



**JOINT LEGISLATIVE AUDIT
& REVIEW COMMISSION**
OF THE VIRGINIA GENERAL ASSEMBLY

Semi-Annual VRS Investment Report: May 1997

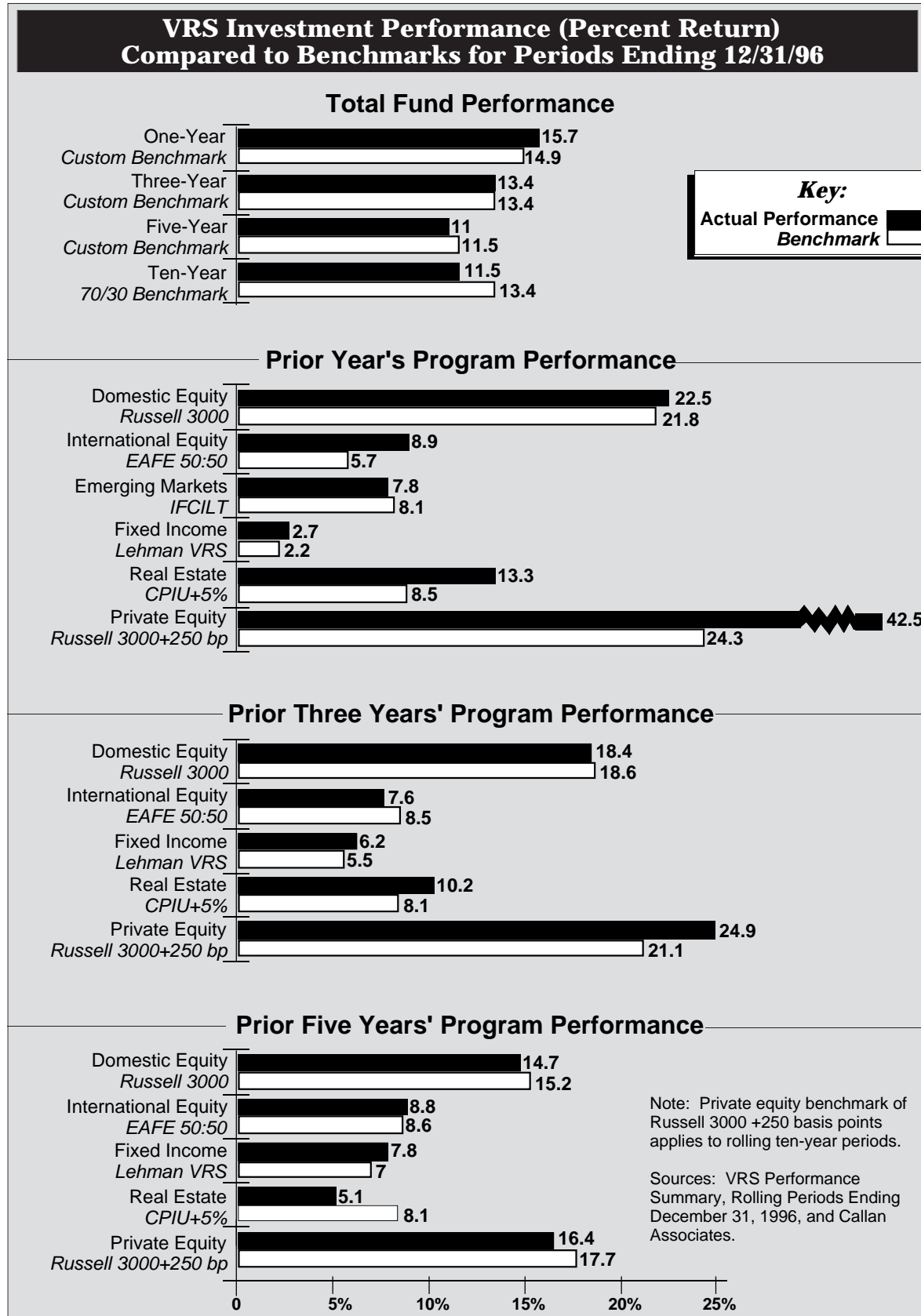
During 1997 the Virginia Retirement System (VRS) is continuing to address numerous issues concerning how and where pension fund assets are invested. For example, VRS is revising the methodology by which it makes its asset allocation policy decisions. For the first time, the process will systematically consider factors pertaining to the fund's benefit liabilities, in order to more completely address the risks faced by the pension fund. In the short run under this approach, risk is defined as volatility in asset values, funded status, and contribution rates. Over the long term, risk is defined as the failure to achieve returns greater than the U.S. inflation rate, a factor which has a strong impact on the future value of plan liabilities. The VRS Board will vote on a recommended asset allocation derived from this new process, which could differ from the current allocation, at its May 15, 1997 meeting.

