Washington State Investment Board

WSIB Overview for the LEOFF Board

Theresa Whitmarsh
Executive Director
September 22, 2010

Overview

- Mission
- Fundamental Policies
- Organizational Structure
- Total Assets Under Management
- Performance and Market Values
- Asset Allocation
- Risk Management
- Future Challenges

Our Mission

Invest with integrity, prudence, and skill to meet or exceed the financial objectives of those we serve.

Fundamental Policies

"The Board shall establish investment policies and procedures designed exclusively to maximize return at a prudent level of risk." (RCW 43.33A.110)

"The State Investment Board shall invest and manage the assets entrusted to it with reasonable care, skill, prudence, and diligence under circumstances then prevailing which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an activity of like character and purpose." (RCW 43.33A.140)

"The Board shall consider investments not in isolation, but in the context of the investment of the particular fund as a whole and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suited for that fund." (RCW 43.33A.140)

Organizational Structure

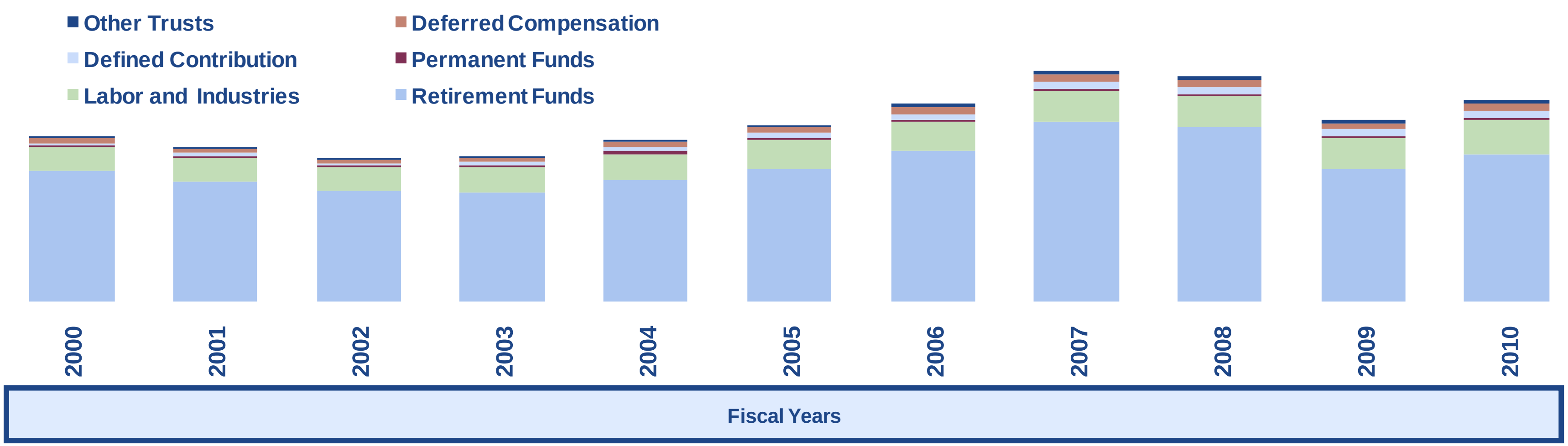
- Board comprised of 15 members
  - 10 voting
  - 5 non-voting
- 80 staff

	Appointment Authority	Name	Position
10 Voting	Ex-Officio	Jim McIntire, Vice Chair	State Treasurer
		Steve Hill	Director, DRS
		Judy Schurke	Director, Labor & Industries
	Senate President	Lisa Brown	State Senator
	House Speaker	Sharon Tomiko Santos	State Representative
	Governor	Vacant	Active Member, PERS
		George Masten	Retired Member, PERS
		Patrick McElligott, Chair	Active Member, LEOFF
	Superintendent of Public Instruction	Judi Owens	Active Member, SERS
		Mike Ragan	Active Member, TRS
5 Non-voting	Selected by the Board	Robert Nakahara	
		Jeffrey Seely	
		David Nierenberg	
		William A. Longbrake	
		Richard Muhlebach	

