

**STATE OF WASHINGTON
STATE INVESTMENT BOARD**

Public Markets Committee Meeting
Minutes

February 3-4, 2004

The Public Markets Committee met in open public session at 9:01 A.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present: Glenn Gorton, Chair
Jeff Hanna (via teleconference)
Charles Kaminski
John Magnuson
Robert Nakahara
Dave Scott
Paul Trause (in attendance on February 4, 2004)

Members Absent: Michael Murphy
Representative Sommers

Other Board Members Present: George Masten

Others Present: Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Nancy Calkins, Senior Investment Officer – Public Equity
Linda Lester, Investment Officer – Public Equity
Bill Kennett, Senior Investment Officer – Fixed Income
Erwin Vidallon, Finance and Budget Manager
Kathy Butler, Administrative Assistant – Contracts
Brian Shrader, Office Assistant Senior – Public Markets
Kristi Bromley, Administrative Assistant – Investments

Paul Silver, Assistant Attorney General

Michael O’Leary, Callan Associates
Robert C. Jones, Goldman Sachs Asset Management
Tom Dempsey, Goldman Sachs Asset Management
Doug Angstrom, Goldman Sachs Asset Management
Michael Lucas, Northern Trust
Steven Santicciolli, Northern Trust
Jim Creighton, Northern Trust
J. Holmgren, DSI International Management, Inc.
George Rooney, DSI International Management, Inc.
Richard Vella, Merrill Lynch Investment Managers

Sid Hoots, Merrill Lynch Investment Managers
James Kase, Merrill Lynch Investment Managers
Glen Sergeant, Merrill Lynch Investment Managers
Joe Silver, Merrill Lynch Investment Managers
Andy Olma, Barclays Global Investors, N.A.
Jim Keagy, Barclays Global Investors, N.A.
Ananth Madhavan, Barclays Global Investors, N.A.
Blake Grossman, Barclays Global Investors, N.A.
Francis Enderle, Barclays Global Investors, N.A.
Diane Shew, Barclays Global Investors, N.A.
Carl Gilchrist, Barclays Global Investors, N.A.
Lynn Blake, State Street Global Advisors
Peter Leahy, State Street Global Advisors
Neil Tremblay, State Street Global Advisors

[Names of other individuals attending the meeting are not included in the minutes but are listed in the permanent record.]

The meeting convened at 9:01 A.M. with Chair Gorton identifying members present.

**INTERNATIONAL DEVELOPED MARKETS EQUITY ENHANCED INDEX
INVESTMENT MANAGER FINALIST INTERVIEWS**

Mr. Bruebaker noted that the changes to the retirement fund's international equity program approved by the Board in July 2003 include the option to invest up to half of the 40 percent passive allocation, approximately \$1.25 billion, in an enhanced index strategy. Out of the 12 submissions received in the enhanced index investment manager Request for Proposal, 6 firms were removed from consideration: 3 for not meeting the minimum qualifications and 3 for other issues. The WSIB staff and two of Callan's senior consultants, Janet Becker-Wold and Michael O'Leary, then scored the remaining firms and selected five finalists for interview by the Public Markets Committee.

[Mr. Scott was in attendance at 9:05 A.M.]

Mr. Bruebaker provided a brief overview of indexing versus enhanced indexing, which included definitions, goals, and characteristics of indexing and enhanced indexing.

Mr. Bruebaker stated that staff's recommendation was to assign half of the 40 percent allocation to passive international equity in enhanced indexing and that the specific manager recommendations would be made after the interviews. He noted that the Board-adopted benchmark for the entire international equity program is the Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) ex U.S. and that the MSCI Europe, Australia, Far East (EAFE) plus Canada index is the benchmark for the international developed markets program.

Mr. O'Leary stated that the same process was followed for both the enhanced index and index searches with all candidates analyzed that were identified as possibly meeting minimum

qualifications. He noted that WSIB staff participated in the Callan Manager Search Committee, and that the Search Committee concurred with the selection of the five finalist firms. He noted that there were variations in the products offered by the five finalists and that it was common in the enhanced arena for managers to offer products with varying degrees of tracking error and embedded active risk. Callan believes that all the finalist firms have the capability to manage to the EAFE plus Canada index within the tracking error and risk constraints required by the WSIB.

