

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
July 13-15, 2010

The Washington State Investment Board met in open public session at 1:00 p.m. on July 13, 2010, in the Cowlitz Room at 7801 NE Greenwood Drive, Vancouver, Washington 98662.

Present: Patrick McElligott, Chair
Treasurer Jim McIntire, Vice Chair
Senator Lisa Brown
Steve Hill
Bill Longbrake
George Masten
Richard Muhlebach
Bob Nakahara
David Nierenberg
Judi Owens
Mason Petit
Mike Ragan
Representative Sharon Tomiko Santos
Judy Schurke
Jeff Seely

Also Present: Theresa Whitmarsh, Executive Director
Gary Bruebaker, Chief Investment Officer
Victor Moore, Chief Operating Officer
Liz Mendizabal, Public Affairs Director
Steve Lerch, Research Director
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
John Graves, Investment Officer – Asset Allocation
Beth Vandehey, Risk and Compliance Director
Kristi Haines, Executive Assistant
Kristi Bromley, Administrative Assistant

Steve Dietrich, Assistant Attorney General
Marcie Frost, Department of Retirement Systems
Edward Chancellor, GMO
Wendy Malaspina, GMO
Nick Bratt, Lazard Asset Management LLC
Tom Franzese, Lazard Asset Management LLC
Paul McCulley, PIMCO
James Clarke, PIMCO
Jim Coulter, TPG
Deepa Patil, TPG
Thomas Kubr, Capital Dynamics
Arnold Wood, Martingale Asset Management

July 13, 2010

Chair McElligott called the meeting to order and took roll call.

ADOPTION OF MINUTES – JUNE 17, 2010

Ms. Owens moved to adopt the June 17, 2010, Board minutes. Senator Brown seconded the motion.

Mr. Ragan noted the June Board minutes list him as absent; however, he tried to participate via teleconference but found the equipment was not functioning properly. Ms. Haines will correct the minutes to note Mr. Ragan was absent due to equipment failure.

The above motion to adopt the minutes, as amended, carried unanimously.

PUBLIC COMMENT

There was no public comment.

STRATEGIC PLAN UPDATE

Ms. Whitmarsh welcomed members to the July meeting. She said staff's goals are to update the Board on progress on key initiatives and to gain perspective and insights on how the Board wants to position itself going forward to prepare for opportunities that arise as the economy comes out of the recession.

[Mr. Nakahara arrived 1:04 p.m.]

Ms. Whitmarsh reviewed the strategic plan framework of value, support, and capacity, which rests on the foundation of a skillful Board. *Value* is what the WSIB will do to ensure it delivers exceptional returns; *support* is how the WSIB will conduct itself in the marketplace and with stakeholders so it receives support to fulfill its mission; and *capacity* is how to build the WSIB into an organization that can execute its plans and programs.

Ms. Whitmarsh updated members on progress and upcoming activities within the following strategic and tactical initiatives: (*Value*) Investment Options Review; Review Asset Allocation and Investment Strategy for Non-retirement Clients; Develop and Implement Investment Plans; Conduct Investment Manager and Consultant Searches for Expiring Contracts; Maintain Position as a Low Cost/High Value Added Investment Management Firm; Move From Ad Hoc Research to Strategic Education/Research Program; Provide Basic Risk and Performance Analysis from Warehouse; Make Risk a Central Part of the Investment Decision Making Process; (*Support*) Position the WSIB as a Mission Driven Global Asset Manager; Drive Better Understanding of Investment Decisions Through Improved Member Communications; Be a Reasoned and Respected Voice in Corporate Governance; (*Capacity*) Remain a Destination Employer with Staff and Resources Adequate to Mission; Drive Additional Efficiencies Through the Back Office; Expand Successful Compliance Program to New Asset Classes; and (*Skillful Board*) Provide Board with Adequate Information and Education to Support Quality Decisions.

Ms. Whitmarsh reported on role clarification discussions occurring between WSIB and the Department of Retirement Systems' (DRS) staff. Senator Brown stressed the importance of enhancing communications between the agencies. Chair McElligott agreed that it is important that

beneficiary groups and beneficiaries understand what is going on in Washington State compared to other states' pension fund programs. Senator Brown suggested staff increase their communications with Legislators and legislative staff. Representative Santos noted that meeting with groups may provide a better communications format compared to one-on-one Legislator meetings. Ms. Mendizabal shared staff's plan for legislative meetings beginning after the election.

A discussion ensued on risk reporting initiatives. Mr. Nierenberg said it is easy to think that risk is managed because it is measured and, while data may be available, it may not be interpreted well. He encouraged the Audit Committee and Board to reach beyond process to find people that will promote thinking beyond systems and boxes and be receptive to qualitative information. Ms. Whitmarsh said the goal is to make risk a central part of next year's July meeting. Treasurer McIntire suggested staff may want to develop a heat map of knowledge and experience base by asset class and fund, both internally and externally, to help identify what is known versus unknown and where WSIB needs to rely on assistance. Mr. Seely suggested the Board routinely discuss the biggest current risks on a periodic basis.

