WASHINGTON STATE INVESTMENT BOARD

Board Meeting Minutes
September 18, 2003

The Washington State Investment Board met in open public session at 9:30 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	George Masten, Acting Chair Debbie Brookman Jeffrey Hanna Charlie Kaminski Patrick McElligott Mike Colleran John Magnuson Bob Nakahara Paul Trause Glenn Gorton Dave Scott Jeff Seely Representative Helen Sommers Senator Joseph Zarelli
Absent:	John Charles, Chair
Also Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Theresa Whitmarsh, Deputy Director for Operations Sue Hedrick, Executive Assistant Liz Mendizabal, Communications & Legislative Coordinator David Thatcher, Contract Specialist Beth Vandehey, Internal Auditor Tom Ruggels, Senior Investment Officer, Private Equity Steve Draper, Senior Investment Officer, Real Estate Nancy Calkins, Senior Investment Officer, Public Equity Alicia Markoff, Portfolio Administrator Linda Lester, Investment Officer, Public Equity Diana Will, Investment Officer, Asset Allocation Tom Bosworth, Investment Officer, Fixed Income Gary Holt, Investment Officer, Private Equity Janet Kruzel, Investment Officer, Private Equity Isabelle Fowler, Investment Officer, Private Equity Linda Lester, Investment Officer, Public Equity Lisa Harrison, Assistant Investment Officer, Steve Verschoor, Investment Accounting Controller Alicia Markoff, Portfolio Administrator

Kristi Bromley, Administrative Assistant, Investments
Kristi Walters, Administrative Assistant, Operations
Brian Shrader, Office Assistant Senior
Brad Christoffer, PC Support Specialist

Paul Silver, Assistant Attorney General

[Names of other individuals attending the meeting are not included in the minutes, but are listed in the permanent record.]

Mr. Masten called the meeting to order and identified the members in attendance.

ELECTION OF CHAIR AND VICE-CHAIR
Mr. Masten called for nominations for Chair of the Board.

Mr. McElligott nominated George Masten as Chair of the Board.

Mr. Masten asked twice for other nominations. There were no additional nominations.
Mr. Masten then called for nominations for Vice-Chair of the Board.

Mr. Gorton nominated Patrick McElligott as Vice-Chair of the Board.

Mr. Masten asked twice for other nominations. There were no additional nominations.
Mr. Masten then entertained a motion to elect the nominees.

Mr. Scott moved to elect the nominees for Chair and Vice-Chair of the Board. Ms. Brookman seconded. The motion carried unanimously.

ADOPTION OF MINUTES – July 31-August 1, 2003, July 30, 2003, and July 17, 2003

Mr. McElligott moved to adopt the Board minutes of July 31-August 1, 2003, July 30, 2003, and July 17, 2003. Ms. Brookman seconded.

The motion to approve the minutes carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT – BUCK CONSULTING CONTRACT EXTENSION

Mr. Masten said the Administrative Committee did not meet prior to the Board meeting because there was not a quorum; however, he said the one item on the agenda was a simple issue of extending a contract. Mr. Bruebaker explained that the WSIB executed a contract in October 2000 with Buck Consultants (Buck) for actuarial consultant services, as a result of a Request for Proposals process. The expiration date of the contract is September 30, 2003.

In 2001, Buck performed a cash flow study for the Board; staff used information derived from that study to develop models for the 2001 Commingled Trust Fund Asset Allocation study as well as for Private Equity projections. Buck will soon be working on an updated cash flow study for the Board. An increase of the contract fee ceiling in the amount of $75,000 is needed for the one-year extension.

[Mr. Trause arrived at 9:35 am]

> **Mr. Gorton moved that the Board extend the contract with Buck Consultants for the first one-year extension through September 30, 2004, as provided in the existing terms of the contract, with the $75,000 increase to the fee ceiling. Mr. McElligott seconded. The motion passed unanimously.**

PUBLIC COMMENT
There was no public comment.

