APPROVED

WASHINGTON STATE INVESTMENT BOARD
Public Markets Committee Meeting Minutes
February 3, 2015

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:	Joel Sacks, Chair Marcie Frost Arlista Holman Stephen Miller Bill Longbrake David Nierenberg (teleconferenced)
Members Absent:	Representative Timm Ormsby Bob Nakahara
Other Members Present (Not Participating):	Kelly Fox George Masten
Others Present:	Theresa Whitmarsh, Executive Director Gary Bruebaker, Chief Investment Officer Phil Paroian, Senior Investment Officer – Public Equity Rhonda McNavish, Assistant Senior Investment Officer – Public Equity Fletcher Wilson, Investment Officer – Public Equity Stacy Conway, Administrative Assistant – Investments Dawn Cortez, Assistant Attorney General Rhonda Berger, Christopher Chard, and Douglas Edman, Brandes Investment Partners Michele Aghassi and William Latimer, AQR Capital Management

[Names of other individuals attending the meeting are listed in the permanent record.]

Chair Sacks called the meeting to order and took roll call.

ADOPTION OF MINUTES

Ms. Holman moved to adopt the December 2, 2014, minutes. Ms. Frost seconded, and the motion carried unanimously.

[Mr. Miller arrived at 1:04 p.m.]

PUBLIC EQUITY EMERGING MARKETS SEARCH RESULTS AND RECOMMENDATION

Mr. Wilson provided an overview of the Public Equity program in the Commingled Trust Fund (CTF). He explained WSIB's definition of emerging markets and shared the rationale for investing in these markets. He said staff continues to recommend an allocation to emerging markets, but that allocation could be either active or passive. He discussed the reasons for using active management and the considerations used by staff in choosing active managers, stating the passive account is used primarily for capacity issues. Mr. Wilson described the search process staff used, saying the process was open and fair and in accordance with state procurement requirements, although customized for the specific needs of this search.

Discussion ensued around the differences in the definitions of emerging markets and the number of emerging markets active managers retained at any given time.

Chair Sacks asked about the results of the most recent search prior to this one. Mr. Paroian introduced himself and shared an overview of the previous search results. He communicated that staff was satisfied with both managers chosen, Aberdeen and Mondrian, and said when their current contracts expire as of March 31, 2015, both will be renewed for an additional five years as allowed under the contracts.

EXECUTIVE SESSION – ADDITIONAL DISCUSSION

Chair Sacks announced that the Committee would go into executive session to discuss financial and commercial information relating to an investment, since public knowledge regarding the discussion would result in loss to the funds managed by the Board or would result in private loss to the providers of the information. He said the executive session was expected to last approximately 20 minutes, at which time the Public Markets Committee would reconvene in open session.

[The Committee went into executive session at 1:12 p.m. and reconvened in open session at 1:32 p.m.]

Messrs. Chard and Edman and Ms. Berger, Brandes Investment Partners, introduced themselves. Mr. Chard provided an overview of the firm's history, staffing, and assets under management (AUM). He noted that Brandes focuses solely on a value investment approach. He discussed the company's philosophy, sharing that the organization was built with a long-term focus. Mr. Chard said the emerging markets portfolio is close to closing, at an AUM that is low but in the best interest of clients. He said the firm has a low level of personnel turnover, and a distinguishing characteristic is the level of co-investment by staff in Brandes mandates.

Ms. Berger discussed the company's long-term mindset and described the research department. She also discussed the considerations in valuing a particular company.

Ms. Berger shared a schematic of the core Benjamin Graham value concept and discussed the drivers of portfolio decisions, including maximizing the margin of safety and discussed guidelines and constraints in place to ensure proper diversification.

She discussed Brandes' risk management and shared a schematic over time of the allocation of the portfolio from large-cap to small-cap stocks, stating that the allocation is driven by the opportunities available.

Mr. Edmond discussed the portfolio's key overweights and underweights.

Discussion ensued regarding the historical comparison of Brandes to the benchmark, with Mr. Edmond sharing some of the specific differences over the last two years and considerations relative to investment risk in Russia. He also described differences in the portfolio makeup over time and shared reasons for the differences.

Mr. Edman discussed the comparison of the Brandes portfolio to the MSCI emerging markets index on price to book, price to earnings, and price to cash flow and dividend yield, both current and the 10-year average, highlighting why Brandes believes there will be some significant outperformance for emerging markets.

[Mr. Fox arrived at 2:10 p.m.]

Mr. Chard discussed performance history and academic studies on growth versus value in emerging markets and said there is real world evidence of Brandes' track record.

Mr. Edman discussed the types of economic environments in which the portfolio should outperform or underperform relative to the benchmark.

