APPROVED

WASHINGTON STATE INVESTMENT BOARD
Public Markets Committee Meeting Minutes
June 2, 2009

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:	Mike Ragan, Chair Charlie Kaminski George Masten Robert Nakahara David Nierenberg Mason Petit Representative Sharon Tomiko Santos Judy Schurke
Members Absent:	John Magnuson
Other Board Members Present:	Pat McElligott
Others Present:	Theresa Whitmarsh, Acting Executive Director Gary Bruebaker, Chief Investment Officer Philip Paroian, Senior Investment Officer – Public Equity Kristi Bromley, Administrative Assistant – Investments Steve Dietrich, Assistant Attorney General Victor Kohn, Capital International, Inc. Paula Pretlow, Capital International, Inc.

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

The meeting convened with Chair Ragan identifying members present.

REVIEW AND APPROVAL OF MINUTES – APRIL 7, 2009

> **Mr. Petit moved to adopt the April 7, 2009, Public Markets Committee minutes. Ms. Schurke seconded, and the motion carried unanimously.**

MEDIUM- TO LONG-TERM PROSPECTS FOR EMERGING MARKETS

Ms. Pretlow introduced herself and Mr. Kohn. Mr. Kohn provided a recap of the emerging markets over the past 15 months, reviewing returns and the startling speed of equity decline in the second half of 2008. Mr. Kohn stated his belief that the decline in emerging markets is not reflective of the fundamentals in those markets.

[Representative Santos was in attendance at 1:06 p.m.]

Mr. Kohn reviewed emerging markets' currencies and noted the strict regulations put in place in emerging markets after the various crises in the 1990s, which were designed to decrease currency variability. He reviewed market fundamentals noting that emerging market countries learned from their previous crises and have put into place more discipline at the corporate level, regulatory level, and government level. Emerging markets demographics support rapid economic growth as younger populations fuel both job growth and consumption. Demand for consumer goods, credit, and better infrastructure should remain high, as should savings, investment, and growth.

Mr. Kohn reviewed the general economic health of emerging markets and reviewed fiscal balances and current account balances (as percent of gross domestic product) for emerging markets versus developed markets. Mr. Kohn noted that emerging markets have had to make do with low debt, which has imposed some discipline, and their governments have learned to live with fiscal discipline. He reviewed the strong surpluses of the corporate sector in emerging markets as well as their healthy domestic credit conditions. Mr. Kohn stated that emerging market economies are staged to grow faster than developed markets and in a more stable fashion.

[Mr. McElligott was in attendance at 1:23 p.m.]

Mr. Kohn reviewed the specific emerging markets of Brazil, Russia, India, and China and noted opportunities in other emerging market countries. He reviewed the historic performance of emerging markets. Fundamentally, emerging markets are on solid footing and should have performance in line with or better than the developed world.

Mr. Nierenberg noted that, given the WSIB's objectives and timeframes, it makes sense to be overweight emerging markets on a portfolio level so long as favorable growth and valuation ratios persist. In addition, as noted by Mr. Kohn, emerging markets represent over 30 percent of the global gross domestic product (GDP) but only about 12 percent of the world's stock market capitalization. Mr. Nierenberg agreed with Mr. Kohn's assessment that emerging markets share of GDP should grow, and more so, emerging markets share of capital markets should move closer to their share of GDP. Finally, he stated his belief that these markets are still less followed and there is an inherent opportunity for stock picking to add value.

EMERGING MARKETS PROGRAM REVIEW UPDATE

Mr. Paroian introduced himself and noted previous conversations with the Public Markets Committee regarding conducting a search to add capacity to the emerging markets equity portfolio. Mr. Paroian noted that the presentation would address additional questions posed by

Mr. Nierenberg regarding public equities' emerging markets strategy and outlook as these questions form an excellent framework for discussion.