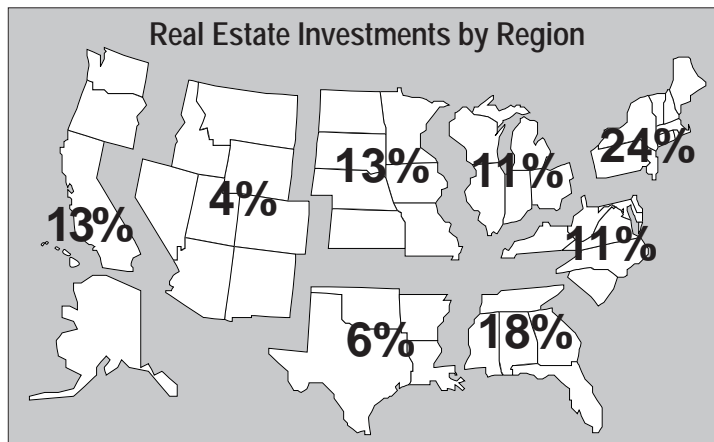
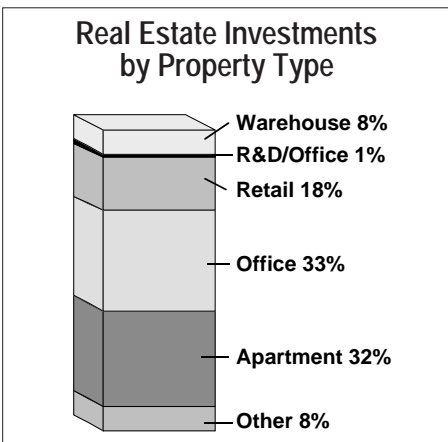
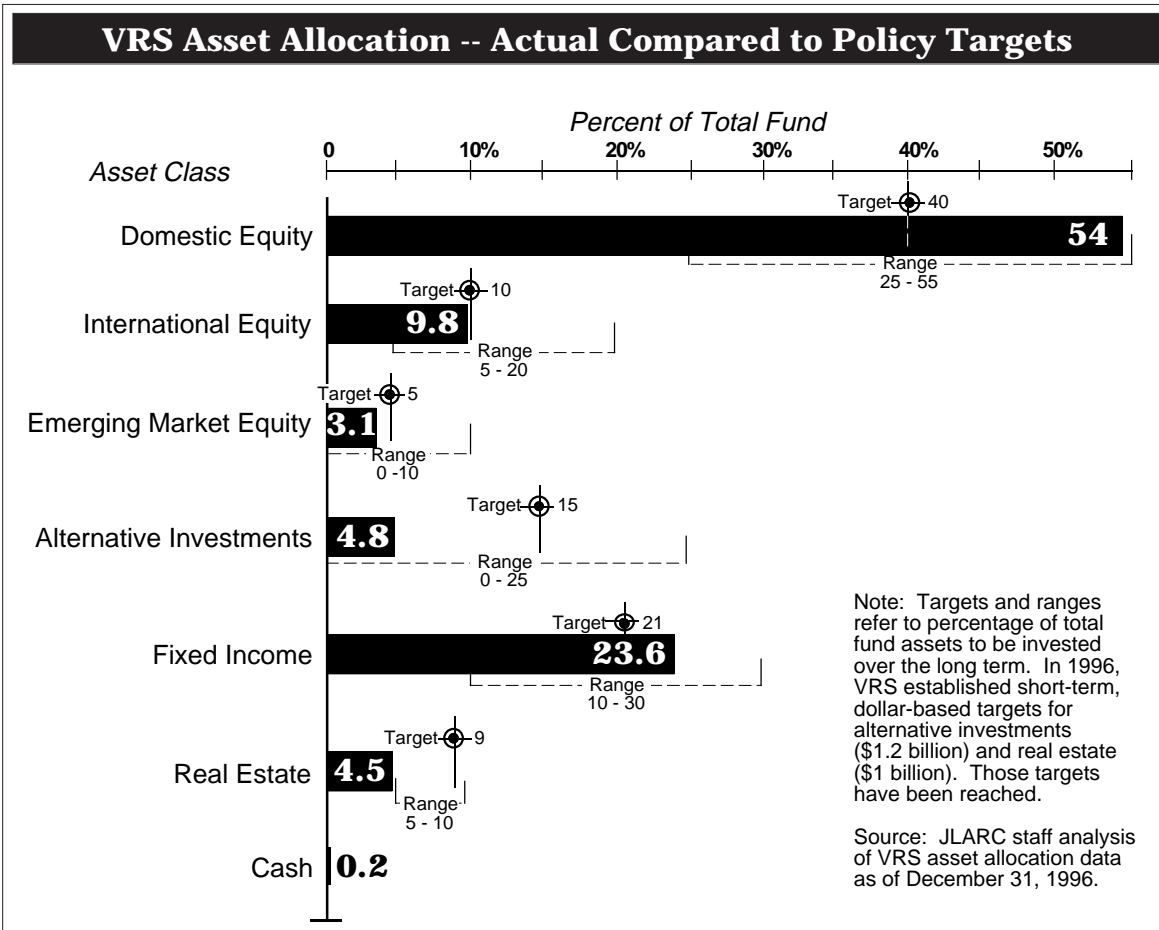
Several investment programs have undergone structural changes over the past year. An international component has been added to the private equity program, with initial investments to be made in Western Europe. The performance benchmark for the international public equity program has been revised, and an active management component is being added to emerging market investments. The real estate investment program is shifting its emphasis towards more specialized, opportunistic investments in which VRS assumes a higher level of property development and leasing risk in return for anticipated higher returns. VRS also expects to better align its interests with those of its real estate investment managers through the use of performance-based fees, and to invest more efficiently. Under this new approach, VRS has committed to invest \$448 million using eight managers, with VRS planning to grant each manager substantial, if not total, discretion.

