

**STATE OF WASHINGTON
STATE INVESTMENT BOARD**

Public Markets Committee Meeting
Minutes

October 5, 2004

The Public Markets Committee met in open public session at 1:07 P.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present: Glenn Gorton
Charles Kaminski
John Magnuson
George Masten
Robert Nakahara
Dave Scott
Paul Trause

Members Absent: Jeff Hanna
Representative Sommers

Others Present: Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Theresa Whitmarsh, Deputy Director for Operations
Beth Vandehey, Internal Auditor
William Kennett, Senior Investment Officer – Fixed Income
Nancy Calkins, Senior Investment Officer – Public Equity
Linda Lester – Investment Officer – Public Equity
Diana Will, Investment Officer – Asset Allocation
Kristi Bromley, Administrative Assistant – Investments

Paul Silver, Assistant Attorney General

Jim Keagy, Barclays Global Investors, N.A.
Jeff Hord, Barclays Global Investors, N.A.
Amy Schioldager, Barclays Global Investors, N.A.
Ross McLellan, State Street Global Markets
David Beach, State Street Global Markets
Bob Werner, Frank Russell Securities
Travis Bagley, Frank Russell Securities
Kristi Mitchem, Goldman Sachs & Co.
Pat Sullivan, Goldman Sachs & Co.
Steven Glass, The Plexus Group
Vinod Pakianathan, The Plexus Group

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

The meeting convened at 1:07 P.M. with Chair Gorton identifying members present.

THE PLEXUS GROUP, INC. TRADE EXECUTION ANALYSIS

[Mr. Scott was in attendance at 1:09 P.M.]

Mr. Bruebaker noted that monitoring transaction costs is part of the Board's fiduciary duty relative to evaluating equity managers for best execution and ensuring that trading strategies are consistent with the investment mandates for the managers. Plexus performs an analysis quarterly and reports to the Committee once a year.

Mr. Glass introduced himself and Mr. Pakianathan. He provided a refresher on trade cost analysis, including the components of trading costs (i.e., commissions, market impact, and delayed or timing costs), how Plexus approaches measuring trading costs, and the value of monitoring trading costs. He noted trade cost analysis plays important role in understanding managers.

[Mr. Trause was in attendance at 1:19 P.M.]

Mr. Pakianathan reviewed trading activity for the fiscal year ended June 30, 2004, and stated that it was appropriate to review difficulty of trades executed to determine appropriateness of trade costs. Plexus reviewed the managers that were underperforming the Plexus transaction cost benchmark. Plexus and WSIB staff addressed concerns regarding trading costs with the appropriate managers when issues arouse. Those managers no longer manage portfolios for the WSIB. In response to a question from Mr. Nakahara, Mr. Pakianathan confirmed that the WSIB's current line-up of managers are doing a good job controlling transaction costs and at this time Plexus has no issues regarding trading costs.

BARCLAYS GLOBAL INVESTORS, N.A. (BGI)

U.S. Equity Portfolio Review

Mr. Keagy introduced himself, Ms. Schioldager and Mr. Hord. He provided an organizational update including total firm assets under management, assets under management for the WSIB, performance, and BGI's research capabilities. Ms. Schioldager provided a summary of the WSIB's index accounts with BGI, including market value as of August 31, 2004, portfolio characteristics, and performance. In response to a question from Mr. Nakahara, Ms. Schioldager agreed to confirm that BGI includes pharmaceutical companies in the consumer non-cyclical sector. Ms. Schioldager also reviewed the Dow Jones Wilshire index rebalance and the transition BGI conducted on behalf of the WSIB, noting that final costs were within the expected range for this transition.

Discussion ensued regarding plan sponsor trends that BGI has identified related to real estate investment trusts (REITs) being used as a substitute for direct real estate investing as well as being used in 401(k) plans and the value BGI added by being ahead of the curve related to the Dow Jones Wilshire index restructure. Ms. Schioldager will forward an article on the REIT issue to the Committee members in addition to information quantifying the value added related to the index restructure when it is available.

Discussion of Portable Alpha

Mr. Bruebaker provided an introduction to the portable alpha discussion noting that BGI was hear to speak to the Committee about the other side of a portable alpha strategy that would provide positive alpha in a known fashion. This position within the strategy involves being a provider of liquidity to others that are looking to hit home runs in the portable alpha arena; he likened this to those that provided picks and shovels to the miners in the California gold rush.

