

**STATE OF WASHINGTON
STATE INVESTMENT BOARD**

Public Markets Committee Meeting
Minutes

May 6, 2003

The Public Markets Committee met in open public session at 1:02 P.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present: Charles Kaminski, Chair
Debbie Brookman
Jeff Hanna
Robert Nakahara

Members Absent: Glenn Gorton
Patrick McElligott
Representative Sommers

Others Present: Joe Dear
Gary Bruebaker
Nancy Calkins
Bill Kennett
Linda Lester
Diana Will
Liz Mendizabal
Kristi Bromley

Michael Steinreuck, Artisan Partners
Lori Johnson, Artisan Partners
Janet Becker-Wold, Callan Associates
Michael O'Leary, Callan Associates
Paula Pretlow, Capital International
Victor Kohn, Capital International
Nick Timberlake, F&C Emerging Markets, Limited
William Ducas, F&C Emerging Markets, Limited
Erin Blake, Nicholas-Applegate Capital Management
Loretta Morris, Nicholas-Applegate Capital Management
Michael Fredericks, Nicholas-Applegate Capital Management

The meeting convened at 1:02 P.M. with Chair Kaminski identifying members present.

REVIEW AND APPROVAL OF MINUTES –APRIL 1, 2003

Chair Kaminski announced that, due to a lack of quorum, adoption of the April 1, 2003, meeting minutes will be deferred to the June 3, 2003, Public Markets Committee meeting.

PUBLIC EQUITY – INTERNATIONAL DEVELOPED MARKETS INVESTMENT MANAGEMENT CONTRACT EXTENSION

Mr. Bruebaker stated that the contracts for the six international developed markets investment managers are eligible for the second, and final one-year extension. He noted that this extension requires an increase to the contract amount for Artisan Partners (Artisan), Delaware International Advisors (Delaware), Nicholas-Applegate Capital Management (NACM), and Putnam Investments (Putnam). Staff built the increases to accommodate a seven percent increase in the capital markets.

Chair Kaminski announced that the consensus of those Committee members present was to forward this item to the Board and for the Board to authorize the executive director to extend the contracts with Artisan Partners, Delaware International Advisers, Dresdner RCM Global Investors, Nicholas-Applegate Capital Management, Putnam Investments, and Pырford International for the final one-year extension through June 30, 2004, as provided in the existing terms of the contracts, with the appropriate increases to the fee ceilings.

PUBLIC EQUITY – EDUCATIONAL SESSION – GAINING EMERGING MARKETS EXPOSURE IN A DIVERSIFIED RETIREMENT FUND

Mr. Bruebaker said that this was the third educational session related to the international equity program review. The Committee has heard presentations on transition management and the outlook for international markets. The focus for this month's educational session was emerging markets exposure in a diversified retirement fund. In June, the educational session will focus on value versus growth and active versus passive investing. In July, Callan Associates (Callan) will make a

presentation on currency approaches and then Callan and WSIB staff will make their respective recommendations regarding the structure of the international program.

F&C Emerging Markets, Limited

Mr. Timberlake reviewed reasons for the poor performance of emerging markets in the late 1990s, and provided a five-year outlook for emerging markets, during which time he believes that emerging markets will be one of the best performing equity assets. He reviewed graphs depicting the state of emerging markets and positive factors for those markets; including the vast majority of global population, land mass, and natural resources, favorable demographics, and an increasing share of world trade.

He reviewed what he sees as the benefit of specialized emerging markets managers – depth and breadth of coverage – and he reviewed the low correlation of emerging markets with the developed markets. He summarized by stating that emerging markets specialists provide greater coverage, the correlation with developed markets is often low, and that excellent market timing is required to opportunistically invest in the asset class.

Capital International, Inc.

Mr. Kohn reviewed the decision points for determining the vehicle for investing in emerging markets within an integrated developed/emerging markets portfolio. He said that the first decision was to determine the appropriate allocation to emerging markets. After that decision has been made, the next decision is whether to invest in a vehicle such as a commingled fund or to buy specific stocks. He reviewed the advantages and disadvantages of each. Advantages of a commingled fund include capturing the best ideas of emerging markets specialists and the fund is already registered in all eligible emerging markets countries. Advantages of buying specific stocks include holding typically larger, more liquid stocks, while a disadvantage is a narrow list of companies.

