WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
September 16, 2010

The Washington State Investment Board met in open session at 9:37 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Patrick McElligott, Chair Treasurer Jim McIntire, Vice Chair Bill Longbrake George Masten Richard Muhlebach Bob Nakahara David Nierenberg (via teleconference) Judi Owens (via teleconference) Mike Ragan Representative Sharon Tomiko Santos Jeff Seely
Absent:	Senator Lisa Brown Steve Hill Judy Schurke
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 Kristi Haines, Executive Assistant Marcie Frost, Department of Retirement Systems Steve Dietrich, Assistant Attorney General Jody MacIntosh, CEM Benchmarking Inc. Michael Humphrey, Courtland Partners Jonathan Barek, Capital Dynamics

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

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

CHAIR AND VICE CHAIR ELECTION

Mr. Masten nominated Mr. McElligott as Chair. Vice Chair McIntire seconded, and the motion carried unanimously. Chair McElligott nominated Treasurer McIntire as Vice Chair. Ms. Owens seconded, and the motion carried unanimously.

ADOPTION OF THE JULY 13-15, 2010, MINUTES

Mr. Ragan moved to adopt the July 13-15, 2010, Board meeting minutes. Mr. Masten seconded, and the motion carried unanimously.

PRIVATE MARKETS COMMITTEE REPORT

Mr. Masten reported the Private Markets Committee met on September 2, 2010, to consider two investment recommendations and schedule its 2011 meetings.

Southern Cross Latin America Private Equity Fund IV, L.P.

Mr. Masten moved the Board invest up to $100 million in Southern Cross Latin America Private Equity Fund IV, L.P., plus fees and expenses, subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair McIntire seconded the motion.

[Mr. Nierenberg was in attendance via teleconference at 9:41 a.m.]

Mr. Masten reported the fund has a target size of $1.5 billion, and will primarily make value-oriented, control buyout investments in companies in the Latin American region. He said Southern Cross would be a new general partner (GP) relationship for the WSIB and the recommendation is based, in part, on the improving macro-economic conditions and long-term growth prospects in Latin America, the firm's experienced team, excellent reputation, strong investment track record, and diversification benefits provided to the WSIB's private equity portfolio. The proposed investment is consistent with the private equity annual plan and model portfolio approved by the Board in January 2010.

The above motion carried unanimously.

GTCR Fund X, LP

Mr. Masten moved that the Board invest up to $300 million in GTCR Fund X, LP, plus fees and expenses, subject to continuing due diligence and final negotiation of terms and conditions. Chair McElligott seconded the motion.

Mr. Masten reported the fund has a target size of $3 billion, and will invest primarily within four growth sectors in North America: healthcare, information services and technology, financial services and technology, and growth business services. The WSIB has invested in four prior GTCR sponsored funds. He said the recommendation is based, in part, on GTCR's proven, differentiated strategy, experienced team with deep industry expertise, strong historical performance with substantial realizations, and the investment's fit in the WSIB's private equity portfolio. The proposed investment is consistent with the private equity annual plan and model portfolio approved by the Board in January 2010.

The above motion carried unanimously.

PUBLIC MARKETS COMMITTEE REPORT – ANALYSIS OF THE INVESTMENT OPTIONS IN THE DEFINED CONTRIBUTION PROGRAMS

Mr. Ragan reported the Public Markets Committee met on September 14, 2010. The Committee participated in an education session on the implications of plan design on participant behavior and considered staff's recommended changes to the investment options offered to defined contribution participants in the Plan 3s, Deferred Compensation Program (DCP), and Judicial Retirement Account (JRA). The Committee also scheduled its 2011 meeting dates.

Mr. Ragan moved the Board approve the recommended menu of investment options for participants in the defined contribution programs. Ms. Owens seconded the motion.

Mr. Ragan said the proposed menu of investment options is designed to best serve the majority of plan members into the future. The recommended lineup includes one-step investing for participants who want funds that are managed on their behalf, and build and monitor options for participants who want to manage their own portfolios.

