



STATE OF WISCONSIN
Department of Employee Trust Funds
 Eric O. Stanchfield
 SECRETARY

801 W Badger Road
 PO Box 7931
 Madison WI 53707-7931

1-877-533-5020 (toll free)
 Fax (608) 267-4549
 TTY (608) 267-0676
<http://etf.wi.gov>

CORRESPONDENCE MEMORANDUM

DATE: October 25, 2006

TO: Wisconsin Deferred Compensation Board

FROM: Shelly Schueller, Director
 Wisconsin Deferred Compensation Program

SUBJECT: Vanguard Target Funds Asset Allocation Review

Deferred Compensation Board members learned in May 2006 that Vanguard was planning changes in the asset allocation models of the Target Retirement Funds (the Wisconsin Deferred Compensation Program's "lifecycle" funds). Vanguard said these changes were intended to provide greater exposure to equities of approximately ten to twenty percent more per fund over a longer period of time, and broader international exposure for all funds. The Board requested further information from Vanguard regarding the changes in asset allocations.

The attached presentation outlines the main reasons Vanguard elected to modify the Target Retirement Funds asset allocations. On September 12, 2006, Vanguard told the Investment Committee that participant feedback indicated that their participants were willing to assume more investment risk than initially anticipated by Vanguard. The willingness to assume more risk, coupled with the realization that people could live longer and outlive their lifecycle fund assets, created the impetus for the asset allocation change. While internal Vanguard reports supporting the decision to change asset allocations are proprietary and not available to the public, Vanguard will provide summary information regarding these reports at the November 2006 Board meeting.

The Investment Committee also asked what circumstances would cause Vanguard to consider adjusting the Target Retirement Funds' asset allocations again. Vanguard responded:

"We regard it as our fiduciary responsibility to continually monitor and evaluate all of our investment products, and to make improvements when the interests of our clients are served. Reviewing and modifying our investment offerings is an ongoing process at Vanguard. That process includes, but is not limited to, our decisions to change or add managers to our funds or to modify fund strategies. In all cases, changes are made only if we believe they will benefit the funds' shareholders. We are not presently considering other changes to our Target Retirement Funds."

Vanguard staff are scheduled to attend the November Board meeting via conference call to discuss their presentation materials and will be available for any additional Board questions.

Attachment

| | |
|--------------------------------------------------------|---------------|
| Reviewed and approved by Dave Stella, Deputy Secretary | |
| _____ Signature | _____ Date |

| Board | Mtg Date | Item # |
|-------|------------|--------|
| DC | 11/14/2006 | 11 |

Vanguard Target Retirement Funds - Overview of Recent Modifications



Wisconsin Deferred Compensation Program
October 2, 2006

Public Information

Retain Key Attributes

- Complete investment portfolio in a single fund solution
- Implemented with index funds
 - Broad diversification
 - Cost effective
 - Limit manager risk, focus on asset allocation
- Grow and preserve purchasing power through stocks and Treasury Inflation-Protected Securities (TIPS)

Why Now? What does it take to make changes?

- Almost three years of history
- Opportunity to revisit methodology
- Change not unprecedented
- Research, various levels of approval

Facts Behind the Change

- Evidence indicates the changes provide a better fit with investors' preferences and risk tolerance
- Longer life expectancies and higher healthcare costs
- Reliance on retirement assets as primary source of income (DB plans disappearing)
- Five year increments allows more choices of retirement dates