[Senator Zarelli left at 9:38 am]

QUARTERLY PERFORMANCE REPORTS
Commingled Trust Fund (CTF)
Mr. Bruebaker provided the CTF performance report for the quarter ended June 30, 2003. The Wilshire 5000 index finished the fiscal year with a top ten quarter return of 16.51, allowing the index to post a small positive return of 1.3 for the fiscal year.

Small cap, as measured by the Russell 2000, rebounded for the second quarter of 2003, earning 23.4 percent, but fell short of positive returns for the fiscal year, ending with a negative 1.64 percent. Large cap, as measured by the Russell 1000, had slightly lower returns for the quarter at 15.7 percent, but outperformed small cap for the fiscal year returning a positive return of 0.9 percent. Value outperformed growth for the quarter by 273 basis points, but underperformed for the fiscal year by over 400 basis points. These are all signs of a challenging market over the course of the last year.

The non-U.S. equity market outperformed the U.S. equity market for the quarter, gaining 19.9 percent as measured by the MSCI AWCI Free ex U.S. Index, bringing the one-year return to negative 4.19, lower than the U.S. equity market for the same period. GDP growth grew at a rate of 2.4 percent on an annualized basis for the quarter while inflation, as measured by the CPI, shrunk 0.2 percent for the quarter but grew 2.1 percent for the year.

In looking at the second quarter of 2003, the Wilshire 5000 was at 16.5 percent, the best quarter it has experienced since December 1985. The current quarter through August 21 is still up 4.2 percent. In looking at second quarter and fiscal year capital market returns, the Russell small cap for the quarter was at 23.4 percent, the Lehman Universal was the lowest at 3.1 percent for the quarter, but the highest for the fiscal year.

We are up $2.9 billion for the quarter with net payouts of over $700 million, which represents higher benefit payments to beneficiaries than contribution rates. The current allocation for 2003 is within policy ranges for everything but real estate. Fixed Income and Real Estate combined are within the target ranges. In terms of net performance, it was a good quarter. Our relative performance to the TUCS Universe was not good. We earned 8.86 percent and TUCS Public Funds greater than $1 billion earned 10.97 percent.

Looking at the CTF historical performance, the fiscal year 2003 ended positive at 3.05 percent. In Domestic Equity, we outperformed the Wilshire 5000 for the quarter, the three-year, five-year and ten-year. Tracking error is negative for the fiscal year-to-date. On the non-U.S. side, we have a positive tracking error for the quarter, the three-year, the five-year, but not for the fiscal year-to-date or the ten-year.

In Non-U.S. Equity, it was a good quarter to have more money in active than passive. We have 13 percent allocated to emerging markets as opposed to the index, which was at 9 percent. This was also a very good time to have more weighting to the emerging markets.

In the Non-U.S. Equity active developed markets, four out of seven managers outperformed the index for the quarter. Pyrford outperformed and Putnam underperformed. Nicholas-Applegate and Dresdner underperformed. Delaware had very good performance entirely due to stock selection. Artisan was the best performing manager for the quarter, with 61 percent attributable to stock selection and 39 percent to country weights. Four out of seven managers outperformed for the three-year period. Since inception, five out of seven outperformed - Pyrford, Putnam, Delaware, Artisan and SSgA.

In non-U.S. equity emerging markets, two out of five managers – SSgA and F&C – outperformed for the quarter. GMO was the only manager that outperformed for the three-year period. For the five-year period, SSgA and GMO outperformed for the five-year period.

Fixed Income is at $10.6 billion, up $400 million from the previous quarter. We outperformed the Lehman Universal as well as the Lehman Aggregate for the quarter, one-year, three-year, five-year and the ten-year. We've had excellent performance in this fund.

Private Equity is at $5.4 billion. Mr. Bruebaker indicated that Pacific Corporate Group would discuss performance for our private equity program later in the meeting. Real Estate is at $3.7 billion, down $100 million from the previous quarter. We have underperformed for the quarter and the five-year, but outperformed for the one-year and the three-year.