ASSET PLAN UPDATES

Public Equity

Mr. Paroian updated the Board on the status of three major Public Equity projects – one involving the Commingled Trust Fund (CTF), one involving the defined contribution plans 3 and the Deferred Compensation Program (DCP), and an initiative affecting the Public Equity unit as a whole. Within the CTF, all non-U.S. contracts (except passive) are being rebid. The focus is to find the best managers within a global framework. Staff did some preliminary background discovery, though there is no pre-decision on how many managers will be hired nor the percentage of monies to be allocated.

Mr. Paroian noted Ms. Whitmarsh had already briefed the Board on the plans 3 and DCP-related project involving communications with DRS.

Lastly, Mr. Paroian said the Public Equity unit is participating in the risk system and data warehouse initiatives but found that it needs some tools of its own specifically related to the equities area. Staff is seeking an improved manager database and risk system to take the program to the next level.

Mr. Paroian commented on other initiatives Public Equity staff is involved with including the internal audit and non-U.S. proxy voting, while never losing focus on vital tasks such as keeping up to-date and initiating deeper dives on the monitoring of current managers. He said a key initiative for 2011 is to examine cap exposure and determine whether and how to access smaller capitalization, less liquid sections of global equity markets.

Fixed Income

Mr. Kennett commented on market activities during the first half of 2010, his views on the second half of the year, the U.S. economy, the European sovereign debt crisis and its affect on markets, and the expected slow growth in the developed world. He noted that emerging market economies are doing well.

He said the portfolio implications of his outlook are to keep duration close to neutral and continue to overweight credit and emerging markets within credit. He believes that Treasuries and mortgages are overvalued. He commented on credit spreads and yield curve changes. He noted the Intermediate Bond Fund is celebrating its 10 year anniversary and is up over 96 percent since inception.

[The Board went into a brief recess at 2:36 p.m. and reconvened in open session at 2:55 p.m.]

Chair McElligott 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 15 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 2:56 p.m.]

Liquidity

Real Assets

Private Equity

[The Board reconvened in open session at 4:32 p.m.]

ARE WE WHERE WE WANT TO BE: BENCHMARK PROS AND CONS

Ms. Will introduced her preliminary work on benchmark examination. She noted the WSIB is right on top of its benchmark but suggested that may not be where it wants to be. She reviewed the country and sector allocations within the CTF as compared to its benchmark. She suggested that, rather than focusing on beating the benchmark, it should be considered a management tool through which a plan for evaluation, measurement, and improvement is implemented.

Ms. Will described float-adjusted indexes take the total market capitalization of a company and subtract out the portion the index provider considers not investable for reasons involving private, cross, and government ownership; and limits and restricted shares to foreign investors. Ms. Will demonstrated that company ranking comparisons using a floating adjustment do not provide a total picture and have the potential to distort the size of markets in relationship to the global economy.

Ms. Will described the gross domestic product (GDP) weighted index theory reflects the available investment opportunity set in public and private markets. She said, because of the difficulties in identifying the GDP weighted index classifications, some other method must be used to determine what industry classes should be weighted.

Ms. Will suggested the investable universe as an alternative benchmark. She described that each asset class is different and can get into different countries at different levels. Weightings should be determined based on which investors can get into what countries.

Ms. Will said she and Mr. Graves will continue to examine benchmarks. She pointed out maps that were developed for the Board's reference based on their latest research. Each map is ranked by different categories.

Treasurer McIntire requested copies of the maps. He shared his concern the GDP index does not take into consideration capital tied up in political decision making. He recommended staff also examine the different asset classes and identify what is investable by country.

[Mr. Seely was not in attendance at 4:57 p.m.]

Mr. Nierenberg complimented staff's work and said he looks forward to future discussions. Senator Brown observed that benchmarks are great as long they can be deconstructed in order to consider fundamental questions.

CTF PERFORMANCE REVIEW

Mr. Bruebaker noted the Wilshire Trust Universe Comparison Service (TUCS) is presented to the Board quarterly as a performance measure for the CTF and is used by many funds to compare performance against others. Given the Board's high allocation to private markets, the CTF's performance will look good compared to TUCS when the private markets outperform public markets and will look bad compared to TUCS when private markets underperform public markets. This was true for all time periods between March 31, 2001, and March 31, 2010, except for two—both exceptions related to extreme returns in real estate. Mr. Bruebaker noted the staff-reported Implementation Value Added is a better benchmark for the Board to use in evaluating the CTF's performance as it is more difficult to outperform and provides a way to analyze the performance attribution by asset allocation and manager decision. There are also some issues that must be considered when using TUCS as funds have such wide variances of investment strategies and beliefs and there are issues related to the quality of the data, as well as classification issues.