Fund Modifications

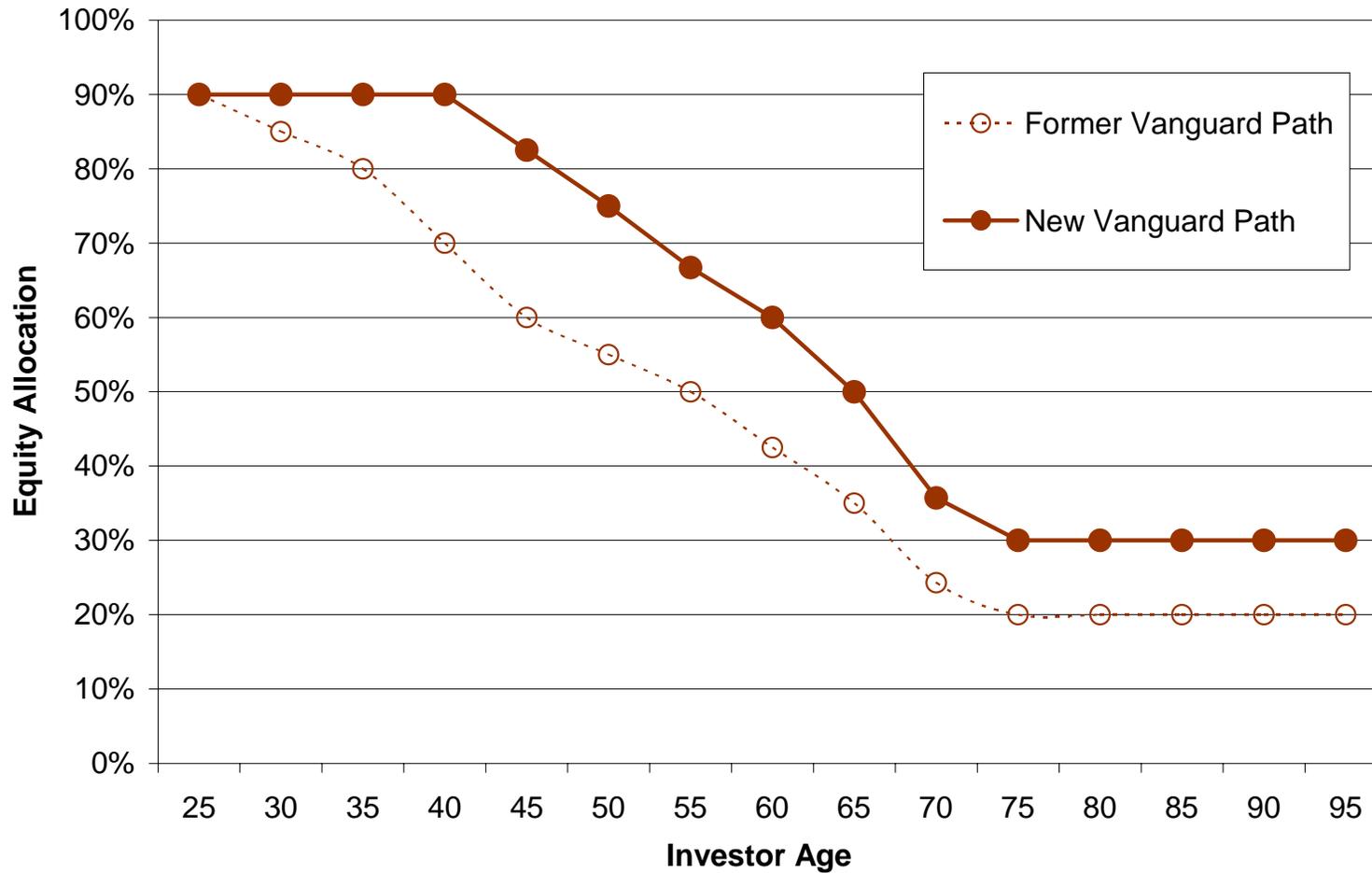
- Adjust shape of asset allocation glide path:
 - 90% equity to age 40
 - Reach 50% stocks/50% bonds by 65
 - Move Retirement Income Fund allocation to 30% stocks/65% bonds/5% cash
- Add international equity allocation to 2005 and Retirement Income Funds (20% of stocks)
- Add market weight in emerging markets stocks to all funds

