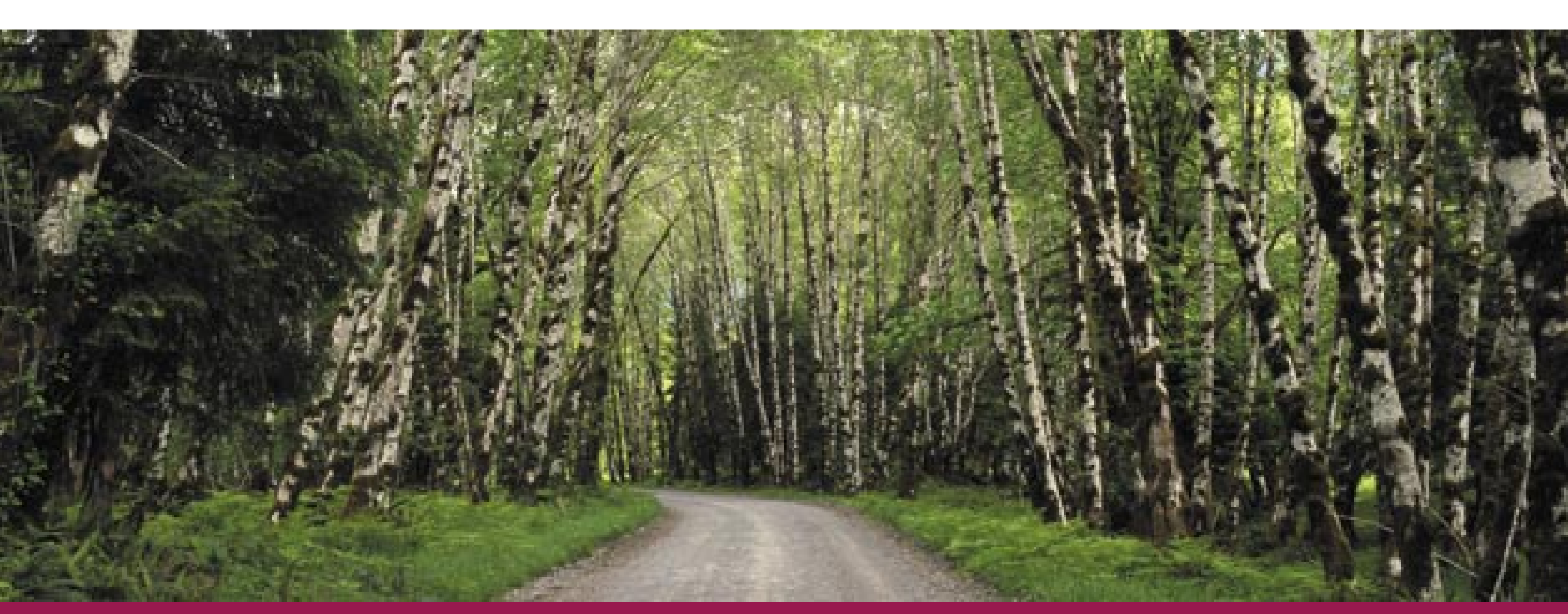
PERS Plan 3
Investment Education

journey to retirement



STATE OF WASHINGTON

Public Employees' Retirement System
Department of Retirement Systems

Contents

Plan 3 Overview 1

The Road to Successful Investing........... 2

Reviewing the Basics............................. 2

What Type of Investor Are You?............ 3

What Type of Investor Should You Be? .. 3

Risk and Reward.................................... 4

Focus on the Long Term........................ 4

Sources of Investment Risk 5

The Benefits of Diversification 5

Steady Investing Pays Off 6

Understanding Your Investment Options... 6

Step 1: What's Your Investment Strategy? 8

How to Read the Portfolio Risk and Return Chart...................................... 9

Step 2: Thinking About Your Situation................................. 10

Personal Risk Profile 11

Things to Consider 12

Step 3: Developing Your Investment Portfolio.. 13

Setting Up Your Portfolio 14

Step 4: Taking Action 15

Glossary... 16

Resources 17

Terms that appear in bold on first reference in the text are defined in the glossary.

Plan 3 Overview

Plan 3 is composed of two retirement benefit components

Plan 3 has a dual benefit structure consisting of a **defined benefit** component, and a **defined contribution** component.

The defined benefit component is funded by your employer and, once you meet age and service requirements, provides for a lifetime monthly benefit at age 65 or a reduced lifetime monthly benefit as early as age 55. The amount of the benefit is based on a formula that includes your years of service credit and your average final compensation.

The defined contribution component is funded by your contributions and provides an investment program that you may access any time after you separate from covered employment. The amount of your retirement income from the defined contribution component depends on how much you contribute and how well your selected investments perform. You have an initial choice of how much you contribute. You also have choices in where your contributions are invested, and how and when you receive payment.

For a complete plan description, read your *PERS Plan 3 Member Handbook* available online at **www.icmarc.org/plan3/pers** or from your employer.

Contributions can be invested two ways

Plan 3 requires you to direct your contributions to one of two investment programs: the Washington State Investment Board (WSIB) Investment Program or the Self-Directed Investment Program.

The WSIB Investment Program enables you to invest in the Total Allocation Portfolio (TAP). The TAP is managed by the WSIB and is rebalanced periodically to meet changing market conditions.

You can contribute to only one of the programs at a time, but you may have investments in both.

The Self-Directed Investment Program enables you to design a **portfolio** from a menu of preselected funds.

This publication will help you understand what to consider when choosing among the Plan 3 investments.

The Road to Successful Investing

When it comes to investing your retirement assets, you may be tempted to set aside the hard decisions for another time. By reviewing this publication, you are taking the first step toward avoiding that temptation, and planning for your retirement *now*.

Your retirement planning should take into consideration all sources of possible income–Social Security, deferred compensation programs, pensions, etc. As a Plan 3 member, the contribution rate you select, and how you manage your investments, will have a great impact on your long-term returns.

Studies show the most important decision an investor can make is how he or she allocates assets among different **asset classes,** such as **stocks, bonds** and cash equivalents. This is important because different types of investments generally behave differently through economic cycles.

This publication will help you determine investments for your retirement. While no publication can guarantee success, this guidebook explains the fundamentals of investing, how risk affects investments of various types, and how you can manage your investments to reduce risk.

Once you understand these basic principles, you will be able to make your own sound investment decisions throughout your career. Good investment management will help you achieve your retirement goals.

Reviewing the Basics

You will need to assess your current financial situation and your retirement goals before you design your investment strategy.

Assessing Your Financial and Retirement Plans

- Estimate your expenses at retirement (looking at your current expenses and your desired retirement lifestyle may help you do this).
- Identify your sources of retirement assets; then estimate the total amount of income generated from those assets.
- Calculate the difference between your estimated income and retirement expenses. You will be able to set your retirement goals with this information.
- Determine how much you should contribute (or save) and the investment return you should try to earn to reach your retirement goals.
- With these goals in mind, you can make decisions about the investment strategies you wish to follow .