Defined Contribution Plans

TRS Plan 3 is at almost $1.8 billion and increased $205 million over the previous quarter. SERS Plan 3 is at $517 million and increased this quarter by $48 million. PERS Plan 3 is at $441 million and increased by $215 million. The balance in the Deferred Compensation Program is at $1.4 billion. During the quarter, it increased $150 million. The Judicial Retirement Account shows a balance of $10.6 million and increased $1 million.

Three out of ten managers outperformed their respective indexes, the U.S. Stock Fund, U.S. Large Stock Fund, and Money Market Fund for the year ended June 30.
Two out of ten managers outperformed for the one-year in the Deferred Compensation Program and the Judicial Retirement Account. Those were the Independence Fund and the Growth Company Fund.

[Mr. Trause left at 10:05 a.m.]

Labor & Industries (L&I) Funds
The total for the Labor and Industries (L&I) funds is at almost $9.3 billion, up $400 million from the previous quarter. The Fixed Income range is between 82 and 88 percent, and currently we're at 85.9 solidly in the middle of that range. The Equities range is between 12 and 18 percent and we're at 14.1 percent, in the center of that range. Conning Asset Management is working on an asset liability study which is planned to be completed by November. It is expected that it will recommend changes to the asset allocation for the Board to consider in November.

We underperformed the CMI for all four funds, the Accident, Medical Aid, Pension Reserve and Supplemental Pension Funds for the year ended June 30, 2003.

A discussion ensued on why the L&I rates are increasing. Mr. Bruebaker said that investment performance is one reason. Mr. Dear said there are other reasons such as health care cost increases and increasing pension frequency.

Permanent and Other Trust Funds
The total for all of the Permanent Funds is $733 million, up $15.4 million from the previous quarter. We continue to have excellent investment performance. We outperformed in every one of the funds except the Millersylvania Park Fund for the quarter, the one-, three- and ten-year.

For the Other Trust Funds, we continue to have solid long-term performance. Every account outperformed for the five- and the ten-year but not the quarter.

The Guaranteed Education Tuition (GET) portfolio is at $271.5 million, up $70.2 million. All of the asset allocations are within the policy ranges. For the quarter, it is up 11.3 percent, trailing by 40 basis points against the passive benchmark. Since inception, the GET Program is up 3.73 percent and is outperforming the passive benchmark by 12 basis points.

The DDEF state funds were at almost $6.3 million, up $240,000. We are within all policy ranges adopted by the Board. Private funds are at $215,000, up $93,000 for the quarter.

[The board took a break at 10:23 a.m. and reconvened at 10:34 a.m.]

Private Equity - Pacific Corporate Group Report
Tom Ruggels, senior investment officer for Private Equity, introduced Eric Becker from Pacific Corporate Group (PCG) who gave the quarterly report for the private equity portfolio for the quarter ending March 31, 2003.

Mr. Becker gave a high level summary of activity during the quarter and then a review of the private equity market. Mr. Becker said that a commitment of $125 million was authorized to GTCR Fund VIII during the quarter. Also, a $75 million commitment to Evercore Capital Partners II was closed. Contributions were nearly $300 million compared to $400 million in the previous quarter. Distributions were nearly $100 million compared to $153 million in the previous quarter. The IRR since inception decreased by 30 basis points from 13.1 percent to 12. 8 percent.

Mr. Becker highlighted a few key drivers of the private equity market. Corporate Finance funds continued to be very active during the quarter with almost $20 billion of new investments. The increased activity was primarily driven by corporate divestitures combined with an improvement in the debt capital markets. Venture capital investments declined from $4.3 billion to $3.8 billion. That was primarily driven by a more cautious investment approach by many of the general partners combined with fewer high-quality deals. Fundraising continues to be slow. The IPO market also was slow during the first quarter; however, there has been an increase in activity in the second and third quarter.

Committed capital increased slightly due to the recent $75 million commitment to Evercore, which was partially offset by an $8.9 million reduction due to Telecom Partners' III reduction in their fund size from $500 million to $425 million.

