfizer Inc	2.36	2.38
Exxon Mobil Corporation	2.10	2.12
Wal-Mart Stores Inc.	2.06	2.08
Citigroup Inc.	1.93	1.95
Johnson & Johnson	1.35	1.36
American International Group Inc.	1.26	1.27
International Business Machines Corporation	1.25	1.26
Merck & Co. Inc.	1.19	1.20

### Sector Diversification

Sector Type	Fund (%)	Wilshire 5000 (%)
Basic Materials	2.4	2.4
Communications	11.5	11.7
Consumer, Cyclical	10.5	10.5
Consumer, Non-cyclical	23.1	23.3
Diversified	0.0	0.0
Energy	6.0	5.9
Financial	21.6	21.6
Industrial	9.7	9.5
Technology	12.3	12.2
Utilities	2.9	2.9
Other	0.0	0.0
<b>Total</b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>

### Fund Summary Statistics

Description	Statistic
Beta versus S&P 500	1.0
Fund yield (%)	1.55
Number of issues in fund	3,660

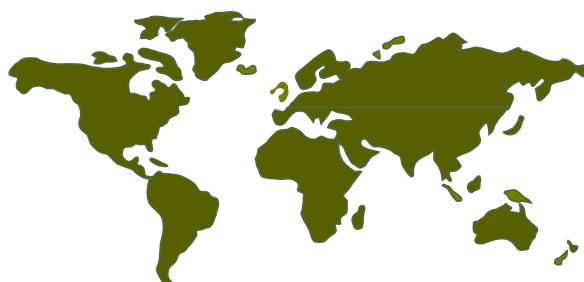
### Fund Makeup by Exchange

Exchange	Number of Companies	% of Fund Market Value
NYSE	1,692	79.4
AMEX	421	0.6
OTC	3,317	20.0

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## ***INTERNATIONAL EQUITY PROGRAM***

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### **THE PROGRAM**

As of June 30, 2003, the international equity program totaled \$5.6 billion and represented 14.5 percent of the retirement commingled trust fund.

The international equity program includes investments in both international developed and emerging markets. The program's benchmark is the MSCI ACWI ex U.S.; an index weighted by market value.

The developed markets' portion of the program currently has a 50 percent active/50 percent passive target mix. The program structure integrates 22 developed 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 that were hired in mid-1999: Artisan Partners, Delaware International Advisers, Dresdner RCM Global Investors, Nicholas Applegate Capital Management, Putnam Investments, and Pyrford International. These firms also are allowed to invest up to 10 percent of the portfolio assets in emerging market countries on an opportunistic basis. The other half of the developed markets program is passively invested by State Street Global Advisors (SSgA) in a fund that tracks the MSCI EAFE + Canada Index. As of June 30, 2003, assets allocated to developed managers were 89.7 percent of the international equity program and totaled approximately \$5 billion.

The emerging markets equity program uses four active commingled funds: Capital International Emerging Markets Growth Fund, F&C Emerging Markets Commingled Trust, Grantham Mayo van Otterloo Emerging Markets Fund, and Schroder Emerging Markets Fund. A semi-passive liquidity-tier portfolio managed by SSgA is also included in the emerging markets equity program. As of June 30, 2003, assets allocated to emerging markets were 10.3 percent of the international equity program and totaled approximately \$578 million.

### **FISCAL YEAR HIGHLIGHTS**

The international equity markets struggled during the year ended June 30, 2003. The weak U.S. economy, the war in Iraq, and the extremely weak economic environment in Japan all had an impact on international markets. The WSIB's international equity portfolio return for fiscal year 2003 was a negative 4.6 percent, underperforming the MSCI ACWI ex U.S. return of negative 4.2 percent.

The WSIB's developed markets portfolio posted a negative 5.8 percent return, underperforming the MSCI EAFE + Canada Index of negative 5.6 percent return. Emerging markets outperformed developed markets during the fiscal year. The WSIB return for the emerging markets portfolio was 7.5 percent, which outperformed the MSCI Emerging Markets Free Index return of 6.7 percent.



# INTERNATIONAL EQUITY PROGRAM

## Allocation To International Equity

June 30, 2003

<b>Developed Markets</b>	<b>Market Value (000s)</b>
<b>Active Managers</b>	
Artisan Partners	\$ 314,158
Delaware International Advisors	752,519
Dresdner RCM Global Investors	410,465
Nicholas Applegate Capital Management	206,920
Putnam Investments	523,204
Pyrford International PLC	<u>273,888</u>
Total Active	\$ 2,481,154
<b>Passive Manager</b>	
State Street Global Advisors	<u>\$ 2,535,294</u>
<b>Total Developed Markets</b>	<u>\$ 5,016,448</u>
<b>Emerging Markets</b>	
<b>Active Emerging Markets Managers</b>	
Capital International Inc.	\$ 140,331
F&C Emerging Markets, Ltd.	95,903
Grantham Mayo van Otterloo & Co.	121,635
Schroder Capital Management	<u>90,272</u>
Total Active Emerging Markets	\$ 448,141
<b>Passive Manager</b>	
State Street Global Advisors	<u>\$ 130,292</u>
<b>Total Emerging Markets</b>	<u>\$ 578,433</u>
<b>TOTAL INTERNATIONAL EQUITY</b>	<u><u>\$ 5,594,881</u></u>

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# ***FIXED INCOME PROGRAM***

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## **THE PROGRAM**

Fixed income securities constitute an important component of the portfolios of most institutional investors. Several factors make these instruments attractive. 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 Universal Index as the performance benchmark. The WSIB may invest in the following fixed income instruments:

- U.S. treasuries (TSY) and government agencies (AGY)
- 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 the sector selection. The portfolio is designed to be overweighted or underweighted relative to the benchmark index's major sectors: Treasuries, Agencies, Credits, MTG, CMBS and ABS. As of June 30, 2003, 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 Lehman Universal, but about 40 percent of those mortgages held are collateralized mortgage obligations (CMOs) whose structure provides cash flows that are more stable than standard pass-through mortgages.

The portfolio's sector structures may also be overweighted or underweighted relative to that of the index. For example, the credit portfolio's allocation to industries and quality ratings differs from the index, and the mortgage portfolio's allocation to coupon and maturity is also different than the index's allocation.

Treasury and Agency debt have the highest quality rating since they are backed by either the U.S. Treasury or governmental agencies. Most mortgage debt has agency equivalent ratings, but some securitized product, such as CMOs and CMBS, may be rated Aaa or Aa. Investment grade credit debt quality ratings range from Aaa (the highest) to Baa3 (the lowest). About 27 percent of credit bonds in the Lehman Universal are rated A and about 26 percent are rated Baa; about 20 percent are rated below investment grade, or high yield.

The portfolio's overall quality allocation reflects its large holdings of credit bonds and those credit bonds' relatively large holdings of Baa-rated companies and relatively low holdings of below investment grade companies, as well as the mortgage and securitized portfolios' holdings of Agency and Aaa rated bonds.

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## ***FIXED INCOME PROGRAM***

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### **FISCAL YEAR HIGHLIGHTS**

The last 12 months were difficult for the economy, and this was reflected in the bond market as interest rates declined dramatically resulting in higher than usual returns for fixed income sectors. Market yields were at their highest for the year on July 5, 2002, when the 10- and 30-year Treasury bonds posted yields of 4.85 percent and 5.53 percent, respectively. The low in yields occurred on June 13, 2003, as bonds had rallied to 3.11 percent for the 10-year and 4.18 for the 30-year. By June 30, those yields had risen to 3.52 percent and 4.56 percent, respectively, as the economy was finally showing signs of recovery, or at least of having bottomed out.

Allocation changed during the year as this rally in yields progressed. The allocation to Treasuries and TIPS was reduced from about 25 to 13 percent. CMBS were cut from 7 to about 4 percent. Mortgages were increased from less than 18 to almost 27 percent as pass-through mortgages were added. More importantly, as longer maturity bonds were sold in all sectors, cash holdings were increased, and cash ended the year at almost 9 percent of the total allocation after starting at less than 2 percent.

During the year, the WSIB's portfolio's duration began at about 9 percent longer than the duration of the Lehman Universal Index. It was as high as 18 percent longer in December, but finished the year almost 4 percent shorter than the index duration as holdings of longer maturity bonds were reduced and shorter duration holdings, such as pass-through mortgages and cash, were increased.

The WSIB's portfolio outperformed the Lehman Universal Index by 2.02 percent for the fiscal year, returning 13.53 percent compared to the Index's 11.51 percent. TIPS held in the portfolio were the best returning sector at 18.49 percent, followed by credit bonds at 16.26 percent, and CMBS at 15.61 percent.

