

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
May 19, 2011

The Washington State Investment Board met in open session at 9:32 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Pat McElligott, Chair (via teleconference)
Treasurer Jim McIntire, Vice Chair
Steve Hill (via teleconference)
Bill Longbrake
George Masten
Richard Muhlebach
Bob Nakahara
David Nierenberg
Judi Owens
Natasha Pranger
Mike Ragan
Jeff Seely

Absent: Senator Lisa Brown
Representative Sharon Tomiko Santos
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 Estate
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
James Mackison, Director of Technology and Innovation
Kristi Haines, Executive Assistant

Steve Dietrich, Attorney General's Office
Tara Blackburn, Hamilton Lane

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

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

[Mr. McElligott was in attendance via teleconference at 9:33 a.m.]

COMMITTEE ASSIGNMENTS

Treasurer McIntire moved the Board accept the Chair's recommended Committee assignments to appoint Ms. Pranger to the Audit Committee and Public Markets Committee. Mr. Masten seconded, and the motion carried unanimously.

ADOPTION OF THE APRIL 21, 2011, MINUTES

Mr. Ragan moved to adopt the April 21, 2011, Board meeting minutes. Ms. Owens seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

PUBLIC MARKETS COMMITTEE REPORT

Plan 3/DCP/JRA New Investment Menu Implementation

Mr. Ragan reported the Public Markets Committee met on May 3 to consider the implementation of the new equity-only options within the Plan 3s, Deferred Compensation Program (DCP), and Judicial Retirement Account (JRA).

Last fall, the Board adopted new equity-only options for the defined contribution plans. Staff's original implementation recommendation included:

- Passive management of the two U.S. equity options
- Mix of passive and active for the global equity option
- Primarily active management for the emerging markets equity option

At the time, Mr. Ragan said staff committed to coming back to the Public Markets Committee with a specific recommendation on how best to implement the active options. During staff's implementation research, it became apparent that using active management in the emerging and global equity options was not feasible until there is a reasonable size of assets within those options. Doing so before then would result in higher fees and the loss of daily liquidity. Therefore, staff modified their stance to recommend that all four equity-only options be implemented with low-cost passive strategies at this time. When assets in the emerging and global equity options reach about \$100 million, staff will re-examine adding active management and return to the Public Markets Committee with a recommendation. Staff solicited bids on passive management of the equity-only defined contribution options from both of the WSIB's passive equity managers. BlackRock Institutional Trust's bid was stronger and their fees were lower than State Street Global Advisors.

Mr. Ragan moved the Board approve the passive management of all equity-only options under the newly designed Plan 3, DCP, and JRA menus to be managed passively by BlackRock Institutional Trust Company. Mr. Masten seconded the motion.

[Mr. Hill was in attendance via teleconference at 9:38 a.m.]

Mr. Hill complimented the excellent teamwork between Department of Retirement Systems and WSIB staff. He believes the recommendation and direction being taken is a significant improvement to the menu in Plans 3, DCP, and JRA.

The above motion carried unanimously.

PRIVATE MARKETS COMMITTEE REPORT

TPG Growth II, L.P.

Mr. Masten reported the Private Markets Committee met on May 5 to consider one investment recommendation.

Mr. Masten moved the Board invest up to \$200 million, plus fees and expenses, in TPG Growth II, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Mr. Ragan seconded the motion.

Mr. Masten said the fund will have a target size of \$1.5 to \$2 billion, and will pursue middle market buyout and growth equity investment opportunities predominantly in the industrials and manufacturing, business services, transportation, retail and consumer products, technology, and healthcare services sectors on a global basis. TPG has been a long-term investment partner of the WSIB. Since 2000, the Board has committed in excess of \$1.8 billion to five TPG-sponsored investment vehicles. The fund's focus on smaller transactions and substantial exposure to emerging markets makes it an attractive fit in the portfolio. The predecessor fund, TPG STAR, is reporting a net IRR of 11 percent and a net multiple of 1.2x as of December 31, 2010. The proposed investment is consistent with both the Board-approved 2011 private equity annual plan and model portfolio.

The above motion carried unanimously.

Mr. Dietrich noted for the record that Mr. Nierenberg recused himself from discussion of this investment recommendation.

[Mr. Hill was no longer in attendance at 9:42 a.m.]