The proposed investment options are consistent with the WSIB defined contribution policies' stated goals of providing an adequate number of investment options that are broad enough to offer a comprehensive set of options, yet limited in number to make the programs simple to understand and offer participants the ease of creating a diverse portfolio. The recommended options also fulfill the WSIB's fiduciary duty to ensure that each defined contribution plan offers a balance of options to provide an asset allocation suitable for a range of participants, from those early in their career to those in retirement. The investment options provide the best choices for a broad group of participants.

He reported that WSIB staff worked very closely with staff from the Department of Retirement Systems (DRS) throughout the review process. DRS supports the recommended changes, which are consistent with the goals of the defined contribution plans, and is prepared to conduct the critical stakeholder communication to implement the changes. If approved, implementation is planned for the second half of 2011.

Ms. Owens asked if the DRS advisory committee is comfortable with staff's recommendation. Ms. Frost said the DRS advisory committee was aware the review was taking place but had not yet seen staff's recommendation. In response to Vice Chair McIntire's inquiry relating to the planned outreach strategy with stakeholders, Mr. Bruebaker reported DRS plans to develop beneficiary communications with the full support of WSIB. The planned communications could be presented for the Board's review, if desired. Ms. Frost said full implementation is scheduled for the third quarter 2011, which requires close coordination with DRS third-party record keepers.

The above motion carried unanimously.

ADMINISTRATIVE COMMITTEE REPORT – NON-VOTING BOARD MEMBER PROCESS RECOMMENDATION

Chair McElligott reported the Administrative Committee reviewed proposed changes to non-voting Board member nomination processes.

Mr. Masten moved the Board approve the revised non-voting Board member nomination process and vacancy announcement for future use.
Vice Chair McIntire seconded the motion.

Mr. Masten relayed the proposal formalizes nomination processes and calls for voting Board members to evaluate non-voting Board member performance in executive session at the end of each term. Non-voting members receiving a positive evaluation would be recommended for reappointment. He said the procedures would also require an open recruitment to occur at the end of each term thereafter, and the incumbent non-voting member may be invited to reapply based upon a positive evaluation by voting members. Mr. Masten said the process also includes a description of a non-voting Board member, under statute, and includes background information about the Board, performance expectations, investment expertise, and desirable characteristics for applicants. Chair McElligott said the draft procedure was distributed to all Board members for comment prior to the Administrative Committee meeting, but none was received.
Vice Chair McIntire said the proposal provides for a good public process on how non-voting Board member appointments are handled and he believes it is a positive step for the Board.

The above motion carried unanimously.

2011 MEETING SCHEDULE
Chair McElligott presented the proposed 2011 Board meeting schedule and noted there are no meetings planned in August 2011. Ms. Whitmarsh pointed out the Board's off-site planning session is scheduled for July 2011, and the Private and Public Markets Committees will only meet during that month if there is business to conduct.

Ms. Owens moved the Board approve the proposed 2011 meeting dates.
Vice Chair McIntire seconded, and the motion carried unanimously.

[Ms. Owens was no longer in attendance via teleconference at 9:54 a.m.]

PUBLIC COMMENT
There was no public comment.

EXECUTIVE DIRECTOR'S REPORT
Ms. Whitmarsh provided her monthly report for September on Board governance, investments, public affairs, staffing, operations, and open and upcoming procurements. She reported all of the October Board and Committee meetings are cancelled. The annual planning session for real estate is scheduled for the December Private Markets Committee meeting and may extend into mid-day on the following day. Mr. Bruebaker said the Tangible Assets annual planning will occur at a later meeting.

Ms. Whitmarsh reported on notification received from the State Auditor's Office they have decided not to conduct the annual conflict of interest review of the WSIB in 2011. Staff is looking into alternatives and will bring a proposal to the December Audit Committee meeting. Ms. Whitmarsh reminded members a Request for Proposals for non-U.S. global managers and Request for Qualifications and Quotations for Real Estate and Tangibles Assets consultancy are still underway and quiet periods are in place.

