

SERS PLAN 3 REPORT May 2006

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Seven Planning Essentials Investors Often Overlook

Reaching important financial goals, such as accumulating the wealth you need to buy a house, educating your children, or financing a comfortable retirement, takes careful planning and investing.

If you are like many people, funding long-term financial goals like retirement are not on your everyday “to do” list. Here is a list of frequently overlooked items to act on now while retirement may still be years down the road.

1 – You need a plan

The Department of Retirement Systems (DRS) offers several ways to help you make decisions regarding your Plan 3 Retirement account:

- Investment Education and Retirement Planning Workshops
- Plan 3 Investment Education booklets
- Retirement planning calculators

You may call 1-888-711-8773 for information about these resources or you can review information at www.icmarc.org/plan3/sers.

2 – You need a thoughtful retirement budget

Life changes at retirement, and spending does too. Not long ago it was thought that 75 percent or so of pre-retirement income was necessary to have an adequate retirement lifestyle. But that guideline doesn't apply to everyone. In addition, some retirees who only adequately planned and saved were often shocked by the rising health care costs that are often a major expense in retirement.

A thoughtful retirement budget will help you understand spending flexibility by distinguishing between needs and wants, focusing attention on debt reduction, and offering peace of mind that retirement is affordable.

SERS PLAN 3 WSIB TOTAL ALLOCATION PORTFOLIO (TAP)

AS OF 3/31/2006

	AVERAGE ANNUAL RETURNS			
	1st Qtr 2006	1-Year	3-Year	5-Year
TOTAL ALLOCATION PORTFOLIO	6.03%	19.26%	18.51%	8.72%

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 3/31/2006

	1st Qtr 2006	1-Year	3-Year	5-Year
MONEY MARKET FUND	1.09%	3.67%	2.06%	2.25%
WASHINGTON STATE BOND FUND	-0.57%	2.26%	2.93%	5.04%
SOCIALLY RESPONSIBLE BALANCED FUND	1.82%	5.39%	N/A	N/A
U.S. LARGE STOCK INDEX FUND	4.17%	11.64%	17.06%	3.85%
U.S. STOCK MARKET INDEX FUND	5.31%	14.22%	18.97%	5.18%
U.S. SMALL STOCK INDEX FUND	13.98%	25.83%	29.26%	12.49%
INTERNATIONAL STOCK INDEX FUND	9.33%	24.34%	30.20%	8.39%
SHORT-HORIZON FUND	1.97%	7.07%	8.33%	5.09%
MID-HORIZON FUND	3.22%	10.33%	13.37%	6.31%
LONG-HORIZON FUND	5.12%	14.26%	18.45%	6.62%

The SERS Plan 3 Self-Directed Funds were available for investment on September 1, 2000 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 and Money Market on October 6, 2000; International Stock Index, U.S. Small Stock Index, Washington State Bond, Short-Horizon and Long-Horizon on October 10, 2000 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/sers/investing.

Returns cover the period ending March 31, 2006.

N/A - Not Applicable

3 – Savings means success

Retirement security is the result of smart choices, especially good saving and spending habits. Even if you expect to have a generous pension, your own savings can mean the difference between just getting by and living the way you want. Few pensions, even when supplemented by Social Security, provide enough income to live a long retirement life the way you would like. Today's retirees that have diligently saved are enjoying their retirement with security and freedom. Others, not so comfortable, are disappointed and struggle to enjoy these years while keeping up with rising health care and other costs. The difference is saving.

4 – Investing costs can eat your nest egg

When it comes to saving additional funds outside of your Plan 3 account, you also need to consider the cost of investing. Loads (sales commissions) on mutual funds as charged by brokers and other salespeople can range from 3 percent to 8.5 percent. Transaction costs for buying and selling individual securities can have a similar impact. Sales charges and ongoing costs for insurance products, such as variable annuities, can be even higher. Costs add up: over 20 years, investing \$500 per month in a fund that has one percent lower costs and a 9 percent average annual return will add \$40,000.