[The Board recessed at 5:12 p.m. and reconvened in open session at 6:30 p.m.]

DINNER PRESENTATION – WHY DO COUNTRIES GO BUST?

Mr. Chancellor gave a dinner presentation focusing on country debt, and also discussed current issues in Greece and Japan.

[The Board recessed at 9:10 p.m. on July 13, 2010.]

July 14, 2010

[The Board reconvened in open session at 8:20 a.m. on July 14, 2010.]

[Ms. Schurke arrived at 8:20 a.m.]

Chair McElligott called the meeting to order and took roll call.

INFLATION, DEFLATION, AND INVESTMENT RETURNS: EXAMINING THE POSSIBILITIES

Mr. Graves introduced his overview discussion on inflation and ways inflation is measured. He said he would also discuss what causes inflation and investment impact and portfolio options for the WSIB.

Mr. Graves noted inflation over the past 30 years has been in decline and remained low. That may not be sustainable and can present an impact to pension funds with regard to indexed liabilities and traditional assets that are not doing well. Mr. Graves demonstrated a comparison of the value of the dollar from 1945 to present.

He examined inflation measurements and issues with using the various measurements, including the Consumer Price Index (CPI), Producer Price Index, Personal Consumption Expenditures, and GDP, as well as the specific Seattle-Tacoma-Bremerton regional measurements used within Washington State for certain funds' comparisons.

[Treasurer McIntire was in attendance at 8:28 a.m.]

Mr. Graves described the Keynesian view, variations, and Monetarist views on causes of inflation.

Mr. Graves discussed how global perspectives and differing levels of inflation are anticipated going forward, the U.S. gold standard versus fiat money, how the U.S. “prints” money, and the cyclical structure of inflation. He described the federal policy goal to avoid deflation by increasing the money supply, ensuring liquidity to the financial system, cutting short-term interest rates, purchasing U.S. government debt, indirectly controlling yield on corporate bonds, devaluing the U.S. dollar, and buying foreign government debt.

Mr. Graves described the investment environments of the 1970s and 1980s and how stocks, bonds, cash, real estate, commodities, private equity, gold, and the U.S. dollar performed compared to inflation during these periods. He concluded that asset allocation and certain options within resource equities, gold, and foreign currencies are potential means to enduring periods of inflation; and preserving principle is pertinent within a deflation environment.

Mr. Longbrake pointed out that, in positioning for inflation, the exact opposite affect could occur in the short term. He suggested staff do scenario analyses based on a deflationary environment, such as a Japan-type situation and real assets investments, taking into consideration supply and demand dynamics. Treasurer McIntire commented that he had investigated inflation as a policy advisor with the Clinton Administration in the early 1990s, and that most inflation measures at that point in time were thought to overestimate actual inflation by several percentage points.

[The Board briefly recessed at 9:13 a.m. and reconvened in open session at 9:32 a.m.]

IT IS DIFFERENT THIS TIME...GLOBALIZATION, THE GROWING IMPORTANCE OF EMERGING MARKETS, AND THE CHANGING ECONOMIC PARADIGM

Messrs. Bratt and Franzese introduced their presentation on global world financing, debt, and emerging economies. They discussed events of the passing era and expectations for the new era.

Mr. Bratt described a growing number of retirees, smaller workforce, and more government involvement in economic systems in the new era. He stated that he anticipates increasing government regulation in the financial sector, deleveraging of companies and individuals, and restrained stock market returns. He shared his views on international difficulties in the new era and the critical role of China.

Mr. Bratt described potential scenarios and asset classes he anticipates to outperform and underperform in an environment of deflation; inflation; and stable, low inflation; and key indicators of the onset of those environments. He shared his view of the affects Greece may have on the Euro. A discussion ensued on the commonality of investing in equity in companies with strong balance sheets, cash flow, and operational flexibility among the three potential environments and the affect banks, regulation, and liquidity may have on small to mid-size companies.

Mr. Bratt shared his view on the future importance of emerging markets and how its role is different than in the past with regard to global GDP, consumption, household income, government debt, auto sales, imports, valuation, and financial productivity. He concluded his presentation stating that global diversification will be essential for risk control.

A discussion ensued on the relationship between China and Russia and changing regulations for financial instruments.

[The Board briefly recessed at 11:01 a.m. and reconvened in open session at 11:14 a.m.]

A FLATTER DISTRIBUTION WITH FATTER TAILS

Mr. McCulley shared his view on the global economy's "new normal." He noted his belief that global economy will be characterized by re-regulation in the developed world, less globalization, deleveraging, and transformation of emerging markets.