### **ALLOCATION TO FIXED INCOME**

*June 30, 2003*

<b>SECTOR</b>	<b>MARKET VALUE (000s)</b>
<b>Cash</b>	<u>\$ 943,742</u>
<b>Bonds</b>	
U.S. Treasuries	545,598
TIPS	934,958
Agencies	337,461
Credit	4,469,005
Asset-Backed	54,700
CMBS	444,637
Mortgages	<u>2,838,865</u>
Total Bonds	<u>\$ 9,625,224</u>
<b>Total Fixed Income</b>	<u><u>\$ 10,568,966</u></u>

# FIXED INCOME PROGRAM

## FIXED INCOME PORTFOLIO CHARACTERISTICS

June 30, 2003

Sector Distribution	WSIB Portfolio	Lehman Universal
Cash	8.9%	0.0%
Treasury	5.2%	19.2%
TIPS	8.8%	0.0%
Agency	3.2%	10.7%
Credit	42.3%	36.1%
Asset-Backed	0.5%	1.6%
CMBS	4.2%	2.5%
Mortgages	26.9%	30.0%
	<u>100.0%</u>	<u>100.0%</u>

Top Ten Issuers	
Market Value – (000s)	
United States Treasury	\$ 1,480,556
FNMA Securitized Mortgages	1,211,949
FHLMC Securitized Mortgages	1,090,492
FNMA Agency Bonds	208,429
Republic of Brazil	104,710
RFMSI CMOs	97,824
Union Pacific Corp.	89,001
Wells Fargo	83,375
Quebec Province Canada	82,917
Mid-American Energy	82,856

Quality Distribution	WSIB Portfolio	Lehman Universal
TSY	14.0%	19.2%
AGY	26.0%	40.6%
Aaa	21.4%	8.0%
Aa	7.6%	5.5%
A	10.9%	9.9%
Baa	15.5%	9.4%
Other	4.6%	7.5%
	<u>100.0%</u>	<u>100.0%</u>

*Moody's Quality Ratings*

Maturity Distribution	WSIB Portfolio	Lehman Universal
0 – 1 Year	14.9%	0.0%
1 – 3 Years	24.3%	32.8%
3 – 5 Years	21.7%	23.5%
5 – 7 Years	11.5%	14.3%
7 – 10 Years	18.6%	13.7%
10 – 15 Years	4.2%	3.5%
15 – 20 Years	0.5%	3.9%
20 – 25 Years	1.2%	3.5%
25+ Years	3.2%	4.8%
	<u>100.0%</u>	<u>100.0%</u>

Coupon Distribution	WSIB Portfolio	Lehman Universal
0 – 4.9%	34.1%	18.6%
5 – 6.9%	45.1%	50.4%
7 – 7.9%	11.9%	16.8%
8 – 8.9%	4.1%	8.1%
9 – 9.9%	2.7%	2.9%
10+%	2.2%	3.3%
	<u>100.0%</u>	<u>100.0%</u>

Effective Duration	WSIB Portfolio	Lehman Universal
0 – 1 Year	17.2%	19.9%
1 – 3 Years	29.8%	32.5%
3 – 4 Years	12.4%	8.4%
4 – 6 Years	16.5%	15.0%
6 – 8 Years	15.4%	9.9%
8+ Years	8.8%	14.3%
	<u>100.0%</u>	<u>100.0%</u>

\* Totals may not equal 100% due to rounding.

# FIXED INCOME PROGRAM

## CREDIT PORTFOLIO CHARACTERISTICS

June 30, 2003

Sector Distribution	WSIB Credit	Universal Credit
Industrial	43.7%	43.9%
Utilities	10.4%	8.7%
Financial	25.8%	27.2%
Non-Corporate	20.1%	20.2%
	100.0%	100.0%

Quality Distribution	WSIB Credit	Universal Credit
Aaa	8.5%	12.8%
Aa	17.9%	14.1%
A	25.7%	27.1%
Baa	36.6%	25.8%
Other	11.4%	20.3%
	100.0%	100.0%

*Moody's Quality Ratings*

Top Ten Credit Holdings	Coupon	Maturity	Market Value (000s)
Petrobras International Finance	9.750%	07/06/11	\$ 61,959
US Bancorp	6.300%	07/15/08	59,310
Cia Brasileira de Bebidas	10.500%	12/15/11	55,733
Province of Manitoba	2.750%	01/17/06	54,139
Verizon NJ	5.875%	01/17/12	53,902
Republic of Brazil	12.000%	04/15/10	53,267
Vale Overseas Ltd.	8.625%	03/08/07	51,229
American Honda Finance	2.875%	04/03/06	48,934
Nordic Investment Bank MTN	2.750%	01/11/06	48,689
Export Development Canada	2.750%	12/12/05	48,272

Top Ten Credit Issuers	Market Value – (000s)
Republic of Brazil	\$ 117,216
Union Pacific Corporation	102,069
Wells Fargo	83,375
Province of Quebec	82,917
Mid-American Energy	82,856
Petroleos Mexicanos	81,894
HSBC	80,942
CSX Corporation	78,642
US Bancorp	70,686
Progress Energy	68,484

Maturity Distribution	WSIB Credit	Universal Credit
0 – 1 Year	2.1%	0.0%
1 – 3 Years	17.3%	20.0%
3 – 5 Years	26.8%	20.1%
5 – 7 Years	11.5%	14.4%
7 – 10 Years	26.5%	23.5%
10 – 15 Years	9.9%	4.2%
15 – 20 Years	1.1%	3.2%
20 – 25 Years	2.8%	5.5%
25+ Years	2.1%	9.2%
	100.0%	100.0%

Effective Duration	WSIB Credit	Universal Credit
0 – 1 Year	2.3%	1.6%
1 – 3 Years	22.6%	23.5%
3 – 4 Years	16.6%	13.1%
4 – 6 Years	22.0%	24.7%
6 – 8 Years	21.5%	18.8%
8+ Years	15.1%	18.3%
	100.0%	100.0%

Coupon Distribution	WSIB Credit	Universal Credit
0 - 4.9%	34.0%	12.9%
5 - 6.9%	25.9%	36.1%
7 - 7.9%	20.4%	25.7%
8 - 8.9%	9.2%	13.4%
9 - 9.9%	6.0%	6.0%
10+%	4.5%	5.9%
	100.0%	100.0%

\* Totals may not equal to 100% due to rounding.

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## **PRIVATE EQUITY PROGRAM**

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### **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 investments 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 4 to 6 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 \$600 million to private equity partnerships. The portfolio increased in value from \$5.12 to \$5.58 billion during the past fiscal year, representing 14 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 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 provided by the general partners and reviewed by WSIB consultants and staff.

Since the program's inception in 1981, the fund has achieved 13.0 percent internal rate of return (IRR), net of partnership fees and expenses. The IRR calculation is the industry standard method for calculating investment performance. Time weighted returns, which represent performance independent of the timing of cash flows, are also calculated for the asset class.

### **ALLOCATION TO PRIVATE EQUITY**

*June 30, 2003*

<b>SUB-ASSET CLASS</b>	<b>MARKET VALUE (000s)</b>	<b>% OF PRIVATE EQUITY</b>
Large Corporate Finance	\$2,183,380	39.1%
Venture Capital	769,156	13.8%
International	950,115	17.0%
Distressed	554,274	9.9%
Small/Medium Corporate Finance	414,866	7.5%
Mezzanine	280,741	5.0%
Other	<u>431,141</u>	<u>7.7%</u>
<b>Total Private Equity</b>	<u><u>\$5,583,673</u></u>	<u><u>100.0%</u></u>

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## ***REAL ESTATE PROGRAM***

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### **THE PROGRAM**

The WSIB's real estate program is an externally-managed selection of partnership investments intended to provide alternative portfolio characteristics when compared with stock and bond investments. The majority of the WSIB's partnerships in this asset class invest in high-quality real estate leased to third parties. The combination of steady income generated from lease payments and the potential upside from appreciation of the physical 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. Many of the WSIB's investment partnerships do not involve co-investment with other financial investors, thereby providing the WSIB with control provisions related to acquisition, liquidation, and ongoing operational decisions such as annual business plans.

Volatility within the real estate portfolio is minimized through a combination of factors:

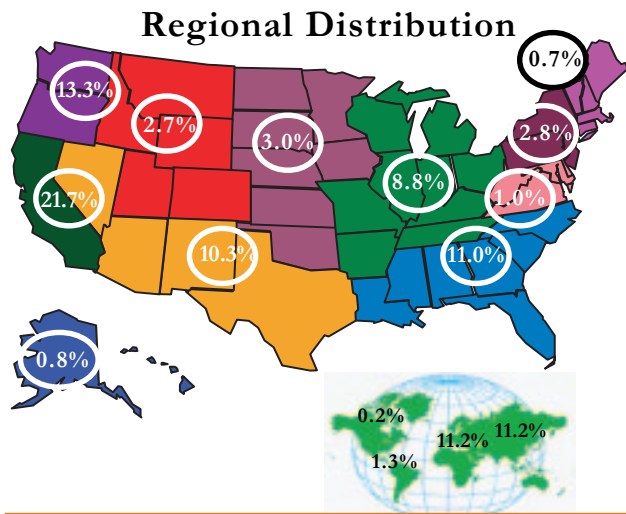
- The majority of the WSIB's partners own real estate assets as private market investments, so they are not subject to the potential volatility of the public markets.
- Capital is diversified among a variety of partners, each with their own investment style.
- Partnership assets are geographically diversified, including outside the U.S.
- Investments are made in a variety of property types to provide further diversification.
- WSIB partners invest at different points in the real estate capital structure, as well as at different times in the property life cycle.

The WSIB's current return objective for real estate calls for a target benchmark return of 100 to 300 basis points (1 to 3 percent) above the National Council of Real Estate Investment Fiduciaries (NCREIF) index. The portfolio's value as of June 30, 2003 was \$3.6 billion representing 9.4 percent of the total retirement fund. This was the same value as recorded the previous fiscal year end. The WSIB's long-term target allocation to real estate is 12 percent.

