APPROVED

STATE OF WASHINGTON
STATE INVESTMENT BOARD

Public Markets Committee Meeting
Minutes

September 12-13, 2005

The Public Markets Committee met in open public session at 9:02 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 on September 13) Charlie Kaminski (September 13) John Magnuson George Masten Dave Scott Representative Sommers (September 12)
Members Absent:	Robert Nakahara Gary Weeks
Others Present:	Joe Dear, Executive Director Gary Bruebaker, Chief Investment Officer Theresa Whitmarsh, Deputy Director for Operations Nancy Calkins, Senior Investment Officer – Public Equity Liz Mendizabal, Public Affairs Director Diana Will, Senior Investment Officer – Asset Allocation Bill Kennett, Senior Investment Officer – Fixed Income David Thatcher, Contracts Manager Kristi Bromley, Administrative Assistant – Investments Paul Silver, Assistant Attorney General (September 12) Robert Vishny, LSV Asset Management Keith Bruch, LSV Asset Management Tim Noel, T. Rowe Price Associates, Inc. David Orlando, T. Rowe Price Associates, Inc. Andre Cuerington, Western Asset Management Company James Flick, Western Asset Management Company Ric Thomas, State Street Global Advisors Neil Tremblay, State Street Global Advisors Robert Fetch, Lord, Abbett & Company Charles Hofer, Lord, Abbett & Company Paul McNamara, Lord, Abbett & Company Mark Landay, The Vanguard Group

Karin Peterson LaBarge, The Vanguard Group
Blake Grossman, Barclays Global Investors
Steve Rogers, Barclays Global Investors
Lynn Roy, Barclays Global Investors
Brent Hartman, Fidelity Investments
Steven Snider, Fidelity Investments
Thomas Harty, Fidelity Investments

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

The meeting convened at 9:02 A.M. with Chair Gorton identifying members present.

REVIEW AND APPROVAL OF MINUTES – JUNE 7, 2005

Mr. Masten moved to adopt the minutes of June 7, 2005. Mr. Scott seconded, and the motion carried unanimously.

U.S. EQUITY ENHANCED INDEX MANAGEMENT INTERVIEWS

Mr. Bruebaker reviewed the manager search process, which commenced with the issuance of a Request for Proposal (RFP) for U.S. equity enhanced index management services on June 20, 2005. Forty-seven products were considered. Callan Associates screened the candidates and narrowed it down to 13 products that were then evaluated by WSIB staff and Callan's Manager Search Committee. As a result of that evaluation, the prospective candidates were narrowed down to seven firms, which WSIB staff scored and then subsequently interviewed three firms via videoconference. The team selected all three firms for the Public Markets Committee to interview. Both Barclays Global Investors (BGI) and State Street Global Advisors (SSgA) are stock based quantitative factor models and Western Asset Management utilizes a futures overlay strategy. Mr. Bruebaker stated that while staff would make their final recommendation following the interviews, staff was leaning toward hiring all three managers for diversification purposes. Mr. Bruebaker also noted that the Board would adopt new asset allocation ranges at the September 15, 2005, meeting. Hiring three U.S. equity enhanced index managers would fit within staff's recommended U.S. equity allocation of 23 percent with 25 to 33 percent of that allocation in enhanced products.

State Street Global Advisors

Mr. Tremblay introduced himself and Mr. Thomas. Mr. Tremblay provided an overview of SSgA's enhanced index products, which were designed to be very consistent in providing quantitative, risk controlled benchmark strategies. He noted SSgA's track record, dedicated team, research capability, flexibility, and outperformance in diverse market environments due to style, size, and beta neutrality and adherence to benchmark characteristics.

[Mr. Silver was in attendance at 9:14 A.M.]

Mr. Thomas reviewed SSgA's assets under management in global enhanced equities and performance of the enhanced strategy in various market environments, noting the importance of risk control and providing consistent, excess returns. He noted that enhanced index strategies will underperform when fundamentals are not properly compensated in the marketplace. Mr. Thomas reviewed the portfolio management and quantitative research team. He reviewed the investment process, including stock and industry ranking, and portfolio construction. The resulting portfolio will look a lot like the benchmark, but be tilted slightly to stocks and industries they favor. The portfolio will not have a capitalization bias and will be tightly constructed with sector/industry weightings within 50 basis points of the benchmark.

[Representative Sommers was in attendance at 9:34 A.M.]

Mr. Thomas noted strong investor interest in moving from passive to enhanced indexing as a way to provide consistent excess returns in a strategy that tracks the underlying benchmark in both up and down markets.

Discussion ensued regarding dispersion of returns in various SSgA enhanced products, performance history, and adjustments over time to SSgA's model.

