

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
February 19, 2009

The Washington State Investment Board met in open public session at 9:31 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Glenn Gorton, Chair
Senator Lisa Brown (via teleconference)
Steve Hill
Charlie Kaminski
John Magnuson
George Masten
Pat McElligott
Treasurer Jim McIntire (via teleconference)
David Nierenberg
Mason Petit
Mike Ragan
Representative Sharon Tomiko Santos (via teleconference)
Judy Schurke
Jeff Seely

Absent: Bob Nakahara

Also Present: Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Theresa Whitmarsh, Chief Operating Officer
Steve Draper, Senior Investment Officer – Real Assets
Bill Kennett, Senior Investment Officer – Fixed Income
Phil Paroian, Senior Investment Officer – Public Equity
Tom Ruggels, Senior Investment Officer – Private Equity
Diana Will, Senior Investment Officer – Asset Allocation
Kristi Haines, Executive Assistant

Brian Buchholz, Assistant Attorney General
Dave Woolford, Capital Dynamics
Michael Humphrey, Courtland Partners

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

Chair Gorton called the meeting to order and roll call was taken.

OATH OF OFFICE – STEVE HILL

Chair Gorton administered the oath of office to Mr. Hill to fill the ex-officio position as the Director of the Department of Retirement Systems. Mr. Hill provided a brief overview of his work

experience.

[Senator Brown was in attendance via teleconference at 9:36 a.m.]

VICE CHAIR ELECTION

Mr. Masten nominated Mr. McElligott as Vice Chair. There were no other nominations.

**Mr. Masten moved White ballot to appoint Mr. McElligott as Vice Chair.
Mr. Petit seconded, and the motion carried unanimously.**

COMMITTEE ASSIGNMENTS

Chair Gorton said that since Mr. McElligott is now Vice Chair, he recommends the Board assign Mr. Masten as Chair of the Private Markets Committee and appoint Mr. Hill to both the Audit and Private Markets Committees. He said that Mr. Kaminski would step down from the Audit Committee.

Mr. Masten moved to accept the Chair's recommended Committee assignments (as described above). Vice Chair McElligott seconded, and the motion carried unanimously.

ADOPTION OF THE JANUARY 15, 2009, AND JANUARY 26, 2009, MINUTES

Vice Chair McElligott moved to adopt the January 15, 2009, and January 26, 2009, meeting minutes. Mr. Ragan seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

RECOGNITION

Chair Gorton acknowledged Ms. Matheson's departure from and contributions to the Board.

Chair Gorton thanked Mr. Dear for his work as Executive Director and said he would be greatly missed. He presented Mr. Dear with a recognition gift from the Board and read aloud a letter of appreciation from Governor Gregoire. Mr. Dear said he is greatly honored for his time serving the Board and beneficiaries as Executive Director. He said his success is shared by all WSIB staff, and he is deeply grateful. Several Board members shared remarks about Mr. Dear's career, legacy, quality of staff, relationship with the Board, and their appreciation for his trustworthiness and hard work.

[Treasurer McIntire was in attendance via teleconference at 9:49 a.m.]

EXECUTIVE DIRECTOR'S REPORT

Mr. Dear provided his monthly report for February on board governance, investments, staff, operations, public affairs, meetings, and open procurements. In response to member's questions about the data warehouse project, Ms. Whitmarsh said a demonstration is planned for the April

Board meeting.

TWENTY-SEVENTH ANNUAL REPORT, 2008

Mr. Dear introduced the 2008 annual report, which was produced entirely in-house. He recognized the work of the Performance Reporting Officer and the Investment Accounting team in compiling the data.

Mr. Masten moved that the Board approve the Twenty-Seventh Annual Report, 2008. Vice Chair McElligott seconded, and the motion carried unanimously.

CTF RISK ANALYSIS

Chair Gorton announced the Board would go into executive session to discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. He said the executive session was expected to last until about 10:30 a.m., at which time the Board would reconvene in open session.

[Treasurer McIntire was no longer in attendance via teleconference at 9:58 a.m.]

[The Board convened in executive session at 9:58 a.m.]

[Senator Brown was no longer in attendance via teleconference at 10:30 a.m.]

[Representative Santos was in attendance via teleconference at 11:29 a.m.]

[Ms. Schurke left the meeting at 11:38 a.m.]

[Representative Santos was no longer in attendance via teleconference at 11:52 a.m.]

[The Board concluded its executive session at 11:56 a.m. and took a brief recess.]

