

**WASHINGTON STATE INVESTMENT BOARD  
Public Markets Committee Meeting Minutes  
February 5, 2008**

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:**

George Masten, Chair  
Charlie Kaminski (via conference call)  
Robert Nakahara  
David Nierenberg  
Mason Petit  
Mike Ragan  
Judy Schurke

**Members Absent:**

John Magnuson  
Representative Helen Sommers

**Others Present:**

Joe Dear, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Theresa Whitmarsh, Chief Operating Officer  
Liz Mendizabal, Public Affairs Director  
Philip Paroian, Senior Investment Officer – Public Equity  
Bill Kennett, Senior Investment Officer – Fixed Income  
Diana Will, Senior Investment Officer – Asset Allocation  
John Lynch, Contracts Manager  
Kristi Bromley, Administrative Assistant – Investments  
Brian Buchholz, Assistant Attorney General

Raymond Decker, Alliance Bernstein  
Joseph Healy, Alliance Bernstein  
Seth Masters, Alliance Bernstein  
Christopher Nikolich, Alliance Bernstein  
James Thyne, Alliance Bernstein  
Lynn Roy, Barclays Global Investors  
Jim Keagy, Barclays Global Investors  
Steve Fulton, Western Asset Management Company  
Joseph Carieri, Western Asset Management Company  
Susan Raynes, State Street Global Advisors  
Rich Thomas, State Street Global Advisors  
Michael O’Leary, Callan Associates, Inc.

[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 Masten identifying members present.

**REVIEW AND APPROVAL OF MINUTES – NOVEMBER 27, 2007**

**Mr. Petit moved to adopt the November 27, 2007, Public Markets Committee minutes. Mr. Ragan seconded, and the motion carried unanimously.**

**TARGET BASED FUND MANAGER REQUEST FOR PROPOSAL FINALIST RECOMMENDATION**

Mr. Bruebaker introduced himself and noted that in February 2007 the Board approved the commencement of a competitive procurement in concert with the Department of Retirement Systems (DRS) for retirement target date funds to replace the Horizon Funds in the defined contribution plans. Studies show that more than 80 percent of defined contribution participants do not make changes to their investment strategy once they have made their initial investment decision. The marketplace developed target date funds as a solution to participants' inertia in making what arguably is their most important financial decision: retirement planning. Target date funds are structured to automatically adjust to the optimal allocation for a participant based on their expected retirement age.

Mr. O'Leary, Callan Associates, introduced himself and noted the movement in corporate retirement plans toward auto enrollment in target date funds, which provides a more professional solution to retirement planning. The target date fund manager search process started with 31 firms and through quantitative and qualitative screens by Callan Associates, a manager search committee review, and detailed evaluation by a five member evaluation team, the prospective candidates were narrowed down to eight firms. WSIB and DRS staff conducted comprehensive video interviews with five firms and further narrowed the search to two finalists.

Mr. Bruebaker stated that it is the evaluation team's unanimous recommendation to advance Alliance Bernstein as the target date fund manager. The flexible construction offered by Alliance Bernstein is important as it offers a structure that parallels as much as possible the investment management strategies of the Commingled Retirement Trust Fund (CTF). The "plug and play" feature is important as it allows the WSIB the flexibility to leverage areas where we have competitive advantages such as low cost indexing and active internal fixed income management. Alliance Bernstein offers a glide path allocation that is better for those in their retirement years, a comprehensive participant education program, and was the least expensive of the two finalists.

Mr. Thyne introduced himself and the other Alliance Bernstein presenters and noted their respective areas of responsibility. He provided an overview of the firm focusing on their research-driven culture, proven investment processes, global scope, and well-balanced and diversified investment management.

Mr. Masters stated that Alliance Bernstein takes their investment mission very seriously with a focus on improving participants' outcomes. He reviewed the firm's experience, target date fund design, assets under management, and history. He highlighted their published report on target date retirement fund construction, noting that it offers a comprehensive approach to target date fund design and management as well as full assessment and consideration of downside risk. Their research concluded that the biggest risk facing employees in their retirement planning was not having enough money in retirement and outliving their savings. Participants need to make their assets work harder both while they work and during retirement. Alliance Bernstein continually focuses on how they can prudently make assets work harder for the best outcomes for the participants.

