

**WASHINGTON STATE INVESTMENT BOARD  
Public Markets Committee Meeting Minutes  
April 4, 2006**

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: Dave Scott, Chair  
Charlie Kaminski (via teleconference)  
John Magnuson  
Pat McElligott  
Robert Nakahara  
Representative Helen Sommers  
Gary Weeks

Members Absent: David Nierenberg

Other Board Members Present: George Masten

Others Present: Joe Dear, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Theresa Whitmarsh  
Liz Mendizabal, Public Affairs Director  
Nancy Calkins, Senior Investment Officer – Public Equity  
Diana Will, Senior Investment Officer – Asset Allocation  
Bill Kennett, Senior Investment Officer – Fixed Income  
John Lynch, Contracts Specialist  
Kristi Bromley, Administrative Assistant – Investments  
Paul Silver, Assistant Attorney General  
  
Mike Thomas, Frank Russell Securities, Inc.  
Scott Grimm, Frank Russell Securities, Inc.  
Alistair Lowe, State Street Global Advisors  
Sean Flannery, State Street Global Advisors  
Neil Tremblay, State Street Global Advisors  
Victor Kohn, Capital International  
Paula Pretlow, Capital International  
Chris Campisano, Barclays Global Investors  
Steve Rogers, Barclays Global Investors

[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 Scott identifying members present.

**REVIEW AND APPROVAL OF MINUTES – FEBRUARY 7, 2006**

**Mr. McElligott moved to adopt the February 7, 2006, Public Markets Committee minutes. Representative Sommers seconded and the motion carried unanimously.**

**CASH OVERLAY PROGRAM MANAGEMENT INTERVIEWS**

Ms. Will introduced herself and the Cash Overlay program. While the Commingled Trust Fund does not have a specific allocation to cash, frictional cash does exist. The object of a cash overlay program is to add small incremental return to the portfolio by eliminating cash drag. A cash overlay program accomplishes this by allowing the cash to be invested without actually being spent through the purchase of derivatives. A cash overlay manager will equitize the cash at the total portfolio level by buying the index exposure of the asset class that is the most underweight. The program is expected to earn 2 to 5 basis points of incremental return over the long run.

[Mr. Weeks was in attendance at 1:06 p.m.]

Ms. Will provided further information on the process, including risk management, possibility of short-term negative returns in down markets, and the underlying belief that over the long-term equities and fixed income will outperform cash.

**Frank Russell Securities, Inc. (Russell)**

Mr. Thomas introduced himself and Mr. Grimm and provided an overview of Russell's differentiating factors, including experienced and well-resourced team, platform, process, and risk controls. He reviewed the overlay services team, including portfolio manager, analysts, and dedicated information technology support. The team trades over \$100 billion in derivatives a year with traders working when the markets they trade in are open and utilizes agency execution on all trades.

Mr. Thomas explained how the program overlays frictional cash on hand in the fund with the underweight asset class to capture premiums and rebalance at the same time. He reviewed a chart depicting the effect of cash in a WSIB model portfolio showing negative cash drag of approximately 5 basis points or \$26 million a year on an average of \$450 million in cash. He noted system capabilities if the WSIB should choose to expand the program in the future, including benefits for tactical asset allocation. He also reviewed Russell's risk management and disaster recovery processes.

Mr. Grimm reviewed the daily process for Russell's overlay program, including portfolio management, trading, and risk controls; the process used for accurate trading, including determination of trade date cash; and actual asset allocation compared to target allocation. He also reviewed performance measurement: portfolio return, benchmark return, and ease of calculation by the WSIB's third party performance measurement provider.

Mr. Thomas summarized the presentation by highlighting the resources, team, platform, and systems dedicated to overlay strategies.

Discussion ensued regarding fee structure, institutional clients, expected return, and effect a stressed market would have on the program.

**State Street Global Advisors (SSgA)**

Mr. Tremblay, Mr. Flannery, and Mr. Lowe introduced themselves. Mr. Flannery reviewed SSgA's cash overlay resources and experience, including assets under management and client and strategy profiles. He reviewed SSgA's global trading platform and disaster recovery processes. He also reviewed the forms that exposure management can take, such as managing excess cash, maintaining strategic asset allocation, and facilitating tactical asset allocation shifts.

Mr. Lowe reviewed SSgA's exposure management philosophy, including risks and tradeoffs, analysis framework, risk controls, and cash overlay management as asset allocation investment solution. He reviewed the importance of the research function, performance measurement, and decision-making process, implementation flow chart, and strategic exposure management. He reviewed the daily investment procedures, including determination of cash balances, anticipated cash flows, actual asset allocation compared with target floated weights, and determination and execution of trades. He also reviewed the pros and cons of different exposure options, index funds, futures, and swaps, and recommended futures for the WSIB program as they are exchange traded, liquid, and have low transactions costs.

Mr. Flannery reviewed compliance monitoring and risk controls and summarized SSgA's program focusing on experience, resources, research, infrastructure, and customization.

Discussion ensued regarding fee and revenue stream, expected return, and effect a stressed market would have on the program.

[The Committee recessed at 2:28 p.m. and reconvened at 2:49 p.m.]

Discussion ensued regarding the proposed fees of each manager, the incremental return expected, the new nature of this program for the WSIB and the need for quality and a high level of service from the service provider.

**Mr. McElligtott moved that the Public Markets Committee recommend that the Board select Frank Russell Securities, Inc. as the apparently successful offeror for the Cash Overlay Program Management mandate, subject to continued due diligence and successful negotiation of terms and conditions. Mr. Weeks seconded and the motion carried unanimously.**

Mr. Dear clarified that, although the contract will allow for shorting to get asset classes closer to their target, staff will not allow shorting without prior notification to the Public Markets Committee and Board at a regularly scheduled meeting.