A continuing challenge for VRS is its ability to actually invest funds in the manner envisioned by its asset allocation policy, such that each asset class can make a meaningful contribution to the fund's overall performance. A consultant to the pension fund recently advised that, unless VRS can invest at least five percent of its assets in an asset class, the expense of investing in that asset class may not be warranted. This report presents information concerning the VRS investment program as of December 31, 1996, including asset allocation, investment performance, and program structure.

Profile: Virginia Retirement System Investments																						
Market Value of Assets: \$23.94 billion																						
Number of External Managers: 73																						
Number of External Investment Accounts, Direct Investments, and Partnerships: 101																						
FY 1997 Investment Expenses: \$69.2 Million*																						
Number of VRS Investment Staff: 24 positions (5 vacancies)																						
<table border="1" style="width: 100%; text-align: center;"> <thead> <tr> <th colspan="4">Total Return on Investments</th> </tr> <tr> <th colspan="4"><small>(Time Periods Ending 12/31/96)</small></th> </tr> <tr> <th><i>10 years</i></th> <th><i>5 years</i></th> <th><i>3 years</i></th> <th><i>1 year</i></th> </tr> </thead> <tbody> <tr> <td>11.5%</td> <td>11.0%</td> <td>13.4%</td> <td>15.7%</td> </tr> </tbody> </table>							Total Return on Investments				<small>(Time Periods Ending 12/31/96)</small>				<i>10 years</i>	<i>5 years</i>	<i>3 years</i>	<i>1 year</i>	11.5%	11.0%	13.4%	15.7%
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Investment Policy Indicators (as of December 31, 1996)																						
<u>Asset Class</u>	<u>Asset Allocation</u> (% of Total Assets)		<u>Where Invested</u> (% of Asset Class)		<u>Type of Management</u> (% of Asset Class)																	
	<u>Target</u>	<u>Actual</u>	<u>Domestic</u>	<u>International</u>	<u>Active</u>	<u>Passive</u>																
Equity	70%	71.7%	82%	18%	50%	50%																
Fixed Income	21%	23.6%	97%	3%	60%	40%																
Real Estate	9%	4.5%	100%	0%	53%	47%																