Artisan Partners

Mr. Steinreuck spoke about the volatility of emerging markets and said that segmenting the markets instead of thinking globally can lead to implementation issues. He said that Artisan argues for not having a separate emerging markets allocation since the best emerging markets will eventually evolve into developed markets anyway. Emerging markets exposure can be obtained through other holdings and opportunistically instead of by separate mandates.

Nicholas-Applegate Capital Management

Mr. Fredericks stated that the emerging markets are a meaningful part of the ACWI Ex. U.S. index. He reviewed issues to consider for emerging markets investment vehicles, including: the cost to trade in restrictive countries, ADR premiums in some markets, and equity-linked instruments as a viable alternative. In an integrated portfolio, emerging markets investments are in liquid stocks, which tend to be globally competitive companies, while investing in smaller, less liquid stocks (which do have potential) would require an emerging markets specialist.

The presenters, Committee, staff, and Callan discussed the most efficient way to tap into all international stocks, focusing on the allocation decision, separate emerging markets mandate or allowing a manager to invest in all international stocks, the role research plays in emerging markets investing, volatility and rebalancing issues, the importance of macro and sector analysis, and liquidity and portfolio turnover issues.

[The Committee recessed at 2:18 P.M. and reconvened at 2:28 P.M.]

PUBLIC EQUITY – INVESTMENT MANAGER PORTFOLIO REVIEWS

F&C Emerging Markets, Limited

Mr. Ducas introduced himself and Mr. Timberlake. Mr. Timberlake reviewed F&C's investment philosophy, and noted that F&C believes emerging markets are inefficient, behave differently than

developed markets, and that country selection is the logical starting point. He reviewed their investment process, which includes a team approach, a top-down macroeconomic approach to country selection, in-house research, bottom-up/fundamental stock selection by country and sector specialists, and disciplined portfolio construction.

He stated that country selection has historically provided the majority of the value added, with stock selection periodically holding back returns. He said that last year F&C reviewed the investment process from beginning to end and made changes as a result of this review. Stock selection, which has not worked well, was a focus of change. The research effort was increased and sector teams formed to share ideas between country and security specialists. He said that this has resulted in more conviction on individual security ideas.

Portfolio construction was the second area of change. Previously, they overweighted the countries they had a positive view on; they now have increased the emphasis to take bigger stakes in individual securities that they already held. Senior portfolio managers are involved in individual security selection in order to take bigger positions where they have a higher level of conviction. Mr. Timberlake stated that they believe these changes are working, but realize it has been a short period of time.

Discussion ensued regarding F&C's performance, with Mr. Bruebaker noting that, while their performance is not as bad as it was previously, they are still underperforming. Mr. Timberlake said that was a fair point and reviewed their performance for the first quarter of 2003, one-year, three-year, five-year, and since inception time periods. He said that year-to-date they have a positive return. He said that their poor performance was the reason for conducting the review of their investment process where they looked at why they have not met their targets and what they are doing now to make those targets. He said that they are only four to five months into the plan but are seeing positive results.

Mr. Timberlake reviewed the performance attribution for the first quarter of 2003, which was due to both stock and country selection, and reviewed their key risk controls. Mr. Hanna noted that their country allocations were remarkably close to the index, and Mr. Timberlake responded that they are

still cautious on the global and U.S. economic outlook and have recently become more aggressive and have been buying into markets that would benefit from quick resolution of the Iraq war.

Mr. Ducas concluded that they strongly believe that F&C provides the WSIB with deeper coverage in the emerging markets and that, although they have experienced performance problems, they have addressed those issues and shared with the Committee what they are doing to improve performance.

Capital International, Inc.