Key Investment Principles

- All types of investments involve risk. Even short-term, government-backed Treasury bills carry risk because their returns may not exceed inflation. Risk is explained in detail on pages 4 and 5.
- Asset classes react differently to varying market conditions. Combinations of investments historically have worked together to reduce risk and improve the potential for return. Read about **diversification** on page 5.

This publication presents very broad guidelines on how you might consider investing your retirement contributions. You may want to consult a professional, such as a financial advisor, accountant, or lawyer for advice on your particular situation. In addition, you should periodically review your investment strategy in light of your financial situation and changing market conditions.

The investment returns represented throughout this brochure are based on historical data and are not intended to predict or guarantee the actual results of any investment.

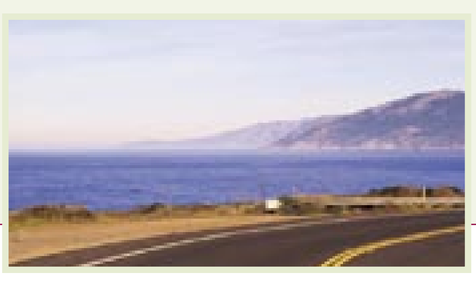
Fund descriptions can be found in your *Plan 3 Investment Guide*, which is part of this packet. You can access the publication online at www.icmarc.org/plan3 or by calling ICMA-RC at 1-888-711-8773 or TDD 1-800-669-7471.

Retirement planning calculators are also available online, at www.icmarc.org/plan3/pers, to help you estimate savings levels that can meet your retirement goals.

Inflation

Even at today's relatively low rates of inflation, investments are at risk over time. For example, with inflation at 3.5 percent, the purchasing power of $1.00 would be cut two-thirds in 30 years. Put another way, a loaf of bread priced at $1.59 today is likely to cost $4.46 in 30 years. As an investor, you must keep inflation in mind throughout your investing and retirement years.

Retirees must be particularly concerned about the effects of inflation, especially if their retirement savings are not diversified. Diversification can lessen the effects of inflation.



- History also shows that a steady strategy generally outperforms an approach that tries to anticipate moves in financial markets. Some investors try to avoid losses by only investing in stocks and bonds when they are going up, and holding cash when they drop. This is called market timing. However, virtually all investors and professionals that attempt market timing get caught twice—first by selling or buying too soon, and then by reversing that decision at the wrong time. For more information, see page 6.
- Contributing consistently regardless of market action, called dollar cost averaging, is another key investment principle. It is explained in detail on page 6.
- Finally, time helps to reduce risk. Over time, an investment's short-term fluctuations tend to even out. That's a key principle to remember before and after retirement. To learn more, see page 4.

With these basics in mind, you should be ready to review some portfolios built on different combinations of stocks, bonds and other asset classes. You will be able to see the effect that changing your assets has on risk and return. You may also use the ICMA-RC retirement planning calculator at www.icmarc.org/plan3/pers.

What Type of Investor Are You?

As a member of Plan 3, you have an active role in building your retirement assets. Critical to your success is how you weigh your objectives against your ability to accept the uncertainty of investment results.

Match your goals with the amount of risk you are willing to accept. If you shy away from greater risk, you may need to adjust your retirement income expectations.

Time is also an important consideration. If you will need your assets relatively soon, you may want to assume less risk. On the other hand, when you have a longer investment horizon, you may be willing to accept greater risk.

What Type of Investor Should You Be?

The Right Mix

It is important to be comfortable with your investments, but it is also important to understand how your investment choices will affect your results. Conservative investors may sleep soundly with the "safest" investments, but they may be unhappy years from now if their savings have been eroded by inflation. Moderate and aggressive investors may be satisfied when the results are in, but they may be unsettled by the **volatility** they experience along the way.

Be a knowledgeable investor

Understanding investment risk and **asset allocation** will help you choose among the investments offered in Plan 3 and avoid poor decisions based on short-term events.

While diversification and time cannot eliminate risk, they can help reduce your vulnerability to the extremes of investment performance. As an investor your goal is to reap a bountiful harvest of retirement income.

Risk and Reward

Although you may think risk is the possibility that your assets will lose value, risk also measures the certainty of eventual returns on any given investment. No investment is entirely risk free, but with the right tools and information you can manage risk.

Risk and reward usually go hand in hand. An investment with greater risk, or uncertainty, has the potential for greater long-term reward. Lower-risk investments that offer you more comfort day-to-day can lead to consistent returns that may be disappointing over time if they do not outpace inflation.

Accepting greater risk and holding that investment over a long period could pay off handsomely. Suppose you invested $4,000 and earned 8 percent. After 20 years, your account would be worth $18,643. But if you earned 10 percent over that period, the same investment would be worth $26,909. Time and compounding can work for you.

The graph on the right illustrates that stocks have far outpaced long-term government bonds, short-term Treasury bills and inflation. While the line representing stocks rises dramatically, its short-term moves are very uneven. On the other hand, the line for short-term Treasury bills is smooth—but barely beats inflation.

Your challenge is to match your financial goals with the level of risk you're willing to accept over various time periods.

Focus on the Long Term

Consider your time until retirement when investing

It is important to match your time until retirement with your investments. If you will need some of your retirement savings soon, you may want to invest that portion so that its value won't fluctuate much over the short-term.

However, if you have five or more years until retirement, you may want to consider investments with more risk. Five years is generally the amount of time you need to weather a market downturn.

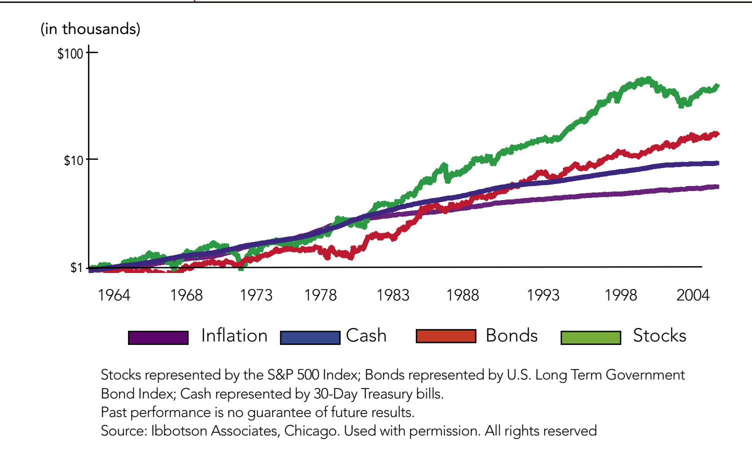
After you retire, you should protect a larger portion of your assets in conservative investments. However, you will want to have a portion of your portfolio in more aggressive assets to protect you from inflation and to take advantage of market appreciation.

While volatility is always a concern, time reduces its impact. Studies show that as the holding period of an investment increases, its average annual return becomes more predictable.

