

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
July 16-18, 2013

The Washington State Investment Board met in open session at 1:02 p.m. in the Rialto A Room at Suncadia Lodge, Cle Elum, Washington.

Present: Treasurer Jim McIntire, Chair
 Mike Ragan, Vice Chair
 Kelly Fox
 Marcie Frost
 Arlista Holman
 Bill Longbrake
 George Masten
 Richard Muhlebach
 Bob Nakahara
 Senator Sharon Nelson
 David Nierenberg
 Joel Sacks
 Representative Sharon Tomiko Santos
 Jeff Seely

Absent: 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
 Kristi Haines, Executive Assistant
 Kristi Bromley, Administrative Assistant – Investments

 Dawn Cortez, Attorney General's Office
 Mary Lobdell, Attorney General's Office
 Tara Blackburn, Hamilton Lane
 Bob McCrory, Cheiron EFI
 Ira Millstein, Weil, Gotshal & Manges LLP
 Lord Myners
 Neil Rue, Pension Consulting Alliance

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

July 16

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

OATH OF OFFICE – ARLISTA HOLMAN

Chair McIntire administered the oath of office to Ms. Holman who was appointed to fill the remaining term of the School Employees Retirement System Board member, effective June 26, 2013, until December 31, 2013. Ms. Holman gave a brief overview of her background and experience.

ADOPTION OF MINUTES – JUNE 20, 2013

Vice Chair Ragan moved to adopt the June 20, 2013, Board meeting minutes. Mr. Masten seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

ASSISTANT ATTORNEY GENERAL'S REPORT

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 until about 1:20 p.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 1:12 p.m., and reconvened in open session at 1:26 p.m.]

Chair McIntire moved that the Board authorize the Attorney General's Office to accept the settlement offer discussed during executive session. Vice Chair Ragan seconded, and the motion carried unanimously.

Chair McIntire moved that the Board authorize the Attorney General's Office to retain outside legal counsel to conduct the litigation discussed during executive session. Vice Chair Ragan seconded, and the motion carried unanimously.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh discussed the planned agenda for the July off-site meeting, and said staff hoped to gain direction from the Board going forward. She said meeting topics include private equity and fixed income deep dives, examining capital market assumptions based on various economic scenarios, asset allocation, venture capital trends, a geo-political discussion, and a discussion of how WSIB can focus its efforts in corporate governance matters.

STRATEGIC PLAN UPDATE

Ms. Whitmarsh reviewed the strategic plan framework of value, support, and capacity which rests upon the foundation of a skilled Board. She provided an update on progress of 2013 goals and a brief overview of WSIB's strengths, risks, opportunities, and challenges.

[Representative Santos arrived at 1:35 p.m.]

Ms. Whitmarsh thanked members for their assistance in securing the Board's full budget request during legislative session. She noted the number of new members who joined the Board this year. Ms. Whitmarsh commented that WSIB is well respected, engaged, and committed to high standards. The technology and infrastructure put into place will give WSIB a real advantage in the market place. She noted these as strengths, and discussed threats and risks within the market environment.

Ms. Whitmarsh reported on progress toward specific initiatives. Within the value area, there are three areas of focus: asset allocation, implementation value added, and cost effectiveness. She reported on 2013 activities occurring in each of these areas, and progress toward goals. She said staff would report on progress toward asset class plans during tomorrow's agenda. Within the capacity area, Ms. Whitmarsh said the cost analysis, leadership development, and process improvement initiatives are on track, as well as other Operations activities relating to risk and compliance, office space, mobile technology, and new employee orientation. Within the support area, staff and members have spent a lot of time telling the WSIB story, expanding interaction with the media to try to raise the WSIB's profile, examining the Board's level of involvement in the corporate governance area, and finalizing a project with the Department of Retirement Systems to be more transparent with web content. She reported on the Board's goals relating to telling the WSIB's story; Board independence, continuity, and competence; and increasing Board effectiveness through various governance initiatives.

Chair McIntire said it is good to keep track on the progress of the Board's planning. As part of the Board's communications efforts, he suggested that staff may want to modify the WSIB's website to include the key performance measures.

