WILSHIRE COMPASS

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Setting New Standards in Fund Sponsor Information Systems and Investment Technology

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THE Ever Changing Outlook for Retirement Plans

Wilshire periodically reports on the financial condition of both state sponsored and corporate retirement funds. Our complete year 2000 study on the shape of the retirement community shows a generally favorable environment after years of uncertainty. In addition, while corporate plans have historically enjoyed a better funding status than their state sponsored counterparts, the gap has narrowed significantly. As would be expected during this severe market retreat, however, Wilshire has subsequently forecasted a significantly different outlook for corporate plans for year 2001 in a follow-up report.

To gauge the condition of corporate retirement Funds in year 2000, Wilshire analyzed the 100 largest corporate defined benefit plans. While the overall health of corporate plans was good, there was a wide dispersion of funding statuses. Pension income has become a more important component of a corporation's earnings, in some cases accounting for half of year 2000 earnings. In a couple instances, the presence of a strong pension has resulted in a positive earnings gain.

Public employee retirement plans have fared similarly well in recent periods. From 1996 to 2000, the number and magnitude of underfunded plans has decreased dramatically. The table below summarizes the year 2000 financial condition of both state and corporate defined benefit funds:

	Public Retirement Systems	**Largest 100 Corporate Plans**
Underfunded Plans in 2000:	25 of 80	21 of 100
Assets as % of Liabilities:	116%	126%
Total Underfunded Liabilities:	$50 billion	$7 billion

On an asset allocation basis, the median exposure to total equities in state retirement funds has risen from 51% in 1996 to 60% in 2000, reflecting the more important role that equities have in these plans. However, corporate plans still report slightly higher allocations to equities, but the difference has lessened.

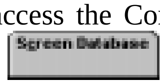
With the continuing downturn in the stock market combined with declining interest rates, Wilshire projects the funding status for corporate defined benefit plans to worsen. The ratio of pension assets-to-liabilities for the collective S&P 500 companies is expected to drop from a level of 1.25 in year 2000 to a forecasted level of 0.95 in year 2001.

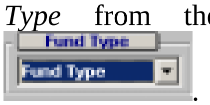
For the complete results of all three studies, please access **www.wilshire.com** under the Reference Library section using your user name and password. Should you have any questions, always feel free to contact any of the Compass Client Service team members.

Active Management: Worth the Risk?

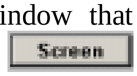
Wilshire frequently receives inquiries from clients on our views of active management (i.e., is there adequate reward for taking active management risk). Wilshire's general view is that markets are fairly efficient, and will most likely become even more efficient in the future. That being said, the active vs. passive decision is a difficult one which should be based upon expected future excess return/active management risk relationships.

The Compass Total Fund Module can be used to provide insight into the historical relationship between active management risk and return. Keeping in mind, if one believes markets will become more efficient in the future, historical relationships would be skewed in the favor of active management versus what we should expect going forward. Below are the steps to perform the analysis for domestic equity portfolios of Defined Benefit Plans.

1. To start, access the Compass Total Fund Module. Click the 

button. First screen the database for defined benefit plans. Select *Fund Type* from the center drop down menu. 

. Click on the "Fund Type" button. Select *Defined Benefit* in the new window that appears and click 

. Now click the 

button. Select *Yes* to have these funds used as your operating list.

2. Next, click on the 

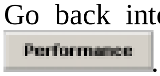
tab. From the "Type" drop down menu, highlight US Equity 

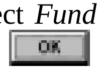
. From the command menu at the top, select "Edit" then "Select All" to drop all the domestic equity portfolios into the box below. This is also accomplished by the *Ctrl+A* keystroke.

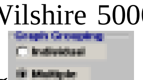
3. From the 

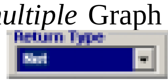
tab, double-click on the **Wilshire 5000 Index**.