Total Assets Under Management

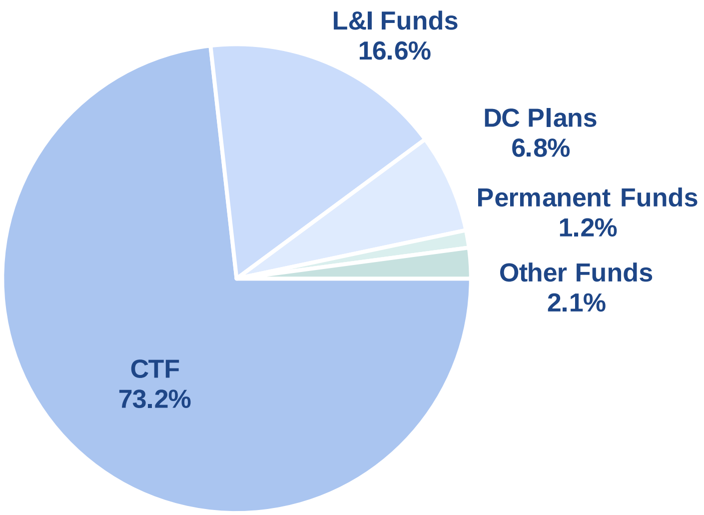
June 30, 2010

Past 10 Fiscal Years



Market Values and Allocation (in billions)

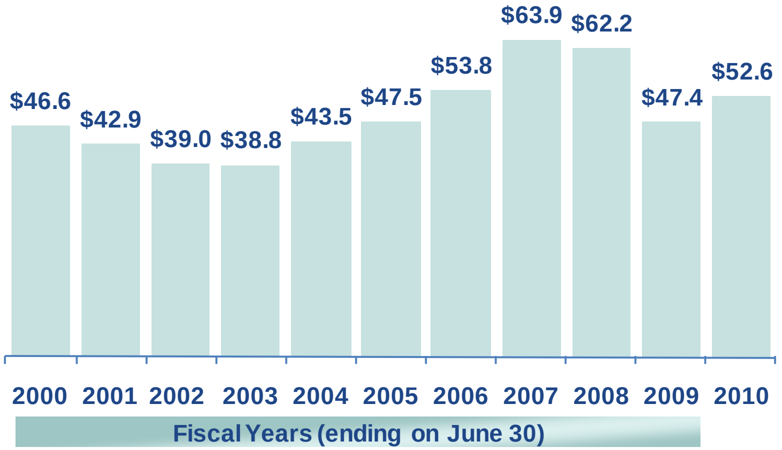
CTF	$52.6	73.2%
L&I Funds	$12.0	16.6%
DC Plans	$4.9	6.8%
Permanent Funds	$0.9	1.2%
Other Funds	$1.5	2.1%
Total Assets Under Management	$71.9	



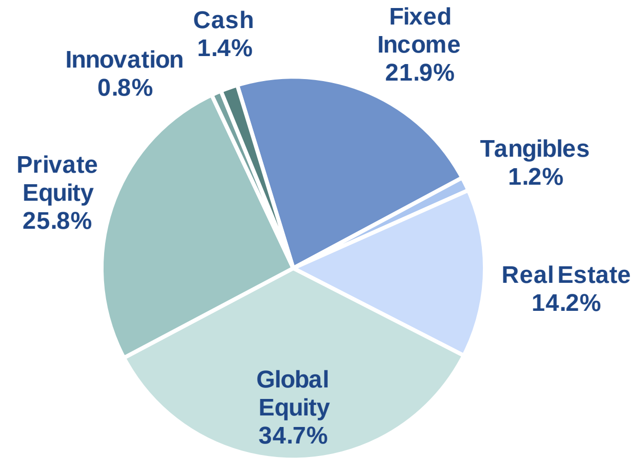
Commingled Trust Fund (CTF) Performance and Market Values

June 30, 2010

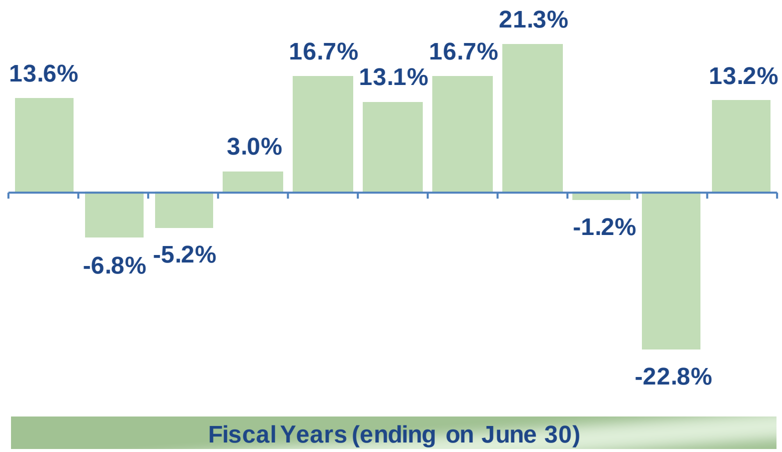
Historical Market Value (billions)



