457 News

Second Quarter • July 2005 • Rod R. Blagojevich, Governor

Illinois Department of Central Management Services

Q&A

Q. My contribution allocation has changed to the Legg Mason Value Trust. I didn't choose that fund. Why do I have it?

A. Over the last several months, the Deferred Compensation Office notified all participants about the pending closure of the Fidelity Fund and its replacement, the Legg Mason Value Trust. As of July 1, 2005, the Fidelity Fund was frozen, meaning the fund was closed to any new contributions or transfers. Participants were given the opportunity to change their future investment elections to any other funds offered in the Plan's investment lineup. Those Fidelity Fund participants who did not elect to make changes to their future contributions were automatically allocated to the Legg Mason Value Trust.

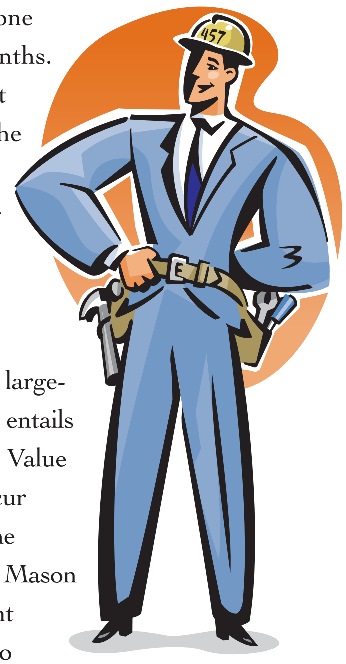
Q. Why doesn't my statement show that I have any money invested in the Legg Mason Value Trust?

A. This fund, the LSV Value Equity Fund, and the series of T. Rowe Price Retirement Funds were added and available as options in the Plan on July 1, 2005. This statement is for the second quarter of 2005 or April 1, 2005 through June 30, 2005. Therefore, you will not see any investment in any of the new funds until the third quarter statement.

Q. I still have money in the Fidelity Fund. What will happen to it?

A. You may keep your balance in the Fidelity Fund until August 31, 2005. At anytime prior to this date, you may move your balance to the appropriate investment option(s) of your choice. Any balances after this date will automatically be transferred to the Legg Mason Value Trust.

Fund Addition Complete



Your Deferred Compensation Plan has undergone some significant changes in the past several months. You have been kept abreast of the progress that led to the latest changes with this newsletter. The changes made increase the diversification opportunities for participants; increase the likelihood that an investment style will perform to expectation; and may make investing easier for many participants.

The Plan added the LSV Value Equity Fund as a large-cap value option. Another change still in progress entails replacing the Fidelity Fund with the Legg Mason Value Trust. The final phase of this replacement will occur August 31, 2005, with any remaining monies in the Fidelity Fund automatically mapping to the Legg Mason Value Trust. Finally, the T. Rowe Price Retirement Funds have been added for those participants who prefer to use a one-step approach to retirement investing.

Two Ways to Invest

To make the investment process as simple as possible, the State of Illinois Deferred Compensation Plan offers you two different ways to invest your savings: the one-step approach, and the design-your-own portfolio approach.

One-Step Approach, Time-Based Retirement Funds

Regardless of your age, if you don't have the time, desire, or experience to manage your own diverse investment mix, you may want to consider the one-step T. Rowe Price Retirement Funds. Based on your retirement date, you select one fund from the series of 10 Retirement Funds.

Design-Your-Own Portfolio Approach

If you feel comfortable selecting your own investment mix, you can pick and choose among the program's 13 core investments. This flexible alternative lets you decide how much to contribute to each fund and adjust your investment mix whenever you see fit.

While you may still choose any combination of all 23 options now offered in the Plan, simply allocating a *portion* of your account to a Retirement Fund may defeat the purpose and design of the Retirement Funds. As always, you still retain the option to move your savings to different funds within the Plan at any time. See pages 2 and 3 for more information on each approach.

One-Step Approach With the T. Rowe Price Retirement Funds

For those participants who are unsure about how to invest, there are several advantages to choosing a Retirement Fund. First, the funds are truly one-step portfolios. You choose one, and your decision is done. Secondly, the funds offer professional diversification, which may help reduce the impact of the market's ups and downs on your account. Lastly, the funds include stocks, which may help your retirement account outpace inflation.

Each Retirement Fund invests in a selection of T. Rowe Price mutual funds carefully chosen for their growth and income potential, as well as for how they perform relative to one another. T. Rowe Price managers carefully monitor and adjust the funds' asset allocations over time.