This is especially true for common stocks. Investors who held stocks for one-year periods since 1926 received returns ranging from a 54 percent gain to a 43 percent loss (see graph on the right). But those who held stocks for 20-year periods averaged as much as 18 percent and never less than 3 percent.

Stocks, Bonds, Cash & Inflation

40 Years Ending December 2004



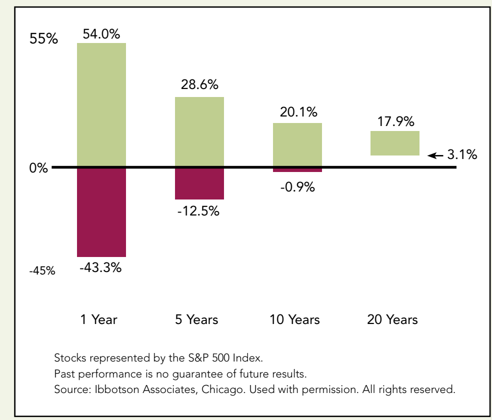
Stocks represented by the S&P 500 Index; Bonds represented by U.S. Long Term Government Bond Index; Cash represented by 30-Day Treasury bills.
Past performance is no guarantee of future results.
Source: Ibbotson Associates, Chicago. Used with permission. All rights reserved

Over the long term, the stock market consistently outperformed every investment vehicle this past century—even after the crash of 1987 and the bear market of the last few years.

The graph above shows the value of $1,000 invested in December 1964. By December 2004, the $1,000 would have grown to $53,739 if it had been invested in stocks. But $1,000 invested in Treasury bills would have grown to only $10,155.

Reduction of Risk Over Time

Stocks from 1926-2004



Stocks represented by the S&P 500 Index.
Past performance is no guarantee of future results.
Source: Ibbotson Associates, Chicago. Used with permission. All rights reserved.

Each bar shows the range of compounded annual returns for common stocks for varying holding periods from 1926-2004.

What is a Bond?

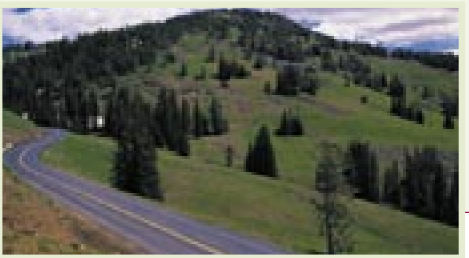
Bonds are loans—and the bondholder becomes a creditor. Whenever an investor buys a bond, he or she actually lends money to a company, in the case of a corporate bond, or to the U.S. government, in the case of a Treasury bond.

U.S. government bonds are backed by the full faith and credit of the federal government, so there is minimal risk of default. Corporate bonds are backed by the issuer, so default risk is greater than it is for government bonds, but minimal if the company is strong.

Many people have the misperception that bond funds are federally guaranteed, especially those invested in securities issued by the federal government. However, all bonds are subject to gains or losses due to fluctuating interest rates.

What is Rebalancing?

Rebalancing is transferring money from one or more funds in your account to another to maintain consistent asset allocation and risk exposure regardless of market fluctuations. In a "self-balancing" fund the investment manager rebalances the portfolio for all the investors.



Sources of Investment Risk

Inflation Risk

Inflation risk is sometimes called purchasing power risk because inflation reduces what your money can buy. If your investments consistently earn less than inflation, your money buys less. For example, if you invest in **securities** (e.g., stocks, bonds) that earn 3 percent and inflation is rising at 4 percent, you actually lose purchasing power. The only way to beat inflation is to earn greater returns on your investments.

Market Risk

Securities traded on the public markets can change in value every day. These price swings can be caused by factors beyond the control of the company's management. For example, the market as a whole may react to domestic and international political developments, investment fads, tax code changes, rumors, investor reaction to economic news or changing trends in investment behaviors.

Credit Risk

Credit risk refers to the ability of individual bond issuers to repay **principal** and **interest** to the bond holder. The greater the risk of default, the higher the yield and the lower the rating on a bond. Among bonds of comparable maturities, U.S. government bonds offer the lowest yield because of their lower default risk.

Interest Rate Risk

Changes in interest rates affect the value of marketable interest-sensitive investments, such as bonds, high-**dividend** stocks and short-term securities. When interest rates rise, bond prices drop and vice versa (see graphic on page 7). The longer the period until a bond is due, the greater the impact changing interest rates will have on the bond's value. When investing in stocks or bonds, it is helpful to measure the **total return** (appreciation or depreciation of the principal plus interest) rather than just interest income.

Currency Risk

In international stocks and bonds, the value of the investments must be translated between currencies. Because currency values fluctuate with respect to each other, the value will reflect these changes. Diversification and time help to moderate this risk.

The Benefits of Diversification

We all know the saying, "Don't put all of your eggs in one basket." Experienced investors understand the importance of this. If you place all of your money in the stock of a single company and that company fails, you could lose your entire investment. But, if you invest in many companies — like you do in Plan 3 — you reduce the potential for loss due to any single company.

Similarly, spreading your assets among stocks, bonds, other classes of investments and different managers helps even out the short-term ups and downs as your money grows over time.

How you mix your investments will have a great impact on your long-term returns. By combining investments that react differently to market conditions, inflation and interest rate changes, you can minimize risk, while maximizing potential for return.

Steady Investing Pays Off

Patience is the best way to see a return on your investment
Trying to outguess the stock and bond markets by frequent shifting of money between types of asset classes (e.g., stocks to cash, bonds to stocks) is very difficult, even for seasoned professionals using sophisticated techniques.

Attempts to time the market probably won't help you very much because securities markets are unpredictable and often move in short, powerful bursts. Certain funds also have restrictions that limit excessive trading. It is better to be patient, recognizing that short-term market changes are far less important than long-term trends.

The years 1973 and 1974 provide a good illustration of the benefits of patience. During that time, the market (as measured by the Standard & Poor's 500 Stock Index) fell 37 percent. But selling then would have been a mistake. Despite the steep decline in the market, staying with a $1,000 investment in stocks made in 1973 resulted in a $16,043 "harvest" at the end of 1996. Those who sold out at the bottom of the market and invested in safer Treasury bills would have earned only $4,761.

Dollar-Cost Averaging

In Plan 3 you routinely contribute a regular amount regardless of market fluctuations. This is called dollar-cost averaging.

When the price of a share of stock or fund is low, your contribution buys more shares. Conversely, when the price is high your contribution buys fewer shares. Over time, this system tends to reduce the average cost of your shares (see example on right). Dollar-cost averaging is especially important when you are investing in more volatile investments, such as stock funds.

As a Plan 3 member, you will automatically be using the dollar-cost averaging technique because you will be contributing a regular amount monthly, regardless of market fluctuations. This is an excellent way to take advantage of volatile markets.

Understanding Your Investment Options

Diversified Funds

One of the greatest advantages of investing in a fund that combines the assets of many investors is diversification. By pooling the money of many investors, a fund can buy securities in a variety of industries, companies and locations.

