APPROVED

WASHINGTON STATE INVESTMENT BOARD
Public Markets Committee Meeting Minutes
January 5, 2010

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 George Masten Robert Nakahara David Nierenberg Judi Owens Mason Petit Judy Schurke
Others Present:	Theresa Whitmarsh, Executive Director Gary Bruebaker, Chief Investment Officer Bill Kennett, Senior Investment Officer – Fixed Income Philip Paroian, Senior Investment Officer – Public Equity David Thatcher, Investment Officer – Public Equity Kristi Bromley, Administrative Assistant – Investments Steve Dietrich, Assistant Attorney General
	Clive Gillmore, Mondrian Investment Partners Patricia Karolyi, Mondrian Investment Partners Andrew Miller, Mondrian Investment Partners Devan Kaloo, Aberdeen Asset Management Kieran McGlynn, Aberdeen Asset Management Peter Rathjens, Arrowstreet Capital

[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 – DECEMBER 1, 2009

Mr. Petit moved to adopt the December 1, 2009, Public Markets Committee minutes. Ms. Owens seconded, and the motion carried unanimously.

SAVINGS POOL POLICY 2.13.200 REVISION

Mr. Kennett introduced himself and reviewed the proposed revision to the Savings Pool policy. As a result of the current market crisis, eight of the ten insurance companies providing guaranteed investment contracts (GICs) to the Savings Pool have been downgraded to below Aa3, the policy's minimum rating. Staff has developed a transition plan for the Savings Pool until the markets stabilize. The plan consists of investing the maximum allowed under policy with the insurance companies rated Aa3 or better and investing the remaining cash in a money market fund. As markets normalize and ratings improve to Aa3 or better, staff will move back out of cash into GICs. If ratings do not improve over time, staff will reevaluate the investment strategy for this investment option. The Savings Pool investment policy requires the weighted average maturity to be between two and four years. If the transition plan is implemented, the weighted average maturity could fall below two years. Staff recommends revising the weighted average maturity constraint to four years or less.

Mr. Bruebaker noted that staff has been in close communication with Steve Hill, director of the Department of Retirement Services, who is in support of this policy change.

> **Mr. Masten moved that the Public Markets Committee recommend the Board approve the proposed revision to the Savings Pool Policy 2.13.200. Ms. Schurke seconded, and the motion carried unanimously.**

ACTIVE GLOBAL EMERGING MARKETS INVESTMENT MANAGEMENT INTERVIEWS

Mr. Thatcher introduced himself and briefed the Committee on the results of the emerging markets investment manager search. In the six-year strategic plan adopted by the Board, emerging markets were identified as a future focus for the WSIB. In the 2009 public equity annual plan, staff identified a significant underweight to emerging markets and, at that time, the prevailing wisdom was that risk aversion would be present in global equity markets for a considerable period. Accordingly, the emerging markets manager search was scheduled for the second half of 2009. However, equity markets bounced back unexpectedly starting in early March 2009.

Mr. Thatcher noted the Committee's and Board's determination that the optimal portfolio positioning is to move closer to neutral emerging markets and overweight emerging markets in the long term. Emerging market countries, having learned from the previous emerging markets crises, now behave with more discipline at the corporate level, regulatory level, and government level. Domestic demand and the need to build better infrastructure are key areas in emerging markets. Strong growth in emerging markets is expected to continue, although at more modest rates.

Mercer Investment Consulting, Inc. (Mercer) was engaged by the WSIB to assist staff with the emerging markets manager search. Mercer reviewed 253 separate products for the mandate and WSIB staff conducted onsite visits with four of the firms. Mr. Thatcher stated that staff recommended adding three additional emerging markets managers and all three managers would present to the Public Markets Committee on their capabilities and differentiating characteristics.

As discussed in the 2010 public equity annual plan, staff believes downside protection is important and investing in managers with styles designed to offer downside protection is preferred. In the more volatile emerging markets, managers that protect on the downside tend to outperform over the long term. With the strong run up in emerging markets over the past year, leading to the current high valuations, there might be a risk of a near-term correction, and staff would recommend a neutral weight to emerging markets at this time.

