

**WASHINGTON STATE INVESTMENT BOARD  
Public Markets Committee Meeting Minutes  
September 10, 2013**

The Public Markets Committee met in open public session at 1:00 p.m. in the boardroom at the Washington State Investment Board in Olympia, Washington.

Members Present:            Marcie Frost, Chair  
                                     Kelly Fox  
                                     Bill Longbrake  
                                     Bob Nakahara  
                                     David Nierenberg  
                                     Mike Ragan  
                                     Joel Sacks  
                                     Natasha Williams

Other Members  
Present:                        George Masten  
                                     Treasurer Jim McIntire

Others Present:            Theresa Whitmarsh, Executive Director  
                                     Gary Bruebaker, Chief Investment Officer  
                                     Phil Paroian, Senior Investment Officer – Public Equity  
                                     Bill Kennett, Senior Investment Officer – Fixed Income  
                                     Allyson Tucker, Senior Investment Officer – Risk  
   Management and Asset Allocation  
                                     Maria Tosteson Rosen, Assistant Senior Investment  
   Officer – Fixed Income  
                                     Rhonda McNavish, Assistant Senior Investment Officer  
   – Public Equity  
                                     David Thatcher, Investment Officer – Public Equity  
                                     Fletcher Wilson, Investment Officer – Public Equity  
                                     Kristi Bromley, Administrative Assistant – Investments  
  
                                     Hamish Douglass, Magellan Financial Group  
                                     William Forsyth, Frontier Partners, Inc.  
                                     Dawn Cortez, Assistant Attorney General

[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 Frost identifying members present.

## ADOPTION OF MINUTES

**Mr. Ragan moved to adopt the June 11, 2013, minutes. Ms. Williams seconded, and the motion carried unanimously.**

## 2014 MEETING SCHEDULE

**Mr. Ragan moved to adopt the 2014 meeting schedule as presented. Ms. Williams seconded, and the motion carried unanimously.**

[Mr. Sacks arrived at 1:03 p.m.]

## U.S. TREASURY INFLATION PROTECTED SECURITIES FUND POLICY 2.14.400 ADOPTION

Ms. Tosteson Rosen introduced herself and noted the Board's approval in June of transferring management of the U.S. Treasury Inflation Protected Securities (TIPS) component of the Retirement Strategy Funds (RSFs) to the internal WSIB fixed income unit. The primary reasons for the change were the lower cost of internal management and our high conviction in WSIB's internal fixed income team. The proposed policy establishes a U.S. TIPS Fund for both qualified and non-qualified assets. She reviewed the goals and permissible investments of the proposed U.S. TIPS Fund, noting that TIPS currently represent about 8 percent of the Treasury market and are backed by the full faith and credit of the U.S. government.

**Mr. Ragan moved the Public Markets Committee recommend the Board approve the U.S. Treasury Inflation Protected Securities Fund Policy 2.14.400. Ms. Williams seconded, and the motion carried unanimously.**

## POLICY REVISIONS

Mr. Thatcher introduced himself and noted the Board-approved changes to the RSFs and public equity portfolio within the Commingled Trust Fund (CTF) require revisions to three investment policies. The revisions reflect the change of the international equity component of the RSFs to a passively managed portfolio, the movement of the U.S. Treasury Inflation Protected Securities component of the RSFs to be managed by the WSIB's fixed income team, and the creation of a passive emerging markets equity portfolio for the CTF. Additionally, the benchmark for the Socially Responsible Balanced Fund was revised to add international equity.

**Mr. Ragan moved the Public Markets Committee recommend the Board approve the proposed revisions to the Public Markets Equity – Retirement Fund Policy 2.10.100, the Defined Contribution Plan 3 Retirement Funds Policy 2.11.100, and Deferred Compensation and Judicial Retirement Account Policy 2.13.100. Ms. Williams seconded, and the motion carried unanimously.**

### **ACTIVE GLOBAL EQUITY MANAGER INTERVIEW AND RECOMMENDATION**

Mr. Paroian introduced himself and offered to answer any questions on the due diligence conducted by staff related to the recommendation. There were none.

Mr. Douglas, Magellan Financial Group (MFG), and Mr. Forsyth, Frontier Partners, introduced themselves. Mr. Forsyth provided an overview of MFG, a Sydney-based global equity investment firm established in 1996 with U.S. \$14.5 billion in assets under management, U.S. \$11.9 billion of which is in the Global Equity strategy (MFG Global Equity). He reviewed the firm's staff size and investment team, as well as the firm's alignment of interest with clients. Mr. Forsyth noted the amount of resources focused on the quality of the investment portfolio.