INVESTMENT AND MARKET DISCUSSION

Private Equity Expanded Capital Markets Assumption Discussion

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 3:15 p.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 1:58 p.m., and recessed at 3:35 p.m. It reconvened in open session at 3:54 p.m.]

Fixed Income Market Outlook and Mid-Year Review

Mr. Kennett introduced himself and provided an overview of his presentation. He noted the framework for decision making by the WSIB fixed income team involves macro,

market, and industry fundamentals; valuations; and judgment. Mr. Kennett reviewed his economic outlook for the global, U.S., Eurozone, Japan, and emerging markets economies. He noted that growth in the developed world was still slow and that emerging markets would continue to drive global growth. He reviewed the 10-year treasury yields, investment grade credit spreads, yield curve changes, and the returns of the Barclays Universal Index. Mr. Kennett reviewed the goals and performance of the retirement fixed income portfolio, as well as the role of fixed income within the Commingled Trust Fund (CTF). He provided his outlook for interest rates, noting they will probably move higher, the pace of quantitative easing may slow before year end and might end completely in 2014. He also noted the Fed funds rate should stay close to zero in 2015 and the 10-year Treasury yield should approach the growth rate of nominal GDP as rates normalize; WSIB fixed income staff believes the growth rate of nominal GDP will be between 3 and 4 percent: 1.5 to 2 percent real growth and 1.5 to 2 percent inflation. In the short term, rising interest rates will cause fixed income prices to fall; however, over longer periods, fixed income prices move to par.

Discussion ensued regarding the impact of immigration on U.S., Japanese, and European growth; inflation; the U.S. deficit with China; and the importance of the liquidity fixed income provides to the CTF.

Expanded Capital Market Assumptions – Scenario Analysis

Ms. Tucker introduced herself and Mr. Rue, Pension Consulting Alliance. She noted that the Board approved the capital market assumptions (CMAs) in April. One of the areas of discussion at the April Board meeting was scenario analyses around the CMAs in various market environments.

Mr. Rue noted the CMAs consist of long-term assumptions for return, risk, and correlation and provide a general starting point and framework for developing asset allocation decisions. CMAs utilize broad, full cycle economic environments; however, in reality, dynamic, regime-specific economic environments can prevail for various periods of time. Mr. Rue noted that this presentation would shed light on the impacts of such environments. He reviewed the 2013 WSIB CMAs, noting they are point estimates and do not represent the actual return the CTF will earn.

Mr. Rue noted that different economic environments can have dramatic impacts on shorter-term outcomes while the CMAs assume a fairly friendly, long-term economic environment going forward with low to moderate inflation and moderate to high growth. Economic environments are often viewed through a two-dimensional framework and placed into one of four different regimes: (1) high inflation and low growth suppress global demand and profits; (2) high inflation and high growth allow for corporate pricing power and high required returns; (3) low inflation and low growth reflect, and can stifle, economic activity; and (4) low inflation and high growth improve economic stability and certainty. Anticipating which economic environment will transpire is very challenging. Mr. Rue reviewed the historical occurrences of the different economic environments as well as the performance of the investment asset classes during these economic environments and specifically how the WSIB portfolio would be expected to perform in the various environments.

Discussion ensued regarding the performance of the WSIB's portfolio in various economic environments and the use of risk analysis in developing the CTF's strategic asset allocation.

[The Board recessed at 5:40 p.m. on July 16, 2013.]

July 17, 2013

Chair McIntire called the meeting to order at 8:33 a.m.

ANNUAL PLAN UPDATES

Public Equity

Mr. Paroian introduced himself and provided an overview of his presentation. He noted the "naughts" of the 21st century are over and the teen years have now begun. He summarized some of the typical characteristics for the human teen years and compared those to investing in the teen years, noting that the framework of the human teen years seems to match the framework of what markets are going through now. Mr. Paroian noted that the current period has often been compared to the 1930s and asked if we should expect the next 15 years to look the same, noting that things may look more like the 1950s going forward.

