WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
May 16, 2013

The Washington State Investment Board met in open session at 9:30 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present:	Treasurer Jim McIntire, Chair Mike Ragan, Vice Chair Kelly Fox Marcie Frost Bill Longbrake George Masten Richard Muhlebach Senator Sharon Nelson David Nierenberg Judi Owens Joel Sacks Representative Sharon Tomiko Santos Jeff Seely
Absent:	Bob Nakahara Natasha Williams
Also Present:	Theresa Whitmarsh, Executive Director Gary Bruebaker, Chief Investment Officer Victor Moore, Chief Operating Officer Liz Mendizabal, Institutional Relations 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 Allyson Tucker, Senior Investment Officer – Risk Management and Asset Allocation Diana Will, Senior Investment Officer – Tangible Assets Fabrizio Natale, Assistant Senior Investment Officer - Private Equity Kristi Haines, Executive Assistant Kristi Bromley, Investments Administrative Assistant Steve Dietrich, Attorney General's Office Lisa Stewart, Sheridan Production Company Stu Porter, Denham Capital Partners Sarah Bernstein, Pension Consulting Alliance, Inc.

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

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

ADOPTION OF THE APRIL 25, 2013, BOARD MEETING MINUTES

Ms. Owens moved to adopt the April 25, 2013, Board meeting minutes. Vice Chair Ragan seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

EDUCATION SESSION

The Operational Aspects and Evolving Economics of the U.S. Oil and Gas Business

Mr. Natale introduced Ms. Stewart, Sheridan Production Company, and Mr. Porter, Denham Capital Partners, and noted they would be providing an education session on the operational aspects and economics of the U.S. oil and gas business. The WSIB has invested in energy within the private equity portfolio for nearly 2 decades. The sector comprises 9 percent of the private equity and tangible asset portfolios combined and this amount is expected to increase.

Ms. Stewart noted that her presentation would focus on exploration and production (E&P). When thinking about the E&P business, a key decision is whether to explore, develop, or buy, or a combination of all three. Ms. Stewart noted the business is fairly simple as it is ultimately a manufacturing process involving taking natural resources out of the ground. The technology involved is quite interesting and key to attracting the younger generation to the business. She noted that, while the business is fairly simple, extracting hydrocarbons from rocks, complying with regulatory and social requirements, and selling the product in the market takes a lot of hard work.

Ms. Stewart reviewed conventional petroleum exploration and the U.S. shale gas revolution. She reviewed a chart showing the U.S. natural gas production and imports and a chart showing the U.S. monthly average crude oil production. Ms. Stewart shared her view that, while technology has changed how much oil is produced in the U.S., oil independence may not be reached but the U.S. will definitely be less dependent on foreign oil.

Ms. Stewart reviewed shale plays/fracking and explained hydraulic fracking, as well as the protections required to ensure ground water is not contaminated when the hydrocarbons are brought to the surface. She noted that it is incumbent on the states to mandate the proper level of protection and follow-up to ensure operators are doing the right thing. It is the responsibility of the operators to do the right thing. She reviewed marketing considerations with pricing influenced by regional and local infrastructure with shale plays altering the marketing landscape.

[Mr. Fox arrived at 9:57 a.m.]

Ms. Stewart reviewed the areas of regulatory compliance and social issues. She noted that, as an operator, regulatory compliance is very important and it is incumbent upon operators to be good corporate citizens with a number of operators setting self-imposed limits related to greenhouse gases and local impacts.

[Mr. Nierenberg arrived at 10:16 a.m.]

Ms. Stewart reviewed the costs and risk/reward characteristics of the decision to explore, develop, or buy. She reviewed the merger and acquisition market and key business terms, noting that margin is key. Managing the margin involves understanding the details, making the information accessible to staff throughout the organization, and incentivizing the right behaviors. She noted that the business is all about people and the industry generates a lot of jobs.

Discussion ensued regarding the commitment of the field staff to do the right thing and the importance of high expectations and engagement throughout the company. Further discussion ensued regarding the outlook for the U.S. energy sector, state regulation, and the importance of investing with the right people.

Mr. Porter provided an overview of the North American natural gas revolution. He reviewed a map showing the growth since 2010 in identified unconventional hydrocarbon plays. He also reviewed a graph depicting the amount of U.S. natural gas resources in 2005, 2008, and 2012 and noted the large impact shale is having on those resources. From 2009 to 2011, North American natural gas production grew from 70 billion cubic feet per day (Bcf/d) to nearly 77 Bcf/d and it is estimated that natural gas resources in the lower 48 states and Canada exceed 3,400 trillion cubic feet of recoverable resource. Mr. Porter noted that the U.S. has gone from a 20-year domestic natural gas supply to a 100-year supply and from a net importer to a potential exporter.