Western Asset Management Company

Mr. Cuerington introduced himself and Mr. Flick. He reviewed Western's Index Plus Concept wherein the S&P index return is replicated by derivatives and value is added by the total return of the short term bond portfolio and to a small degree by the management of the index exposure. Mr. Cuerington also reviewed the investment management team.

Mr. Flick reviewed the investment process, noting the team orientation and consensus of themes and strategies. He discussed the structure, size, and experience of the dedicated short duration team. He reviewed the process used to replicate the index, noting that about 10 percent of the team's time is spent in this area. He noted that there are no futures contracts available to exactly replicate the other indices the WSIB may want to consider, so they would instead take advantage of a total rate of return swaps and pay a hurdle rate for a third party to manage that process. He reviewed Western's history of outperformance over the 3 month LIBOR, noting they add value through active management in the fixed income market place.

He reviewed Western's investment philosophy and process, including longer-term, fundamental value orientation and management of risk on qualitative basis by a diversified approach. Mr. Flick reviewed the Index Plus portfolio construction, including interest rate exposure, term structure weighting, sector and sub-sector allocation. He also reviewed the direction exposure of the U.S. Index Plus portfolio, noting that Western considers how interest rate risk fits into the portfolio versus it being a driver of alpha on its own. He reviewed term structure analysis, noting that Western looks at the 3 month to 5 year section of the yield curve to determine where to place assets, and reviewed the historical sector allocation of the Index Plus portfolio. He reviewed the due diligence process for the structured products sector analysis.

Discussion ensued regarding market types in which this product might underperform. He expects a minimal effect on Western as a result of Legg Mason taking over Citigroup's asset management and brokerage divisions.

[The Committee recessed at 10:30 A.M. and reconvened at 10:44 A.M.]

Barclays Global Investors

Ms. Roy, Mr. Rogers, and Mr. Grossman introduced themselves. Mr. Rogers noted that BGI has been managing enhanced products since 1979. Mr. Grossman noted that BGI believes that research is central to consistent returns as sources of return decay over time as market inefficiencies are arbitraged away and systematic changes occur. He reviewed the investment team and BGI's investment in research and innovation. He also reviewed the evolution of the U.S. and international alpha tilts strategy.

Ms. Roy reviewed BGI's investment philosophy to outperform the benchmark at the lowest risk possible and the importance of people, technology, and realistic constraints. BGI seeks to build the best portfolio at the lowest cost and add 75 to 100 basis points of excess return over the benchmark. She reviewed the performance of various active strategies and noted that the Alpha Tilts strategy works well in most market environments with positive alpha in both up and down markets. The strategy has a more difficult time in markets were relatively few stocks account for the bulk of the market return and stocks are not priced according to current fundamentals and future prospects for the companies. She reviewed the stock selection process, including focus on value, earnings quality, and sentiment, and reviewed risk controls, including small industry bets and limiting active positions in individual stocks versus the benchmark. She reviewed the portfolio characteristics of the Alpha Tilts portfolio versus the benchmark, noting that value is added through stock selection within industries.

Discussion ensued regarding changes to the model over time, commingled versus separate account, and the importance of stock selection to BGI's enhanced strategy.

Following the interviews, the Committee compared and contrasted the groups, including performance and strategies. Mr. Bruebaker noted that while enhanced is active management, it is tightly controlled against the benchmark and discussed information and Sharpe ratios of the three firms.

Further discussion ensued regarding research focus of the firms and effect of constraints put on active managers.

[The Committee recessed for lunch and staff deliberations at 11:41 A.M. and reconvened at 12:13 P.M.]

Mr. Bruebaker stated that staff strongly believes the Board should implement enhanced indexing with up to a third of the domestic equity portfolio and recommends hiring all three managers for diversification reasons.

Discussion ensued regarding differences in the firms' strategies and advantages of hiring all three firms.

> **Mr. Scott moved that the Public Markets Committee recommend that the Board select State Street Global Advisors, Western Asset Management, and Barclays Global Investors as the apparently successful offerors for the U.S. equity enhanced index mandate, subject to continued due diligence and successful negotiations of terms and conditions. Representative Sommers seconded, and the motion carried unanimously.**

DEFERRED COMPENSATION PROGRAM AND JUDICIAL RETIREMENT ACCOUNT U.S. EQUITY CORE OPTION MANAGEMENT INTERVIEWS

Mr. Bruebaker reviewed the process used for this search, which commenced with the issuance of an RFP for U.S. equity core and value options for the Deferred Compensation Program and Judicial Retirement Account on June 22, 2005. Callan's database screened 463 funds for the core style and narrowed the list to 16 products. Those products were evaluated by WSIB staff and the Callan Manager Search Committee and reduced to 10 products. WSIB and Department of Retirement Systems (DRS) staff evaluated the 10 products and interviewed the top five firms via videoconference. The team selected the three firms for the Public Markets Committee to interview. Mr. Bruebaker stated that the WSIB staff worked closely with DRS staff during this process and both the WSIB and DRS staff believe any one of the three firms would be a benefit to the DCP and JRA programs.

