

WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
January 15, 2015

The Washington State Investment Board met in open session at 9:39 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Marcie Frost, Chair
Kelly Fox, Vice Chair
Senator Mike Hewitt
Arlista Holman
Judy Kuschel
Bill Longbrake
George Masten
Treasurer Jim McIntire
Stephen Miller
Richard Muhlebach
Bob Nakahara
David Nierenberg (teleconferenced)
Joel Sacks

Absent: Representative Timm Ormsby
Jeff Seely

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 – Tangibles
Janet Kruzel, Assistant Senior Investment Officer – Private
Equity
Morian Mooers, Assistant Senior Investment Officer – Private
Equity
Kristi Haines, Confidential Secretary

Mary Lobdell, Attorney General's Office

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

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

OATH OF OFFICE

Chair Frost administered the oath of office to new Board member, Senator Mike Hewitt, appointed January 6, 2015, until December 31, 2016, into the Senate representative position.

ADOPTION OF THE DECEMBER 18-19, 2014, MINUTES

Vice Chair Fox moved to adopt the December 18-19, 2014, minutes. Treasurer McIntire seconded, and the motion carried unanimously.

PUBLIC COMMENT

There was no public comment.

EXECUTIVE DIRECTOR'S REPORT

Ms. Whitmarsh reported she met with Senator Nelson on January 8 to gain her advice as an outgoing Board member and with transitioning the new Senate member. She also met with Representative Ross Hunter on January 7 to discuss risk mitigation in the private markets asset classes, as well as the WSIB's budget proposal. Ms. Whitmarsh said the risk materials she prepared for Representative Hunter may be helpful to Board members in speaking with constituents, and she plans to distribute those for members' use. She introduced Ms. Cathy Nielsen, newly appointed Administrative Assistant 5-Operations, supporting Mr. Moore, and the Administrative and Audit Committees. She said that offers were made and accepted by two new Investment Officers who would be introduced to the Board once they join staff. Ms. Whitmarsh announced the Real Estate team had completed its move to the Seattle office as part of the space planning strategic initiative, and management will ensure the team maintains good communications and connection with the Olympia office. She reported the Public Markets emerging markets manager search is nearing completion and is scheduled for presentation at the February Public Markets Committee and Board meetings. A quiet period remains in place until a decision is reached and any inquiries received by Board members related to this procurement should be directed to Mr. John Lynch, Contract Manager.

PRIVATE MARKETS COMMITTEE REPORT

Mr. Masten reported the Private Markets Committee met on January 8 to consider four private equity investment recommendations.

TPG Growth III, L.P.

Mr. Masten moved that the Board invest up \$300 million, plus fees and expenses, in TPG Growth III, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Fox seconded the motion.

Mr. Masten said that, consistent with its predecessor funds, TPG Growth III will pursue investment opportunities predominantly in the technology, healthcare services, business services, retail, consumer products, industrials, and manufacturing sectors globally, with an emphasis on the U.S., China, India, and frontier markets (primarily Africa, Turkey, Southeast Asia, and Latin America, especially Brazil). The WSIB has invested in TPG

funds since 1999. The proposed investment is consistent with the 2015 private equity annual plan and model portfolio. He said the recommendation is based on TPG's strong performance, demonstrated price discipline, consistent investment strategy, solid and experienced team, excellent fit within the WSIB's private equity portfolio, and other factors relevant to the recommendation.

The above motion carried unanimously.

Insight Venture Partners IX, L.P., and Insight Venture Partners Growth-Buyout Coinvestment Fund, L.P.

Mr. Masten moved that the Board invest up to \$150 million, plus fees and expenses, in Insight Venture Partners IX, L.P. and up to an additional \$50 million, plus fees and expenses, in Insight Venture Partners Growth-Buyout Coinvestment Fund, L.P., for an aggregate commitment of up to \$200 million, subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Fox seconded the motion.

Mr. Masten reported the fund will invest in in buyout and growth equity transactions in software, software enabled services, and internet businesses with established momentum and potential for significant future growth. The WSIB invested in four prior Insight funds, at first through Pathway, and then directly in Fund VIII. The proposed investment is consistent with the 2015 private equity annual plan and model portfolio. He said the recommendation is based on the proven investment team, which is backed by in-house operational experts, a proven and successful growth and buyout strategy in the technology sector, a differentiated sourcing model, consistent and attractive performance, strong fit within the WSIB's private equity portfolio, and other factors relevant to the recommendation.