Mr. Nikolich noted the importance of balancing the two goals of maximizing savings during working years and prolonging those savings into retirement. He reviewed the framework for determining glide path design that balance return, income, and risks throughout the participant's life. He discussed risks in defined contribution investing: market volatility, savings shortfall, outliving savings, and inflation in addition to what asset classes were "safer" or "riskier" for each risk type. He reviewed the likely participant circumstances and investment objectives for different participant life stages that determine glide path design. Mr. Nikolich reviewed Alliance's approach to asset class diversification to dampen volatility without unnecessarily sacrificing returns. He also reviewed the performance of various Alliance Bernstein products, specifically focusing on products that Alliance Bernstein would actively manage for the WSIB. Mr. Healy noted the importance of an adaptable structure in target date fund implementation and reviewed Alliance Bernstein's customized retirement strategies which offer flexible plug and play manager structure. He reviewed areas of implementation, noting that simple, efficient, and proven operations provide for easy implementation.

Mr. Decker reviewed advantages of target date options for participants: simplified decision making for the vast majority of participants and improved participant investment elections. Target date fund options also address fiduciary concerns. Target date funds are an excellent solution to the majority of defined contribution investors that are not actively engaged in the management of their investments. Participant education is a crucial component of plan implementation and Alliance Bernstein offers customized communication approaches based on their experience and research of defined contribution investing. He reviewed two implementation case studies—"add to menu" and "plan re-enrollment"—which demonstrated that participant inertia is a large and extremely important obstacle to overcome. Mr. Decker reviewed key milestones of plan implementation and reviewed recent implementation experiences.

Mr. Thyne reviewed the Alliance Bernstein mission which is to have more knowledge and use knowledge better than any investment firm in the world, to use and share that knowledge to help their clients achieve investment success and peace of mind, and to place their clients' interests first and foremost.

Committee members expressed concern over participant education. Mr. Masters noted that, in concert with rigorous participant education, it is also important to carefully select the plan default option in order to assist participants in making a decision of utmost gravity.

**Ms. Schurke moved that the Public Markets Committee recommend the Board select Alliance Bernstein as the apparently successful firm for the Target Date Fund Manager search, subject to continued due diligence and successful negotiation of terms and conditions. Mr. Petit seconded, and the motion carried unanimously.**

Discussion took place regarding the 40-year term of this contract, the ability of the Board to cancel anytime without reason upon 5 days notice, the length and quality of the search process, and the extreme importance of participant outreach and education.

[The Committee recessed at 2:14 p.m. and reconvened at 2:21 p.m.]

### **U.S. ENHANCED INDEX STRATEGY AND PORTFOLIO REVIEWS**

Mr. Bruebaker noted that enhanced indexing is a form of active management managed around the index, which is structured to have less risk than pure active management but more risk than pure index investing. He stated that the U.S. equity enhanced index managers, Barclays Global Investors, Western Asset Management Company, and State Street Global Advisors, would provide overviews of their portfolio structure and performance. Mr. Bruebaker stated that staff's goal for the day was to provide the Committee the opportunity to hear the manager presentations, ask questions, and then direct staff to present a recommendation on enhanced indexing at the April Public Markets Committee meeting.

#### Barclays Global Investors

Mr. Keagy and Ms. Roy introduced themselves. Mr. Keagy noted that Barclays Global Investors (BGI) manages funds in two different enhanced strategies on behalf of the WSIB: a U.S. and an international strategy. He reviewed performance for 2007, since WSIB inception, and since inception of the strategy. Mr. Keagy noted that, while negative performance is expected from time-to-time in an enhanced index strategy, last year's experience was very difficult and not typical.

