

**STATE OF WASHINGTON  
STATE INVESTMENT BOARD**

Public Markets Committee Meeting  
Minutes

February 4, 2003

The Public Markets Committee met in open public session at 11:35 A.M. at the Washington State Investment Board (WSIB) office at 2424 Heritage Court Southwest, Olympia, Washington.

Members Present: Charles Kaminski, Chair  
Debbie Brookman  
Glenn Gorton  
Jeff Hanna  
Robert Nakahara  
Lee Ann Prielipp

Other Board Members Present: George Masten

Members Absent: Patrick McElligott  
Representative Sommers

Others Present: Joe Dear  
Gary Bruebaker  
Nancy Calkins  
Diana Will  
Linda Lester  
Maria Tosteson Rosen  
William Kennett  
Bill Ireland  
Kristi Bromley

Barclays Global Investors

Patrick Hoban, Chief Credit Officer  
Jim Keagy, Client Service Team Manager  
David LaHorgue, Global Cash Management  
David Lonergan, Money Market Portfolio Management

BlackRock

Rich Hoerner, Managing Director  
Barbara Novick, Managing Director  
Tom Rudwall, Vice President

Federated Investors, Inc.

Debbie Cunningham, Senior VP and Portfolio Manager

Darlene Dreano, Internal Client Service/Operational Support Team  
Jim Heaton, Senior Vice President, Institutional Sales  
Greg Spradling, Client Service Representative

Harris Investment Management, Inc.  
Don Jackson, Relationship Manager  
Randy Royther, Senior Partner, Portfolio Manager

State Street Global Advisors  
Sue Bonfeld, Principal  
Vince Thornton, Principal

The meeting convened at 11:35 A.M. with Chair Kaminski identifying members present.

**ADOPTION OF MINUTES – NOVEMBER 5 AND NOVEMBER 19, 2002**

**Ms. Prielipp moved to adopt the Public Markets Committee minutes of November 5 and November 19, 2002. Ms. Brookman seconded, and the minutes passed unanimously.**

**PUBLIC EQUITY – STATE STREET GLOBAL ADVISORS NON-US. EQUITY INDEX INVESTMENT MANAGEMENT CONTRACT EXTENSION**

Ms. Calkins stated that the investment management contract with State Street Global Advisors (SSgA) will expire on March 31, 2003, and that staff requests that the Committee recommend that the Board authorize the executive director to extend the contract for the final one-year extension through March 31, 2004. Ms. Calkins reviewed the timeframes for the upcoming international program review and international manager search.

**Ms. Prielipp moved that the Public Markets Committee recommend that the Board authorize the executive director to extend the contract with State Street Global Advisors for the final one-year extension through March 31, 2004, as provided in the existing terms of the contract. Ms. Brookman seconded, and the motion passed unanimously.**

**PUBLIC EQUITY – WATCHLIST UPDATE – SCHRODER INVESTMENT MANAGEMENT NORTH AMERICA**

Mr. Bruebaker stated that Schroder Investment Management North America (Schroder) was hired by the WSIB in the fourth quarter of 1995. As of December 31, 2002, the portfolio was valued at \$79.1 million. Schroder met with the Committee on June 4, 2002, and with staff on September 27, 2002. During 2002, Schroder made changes to increase accountability, realign the portfolio around sectors rather than countries, and reduce turnover and transaction costs.

Mr. Bruebaker reviewed Schroder's performance, noting that the benchmark for this portfolio is the MSCI Emerging Markets Free index, and that WSIB policy 2.10.100 states that the active international managers are to "strive to markedly exceed the returns of the passive benchmark." Mr. Bruebaker noted that, while he is very cautious and reserved in making recommendations to hire or fire managers, his recommendation is to terminate this manager and, given the upcoming review of the international program and where this asset class is relative to asset allocation targets, transition the assets to the passive developed markets portfolio.

Ms. Sullivan introduced herself and Mr. Clark and reviewed Schroder's new leadership structure. Mr. Clark discussed Schroder's research capability, the emerging markets investment team, analyst coverage, Schroder's grading system for portfolio holdings, including the relative performance of buy and sell rated stocks since the introduction of the rating system in April 2001, best ideas research portfolio, and the portfolio implementation process. Mr. Clark addressed how he manages his two roles of emerging markets CIO and CEO of Schroder Investment Management North America and noted that his top three priorities are: 1) ensure that the emerging markets product performs appropriately for clients; 2) leadership of his staff; and 3) strategy for U.S. business.

Mr. Clark reviewed Schroder's market expectations over the last quarter, including risks for the portfolios, and performance drivers. He reviewed performance attribution, overall and by country and stock selection, as well as changes in the portfolio over the fourth quarter of 2002. He reviewed their investment outlook and strategy, portfolio characteristics, risk, and portfolio construction.