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh reported on a bill expected to be signed into law relating to reducing Boards' and Commission's travel and other costs. Despite the expectations for reduced travel, Ms. Whitmarsh stressed the importance of the WSIB meeting face-to-face. She plans to refer the matter to the Board Governance *ad hoc* Committee for review. Ms. Whitmarsh said the Audit Committee will meet in June, but Private and Public Markets Committee meetings are cancelled due to lack of business. She reviewed the July Board meeting agenda. Staff is working hard to create a line-up of topics and speakers to build dialogue and discussion into the meeting. Ms. Whitmarsh reported on the emerging market fund-of-fund's investments. Mr. Bruebaker recently participated in a *Bloomberg* interview, drawing interest from the reporter who found the WSIB was the top performing pension fund over the past five years ended June 2010. Interviews are continuing for a Senior Investment Officer in Tangibles Assets—the recruitment has proven difficult due to the market for talent and salary. Two staff resigned over the past month—one departure was a Fixed Income Investment Officer for a job opportunity with better pay. Ms. Whitmarsh reported one of the discussion themes for July relates to managing staff resources within the current budget situation. The custodial bank Request for Proposals is planned for mid-June and members will be

notified once the quiet period begins.

FIXED INCOME REVIEW AND OUTLOOK

Mr. Kennett said his report would cover current market conditions, the outlook for the remainder of 2011, risks to the macro-economic outlook, portfolio implications, market information, and fixed income portfolios performance.

Mr. Kennett reported on the global and U.S. recoveries in terms of debt, inflation, unemployment, housing, oil, commodities, sovereign debt, emerging markets, currencies, and credit. A discussion ensued relating to long-term budget cutting initiatives and implications, and political influences on credit ratings.

Mr. Kennett provided his outlook through year-end on global growth, developed and emerging markets, and U.S. economic variables. He anticipates low- to mid-single digit returns for fixed income. He relayed that macro-economic risks going forward include spiking oil prices, European sovereign debt, anemic growth in Japan, the debt ceiling, end of quantitative easing, U.S. unemployment and the weak U.S. housing market. A discussion ensued on Brazil investments and taxation issues.

Mr. Kennett said plans for the retirement portfolio include overweighting credit with a focus on emerging markets and non-dollar opportunities. A discussion ensued on municipal opportunities and liquidity concerns.

[Mr. McElligott was no longer in attendance at 10:41 a.m.]

Mr. Kennett said the fixed income portfolios have about \$26 billion in assets under management—46 percent within retirement, 42 percent within Labor and Industries', and the remainder within Permanent and other funds. He said, fiscal year to-date, the retirement fixed income portfolio is outperforming by 257 basis points. He provided details on country and industry allocations, and non-U.S. dollar holdings. Mr. Kennett said the return on non-U.S. dollar holdings fiscal year-to-date is 20.79 percent.

Mr. Kennett reviewed the goals and implications for the Labor and Industries' portfolios. He said he is very proud of the fixed income team.

[The Board took a recess at 10:57 a.m., and reconvened in open session at 11:12 a.m.]

BOARD AUTOMATION INITIATIVE

Ms. Haines provided background details and upcoming plans to automate the creation, approval, distribution of, and access to Board and Committee packet materials. The initiative was undertaken based on staff-initiated proposals and Board members' suggestions, and in response to Legislative requests for agencies to increase efficiencies and reduce costs. After researching options, staff selected BoardDocs, a web-based system, to replace current manual processes. The BoardDocs system was also recommended by Ms. Owens.

Mr. Mackison described various technology device options that can be used to access BoardDocs, which can include home computers, laptops, iPads, or a combination of these based on individual work styles and preferences. He reported the agency procured a number of iPads equipped with web access and pre-loaded applications for members' consideration. He stipulated that restrictions

would apply should members opt to use state-assigned equipment. A discussion ensued on accessibility and public disclosure issues involving use of personal and state-issued equipment. Mr. Dietrich suggested staff develop a policy on de minimis usage.

LABOR AND INDUSTRIES' INVESTMENT BELIEFS

Treasurer McIntire announced the Labor and Industries' investment beliefs discussion is deferred to the June Board meeting since Ms. Schurke could not be in attendance today.

[The Board took a recess at 11:50 a.m., and reconvened in open session at 12:16 p.m.]