Barclays Global Investors

Ms. Roy, Mr. Rogers, and Mr. Grossman introduced themselves and Mr. Rogers reviewed BGI's defined contribution business and differences between the two products they presented to the Committee. He noted that BGI is already a provider for the state of Washington's defined contribution programs, for the DCP and the Plan 3s. He reviewed BGI's defined contribution business, including history, assets under management, and BGI's exclusive focus on investment management in the defined contribution arena, institutional product offerings, and active development of various investment strategies. Mr. Rogers stated that the management of the defined benefit products, such as what was presented to the Committee for enhanced indexing, and defined contribution products are the same—including the process and drivers of performance, and researchers and portfolio managers. As such, the WSIB is able to leverage its access to institutional products for defined contribution participants. Differences between the defined benefit and defined contribution offerings include risk taken and the option in the defined contribution environment for fees to be either accrued or billed. In addition, in the defined contribution environment, transaction costs are borne by the fund, which leads to some difference in tracking error between defined benefit and defined contribution plan offerings.

Mr. Grossman reviewed BGI's array of active and passive defined contribution strategies. He noted the importance of in-house research with research being central to consistent returns and noted BGI's focus on continually lowering trading costs. Ms. Roy reviewed the evolution of

BGI's U.S. and international alpha tilts strategies. Mr. Grossman concluded by noting that BGI's investment philosophy and organizational values are in line with the WSIB's.

The Vanguard Group

Mr. Landay introduced himself and Ms. Peterson LaBarge. He noted that Vanguard is owned by its shareholders and if the WSIB selected Vanguard for this mandate it would own part of the organization.

Ms. LaBarge provided an overview of the fund, including the portfolios objective of adding value over that of S&P 500 and maintaining a risk posture similar to the index. The funds investment focus is blended with a slight value bias. Franklin Portfolio Associates, LLC has been the fund advisor since its inception. She reviewed the fund's assets under management, expense ratio, and turnover rate, and provided an organizational overview of the investment advisor, including ownership structure, assets under management, and investment process and philosophy. She reviewed the investment process, which includes value orientated themes as well as momentum and growth orientated themes, and reviewed the investment process, including universe definition, investment style, research, and decision making process. The expectations for the fund are that it will have risk and sector profile similar to the S&P 500 with and emphasis on undervalued stocks. Ms. LaBarge provided a portfolio profile, including equity characteristics, top ten holdings, and sector weightings, and reviewed performance.

Ms. LaBarge discussed Vanguard's interaction with the subadvised funds. Vanguard's portfolio review group monitors the subadvisors for tracking error, sector neutral process, portfolio characteristics, consistency, and performance expectations.

[The Committee recessed at 1:33 P.M. and reconvened at 1:45 P.M.]

Fidelity Investments

Mr. Harty introduced himself and Mr. Hartman introduced himself and Mr. Snider. Mr. Snider provided an overview of Fidelity's Disciplined Equity Fund, including quantitative process and style consistency. He noted the coming separation of Fidelity's institutional investment management business from its retail investment management offerings; this fund will remain a retail fund. Mr. Harty reviewed the fund's objectives and strategy, noting that the fund seeks long-term capital growth through stock selection using a quantitative discipline. He reviewed the fund's investment philosophy and its underlying premises that stock returns are primarily driven by stock-specific factors, which tend to be consistent over time, mathematical models can find and exploit these factors, and statistical probabilities can substitute for individual company analyses provided attention is paid to diversification and risk.

Mr. Harty reviewed the investment process, which includes characteristics such as earnings, valuation, momentum, balance sheet, as well as the buy/sell discipline, bottom-up stock selection, fund characteristics, and performance. He stated that the portfolio does well in choppier markets and has more difficulty performing in narrower, thematic markets. Discussion ensued regarding tracking error, portfolio constraints and fees.

Following the interviews, the Committee compared and contrasted the groups, including performance, information ratios, fees, and concerns with organizational changes within Fidelity.

[Mr. Hanna was no longer in attendance at 2:27 P.M.]

[The Committee recessed for staff deliberations at 2:27 P.M. and reconvened at 2:53 P.M.]

Mr. Bruebaker stated staff's recommendation was that the Committee recommend Barclays Global Investors for the DCP/JRA U.S. equity core option. BGI offers the most stable investment returns for members, the lowest downside risk, and the highest information ratio for the 5 and 7 year periods.

The Committee discussed fees, DRS' participation in the process and satisfaction with the decision, and the Committee members' recommendations.