Mr. Hord reviewed the philosophy and structure of BGI's portable alpha strategy, including a description of BGI's asset trust and the benefits of the asset trust. The trust matches BGI clients that have portable alpha hedging needs with those clients, such as the WSIB, that are long-term equity holders. The trust combines investors with those different needs in a common vehicle. Investors such as the WSIB receive perfect tracking error and guaranteed enhancement above the index with no management fees. The other type of investor receives a beta management tool that pays them their current beta plus or minus actual alpha, less the premium and trust fees. Discussion ensued regarding how this portable alpha strategy meets the needs of both alpha and beta seeking clients, including safeguards, effect on security lending assets, and returns.

REVIEW AND APPROVAL OF MINUTES – JUNE 15 2004

Mr. Scott moved to adopt the minutes of June 15, 2004. Mr. Masten seconded, and the motion carried unanimously.

[The Committee recessed at 2:25 P.M. and reconvened at 2:36 P.M.]

REVIEW OF INTERNATIONAL EQUITY TRANSITIONS

Mr. Bruebaker noted that two of the transition managers used for the international equity program restructure would report on the transitions they managed as fiduciaries for the Board. In addition, Plexus would provide a summary of the transitions. The two transition managers completed three extremely complex transitions. Mr. Bruebaker also noted that Callan Associates reviewed the transitions. (Their letter was included in the Committee packet.) Mr. Bruebaker noted that the State Street Global Markets transition succeeded even through a declining international market during the transition period. The Frank Russell/Goldman Sachs transition succeeded in moving assets from a broad portfolio to a concentrated LSV portfolio and expertly managed the other active transition even with an unexpected federal holiday for President Reagan's death in the middle of the transition.

State Street Global Markets (SSGM)

Mr. McLellan reviewed the transition that SSGM managed, reallocating assets from the passive international equity option to two new enhanced international equity managers. The coordinated cross between SSGM's transition portfolio and the Frank Russell transition portfolio resulted in a savings to the WSIB of approximately \$1 million. Another overall benefit to the WSIB was SSGM being more passive in their transition so they did not compete with FR/GS for liquidity in the market place. Since SSGM's alpha was smaller and there was less tracking risk in the passive to enhanced transition it was more important for the active-to-active transition to move quickly. Mr. McLellan reviewed the strategy utilized for the transition and noted the importance of managing both sector and country risk. He reviewed the trading results and transition performance. In summary, he noted that the transition was successful operationally with the managers funded in the expected timeframe, and costs were as expected with crossing between two transition portfolios and internal State Street crossing saved over \$2.9 million in potential transaction costs.

Frank Russell Securities (FR) and Goldman Sachs & Co. (GS)

Mr. Sullivan introduced Ms. Mitchem, Mr. Bagley, and Mr. Werner. He reviewed the reasons for utilizing a transition manager. Mr. Werner noted that transition management requires a combination of temporary investment management and trading expertise. Mr. Bagley reviewed the first transition managed by FR/GS on behalf of the WSIB, which resulted in the funding of all but one of the active international managers (the final active manager was funded later due to delays in hiring that manager). He reviewed the transition strategy, savings generated by crossing between SSGM and FR/GS, the complexity of the transition, and transition performance. Ms. Mitchem spoke about the effect of the unexpected holiday on the transition. In summary, the first transition was within expectations, with crossing opportunities maximized, the new managers funded prior to June 30, 2004, and \$2.7 billion transitioned across 12 different managers consisting of over 4,100 trades covering 31 different countries.

Mr. Bagley then reviewed the transition to the LSV portfolio, which involved transitioning assets from a broad portfolio to a concentrated portfolio. In summary, transition performance was as expected with minimal price impact on the concentrated target portfolio.

Discussion ensued regarding the FR/GS partnership and the benefits to the WSIB.

The Plexus Group (Plexus)

Mr. Glass provided a post trade review of the international equity transitions. He reviewed the policy decisions involved in the transitions and the execution costs. He noted the importance of managing all the risks in a transition, costs and operational risk, and rated the success of the transitions as high. Mr. Glass stated that in his professional opinion all three transitions were successful.

QUARTERLY WATCHLIST REPORT

Mr. Bruebaker noted two additions to the Quarterly Watchlist Report: Fidelity Equity Income and Capital International. Both managers will provide annual reviews at the December Public Markets Committee meeting. He also briefed the Committee on the planned Fidelity Overseas Fund trading penalty for funds moved within 30-days of contribution and the expense of notification that the Department of Retirement System must provide to Plan 3 members. He noted the WSIB is trying to get an extension to the fee implementation date and that both DRS and WSIB staff have some major disagreements with Fidelity on how this was handled. Mr. Bruebaker stated that it was his belief that staff will recommend replacing the Fidelity Overseas Fund.

OTHER ITEMS

There being no further business to come before the Public Markets Committee, the meeting adjourned at 3:48 P.M.