

The Importance of Diversification

Are you wondering if now is the right time to diversify your Plan 3 account balance? Or perhaps you're wondering if diversifying really pays off? To help achieve long-term retirement security, you should give careful consideration to the benefits of a well-balanced and diversified investment portfolio. Spreading your assets among different types of investments can help you achieve a favorable rate of return, while minimizing your overall risk of losing money. Market or other economic conditions that cause one category of assets, or one particular security, to perform very well often cause another asset category, or another particular security, to perform poorly. Although diversification is not a guarantee against loss, it is an effective strategy to help you manage investment risk.

In deciding how to invest your retirement savings, you should take into account all of your assets, including any retirement savings outside of Plan 3. No single approach is right for everyone. Members have different financial goals, different time horizons for meeting their goals, and different tolerances for risk.

(See *Diversification*, p. 2)



MARKET COMMENTARY

as of February 28, 2007

Stock markets experienced a sharp wave of volatility across the globe as the month of February was coming to a close. The disruption started in China when after-market trading systems sent the Shanghai stock market plummeting nearly 10%. This seemed to cause investor panic across the globe and had a powerful negative effect on markets everywhere. Concerns regarding U.S. economic growth were heightened: the Dow Jones Industrial Average experienced its sharpest point decline since 9/11. While this turn of events has worried investors, it's important to remember that periods of sustained downturns have historically been preceded by high interest rates and falling corporate profitability, neither of which are evident in today's market environment.

Bonds

December and January produced negative results for bond investors but bounced back with an impressive 1.5% gain for the month of February. Default rates have begun to increase in the sub-prime mortgage market, resulting in tighter approval standards required by lenders. This may be a sign of negative things to come in the high yield bond market where default rates have been essentially non-existent for the past three years.

(See *Stocks*, p. 2)

PERS PLAN 3 WSIB TOTAL ALLOCATION PORTFOLIO (TAP)

AS OF 12/31/2006

	4th Qtr 2006	AVERAGE ANNUAL RETURNS		
		1-Year	3-Year	5-Year
TOTAL ALLOCATION PORTFOLIO	5.75%	17.90%	15.04%	11.00%

The Washington State Investment Board (WSIB) periodically reviews and adjusts the TAP Fund's asset allocation. Over the last five years, the TAP Fund has shifted to a more aggressive asset mix. These returns reflect the asset mixes during the time periods shown.

PERS PLAN 3 SELF-DIRECTED FUNDS

AS OF 3/31/2007

	1st Qtr 2007	1-Year	3-Year	5-Year
MONEY MARKET FUND	1.25%	5.27%	3.47%	2.64%
WASHINGTON STATE BOND FUND	1.78%	6.28%	2.84%	5.08%
SOCIALLY RESPONSIBLE BALANCED FUND	0.70%	5.44%	5.29%	N/A
U.S. LARGE STOCK INDEX FUND	0.61%	11.77%	9.94%	6.17%
U.S. STOCK MARKET INDEX FUND	1.27%	11.16%	10.74%	7.10%
U.S. SMALL STOCK INDEX FUND	1.91%	5.56%	11.86%	10.77%
INTERNATIONAL STOCK INDEX FUND	4.06%	20.24%	19.80%	14.50%
SHORT-HORIZON FUND	1.82%	8.38%	6.23%	6.06%
MID-HORIZON FUND	2.05%	10.52%	8.67%	7.87%
LONG-HORIZON FUND	2.09%	12.30%	11.36%	8.89%

The PERS Plan 3 Self-Directed Funds were available for investment on March 4, 2002, and have no performance history prior to this date. Actual inception dates (start of fund activity) are: U.S. Stock Market Index, U.S. Large Stock Index, Mid-Horizon, Money Market, International Stock Index, U.S. Small Stock Index, Washington State Bond and Long-Horizon on March 27, 2002; Short-Horizon on March 28, 2002 and Socially Responsible Balanced Fund on April 1, 2004.

All returns are net of fees. Self-Directed funds are valued daily; your account balance and rate of return will vary accordingly. Past performance is no guarantee of future results. For more information about the funds, please see the Plan 3 Investment Guide or the Web site at www.icmarc.org/pers/investing.

Diversification *from p.1*

It is also important to periodically review your investment portfolio, objectives, and the investment options under Plan 3 to help ensure that your retirement savings will meet your goals.

To illustrate the benefits of diversification, the graph below shows the growth of \$10,000 over the last five-year period (Feb. 2002 through Feb. 2007). If you remained in the Money Market fund, either by choice or default, your investment grew to \$11,345 with a 2.56% average annual rate of return. Inflation over the past five years has been 2.39%, meaning your growth rate would have barely stayed ahead of inflation.