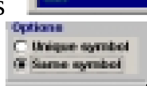
4. Go back into the 

tab and click on 

. Select *Fund Consistency* under *Skill Analysis*, click the 

button, highlight all the US Equity portfolios and the Wilshire 5000 Index, select *multiple* Graph Grouping 

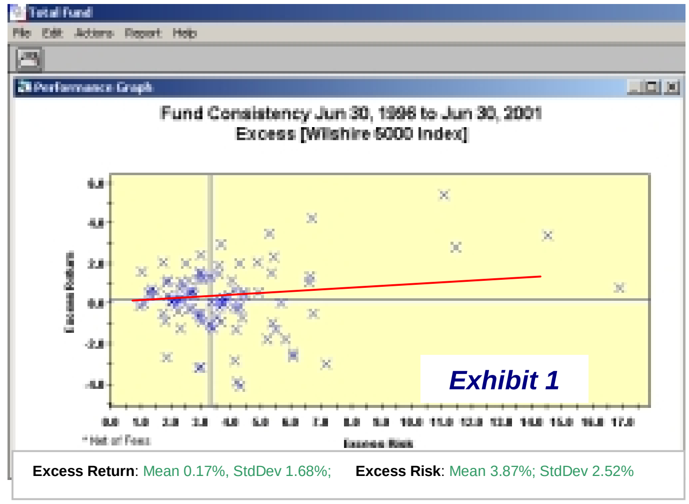
, use *Net* returns 

, select the *Same Symbol* option 

, and click on the 

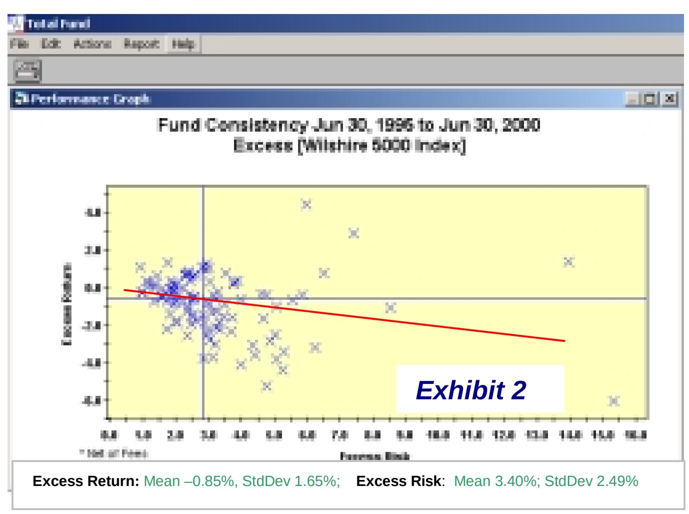
button.

Exhibit 1 below is the resultant graph:



To find the best-fit line, regress the data in Excel while forcing the Y-intercept to be zero (i.e., no risk equates to no excess return). The red line above is the product of this analysis. It yields a slope of 0.07, indicating that there has been little reward for active management risk over the last five years.

If we roll back the analysis to the five-year period ended 6/30/00 **(Exhibit 2)**, the best-fit line's slope is -0.21, an actual penalty for taking active management risk! Historically, the risk/reward relationship for U.S. Equity is typically produces a downward or negatively sloping. The past year however, has been a particularly positive period for active management. In this difficult domestic equity market environment, active management has added value for plan sponsors.



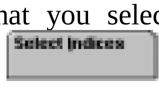
Active Management Cont…

Now let's see what the impact of active management has had in both the fixed income and international equity markets.