Mr. Douglas reviewed MFG Global Equity's philosophy, which is a long-term investment approach with the objectives of protecting capital in adverse markets and generating a gross return of 10 percent per annum through the economic cycle. The portfolio is driven by the adoption of an unconstrained, concentrated approach focused on risk-adjusted returns rather than benchmark-relative returns. He noted that their investment process integrates multiple alpha generation sources: intensive bottom-up stock analysis and industry research; broad and detailed macroeconomic insight; and rigorous portfolio construction and risk discipline all resulting in a portfolio designed for capital preservation and absolute returns. He provided a review of the portfolio construction process, which combines a portfolio of consistent, low-beta stocks with a portfolio of higher beta stocks for a total portfolio that has lower volatility than the overall market yet participates in strongly up markets, and reviewed MFG Global Equity's risk controls.

Discussion ensued regarding inherent risks in the strategy, lessons learned, sector focus, culture of accountability, and portfolio turnover.

Mr. Forsyth reviewed MFG Global Equity's composite performance and risk measures as of June 30, 2013. He summarized the presentation by noting their strong alignment of interest with clients; well-resourced team;

long-term, unconstrained approach; in-depth company analysis with macroeconomic overlay; and conviction and discipline to invest in a concentrated manner.

Further discussion ensued regarding average market cap of the portfolio and point at which they would close the strategy to new investors.

Upon the departure of the presenters, the Committee and staff discussed the fit of MFG Asset Management within the public equity CTF portfolio.

**Mr. Ragan moved the Public Markets Committee recommend the Board hire MFG Asset Management for an active global equity mandate within the Commingled Trust Fund, subject to continued due diligence and successful negotiation of terms and conditions. Ms. Williams seconded, and the motion carried unanimously.**

## **INVESTMENT DISCUSSIONS**

### **Alternative Passive Research Presentation and Recommendation**

Ms. McNavish introduced herself and provided background on the public equity program, including strategies and objectives, and reviewed select Investment Beliefs for the CTF. She noted the alternative passive investing education session given by Ms. Tucker in December 2012 and provided a review of key concepts related to alternative passive investing, including market capitalization; beta; volatility; tracking error; benchmark; and passive management. She reviewed the pros and cons of market-capitalization weighting methodology for passive benchmarks, as well as the pros and cons of alternative weighting methodologies emphasizing value characteristics and those that emphasize low absolute volatility.

Ms. McNavish reviewed charts as of June 30, 2013, which showed the effect of value in the U.S., World ex-U.S., and Global markets. She also reviewed the style factors of the current public equity CTF portfolio and the effect on the overall portfolio of a \$1.5 billion investment in a value-weighted index. She reviewed the same information for a \$3.0 billion investment.

In conclusion, Ms. McNavish noted that staff recommended replacing \$1.5 billion of the U.S. passive equity CTF portfolio currently managed against the MSCI USA IMI with a product passively managed against a benchmark with a construction methodology emphasizing value characteristics. The \$1.5 billion allocation represents approximately 15 percent of the passively managed U.S. assets and approximately 10 percent of the overall CTF passive equity portfolio. She stated that staff believes the use of an alternative construction methodology is an active decision and represents an important

change to passive U.S. equity management within the WSIB's public equity CTF portfolio. She reviewed the next steps involved if the Public Markets Committee and Board approved the investment

Discussion ensued regarding the backdated performance of value-weighted indices versus non-value weighted indices since 1999; low fees for a value weighted alternative passive investment; diversification and risk management aspects of utilizing an alternative weighted methodology for a portion of the CTF public equity program; and implementation plan.

**Mr. Ragan moved the Public Markets Committee recommend the Board replace \$1.5 billion of the U.S. passive equity portfolio currently managed by Blackrock against the MSCI USA IMI with a product that is passively managed against a benchmark whose construction methodology results in an increased emphasis on value characteristics for the U.S. passive portfolio overall. Ms. Williams seconded, and the motion carried unanimously.**

### **Adding Emerging Markets Capacity**

Mr. Paroian introduced himself and reviewed reasons this may be an opportune time for the WSIB to increase its exposure to emerging markets within public equity, as well as challenges of doing so. He reviewed the pros and cons of using intermediaries to access emerging markets equity managers as well as potential approaches for the upcoming emerging markets managers search.

Discussion ensued regarding finding the right managers with whom to conduct business and the use of alternative strategies to maximize the reach of staff.

### **OTHER ITEMS**

There was no further business to come before the Public Markets Committee and the meeting adjourned at 3:05 p.m.