Mr. Porter reviewed natural gas economics noting the potential large savings from converting from oil to gas for transportation fuel. He reviewed a comparison of the global natural gas prices noting that natural gas prices are much lower in the U.S. compared to Europe and Asia. He reviewed the U.S. liquefied natural gas import and export outlook over time, noting the potential for a $30-$50 billion per year reduction in the trade deficit.

Mr. Porter reviewed the effect of increased natural gas generation on the coal industry. He noted the impact of shale gas on the U.S. economy, with estimates that by 2020 over 3.5 million jobs will be supported by shale gas across the oil and gas extraction, manufacturing, and services sectors. He reviewed the opportunity liquefied natural gas offers the long-haul trucking industry as an alternative to diesel fuel.

Discussion ensued regarding the importance of energy infrastructure to support natural gas extraction. The infrastructure the U.S. has in place provides a competitive advantage over other countries that have the resource but not the infrastructure.

Further discussion ensued regarding the evolution of the oil and gas industry, the effect of commodity prices, the regulatory landscape, and natural gas as an alternative to coal.

[The Board recessed at 11:24 a.m., and reconvened in open session at 11:45 a.m.]

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh announced a potential correction to the upcoming meeting schedule. Mr. Bruebaker reported the June Private Markets Committee meeting would likely be cancelled. Ms. Whitmarsh will inform the Committee as to the final decision. Public Markets will meet in June. The Board's planning session is scheduled for July 16-18, at Suncadia Lodge in Cle Elum.

For staffing, Matt Meredith is leaving the WSIB at the end of the week. Real Estate has interviewed and is close to hiring one candidate. Mr. Moore is hiring an administrative assistant. Ms. Whitmarsh said she was interviewed by Bruce Ramsey of *The Seattle Times*, and by Julia Chung of the *Wall Street Journal (WSJ)* regarding hedge fund investing. The *WSJ* article has not run as of yet. Also, she was interviewed by *Bloomberg* and the resulting article was circulated to members.

CTF QUARTERLY PERFORMANCE UPDATE
Mr. Bruebaker said the first quarter was great for investment returns. The Commingled Trust Fund was up 4.5 percent for the quarter and 11.3 percent for the year. The equity markets were up 6.0 percent since the quarter end March 31, 2013. The CTF was up 1.6 percent for the month of April and up 8.7 percent since inception.

Mr. Bruebaker said, compared to the implementation value added benchmark, the CTF outperformed for the quarter due to manager selection in private equity and real estate but underperformed in the other time periods. The real estate managers assisted outperformance by 34 basis points (bps), and private equity managers helped outperformance by 82 bps. He said the portfolios are well positioned for the long term, but shorter-term performance will lag as private markets recover more slowly than public markets. He reported public equities were up 7.1 percent for the quarter, while private equity was only up 4.4 percent. He provided survey results for the WSIB from the recent *Pensions & Investments* survey on top pension funds.

RECOGNITION
Chair McIntire recognized Ms. Owens for her leadership, involvement, and accomplishments as a Board member over the past three and a half years. Ms. Owens will retire from public service effective July 1, 2013.

[Senator Nelson left at 11:55 a.m.]

[The Board recessed at 11:55 a.m., and reconvened in open session at 12:24 p.m.]

EDUCATION SESSION
Portfolio Allocation Approaches – WSIB, Peers, and Others
Ms. Tucker introduced herself and Ms. Bernstein, Pension Consulting Alliance, Inc. (PCA), and provided background on the presentation. Ms. Tucker noted the education session explores the findings of a survey conducted by PCA on behalf of the WSIB on portfolio allocation strategies of 17 large U.S. and non-U.S. plan sponsors. The 17 plans surveyed include 8 WSIB peers and 9 non-peer large plans. PCA and WSIB staff selected all of the plans that were sent the survey. The non-peer organizations were selected by PCA and WSIB staff based on WSIB's interest in a better understanding of newer portfolio allocation approaches beyond traditional mean variance optimization.

