

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
January 21, 2010

The Washington State Investment Board met in open session at 9:43 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Pat McElligott, Chair
Treasurer Jim McIntire, Vice Chair
Steve Hill
George Masten
Bob Nakahara
David Nierenberg
Judi Owens
Mason Petit
Mike Ragan
Jeff Seely
Judy Schurke

Absent: Senator Lisa Brown
Representative Sharon Tomiko Santos

Also Present: Theresa Whitmarsh, Executive Director
Gary Bruebaker, Chief Investment Officer
Liz Mendizabal, Public Affairs Director
Steve Lerch, Research Director
Steve Draper, Senior Investment Officer – Real Assets
Bill Kennett, Senior Investment Officer – Fixed Income
Tom Ruggels, Senior Investment Officer – Private Equity
Diana Will, Senior Investment Officer – Asset Allocation
Janet Kruzel, Investment Officer – Private Equity
Kristi Haines, Executive Assistant

Steve Dietrich, Assistant Attorney General
Charlie Kaminski
Tom Kubr, Capital Dynamics

[Names of other individuals attending the meeting are listed in the permanent record.]

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

ADOPTION OF THE DECEMBER 17, 2009, MINUTES

**Mr. Ragan moved to adopt the December 17, 2009, Board meeting minutes.
Ms. Owens seconded, and the motion carried unanimously.**

PUBLIC COMMENT

There was no public comment.

RECOGNITION

Chair McElligott thanked Mr. Kaminski for 17 years of service on the Board. Mr. Kaminski commented on the positive changes at the WSIB throughout his tenure, noting the significant accomplishments of Board and staff.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh provided her monthly report for January on Board governance, investments, meetings, legislative, media, corporate governance, staffing, operations, and open procurement activities. The February Public Markets Committee meeting is cancelled. Woody Brock will conduct his semi-annual presentation on February 2. A recognition dinner for Mr. Kaminski is planned on February 17. Ms. Whitmarsh introduced, Reggie Ross, Investment Officer-Real Assets.

ASSET BUBBLES EDUCATION SESSION

Mr. Lerch introduced the Asset Bubbles education session, which is a recent discussion topic in the media. He said asset bubbles need price spikes to exist, but that does not provide a complete definition. He described circumstances that can create price spikes. If asset prices are greater than fundamental value, an asset bubble exists.

Some economists insist asset bubbles cannot happen, which is consistent with the efficient markets hypothesis. However, research and market behavior provide evidence that asset bubbles occur. Mr. Lerch described laboratory experiments, and historical events and data that demonstrate asset bubbles. Cognitive errors leading to asset bubbles include confirmation bias (looking only at data/research to support an individual viewpoint), herding behavior ("everyone else is doing it"), new era thinking and over-optimism ("this time is different"), and representativeness (assuming patterns will continue).

Mr. Lerch reviewed behavior/market inefficiencies by bubble types; categorized as rational, intrinsic, fads, and information bubbles. He reviewed the circumstances, challenges, possible responses, and indicators of near rational bubbles, and provided characteristics and examples of intrinsic, fad, and information bubbles. He demonstrated examples of the aftermath of bubbles using historical data from the S&P 500 and NASDAQ, and suggested that gold could represent a current asset bubble. Mr. Lerch said asset bubbles do not always involve irrationality, noting the dot-com period and past economic examples; and can involve a mix of irrational and rational thinking. Mr. Lerch reviewed central banks' reactions and the Federal Reserve's recognition of and responses to bubbles. He suggested investors should think about the impact the Federal Reserve could have on investment decisions by implementing tools to deflate bubbles.

Mr. Lerch proposed the Board may want to examine the following responses to asset bubbles: whether asset bubbles exist; warning signs; investment strategies (stop buying, sell, or hedge asset bubbles); rebalancing policies; and liquidity issues. Strategic Plan activities for 2010 include additional tools and data to identify asset bubbles. Staff will also incorporate lessons learned during the recent financial crisis and concepts shared by Rick Funston at the July off-site meeting. As risk tools are in place, staff can get sense of what affects various asset bubbles would have on the portfolio.

Mr. Seely asked about the downward price spikes created by irrational undervaluing of assets. Mr. Lerch said downward bubbles can create investment opportunities.

Mr. Nierenberg shared his view of practical implications for the Board. He believes it is important to regularly go through risk identification and scoping exercises, in order to manage risk. Once the data warehouse reporting is in place, category and partnership analysis can help identify and articulate risk areas. He suggested the Board seek out external specialists, such as Mark Faber, Rick Funston, Jim Chanos, John Paulsen, and other international, hedge fund managers, and venture capital relationships who could share their practices and help the Board think about bubbles to retain and protect assets. He also supports scenario analysis.

Mr. Nakahara said he appreciated staff's timely presentation. He noted Japan's experience over the past 20 years, and his view that similar trends are occurring in China.