> **Mr. Masten moved that the Public Markets Committee recommend that the Board select Barclays Global Investors as the apparently successful offeror for the Deferred Compensation Program and Judicial Retirement Account U.S. equity core option, subject to continued due diligence and successful negotiations of terms and conditions. Mr. Scott seconded, and the motion carried unanimously.**

EMERGING MARKETS MANAGER DISCUSSION

Mr. Bruebaker stated that staff recommends that the dedicated emerging markets manager, F&C, be terminated. F&C's performance has been weak for some time, although it has shown signs it might be turning around. However, as of June 30, 2005, they have unperformed by 810 basis points for the 1-year period, 386 basis points for the 3-year period, and 23 basis points since inception in December 1996. In addition, the company lost a portfolio manager earlier this year. Discussion ensued regarding options available for the assets currently invested with F&C.

> **Mr. Masten moved that the Public Markets Committee recommend that the Board redeem the assets currently invested in the F&C Emerging Markets Commingled Trust. Mr. Scott seconded, and the motion carried unanimously.**

[The Committee adjourned for the day at 3:03 P.M.]

The meeting reconvened at 9:01 A.M. September 13, 2005, with Chair Gorton identifying members present.

DEFERRED COMPENSATION PROGRAM AND JUDICIAL RETIREMENT ACCOUNT U.S. EQUITY VALUE OPTION MANAGEMENT INTERVIEWS

Mr. Bruebaker summarized the process used for this search, which commenced with the issuance of an RFP for U.S. equity core and value options for the Deferred Compensation Program and Judicial Retirement Account on June 22, 2005. Callan's database screened 485 funds for the core style and narrowed the list to 19 products. Those products were evaluated by WSIB staff and the Callan Manager Search Committee and reduced to 11 products. WSIB and Department of Retirement Systems (DRS) staff evaluated the 11 products and interviewed the top five firms via videoconference. The team selected the three firms for the Public Markets Committee to interview. Mr. Bruebaker reiterated that the WSIB staff worked closely with DRS staff during this process and both the WSIB and DRS staff believe any one of the three firms would be a benefit to the DCP and JRA programs.

[Mr. Kaminski was in attendance at 9:06 A.M.]

Lord, Abbett & Company

Mr. Fetch, Mr. Hofer, and Mr. McNamara introduced themselves. Mr. McNamara provided an overview of the investment team, ownership structure, importance of fundamental research to Lord Abbett's process, and assets under management.

Mr. Hofer reviewed the Multi Cap Value investment philosophy and investment process, including quantitative valuation measures, fundamental analysis, and portfolio construction. He reviewed the constituents of the Multi Cap Value product, noting that approximately 59% was invested in large cap, 30% in mid cap, and 11% in small cap. The portfolio will approximate the market cap distribution of the Russell 3000 Value Index and will have a minimum of 50% invested in large cap stocks. He reviewed representative sector diversification and risk controls.

Discussion ensued regarding risks facing the portfolio, portfolio characteristics, style consistency, management of separate accounts, and management of cash flow.

LSV Asset Management

Mr. Bruch and Mr. Vishny introduced themselves. Mr. Bruch provided an overview of organizational highlights, including assets under management, ownership structure, and history. Mr. Vishny reviewed LSV's investment approach, including deep value orientation, quantitative process, and risk control. He reviewed the major components of the LSV model as well as the investment process, portfolio construction, and portfolio characteristics. Mr. Bruch reviewed the fund's performance, including downside protection.

Discussion ensued regarding trading processes, management of cash flow, performance attribution, capitalization and style bias, and fees.

[The Committee recessed at 10:21 A.M. and reconvened at 10:30 A.M.]

T. Rowe Price Associates

Mr. Orlando and Mr. Noel introduced themselves. Mr. Noel reviewed the firm's research capabilities and the Large Cap Value investment team. He reviewed the fund's investment principles, noting the contrarian orientation which seeks to benefit from changes in investor perception, and reviewed the investment objective of providing strong risk-adjusted returns through well-timed investments in undervalued companies. He also reviewed the portfolio construction process, style consistency, performance, and portfolio construction process.

Discussion ensued regarding tracking error, risks to the portfolio, and expense ratio.

[The Committee recessed at for staff deliberations at 11:09 A.M. and reconvened at 11:31 A.M.]

Mr. Bruebaker stated that while staff believes all three firms would meet the needs of the program and of the participants, staff's recommendation is that the Committee recommend LSV to the Board for the DCP/JRA U.S. equity value option. Discussion ensued regarding the pros and cons of the firms, including portfolio characteristics and downside protection.

> **Mr. Scott moved that the Public Markets Committee recommend that the Board select LSV Asset Management as the apparently successful offeror for the Deferred Compensation Program and Judicial Retirement Account U.S. equity value option, subject to continued due diligence and successful negotiation of terms and conditions.**
> **Mr. Masten seconded, and the motion carried unanimously.**

OTHER ITEMS

There being no further business to come before the Public Markets Committee, the meeting adjourned at 11:43 A.M.