[The Board took a brief recess at 10:01 a.m., and reconvened in open session at 10:10 a.m.]

COST EFFECTIVENESS MEASUREMENT ANNUAL REPORT
Mr. Moore introduced Ms. MacIntosh who provided the annual cost effectiveness measurement report of the WSIB for 2009. The report compares the WSIB against a universe of 157 U.S. funds and a custom peer group of 18 funds (10 public and 7 corporate) with characteristics similar to the WSIB. It compares total and policy returns, value added, costs, cost effectiveness, and risk analyses.

Ms. MacIntosh reported the WSIB's 5-year total return of 5.6 percent was above the U.S. median of 4 percent, which was attributed to the WSIB's lower policy mix in U.S. stocks, higher weighting to private equity, and the WSIB's unique NCREIF real estate investment benchmark compared to other U.S. funds. The WSIB had very strong returns in each year between 2005 and 2008, but its 2009 performance was below the U.S. universe. This was mainly due to the WSIB's lower U.S. stock allocation, which experienced a bounce back last year. Ms. MacIntosh reported the policy return of 4.2 percent is also above the U.S. median and noted the WSIB was the very top performer in 2007. She relayed that emerging markets had the strongest returns last year, followed by private equity and hedge funds. REITs and the three Russell indices experienced lower returns. In response to Mr. Seely's question, Ms. MacIntosh said a different real estate benchmark would have impacted the results.

Ms. MacIntosh described how the WSIB's policy mix had changed over the past 5 years, with its global mandate, larger allocation to real assets and private equity, lower allocation to stocks, and differentiating fixed income allocations compared to the U.S. universe. She reported the WSIB's value added comparison showed very strong performance at 1.4 percent compared to peers and the U.S. median of 0.02 percent. Performance results were down in 2009, primary due to underperformance in real estate and private equity, but individual asset class performance over the 5-year period was very strong.

Ms. MacIntosh reported that WSIB's total costs on a 1-year basis were about 83 basis points (bps). She said investment management and oversight, consulting, performance measurement, and the WSIB's allocation to alternative assets are higher cost. She pointed out that CEM changed its methodology in 2009 and now measures plan's alternative assets based on contractual terms but does not reflect rebates. The change impacted all funds in the survey and resulted in increases from previous years' results.

The survey also analyzes benchmarks, modeling the WSIB against similar mandates with peer funds. It showed the WSIB was low cost by 14.9 bps, which is due to WSIB's implementation style and external management of real estate and private equity. Ms. MacIntosh noted the WSIB's peer group does not do a sufficient amount of internal management to perform a meaningful analysis.

Ms. MacIntosh said WSIB's cost effectiveness results showed excess costs and net value added compared to peers. The 1-year comparison is down from previous reports, but the 5-year results show the WSIB is above its peer group. She reported the WSIB's risk comparison against its peers is quite different due to the larger allocation to alternative assets.

Vice Chair McIntire said it would be interesting to compare cost differences between private and public plans. Mr. Longbrake referenced implementation style differences and cost savings data within the report and asked if there were details that could provide insight to management for improvement. Mr. Bruebaker said the WSIB does more active management compared to peers, but does not pay any more for managers than other funds. He said staff does a thorough examination of WSIB's results from the CEM report every year, to see where improvements could be made. Mr. Nierenberg pointed out that questions about what other funds are doing are raised each year, and he would be interested to have staff report back to the Board on any substantive findings and action steps. Mr. Seely said an analysis shown on page 16 would be interesting to break down by asset class. Chair McElligott said the Board should look further at its costs to see if improvements can be made.

Representative Santos requested the report include specifics of the change in methodology CEM applied to its private equity analysis this year, to provide explanation for the significant difference from previous reports for the benefit of public understanding. Mr. Masten commented on the higher costs due to the WSIB's larger allocation to real estate and private equity compared to other funds and pointed out the report does not include data on the increased returns resulting from those investments. Mr. Moore said staff had analyzed that data and would report on that at a future Board meeting. Mr. Longbrake said he would like to see an analysis of the returns based on profile changes and net returns after expenses. Representative Santos stressed the importance of having data available that compare the WSIB's costs against other funds.