If you had been willing to take on some investment risk in a conservative mix of assets (see footnote for exact allocation of asset classes in each portfolio), you would have come away with an average annual growth rate of 6.26% and an ending account balance of \$13,547; a \$2,000 increase over earnings from the Money Market fund. If you'd moved your money into a moderate mix of assets, your account balance would have grown to \$14,908 in five years, or an average annual

return of 8.31%. With even more investment risk in an aggressive mix of assets, you would have seen an average annual gain of 9.73% and an ending account balance of \$15,907.

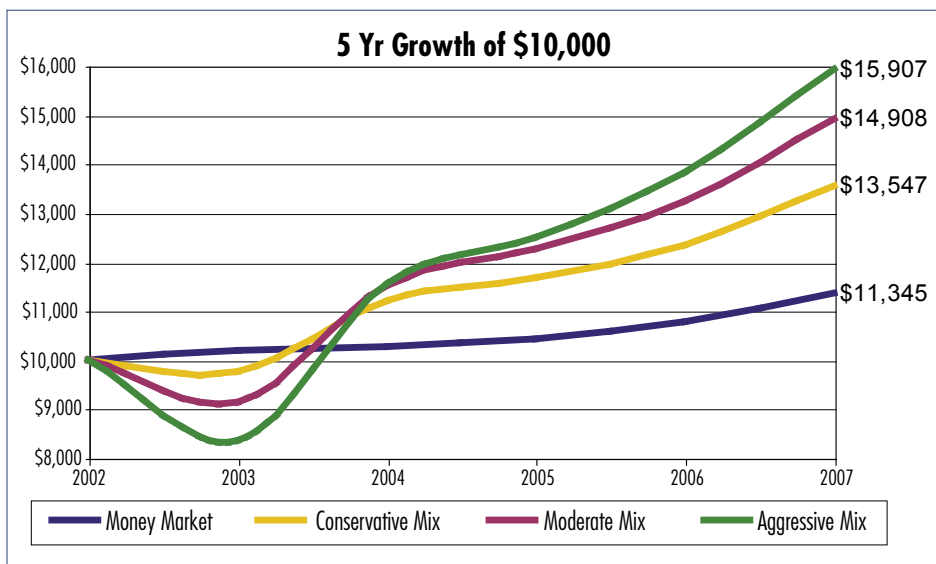
What is the downside of diversification? In those periods when the stock or bond markets fall (like 2002 - 2003), your investment's value tumbles with them. Your quarterly statement arrives, and instead of seeing gains, you see losses. If that three-month loss feels painful, remaining in the Money Market fund would have been one way to avoid that discomfort. If you are able instead to realize that you are investing for the long run, you might just have the resolve required for investment risk.

Is diversification a good thing? In almost every situation, yes. But, should it be applied to your Plan 3 retirement account? That depends. The questions you must ask yourself are: "Do I have time for the market to recover from any downturns? Are the extra gains worth the possible short-term losses?" For more information about diversifying your account, contact ICMA-RC at 1-888-711-8773. 🍷

Stocks *from p.1*

Despite the dramatic fall U.S. stocks experienced at the end of February, the S&P 500 Index still managed to produce a 0.9% gain for the three-month period. U.S. stocks have climbed steadily for eight consecutive months without even a 2% pullback, a phenomenon that hasn't been experienced for over 50 years. Value-oriented stocks once again outperformed growth, which has proved to be a trend. Midcap stocks were the standout performers from a capitalization perspective. Basic Materials and Utilities have been the strongest performers thus far in 2007 while Energy and some portions of the Technology sector have lagged.

Foreign stocks were largely able to withstand the market decline in China by posting positive results during each month of the quarter. The MSCI ACWI ex-U.S. Index finished the quarter with an impressive 4.1% gain. The U.S. dollar held its ground versus most foreign currencies so currency had a limited impact on performance. Emerging Markets were severely impacted during the market downturn, which dampened the impressive gains experienced in December. Keep in mind the relative performance however: China's stock market fell less than 2% for the month of February but more than doubled over the past year. 🍷



Footnotes:

- Money Market Fund – 100% Cash
- Conservative Mix – 25% Cash, 46% Bonds, 19% Domestic Stocks, 10% International Stocks
- Moderate Mix – 46% Bonds, 38% Domestic Stocks, 16% International Stocks
- Aggressive Mix – 20% Bonds, 58% Domestic Stocks, 22% International Stocks
- Cash represented by the Plan 3 Money Market Fund
- Bonds represented by the Plan 3 Washington State Bond Fund
- Domestic Stocks represented by the Plan 3 Large Stock Index Fund (33.4%), Plan 3 U.S. Stock Market Index Fund (33.3%), Plan 3 Small Stock Index Fund (33.3%)
- International Stocks represented by the Plan 3 International Stock Market Index Fund

The investments available in Plan 3 are not offered by or through the ICMA Retirement Corporation, the VantageTrust, or ICMA-RC Services, LLC.