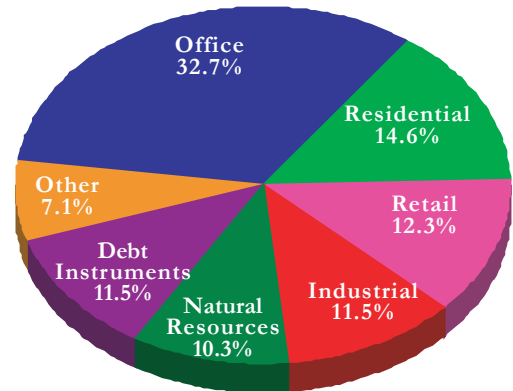
### **FISCAL YEAR HIGHLIGHTS**

Despite challenging domestic property markets, the WSIB's real estate portfolio posted attractive risk-adjusted returns. For the one-year period ended June 30, 2003, the WSIB's real estate portfolio significantly outperformed the NCREIF Index, 12.1 percent to 7.6 percent.

# REAL ESTATE PROGRAM



## Asset Type Distribution



## ESTIMATED REAL ESTATE VALUE

June 30, 2003

ADVISOR/PARTNER	INVESTMENT	MARKET VALUE (000s)
Principal Global Investors	Principal Enterprise Capital	\$ 538,188
Pacific Realty Associates	PacTrust	257,021
Pacific Realty Associates	Pac/SIB	162,261
TA Associates	Olympia Properties	361,445
Hudson Advisors	Lonestar I	16,285
Hudson Advisors	Lonestar II	58,648
Hudson Advisors	Lonestar III	290,265
Hudson Advisors	Lonestar IV	96,006
Campbell Group	Hawthorne Timber	299,712
Hometown Residential Manager	Hometown America	232,880
Lake Union Partners, LLC	Washington Holdings	43,045
Lake Union Partners, LLC	Union Square	187,574
Morgan Stanley	MSREF International III	84,239
Morgan Stanley	MSREF International IV	162,753
Morgan Stanley	MSSS	1,937
Lowe Enterprises	Lowe Northwest	256,544
Black Creek Capital/EIP	Corporate Properties of the Americas	30,793
Cherokee Investment Services	Cherokee Investment Partners II	69,073
Cherokee Investment Services	Cherokee Investment Partners III	16,461
Colonnade	MCPI	101,124
PRICOA	European Investment Properties	178,212
ING Realty Associates	ING Realty Partners	62,285
Hearthstone	Hearthstone Olympia Homebuilding Partners	(4,295)
Hearthstone	MSII	19,397
JE Roberts Companies	JER I	42,690
Hancock Nat. Res. Group	ForesTree Washington	70,274
<b>Total Real Estate</b>		<b>\$ 3,634,817</b>



## ***DEFINED CONTRIBUTION RETIREMENT PLANS***

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

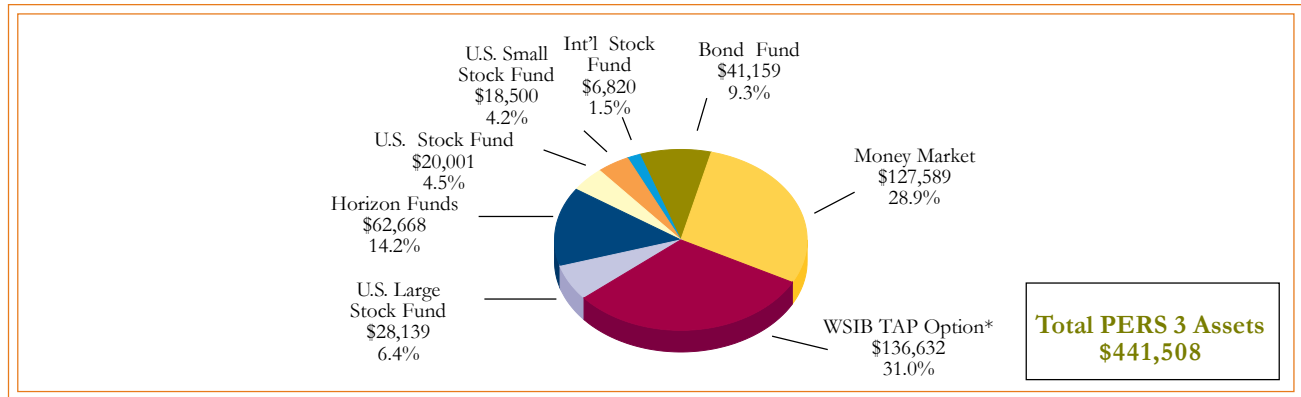
# PUBLIC EMPLOYEES' RETIREMENT SYSTEM PLAN 3

As trustee of the PERS Plan 3, the WSIB is responsible for the investment of plan assets and for the provision of self-directed investment options to plan members. 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 Defined Contribution Assets and Performance

June 30, 2003

(000s)



\* The WSIB Total Allocation Portfolio (TAP) option, the statutory default option for PERS Plan 3, is invested in the CTF.

FUND PERFORMANCE	One-Year	+ Three-Year	+ Five-Year
<b>WSIB TAP Option</b>	3.0%	-3.1%	3.0%
<i>Custom Benchmark*</i>	3.4%	-5.6%	0.6%
<b>Short-Horizon Fund</b>	5.9%	**	**
<i>Custom Benchmark‡</i>	6.8%	2.7%	4.5%
<b>Mid-Horizon Fund</b>	5.4%	**	**
<i>Custom Benchmark‡</i>	6.6%	-1.0%	3.1%
<b>Long-Horizon Fund</b>	1.6%	**	**
<i>Custom Benchmark‡</i>	2.8%	-6.7%	0.4%
<b>U.S. Stock Fund</b>	0.9%	**	**
<i>Russell 3000 Index</i>	0.8%	-10.5%	-1.1%
<b>U.S. Large Stock Fund</b>	0.3%	-11.2%	-1.6%
<i>S &amp; P 500 Index</i>	0.3%	-11.2%	-1.6%
<b>U.S. Small Stock Fund</b>	-1.9%	-3.3%	0.8%
<i>Russell 2000 Index</i>	-1.6%	-3.3%	1.0%
<b>International Stock Fund</b>	-10.1%	-15.1%	-5.0%
<i>MSCI EAFE Index</i>	-6.5%	-13.5%	-4.0%
<b>Bond Fund</b>	12.8%	**	**
<i>Lehman Intermediate Credit</i>	13.7%	11.1%	8.0%
<b>Money Market</b>	1.7%	3.6%	4.5%
<i>90 Day T-Bill</i>	1.5%	3.3%	4.3%

\* TAP Custom Benchmark: 60% Wilshire 5000 + 25% Lehman Universal + 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.

+ The returns shown in the three-year and five-year columns are the returns earned by the fund that PERS 3 invests in.

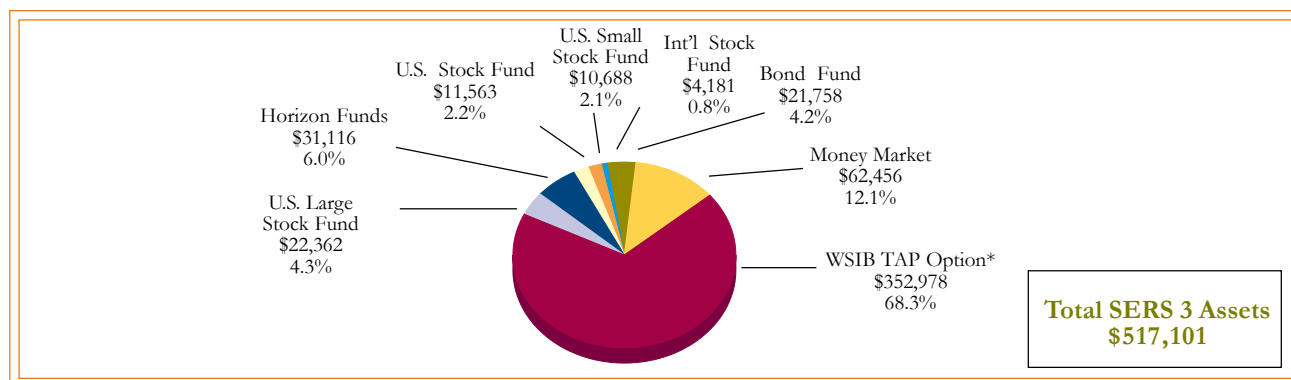
# SCHOOL EMPLOYEES' RETIREMENT SYSTEM PLAN 3

As trustee of the SERS Plan 3, the WSIB is responsible for the investment of plan assets and for the provision of self-directed investment options to plan members. DRS is responsible for plan administration, accounting, and record-keeping.

## SERS Plan 3 Defined Contribution Assets and Performance

June 30, 2003

(000s)



\* The WSIB Total Allocation Portfolio (TAP) option, the statutory default option for SERS Plan 3, is invested in the CTF.