Ms. Pretlow introduced herself and Mr. Kohn. She reviewed their investment philosophy, style, and approach, and stated that they manage all of their portfolios exactly the same regardless of strategy. She said that Capital believes that good people make a difference and that a global perspective is beneficial to adding value across asset classes. They have a core style, which looks to add value across the spectrum and their Multiple Portfolio Manager System builds portfolios one stock at a time and enables each manager and research portfolio to invest in their respective highest conviction ideas.

She reviewed performance of the WSIB portfolio for the first quarter of 2003, one-year and since inception time periods. She said that while they have underperformed for these time periods, Capital has outperformed over the medium and long term with the Emerging Markets Growth Fund outperforming the Emerging Markets Free index and the S&P since inception of the fund.

Mr. Kohn reviewed the 20 largest stocks in the portfolio as of March 31, 2003, and noted that almost 45 percent of the portfolio is in these 20 stocks. He reviewed the portfolio diversification by sector and industry, sector weightings by country, and diversification by regions and individual countries. Mr. Kohn said that the biggest detriment to performance was a heavy underweight in South Africa, as well as overweights in Mexico, Brazil, and telecoms. Mr. Kohn reviewed their major market weightings versus the index from December 31, 1993, to March 31, 2003. Further discussion took place regarding the Multiple Portfolio Manager System, with Mr. Kohn stating that portfolio managers are measured by how their portfolios perform against the index.

Nicholas-Applegate Capital Management

Ms. Blake introduced herself and Ms. Morris. Ms. Blake provided an overview of the firm, including total assets under management. She also reviewed personnel changes in the firm, notably the addition of Horacio Valeiras as Chief Investment Officer and the firm reorganization in October 2002, which resulted in the departure of 18 investment professionals and the consolidation of the emerging and international markets teams. Ms. Morris noted that the restructuring has improved performance, increased accountability, and eliminated duplication of research functions by creating one integrated team with a global research platform.

Ms. Morris reviewed NACM's investment philosophy and investment process, including stock selection and portfolio construction. She reviewed their performance for the first quarter 2003, one-year, three-year, and since inception time periods and reviewed performance attribution by security selection, style, sector, region/country, and currency. Ms. Morris reviewed their risk controls and explained the larger variances in performance from the index. Mr. Bruebaker noted that, although NACM cited performance information gross of fees, staff focuses on performance net of fees.

Artisan Partners

Mr. Steinreuck introduced himself and Ms. Johnson. He reviewed Artisan's investment objectives and guidelines. He provided an update on the firm including total assets under management, assets under management by product line, and ownership structure. He reviewed their investment philosophy and stock selection. He said that they buy the best companies regardless of size and pay attention to valuation. He reviewed their decision-making process, portfolio construction, performance for the first quarter of 2003, one-year, three-year, and since inception time periods, and performance as of April 30, 2003, for the year-to-date and since inception periods. Mr. Steinreuck reviewed the portfolio structure, sector weightings, major under and overweights by sector, which resulted from stock selection, and noted the drivers of performance. He provided a sector attribution analysis for the first quarter of 2003 and reviewed the portfolio characteristics versus the index.

PUBLIC EQUITY – WATCHLIST UPDATE

Mr. Bruebaker noted that the Watchlist update information in the Committee packet was provided for the Committee's information and there are no changes at this time.

PUBLIC EQUITY – BENCHMARK REVIEW UPDATE

Mr. Bruebaker said that Wilshire still has not publicly announced its partners for the Wilshire 5000 index changes and has made no additional changes to the benchmark itself. MSCI has not announced anything new either. Staff will continue to report on this item monthly and intends to have a final recommendation to the Committee by early fall.

Chair Kaminski inquired about one of the Deferred Compensation Program managers. Mr. Bruebaker said that staff would be meeting with the Department of Retirement Systems to discuss this manager as well as other issues.

Discussion ensued pertaining to the status of managers on Watchlist and options for transitioning assets if the Board terminated one or more of the managers. The Committee and staff discussed transition management, the development of a request for proposals (RFP) for transition management services, the expense and effectiveness of transitioning assets, and the timing of the international program review and RFP process.

OTHER ITEMS

There being no further business to come before the Public Markets Committee, the meeting adjourned at 4:50 P.M.