Another advantage of a fund is professional management. By working with large amounts of money, these professionals buy large blocks of securities at a discount, have greater access to corporate management, and use the latest technology to help make investment decisions. Fund managers who research and select the holdings in the portfolio are often described as "actively" managing a fund.

Index Funds

In the case of **index funds** (see box on this page) individual investors "hire" professionals to undertake the sophisticated process of replicating a particular **index.** This is often referred to as "passive" management because the index funds are buying proportional amounts of the securities in the index.

An Example of Dollar-Cost Averaging

Month	Amount Invested	Share Price	Shares
JANUARY	$200	$10	20
FEBRUARY	$200	$25	8
MARCH	$200	$20	10
APRIL	$200	$40	5
TOTAL	**$800**	**$18.61**	**43**

With dollar-cost averaging, $800 buys 43 shares over four months. At the average market price of $23.75, $800 buys only 33.7 shares.

AVERAGE SHARE PRICE = $23.75
The average share price equals the total of the market price ($95) divided by the number of purchases (4), for an average of $23.75 per share.

AVERAGE COST PER SHARE PRICE = $18.61
The average cost per share price equals the amount invested ($800) divided by the number of shares (43), or $18.61 per share.

YOUR SAVINGS: $5.14 PER SHARE
You have reduced your cost through dollar-cost averaging by $5.14 per share ($23.75 - $18.61 = $5.14).

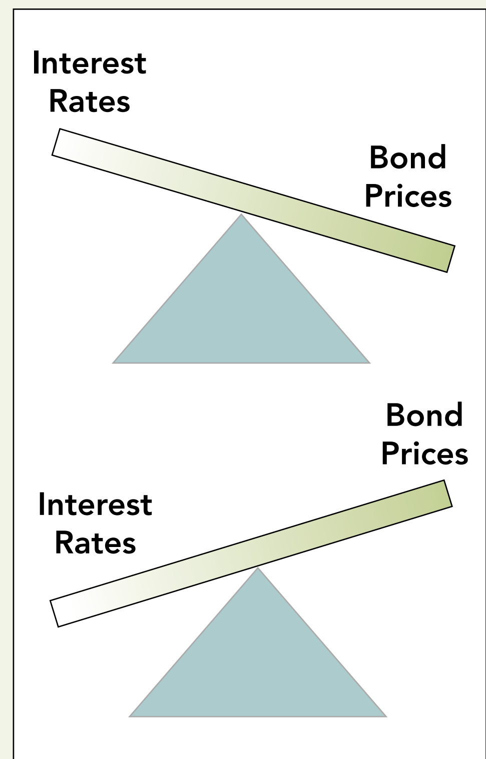
What is an Index Fund?

An index tracks the movement in price, as a whole, of a securities market or a segment of a securities market.

An index fund develops a portfolio designed to mimic the returns of a chosen market index, by buying proportional amounts of the securities in the index.

An example of an index fund is the U.S. Large Stock Index Fund, which seeks to replicate the returns and characteristics of the Standard and Poors (S&P) 500 Index.

Bond Prices and Interest Rates



Bond prices rise and fall inversely to interest rates.

An investor won't pay full price for a bond yielding 6 percent when a similar newly issued bond pays 9 percent interest. Therefore, the market will mark down the price of the 6 percent bond.

At the same time, an investor would be willing to pay more for a bond yielding 9 percent when newly issued bonds are yielding 6 percent.

Investors who buy and sell bonds can make or lose money on the value of the bonds depending on the movement of interest rates.

Stock Funds

Stock funds reflect the share price of the stocks, along with the reinvestment of any dividends paid. Some of the factors stock fund advisers consider in selecting stocks are new products, the business environment, projected future **earnings** and growing dividend payouts.

Certain funds concentrate on specific factors. A growth stock fund would seek companies with potential for strong earnings growth, while an equity-income fund would look for strong dividend history. International funds expand their search to overseas companies.

Bond Funds

Bond funds offer many of the same advantages as stock funds. Professional managers select bonds from a variety of issuers, which reduces the impact if an individual company fails to repay its debt. Bond funds also diversify among different maturities and types of bonds, so prices fluctuate less when interest rates change.

Making judgments about bonds requires a great deal of expertise and information. Most bonds are not traded like stocks on exchanges, so negotiating for good prices is essential. Through bond funds, individual investors benefit from the skills of professionals.

Investors in bond funds should understand the close relationship between total return (interest payments plus appreciation or depreciation of principal) and changes in interest rates. Bond funds lose value when interest rates increase and rise in value when interest rates fall (see graphic on the left). Short-term bonds fluctuate less than long-term bonds.

Most bond funds carry less risk than stock funds, but they have also historically produced lower returns. Because bond funds often act differently than stock funds during a given economic period, they can help diversify a total portfolio.

Money Market Funds

Money Market funds invest in debt instruments that mature within 90 days, on average. Money Market funds are considered as a cash or cash equivalent asset class. Cash equivalents are defined as short-term investments that are readily convertible to known amounts of cash and with low risk of changes in value.

The value of the funds generally does not fluctuate much because there is less uncertainty about what can happen to these securities over a short period of time. Investors typically use these funds when they believe they will need the assets soon.

Balanced/Asset Allocation Funds

Balanced funds invest in a mixture of stocks, bonds and cash. Their goal is to balance volatility and return by blending capital appreciation from stocks, with steady income from bonds and cash. The mix of the balanced fund remains relatively unchanged over time although the securities in the fund may be actively traded.

By contrast, asset allocation funds regularly alter the blend of stocks, bonds and short-term cash investments.

Step 1: What's Your Investment Strategy?

Preparing for a comfortable retirement means putting away enough money every month and then investing it wisely. As a Plan 3 member you can select both your contribution rate and your investment strategy.

It is important to develop an investment strategy that works for you. Over time, your retirement assets will probably grow more through the earnings on your investments than your contributions.

Use this publication to help build your strategy

Step 1: Review a few basics of retirement planning and investing, which will guide you to resources that can provide more information and offer data on the performance of different combinations of asset classes.

Step 2: Assess your investment time horizon and attitude toward risk – critical factors in preparing your strategy.

Step 3: Study all Plan 3 portfolio options with different mixes of asset classes.

Step 4: Periodically review your investment strategy and take action as needed.

By completing this process, you should have sufficient information to develop your own investment strategy and begin building a secure retirement.

Choose an investment program

Plan 3 allows you to direct your contributions to either the Washington State Investment Board (WSIB) Investment Program or the Self-Directed Investment Program.