FUND PERFORMANCE	One-Year	+ Three-Year	+ Five-Year
<b>WSIB TAP Option</b> <i>Custom Benchmark*</i>	3.0% 3.4%	-3.1% -5.6%	3.0% 0.6%
<b>Short-Horizon Fund</b> <i>Custom Benchmark†</i>	5.9% 6.8%	** 2.7%	** 4.5%
<b>Mid-Horizon Fund</b> <i>Custom Benchmark†</i>	5.4% 6.6%	** -1.0%	** 3.1%
<b>Long-Horizon Fund</b> <i>Custom Benchmark†</i>	1.6% 2.8%	** -6.7%	** 0.4%
<b>U.S. Stock Fund</b> <i>Russell 3000 Index</i>	0.9% 0.8%	** -10.5%	** -1.1%
<b>U.S. Large Stock Fund</b> <i>S &amp; P 500 Index</i>	0.3% 0.3%	-11.2% -11.2%	-1.6% -1.6%
<b>U.S. Small Stock Fund</b> <i>Russell 2000 Index</i>	-1.9% -1.6%	-3.3% -3.3%	0.8% 1.0%
<b>International Stock Fund</b> <i>MSCI EAFE Index</i>	-10.1% -6.5%	-15.1% -13.5%	-5.0% -4.0%
<b>Bond Fund</b> <i>Lehman Intermediate Credit</i>	12.8% 13.7%	** 11.1%	** 8.0%
<b>Money Market</b> <i>90 Day T-Bill</i>	1.7% 1.5%	3.6% 3.3%	4.5% 4.3%

\* TAP Custom Benchmark: 60% Wilshire 5000 + 25% Lehman Universal + 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.

+ The returns shown in the three-year and five-year columns are the returns earned by the fund that PERS 3 invests in.

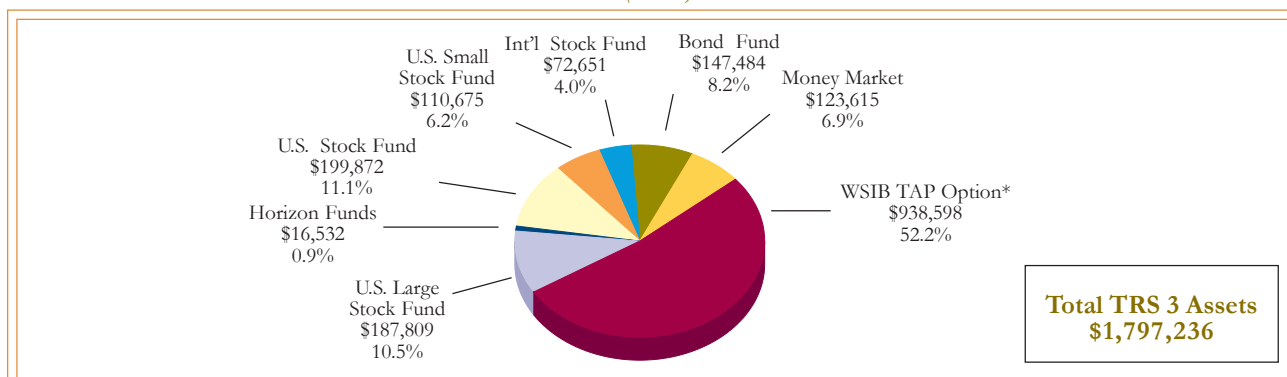
## TEACHERS' RETIREMENT SYSTEM PLAN 3

As trustee of the TRS Plan 3, the WSIB is responsible for the investment of plan assets and for the provision of self-directed investment options to plan members. DRS is responsible for plan administration, accounting, and record-keeping.

### TRS Plan 3 Defined Contribution Assets and Performance

June 30, 2003

(000s)



\* The WSIB Total Allocation Portfolio (TAP) option, the statutory default option for TRS Plan 3, is invested in the Retirement Commingled Trust Fund.

FUND PERFORMANCE	One-Year	Three-Year	Five-Year
<b>WSIB TAP Option</b>	3.0%	-3.1%	3.0%
<i>Custom Benchmark*</i>	3.4%	-5.6%	0.6%
<b>Short-Horizon Fund</b>	5.9%	**	**
<i>Custom Benchmark‡</i>	6.8%	2.7%	4.5%
<b>Mid-Horizon Fund</b>	5.4%	**	**
<i>Custom Benchmark‡</i>	6.6%	-1.0%	3.1%
<b>Long-Horizon Fund</b>	1.6%	**	**
<i>Custom Benchmark‡</i>	2.8%	-6.7%	0.4%
<b>U.S. Stock Fund</b>	0.9%	**	**
<i>Russell 3000 Index</i>	0.8%	-10.5%	-1.1%
<b>U.S. Large Stock Fund</b>	0.3%	-11.2%	-1.6%
<i>S &amp; P 500 Index</i>	0.3%	-11.2%	-1.6%
<b>U.S. Small Stock Fund</b>	-1.9%	-3.3%	0.8%
<i>Russell 2000 Index</i>	-1.6%	-3.3%	1.0%
<b>International Stock Fund</b>	10.1%	-15.1%	-5.0%
<i>MSCI EAFE Index</i>	-6.5%	-13.5%	-4.0%
<b>Bond Fund</b>	12.8%	**	**
<i>Lehman Intermediate Credit</i>	13.7%	11.1%	8.0%
<b>Money Market</b>	1.7%	3.6%	4.5%
<i>90 Day T-Bill</i>	1.5%	3.3%	4.3%

\* TAP Custom Benchmark: 60% Wilshire 5000 + 25% Lehman Universal + 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.

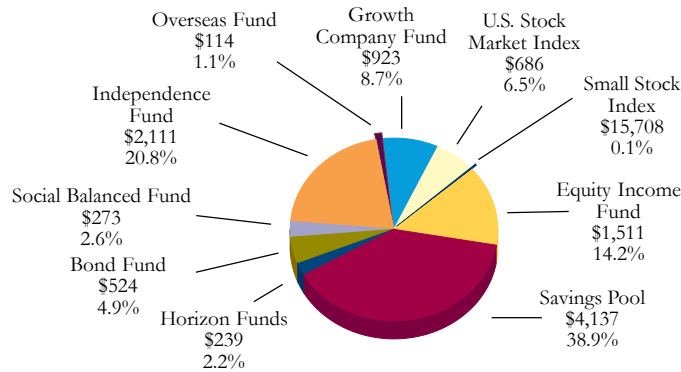
# JUDICIAL RETIREMENT ACCOUNT

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

## JRA Assets and Performance

June 30, 2003

(000s)



**Total JRA Assets**  
**\$10,634**

### FUND PERFORMANCE

#### U.S. Stock Market Index Fund

*Wilshire 5000*

### ONE-YEAR

### THREE-YEAR

### FIVE-YEAR

1.2%      -10.4%      -0.9%

1.3%      -10.6%      -1.3%

#### Small Stock Index

*Russell 2000 Index*

-1.9%      -3.3%      0.8%

-1.6%      -3.3%      1.0%

#### Equity Income Fund

*Russell 3000 Value*

-2.2%      -1.1%      0.5%

-1.2%      0.6%      1.3%

#### Growth Company Fund

*Russell 3000 Growth*

5.7%      -20.2%      2.0%

2.8%      -21.2%      -5.0%

#### Independence Fund

*Russell 3000*

2.9%      -15.6%      2.2%

0.8%      -10.5%      -1.1%

#### Overseas Fund

*MSCI EAFE Index*

-8.9%      -15.2%      -4.1%

-6.5%      -13.5%      -4.0%

#### Short-Horizon Fund ‡

*Custom Benchmark ‡*

5.9%      \*\*      \*\*

6.8%      2.7%      4.5%

#### Mid-Horizon Fund ‡

*Custom Benchmark ‡*

5.4%      \*\*      \*\*

6.6%      -1.0%      3.1%

#### Long-Horizon Fund ‡

*Custom Benchmark ‡*

1.6%      \*\*      \*\*

2.8%      -6.7%      0.4%

#### Social Balanced Fund

*Custom Benchmark*

3.5%      -4.8%      -0.4%

7.1%      -1.7%      2.9%

#### Bond Fund

*Lehman Intermediate Credit*

12.8%      \*\*      \*\*

13.7%      11.1%      8.0%

#### Savings Pool

5.8%      6.2%      6.6%

‡ 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***

- **Assets and Performance**

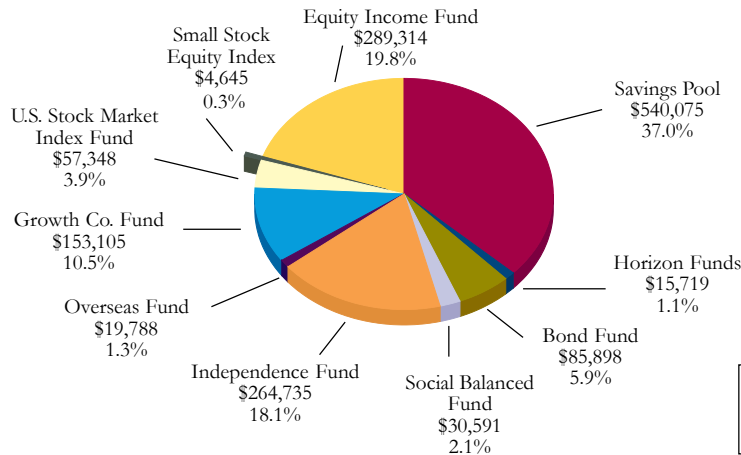
# DEFERRED COMPENSATION PROGRAM

As trustee of state DCP assets, the WSIB is responsible for the investment of DCP funds and for the provision of investment options to participants in the program. DRS is responsible for DCP administration, accounting, and record-keeping.