5 – You may live longer than you think

It is a common mistake to assume a short number of years in retirement. Life expectancy has increased dramatically in the past decades. Today, an average American woman at age 65 can expect to live to age 86, the average man to age 83. Half will outlive these ages. Your own lifespan depends on many things including inherited traits, your own health and luck. A person in reasonably good health ought to plan to live beyond the average to assure that resources will last that long.

6 – Inflation can steal your security

Modest inflation can have a distressing impact on purchasing power over the long life spans we now expect. For example, if prices rise at an average of only 3.5 percent over the next 25 years, today's \$1.25 loaf of bread will cost \$3.00 and a \$25,000 vehicle will be more nearly \$60,000.

7 – Health care costs are going up

Everyone who pays health care costs or reads a newspaper knows that health care costs are rising far faster than general inflation. The impact of rising prices might be much worse for retirees than others because a higher share of their spending goes to health care. There is no end to cost increases in sight, driven by increases in health system usage as the population ages and costly new lifesaving drugs and technology are developed. Some experts expect prescription drug price increases of an astounding 20 percent per year over the next decade.

Market Commentary as of February 28, 2006

After eight consecutive quarters of exceptional GDP growth, the U.S. economy appears poised for a slowdown. Rising interest rates and higher energy prices began to take their toll on consumer spending. Even with the decline in consumer spending, Americans' personal savings rate finished in negative territory for the first time since the Great Depression. This suggests that American consumers spent every penny of their after-tax income and then dipped even further into debt or pulled money from their savings. Despite strong export growth, the U.S. continues to rely on foreign imports, as the U.S. trade deficit widened to record levels. Corporate earnings remained a bright spot. A solid employment environment and continually rising housing market kept investor confidence strong.

Bonds

While the Federal Reserve underwent a changing of the guard in the first quarter, not much changed in the way of monetary policy. In his last Committee meeting, Alan Greenspan continued his "measured" approach to fiscal policy by raising the overnight borrowing rate by a quarter-point to 4.5 percent. Newly appointed Chairman Ben Bernanke appears ready to take a similar path, gradually raising rates in an effort to curb inflation while promoting growth. As a result of the rate hikes, short-term rates rose while little else changed in the fixed income asset class.

Stocks

The rally in the U.S. stock market came to an abrupt halt on the final day of the three-month period. After stocks posted exceptional gains in January and solid increases in February, the market dropped as the period closed. Despite the disappointing finish, stocks experienced strong gains overall. Small company stocks regained their leadership position. The telecommunications sector, which has been lagging for some time, surged in the opening months of 2006. The technology sector, on the other hand,

trailed the pack. Energy stocks continued to reward investors during the period, but demonstrated a high degree of volatility, booming in January and falling in February. International stock markets continued to climb in this period. Europe, which trailed most foreign markets in 2005, experienced the largest gains. However, Europe's gains were due more to currency fluctuations than stock gains. Japan did well during the period but also experienced its share of uncertainty that resulted in a surge of trading activity. This overloaded the Tokyo Stock Exchange which caused a temporary halt in trading. Emerging Markets continued to soar.

*By Arnerich Massena & Associates
Due to printing requirements, this article includes market activity as of February 2006.*

Keep us informed

From the time you join a retirement system to the time you begin collecting retirement benefits, some of the initial information you provide can, and probably will, change. Please keep DRS informed when you make any changes to the following:

Beneficiary designation

Your beneficiary designation is one of the most important pieces of information associated with your retirement account. Be sure to keep it up-to-date. If you marry or divorce, you should complete and submit a new form, even if your beneficiary remains the same.

To complete a new **Beneficiary Designation form**, please visit www.icmarc.org/plan3.

Address

If you move or change your mailing address, please be sure to have your employer update this information on your retirement account. We require employers to submit any address changes for active members. This ensures that both DRS and your employer have updated information and that you receive correspondence quickly and securely.