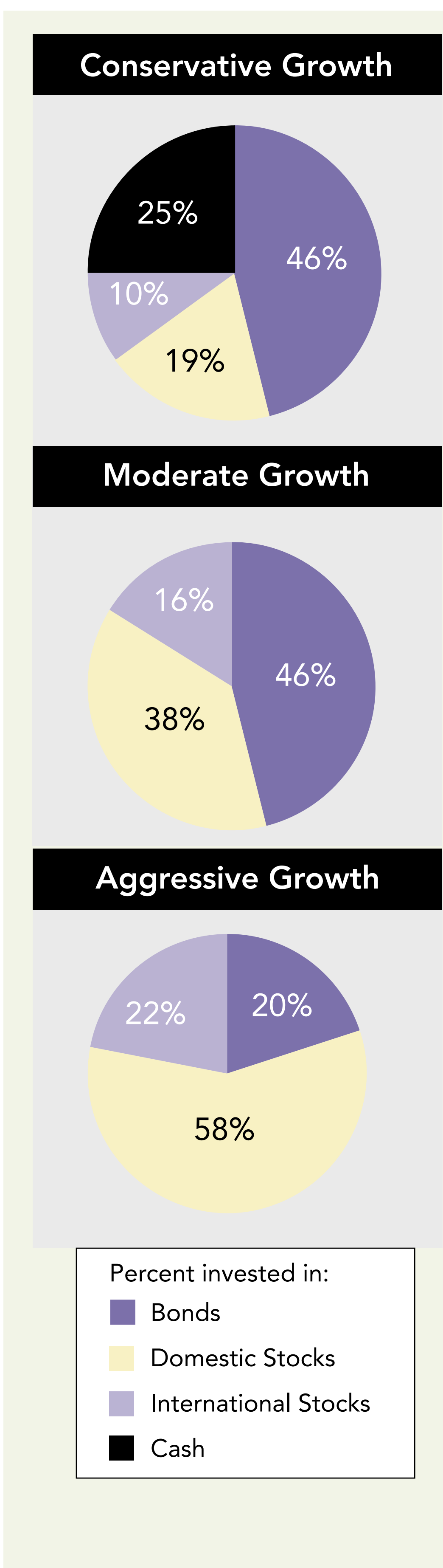
In the WSIB Investment Program you will invest in the Total Allocation Portfolio (TAP). The TAP is periodically balanced by the WSIB. If you do not choose an investment program, your contributions will automatically go into the WSIB Investment Program.

The Self-Directed Investment Program allows you to create your own portfolio using three Horizon Funds (Short-Horizon, Mid-Horizon or Long-Horizon), and seven separate investment funds (Money Market Fund, Washington State Bond Fund, Socially Responsible Balanced Fund, U.S. Large Stock Index Fund, U.S. Stock Market Index Fund, U.S. Small Stock Index Fund, International Stock Index Fund).

Only you can decide which program matches your investment goals. You may wish to consult a personal financial planner or tax consultant before making a final decision.

Here is a 4 Step process to build your retirement strategy:

Review the Basics

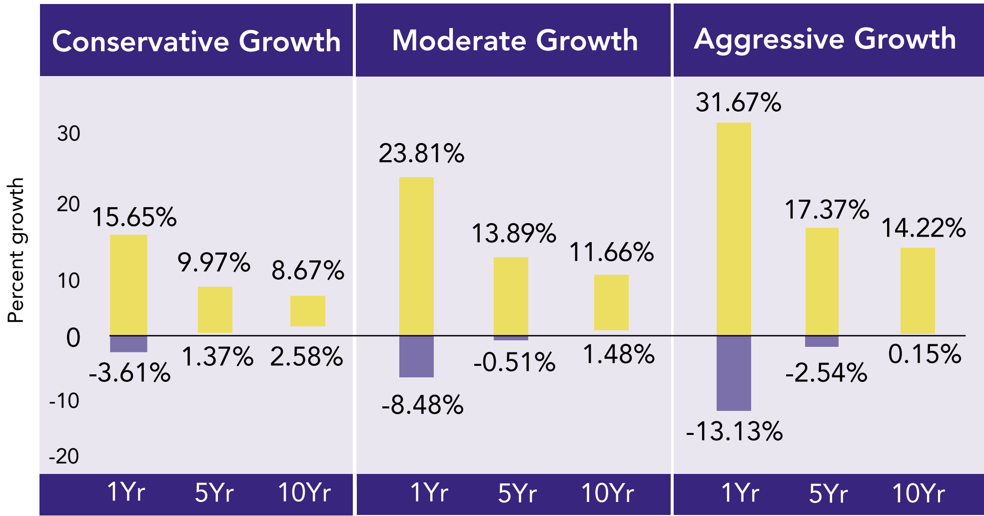


How to Read the Portfolio Risk and Return Chart

A Guide to the Portfolio Information

- **Assessing Your Time Horizon.** One approach to retirement investing suggests investors who have many years until retirement invest their money aggressively. The thinking here is that there will be plenty of time remaining should your investments hit a bumpy road. For those who are closer to retirement, more conservative investments are generally recommended. If you are somewhere in between, a mix of aggressive and conservative investments may be in order.
- **When You Retire**, you may want to develop an investment mix aimed at balancing the preservation of capital with adequate growth. Although you've retired, your money will still be working. You will want to consider having a portion of your portfolio in more aggressive assets to protect you from inflation and take advantage of market appreciation.This is especially important if you will be withdrawing from your Defined Contribution account for a number of years.
- **Average Annual Return** can indicate how different mixes of assets also affect the return opportunity. The return is calculated using the historical returns of various benchmarks. These benchmarks are weighted to the mix of assets for the last 20 years and annualized. The returns earned during the last 20 years have been statistically higher than normal and are not meant to imply that the portfolios will always earn these returns, but are intended to show the differences between the portfolios. Always remember that past results are not a guarantee of future returns.
- The **Pie Charts** show the asset mix of a portfolio with different investment strategies.
- The **Bar Charts** show the ranges where returns have fallen and illustrate how volatility decreases over time. The charts are based on historical experience and are not a prediction of future returns. Actual returns will vary based on actual experience of the investment markets.

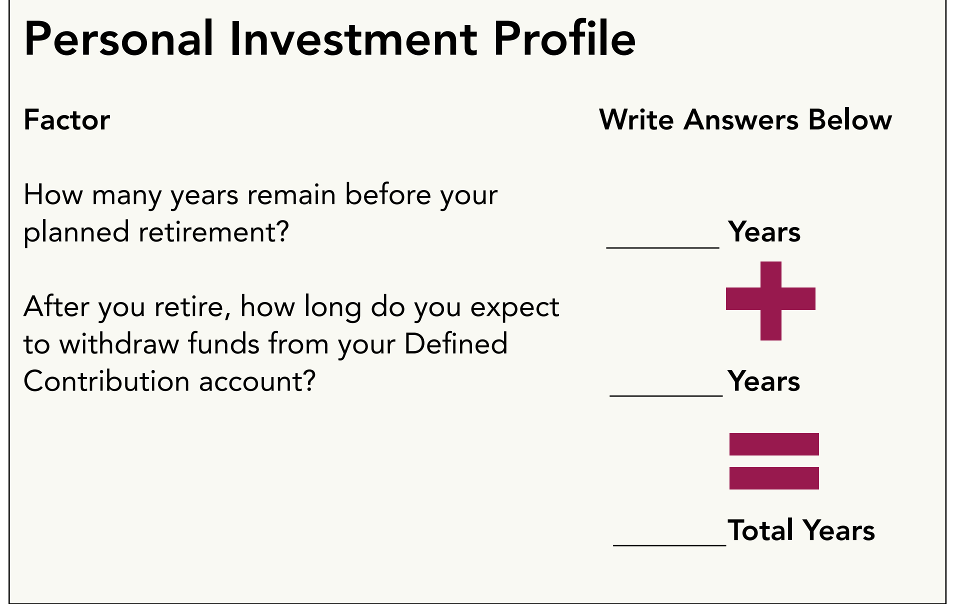
Risk and Return Over Time Using Broad Based Indexes



Source: Washington State Investment Board 2004 Capital Market Assumptions

Step 2: Thinking About Your Situation

Time Horizon...how long do you have to manage your account?