Glide Path Modifications: 3 Distinctive Phases

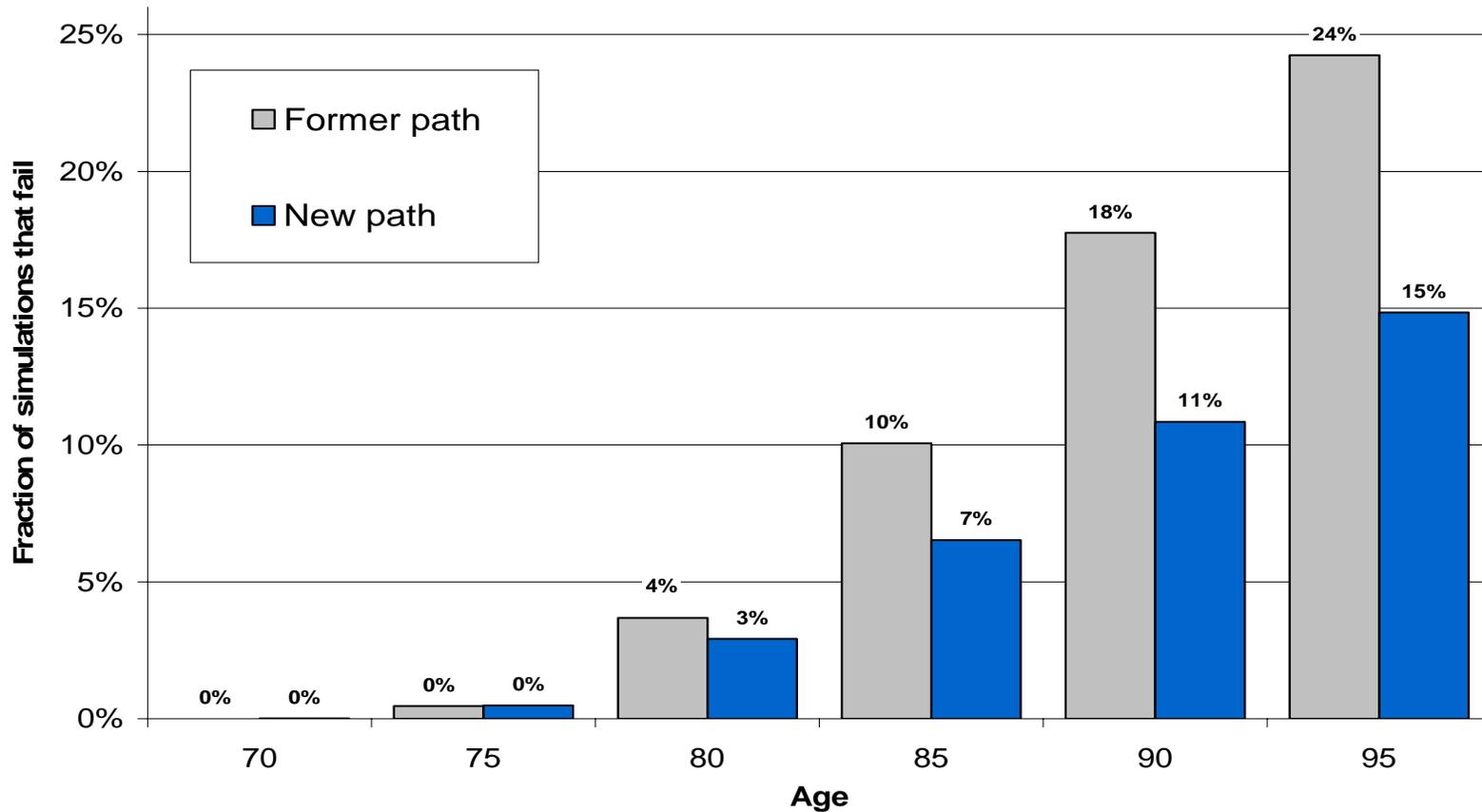
- Investors up to age 40 will have a higher equity allocation for a longer period of time
- Transition investors will move gradually to a 50% stocks/50% bonds allocation at age 65
- Retired investors (early 70's and beyond) will have a modestly higher exposure to stocks: 30% vs. 20%



Overall “Life-Cycle Equity Glide Path” Comparison



Probability of “running out” at older ages declines slightly



Assumes spending 50% of age-65 salary, adjusted for inflation, in each year in retirement.
See previous slide for simulation methodology.



Vanguard Target Retirement Funds: Fund Characteristics

- **Fund Characteristics**
 - Eleven different funds based on expected retirement dates
 - Fund automatically grows more conservative as retirement date approaches
 - Funds that Mature will consolidate into the Target Income Fund
- **Low Fees**
 - Expense ratios less than one-third the industry average
 - No additional program fees above underlying funds
- **Transparency**
 - Each fund invests in five to seven underlying funds
 - Easy to explain to participants
- **Sophisticated Methodology**
 - Funds rely on research based asset allocation methodology
 - Investment Research
 - Investor Research