Actual Allocation



Historical Fund Returns



Market Values and Returns

Commingled Trust Fund (CTF) Market Values and Returns					
	Market Value (000s)	1 Year	3 Year	5 Year	10 Year
Total CTF	$52,631,343,408	13.22%	-4.80%	4.08%	3.92%
Fixed Income	$11,520,484,474	12.47%	8.92%	6.68%	7.41%
Tangibles	$610,342,643	10.10%	0.10%	N/A	N/A
Real Estate	$7,481,110,628	-3.82%	-7.68%	4.13%	9.17%
Global Equity	$18,265,479,128	13.52%	-10.69%	0.91%	0.28%
Private Equity	$13,557,800,697	23.95%	-4.10%	9.67%	6.58%
Innovation	$438,620,576	11.89%	N/A	N/A	N/A
Cash	$757,505,261	0.17%	1.92%	3.01%	2.18%

Return since inception of the CTF (6/30/1992): 8.16%

Asset Allocation Review – Conducted in 2009

The questions for us:

- Is it different this time?
- Are there fundamental shifts in the world economic order that would cause us to change course?

Series of analysis and Board education sessions in the six months leading up to the asset allocation review at the Board's July annual planning session.

These included:

- Liquidity analysis
- Review of capital market assumptions
- Review of investment beliefs
- Review of risk preferences

Asset Allocation Review – Liquidity Analysis

What we knew before the crisis:

- Nearly 40 percent of portfolio illiquid
- Large unfunded commitments
- Illiquid investments balanced by liquid investments
  - Public equity and fixed income
- Unfunded commitments will be drawn down over many years

What we learned during the crisis:

- Credit markets seized up and corporates were thinly traded
- Gates on some commingled equity funds limited ability to withdraw

What we did in response:

- Sold treasuries, then moved to public equity rather than selling corporates
- Asked partners to raise the investment return hurdle for investing, reducing capital calls, though lack of credit made this a moot point – deal flow ground to a halt
- Set up separate accounts for equities, without gates
- Built up cash balances

Results:

- Made it through the crisis without having to sell any illiquid instruments
- Follow on measures position us well for future liquidity events

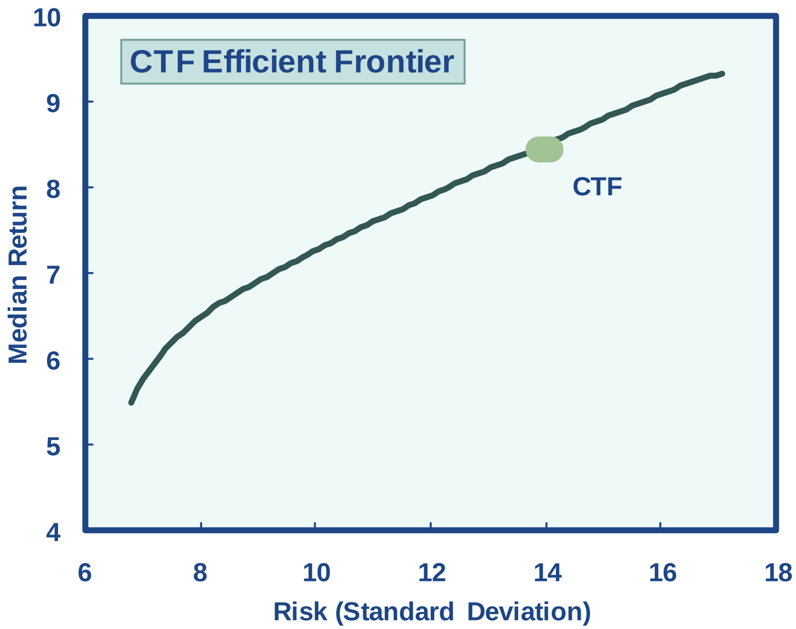
Asset Allocation Review – Capital Market Assumptions