QUARTERLY DISCUSSION OF MARKETS
Portfolio Discussion
Mr. Bruebaker reported it was not a good quarter for the markets, but it continues to be a good year for performance. The equity markets were up 9.2 percent. The Commingled Trust Fund was down 3.69 percent for the quarter but, since inception, is returning 8.16 percent as of June 30. He said the implementation value added helps assess the impact of allocation and manager decisions. The allocation decisions added 5 percent of positive alpha. The manager decision hurt the portfolio by 189 bps, with underperformance by the private equity managers. He noted that whenever the equity markets come back, the private equities are delayed and the portfolio will get benefit on the upside. Mr. Bruebaker said it was also not a good quarter for fixed income, but fixed income had outperformance in all other time periods, with global equity and real estate managers helping performance. Staff believes the portfolio is positioned well for the long-term.

Vice Chair McIntire said he appreciates the performance report comparison to benchmarks. He asked what the anticipated recovery pattern in returns might be if we are facing an L-shaped recovery. Mr. Bruebaker said he expects the large allocation to private equity and lower allocation to public equity will help WSIB to have better returns relative to other pension funds. However, the WSIB would struggle to meet the 8 percent return if the economy has very slow GDP growth. Mr. Longbrake agreed with Mr. Bruebaker and added that periods of slow inflation also hurt the policy rate of return. A discussion ensued regarding industry predictions of the future of the economy.

<u>Fixed Income</u>
Mr. Kennett said, for the fiscal year, the retirement fixed income portfolio returned 12.47 percent versus 10.60 percent by the Barclays Universal Index, with outperformance of 187 basis points due to an overweighting in credits. Governments, securitized, and credits returned 6.46, 9.30, and 16.35 percent, respectively, for the index. He said there was outperformance in each quarter for the fiscal year, with the exception of the last quarter, which was attributed to a flight to quality and the short duration of the portfolio's treasuries. He reported the portfolio is up by 139 bps for the current quarter and has returned 8.05 percent for the calendar year–to-date.

Mr. Kennett said the three large Labor and Industries' funds have $12 billion in assets under management. For the fiscal year, the Accident, Medical Aid, and Pension Reserve funds returned 13.39, 12.75, and 13.78 percent, respectively.

Public Equity

Mr. Paroian reported the equity managers agree with the comments made earlier regarding the chance of a double-dip recession. He said the equity managers are trying to build robust portfolios with higher quality stocks and companies. The volatility in the public markets makes the quarter-to-quarter results even less meaningful than usual and WSIB should continue its practice of focusing on the long term. Mr. Paroian commented on the market activities within the indices, sectors, and countries. He noted geographic distinctions are getting more difficult to identify. Emerging markets have performed the strongest recently. He said the portfolio is somewhat overweight U.S. versus non-U.S. and broadly neutral in emerging markets. Within the sectors, the portfolio's largest underweight is to financials and the portfolios most significant overweights are in healthcare, consumer, and telecoms.

For the quarter, global equity slightly outperformed. The passive U.S. continues to outperform slightly. For the developed non-U.S., all nine mgrs outperformed for the quarter.

Mr. Paroian reported within Plan 3, equity funds are all passive and continued to match the indices. Within the DCP the funds are a mix of four active and two passive. Within the four active funds, Fidelity Growth has consistently outperformed, and the Walden Socially Responsible Balanced Fund outperformed for the quarter. The retirement target date strategies are performing as expected. He noted the implementation of the revised menu of investment options for Plan 3, DCP, and JRA members (as approved by the Public Markets Committee and the full Board earlier this meeting) will consider questions of active versus passive for these accounts and which managers should be used.