## DCP Assets and Performance

June 30, 2003

(000s)



**DCP Total Assets**  
**\$ 1,461,218,424**

### FUND PERFORMANCE

	ONE-YEAR	THREE-YEAR	FIVE-YEAR
<b>U.S. Stock Market Index Fund</b> <i>Wilshire 5000</i>	1.2% 1.3%	-10.4% -10.6%	-0.9% -1.3%
<b>Small Stock Equity Index</b> <i>Russell 2000</i>	-1.9% -1.6%	-3.3% -3.3%	0.8% 1.0%
<b>Equity Income Fund</b> <i>Russell 3000 Value</i>	-2.2% -1.2%	-1.1% 0.6%	0.5% 1.3%
<b>Growth Company Fund</b> <i>Russell 3000 Growth</i>	5.7% 2.8%	-20.2% -21.2%	2.0% -5.0%
<b>Independence Fund</b> <i>Russell 3000</i>	2.9% 0.8%	-15.6% -10.5%	2.2% -1.1%
<b>Overseas Fund</b> <i>MSCI EAFE Index</i>	-8.9% -6.5%	-15.2% -13.5%	-4.1% -4.0%
<b>Short-Horizon Fund</b> <i>Custom Benchmark</i> ‡	5.9% 6.8%	** 2.7%	** 4.5%
<b>Mid-Horizon Fund</b> <i>Custom Benchmark</i> ‡	5.4% 6.6%	** -1.0%	** 3.1%
<b>Long-Horizon Fund</b> <i>Custom Benchmark</i> ‡	1.6% 2.8%	** -6.7%	** 0.4%
<b>Social Balanced Fund</b> <i>Custom Benchmark</i> ‡	3.5% 7.1%	-4.8% -1.7%	-0.4% 2.9%
<b>Bond Fund</b> <i>Lehman Intermediate Credit</i>	12.8% 13.7%	** 11.1%	** 8.0%
<b>Savings Pool</b>	5.8%	6.2%	6.6%

‡ 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.

***DAILY-VALUED FUNDS  
FOR SELF-DIRECTED INVESTMENT PROGRAMS***

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



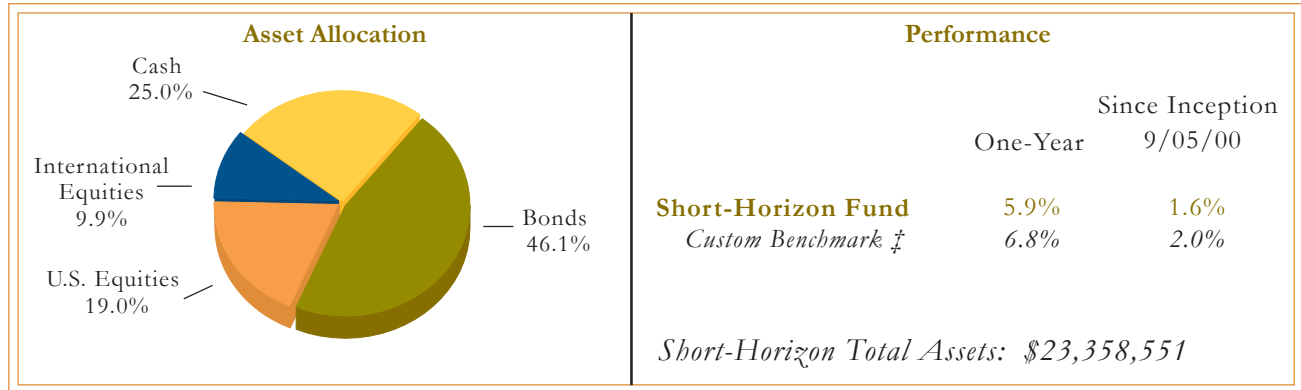
# WASHINGTON STATE HORIZON FUNDS

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 JRA) and the DCP. The three Horizon Funds provide participants in these plans 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 the WSIB to preserve the proper asset allocation mix.

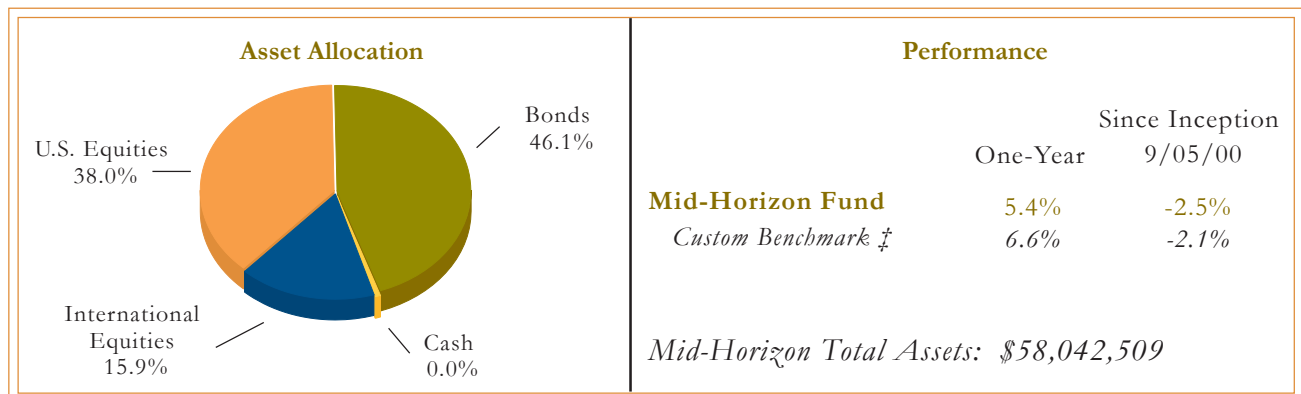
## Horizon Funds Asset Allocation and Performance