*Estimated





OVERSIGHT

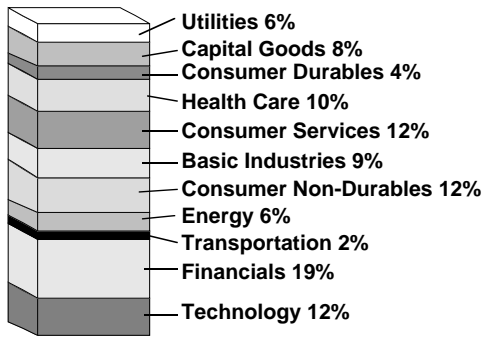
Report

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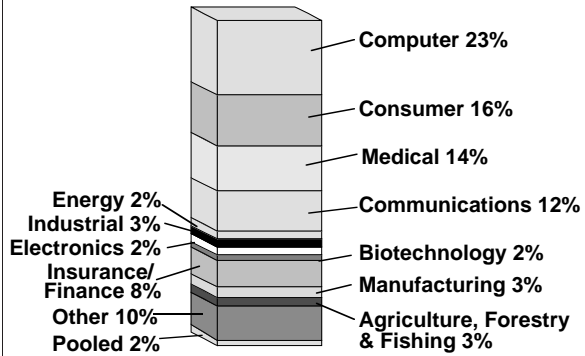
VRS Oversight Report is published periodically by the Joint Legislative Audit and Review Commission (JLARC) in fulfillment of Section 30-78 et seq. of the Code of Virginia. This statute requires JLARC to provide the General Assembly with oversight capability concerning the Virginia Retirement System (VRS), and to regularly update the Legislature on oversight findings.

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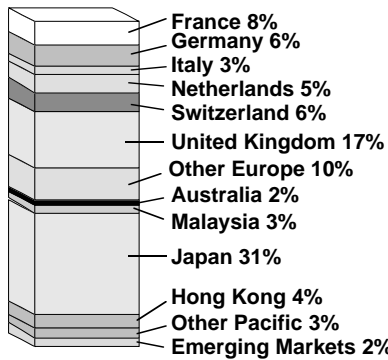
Domestic Equity Investments, by Sector



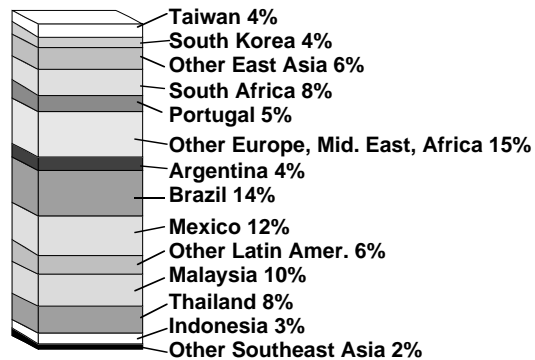
Private Equity Investments, by Industry



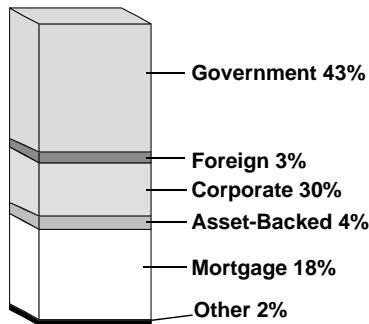
International Equity Investments, by Country



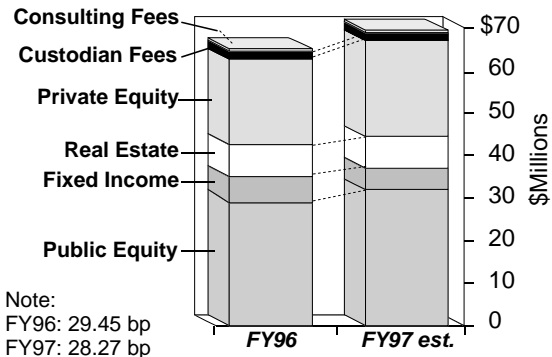
Emerging Market Investments, by Country



Fixed Income Investments, by Sector



VRS Investment Management Expenses



Notes: All investment data are as of 12/31/96, except private equity (9/30/96). Some graphics do not total to 100% due to rounding. Sources: VRS and Callan Associates.

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