Real Estate

Mr. Draper commented on the real estate portfolio, stating he feels recent write-downs were a bit aggressive and holdings have been less impacted from a valuation standpoint than we expected, but it is better to be conservative. He attributes market and property type selection as the best markets with an extraordinary amount of pent up capital and, as a result, valuations have not declined materially. Mr. Draper said he believes the weak economy will create weak fundamentals and that combined with increased capital, values translates into relatively even performance in the near term. Some markets have recovered quickly, while other markets were only slightly impacted by the downturn. He said a few partners are beginning to get traction in the market place and are making acquisitions. He is seeing very attractive financing terms. In response to a concern voiced by Mr. Nierenberg during the last quarterly discussion of markets, Mr. Draper said the portfolio has reduced its exposure in Mexico by an additional 10 percent and is continuing to work to reduce long-term exposure.

[Chair McElligott and Mr. Nakahara left the meeting at 11:30 a.m.]

Private Equity

Mr. Ruggels noted the Capital Dynamics' quarterly report in the meeting materials highlight returns within the private equity portfolio. He said public markets have recovered nicely from the first quarter 2009, and private markets have followed with a 1-year net return of 30.8 percent for the period ending March 31, 2010. The 5-year return is 9.7 percent, which compares favorably to the Russell 300 + 300 bps benchmark of 3.8 percent.

Mr. Ruggels commented on the difficulty in managing illiquid assets to the allocation target. The private equity allocation was at 25.8 percent as of June 30, which is above the target of 25.0 percent, and slightly ahead of where staff projected it would be at this time. While this is well within policy range, staff is watching it closely.

He said private markets are generating more investment activity and exits. He commented on drawdown and distribution activity, which are tracking well above what they were at this time last year, but still well below the historic high levels recorded in 2007. The pace is gradually picking up and valuations are relatively full.

Mr. Ruggels responded to Mr. Nierenberg's question relating to situations in which more than one of the WSIB's GPs have invested in the same security of the same company and value their holdings differently. Mr. Ruggels noted that, while there have been some inconsistencies noted, they have been relatively minor. As long as each GP has a reasonable valuation policy in place that is consistent with FAS 157 and the policy is consistently applied in the valuation of the portfolio, the GPs valuation is accepted.

[Mr. Longbrake left the meeting at 11:50 a.m.]
[Representative Santos was out of attendance at 11:50 a.m.]

Real Assets

Mr. Humphrey said Courtland Partners has had ongoing discussions with clients about the economy. They think the following scenarios could occur with the economy going forward: (1) double dip recession, (2) sideways growth, or (3) slow GDP growth for the next few years. He said these market condition discussions are important for strategy and implementation decisions.

Mr. Humphrey discussed U.S. debt, mortgage re-sets, distressed deals, and commercial real estate transaction volumes. He said maturing debt issuances present opportunities for investors and create profitability for banks, which will cause movement in the market. There is a lot of capital chasing high quality core properties, which is driving up prices.

Mr. Muhlebach asked if the value of the properties in WSIB's portfolio had held up better because of their locations and because they are owned through real estate operating companies (REOCs). Mr. Humphrey and Mr. Draper both indicated that investing through REOCs had been helpful during the recent downturn. Mr. Humphrey described trends in commercial real estate spreads, impacts of leverage, investment activity, and market cycle sensitivity, and anticipated forecasts for real estate returns.

[Representative Santos was back in attendance at 12:20 p.m.]

Private Equity
Mr. Barek discussed recent private equity trends and statistics during the last quarter. He commented on exits, valuations, exit pace, and fundraising. He said credit availability continues to improve and there has been a little activity in deal flow. Mr. Barek discussed recent trends in U.S. venture capital, specifically the IPO market, venture backed merger and acquisition exits, availability of capital, 10-year returns, rise of super-angels, growth of secondary direct transactions, and cleantech. He also described increased movement in, and pros and cons of Renminbi denominated private equity funds investing in China.

OTHER ITEMS
There was no further business to come before the Board and the meeting adjourned at 12:43 p.m.

Patrick McElligott
Chair

ATTEST

Theresa J. Whitmarsh
Executive Director