At this point, the easiest way to execute the analysis for US Fixed Income portfolios is to return to the 

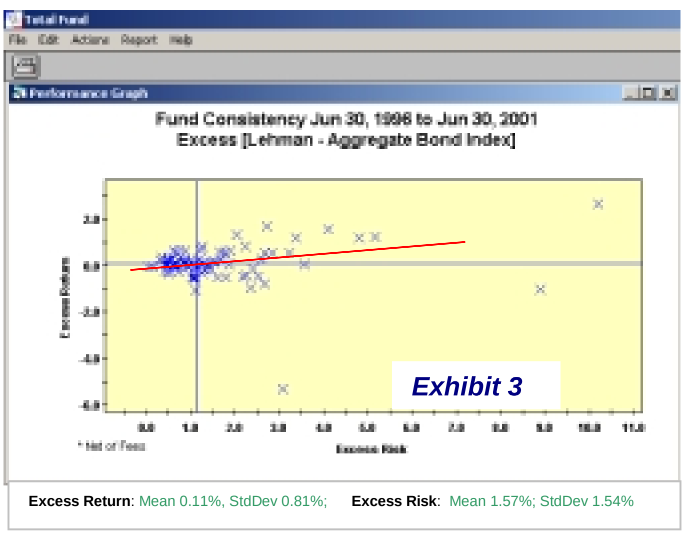
tab. From the command menu at the top, select "Edit" then "Clear All" to remove the US Equity portfolios from the analysis.

Next, from the "Type" drop down menu highlight US Fixed Income 

. From the command menu at the top, select "Edit" then "Select All" to drop all the US Fixed Income portfolios into the box below. Also ensure that you select the **Lehman Aggregate Index** from the 

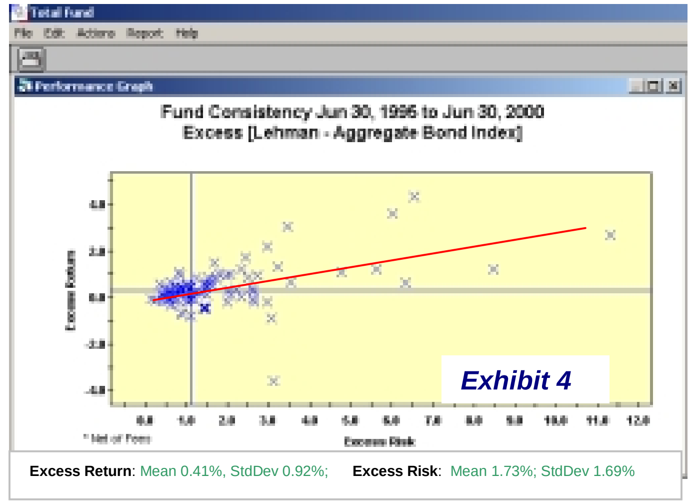
tab.

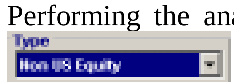
Run the analysis as you did for the US Equity portfolios and the result is **Exhibit 3** below:



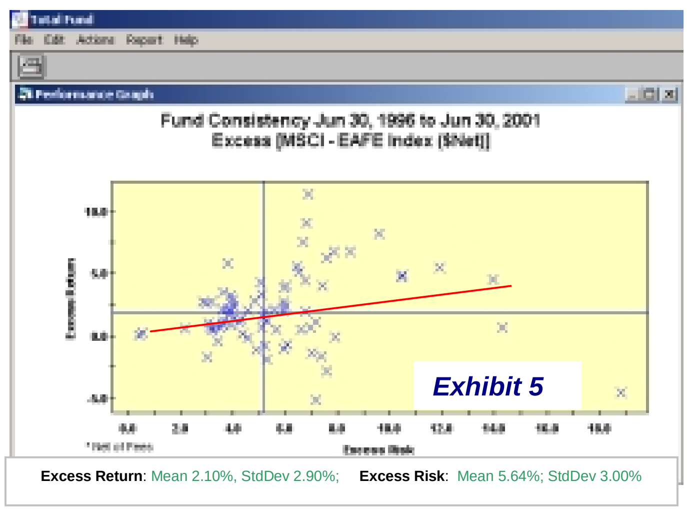
The results are very similar to what was observed in the US Equity portfolios over the same time period. The slope of the red line is 0.08, reflecting little reward for taking on active management risk.