When you are far from retirement, the fund will include more stock mutual funds to make the most out of opportunities to build your assets during your peak savings and earning years. Later, as the fund's target date approaches, the allocation becomes more conservative, emphasizing bond funds more heavily, which can provide greater investment stability and income potential.

If you were born...	This Retirement Fund may be right for you...
In 1978 or after	Retirement 2045
1973 – 1977	Retirement 2040
1968 – 1972	Retirement 2035
1963 – 1967	Retirement 2030
1958 – 1962	Retirement 2025
1953 – 1957	Retirement 2020
1948 – 1952	Retirement 2015
1943 – 1947	Retirement 2010
1938 – 1942	Retirement 2005
In 1937 or before	Retirement Income

How to Choose a Retirement Fund

It's easy: Simply choose the fund with the target date that most closely matches the year in which you plan to retire, or you may choose a fund based on the year you were born. (Remember, the funds' investment programs assume a retirement age of 65 as a guideline.)

If the retirement date you have in mind falls between two funds, choosing the fund with the earlier date may expose you to less risk and lower return potential, while the fund with the later date may invest more aggressively, giving you a greater risk and return potential.

Please note that the Retirement Funds should not be considered a complete retirement solution. Before investing in one of these funds, be sure to weigh your objectives, time horizon, and risk tolerance, as well as your retirement needs and other sources of income. All funds are subject to market risk, including the possible loss of principal.

Design-Your-Own Portfolio Approach

If you prefer to choose your own asset allocation among stocks, bonds, and money market/stable value investments, and hand select your own investment options, you are still able to build your own portfolio with the investment options available through the core holdings in the Plan. This is the method of portfolio design and investment selection participants of the Plan have been utilizing since the inception of the Plan. Remember, Retirement Funds are not intended to be used in tandem with other plan investment options.

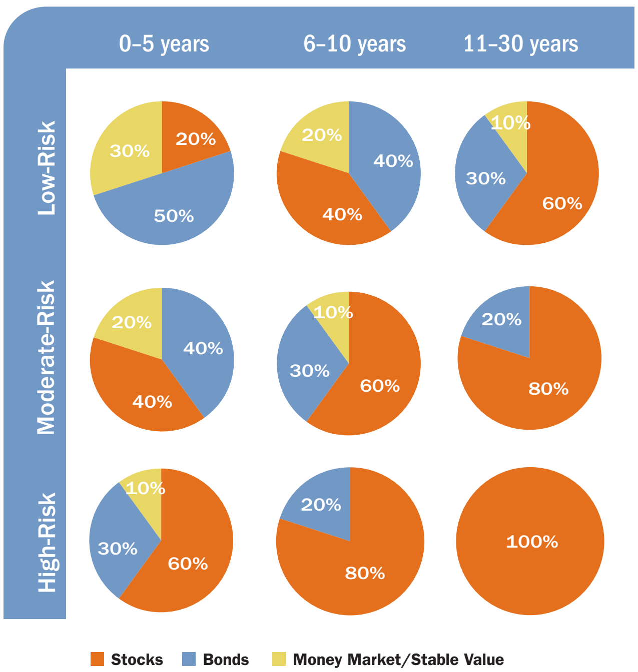
Where to Start?

First you'll need to determine your risk tolerance level. The amount of risk you're willing to take with your investments depends upon your time frame, your goals, your overall financial situation, and your attitude toward risk. If you don't already know your risk tolerance, tools are available to help you on the Deferred Compensation's Web site in the Building Blocks Booklet. You can access the Web site at www.state.il.us/cms/employee/defcom.

Selecting an Investment Mix

The accompanying chart has several sample asset allocation models based on a person's risk tolerance and number of years to retirement. The chart may give you an idea of how you might consider dividing your contributions among the different types of investments. There are 13 mutual funds that you can use to build your own portfolio. These choices have diverse objectives and management styles. Once you've developed your asset allocation strategy, you can select the funds to implement it. You can learn more about these investment options by reviewing Morningstar fund fact sheets that can be found on the ***my***RetirementPlan Web site at rps.troweprice.com or for more complete information carefully read the funds prospectus, which includes investment objectives, risks, fees, expenses and other information. Once you've set your strategy and chosen your investments, you should review your portfolio once or twice a year or whenever your goals change.