Goldman Sachs Asset Management (GSAM)

Mr. Angstrom introduced himself, Mr. Jones, and Mr. Dempsey. He provided an organizational overview, including staff, office locations, total assets under management (AUM), and AUM by product area. He provided a representative list of quantitative resource clients and a representative public fund client list.

Mr. Jones reviewed the two components of GSAM's quantitative resources strategy: quantitative equities and quantitative strategies, and noted that the quantitative equities group is responsible for bottom-up stock selection while the quantitative strategies group is responsible for the top-down review. He reviewed performance highlights for GSAM's various structured products and how the structured EAFE product could be managed for lower or higher tracking errors. He reviewed the investment process and how risk is diversified between stock selection (bottom-up) and country/currency selection (top-down) to produce less overall risk in the portfolio.

Mr. Dempsey reviewed the factors GSAM deploys in evaluating countries and currencies to build portfolios with diverse sources of alpha: risk premium, valuation, momentum, and macroeconomics.

Mr. Jones reviewed GSAM's process for evaluating stocks, which includes valuation, analyst sentiment, and momentum, and reviewed GSAM's trade execution practices. He reviewed the structure of a sample portfolio and the five largest stock over and underweightings versus the index.

Mr. Dempsey reviewed performance and performance attribution for the structured EAFE product as of December 31, 2003. He also reviewed the performance of GSAM's structured Canada product as of December 31, 2003.

A question and answer period ensued focused on tracking error, fees, risk management, and strategies employed.

Mr. Kaminski inquired about the recent Wall Street Journal article regarding the Initial Public Offering preference given to eBay officials by Goldman Sachs and the Spear, Leeds & Kellogg regulatory investigation. Messrs. Dempsey and Jones responded that while they could not speak specifically to the issues that pertained to the overall Goldman Sachs firm they could speak to the tight controls in place at Goldman and the corporate culture of doing what is right and appropriate in compliance with both the letter and spirit of the law.

Further discussion ensued regarding the AUM for enhanced international equities, compensation structure for the team involved in enhanced indexing, compliance controls, and risk parameters.

Northern Trust Global Investments (NTGI)

Mr. Lucas introduced himself, Mr. Creighton, and Mr. Santicciolli. He provided an organizational overview, including firm history, total firm AUM, staff, range of product offerings, client relations, type of clients, and quantitative AUM by product type.

Mr. Creighton reviewed the organizational structure for the enhanced international strategies, experience of the team members, investment process, and performance. He reviewed NTGI's investment philosophy and the objectives for performance, risk control, and portfolio configuration.

Mr. Santicciolli reviewed NTGI's investment process, including types of strategies employed, country exposures, and the percent of futures, swaps, and convertibles utilized to gain country exposures. He reviewed the investment process, which includes quantitative and event-driven strategies employed in stock selection. He reviewed risk management, portfolio construction, and performance attribution of the various strategies.

Mr. Lucas reviewed the annualized performance of the enhanced EAFE index fund for the past ten years.

A question and answer period ensued focused on mechanics of employed strategies, risk control, AUM in international enhanced indexing, compensation structure of the enhanced indexing team, and securities lending,

[The Committee recessed at 10:46 A.M. and reconvened at 10:58 A.M.]

DSI International Management, Inc. (DSI)

Mr. Holmgren introduced himself and Mr. Rooney. He provided an organizational overview, including history, total AUM, AUM in enhanced index strategies, representative client list, a review of DSI's fit into the overall business structure of UBS Global Asset Management, AUM by client and product type, and structure of the DSI international team. He reviewed DSI's philosophy, process, and risk control.

Mr. Rooney reviewed DSI's investment process, stock ranking systems, portfolio construction process, risk control process, trade execution system, and portfolio oversight. He stated that DSI utilizes bottom-up fundamental factors to determine if a stock is under valued and different quantitative techniques to determine what factors are effective in the current environment, with the factors then weighted accordingly. He explained how unintentional bets are neutralized, including region and individual security weightings relative to the index, only index constituents included in the portfolio, and monthly rebalancing.