[The Board reconvened in open session at 12:19 p.m.]

ADMINISTRATIVE COMMITTEE REPORT

Executive Director Transition

Chair Gorton moved that the Board accept Joe Dear's resignation effective February 27, 2009. Mr. Ragan seconded, and the motion carried unanimously.

Appointment of Acting Executive Director

Chair Gorton moved that the Board appoint Theresa Whitmarsh as the Acting Executive Director effective February 28, 2009. Mr. Ragan seconded, and the motion carried unanimously.

Recruitment Process for New Executive Director

Chair Gorton moved that the Board establish an *ad hoc* Committee to come back with recommendations on organizational structure and a recruiting process for consideration by the Board. He added that the *ad hoc* Committee will be chaired by the Chairman of the Board who will determine the membership. Mr. Ragan seconded, and the motion carried unanimously.

PUBLIC MARKETS COMMITTEE REPORT

Mr. Ragan reported the Public Markets Committee met on February 9, 2009, to consider the results of the Index-Related Products Manager Search and conduct a review of the Enhanced Indexing Program.

Index-Related Products Manager Selection

Mr. Ragan moved that the Board approve the selection of State Street Global Advisors as an index-related products investment manager for the WSIB, with a focus on non-U.S. index related products, subject to final negotiations of terms, conditions, and fees. Mr. Petit seconded the motion.

Mr. Ragan reported that the contract with the incumbent, State Street Global Advisors (SSgA), expires March 31, 2009. The process used for this search was similar to the one conducted for U.S. indexes in 2007 to provide the WSIB with access to all index-related products offered by the firm. The primary focus will be non-U.S. equity products. He said two firms met the minimum qualifications for the search: SSgA and Barclays Global Investors. The recommendation to award the contract to SSgA is based on three main factors.

(1) Incumbency—as the incumbent, SSgA has served the WSIB in this role for the past 13 years. (2) Diversification—the WSIB benefits from having two separate and different index providers. This also limits some operational and investment risks by not concentrating all passive mandates with one firm. (3) Performance—SSgA’s performance record has been good and they have added between 20 and 40 basis points (bps) annualized over various time periods.

The above motion carried unanimously.

Enhanced Indexing Program Review

Chair Gorton announced the Board would go into executive session to discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. He said the executive session was expected to last about 5 minutes, at which time the Board would reconvene in open session.

[The Board convened in executive session at 12:26 p.m. and reconvened in open session at 12:42 p.m.]

Mr. Ragan moved that the Board terminate the U.S. equity enhanced index mandate managed by State Street Global Advisors and authorize staff to transfer the funds to Barclays Global Investors, either in the U.S. enhanced index portfolio or U.S. passive index portfolio, as appropriate, as discussed in executive session. Mr. Masten seconded, and the motion carried unanimously.

Mr. Ragan moved that the Board terminate the relationship with WAMCO and move the transition and liquidation of this portfolio to BlackRock, as

discussed in executive session. Mr. Petit seconded, and the motion carried unanimously.

Mr. Ragan moved that the Board direct staff to begin a competitive process to identify enhanced index managers for the Committee's and the Board's consideration, as discussed in executive session. Vice Chair McElligott seconded, and the motion carried unanimously.

Mr. Masten pointed out there was another action at the Public Markets Committee meeting that he believed would be brought forward to the Board. Mr. Dear and Mr. Bruebaker clarified that motions that did not pass at the Committee level are not brought to the full Board but that the Board could certainly consider any additional action they would like.

PRIVATE MARKETS COMMITTEE REPORT

Vice Chair McElligott reported the Private Markets Committee met on February 5, 2009, and discussed two investment recommendations.

Private Equity Investment Recommendations

Advent Latin American Private Equity Fund V L.P.

Vice Chair McElligott moved that the Board invest up to \$100 million, plus fees and expenses, in Advent Latin American Private Equity Fund V L.P., subject to continuing due diligence and final negotiation of terms and conditions.

Mr. Ragan seconded the motion.

Vice Chair McElligott reported that Advent International is an existing general partner relationship. The fund will pursue control positions in later-stage mid-market businesses primarily in Mexico, Brazil, and Argentina. He said the recommendation is based, in part, on Advent's experienced Latin American team, proven investment strategy, successful performance record, and excellent fit in the WSIB private equity portfolio. The recommendation is consistent with the 2009 private equity annual plan approved by the Board in November 2008.

The above motion carried unanimously.