ASSET ALLOCATION



These allocations are determined by using standard indices that represent each category: stocks, bonds, and money market/stable value. The categories are designed to correspond to various risk levels centered around a "balanced" portfolio (60% stocks, 30% bonds, 10% money market/stable value). T. Rowe Price defines the "risk level" as the degree to which the monthly rates of return of a portfolio differ from the average rate of return of the portfolio over a specific time period (standard deviation). These illustrations use the following indices to represent the categories: stocks, 85% Dow Jones Wilshire 5000 Composite Index/15% MSCI EAFE Index; bonds, Lehman Brothers U.S. Aggregate Index; money market/stable value, 30-day T-bills.

Data Source: Ibbotson Associates.

RISK AND POTENTIAL RETURN OF BUILD-YOUR-OWN PORTFOLIO INVESTMENT OPTIONS

Stock Funds: Higher risk/return potential	Bond Funds: Moderate risk/return potential	Money Market/ Stable Value: Lower risk/return potential
Ariel Fund	T. Rowe Price New Income Fund	Stable Return Fund
Columbia Acorn Fund, Z	Vanguard Total Bond Index Fund—Institutional	Vanguard Money Market Reserves
Fidelity Puritan® Fund		
Legg Mason Value Trust		
LSV Value Equity		
T. Rowe Price International Stock Fund		
Provident Small Cap Equity Growth Fund		
Vanguard Institutional Index Fund		
Wells Fargo Large Company Growth		

The income and price information page will no longer be displayed in the quarterly newsletter. This information is available online at the Deferred Compensation Plan's Web site at www.state.il.us/cms/employee/defcom. You will also find links to each investment company's Web site where this information may also be provided. For important information on the price of a mutual fund, please read the article below.

What is Investment Performance?

How can you know if your investments are doing well? Don't focus on a fund's share price alone. Instead, look at long-term investment returns.

Investment returns are made up of two parts:

1. How much a fund's share price changed (up or down) over the particular time period, plus
2. Any income your money may have earned for that same period. (Stock funds generally pay dividends quarterly or annually, and bond funds generally pay dividends monthly. Both can earn capital gains when the fund makes money by selling stocks or bonds it owns.)

Investment returns are expressed in percentage rates. For example, one year a fund might have an annual return of 7%. This means that if your investment was worth $5,000 on January 1, it would be worth $5,350 on December 31. Please note that the return is computed on the dollar amount invested, not the share price of the fund. Share price provides for the accounting method of computing the return in combination with any income received. The price itself is no indication of the performance of the fund. (Remember that changes in the value of an investment are only "on paper" until you sell that investment. Long-term investors are likely to experience both "paper losses" and "paper gains" at different periods.)

Look for Longer-Term Results

Common periods used for measuring average return are annual, five-year, 10-year, and "since-inception" (that is, since the fund began) periods. For a retirement investor with long-term goals, a fund's performance since inception or for five or 10 years is more meaningful. How it does today, next quarter, or even this year is less important because you don't need the money yet.

Use Benchmarks for "Apples-to-Apples" Comparison

To see how your fund measures up, don't compare apples to oranges. For example, don't think that the 10-year, 6.5% average annual return of your bond fund is poor because you're comparing it with the 14% average annual return for your stock fund. To be fair, make an "apples-to-apples" comparison. One way to do this is by comparing your fund's performance to the average performance of similar funds. You can do this by consulting a benchmark index—an average for a particular investment type (like short-term bonds, small-cap stocks, or international stocks).

Consider Risk-Adjusted Performance

When evaluating the appropriateness of an investment, it may be important to consider both risk and performance together. Many companies that evaluate funds for investors rate them according to risk-adjusted performance. A high rating means a fund has been able to get good investment return without undue investment risk.

A "hot" fund—one that's listed in a monthly financial magazine list of "top performers"—won't necessarily earn a high rating. That's because "hot" funds are generally singled out only because they've had high short-term returns, regardless of risk.

When you have a long-term retirement investment strategy, success is not measured daily, monthly, or yearly. Success can come from making a financial plan and sticking with it—choosing and holding onto funds that deliver consistently good risk-adjusted performance over time.

Telephone Numbers

Deferred Compensation:

Plan Rules/Options Information

800-442-1300

217-782-7006

TDD/TTY 800-526-0844

Internet: www.state.il.us/cms/employee/defcom

Recordkeeper:

T. Rowe Price Retirement Plan Services

Account Value Information and

Investment Changes: 888-457-5770 or

TDD/TTY 800-521-0325

Internet Access: 800-541-3022

Internet: rps.troweprice.com