Discussion ensued regarding geopolitical risk, performance attribution, and changes Mr. Clark has made to the management of the portfolio.

[The Committee recessed briefly for lunch at 12:20 P.M. and reconvened at 12:30 P.M.]

Mr. Bruebaker stated that when Schroder has outperformed they have done so by a good margin, but they have had 11 quarters of underperformance recently, excluding last quarter. He noted that the change to the sector focus was done in April 2001, seven quarters ago, and that the manager has had sufficient time to show that they can add value and have not done so.

Discussion ensued regarding the length of time Mr. Clark has been at the organization, the forthcoming international program review, transition management, and staff's comfort level with the depth and breadth of the Schroder team.

The consensus of the Committee was to maintain Schroder on Watchlist, continue to monitor them closely, and assess the firm's role in the portfolio in the context of the international equity program review.

## **BENCHMARK REVIEW UPDATE**

Mr. Bruebaker discussed Wilshire's announcement that it will introduce a new Investable Wilshire 5000 index effective June 30, 2003, while continuing the current Wilshire 5000 index with minor modifications. The Investable Wilshire 5000 index will consist of 5000 stocks, compared to the approximately 6000 stocks included in the Wilshire 5000. Mr. Bruebaker reviewed the announced changes to the current Wilshire 5000 and the construction of the Investable Wilshire 5000, including the elimination of cross holdings, additions and deletions to the indices, reconstitution of the Investable Wilshire 5000, and the handling of stocks which stop trading. Mr. Bruebaker noted that no additional information has been received related to potential changes to the Morgan Stanley Composite Indices, and that staff will continue to update the Committee monthly.

[The Committee took a brief recess at 12:50 P.M. and reconvened at 12:57 P.M.]

### **U.S. MONEY MARKET AND/OR SHORT-TERM INVESTMENT FUNDS FINALIST INTERVIEWS**

Ms. Will stated that staff selected five firms for finalist interviews by the Committee to provide three types of U.S. money market and/or short-term investment funds: a money market or enhanced yield option for the Plan 3 participants, a general money market for the tax-exempt and taxable non-retirement options, and a government money market fund for restricted funds, such as the Emergency Reserve Fund. She noted the importance of operational timelines for the two daily valued funds that are used in defined contribution options. Mr. Bruebaker stated any of the five firms would do a very good job of managing these funds, and noted that staff prefers that the same manager be used for the government and general money market funds, unless there is a compelling reason otherwise.

#### *Barclays Global Investors (BGI)*

Mr. Keagy introduced himself, Mr. Hoban, Mr. LaHorgue, and Mr. Lonergan. He noted that their presentation would address five dimensions of cash management: liquidity, returns, safety, service and value. He reviewed BGI's total assets under management, amount in cash under management, ownership structure of the firm, benefit of their firm size, benefit of their close proximity to the WSIB, and strategic relationship between BGI and the WSIB. He noted that the WSIB's daily access timelines can be accommodated with custom daily reports available via multiple media. Mr. Keagy reviewed BGI's investment philosophy of total performance management – managing returns while controlling risk and transaction costs.

Mr. Lonergan reviewed BGI's portfolio management team, which includes an interest rate team, credit team and liquidity team, and tactics utilized by BGI to enhance performance. Mr. Hoban reviewed their risk controls, including process, oversight and risk budgeting framework.

Mr. LaHorgue reviewed their three product proposals, one mutual fund and two short-term investment funds, including credit quality, maturity, operational timelines, performance, and fees.

A question and answer period ensued, focused on operational timelines, how close they have ever come to “breaking the buck,” and any audit or compliance findings that the Committee should be aware of, to which BGI responded there were none.

BlackRock

Ms. Novick introduced herself, Mr. Hoerner and Mr. Rudwall. She reviewed the history of BlackRock, including ownership structure, total assets under management, assets in liquidity products, and products offered by BlackRock. She also described the firm’s liquidity experience, conservative risk-managed approach, and its relationship with the WSIB. Mr. Hoerner reviewed their liquidity team, investment philosophy (quality, stability, liquidity, and yield), investment process, and credit research.

Chair Kaminski asked if they had a measure of how close they had ever come to “breaking the buck.” Mr. Hoerner responded that they closest they had ever come was 99.98¢.

Mr. Hoerner reviewed their investment process, portfolio structure, and credit and risk management processes. Mr. Rudwall stated that BlackRock’s emphasis in on safety, quality, liquidity and yield, in that order. He reviewed the operational timelines and investment options for their various money market funds.

A question and answer period ensued, focused on operational timelines, and any audit or compliance findings that the Committee should be aware of, to which BlackRock responded there were none.

Federated Investors, Inc.