Vice Chair McIntire suggested that staff examine the correlation of returns across asset classes during asset bubbles, which could provide some indications of how to respond to similar circumstances in the future.

Mr. Petit said he appreciates the discussion, but shared his view that responses to asset bubbles could be perceived as market timing. He believes the Board should focus on risk efforts rather than identifying bubbles, and move slowly on investment strategies as a long-term investor.

Mr. Nierenberg said identification of asset cycles is important, to know when the most profit is made and the best buy and sell opportunities exist.

[The Board took a brief recess at 11:00 a.m. and reconvened in open session at 11:14 a.m.]

ADMINISTRATIVE COMMITTEE REPORT

Strategic Plan

Ms. Whitmarsh presented the 2010 Strategic Plan for the Board's consideration, which was discussed in detail at the Administrative Committee meeting held earlier in the day. She reviewed the six-year plan and budget adopted by the Board in June 2008, strategic initiatives completed in 2009 and those carrying over into 2010, and new strategic and tactical initiatives identified for 2010 in core areas of value, support, and capacity, as well as planned Board activities. All proposed activities take into consideration Board member discussions at the July off-site planning session and expressed interest in risk, staffing, corporate governance, and WSIB branding efforts. A proposed staffing plan and budget will be presented at the June Administrative Committee and Board meetings.

With regard to governance issues, Mr. Nierenberg noted his concern with business relationships and investment opportunities introduced within others states' pension funds by their former board members. Ms. Whitmarsh noted the WSIB's Conflict of Interest Policy and Washington State ethics laws provide limits on former WSIB member and staff's activities and employment. Additionally, Internal Audit staff is examining best practices and will present recommendations to the Audit Committee. Mr. Ragan said it is worthwhile to be aware of Washington State practices to contrast WSIB against issues occurring in other states.

Mr. Nierenberg asked about possibilities in consolidating cash services of the WSIB and Office of the State Treasurer (OST). Ms. Whitmarsh reported staff held some preliminary discussions with OST. Vice Chair McIntire said OST had recently prepared legislation that could be beneficial to cash management processes.

Ms. Whitmarsh said 2010 Board initiatives include developing Board-level risk reporting, appropriately structuring risk and compliance reporting, and Board education focusing on topics of strategic importance in the current economic climate. Mr. Nierenberg suggested staff examine how Glass Lewis and other fund's structure and conduct risk reporting. A proposed Board education sessions listing was distributed to members.

Ms. Whitmarsh said the past year was a good test of the WSIB's conviction to stay with its strategy, and has raised risk awareness.

AUDIT COMMITTEE REPORT – NONVOTING BOARD MEMBER CANDIDATES RECOMMENDATION

Mr. Hill reported the Audit Committee met in November to review letters of interest submitted by ten candidates for the two vacant nonvoting Board member positions, created by John Magnuson's decision to retire and Charlie Kaminski's term expiration. The Committee chose four candidates to interview at its December 17 meeting. Following the interviews, the Committee discussed the candidates' qualifications and motions on each were entertained. The Committee decided to recommend two candidates for appointment to the vacant nonvoting positions. Staff and the Audit Chair conducted reference checks and found references for both candidates satisfactory, with each receiving strong recommendations for service on the Board.

Mr. Hill moved the Board appoint Richard Muhlebach and Bill Longbrake to fill the two vacant nonvoting Board member positions. Mr. Masten seconded, and the motion carried unanimously.

Mr. Hill said, throughout the process, the Committee found that existing nonvoting member nomination processes are not well defined, and plans to explore practices over the next few quarters to develop a well-defined process for the Board's consideration.

PUBLIC MARKETS COMMITTEE REPORT

Active Global Emerging Markets Investment Management Recommendation

Mr. Ragan said emerging markets were identified as an area of focus in the last six-year strategic plan adopted by the Board and the active global emerging markets manager search was identified in the 2009 Public Equity Annual Plan to address the portfolio's persistent underweight to emerging markets. The consultant assisting staff with the search, Mercer, reviewed 253 separate products for the mandate, of which 32 products met minimum qualifications. Further evaluation by staff and the consultant resulted in 9 firms being interviewed by video conference and onsite visits with 4 of those firms. The Public Markets Committee heard presentations from the 3 finalist firms. Since the Public Markets Committee meeting, there was a significant change announced by one of the candidates.

Mr. Ragan moved that the Board select Aberdeen Asset Management, Arrowstreet Capital, and Mondrian Investment Partners for active global emerging markets investment management mandates, subject to continued due

diligence and successful negotiation of terms and conditions. Ms. Owens seconded, and the motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT (CONTINUED)

Strategic Plan

Chair McElligott moved the Board approve the 2010 Strategic Plan.

Vice Chair McIntire seconded, and the motion carried unanimously.