Discussion ensued regarding reasons for the improved performance over the benchmarks since 2007; the proportion of Brandes staff who were born, raised, and/or are located in emerging markets; locations in which company earnings are derived; the determination of at what level to close AUM to new accounts; proxy voting; internal policies; and reassessment of holdings over time relative to climate change,

[The Committee recessed at 2:35 p.m. and reconvened at 2:50 p.m.]

Ms. Aghassi and Mr. Latimer, AQR Capital Management, introduced themselves. Mr. Latimer provided an overview of the firm's history, staffing, and strategies. He discussed the differentiated way the company approaches management of the strategy, primarily the separation of stock selection from the selection of currencies and the selection of countries. Mr. Latimer shared the breakdown of the firm's AUM, in total and by strategy.

Mr. Latimer provided an overview of the AQR staff and team structures. He said innovations are shared across all the strategies. Mr. Latimer discussed the team leadership, saying there is overlap between teams to maintain consistency of the approach and application of investments. He described the history of the firm's ability to run this type of mandate and consistency in the principals and the approach over time.

Ms. Aghassi provided an outline of the specific way AQR implements its approach. She discussed the reasons for and the key benefits of this approach and described AQR's processes in building its portfolio. Ms. Aghassi described the considerations in analyzing stocks, country, and currency and said that, while AQR is a quantitative investment manager, fundamentals drive asset returns. The ideas are similar to those of a fundamental investor; however, AQR will use a systematic process.

Ms. Aghassi discussed AQR's process for getting the implementation right and said that while the process is systematic, it is not on autopilot. She said AQR can and will override models and processes when needed, and getting it right can and does have a meaningful effect on returns. Ms. Aghassi said the end result is an investment process that is fully invested at all times. Their goal is to take lots of small to moderate size positions that add up to a moderate excess return. She shared examples of overrides made due to specific circumstances.

Mr. Nierenberg said it is great that even though AQR is a quantitative shop, they are willing to exercise subjective judgment. Ms. Aghassi added that the nature of overrides is always to reduce active risk.

Ms. Aghassi described AQR's approach to trading and risk control and the realized returns and tracking error, including a breakdown from each of the three strategies: stock, country, and currency.

Mr. Nierenberg asked why higher growth rates in emerging markets have not translated into greater wealth creation for public stock investors in those markets in the recent past. Ms. Aghassi noted that a 6-year period is relatively short. Looking over a longer period, emerging markets have outperformed versus developed market counterparts.

Ms. Aghassi discussed the allocations, returns, and tracking error of the large- and small-cap strategies, as well as the process of combining them into a customized 80/20 allocation as requested by the WSIB. She explained the country and currency tilts, particularly the largest overweights and underweights.

Discussion ensued regarding the country and currency tilts over time, holding times for country and currency investments versus that of stocks, AQR's modeling sensitivity relative to quantitative easing and other factors that deviate from the norm, testing of tracking error to find causes for differences, and use of economic intuition along with modeling.

Mr. Longbrake asked if staff had reviewed AQR's models and raised a concern that the correlation among the stock, country, and currency models could change over time.

Mr. Wilson responded that 2008 demonstrated the most diversification within results for the stock, currency, and country models, showing that in times of really needing it, AQR had been able to create diversification. He stated AQR has a very impressive, educated staff and is a very sharp, forward-thinking quantitative shop.

Discussion followed around the use of quantitative versus fundamental management and the associated issues with each; the pros and cons of the investment strategy of each of the managers presenting; the ongoing search for managers in which the WSIB has high conviction; the importance of diversity in emerging markets manager staff and the various approaches to this used by managers; the challenges in finding managers; and the amount of trading done by quantitative managers versus that of fundamental managers.

> **Mr. Miller moved that the Public Markets Committee recommend the Board approve the proposed restructuring of the public equity emerging markets program, including the hiring of AQR Capital Management LLC and Brandes Investment Partners, along with the specific steps discussed in executive session. Ms. Holman seconded, and the motion carried unanimously.**

Other Trust Fund Investment Policy

Mr. Moore said the Board is required to review certain agency policies every 3 years. Staff's proposed update to the Other Trust Fund Investments Policy 2.35.200 is for the Committee's consideration and recommendation to the Board for final approval.

In 2012, the Legislature unanimously passed and the Governor signed Engrossed House Bill 2620, which moved 11 different funds from the WSIB to the State Treasurer. The proposed revision reflects the removal of 5 of those funds from the policy to align with the current statute. The other 6 funds were contained in other policies the Board had already dealt with.

> **Ms. Holman moved that the Public Markets Committee recommend the Board approve the proposed revisions to the Other Trust Funds Investment Policy 2.35.200. Mr. Miller 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 4:16 p.m.