QUARTERLY DISCUSSION OF MARKETS

Portfolio Discussion

Mr. Bruebaker reported on quarterly performance of the Commingled Trust Fund (CTF). He reported the CTF is up 4.44 percent for the three months ended March 31, 2011, and up 13.74 percent for the year. Equity markets are up 1.4 percent since the quarter end March 31, 2011, although it has been a very bumpy ride. The since inception return for the CTF is up to 8.78 percent as of March 31, 2011. Looking at the implementation value added for the quarter, the portfolio underperformed for all time periods. The portfolio was hurt by an overweighting to global, underweighting to private equity, but assisted by underweighting to fixed income. Manager decisions underperformed the benchmark. Mr. Bruebaker said the portfolio's positioning continues to look good for the long-term.

Public Equity

Mr. Paroian reported on quarterly and year-to-date public market performance and portfolio positioning. He said the equity markets were surprisingly strong with returns for global equity of 4.5 percent in the first quarter and 4.6 percent year-to-date. The U.S. performed better than non-U.S. and emerging markets were flat.

The CTF public equity portfolio is mostly passive, so weights are very similar to the benchmark. U.S. equity is about 3.7 percent overweight, which will be partially rebalanced during the transition and funding of the new global equity managers. The largest underweights are Japan and Canada, each about 1 percent underweight the benchmark. In sectors, the only positioning that is greater than plus or minus -1.0 percent is telecommunications being +1.3% overweight and financials being -1.1% underweight.

As for managers, in the CTF, the passive managers are meeting expectations and the remaining non-U.S. managers have all added value long-term. Emerging markets active management has been mixed, but has still generally been better than passive management which tends to underperform the benchmark in emerging markets. Within the Labor and Industries, Guaranteed Education Tuition, and Permanent Funds, equity is passively managed and continued to perform in line with expectations.

In Plan 3, DCP, and JRA, staff will be changing the menus as discussed earlier. The balanced options—the Total Allocation Portfolio in Plan 3, the Socially Responsible Fund, and the Target Date Funds—continue to meet or exceed expectations over longer periods of time. The passive equity options in the defined contribution program have performed in line with their indices. Three of the four active equity funds in DCP have underperformed, which is one of the reasons that all equity options under the new menu will start out passive.

Private Equity

Mr. Ruggels commented on the healthy pace of private equity portfolio cash flows. Drawdown activity is steady and distributions are ramping up. The calendar year-to-date distributions as of the end of April were \$1.357 billion, compared with drawdowns of \$655 million. Mr. Ruggels commented on Microsoft's recent announcement of its purchase of Skype. Silver Lake Partners III is the largest owner of Skype and the WSIB is invested in that fund, so the WSIB should see a nice profit on that deal. Mr. Ruggels said the WSIB's commitment to Silver Lake III represents approximately 2.7 percent of the fund.

Real Estate

Mr. Draper reported the real estate portfolio has outperformed its benchmark by 50 basis points over 10 years. In terms of the markets, fundamentals in global gateway cities are recovering strongly, but other markets are still struggling. He said the WSIB's portfolio is positioned well to deal with that, seeing good recovery following the downturn, and staff is actively working to position the portfolio to stay in front of the curve. Staff continues to focus on long-term growth oriented markets and necessity real estate, such as housing, necessity-based retail, and warehousing with a global focus. A discussion ensued relating to how resort properties are doing. Mr. Draper noted it depends on their location. The Board also discussed previously problematic deals in the marketplace that are now getting resolved quickly, the timeline on getting properties in desirable locations, and the portfolio's main goal of achieving cash flow.

Other

Mr. Bruebaker noted the fiscal year return for the CTF is 24.7 percent. This could outpace the best fiscal year performance the WSIB has ever had.

Treasurer McIntire thanked Mr. Bruebaker for his recent presentation at the National Association of State Treasurers' conference on pension returns.

Private Equity – Hamilton Lane

Ms. Blackburn provided an overview and update of liquidity drivers, deal flow, and fundraising activities. She detailed the affect of middle-market deals and changes in industry sectors, and discussed deal pricing and structuring, debt trends, and liquidity activity. Ms. Blackburn said WSIB portfolio returns since inception are consistent and self-funding over the past two quarters, with distribution activity picking up.

Other

Ms. Whitmarsh introduced Paul Elwood, a newly hired Fixed Income Investment Officer, who will focus on energy.

INVESTMENT DISCUSSION

Acting Chair McIntire 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 1:15 p.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 1:09 p.m., and reconvened in open session at 1:33 p.m.]

OTHER ITEMS

There was no further business to come before the Board and the meeting adjourned at 1:33 p.m.



Treasurer Jim McIntire
Acting Chair

ATTEST



Theresa J. Whitmarsh
Executive Director