

**STATE OF WASHINGTON
STATE INVESTMENT BOARD**

Public Markets Committee Meeting
Minutes

February 1, 2005

The Public Markets Committee met in open public session at 1:00 P.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present: Glenn Gorton
Jeff Hanna
Charles Kaminski
John Magnuson
George Masten
Dave Scott
Paul Trause

Members Absent: Robert Nakahara
Representative Sommers

Others Present: Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Theresa Whitmarsh, Deputy Director for Operations
Diana Will, Senior Investment Officer – Asset Allocation
Tom Bosworth, Assistant Senior Investment Officer – Fixed Income

Nancy Calkins, Senior Investment Officer – Public Equity
Linda Lester, Investment Officer – Public Equity
Kristi Bromley, Administrative Assistant – Investments

Paul Silver, Assistant Attorney General
George Pickett, Department of Retirement Systems

Neil Tremblay, State Street Global Advisors
Craig Scholl, 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 1:00 P.M. with Chair Gorton identifying members present.

REVIEW AND APPROVAL OF MINUTES – DECEMBER 7, 2004

Mr. Trause moved to adopt the minutes of December 7. Mr. Scott seconded, and the motion carried unanimously.

DEFERRED COMPENSATION PROGRAM AND JUDICIAL RETIREMENT ACCOUNT INTERNATIONAL EQUITY OPTION APPARENTLY SUCCESSFUL OFFEROR PRESENTATION – STATE STREET GLOBAL ADVISORS

Mr. Bruebaker noted that on December 17, 2004, the WSIB issued a Request for Proposals for a replacement international equity option for the Deferred Compensation Program (DCP) and Judicial Retirement Account (JRA). The WSIB sought to replace the current international equity option, the Fidelity Overseas Investment Option, primarily for investment performance reasons. The Department of Retirement Services (DRS) has received communications from DCP members indicating their desire for an international equity option with solid investment returns, lower volatility, and low fees. Mr. Bruebaker noted that the universe for this mandate started out with 741 products, from 424 firms from the Callan Associates database. The universe was narrowed down by screening processes and the Callan Manager Search Committee to 10 semi-finalist products from 8 firms. The evaluation team, comprised of WSIB public equity staff and George Pickett, DCP Administrator, interviewed the five semi-finalist firms, covering six products. Due to a large gap between the scoring of the first-ranked semi-finalist and the second- and third-ranked semi-finalists, staff presents one firm, State Street Global Advisors, for consideration by the Committee for the replacement international equity option for the DCP and JRA. The SSgA product before the Committee is the international alpha product, which focuses on passive country selection and active security selection. The product is a first quartile performer with low tracking error. It meets the objectives of DCP participants by offering stable returns, low volatility, and very low fees. The fees for the SSgA international alpha products are 16 basis points less than the current product offered by Fidelity.

[Mr. Kaminski was in attendance at 1:04 P.M.]

Mr. Tremblay, SSgA, introduced himself and Mr. Scholl. Mr. Tremblay noted that SSgA is the largest manager of international assets in the world with passive, enhanced, and active products. He reviewed the number of portfolio managers and analysts in the active international equity strategies. The international alpha product provides a quantitative, risk-controlled process that has outperformed the MSCI EAFE benchmark by 279 basis points since inception.

Mr. Scholl reviewed the investment philosophy of the international alpha strategy and noted that SSgA's focus is on stock selection versus the style and regional decisions, which can add a lot of value but are difficult to time. He reviewed the investment process: stock selection, risk assessment, and portfolio construction and trading; portfolio characteristics; sector weights; top ten holdings; and consistency of returns.

Discussion ensued regarding performance and tracking error.

Mr. Trause moved that the Public Markets Committee recommend that the Board select State Street Global Advisors as the apparently successful offeror for the defined contribution plan core international equity mandate, subject to continued due diligence and successful negotiation of terms and conditions. Mr. Masten seconded the motion.

Further discussion ensued regarding strategy, assets under management, and performance.

The motion carried unanimously.