Mr. Rooney reviewed the portfolio characteristics and regional and sector weightings versus the MSCI EAFE as of September 30, 2003, annualized performance since 1999, and the characteristics of a controlled risk portfolio.

A question and answer period ensued focused on performance, portfolio construction, AUM in international enhanced indexing strategy, team member compensation structure, and DSI's fit in UBS Global Asset Management.

[The Committee recessed for lunch at 11:34 A.M. and reconvened at 12:01 P.M.]

Merrill Lynch Investment Managers (MLIM)

Mr. Sergeant introduced himself and Messrs. Silver, Kase, Hoots, and Vella. Mr. Kase provided an organizational overview, including firm history, total AUM, investment professionals, AUM by client type and product type, organizational structure of the quantitative index and enhanced group, representative public fund client list, and MLIM's quantitative business growth.

Mr. Vella reviewed MLIM's investment philosophy, including diversification of strategies and alpha sources, risk control, key professionals of the quantitative team, strategies for stock selection and stock substitution, and quarterly returns since 1992.

Mr. Hoots reviewed the research and stock selection strategies, including over/underweighting stocks based on valuation measures, management signals, and historical pricing patterns.

A question and answer period ensued focused on performance, growth of MLIM's institutional business, compensation structure, strategies employed, and AUM in international enhanced indexing.

Barclays Global Investors, N.A. (BGI)

Mr. Keagy introduced himself and Messrs. Olma, Madhavan, and Grossman. He provided an organizational overview, including firm history, total AUM, product and client types, AUM by product type, and BGI's approach to investing, including local market presence with global management platform, trading cost control, and research focus.

Mr. Olma reviewed the international active equity team professionals; global investment philosophy, which integrates return, risk, and cost; and portfolio characteristics and sector allocation versus the MSCI World ex-U.S. index. He reviewed BGI's stock selection process, portfolio construction, and risk control.

Mr. Madhavan reviewed BGI's focus on research and the scientific research process employed.

Mr. Grossman reviewed performance of enhanced international equity strategies and highlights of BGI's enhanced strategies, including research, trading, risk management, transition management, and strategic partnership.

A question and answer period ensued focused on portfolio construction, compensation structure for the international enhanced indexing team, importance of research in enhanced indexing, and pros and cons of commingled funds versus separate accounts. Mr. Keagy stated that BGI is negotiable on the offered fee levels.

[The Committee recessed at 1:35 P.M. and reconvened at 1:56 P.M.]

Mr. Bruebaker provided staff's recommendation to allocate half of the 40 percent allocation to passive international equity in enhanced indexing split evenly between BGI and GSAM. Mr. O'Leary concurred. Discussion ensued regarding fees, research, risk control, and manager concentration.

Chair Gorton announced that it was the consensus of the members present to forward this item to the Board for consideration of approval of allocating 50 percent of the total international developed markets passive equity allocation to an enhanced index strategy with Goldman Sachs Asset Management and Barclays Global Investors, N.A., subject to continued due diligence and successful negotiation of terms and conditions.

[The Committee adjourned for the day at 2:14 P.M.]

The meeting reconvened February 4, 2004, at 9:01 A.M. with Chair Gorton identifying members present.

**INTERNATIONAL DEVELOPED MARKETS EQUITY INDEX INVESTMENT
MANAGER FINALIST INTERVIEWS**

Mr. Bruebaker noted that the current international index contract expires June 30, 2004, after execution of the three-month extension approved by the Board. With the Committee's consensus recommendation to allocate half of the 40 percent passive allocation to enhanced indexing, approximately \$1.3 billion would be allocated to international indexing. Out of the eight firms that submitted an intent to bid, five did not meet minimum qualifications and one was eliminated during the review process, leaving two for interview by the Public Markets Committee.

Mr. O'Leary stated that the process used for the index search was the same process used in the other international searches Callan has worked on with the WSIB. Callan and the WSIB evaluation team independently scored the three semi-finalists and then met with the Callan Manager Search Committee. The selection of BGI and State Street Global Advisors as the two finalists was unanimous.