Ms. Holman asked if staff inquired about whether the firm had an environmental/social/governance policy and, if not, how receptive they are to creating one. Chair Frost said staff had asked the question, and the firm said the policy is being actively worked on and forthcoming in the near future.

The above motion carried unanimously.

Oaktree Opportunities Fund X, LP, and Oaktree Opportunities Fund Xb

Mr. Masten moved move that the Board invest up to \$200 million, plus fees and expenses, in Oaktree Opportunities Fund X, LP, and \$400 million, plus fees and expenses, in Oaktree Opportunities Fund Xb, LP, subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Fox seconded the motion.

Mr. Masten reported the funds will make non-control investments in senior or secured debt of financially distressed companies with hard asset values, dependable cash flows, and durable business franchises, primarily in the U.S. and Europe. The WSIB has invested in 11 Oaktree Opportunities funds and two Principal funds since 1994. The

proposed investment is consistent with the 2015 private equity annual plan and model portfolio. He said the recommendation is based on the firm's experienced global investment team, performance, proven strategy, strong deal flow, fit within the WSIB's private equity portfolio, and other factors relevant to the recommendation.

The above motion carried unanimously.

Francisco Partners IV, L.P.

Mr. Masten moved that the Board invest up to \$150 million, plus fees and expenses, in Francisco Partners IV, L.P., subject to continuing due diligence and final negotiation of terms and conditions. Vice Chair Fox seconded the motion.

Mr. Masten reported the firm's strategy is to invest in middle-market technology companies. Francisco will typically seek to be the controlling investor in transactions and drive operational improvements when needed. A commitment to the fund will re-establish a general partner relationship for the WSIB in a targeted investment strategy. The proposed investment is consistent with the 2015 private equity annual plan and model portfolio. He said the recommendation is based on Francisco's proactive investment approach, large and experienced team, deep industry expertise, improving fund performance, operating executive resources, Sequoia relationship, fit within the WSIB's private equity portfolio, and other factors relevant to the recommendation.

The above motion carried unanimously.

EDUCATION SESSION

Fixed Income Review and Outlook

Mr. Kennett presented his review of fixed income related activities during 2014, his outlook for 2015, and performance—how the portfolios performed as they did, why they are positioned the way they are, and the thought process behind that.

Mr. Kennett discussed the 2014 global economy. He said the U.S. did well, but Japan and the Euro area did not; China and emerging markets were slowing. Lead stories for the year included oil and commodity pricing, quantitative easing, and declining yields. Mr. Kennett said he thinks the economy is fragile, but is not convinced there is "secular stagnation" as some believe. He said the term refers to anemic recoveries that last a long time. He said that deflation has led to market turmoil in the past and the risk is real.

For the U.S., the gross domestic product (GDP) growth for the third quarter 2014 was at its strongest rate since 2003. The U.S. dollar was strong, and quantitative easing came to an end in the U.S. Housing starts, building permits, and property values continue to recover from the 2008 downturn. Manufacturing did well, and the U.S. deficit shrank to a six-year low.

[Treasurer McIntire left at 9:55 a.m.]

For international development markets, Germany, France, and Italy were weak; Greece was in depression, with youth unemployment at 50 percent; and Japan hugely expanded quantitative easing. The recession in Russia is spilling over to Europe; some Euro government bond yields hit all-time lows and German bond yields briefly went negative.

For emerging markets, there was broad-based slowing. China began easing monetary conditions, and its growth may be the slowest in 25 years. Mr. Kennett said he remains optimistic that orderly reforms can occur.

Mr. Kennett reported that Brazil suffered from low growth and high inflation, economic interventions did not work, and the timing of the Petrobras scandal was unfortunate. Brazil's investment grade credit rating is at risk. He said that India is a bright spot in emerging markets; Argentina defaulted; Turkey's president was accused of massive corruption; and hopes are high for Indonesia.

For fixed income, U.S. yields were expected to go up and steepen the curve, but the opposite happened. The credit market did well in the first half of the year, but not the second. Short-term interest rates stayed around 0, and there is uncertainty about when the Feds will start raising rates. Mr. Kennett said most think rates will raise mid-year in 2015, but he does not see it happening.