Mr. Paroian introduced himself and reviewed analysis conducted by Mercer on the composite emerging markets program should the three recommended managers be hired. The analysis showed a capitalization overweight to mid- and small-cap securities with a slight bias to certain value and growth characteristics.

Discussion ensued regarding the importance of exposure to areas such as natural resources, commodities, and energy as well as particular country concerns.

<u>Mondrian Investment Partners</u>
Mr. Gillmore, Mr. Miller, and Ms. Karolyi introduced themselves. Mr. Gilmore provided an organizational overview, including leadership, ownership structure, assets under management, consistent focus on investment philosophy and process, and team. He provided an overview of the emerging markets investment team and discussed the investment decision-making process. He reviewed Mondrian's business profile, including types of clients served, types of assets managed, and diverse investment products. He reviewed their investment philosophy, noting that Mondrian is a value-orientated defensive manager that focuses on producing a real rate of return and on risk as they seek to preserve client capital during market declines. Mr. Gillmore reviewed Mondrian's defensive characteristics and performance during both bull and bear markets, noting their outperformance during down markets. He reviewed a risk/reward scatter chart for ten years ended September 30, 2009, showing a high, annualized rate of return with low standard deviation.

Mr. Miller noted that Mondrian spends a lot of time analyzing worst-case scenarios as part of their risk management process. They utilize a value-oriented dividend discount methodology, purchasing power parity approach to currency, and extensive worldwide fundamental research with an emphasis on company visits. Mondrian utilizes a fundamental process focused on the long term.

Mr. Miller reviewed Mondrian's framework for decision making, which is both top down and bottom up. Country analysis is very important, as is stock selection. He reviewed bottom up screening tools, such as security research, as well as top down analysis, such as country and currency analysis. He also reviewed Mondrian's defensive currency strategy, sell discipline, and risk control features. Their sell discipline is focused on price appreciation, change in fundamentals, more attractive opportunities, and change in political environments. Risk control features include dividend discount model, worst-case risk assessment, security holding limits, currency issues, and avoiding direct local markets where necessary. He reviewed portfolio characteristics, including country allocation and sector allocations, and provided summary portfolio characteristic, including portfolio turnover, market capitalization, price to book value ratio, price to cash flow ratio, price to earnings ratio, and dividend yield.

Mr. Gillmore reviewed Mondrian's differentiating characteristics, including long-term objectives, disciplined and fundamentally driven approach, defensive strategy, and consistent characteristics in addition to their focus on helping clients meet their long-term needs.

Discussion ensued regarding the outlook for emerging markets and specific emerging market country concerns.

Aberdeen Asset Management

Mr. McGlynn introduced himself and Mr. Kaloo. He provided a brief overview of the firm's history, assets under management, office locations, team, proprietary research, ownership structure, investment process, and track record.

Mr. Kaloo discussed the emerging markets team and noted their disciplined investment process with team members cross-covering markets. He reviewed Aberdeen's investment philosophy and approach including their belief that, over the long term, share prices reflect underlying business fundamentals. He stated that Aberdeen invests for the long term in companies that they believe they can understand and can add value. They seek to identify 'best ideas' at reasonable/cheap valuations through company visits and view risk as investing in a poor quality company and/or overpaying.

Mr. Kaloo reviewed Aberdeen's investment process, which begins with company visits and a decision on the quality of the company based on business prospects/strategy, management team, financials, transparency, and commitment to shareholder value. The second step of the investment process is a determination of price, which includes valuation, cross border and industry comparisons, focusing on the downside, and modeling of each investment prospect. The third step is portfolio construction, which incorporates risk controls such as diversification. Aberdeen prefers straightforward, focused businesses with good management. He reviewed factors used in evaluating companies including dilution, management and corporate governance, accounting policies, and balance sheet/cash flow.

Mr. Kaloo reviewed portfolio construction and potential sell triggers. He summarized Aberdeen's competitive advantages: significant experience investing in emerging markets, experienced and cohesive team, robust investment process, proprietary research, independence, and strong track record.

Discussion ensured regarding company visits and country weightings.