June 30, 2003

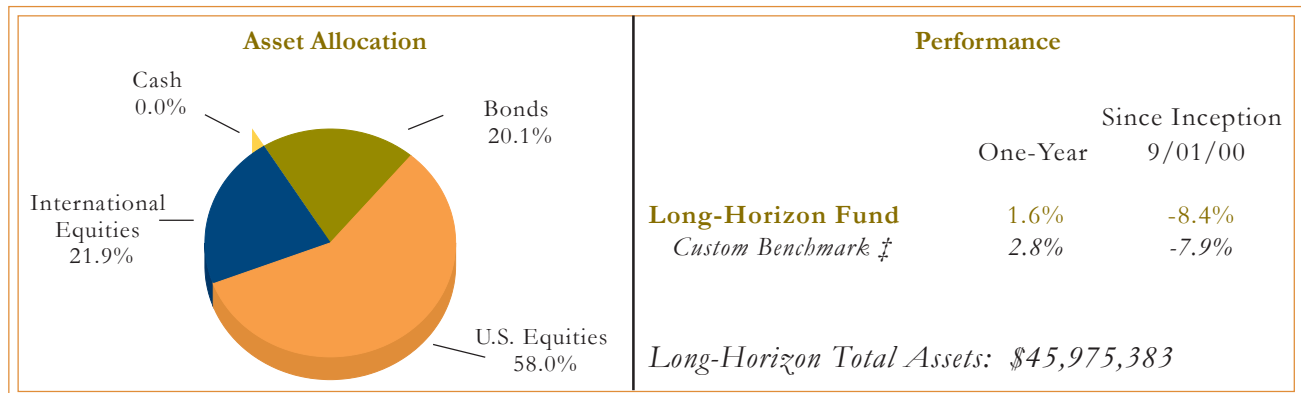
### Short-Horizon



### Mid-Horizon



### Long-Horizon



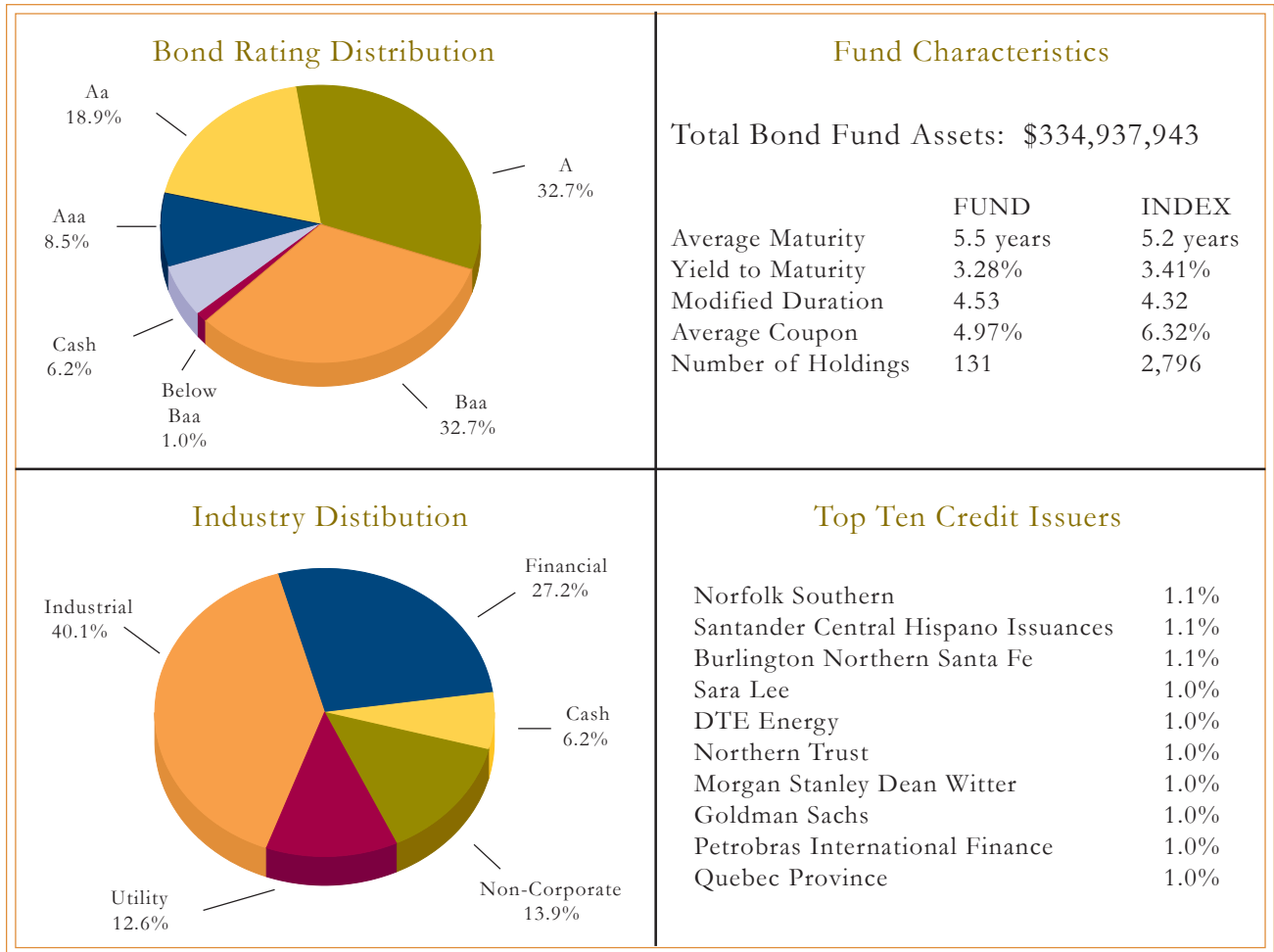
‡ Horizon Fund Custom Benchmarks: **Short** - 46% Lehman Intermediate Credit + 25% London Interbank Offered Rate + 19% Wilshire 5000 + 10% MSCI EAFE; **Mid** - 46% Lehman Intermediate Credit + 38% Wilshire 5000 + 16% MSCI EAFE; **Long** - 58% Wilshire 5000 + 22% MSCI EAFE + 20% Lehman Intermediate Credit.

# 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 JRA) and the DCP. The goal is to provide attractive returns while controlling risk by investing in high-quality corporate bonds. The 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, 2003*



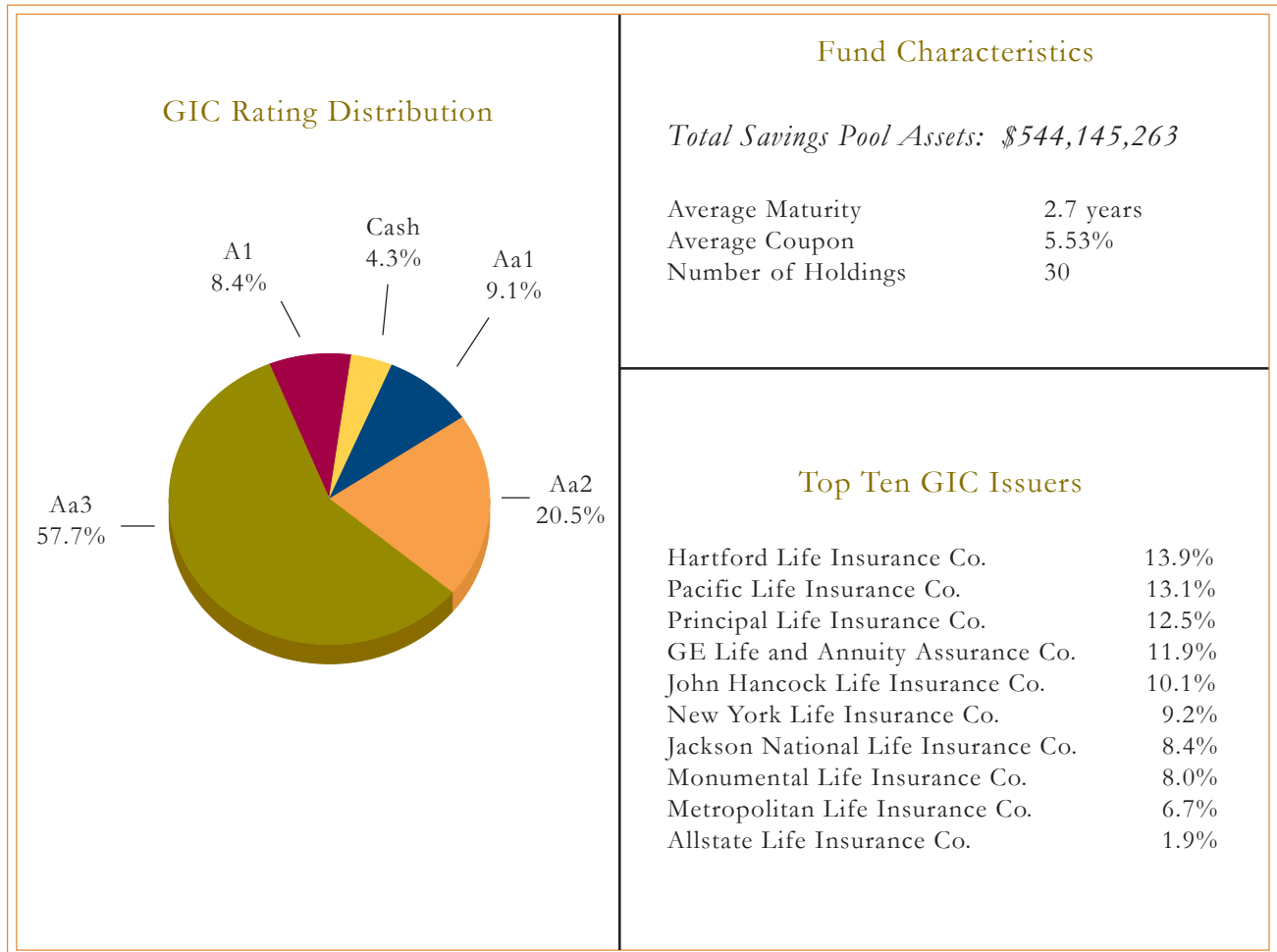
Fund Performance	One-Year	Since Inception 7/23/00
Washington State Bond Fund	12.8%	10.5%
<i>Lehman Intermediate Credit Index</i>	13.7%	11.0%

# 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 are the primary objectives. In addition to the DCP, this investment option is also available to participants in the JRA. The Savings Pool is a diversified portfolio of guaranteed investment contracts (GICs) and short-term cash funds. Its 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, 2003*



Fund Performance	One-Year	Three-Year	Five-Year
Savings Pool †	5.8%	6.2%	6.4%

† 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**

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## **INDUSTRIAL INSURANCE FUNDS**

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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 \$9.3 billion.

### **ACCIDENT FUND**

This fund receives premiums from employers for industrial insurance and income from investments. It's primarily used 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.

### **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 permanently disabled workers and survivors of deceased workers.