Mr. Kennett said he expects the global economy will grow by about 3 percent during 2015, helped by the oil price drop, as consumers increase spending. He said that all commodities will recover at some point but probably not this year.

Mr. Kennett expects the U.S. dollar to appreciate, and that U.S. growth will increase by 2 to 3 percent. Lower oil prices should boost consumption in international developed markets, with the Euro area and Japan growth both expected to be about 1 percent. He expects emerging markets growth will continue to slow, which impacts global growth. He anticipates the highest growth in China, India, and Asia ex-Japan, with Latin America at lower growth expectancy and Brazil flat. He said an increase in U.S. interest rates could impact emerging markets, but careful country selection can still offer higher returns and yields than other fixed income asset classes.

Mr. Kennett discussed potential risks in 2015 including policy issues, quantitative easing, deflation, central bank actions, a slowdown in China, geopolitical issues, climate change, commodity prices, income and wealth inequality, mispricing due to liquidity injections, and other social matters. He reviewed the global GDP forecast.

He said implications for the fixed income portfolios are to keep durations close to neutral versus their respective benchmarks, keep focusing on emerging markets, seek liquidity via Treasuries, and add credit exposure for income return.

[Treasurer McIntire returned at 10:49 a.m.]

Mr. Kennett reviewed the 10-year Treasury yield; GDP, unemployment, and inflation projections; government bond yields; investment grade credit spreads; yield curve changes; and returns for both the Barclays Aggregate and Universal indices.

[Mr. Nakahara left at 10:51 a.m.]

The fixed income portfolios totaled over \$34 billion as of December 31, 2014; the retirement funds represent 51 percent, Labor and Industries' funds represent nearly 38 percent, and smaller funds make up the balance. He said that credit is the largest sub-asset allocation. Mr. Kennett reported the retirement fund underperformed by 75 basis points in 2014 due to the portfolio's short duration, oil company bonds widening, and underperformance of some emerging markets investments. Mr. Kennett reviewed the retirement fund's country, industry, and currency allocations and reasons for the weightings. The portfolio is comprised mostly of U.S. holdings, at just over 50 percent. He said the focus going forward will be on Anglo countries, Asia, and Latin America.

[Mr. Miller left at 10:55 a.m.]

Mr. Nierenberg asked if there is any consideration of decreasing the portfolio's allocation to Brazil and what type of company bonds are held there. Mr. Kennett said he does not think any Brazil holdings should be sold. Bonds held include Brazil's large banks, Petrobras, and food and beverage companies. Mr. Longbrake commented that his main concern is Petrobras. Mr. Nierenberg noted, with the exception of Petrobras, they appear to be strong investments.

[Mr. Miller returned at 11:03 a.m.]

Mr. Kennett said the Labor and Industries' funds are managed similarly to the retirement funds but with different goals and risk constraints, keeping in mind the goals to maintain solvency and rate stability. He said that during the year staff sold TIPS holdings within the portfolio and put the proceeds into credit.

He reviewed the goals and returns for the Permanent Funds, Intermediate Bond Fund, Savings Pool, Guaranteed Education Tuition TIPS, U.S. TIPS, and Developmental Disabilities Endowment Fund. He said the 10-year returns are very good for all funds. He commented on the positive results provided by the policy change last year within the Savings Pool.

Mr. Kennett said that fixed income decisions are made from a framework involving analyses of macro-economics, market and industry fundamentals, company research, security valuations, and judgment. Mr. Kennett credited the eight-member Fixed Income team for their hard work and success.

[The Board recessed at 11:15 a.m., and reconvened in open session at 11:28 a.m.]

ADMINISTRATIVE COMMITTEE REPORT

Chair Frost reported the Administrative Committee met earlier this morning. She said that Ms. Whitmarsh gave a comprehensive report on staff projects and thoughts for the 2015 Strategic Plan. The Committee provided feedback, which Ms. Whitmarsh will incorporate and then present the proposed 2015 Strategic Plan at the February Board meeting. Also, Ms. Lobdell provided the Committee with a 2014 year-in-review report, which will also be shared with the Board in executive session.