Real Estate Investment Recommendations

Corporate Properties of the Americas, LLC – Follow-on Investment

Vice Chair McElligott moved that the Board invest an additional \$250 million, plus fees and expenses, in Corporate Properties of the Americas, LLC, and changes to the company's financial terms consistent with the discussion in the confidential memo provided to the Board, subject to continuing due diligence and final negotiation of terms and conditions. Mr. Petit seconded the motion.

Vice Chair McElligott reported that Corporate Properties of the Americas, LLC (CPA) is a real estate operating company which specializes in industrial properties in Mexico and is owned exclusively by the WSIB and company management. Staff believes the CPA team has assembled the highest quality portfolio of industrial properties in the country and will provide the

WSIB with excellent long-term returns. He said the recommendation is based, in part, on CPA's relatively low-volatility property type, quality of management, quality of portfolio, and the high income yield received from the investment. The recommendation is consistent with the 2009 real estate annual plan approved by the Board.

The above motion carried unanimously.

QUARTERLY DISCUSSION OF MARKETS

Portfolio Discussion

Mr. Bruebaker introduced the quarterly discussion of markets and portfolio performance for the period ended December 31, 2008. He said the only time period during which the 8 percent return objective was met was since inception of the fund, which returned 8.53 percent. Overall performance for the quarter was not good. Allocation decisions added value for the quarter. The portfolio was underweight in global equities, which has been beneficial; however, underweighting in public equities is an area of concern and staff is continuing to explore ways to address this underweight. Manager decisions detracted by 33 bps in Real Estate, 19 bps in Private Equity, and 55 bps in Fixed Income. Mr. Bruebaker said this was the first quarter the Implementation Value Added benchmark underperformed for both the quarter and one-year time periods. While he stated that he continues to believe that TUCS is not a good comparison, total fund performance compared to the TUCS universe outperformed in all time periods.

Mr. Bruebaker said the financial turmoil is not over; however, although he is uncertain as to whether or not it will end in the next year or two, he is confident it will end. The WSIB will realize its share of investment losses, but has a high quality, globally diversified investment portfolio positioned well for long-term investment performance.

Fixed Income

Mr. Kennett reported that retirement Fixed Income underperformed during the fourth quarter by 273 bps, which was attributed to being overweight in credit and governments, and TIPs exposure. There was outperformance within credit and securitized investments. He said that January 2009 was the second best month ever for performance. Fixed Income had outperformance of 188 bps as of February 18, 2009. He stated his belief that the one-year performance by the end of the fiscal year will be negative, with positive results anticipated for the 3-, 5-, and 10-year periods. The portfolio underperformed by just over 200 bps for calendar year 2008, but was outperforming for the 10-year period. Mr. Kennett reported that Labor and Industries' funds and the Bond Fund are doing well, and Permanent Funds are trailing a bit as compared to their indices.

Public Equity

Mr. Paroian said that equities had an extraordinary fourth quarter. There were 27 days during the quarter where the market moved more than 5 percent. This shows the tremendous volatility of that quarter as the entire 50 year period from 1950 to 2000 also had 27 days where the market moved more than 5 percent. He said the market decline began in October and continued into early November and has since flattened. For the year, almost all global markets were down 40 percent or more. Emerging markets had their worst year on an absolute basis, down by over 50 percent in U.S. dollar terms. He said there was little variation between value versus growth,

or between small versus large cap. He said healthcare was the best performing sector, down 22 percent; other sectors were down 33 percent or worse. In terms of performance, the Board has addressed concerns within the enhanced index area, and staff plans a review of the emerging markets program in March. Mr. Paroian believes that debt levels in the financial system, consumer debt, and government debt must be worked through before economic conditions can return to full health.

Mr. Hill commented on the increases in nominal federal debt and entitlement unfunded liabilities. He suggested that public debt may be the biggest concern.

Real Estate

Mr. Draper said that Real Estate performance for the third quarter 2008 was off a bit more than 2 percent. He said the bigger issue is the fall in valuations since the end of the third quarter, with write-downs anticipated to be 20 percent or more for the fourth quarter. He pointed out the WSIB generally reports write downs more quickly than many of its peers and the NCREIF index is not expected to move downward as quickly, but the WSIB's returns versus the benchmark will even out over time. Mr. Draper said that rents are falling, and there is a lack of capital in the market, leading to further deterioration of value. The largest concern is the ability to refinance properties in the current environment, which will continue to impair value. He said the Real Estate portfolio is well diversified, with underweighting in some more volatile property types such as office and mall properties, and that the WSIB has a great group of real estate partners.