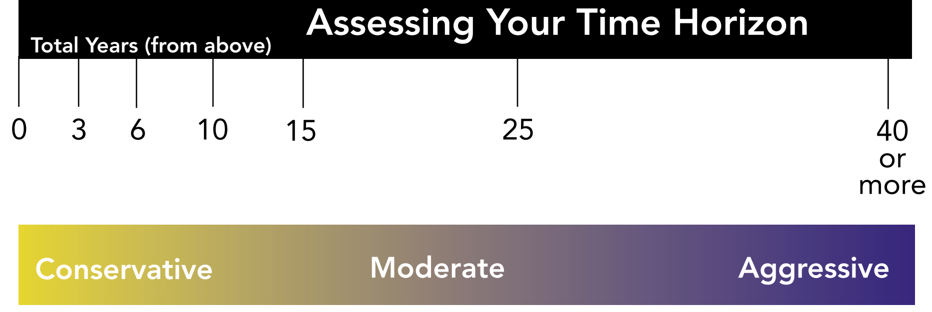


Personal Investment Profile

Factor	Write Answers Below
How many years remain before your planned retirement?	______ Years
	+
After you retire, how long do you expect to withdraw funds from your Defined Contribution account?	______ Years
	=
	______ Total Years

Your Personal Time Horizon should be reassessed periodically.

Choosing investments for your retirement savings requires careful consideration of your personal situation and preferences. To help you in this process, complete the Personal Investment Profile above, and review the table below to determine your Personal Time Horizon. Use the Personal Risk Profile on page 11 to assess your risk tolerance.



Step 2

How long do you have until retirement?

How do you feel about investment risk?

After determining your time horizon, you can begin to build a portfolio to fit your needs. Remember that this is only one consideration in your investment process, you will also need to review pages 11 and 12 and factor those pieces into your decision making.

Personal Risk Profile

How comfortable are you with investment risk? For each set of statements, consider which one sounds more like you – the one on the left or the one on the right. Circle the number that best describes where you fall between the two statements.

My primary goal is to protect my retirement savings. I am most concerned about not losing what I have and I am not willing to accept any market risk simply to keep up with inflation.	1 2 3 4 5	My primary goal is to maximize my retirement income. I am willing to take on sufficient investment risk to do so.
I would worry over short-term investment declines, even if I didn't need my retirement savings for 20 years.	1 2 3 4 5	I wouldn't worry about short-term investment declines. I expect there to be growth potential in 5 or 10-year holding periods.
If the stock market dropped dramatically tomorrow, I'd probably take my losses and pull my savings out of stocks to keep from losing more money.	1 2 3 4 5	If the stock market dropped dramatically tomorrow, I'd probably put more of my money into the market, to catch it before it moves back up.
I would be upset if my quarterly financial report showed a loss.	1 2 3 4 5	A loss on my quarterly financial report wouldn't bother me, as long as I had plenty of time until I needed my savings.
I would prefer a conservative investment that kept me from losing money in a market downturn to a riskier investment with higher potential returns.	1 2 3 4 5	I would prefer an aggressive investment that earned a lot of money over a 10-year plus period to an investment offering more stability.
I wouldn't invest in a start-up company, even one with a promising idea. The risk of losing my entire investment is just too great.	1 2 3 4 5	I'd invest in a start-up company if it had a promising idea. I'm willing to take some chances to earn a good return.

Assessing Your Risk Profile

Risk Spectrum

Conservative Growth	Moderate Growth	Aggressive Growth
If your answers are mostly 1s and 2s, you have a low risk tolerance.	If your answers are mostly 3s, you're between a low risk and high risk tolerance.	If your answers are mostly 4s and 5s, you have a high risk tolerance.

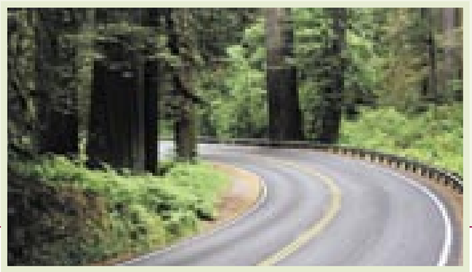
Things to Consider

- At what age do you plan to retire? What are your income goals?
- Are you the only income earner in your household? If not, to what extent does your spouse or partner have employer-sponsored retirement programs, either a pension or savings plan, or both? What role will those benefits play in providing income for your retirement?
- How much will you receive from the defined benefit portion of Plan 3? For more information about the defined benefit, request a member handbook from your employer.
- How much will you receive as a Social Security benefit? Will your spouse or partner receive a Social Security benefit? (You can request an estimate of your Social Security benefit by calling 1-800-772-1213.)
- To what extent are your other retirement assets protected from inflation? For example, the defined benefit portion of your Plan 3 benefit and your Social Security benefit both have cost-of-living adjustments.
- Do you have other financial assets that you plan to use in providing income for retirement? If so, how much will these assets accumulate in value by the time you retire?
- Do you have significant non-financial assets, such as a house, that you plan to use in financing your retirement? What are the values of those assets and how much will they increase by the time you retire?
- Are you close to retirement and do you plan to begin withdrawing your funds in the near future? If so, you may want to consider investing that portion of your assets in Money Market funds, which are not subject to as much market risk.
- Will you need a longer time horizon to provide for your spouse after your death?
- Are you taking full advantage of other retirement savings opportunities? Increasing your contributions and diversifying your investments can mean a larger nest egg when you retire.

Putting It All Together

1. Where do you fall on the time horizon?
2. What is your risk profile?
3. Do any of the additional considerations listed at the left apply to you?

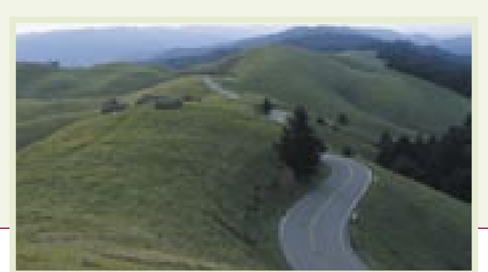
After answering these questions, you are ready to develop your personal investment strategy.