Ms. Roy reviewed the portfolio characteristics and risk controls around the benchmark. The Russell 3000 Alpha Tilts is a well diversified portfolio that seeks to add 0.5 percent to 1.0 percent alpha through risk-controlled stock selection. Quantitative methods allow very broad coverage universe. Ms. Roy stated her belief that quantitative investing as practiced by BGI is not a "black box" or purely technical. It is a tool to apply fundamental investment ideas to a broad universe with discipline and with risk control. She reviewed BGI's sector allocation noting how they look to add value in stock selection while remaining roughly neutral on industry allocation.

Ms. Roy reviewed the three drivers of BGI's stock over/underweight decisions: relative valuation insights; quality of financial statements; and sentiment insights. She provided an example of how BGI integrates alpha forecasts, risk, and transition costs to develop a well-diversified portfolio. Quantitative optimization allows them to balance forecasts with risks and

goals. Ms. Roy stated that it was unusual to have two of their three stock selection themes not rewarded. In 2007, relative valuation and quality were not rewarded in the U.S. strategy and relative valuation and sentiment were not rewarded in the international strategy.

Discussion ensued regarding cyclicalness of markets and strategies.

Ms. Roy provided examples of BGI's models for relative value and quality investing. She reviewed the areas of leadership, experience, and product commitment. Quantitative investing is a set of tools that allow BGI to apply good investment ideas very efficiently. She noted BGI's continued focus on industry-specific models and proprietary data and noted that product innovations were key to future success.

Significant discussion took place regarding performance; the viability of quantitative investing going forward; market volatility; active management; and market competition.

[Mr. Nakahara was no longer in attendance at 3:12 p.m.]

Western Asset Management Company

Mr. Fulton and Mr. Carieri introduced themselves. Mr. Carieri provided an organizational update including history, focus, organization structure, investment team, and assets under management. He reviewed Western's investment philosophy of long-term, fundamental value orientation and diversified strategies as well as their top/down, bottom/up investment process.

Mr. Fulton provided a performance and portfolio review. He noted that 2007 was one of the most difficult and illiquid investment periods with a tremendous amount of deleveraging within the financial system. He reviewed the U.S. fixed income market sector returns, noting that diversification did not help as everything, other than Treasuries, was affected.

Significant discussion ensued regarding the structure of Western's investment portfolio, sector allocation, and credit quality allocation. The Committee asked for an explanation of the decision making process Western undertook before entering into subprime and Alt A holdings.

Mr. Fulton noted their selections were generally in the highest part of the capital structure and they had never seen anything in the market that would have led them to expect losses in that part of the capital structure to the extent that has occurred. Western retains conviction that their holdings are undervalued and worth par.

[Ms. Schurke was no longer in attendance at 3:32 p.m.]

Discussion ensued regarding portfolio structure and risk.

State Street Global Advisors

Ms. Raynes and Mr. Thomas introduced themselves. Mr. Thomas provided an overview of the global enhanced equity team and assets under management. He reviewed the investment goal of the enhanced index product in which the WSIB is invested—excess return of 0.75 percent to 1.25 percent with a predicted tracking error of 1.50 percent—and their three step investment process: stock ranking, industry ranking, and portfolio construction. Mr. Thomas reviewed the portfolio characteristics, sector weighting versus the benchmark, and performance.

Discussion ensued regarding short-term and long-term performance. Mr. Thomas stated that they believe in their strategy going forward. He provided a recap of the 2007 market environment and reviewed current areas of concern. Mr. Thomas reviewed their performance attribution by stock and noted that performance was affected due to extreme underperformance of valuation models rather than specific stocks or sectors.

Discussion ensued regarding robustness of quantitative investment models going forward.

Following the manager presentations, the Committee directed staff to take a deliberate approach in reviewing the WSIB's enhanced index investments and come back to the Public Markets Committee in April with a formal recommendation. Mr. Nierenberg requested that in the future, staff investment recommendations contain much more analysis of risk.

**OTHER ITEMS**

There was no further business to come before the Public Markets Committee and the meeting adjourned at 4:23 p.m.