Exited investments posted a 15.5 percent IRR and a 2.5x multiple on $876 million of invested capital to-date. Active investments posted a 10.1 percent return and a 1.3x multiple on $8.2 billion of invested capital to-date.

KKR's IRR was down from 16.6 to 16.4 percent, and the LP portfolio return was down from 6.8 to 6.4 percent. The combined portfolio depreciated by $79.3 million or 1.5 percent during the quarter. However, Mr. Becker indicated there is good news for the second quarter. The portfolio turned cash flow positive with distributions of $220 million and contributions of $93 million for a net positive cash flow of $127 million. Mr. Becker also said it appears that the portfolio may have appreciated in value during the second quarter, although PCG has not yet received June 30 data from several funds, and that is subject to change.

During the first quarter, the KKR portfolio had a negative 3.0 percent IRR, and the LP portfolio had a negative 0.9 percent IRR, compared with the S&P 500 which posted a negative 3.2 percent return during the period.

The best performing sectors during the quarter were the Distressed portfolio, which posted a 3 percent return, followed by the Mezzanine portfolio, which posted a 0.8 percent return. Venture Capital and Large Corporate Finance lagged during the quarter with a negative 4.7 percent return and a negative 2.4 percent return, respectively.

The KKR portfolio depreciated by $42.8 million during the quarter, due to valuation declines in public securities in both the '86 and '96 funds. The LP portfolio experienced a $36.5 million decline in value, due to declines in public holdings combined with write-downs of private securities.

Seventy-six funds reported losses compared to 50 funds reporting gains during the quarter.

INVESCO and Pathway depreciated by 8.7 percent and 6.1 percent, respectively. The four funds managed by Warburg Pincus depreciated by 3.4 percent, and the eight funds managed by HarbourVest depreciated by 6.3 percent.

On a positive note, OCM III distributed proceeds of $25 million, and Fortress Investment Fund distributed $10 million during the quarter. Joseph, Littlejohn & Levy Fund III appreciated by 8.5 percent during the quarter.

PUBLIC MARKETS COMMITTEE REPORT
There was nothing to report.

PRIVATE MARKETS COMMMITTEE REPORT
There was nothing to report.

EXECUTIVE STAFF'S REPORT
Executive Director's Report
Mr. Dear presented his report for September. The eight new charters and five new policies adopted at the Board Governance Workshop were sent to the Board members this week. The next step is to integrate the changes with existing policies. Mr. Dear introduced Theresa Whitmarsh, the new deputy director for Operations. Recruitment is ongoing for an investment officer for Real Estate. One investment officer in Fixed Income resigned effective September 5; recruitment for that position will begin soon. Mr. Dear recognized David Thatcher, our contract specialist recently returned from active duty in the Marine Corps, and thanked the Department of Labor & Industries for loaning Bill Ireland to the WSIB in Mr. Thatcher's absence.

Mr. Dear highlighted what will be coming before the committees in late September and October. He reported that last biennium's budget ended at $234,792. Heartland LLC was selected, out of three qualified bidders, to provide multiple investment strategy options for Washington State to maximize the value of surplus property at the state's five residential habilitation centers for the developmentally disabled. Development of the Information Technology Strategic Plan is on hold until Ms. Whitmarsh reviews opportunities to partner with existing vendors and possibly avoid major expenditures for new information technology systems.

Mr. Dear said he attended the Fall meeting of the Council of Institutional Investors (CII) in early September. The top two corporate governance issues are access to the proxy and CEO compensation. The Securities and Exchange Commission will propose an access to proxy rule later this month.

Monthly Investment Reports
Mr. Bruebaker gave the asset allocation report for the months of July and August. In the capital markets environment, the current quarter is up 7.2 percent through September 16, 2003. July and August were positive months, except for the Lehman Universal, which was negative for July.

Assets under Management are at $52.2 billion as of the end of August, up $340 million from June 30, 2003. The return for U.S. Equity is at 2.4 percent, as is the return for non-U.S. Equity. Fixed Income is up 0.5 percent. Private Equity is up 1.5 percent. Real Estate is up 9 percent. Cash is up 0.1 percent for a total of 1.6 percent for the month.