Private Equity

Mr. Ruggels said that not much is happening within private equity markets. Liquidations are very difficult, and there is no IPO window and no debt to do large transactions. General partners are focusing on existing portfolios. He said performance for the quarter ended September 30, 2008, is down 7.9 percent, and fourth quarter returns are expected to be bad. Valuations are falling, even for companies that are performing according to plan, due to multiple contraction. Mr. Ruggels expects the year to be relatively slow in terms of investment pace, but anticipates good investment opportunities to arise in 2010-2011.

Mr. Petit said he is appreciative of the attention to detail and diligence staff puts into their work.

In response to Mr. Kaminski's question about distressed markets, Mr. Kennett said he does not think there will be opportunities. He believes the outlook to be grim and expects the recovery will take years given the huge problems that exist in banking, housing, unemployment, and debt.

Mr. Nierenberg inquired, given the comments today, about hedging strategies that may help protect the fund from further downside risk.

Private Equity

Mr. Ruggels said that Capital Dynamics' report for the period ended September 30, 2008, was distributed in the Board packet. He introduced Mr. Woolford to report on market conditions. Mr. Woolford said that Capital Dynamics views private equity as equity. There are cycle movement patterns between Venture Economics and S&P 500 data. He believes the fourth quarter report will reflect a 20 to 30 percent decline for the portfolio. Mr. Woolford shared

Capital Dynamics' view on market concerns and the implications of those concerns. He discussed the effect of public funds on private equity valuations and differences in premiums paid during different market conditions.

Mr. Woolford concluded his presentation, remarking that general partners have slowed their pace and are preserving remaining commitments; secondary transactions are an exchange rather than cash market; there are opportunities to get better terms and governance changes; more transactions are taking place where general partners are participating rather than competing with strategic players; and forward starts are potential solutions to liquidity constraints.

Real Estate

Mr. Humphrey discussed the U.S. foreclosure activity during 2008, which has increased since 2006 by over 225 percent. He said Courtland is focusing on debt and deleveraging as indicators on how the recovery is going and how long it will take. He commented on public and private debt, the housing problem, bank failures, and job losses which could result due to restructuring of major manufacturers.

[Vice Chair McElligott left the meeting at 1:41 p.m.]

Mr. Humphrey reviewed historical cap rates, U.S. net capital flows, vacancy rates, real estate income versus treasury yields, and NCREIF property cap rates. He noted this information is helpful in assessing risk and said understanding cap rates could guide decisions to either invest or sell during certain periods. Mr. Magnuson stressed the need for a long-term strategy focusing on cash flow that is sustainable and high quality. He stated his belief that the portfolio has such a long term strategy in place. Mr. Humphrey suggested the Board may want to consider whether to harvest part of the portfolio every 5 to 7 years, as it may be better to do that during certain periods. Mr. Magnuson noted it is also important to have a strategy in place to reinvest the proceeds from assets sold if that approach were pursued. Mr. Draper said that, during the latter part of the last upward cycle, the difference in premiums earned from value added property to core property was negligible.

Mr. Humphrey briefly commented on investment opportunities, CMBS spreads and issuance, and global markets.

[Mr. Nierenberg left the meeting at 1:54 p.m.]

BOARD DISCUSSION

Chair Gorton announced the Board would go into executive session at 1:55 p.m. to discuss financial and commercial information relating to an investment since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. He said the Board may also review and discuss the performance of Board members and of the Board during the executive session. He said the executive session was expected to last about 10 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 1:55 p.m., and reconvened in open session at 2:18 p.m.]

OTHER ITEMS

Chair Gorton thanked Mr. Dear for his years of service to the Washington State Investment Board.

Mr. Hill commented on the Board's committee structure, and suggested the Board may want to consider innovative ways to help staff think through alternatives relating to the risk strategy on liquidity, which seems to be a significant issue. Chair Gorton said the Board would discuss the matter in April and May, and determine at that time if there was a need to expand the discussion at its July meeting. Mr. Dear said that Board policy provides that asset allocation issues are brought to the full Board, and could be discussed on a monthly basis. Mr. Seely said the ability to have open dialogue in executive session is extremely helpful.

There was no further business to come before the Board, and the meeting adjourned at 2:24 p.m.



Glenn Gorton, Chair

ATTEST



Joseph A. Dear
Executive Director