Mr. Paroian provided a brief review of the public equity program, including assets under management and number of accounts. He stated that focus is an advantage. He updated the Board on progress on 2013 initiatives and longer-term research.

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 10:15 a.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 9:04 a.m.]

Private Equity

Real Estate

Tangible Assets

[The Board recessed at 10:34 a.m., and reconvened in open session at 10:49 a.m.]

2013 ASSET ALLOCATION REVIEW

Commingled Trust Fund – Asset Allocation History and Investment Beliefs

Mr. Bruebaker introduced himself and provided a brief overview of the WSIB's CTF asset allocation history for the past 15 years, as well as a review of the CTF 10-year asset class excess investment results. Over the past 10 years, private equity provided \$6 billion in excess returns over what would have been earned if the money had been invested in global equities. He also provided an overview of the process undertaken by the Board and staff to develop the WSIB's investment beliefs for the CTF. He highlighted the value of the discussions in developing the investment beliefs and noted having investment

beliefs improves transparency, promotes consistency and investment discipline in all investment environments, and provides written direction to staff. They also serve as an excellent communication tool to stakeholder groups. Mr. Bruebaker reviewed each of the 16 investment beliefs for the CTF.

Discussion ensued regarding the investment beliefs and the importance of reviewing them periodically.

Education Session – Asset Allocation Primer and Concepts

Ms. Tucker reviewed the work already undertaken by the Board related to the CTF asset allocation review since the July 2012 Board meeting. She provided an overview of the day's discussions. Messrs. Rue and McCrory introduced themselves and Mr. Rue reviewed the outline for the asset allocation primer. He provided background on the meaning and purpose of a strategic asset allocation. Determining the appropriate mix of asset classes is important to meeting the long-term objectives of an investment portfolio. He reviewed the correlations and risks of the major asset classes over the past 20 years and noted the WSIB's strategic framework for the CTF generally reflects the return seeking/diversifying and public/private dimensions. Determining the right mix of asset classes involves an examination of the risk and return tradeoffs of each individual asset class and developing forward-looking long-term assumptions for each customized WSIB asset class. A critical factor in selecting a policy portfolio is determining the appropriate risk level.

Discussion ensued regarding liquidity, risk of loss, strategy implementation, and diversification.

[The Board recessed at 12:27 p.m., and reconvened in open session at 1:40 p.m.]

2013 ASSET ALLOCATION REVIEW (CONTINUED)

Asset Allocation Review and Model

Risk Philosophy Selection Process and Discussions

Ms. Tucker noted that the modeling program built by Mr. McCrory takes qualitative assessments about risk appetite and translates those into quantitative measures. The modeling process is a tool to guide conversation and will result in a policy portfolio based on the qualitative assessments of risk appetite. This will serve as a starting point for further discussions related to determining the appropriate strategic asset allocation mix.

Mr. McCrory provided an overview of the model and the five decision factors used to assess the Board's risk tolerance: minimize employer cost volatility; minimize funded ratio volatility; maximize CTF average real rate of return; minimize volatility of CTF real rate of return; and minimize CTF cash flow/liquidity stress. He explained the voting process wherein the Board members would allocate points across the five decision factors, thereby translating qualitative views into quantitative representations. He noted that a risk avoiding portfolio would result in average returns dropping significantly while a higher risk portfolio maximizes returns demonstrating the risk/reward tradeoff in the modeling process. The Board would communicate their overall risk tolerance by the weighting of the various decision factors. Mr. McCrory noted that the process consists of three steps: modeling, measurement, and optimization. Mr. Rue summarized the history

of the last three asset allocation studies, showing the evolution of the WSIB's risk tolerance.

Discussion ensued regarding the various modeling performed by Mr. McCrory around various scenarios, including different funded ratios and cash flow scenarios.

[The Board recessed at 3:12 p.m., and reconvened in open session at 3:28 p.m.]

Mr. McCrory reviewed the process for the voting exercise. The Board and senior staff participated in the voting exercise and discussed the results of each voting process as well as the constraints built into the model.