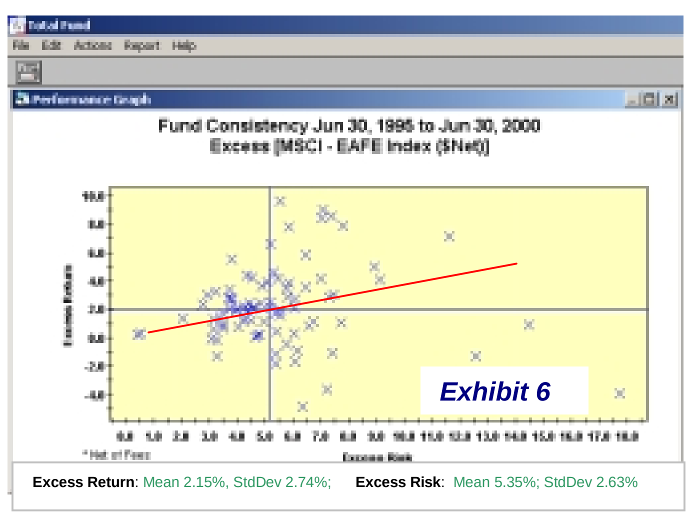
As was done for the US Equity portfolios, let's see what happens when the dates are rolled back a year. As shown in **Exhibit 4**, historically the risk return relationship has been more advantageous to active management, as represented by a slope of 0.26. With the recent strong performance in the debt markets, fixed income portfolios have struggled to add value for a commensurate level of risk.



Performing the analysis for Non US Equity portfolios 

against the **MSCI EAFE Index** lends credence that active management can add value internationally. The five-year periods ended 6/30/01 **(Exhibit 5)** and 6/30/00 **(Exhibit 6)** both have slopes of 0.33.





Compass 2001 Technology Conference

From October 3-5, The Westin La Paloma Resort, adorned by breathtaking views of the mountains surrounding Tucson, AZ, hosted the Wilshire Compass Technology 2001 Conference. The conference was kicked off by a presentation on Private Equity by Tom Lynch from Wilshire's Private Markets Group. Many of the other sessions over the 2½-day event were hands-on interactive sessions that allowed attendees to hone their skill with many of the tools available in Compass. Topics ranged from risk budgeting to a discussion on integrated wealth management.

Attendees were also treated to a "sneak peek" into the look and feel of the next release of Compass, scheduled for delivery in mid-2002. Highlights of the display included a demonstration of the new performance module and the multiple graphical enhancements of the new system.

This year participants were treated to one of three activities: a round at the Resort's renowned golf course, a Jeep Rally, or a stroll through Tucson's famous desert museum. We bet you didn't realize that there were so many varieties of desert cacti, or even know the correct pronunciation of some of them. Nor did you ever want to know!

Copies of the materials from the Compass Investment Technology 2001 Conference are being copied onto CDs and will soon be mailed to each user. Feel free to call any of the Compass client service team if you have any questions or comments regarding the conference. Thanks again to all of you who were able to join us. We hope you found the conference to be fun and informative.

Wilshire Compass People

Please join us in welcoming Michael Tudor to the Wilshire Compass Team. Michael joined Wilshire in 1997 and was most recently in Wilshire's Santa Monica office where he was responsible for servicing the firm's Funds Management clients. He joined the Pittsburgh client service team in July 2001. Michael also just completed his requirements for and has been awarded the Chartered Financial Analyst (CFA) designation. Congratulations Michael! Michael can be reached at 412-434-1580.

Also join us in greeting Chris Tessman as a new member of the client service team. Chris has been with Compass for about a year and will now be assisting clients from our Santa Monica office. His direct line is 310-260-7262.

Finally, we are very excited to report that Mark Williams in our Santa Monica office and his wife, Charmaine, are the proud new parents of Jake Edward Williams, born October 14, 2001**.**

The entire Compass team can be seen on our website, www.wilshirecompass.com by clicking on the Compass Team button.