Arrowstreet Capital

Mr. Rathjens introduced himself and provided an overview of the firm including focus on global/international and emerging markets equities, commitment to research, ownership structure, and assets under management. He reviewed the performance objective of Arrowstreet's emerging markets equity strategy as well as the core investment style of the strategy, which is style neutral over long periods, risk controlled, and has outperformed during a broad range of market environments. He noted that Arrowstreet's quantitative investment approach provides diversification from other managers.

Mr. Rathjens reviewed Arrowstreet's investment philosophy of adding value by identifying investment signals that are relevant to prices, reflected slowly in prices, and derived from both behavioral and informational mispricings; measuring direct effects (stock) and indirect effects (country, global sector, country/sector basket, and related company information); and disciplined approach, which avoids emotional overrides. He reviewed an example of the influence of countries, sectors, baskets, and expanded linkages in portfolio construction and provided an example of Arrowstreet's investment process, including sector information, country information, expanded linkages (i.e., proprietary model), currency information, and stock information, which all result in an overall stock forecast.

Mr. Rathjens discussed Arrowstreet's risk management, which includes their proprietary risk model, and their portfolio construction process, which includes transaction costs, risk estimates, and risk controls. He reviewed an example of emerging markets trading, including direct effects (stock factors), indirect effects (country, sector, currency factors), excess return forecasts, and optimized portfolio construction weighting.

Discussion ensued regarding Arrowstreet's performance and how country weighting is an implicit outcome of stock selection.

Following the manager presentations, the Committee discussed the ability of the WSIB to put money to work with these managers, who all have high demand for their product.
Mr. Nierenberg noted his support for all three managers based on the following: (1) Emerging markets are a good place for the WSIB to be invested. On average, the growth rate in emerging markets countries will be higher than developed markets over the long term. With the effect of compounding, this is a significant benefit to the plan's beneficiaries. (2) Emerging markets are not informationally efficient and active, shrewd investing by high quality firms adds a great deal of value in this market space. (3) The manager search was a rigorous global process that canvassed hundreds of firms, and these three have emerged at the top. They are all different from each other and all have outstanding performance.

[Ms. Schurke was no longer in attendance at 3:49 p.m.]

> **Mr. Masten moved that the Public Markets Committee recommend the Board select Aberdeen Asset Management, Arrowstreet Capital, and Mondrian Investment Partners for active global emerging markets investment management mandates, subject to continued due diligence and successful negotiation of terms and conditions.**
> **Ms. Owens seconded.**

Mr. Masten noted his agreement with Mr. Nierenberg's statement and said that emerging markets is an area where we get our money's worth with active management.

Discussion ensued regarding the long-term focus for emerging markets investing and staff's recommendation for a neutral weight to emerging markets at this time, given the recent run up, as well as the importance of having managers that offer downside protection. Mr. Bruebaker stated that the WSIB has a long investment horizon and emerging markets investing is a long term strategy in which we expect to be overweight in the long term, benefiting the WSIB's members.

> **The motion carried unanimously.**

PUBLIC MARKETS EQUITY – RETIREMENT FUNDS POLICY 2.10.100 REVISION

Mr. Paroian introduced himself and reviewed the proposed changes to the Public Markets Equity – Retirement Funds policy. These changes are consistent with the 2010 public equity annual plan approved by the Public Markets Committee and Board in December 2009. The revisions correct the emerging markets underweight created by the policy's limitation on the allocation to dedicated emerging markets managers to a maximum of 5 percent less than the emerging markets weight of the non-U.S. benchmark. It also removes the segmented framework for the asset class, removing the specific percentage target allocations for passive, enhanced index, core, value, and growth managers.

[Mr. Nierenberg was no longer in attendance at 3:56 p.m.]

Discussion ensued regarding passive options for emerging markets investing.

[Ms. Owens was no longer in attendance at 4:03 p.m.]

> **Mr. Petit moved that the Public Markets Committee recommend the Board approve the proposed revisions to the Public Markets Equity – Retirement Funds Policy 2.10.100. Mr. Masten seconded, and the motion carried unanimously.**

OTHER ITEMS

There was no further business to come before the Public Markets Committee and the meeting adjourned at 4:04 p.m.