### **MEDICAL AID FUND**

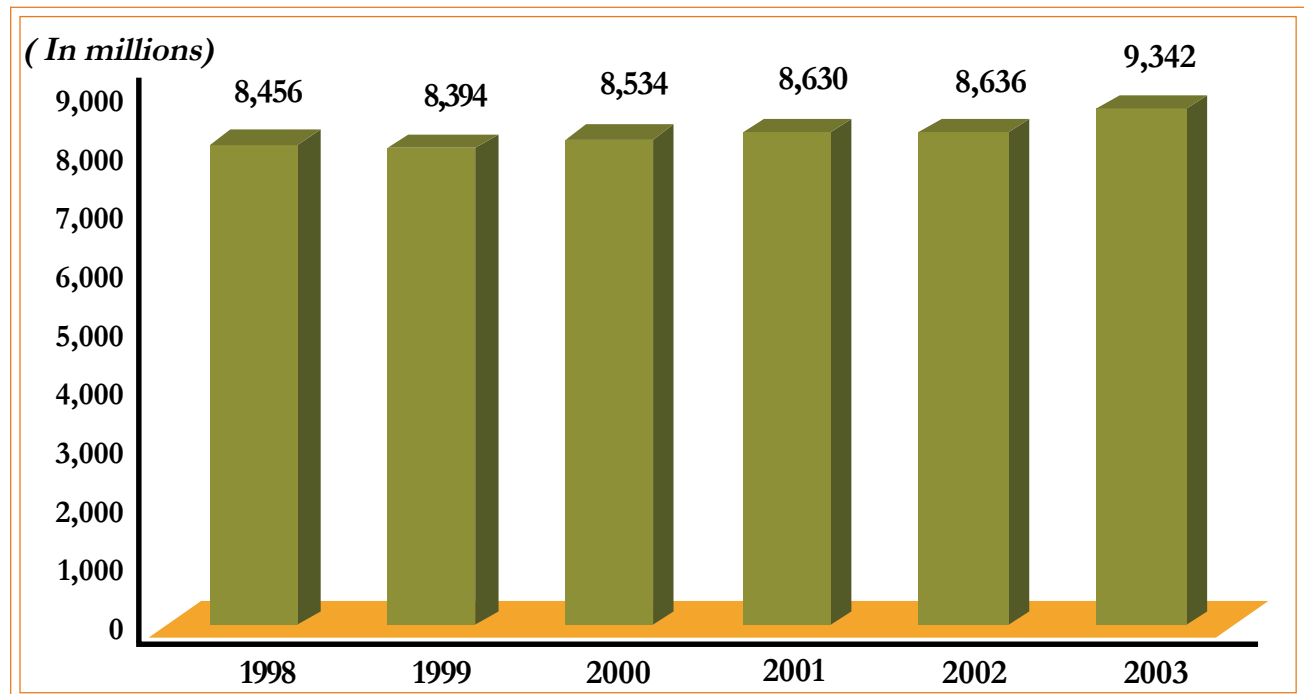
This fund receives premiums paid by both the employer and employee, as well as income from investments. Payments are made for conservative medical care, hospital services, artificial appliances, physical and vocational rehabilitation, travel expenses, any other service required by the injured worker, and administrative costs.

### **SUPPLEMENTAL PENSION FUND**

This fund receives earnings from investments, and premiums from employer and employees. These assets 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, 2003*



# INDUSTRIAL INSURANCE FUNDS

## ASSET ALLOCATION

*June 30, 2003*

The Industrial Insurance Funds' 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 and equities provide 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 14.1 percent.

Assets	Market Value (000s)	Percent
<b>Short-Term (Cash)</b>	\$ 190,519	2.0%
<b>Long-Term Fixed Income</b>		
U.S. Government (TSY & AGY)	\$ 1,956,100	20.9%
Credit Bonds	4,188,131	44.8%
Asset-Backed Securities	106,046	1.1%
Mortgages	<u>1,587,897</u>	<u>17.0%</u>
<b>Total Fixed Income plus cash</b>	<u>\$ 8,028,693</u>	<u>85.9%</u>
<b>Equities</b>		
U.S. Equity Market Index	\$ 1,116,337	11.9%
MSCI EAFE Index	<u>196,947</u>	<u>2.1%</u>
<b>Total Equity</b>	<u>\$ 1,313,284</u>	<u>14.1%</u>
<b>TOTAL</b>	<u><u>\$ 9,341,977</u></u>	<u><u>100.0%</u></u>

## TIME-WEIGHTED RETURNS

*June 30, 2003*

	— Annualized —		
	One-Year	Three-Year	Five-Year
Accident Fund	15.5%	9.6%	7.2%
Medical Aid Fund	7.6%	5.1%	5.6%
Pension Reserve Fund	19.1%	3.4%	8.7%
Supplemental Pension Fund	4.2%	6.2%	5.5%

\* Totals may not equal to 100% due to rounding.

# INDUSTRIAL INSURANCE FUNDS

## BOND PORTFOLIO CHARACTERISTICS

June 30, 2003

### Sector Distribution

U.S. Treasuries	15.1%
Agency	9.9%
Credit	53.4%
Asset-Backed	1.4%
Mortgages	13.7%
CMBS	6.6%
	<u>100.0%</u>

### Top Ten Issuers

#### Market Value

United States Treasury	\$1,180,766
FHLMC Securitized Mortgages	474,611
FNMA Securitized Mortgages	319,305
Resolution Funding Corp.	261,357
FNMA Agency Bonds	176,353
Tennessee Valley Authority	153,569
DLJMA CMBS	125,152
FHLMC Agency Bonds	107,674
Boeing	88,160
Verizon	86,801

### Quality Distribution

TSY	15.1%
AGY	20.9%
Aaa	12.5%
Aa	10.2%
A	19.0%
Baa	21.5%
<Baa	0.9%
	<u>100.0%</u>

Moody's credit ratings

### Coupon Distribution

0 – 4.9%	13.4%
5 – 6.9%	51.6%
7 – 7.9%	24.8%
8 – 8.9%	8.6%
9 – 9.9%	1.4%
10+%	0.1%
	<u>100.0%</u>

### Maturity Distribution

0 – 1 Year	3.0%
1 – 3 Years	9.7%
3 – 5 Years	12.5%
5 – 7 Years	13.6%
7 – 10 Years	12.6%
10 – 15 Years	6.1%
15 – 20 Years	7.1%
20 – 25 Years	9.3%
25+ Years	26.1%
	<u>100.0%</u>

### Effective Duration

0 – 1 Year	3.9%
1 – 3 Years	9.1%
3 – 4 Years	6.4%
4 – 6 Years	17.8%
6 – 8 Years	11.6%
8+ Years	51.2%
	<u>100.0%</u>

\* Totals may not equal to 100% due to rounding.

# INDUSTRIAL INSURANCE FUNDS

## CREDIT SECTOR DETAIL

*June 30, 2003*

Sector Distribution	
Industrial	51.3%
Utilities	13.4%
Financial	23.7%
Non-Corporate	11.5%
	100.0%

Quality Distribution	
Aaa	5.2%
Aa	17.4%
A	35.6%
Baa	40.1%
Other	1.7%
	100.0%

*Moody's Quality Ratings*

Top Ten Credit Holdings	Coupon	Maturity	Market Value (000s)
Mellon Financial	6.375%	02/15/10	\$58,809
Anadarko Petroleum	7.150%	05/15/28	\$53,262
First Energy	7.375%	11/15/31	\$50,718
Norfolk Southern	9.000%	03/01/21	\$48,975
Devon Energy	7.950%	04/15/32	\$45,499
Region of Lombardy	5.804%	10/25/32	\$44,984
Hydro Quebec	8.250%	01/15/27	\$43,722
Washington Mutual	7.500%	08/15/06	\$41,349
Lockhead Martin	8.500%	12/01/29	\$41,020
Inter. American Dev. Bank	8.500%	03/15/11	\$40,496

Top Ten Credit Issuers	
Market Value – \$000	
Boeing Capital	\$88,160
Verizon	\$86,801
Burlington Northern	\$75,886
Anadarko Petroleum	\$72,893
First Energy	\$67,954
Pfizer	\$65,396
Norfolk Southern	\$64,407
Canadian National Railway	\$62,160
Inter. American Dev. Bank	\$61,918
Petroleos Mexicanos	\$61,837

Maturity Distribution	
0 – 1 Years	1.0%
1 – 3 Years	7.7%
3 – 5 Years	16.2%
5 – 7 Years	7.3%
7 – 10 Years	15.1%
10 – 15 Years	5.3%
15 – 20 Years	7.3%
20 – 25 Years	10.8%
25+ Years	29.4%
	100.0%

Effective Duration	
0 – 1 Years	1.1%
1 – 3 Years	10.4%
3 – 4 Years	9.1%
4 – 6 Years	15.4%
6 – 8 Years	10.7%
8+ Years	53.2%
	100.0%

Coupon Distribution	
0 - 4.9%	15.9%
5 - 6.9%	40.2%
7 - 7.9%	30.4%
8 - 8.9%	10.9%
9 - 9.9%	2.5%
10+%	0.0%
	100.0%

\* Totals may not equal to 100% due to rounding.



## ***PERMANENT FUNDS & OTHER TRUST FUNDS***

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

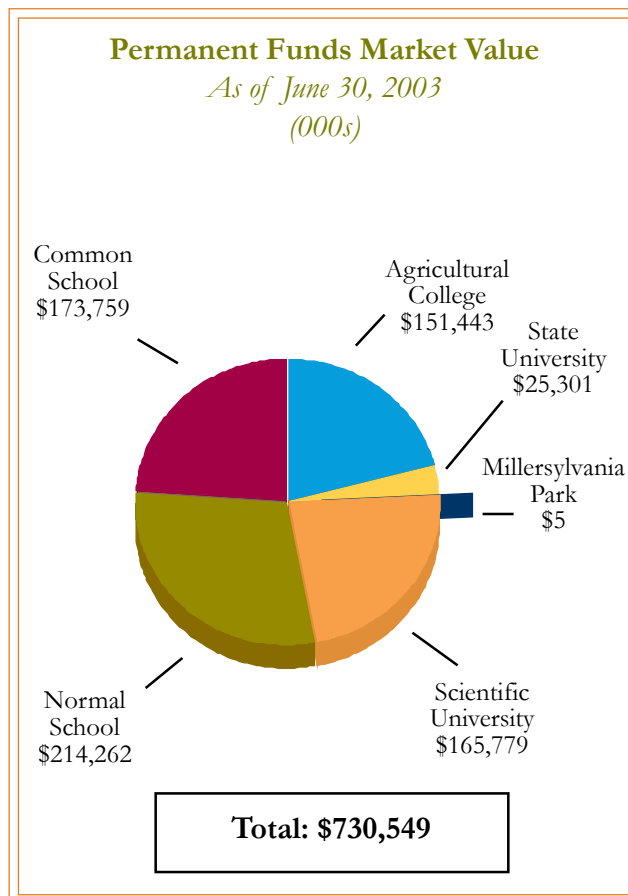
## ***PERMANENT FUNDS***

The Permanent Funds are non-expendable trusts in which the investment principal (corpus) remains intact as required by the Washington state constitution. Earnings from these funds (less expenses) are reinvested (added to corpus) or distributed to a beneficiary fund. The assets of the six permanent funds total approximately \$730 million as of June 30, 2003.