[Mr. Kaminski was no longer in attendance at 3:04 p.m.]

**CAPITAL INTERNATIONAL STRATEGY AND PORTFOLIO REVIEW**

Mr. Bruebaker stated that the Board first invested in Capital International's (Capital) Emerging Markets Growth Fund (EMGF) on April 21, 2001. Capital's strategy employs a Multiple Portfolio Manager System where the seven portfolio managers each have responsibility for their own portfolio as well as a portfolio constructed with the best ideas of Capital's research group. Capital has outstanding long-term performance, outperforming by 309 basis points and 299 basis points, respectively, for the 10- and 15-year periods ended March 31, 2006. They have underperformed in the most recent periods going back 5 years. Mr. Bruebaker stated his belief in mean reversion and in market cycles and noted that, given that Capital has outstanding investment performance over the long-term but has underperformed over the most recent five year period, this is likely an optimal time to invest additional assets in Capital's EMGF.

Ms. Pretlow introduced herself and Mr. Kohn and stated the highlights of their presentation: Capital's beliefs about emerging markets, the WSIB portfolio, performance, changes made that led to the outperformance in 2004, and why they believe Capital will continue to outperform for the WSIB going forward. Capital believes that markets are not always efficient and fundamental research can identify opportunities. Their track record demonstrates that the long-term view works for them and their clients. She reviewed Capital's emerging markets team stating that their people make the difference and their global presence leads to local insight. She reviewed the components of their investment process: research, communication, stock selection, and implementation and risk control. She highlighted ways the investment process has evolved and improved, including more opportunities to share information in small groups and an increase in the percentage of assets managed by the regional managers all contributing to Capital's singular goal of providing superior long-term results.

Mr. Kohn reviewed performance, the areas Capital looked at when reviewing their processes, and what is working better now bringing them back to the longer-term trend of outperformance. Capital decreased the total part of the assets managed by global portfolio managers and gave more assets to those managers focused on regional responsibilities as well as more assets to the research portfolio. They also added five analysts over the past three years and increased the number of live investment calls to better connect the Asian emerging markets and U.S. emerging markets team members.

[Mr. Weeks was no longer in attendance at 3:17 p.m.]

Mr. Kohn reviewed the summary attribution analysis, including sector weightings. He stated that in 2005, stock selection attribution more than made up for negative contribution of sector decision. Capital believes the portfolio is well positioned with stock selection decisions driving results.

Discussion ensued regarding valuations of emerging markets companies, qualitative and quantitative evaluations in emerging markets, outlook for emerging markets, currency effect on returns, and the outlook for energy prices and the effect on emerging markets.

[Representative Sommers was no longer in attendance at 3:39 p.m. A quorum was no longer present.]

**It was the consensus of the Public Markets Committee to forward this item to the Board for the consideration of investing additional assets in Capital International's Emerging Markets Growth Fund.**

**PORTABLE ALPHA RELATED INDEX IMPLEMENTATION**

Mr. Bruebaker reviewed the highlights of the proposed portable alpha strategy. In the proposed structure, the WSIB would contribute shares of the U.S. index fund to the trust vehicle in return for Preference Shares. The WSIB would receive the Russell 3000 return plus a premium of 15 basis points to compensate for a 3-year lock up on the assets and any securities lending income that would have been earned. This strategy will provide additional incremental returns to the portfolio.

Mr. Rogers introduced himself and Mr. Campisano. Mr. Campisano reviewed the Barclays Global Investments asset trust structure, which facilitates pooling of capital from complementary investors and payment of differentiated return streams. Typically, the trust receives assets from two investors, an active investor and an index investor. The assets are invested in various defined strategies and the Preference Shareholder, the index investor, receives index return plus a fixed basis point spread over the index with no management fees and no tracking error; the Ordinary Shareholder, the active investor, is paid the trust return less the return paid to the Preference Shareholder and all expenses. Mr. Campisano reviewed the structure and risk controls of the asset trust, including rigorous testing of collateral levels, no credit/counterparty exposure, restrictions and monitoring of collateral levels, and full transparency. He summarized that Preference Shares are an attractive supplement to existing index fund exposure and provide opportunity to capture a liquidity premium within a collateralized structure with no counterparty exposure in a way that is seamless and costless to invest.

Discussion ensued regarding benefits the WSIB would receive from this strategy and the lock-up period for the assets. Staff will obtain further information on which entity would vote the shares for assets invested in the trust.

**It was the consensus of the Public Markets Committee to forward this item to the Board for consideration of adopting the portable alpha concept as a preference shareholder with a total investment of up to 25 percent of the Commingled Trust Fund indexed assets (at time of purchase) subject to continued due diligence and successful negotiation of terms and conditions.**

**CONTRACT EXTENSIONS**

Mr. Bruebaker stated that both the Domestic Equity Index Investment Management contract and the Labor and Industries Industries Industrial Insurance Consultant contract are up for their final extension. Staff is satisfied with the performance of both vendors.

**It was the consensus of the Public Markets Committee to forward this item to the Board for consideration of authorizing the executive director to extend the contract with**

- **Barclays Global Investors, Contract Number 02-005, for one year, through December 31, 2007, as provided in the terms of the contract.**
- **Conning Asset Management, Contract Number 02-006, for one year, through December 31, 2007, as provided in the terms of the contract.**

**OTHER ITEMS**

There was no further business to come before the Public Markets Committee and the meeting adjourned at 4:27 p.m.