Mr. Spradling introduced himself, Ms. Cunningham, Ms. Dreano and Mr. Heaton. Mr. Heaton provided an overview of the firm, including history, ownership structure, total assets under management, assets in money market products, firm growth, money management style, institutional focus, and their presence on the West Coast and Washington. He reviewed Federated’s portfolio management team, credit expertise, and client service structure.

Ms. Cunningham reviewed their investment process and investment management team. She reviewed the specifics of the two proposed investment options, including assets in each option, types of securities held, portfolio construction, performance, credit ratings, and risk management. She reviewed their decision making process, which uses the underlying principles of preservation of capital, liquidity and yield, their credit review process, portfolio structure, portfolio monitoring, and risk controls.

Chair Kaminski inquired if they quantified the probability of “breaking the buck” and how close they had ever come to doing so. Ms. Cunningham discussed their processes for pricing and risk management, noting that they were at the 99.75¢ threshold when interest rates rose unexpectedly in 1994.

Ms. Dreano reviewed their client service group, operational support, operational timelines, and availability and delivery options for information.

A question and answer period ensued, focused on operational timelines and any audit or compliance findings that the Committee should be aware of, to which Federated responded there were none.

[Mr. Dear was no longer in attendance at 3:05 P.M.]

[The Committee took a brief recess at 3:05 P.M. and reconvened at 3:10 P.M.]

Harris Investment Management, Inc.

Messrs. Jackson and Royther introduced themselves. Mr. Jackson provided a firm overview, including ownership structure, total assets under management, assets in cash products, philosophy, people, and investment products offered. Mr. Royther reviewed the cash products portfolio management team and their cash products organization, which includes quantitative, taxable credit and tax-exempt research staff, and staff that cover the various cash products. He reviewed their investment process and performance drivers: interest rate risk management, liquidity premium, sector spreads, and issue selection.

Chair Kaminski asked how close they had come to ever “breaking the buck.” Mr. Royther reviewed their risk management process and stated that they had never been close.

[Mr. Dear was in attendance at 3:34 P.M.]

Mr. Royther reviewed portfolio characteristics, including credit quality and sector composition, the number of holdings, average maturity, performance and risk controls. Mr. Jackson reviewed operational timelines, reports and client service.

A question and answer period ensued regarding performance numbers, performance attribution, average maturity, term structure, and operational timelines.

State Street Global Advisors (SSgA)

Ms. Bonfeld introduced herself and Mr. Thornton. She provided an overview of SSgA, including ownership structure, total assets under management, assets in cash, and staff. Mr. Thornton reviewed SSgA’s investment process, compliance and risk controls, technology, credit and quantitative analysis, portfolio management team, decision-making process, investment strategy, investment guidelines, and objectives of their cash product.

Chair Kaminski asked what their confidence level was that they would not “break the buck” and how close they had ever come to doing so. Ms. Bonfeld responded that, on a separately managed securities lending product they had reached 99.72¢ in the past, but that she was not aware of how close the cash product may have been.

Mr. Thornton reviewed operational timelines, trade verification process, performance, and portfolio characteristics, including sector and maturity distribution. Ms. Bonfeld reviewed reporting capabilities and fee.

Mr. Nakahara asked if there were any audit or compliance issues of which the Committee should be aware, to which Ms. Bonfeld responded that there were none.

[The Committee recessed at 4:21 P.M. and reconvened at 4:32 P.M.]

Discussion ensued regarding the investment vehicle that the Other Trust Funds could be invested in, and the assets currently in each cash option.

Mr. Bruebaker reviewed the operational timeframe requirements of the Horizon Funds, and noted the preference for not changing managers for participant-driven options unless there was a compelling reason to do so. He stated that staff's recommendation was that BlackRock be retained as the manager for both the government and general money market funds, and that BGI be selected as the manager for the Plan 3 money market option.

Discussion ensued regarding staff's recommendation, operational timelines, risk management, reporting timeliness, transition costs, business concentration risk, and performance. Chair Kaminski commented on the restrictive "playing field" for money market funds and noted that, average maturity issues aside, the major differentiator between the proposals for the Plan 3 money market option was price (i.e., fees or yield). Further discussion ensued differentiating options based on the risks versus returns, as well as the importance of the operational timelines for the daily valued funds.

[Mr. Dear was no longer in attendance at 4:52 P.M.]

**Ms. Prielipp moved that the Public Markets Committee recommend that the Board select BlackRock Fed Fund as the government money market fund, BlackRock Temp Cash as the general money market fund, and Barclays Global Investors to provide the Plan 3 money market option. Ms. Brookman seconded, and the motion passed unanimously.**

## **OTHER ITEMS**

There being no further business to come before the Public Markets Committee, the meeting adjourned at 4:56 P.M.