HORIZON FUNDS ANNUAL REVIEW

Ms. Will introduced herself and presented the WSIB Horizon Funds Annual Report. The Horizon Funds are comprised of three different funds with three distinct levels of risk and return and are composed of varying percentages of four asset classes: cash; fixed income; U.S. equity; and international equity. She reviewed the target asset allocations for each of the three Horizon Funds, provided a history of the funds, and reviewed growth of assets since inception. Ms. Will noted participant distribution and percentage of plan assets. Discussion ensued regarding participant use of the Horizon Funds.

Ms. Will reviewed total return and performance attribution for each fund. The funds have underperformed their custom benchmarks over all time periods but have improved over the past year. Despite of the underperformance, the Horizon Funds compare favorably versus other balanced funds and the Mid-Horizon Fund is in the top quartile for the three-year period when compared to the Morningstar Balanced Fund Universe. Ms. Will reviewed changes made to the Horizon Funds, including utilizing a different passive international fund that has trading restrictions to prevent participants from market timing. Since that change, the international passive option has outperformed the benchmark. Tracking error from rebalancing has also been lowered by tightening up rebalancing procedures. Ms. Will reviewed the performance of the underlying managers.

Discussion ensued regarding the appropriateness of the benchmarks, use of a money market option versus stable value option, asset allocation, and participant use of the funds. Mr. Pickett, DCP Administrator, addressed the Committee's questions regarding roll over from and into private plans.

[The Committee recessed at 2:02 P.M. and reconvened at 2:12 P.M.]

FIXED INCOME ANNUAL REVIEW

Mr. Bosworth introduced himself and noted that he would present the WSIB Fixed Income Annual Review on behalf of Mr. Kennett, who was ill with the flu. He provided a market review for 2004 and noted that, while the Federal Open Market Committee raised rates five times over the year, rates did not increase as much as expected given the various economic indicators. He reviewed the 10-year treasury yield, 10-year credit spread, interest rate changes, yield curve change and implications on the portfolios, and the Lehman Aggregate returns. Mr. Bosworth provided a market outlook for 2005, focused on continued Fed tightening, GDP growth, employment growth, and expected low single digit returns for fixed income, and a review of possible risks to the market.

Mr. Bosworth reviewed the overriding portfolio strategies: maintain short duration stance, TIPS exposure, and credit exposure; underweight high yield; add to mortgage holdings; and remain underweight agencies. He reviewed the market value of the fixed income portfolios, which totaled \$21.5 billion as of December 31, 2004, sector allocations, and trading activity across all funds.

Mr. Bosworth reviewed the goals, performance, and fund statistics for each of the various fixed income portfolios: Retirement Fund, Labor and Industries' Funds, Permanent Funds, Intermediate Bond Fund, Savings Pool; Guaranteed Education TIPS; and Developmental Disabilities Endowment Fund TIPS.

Discussion ensued regarding sector holdings, duration, and performance and strategy for the Intermediate Bond Fund.

CONTRACT EXTENSIONS

- Barclays Global Investors Domestic Equity
- Labor and Industries' Industrial Insurance Consultant
- Frank Russell Directed Brokerage
- State Street Bank Securities Lending

Mr. Bruebaker noted that the WSIB's contracts with Barclays Global Investors for domestic equity index investment management, Conning Asset Management (Conning) for Labor and Industries' industrial insurance consultant, Frank Russell Securities, Inc. for directed brokerage and soft dollar services, and State Street Bank for securities lending, will expire in 2005 and are eligible for extensions. These firms are all performing well and meeting the expectations of their contracts.

Mr. Trause moved that the Public Markets Committee recommend that the Board authorize the executive director to extend the contract with:

- **Barclays Global Investors, Contract Number 02-005, for one year, through December 31, 2006, as provided in the terms of the contract.**
- **Conning Asset Management, Contract Number 02-006, for one year, through December 31, 2006, as provided in the terms of the contract.**
- **Frank Russell Securities, Inc., Contract Number 01-016, for one year through December 31, 2006, as provided in the terms of the contract.**
- **State Street Bank, Contract Number 002-004, for two years through September 30, 2007, as provided in the terms of the contract.**

Mr. Masten seconded the motion.

Mr. Trause noted that Labor and Industries is very pleased with Conning's work.

The motion carried unanimously.

OTHER ITEMS

There being no further business to come before the Public Markets Committee, the meeting adjourned at 3:02 PM.