He discussed how deregulation and globalization led up to the recent financial crisis and how he expects re-regulation, deleveraging, and deflation to occur going forward. He commented on the role of China as an emerging market and how he anticipates developed markets will perform in the future.

[The Board recessed at 12:24 p.m. and reconvened in open session at 1:32 p.m.]

PRIVATE EQUITY PANEL: EVOLUTION IN THE MARKETPLACE

Mr. Coulter reflected upon recent market events and future challenges and opportunities. He addressed the differences between public and private equity and different "tool sets" available for those asset classes. He stressed the importance of sector expertise and operational control within private equity investments.

Mr. Kubr discussed general partner (GP) performance. He said the WSIB has been very successful in investing with top quartile GPs through its selection process and diversification.

Mr. Coulter discussed emerging markets, commenting on TPG's established presence, successes, and challenges in Asian markets, specifically China. He described entrance and exit strategies.

Mr. Coulter shared his view on building exposures in a variety of geographies, industries, and transaction types while being mindful of the cyclical nature of private equity. Mr. Kubr stressed the importance of having well established fund information to formulate quality investment decisions.

Mr. Coulter discussed the cycle of the private equity industries, performance, and future activities. A discussion ensued on the WSIB's current GP relationships and consideration of new partnership relationships, cycles, strategies, and risk and returns. Mr. Bruebaker said he and Mr. Ruggels spend a great deal of time discussing fund raising discipline. Further discussion ensued relating to the Institutional Limited Partners Association's Private Equity Principles and changes to industry terms. Mr. Coulter compared TPG's management fees to those incurred with mutual funds. Mr. Bruebaker stated the WSIB's goal is to be compensated for any risks taken and noted that monetary and transaction fees are difficult to compare.

[The Board briefly recessed at 3:31 p.m. and reconvened in open session at 3:48 p.m.]

VENTURE CAPITAL DISCUSSION

Chair McElligott 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 15 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 3:49 p.m. and reconvened in open session at 5:05 p.m.]
[The Board recessed at 5:08 p.m. on July 14, 2010.]

July 15, 2010

[The Board reconvened in open session at 8:59 a.m. on July 15, 2010.]

Acting Chair McIntire called the meeting to order and took roll call.

[Messrs. McElligott, Seely, and Ragan were not in attendance at 8:59 a.m.]

RECOGNITION

Acting Chair McIntire announced this would be Mr. Petit's last Board meeting. He recognized Mr. Petit's four years of service to the WSIB.

BEHAVIORAL FINANCE AND INVESTMENT COMMITTEE DECISION MAKING

Mr. Wood presented theories and insights on the impacts of choices and decisions, social behavior, self interests, and governance on investment committees.

Mr. Wood shared examples of issues created by optimism, predictions, perception, correlations, misinterpretations, confirmation bias, anchoring, differing views, composition, and conformity behaviors.

He discussed the importance of committees keeping track of why decisions are reached. He stressed the importance of committee diversity, stating that consistent minorities are more persuasive than weak majorities. Mr. Wood said statistics show that committees spend more time on tasks than on strategic planning, which is what committees rank as highest importance. In conclusion, Mr. Wood provided a governance checklist for the committee chair.

[The Board briefly recessed at 10:37 a.m. and reconvened in open session at 10:54 a.m.]

ASSISTANT ATTORNEY GENERAL'S REPORT

Acting Chair McIntire 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 executive session was expected to last about 5 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 10:54 p.m. and reconvened in open session at 11:12 a.m.]

Mr. Masten moved the Board authorize the Executive Director and request the Attorney General to take the actions recommended during the executive session discussion of potential litigation. Mr. Hill seconded, and the motion carried unanimously.

[The Board briefly recessed at 11:13 a.m. and reconvened in open session at 11:19 a.m.]

BOARD EVALUATION DISCUSSION AND FEEDBACK

Acting Chair McIntire announced the Board would go into executive session to review and discuss the performance of Board members and of the Board. He said the executive session was expected to last about 15 minutes, at which time the Board would reconvene in open session.

[The Board went into executive session at 11:19 a.m.]

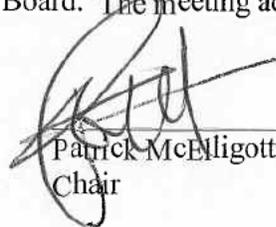
[Senator Brown departed at 12:17 p.m.]

[Mr. Nierenberg departed at 12:35 p.m.]

[The Board reconvened in open session at 12:37 p.m.]

OTHER ITEMS

There was no further business to come before the Board. The meeting adjourned at 12:37 p.m. on July 15, 2010.


Patrick McElligott
Chair

ATTEST


Theresa J. Whitmarsh
Executive Director