

The Importance of Diversification

When it comes to planning for retirement, you may be tempted to set aside the hard decisions for later, believing that because retirement is years away you have plenty of time. This is a common mistake. One of the key decisions you will need to make is the diversification of your Plan 3 investments. Diversification is the way you allocate your investments.

For your Plan 3 account, you can allocate among the individual stock, bond, and cash funds to achieve diversification. Or, you can select one of the three Horizon Funds or the TAP Fund and you will have a diversified portfolio with only one investment. Members who initially selected the Self-Directed Investment Program without selecting specific investments were defaulted into the Money Market Fund. If you are reviewing the enclosed quarterly statement and find that you have 100% of your assets in the Money Market fund, you may wish to diversify. To learn more, please attend a free Investments Basics seminar offered by the Department of Retirement Systems. The seminars are listed on the Plan 3 Web site at www.icmarc.org/plan3/sers; select Seminars on the left hand side.



MARKET COMMENTARY

as of November 30, 2006

Global capital markets produced some impressive results during the three-month period ending November 30, 2006. While the fall months have historically been a challenging time for stocks, markets around the world surged during this period. The Fed's stable monetary policy, together with falling energy prices and continued strong corporate earnings, set the stage for a welcome rally. Bond markets got into the act as well, continuing to build on impressive gains in the prior quarter. The Federal Reserve's rate hike policy is now clearly helping to slow economic growth, but investors appear to be taking this in stride. Concerns of a possible collapse in the housing market remain; however, consumers are showing resilience as solid job and income growth have helped diminish those concerns.

Bonds

Bond markets realized another strong quarter. The Lehman Brothers Aggregate Bond Index rose 2.7% for the three-month period. Over the past few years, bond markets have largely struggled

(See *Bonds*, p. 2)

SERS 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.

SERS PLAN 3 SELF-DIRECTED FUNDS

AS OF 12/31/2006

	4th Qtr 2006	1-Year	3-Year	5-Year
MONEY MARKET FUND	1.34%	5.04%	3.13%	2.47%
WASHINGTON STATE BOND FUND	0.90%	3.84%	3.13%	4.66%
SOCIALLY RESPONSIBLE BALANCED FUND*	3.04%	6.61%	5.59%	N/A
U.S. LARGE STOCK INDEX FUND	6.71%	15.74%	10.34%	6.08%
U.S. STOCK MARKET INDEX FUND	7.06%	15.59%	11.07%	7.03%
U.S. SMALL STOCK INDEX FUND	8.82%	18.05%	13.41%	11.19%
INTERNATIONAL STOCK INDEX FUND	10.31%	26.27%	19.88%	13.72%
SHORT-HORIZON FUND	3.04%	8.54%	6.35%	5.74%
MID-HORIZON FUND	4.68%	11.78%	8.98%	7.54%
LONG-HORIZON FUND	6.51%	15.63%	11.65%	8.57%

*The Socially Responsible Balanced Fund inception date is 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/sers/investing.

Bonds from p. 1

as rising interest rates eroded their returns. Lower-quality bonds outperformed their higher-quality counterparts during the quarter as investors showed an increased appetite for risk. From a maturity perspective, long-term bonds significantly outpaced short-term bonds, particularly in Treasuries.

Stocks

U.S. stocks posted exceptional results across the board during the quarter. In a reversal from the prior quarter, smaller company stocks once again took the leadership position away from large companies. The S&P 500 Index rose 7.9% while the Russell 2000 Index posted a strong 9.4% for the three-month period. Across all company sizes, growth stocks tended to perform slightly better compared to value stocks. Consumer discretionary stocks posted the strongest price increases during the quarter, demonstrating the resiliency of the U.S. consumer. Technology stocks, for a long time a drag on the S&P 500 Index, realized the second strongest gains during the quarter. Energy and Materials stocks also produced above-index returns. Consumer Staples and Health Care stocks were the worst-performing sectors during the quarter, barely managing to realize positive gains.

The international stock market rally began after a sharp sell-off in April and May and continued during each month of the period. The MSCI ACWI ex-U.S. Index advanced 8.6% during the three-month period. Currency played a critical role as the U.S. dollar lost

ground versus foreign currencies, thus boosting international stock returns. Investors continued to experience growth in emerging market countries as well as the MSCI Emerging Markets Index rose 13.5%.

Privacy Policy

The following is the privacy policy for DRS' Plan 3 record keeper (ICMA-RC).

We at ICMA-RC recognize the sensitive nature of your personal financial information, and take every precaution to protect your privacy. In order to provide services to you, DRS collects certain nonpublic personal information about you from your employer. DRS then provides that information to ICMA-RC, to allow your account to be serviced. Our policy is to keep this information strictly confidential. We will use this information only as necessary to provide services to you or as otherwise required by law. Our contract with DRS also requires us to maintain the privacy of your personal information. You can be certain your financial information will only be used within our strict guidelines. Our privacy policy applies equally to nonpublic personal information about former clients and individuals who have inquired about our services.

Information We Collect

“Nonpublic personal information” is personally identifiable financial information about you as an individual or your family. Nonpublic personal information we have about you includes information provided by DRS and information you provide to us in telephone calls, forms, and correspondence.

Information We Disclose

We use this information to process your requests and transactions, for example, to provide you with additional information about the investments available in your plan or to process a withdrawal. In order to service your account and carry out your instructions, we may also provide your personal information to firms that assist us. For example, we will provide your address to the company that mails your quarterly financial statements. We do not provide customer names and addresses to outside firms, organizations or individuals except as provided to conduct official business on your behalf, or as otherwise allowed by law. In addition to our own policies, our contract with DRS requires us to keep all information regarding plan members confidential. We are prohibited from disclosing, using, selling or sharing your personal information except to conduct business on your behalf or as directed by DRS.

How We Safeguard Your Information

We restrict access to nonpublic personal information to those persons with ICMA-RC who need the information to provide services to you or who are permitted by law to receive it. We maintain internal policies and procedures to safeguard your personal information.

CONTACT INFORMATION

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