[Mr. Scott was in attendance at 9:03 A.M.]

REVIEW AND APPROVAL OF MINUTES – DECEMBER 2, 2003, AND JANUARY 13, 2004

Mr. Trause moved to adopt the minutes of December 2, 2003, as amended, and the minutes of January 13, 2004. Mr. Scott seconded and the motion carried unanimously.

INTERNATIONAL DEVELOPED MARKETS EQUITY INDEX INVESTMENT MANAGER FINALIST INTERVIEWS - CONTINUED

BGI

Mr. Keagy introduced himself, Mr. Enderle, Ms. Shew, and Mr. Gilchrist. He provided an organizational overview, including firm history, indexed AUM, indexed products, types of clients, crossing opportunities afforded to clients, strategic partnership between BGI and WSIB, investment philosophy, and trading cost controls.

Mr. Enderle reviewed the international index team and performance versus the MSCI World ex U.S. index for the past five years including performance drivers and annualized risk level relative to the index. He reviewed the returns, risk control, and cost savings provided by BGI.

Ms. Shew reviewed the investment process, including crossing opportunities in the overall strategy level, country level, and security level. She reviewed BGI's investment approach, including full replication, risk controls, crossing opportunities, and sources of added return: tax management process and securities lending.

Mr. Gilchrist reviewed case studies of BGI's portfolio management system.

A question and answer period ensued focused on manager concentration risk, AUM in international indexing, portfolio construction, compliance with regulatory agencies, trade processing, tax reclaims, crossing, and performance.

State Street Global Advisors (SSgA)

Mr. Tremblay, Mr. Leahy, and Ms. Blake introduced themselves. Mr. Tremblay provided an organizational overview, including history, AUM across asset classes, international indexing staff, core business services, office locations, number of client relationships, and representative list of public fund clients.

Mr. Leahy stated that indexing is core to what SSgA does and reviewed services offered to clients, team experience, breadth and flexibility of products, liquidity sources, crossing capabilities, AUM by product type in global structured products, research capabilities, and transition management. He reviewed the savings achieved through crossing in international developed markets and emerging markets.

Ms. Blake provided an overview of SSgA's MSCI EAFE plus Canada strategy and reviewed portfolio construction, performance, and trading process. She provided a specific liquidity example that SSgA executed for the WSIB and the savings achieved.

Mr. Tremblay reviewed SSgA's security lending process, including risk management and incremental return, noting that SSgA does not include security lending income in returns.

A question and answer period ensued focused on securities lending income, performance, AUM in international indexing, portfolio construction, compliance with regulatory agencies, trade processing, tax reclaims, crossing, and performance.

[The Committee recessed at 10:32 A.M. and reconvened at 10:46 A.M.]

Mr. Bruebaker provided staff's recommendation to select SSgA as the passive international equity manager for the WSIB. He stated that while both SSgA and BGI are premier firms, staff believes having a strategic relationship with each firm adds value and alleviates manager concentration risk. Mr. O'Leary concurred and noted that SSgA was the preeminent international index manager.

Discussion ensued focused on fees and business concentration risk.

Mr. Scott moved that the Public Markets Committee recommends to the Board State Street Global Advisors as the apparently successful offeror for the international developed markets equity index investment mandate, subject to continued due diligence and successful negotiation of terms and conditions. Mr. Trause seconded and the motion carried unanimously.

PUBLIC EQUITY – QUARTERLY WATCHLIST REPORT

Mr. Bruebaker stated that the Watchlist report was provided for the Committee's information. He noted that the Fidelity Overseas Fund was still on the Watchlist, although long-term performance has turned around. He reported two internally managed funds were placed on Watchlist on February 2: the Bond Market Fund and the Horizon Funds. Discussion ensued regarding Fidelity's decision to charge Deferred Compensation participants fees in an attempt to restrict excess trading.

OTHER ITEMS

There being no further business to come before the Public Markets Committee, the meeting adjourned at 11:02 A.M.