1. What countries are emerging markets and what are not?

There is no clear definition or agreement on the criteria that make a country "emerging." Different benchmark providers use different methodologies. The Board, by adopting the Morgan Stanley Capital International (MSCI) and the Dow Jones (DJ) indices, effectively adopted their classification methods. MSCI focuses on market accessibility; size and liquidity; economic development; and geo-political risk while DJ uses the International Monetary Fund (IMF) framework, which uses per capita income, diversification of exports and the economy, and integration in the global markets as its three most important criteria.

Mr. Paroian reviewed the differences between the emerging markets classifications used by DJ and MSCI. DJ, by using the IMF classification, is primarily looking at a country's economic development. MSCI concentrates on whether a country's capital markets function in a manner consistent with developed markets. The biggest differences are South Korea, Taiwan, and Israel, countries in which the economies are developed, but where there may be significant geo-political risk and, in the case of South Korea and Taiwan, markets that do not have freely traded currency.

2. What should our strategy be for investing in emerging markets and what should our strategy be for investing in countries like Korea and Israel, which already have emerged? What should be our strategy for investing in pre-emerging, also known as frontier markets?

As equity markets are rapidly becoming global, classifications such as developed or emerging are becoming more irrelevant. Accordingly, the Board has moved to a global equity framework and benchmark. It is important to identify external managers that are skilled and smart and let them determine the appropriate exposure to the various markets.

3. Normatively what portion of our global equity mandate (domestic and foreign combined) should be invested in emerging, post-emerging, and pre-emerging, given our beliefs about long term growth, currency purchasing power over time, etc? How does this fit into our overall portfolio and why?

The equity portfolio is currently underweight emerging markets; this is not the desired long-term exposure. The optimal allocation is to fund emerging markets managers at a rate that would put the portfolio approximately neutral to the benchmark and use the developed market managers' ability to opportunistically invest in emerging markets to gain any desired overweighting of the benchmark.

4. Do we believe in active management or passive management in this area, or should we break the issue down further to say that certain parts might be passive and others active?

WSIB believes in active management in emerging market equities. The upcoming search is intended to identify managers in whom we have high conviction that have capacity for our size.

Staff are also exploring passive options for emerging markets exposure given that the current underweight is not desirable.

5. Assuming we want active management, what is the best way to proceed? How many segments comprise this market, defined by cap, geography, style, etc.?

While there may be superior managers that concentrate on particular countries or sectors or capitalization slices, the WSIB believes that the most efficient and productive equity structure is one that employs fewer managers with broader mandates and the freedom to migrate towards whatever countries, capitalizations, and sectors currently offer the best opportunities. This structure also facilitates more detailed monitoring within the constraints of the WSIB's staff resources. Accordingly, the search will look for managers that invest in broad global emerging market mandates.

6. Should we have a separate manager for each segment or more than one per segment? (How does this compare with our existing stable of emerging country managers? How do we characterize each of them? Are there any cap sizes, geographies, and or styles which are missing among our current set of managers? If so, shouldn't this be guiding the search for the additional managers that we might need?)

For diversification purposes, it is important to have more than one manager in every market segment. The equity portfolio currently employs four emerging markets managers. Mr. Paroian provided a review of each manager's strategy. Amongst the four managers, there are no major countries or geographies that are not represented. The upcoming search will seek to identify managers that may bring something new to the portfolio.

7. Who are the best managers in the world in each segment?

That is exactly the question the search is designed to address. Staff may use a global consulting firm such as Mercer Investment Consulting, which has offices around the world providing a local presence in Europe, in Asia, and in other regions that may uncover managers we would not identify if the search was limited to those managers primarily based in the U.S.

8. To the extent that we cannot today fund the full mandate for emerging markets, how and when should we close that gap?

Staff are investigating the use of passive management both as a temporary allocation to close the gap and as an alternative if we cannot identify or fund active managers. Staff are also discussing giving more assets to existing managers.

Discussion ensued regarding the desired allocation to emerging markets equity managers; risk of not being invested adequately in emerging markets; ability to use passive options to gain temporary exposure; emerging markets exposure across the entire portfolio; and potential risks and volatility if the current market recovery is not sustained.

OTHER ITEMS

There was no further business to come before the Public Markets Committee and the meeting adjourned at 2:30 p.m.