[Ms. Owens and Vice Chair McIntire departed at 11:57 a.m.]

Iran/Sudan Resolutions Annual Report

Chair McElligott said staff presented its annual report on engagement efforts at this morning's Administrative Committee meeting. The Sudan Investment Resolution was adopted by the Board in March 2007, and the WSIB Resolution on Iran Investment was adopted in February 2008. Using lists compiled by advocacy groups, staff has written letters to companies targeted on the "highest offender" lists for their business operations in Sudan and Iran. WSIB fund managers recently identified 12 companies in the Public Equity portfolio that will be receiving a letter urging them to curtail their activities in Sudan. Staff also has initiated engagement efforts with a company doing business in Iran. Since both resolutions have expired, staff will bring updated copies of the resolutions to the next Administrative Committee meeting for consideration.

[The Board took a brief recess at 11:59 a.m. and reconvened in open session at 12:29 p.m.]

PUBLIC MKTS COMMITTEE REPORT (CONTINUED)

Active Global Emerging Markets Investment Management Recommendation (Continued)

Mr. Paroian provided an update on the recent change at Aberdeen Asset Management, the firm recommended by staff and approved by the Board to become one of the active global emerging markets mandates. One of the four senior members of the emerging markets team announced his planned departure from the firm shortly after the Public Markets Committee meeting. Staff remains comfortable with its recommendation of Aberdeen, but said any further changes would trigger an immediate review of the manager. In response to member comments, Mr. Paroian said a long transition plan is in place and the person in question would not actually leave the firm until late summer 2010.

ADMINISTRATIVE COMMITTEE REPORT (CONTINUED)

Assistant Attorney General's Report

Chair McElligott announced the Board would go into executive session to discuss litigation or potential litigation with legal counsel since public knowledge regarding the discussion is likely to result in an adverse legal or financial consequence to the WSIB. He said the Board would also discuss financial and commercial information relating to an investment in executive session since public knowledge 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 approximately 10 minutes, at which time the Board would reconvene in open public session.

[The Board went into executive session at 12:37 p.m.]

PRIVATE MARKETS COMMITTEE REPORT

Private Equity Annual Plan

[Ms. Schurke arrived at 1:02 p.m.]

[The Board concluded its executive session and reconvened in open session at 1:03 p.m.]

Mr. Masten moved the Board adopt the private equity model portfolio that was discussed in executive session. Mr. Petit seconded, and the motion carried unanimously.

Mr. Masten moved the Board adopt the benchmark of Russell 3000 + 300 basis points for the private equity portfolio. Mr. Petit seconded, and the motion carried unanimously.

Mr. Masten moved the Board adopt the confidential 2010 Private Equity Annual Plan that was discussed in executive session. Mr. Petit seconded, and the motion carried unanimously.

PUBLIC MKTS COMMITTEE REPORT (CONTINUED)

Savings Pool Policy 2.13.200 Revision

Mr. Ragan said, due to deteriorating credit fundamentals, 8 of the 10 insurance companies providing guaranteed investment contracts to the Savings Pool have been downgraded to below the policy's minimum credit rating. Due to the reduced number of insurance companies in which staff is able or willing to invest more of the assets are being held in cash so the weighted average maturity of the Savings Pool may fall below the current policy requirement of between 2 and 4 years; therefore, a change to the weighted average maturity is necessary.

Mr. Ragan moved that the Board approve the proposed revision to the Savings Pool Policy 2.13.200. Mr. Petit seconded the motion.

Mr. Hill emphasized the significance of the policy change, noting there is \$1 billion of beneficiary money in the Savings Pool, which attracts investors seeking stability. He said he fully supports the Board's decision, but acknowledged it represents a substantial change in fund management and could pose a communications challenge for the Department of Retirement Systems and WSIB since the performance of the savings pool has been excellent and cash is earning so little.

The above motion carried unanimously.

Public Markets Equity – Retirement Funds Policy 2.10.100 Revision

Mr. Ragan reported changes to the Public Markets Equity – Retirement Fund Policy are proposed to correct the emerging markets underweight created by the policy's limitation on the allocation to dedicated emerging markets managers. The changes also remove the segmented framework for the asset class, removing the specific percentage target allocation for passive, enhanced index, core, value, and growth managers. The revisions are consistent with the 2010 Public Equity Annual Plan approved by the Board.

Mr. Ragan moved that the Board approve the proposed revisions to the Public Markets Equity – Retirement Funds Policy 2.10.100. Mr. Petit seconded, and the motion carried unanimously.

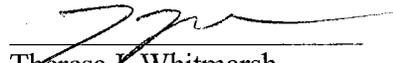
OTHER ITEMS

There was no further business to come before the Board and the meeting adjourned at 1:08 p.m.



Patrick McElligott
Chair

ATTEST



Theresa J. Whitmarsh
Executive Director