Ms. Bernstein reviewed the key findings focused on portfolio allocation approaches, benchmarking, asset allocation, and performance. Many plans have moved beyond traditional approach to allocation and some plans are making more decisions based on risk. Four plans have a real return objective in order to match better with inflation-linked liabilities; one plan only reports performance for 5-year periods and longer in order to stay focused on the long term, and one plan was focused entirely on absolute return and did not utilize a return benchmark. With regard to asset allocation, the trend to increase alternatives and reduce equity was global and funds with more innovative approaches had lower allocations to publicly-held equity. The 3 plans that outperformed the median for the 5- and 10-year periods employed innovative approaches. In terms of governance, more plans were utilizing independent governance structures and only 4 of the 17 had staff salaries set by the Legislature and one of those currently has legislation under consideration which would establish independent salary setting authority. None of the plans surveyed delegated asset allocation policy targets to staff but most delegated rebalancing and external manager selection to staff. More than a majority, 13 of the 17, had more than 50 percent of their assets managed internally and those plans had larger staff size. Plans with larger assets under management were pursuing more innovative strategies. Larger plans also tended to pay more, delegated more to staff, had more assets managed internally, and protected more on the downside.

Discussion ensued regarding the peer and non-peer survey groups, asset allocation trends and alternatives, portfolio risk measurement, internal asset management, performance attribution, and the importance of organizational culture and corporate governance.

[Mr. Seely left at 1:46 p.m.]

Private Markets Annual Performance Discussion
Private Equity

Mr. Ruggels reported on the private equity portfolio for the period ended December 31, 2012. He reviewed the returns for the various sub-sector strategies and the total combined portfolio for the 1-, 3-, 5-, and 10-years, and since inception. The lower 5-year return reflects the global financial crisis, which was a difficult period for all asset classes. For the 10-year period, the portfolio returned 12.9 percent, which exceeded the Russell 3000 plus 300 bps benchmark return of 10.7 percent. Mr. Ruggels reported the venture capital/growth equity sub-sector has generally under-performed other sub-sectors, which is consistent with the Board's decision to de-emphasize venture a few years ago. The Board has been proactively increasing exposure to the small/mid corporate finance sub-sector, which has performed better than mega/large corporate finance for all time periods. In response to Mr. Masten's question, Mr. Ruggels said that since inception returns are not necessarily comparable because the start dates for investments in the various sub-sectors do not align. Mr. Bruebaker said the 5- and 10-year periods are the most important, and the returns should be looked at cumulatively.

Mr. Ruggels discussed the portfolio's positive cash flow (distributions received in excess of capital drawn), a trend that has continued over the last few quarters. Over the past 28 months, the cumulative net positive cash flow has been approximately $3.0 billion. He reported that general partners (GPs) are not investing at a rapid pace and drawdowns have been slower than expected over the past couple of years. The combination of the strong positive cash flow and growth in the value of the total fund has caused the private equity portfolio to recently drop below its 25 percent target allocation, although still well within its range of plus or minus 4 percent.

Real Estate

Mr. Draper reported there was not a lot of change in the real estate portfolio for the fourth quarter 2012. Some sectors and geographies do better or worse from time to time, and he expects a period of modest returns going forward. Some facets of the portfolio have seen unexpectedly strong returns. The portfolio had a net return over the 10-year period ended December 31, 2012, of 9.6 percent, or 160 bps above its benchmark. For the 1-year period, the portfolio returned 16.5 percent, which is very attractive. He said the drivers for those returns include holdings in Mexico, residential properties, and holdings in the cemetery/funeral home sector. He reported there has been swifter than expected recovery in some sectors more strongly affected by the economic downturn, and some of the holdings hit hardest in the portfolio are bouncing back. Healthcare holdings that provided positive returns during the downturn have now reversed, which shows the importance of diversification. Another factor that negatively impacted returns during the past year was the decline in the Euro, in which the WSIB has a fair amount of exposure. He emphasized the importance of the real estate portfolio structure, specifically with real estate operating companies (REOCs). Compared to the overall portfolio return of 16.5 percent for calendar year 2012, the REOCs returned 26.9 percent, or more than a 1000 bps differential. He said the overall leverage level of the portfolio is the lowest it has been in many years, moving from 54 to 46 percent over a 1-year period. This is largely the result of increasing values combined with some debt repayment. Mr. Draper complimented his team on their hard work on behalf of beneficiaries.

Tangible Assets
Ms. Will reported that Tangible Assets is underperforming its benchmark since inception (March 2008); however, on the positive side, most of the portfolio return is income which is what staff wants. Three commitments closed totaling $650 million in 2013, and the portfolio finished the year at $879 million of unfunded commitments. There were $152 million in capital calls during the fourth quarter 2012, and $82 million in draws this year—the majority of which came from Sheridan Production Company.

OTHER ITEMS
There were no further items to come before the Board, and the meeting adjourned at 2:20 p.m.

James L. McIntire, Chair

ATTEST

Theresa J. Whitmarsh
Executive Director