Finding Your Starting Point

Start with the portfolio on page 9 closest to your position on the risk spectrum, as determined by the Personal Risk Profile on page 11. Also, take your investment time horizon from page 10 into account. Then, try it on! If the portfolio is too aggressive, look to more conservative portfolios.

If you would like the opportunity for higher earnings, consider more aggressive portfolios.



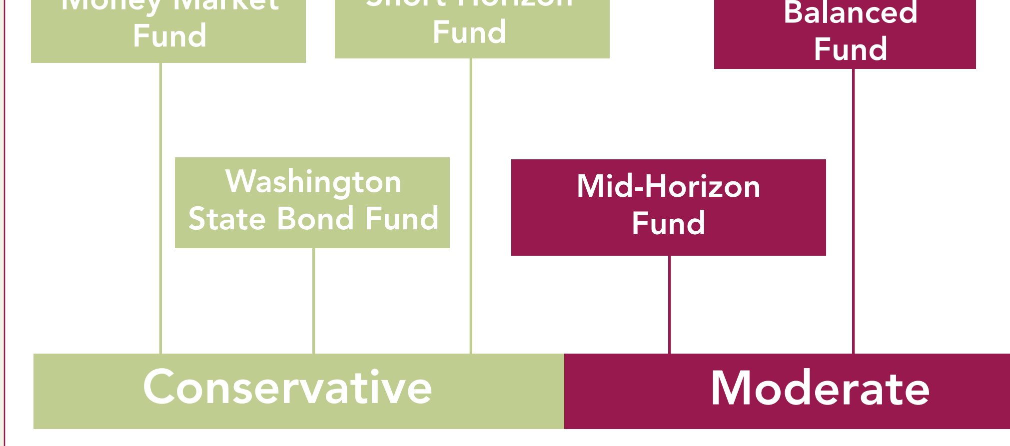
Step 3: Developing Your Investment Portfolio

In Step 1 you saw how mixing asset classes affects return potential as well as risk. Now you must decide the combination that is right for you.

These portfolios have been developed to meet a wide variety of risks and horizons and may not fit your retirement goals. As you review the Horizon Funds and your own investment needs, consider all your retirement assets – those invested with Plan 3, as well as elsewhere. For example, if you have other savings invested in bonds, you may want to adjust your Plan 3 portfolio accordingly.

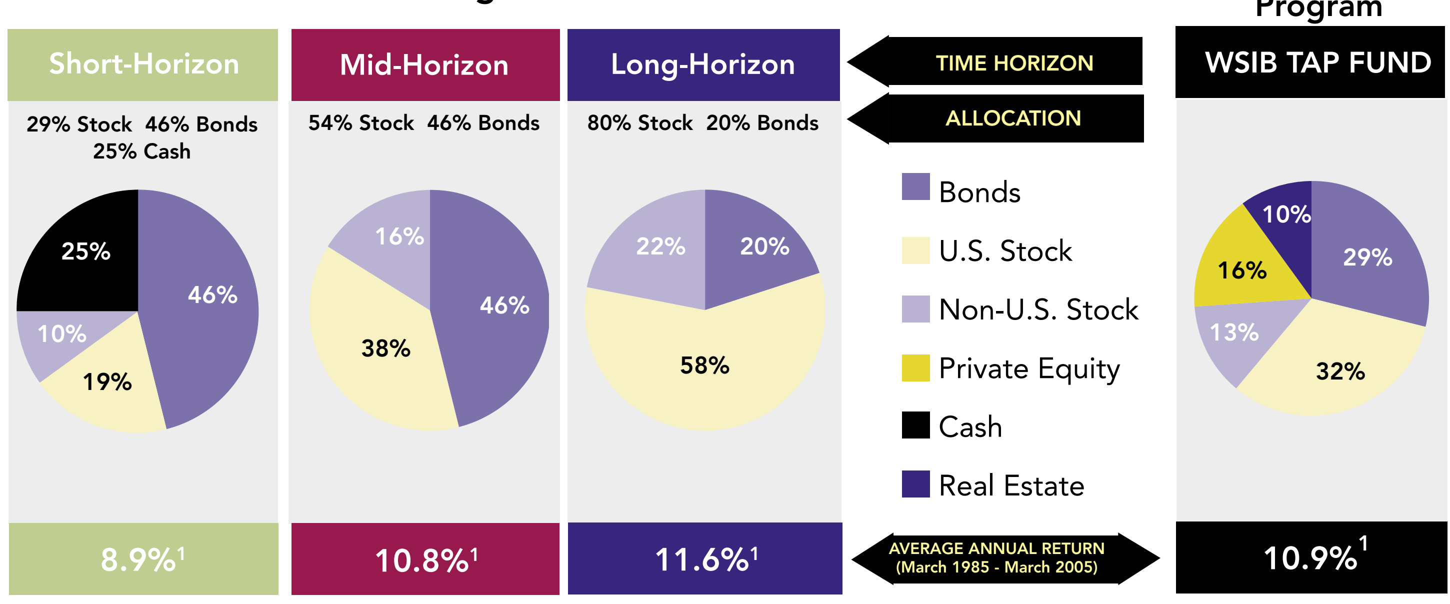
The WSIB designed the Horizon Funds to match the Conservative, Moderate and Aggressive Growth models shown on page 9. The composition of each of the three Washington State Horizon Funds is illustrated on the following pages. These Horizon Funds are built on the same target mix of stocks and bonds shown on page 9 and are rebalanced back to the asset allocation as often as market conditions warrant.

The TAP Fund, also shown on the next page, differs from the Horizon Funds in that the target allocation is managed by the WSIB and may change from time to time. The TAP also includes asset classes not available in other Plan 3 investment choices.



Setting Up Your Portfolio

Preset Portfolios



Source: Washington State Investment Board.

Choose one of the four portfolios above, or set up your own from the Self-Directed funds in the chart below.

The Self-Directed funds represent the following asset classes:

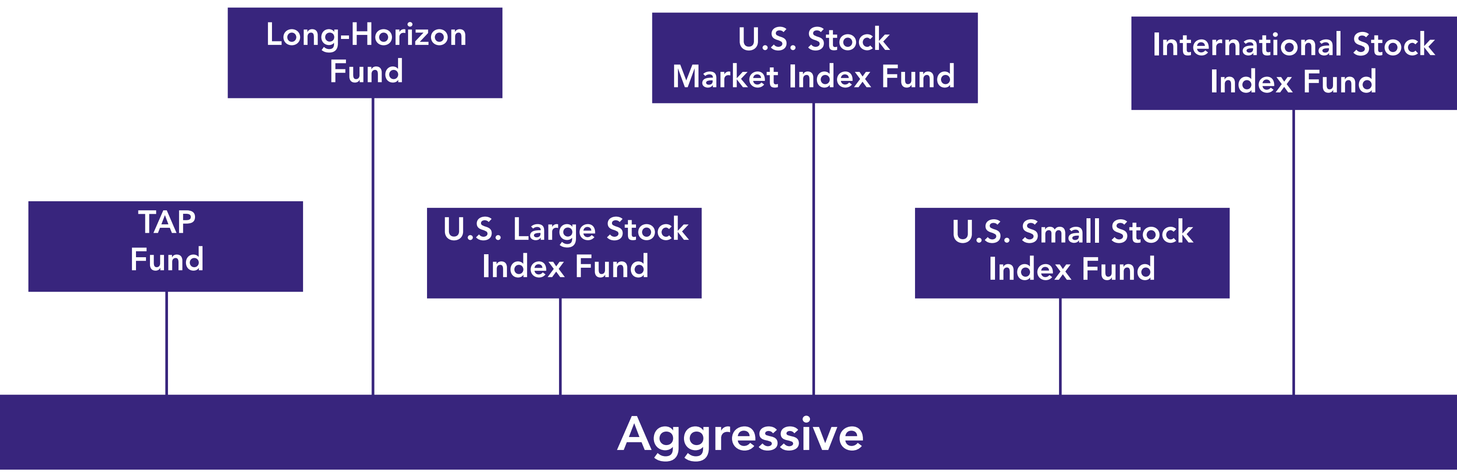
Bonds - The Washington State Bond Fund

Domestic Stocks - U.S. Stock Market Index Fund, U.S. Large Stock Index Fund, U.S. Small Stock Index Fund

Bonds/Domestic Stocks/Cash - Socially Responsible Balanced Fund

International Stocks - International Stock Index Fund

Cash - Money Market Fund



[1] Over the past 20 years, the Washington State Investment Board (WSIB) has significantly shifted the mix of the TAP fund, from conservative in the 1970s and 1980s to a more aggressive mix since 1989. The 10.9 percent return is the portfolio's **actual** rate of return (based on all of those different mixes) over the 20 year period. The current mix (shown) would have generated a significantly higher return over that time period. The Horizon Funds have only been in existence since September 2000. Therefore, the twenty year average annual returns are calculated using index returns.

Making Your Investment Choices

Step 4: Taking Action

Investing Your Contributions

Now that you are familiar with the Plan 3 Investment Funds within the two investment programs, decide which one best meets your needs:

- The WSIB Investment Program's TAP Fund

  or
- The Self-Directed Investment Program in which you may invest in the three Washington State Horizon Funds or build your own portfolio by choosing specific funds within the Self-Directed Investment Program.

If you are a new Plan 3 member, you will direct your contributions into either the WSIB Investment Program or the Self-Directed Investment Program by completing the Member Information Form when you enroll in Plan 3. You can change which investment program your contributions go to at any time by simply contacting your employer and completing the proper form. To direct your retirement contributions into one or more of the funds within the Self-Directed Investment Program, contact ICMA-RC at 1-888-711-8773; or via the Internet at www.icmarc.org/plan3/pers.

When contributions for Self-Directed investments are received, ICMA-RC will invest your funds according to your instructions. If you do not provide investment instructions, your Self-Directed Investment Program contributions will be invested in the Money Market Fund.

You can change your investment decisions at any time using VantageLine (1-888-711-8773) or Account Access (www.icmarc.org/plan3/pers).

A Note on Rebalancing

If you are in the Self-Directed Program, and are not investing in one of the Horizon Funds, rebalancing your portfolio will be necessary. You will need to periodically reassess and rebalance.

If one investment grows faster than others, it may "unbalance" your portfolio — compared to your planned asset allocation. In that event, you may need to rebalance your portfolio by moving assets from one fund to another.

If you invest in the WSIB Investment Program's TAP fund or the Self-Directed Horizon Funds, the WSIB reviews and rebalances these portfolios.

When you wish to rebalance your portfolio, contact ICMA-RC. Though you can contribute to only one of the investment programs at a time, you may have investments in both programs.

Now that you have completed this brochure, you have the information to choose the portfolio that is right for you.

Glossary

Asset Allocation
How your investments are divided among the different asset classes to obtain the best risk/return trade-off.

Asset Classes
The different types of investments available to investors. The three principal classes are stocks, bonds and cash. Funds may focus on one or several asset classes.

Bonds
A fixed income debt security. Bonds may be issued by corporations or governments (both federal and municipal), and pay a set amount of interest, on a predetermined schedule over a predetermined number of years, until maturity.

Defined Benefit
Your Plan 3 defined benefit component provides a lifetime retirement benefit based on a formula. The formula includes your years of service, average final salary, and a one percent multiplier. Funding for the benefit comes from your employer's contributions.

Defined Contribution
Your Plan 3 defined contribution benefit is based solely on your contributions and any income, expenses, gains and losses.

Diversification
The investment technique of spreading risk among securities and asset classes.

Dividends
The portion of a company's profits that is paid to shareholders.

Earnings
The profit a company makes after all expenses are deducted from revenues. Companies often distribute a portion of the earnings to shareholders in the form of dividends.

Index
An index tracks the movement in price, as a whole, of a securities market or a segment of a securities market.

Index Fund
An index fund develops a portfolio designed to mimic the returns of a chosen market index, by buying proportional amounts of the securities in the index.

Interest
The amount a borrower pays the lender for the use of the lender's money. The rate of interest varies by the length of the loan, the assurance that the loan will be repaid and the rate of inflation.

Portfolio
A grouping of your investments. All of your investments – stocks, bonds, etc. – comprise your total portfolio.

Principal
The amount of money you put into an investment. It does not include appreciation, dividends or interest.

Securities
A general term for publicly traded stocks and bonds.

Stocks
A security that represents ownership interest in a corporation.

Glossary – continued

Total Return
The amount of interest or dividends your investment earns plus any increase or decrease in principal.

Volatility
An investment's volatility refers to how much and how often its price changes. Common stocks, for which prices can change sharply, are said to be more volatile than bonds.

Resources

ICMA Retirement Corporation (ICMA-RC)
toll free service line: 1-888-711-8773
TDD Line: 1-800-669-7471
Web site: www.icmarc.org/plan3/pers

Department of Retirement Systems (DRS)
local: 360-664-7000
toll free: 1-800-547-6657
TDD Line: 1-866-377-8895
Web site: www.drs.wa.gov

Social Security Administration
toll free: 1-800-772-1213
Web site: www.ssa.gov

Public Employee Benefits Board (PEBB)
local: 360-412-4200
toll free: 1-800-200-1004
Web site: www.pebb.hca.wa.gov

Financial Modeling Software (FMS)
Web site: www.icmarc.org/planchoice

The investment options available in Plan 3 are not offered by or through the ICMA Retirement Corporation, the VantageTrust Company or ICMA-RC Services, Inc.

This brochure is available in alternate formats. To request, call 1-888-711-8773 or TDD 1-800-669-7471

777 North Capitol Street, NE
Washington, DC 20002
www.icmarc.org/plan3
TDD Line: 1-800-669-7471

Toll Free: 1-888-711-8773

June 2005
BRC000-019-200506-107182-C725

The Washington State Department of Retirement Systems contracted with ICMA Retirement Corporation to provide record-keeping and investment education services for PERS Plan 3.