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 five education Permanent Funds were established through land grants from the federal government to benefit Washington's schools and colleges. Proceeds from the sale of land and timber are transferred from the Washington State Department of Natural Resources to the WSIB for investment purposes. Investment earnings are distributed to schools, colleges, and universities in the state for the purpose of bond repayment, capital development, and facilities maintenance.

### **Fiscal Year 2003 Distributions:**

Agricultural College Fund: \$7,671.  
 Common School Fund: \$8,421.  
 Normal School Fund: \$10,676.  
 Scientific University Fund: \$8,431.  
 State University Fund: \$1,235.  
 Millersylvania Park Fund: \$72.



<b>Performance</b> <i>June 30, 2003</i>	<b>One-Year</b>		<b>Three-Year</b>		<b>Five-Year</b>	
	<b>Total Return</b>	<b>Distribution Return</b>	<b>Total Return</b>	<b>Distribution Return</b>	<b>Total Return</b>	<b>Distribution Return</b>
Agricultural College Fund	11.1%	5.7%	10.3%	6.5%	7.4%	6.6%
Common School Fund	10.4%	5.4%	9.9%	6.2%	7.1%	6.3%
Normal School Fund	10.6%	5.6%	10.4%	6.4%	7.5%	6.5%
Scientific University Fund	10.6%	5.7%	10.5%	6.5%	7.5%	6.5%
State University Fund	10.5%	5.5%	10.6%	6.4%	7.7%	6.7%
Millersylvania Park Fund	1.4%	1.5%	3.2%	3.4%	4.1%	4.2%

*Distribution returns include coupon interest, expenses and fees, realized gains and losses, and additional income. Total return also includes unrealized market gains and losses on the investments held based on values captured at a point in time (June 30, 2003).*

## ***OTHER TRUST FUNDS***

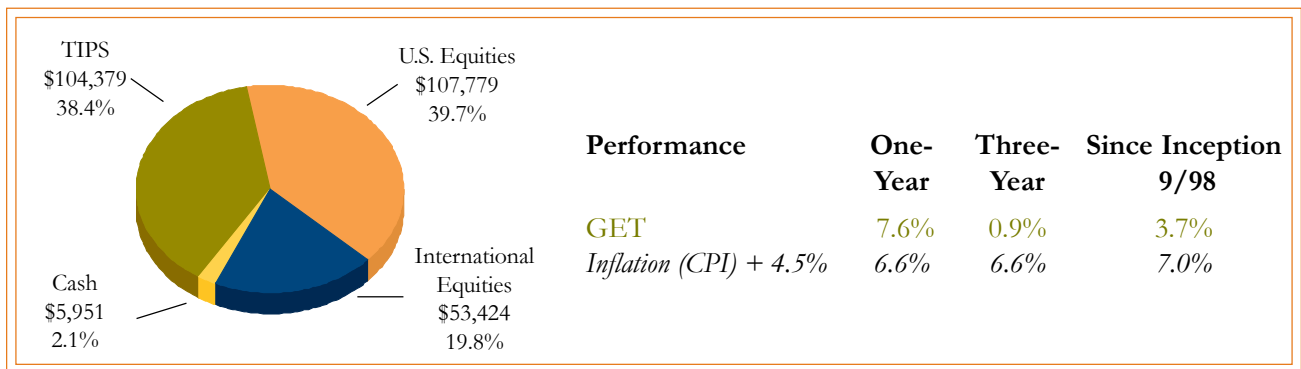
The WSIB manages assets for seven Other Trust Funds that total about \$396 million in aggregate. Each fund has its own specific purpose and investment policy.

### ➤ **Guaranteed Education Tuition Fund (\$271.5 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 the funds and invests them from advanced tuition purchases in a mix of short-term holdings, TIPS, U.S. equity, and International equity.

#### **GET Fund Asset Allocation and Performance**

*June 30, 2003  
(000s)*

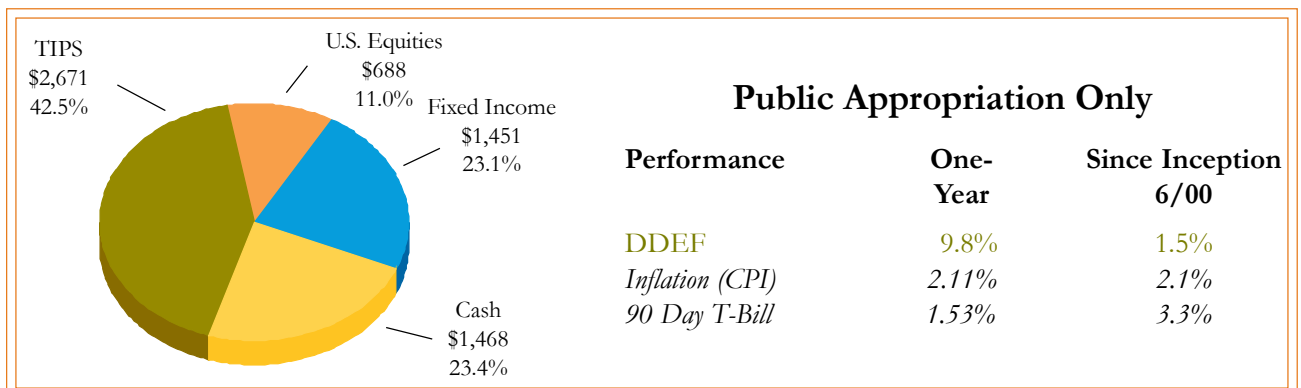


### ➤ **Developmental Disabilities Endowment (DDEF) Fund (\$6.5 million)**

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, TIPS, fixed income, and U.S. equity.

#### **DDEF Asset Allocation and Performance**

*June 30, 2003  
(000s)*



## ***OTHER TRUST FUNDS***

➤ **State Emergency Reserve Fund: \$57.6 million**

This Fund was created under the guidelines of State Proposition 601 to provide the state of Washington with a budget reserve fund. The monies 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. **Fiscal Year 2003 Net Investment Earnings: \$1,501,436**

➤ **Game and Special Wildlife Fund: \$11.8 million**

This fund was created to hold monies received as compensation for wildlife losses. The WSIB is authorized to invest surpluses in the Game and Special Wildlife Fund. The program is under the authority of the State Fish and Wildlife Commission. The fund is invested in short-term holdings. **Fiscal Year 2003 Net Investment Earnings: \$151,070**

➤ **State Employees' Insurance Reserve: \$47.6 million**

This fund was created to hold and invest 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. **Fiscal Year 2003 Net Investment Earnings: \$567,123**

➤ **Radiation Perpetual Fund: \$278 thousand**

This fund was created to provide monies for the maintenance, monitoring, and other care of radioactive materials at sites no longer in operation. 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. The fund is invested in short-term holdings. **Fiscal Year 2003 Net Investment Earnings: \$3,574**

➤ **Reclamation Revolving Fund: \$1.1 million**

This fund was created to provide a source of funding for the reclamation and development of land suitable and economically available for development as agricultural land. The program is under the authority of the Department of Ecology. The fund is invested in short-term holdings and municipal water district bonds. **Fiscal Year 2003 Net Investment Earnings: \$18,224**

<b>Performance as of June 30, 2003</b>	<b>One-Year</b>	<b>Three-Year</b>	<b>Five-Year</b>
State Emergency Reserve Fund	1.3%	3.4%	N/A*
Game and Special Wildlife Fund	1.3%	3.1%	4.1%
State Employees' Insurance Reserve	1.3%	3.1%	4.1%
Radiation Perpetual Fund	1.3%	3.2%	4.1%
Reclamation Revolving Fund	1.7%	4.0%	4.4%

*\*Fund has been under WSIB management for only four years.*

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## GLOSSARY

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**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 that 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 securities include government and corporate bonds, mortgage-backed securities, asset-backed securities, convertible issues, and may also include money-market instruments.

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## GLOSSARY

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**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 voting Board members 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 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 claimed on the corporation's earnings and assets.

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

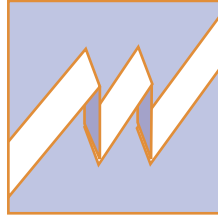
**TUCS Public Fund Median.** Trust Universe Comparison Services Median return of other public funds.

**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.** There are ten voting members on the Board. They include four members who represent various stakeholders in the pension systems, three ex-officio members, and one legislator each from the House and Senate. In September 2002, a tenth voting member was 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.*



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**Patricia Sheridan** - Project Coordinator

**Steve Verschoor** - Financial Statements and Schedules

**Tom Edwards, Brad Christoffer, and Bill Duris** - Technical Support

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