[The Board recessed at 4:39 p.m. on July 17, 2013.]

[Mr. Seely left the meeting.]

July 18

Chair McIntire called the meeting at 8:35 a.m.

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 9:00 a.m., at which time the Board would reconvene in open session.

[The Board went into executive session at 8:37 a.m.]

TOTAL ALLOCATION PORTFOLIO DISCUSSION

[Senator Nelson left the meeting at 9:21 a.m.]

[The Board recessed at 9:21 a.m., and reconvened in open session at 9:37 a.m.]

CORPORATE GOVERNANCE PANEL

Lord Myners and Mr. Ira Millstein presented their thoughts on what kind of corporate governance activities may make a difference for the WSIB.

Mr. Millstein remarked that WSIB has already done a lot in the corporate governance area. He believes the U.S. as a whole has a short-term focus on performance rather than on what can make a difference. He suggested that corporations that focus on innovation, growth, and jobs as key functions will create change and can help the country move in the right direction. It provides a different view for making corporate governance, allocation, and investment decisions. The WSIB should examine if innovation, growth, and jobs can be seen in its investments and, if not, what can be done about that?

Mr. Millstein commented on federal regulations, Dodd Frank, the Securities and Exchange Commission, unemployment, disparities in income, and the country's track record with innovation. He suggested that if WSIB focuses on the three areas as he suggests, other organizations will look to Washington for its best practices and can make a difference. WSIB is a non-conflicted shareholder and has a fiduciary duty to its beneficiaries. He

commented that WSIB has a good voting track record. He said WSIB should continue to communicate concerns with corporate boards, and not necessarily follow the vote suggested by Institutional Shareholder Services (ISS) as rules sometimes have unintended consequences. He provided a few examples where he believes the ISS suggested vote did not make sense.

Lord Myners discussed how corporate governance can be implemented in the area of allocation. He pointed out his comments represent a minority view and radical agenda. He said there are multiple agents in the investment process, to the point where the principal or ultimate owner has become almost invisible and has led to social unintended consequences. He suggests the WSIB be aware of that and willing to confront it to benefit not only beneficiaries, but tax payers, companies, and employees. He commended the WSIB on its work in taking care of its responsibilities, being innovative and accountable, and meeting challenges. Lord Myners discussed public equity investing, ownership, asset gathering, performance, and how modern portfolio theory has worked within a short-term focus.

Lord Myners suggested to the WSIB a two-way engagement between owners and companies, investments with higher conviction strategies, fewer stocks in the portfolio, and more involvement in the appointment of independent directors.

Mr. Nierenberg shared his view of using proxy voting services such as Glass Lewis and ISS. He said the challenge is how WSIB can step outside of the current system and encourage visible companies to grow in the right and responsible way.

Mr. Millstein said the WSIB should avoid short-termism and think about individual companies. It should let constituents know how important it is to focus on innovation, growth, and jobs. Lord Myners commented if the WSIB had to choose where to focus the few proxies it votes, it should be directed toward poor performing companies to help improve them.

[The Board recessed at 11:12 a.m., and reconvened in open session at 11:28 a.m.]

BOARD GOVERNANCE REPORTS

Ms. Haines introduced the annual reports on Board attendance, educational activities, and the percentage of time the Board spent doing specific activities.

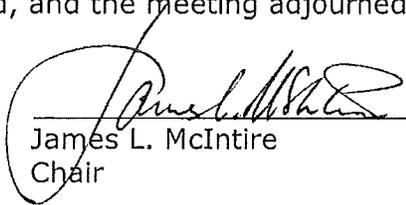
BOARD SELF-EVALUATION DISCUSSION AND FEEDBACK

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 is expected to last about 60 minutes, at which time the Board would reconvene in open session and adjourn.

[The Board went into executive session at 11:28 a.m. and reconvened in open session at 12:45 p.m.]

OTHER ITEMS

There were no further items to come before the Board, and the meeting adjourned at 12:45 p.m. on July 18, 2013.


James L. McIntire
Chair

ATTEST


Theresa J. Whitmarsh
Executive Director