For the month of July, U.S. Equity is up 2.37 percent versus the Wilshire 5000 Index of 2.41 percent. International Equity is up 2.64 percent versus the MSCI ACWI ex U.S. Index of 2.66 percent. Developed markets are up 2.34 percent versus the MSCI EAFE + Canada Index of 2.29 percent. The highest performing manager was Artisan with an overperformance of 176 basis points. The lowest performing manager was Dresdner, under 125 basis points.

Emerging markets were at 5.29 percent, 93 basis points below the MSCI Emerging Markets Free Index, which was at 6.22 percent. F&C was the highest performing manager at 6.91 percent. The lowest performing manager was passive SSgA Liquidity Tier.

For the month of August, U.S. Equity had a positive tracking error of 4 basis points. International Equity was under as a total by 54 basis points. Developed Markets were under by 64 basis points. The highest performing manager was Nicholas-Applegate, 74 basis points over the index. Delaware was the lowest performing manager, 238 basis points below the index.

Emerging Markets earned 6.6 percent, or three basis points under the MSCI Emerging Markets Free Index at 6.69 percent. Schroder Capital Management was the highest performing manager, 177 basis points over the index for the month. The lowest performing manager for August was the SSgA Liquidity Tier.

In July, Fixed Income outperformed the Lehman Universal by 43 basis points. The fund benefited from a shorter duration. Government Securities outperformed the indexes by 54 basis points. Fund Credits underperformed by two basis points, and Fund Securitized underperformed by nine basis points.

In August, Fixed Income underperformed the Lehman Universal by 24 basis points. Yield curve positioning hurt the fund's performance as the long end was the best performing part of the curve. The CTF is underexposed in the long end. Fund Governments outperformed by 54 basis points. Fund Credits underperformed by 55 basis points, and Fund Securities underperformed by 17 basis points.

In Private Equity for July, draws were $79.8 million; $18.8 million were from KKR, while $61 million were from the LP portfolio. Distributions were $90.4 million; $1.7 million from KKR and $88.7 from the LP portfolio. No investments were made or closed during the month.

In August, draws were $35.5 million, all from the LP portfolio. The average for 2003 was $70.7 million. Distributions were $38.3 million, again all from the LP portfolio. The average for 2003 was $55.5 million. No investments were made or closed during the month.

In Real Estate for July, Lowe NW sold an office building in L.A. for a $3.3 million profit. Corporate Properties of America continued to made acquisitions in Mexico, including purchases in two new markets. Hometown/Chateau should close between Sept 30 and Oct 2. During August, EuroInvest closed on a portfolio of four retail properties in Central Europe for $60 million, and PEC created a new investment platform with a local team that specializes in California industrial property.

For asset allocation as of August 31, all asset classes were within their policy ranges with the exception of Real Estate, but Fixed Income and Real Estate combined and U.S. Equity and Private Equity combined were within their respective ranges.

ASSISTANT ATTORNEY GENERAL'S REPORT – EXECUTIVE SESSION
Mr. Masten called the Board into Executive Session, pursuant to the Open Meetings Act, to discuss with legal counsel litigation or potential litigation to which the WSIB is a party or is likely to become a party. Public knowledge regarding these discussions is likely to result in an adverse legal or financial consequence to the WSIB.

Mr. Masten said the executive session was expected to last about 15 minutes. After the executive session, the Board anticipated re-convening in public session to adjourn the meeting as no action was anticipated and there were no other remaining matters on the agenda. Mr. Masten also indicated that, following the adjournment of the Board meeting, members were invited to attend an ethics training session, which would be held in open session.

[The open session concluded at 11:10 a.m. and the executive session immediately convened. The executive session concluded at 11:23 a.m. and the open session reconvened immediately thereafter.]

There being no further business to come before the Board, the meeting adjourned at 11:23 a.m.

George Masten

George Masten
Acting Chair

ATTEST

Joseph A. Dear

Joseph A. Dear
Executive Director