Chair Frost 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. She said the executive session was expected to last until about 11:45 a.m. at which time the Board would reconvene in open session.

[The Board went into executive session at 11:29 a.m.]

Assistant Attorney General's Year-in-Review

[The Board reconvened in open session.]

EDUCATION SESSION

Economically Targeted Investments (ETI) Annual Report

Ms. Kruzel introduced the annual report of ETI activities within Washington State. She reminded the Board that the objective of the program is to produce investment returns to pension fund assets with a possible collateral effect of assisting the regional economy under certain circumstances. She noted the ETI policy has been updated over time, but particularly in 2003. Since then the Legislature has pursued ways to assist the Board in its focus, including proposed legislation. While the Board agrees that Washington is an excellent place to invest a portion of the Commingled Trust Fund (CTF), it has a primary fiduciary duty to invest and entrust managed funds consistent with policies and laws for the exclusive benefit of fund beneficiaries. As such, all of the Board's investment policies and procedures are designed to maximize returns at prudent level of risk, including the ETI policy.

Ms. Kruzel said the ETI policy was written, in part, to address specific questions about how the WSIB invests or does not invest in certain local firms and local companies, and to facilitate discussion with general partners (GPs) and others about in-state opportunities. Staff seeks to identify institutional quality opportunities in state, clarify if WSIB GPs are investing in Washington, and determine how the WSIB can contribute to the local investment environment. Research, ground work, and multiple contacts were done early in the policy's implementation to build awareness for WSIB policies, procedures, and investment strategy and to help others understand boundaries for investments. Ms. Kruzel provided a high level summary of staff's regional activities during 2014.

Mr. Mooers reviewed the venture capital transactions and dollars invested for the July 1, 2013, through June 30, 2014, period within Washington as compared to the entire Northwest and U.S. He reported that Washington investments amounted to 2.9 percent, which is an increase from last year's result of 2.6 percent. He noted that larger deals are getting done. U.S. initial public offering activity was \$85 billion in 2014; its highest level since 2000. U.S. venture capital fundraising for the nine months ended September 30, 2014, was \$23.8 billion; and venture capital fundraising is around the same level as the 2005-2007 time periods.

Mr. Mooers reviewed a listing of the 10 largest private fundings for Washington companies in 2014. A listing of the capital raised by six Washington-based companies due to an initial public offering was presented.

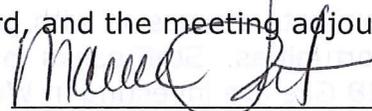
Mr. Mooers reported the twelfth annual poll of GP activities in Washington State showed that 1,029 deals were reviewed; 36 of 47 partners with funds actively investing domestically looked at Washington deals; and 26 transactions were completed by 13 GPs. This shows good engagement in Washington State by WSIB GPs. He reviewed annual private equity investments and transactions in Washington State during the 2007 to 2014 time periods, with a low of \$4.5 million invested in 2012 and a high of \$93.9 million invested in 2011.

Mr. Mooers said, as of June 30, 2014, the fair market value of investments in Washington State by WSIB GPs was \$234.1 million in 42 funds, by 27 GPs, and diversified across 9 industries. The technology sector had the largest increase over the past year. Washington investments from all asset classes in the WSIB's portfolio were valued at \$1.6 billion, which represented 2.07 percent of the CTF. He reviewed the dollars invested in Washington State by all asset classes for the 2003-2014 time periods.

In response to Mr. Miller's question about other state pension funds' activity within Washington State, Ms. Kruzel said past activities have shown that other states active in private equity and venture capital do invest in Washington, but the data is not as readily available as it had been. Ms. Whitmarsh noted the WSIB does not have any specific bias to Washington State private equity investments, as it cannot influence where GPs invest. Mr. Bruebaker said the bias is more toward time spent looking within the state. In response to Treasurer McIntire's questions about returns on Washington State investments relating to the overall portfolio, Ms. Kruzel said the returns still lag all private equity investment returns but have improved over the past three years. A discussion ensued on the top-tier GPs and any relationship with geographical investing.

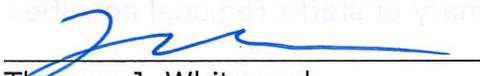
OTHER ITEMS

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



Marcie Frost
Board Chair

ATTEST



Theresa J. Whitmarsh
Executive Director