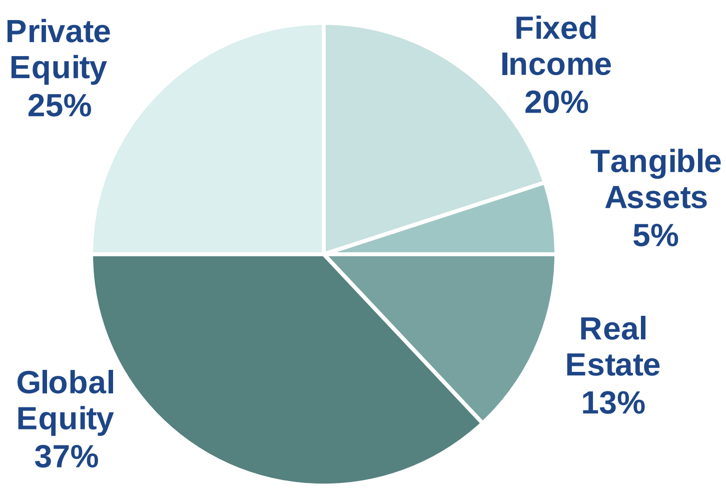
Comparison of 2009 and 2010

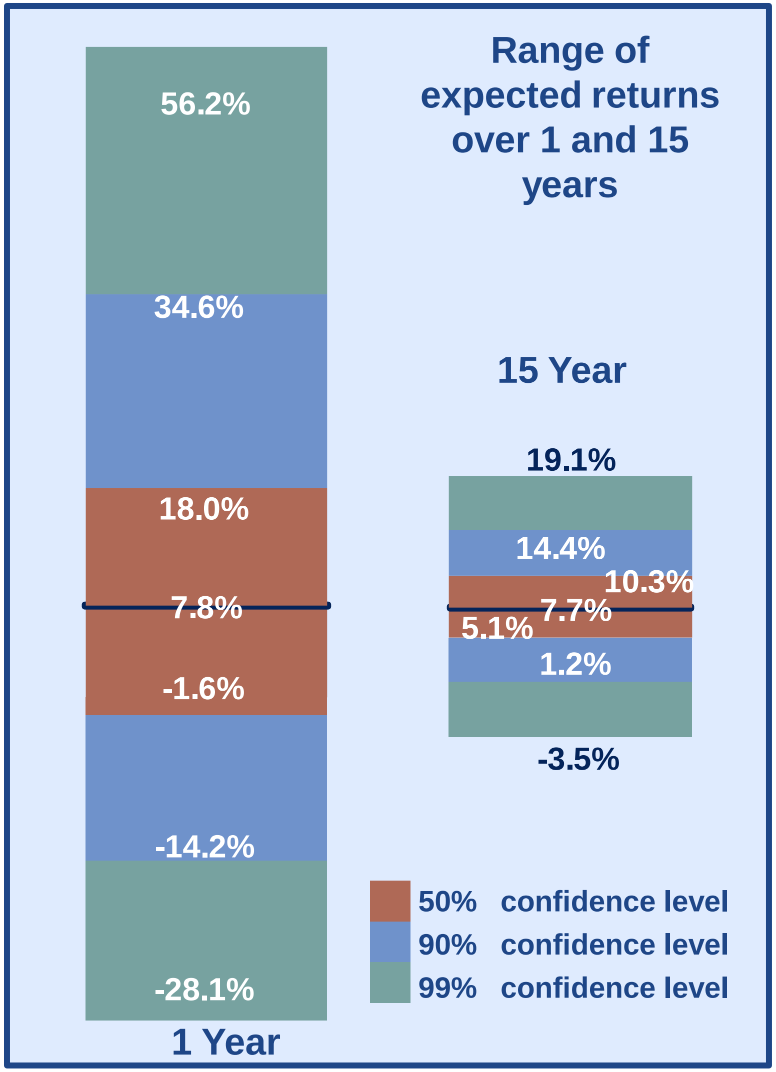
	2009 Return	2010 Return	2009 Standard Deviation	2010 Standard Deviation
TIPS	4.50	4.50	6.00	6.00
Fixed Income	4.75	4.50	4.75	5.00
Tangible Assets	6.50	6.50	8.00	8.00
Real Estate	8.00	8.00	15.00	15.00
Global Equity	9.25	8.90	16.90	17.30
U.S. Equity	9.25	8.75	17.00	17.00
International Equity	9.25	9.00	19.00	19.00
Private Equity	12.25	11.75	29.00	28.00
Cash	3.00	3.00	1.50	2.00
Inflation	2.50	2.50		1.75

Asset Allocation Review – Capital Market Assumptions

CTF Policy Allocation with Returns Using 2010 Capital Market Assumptions

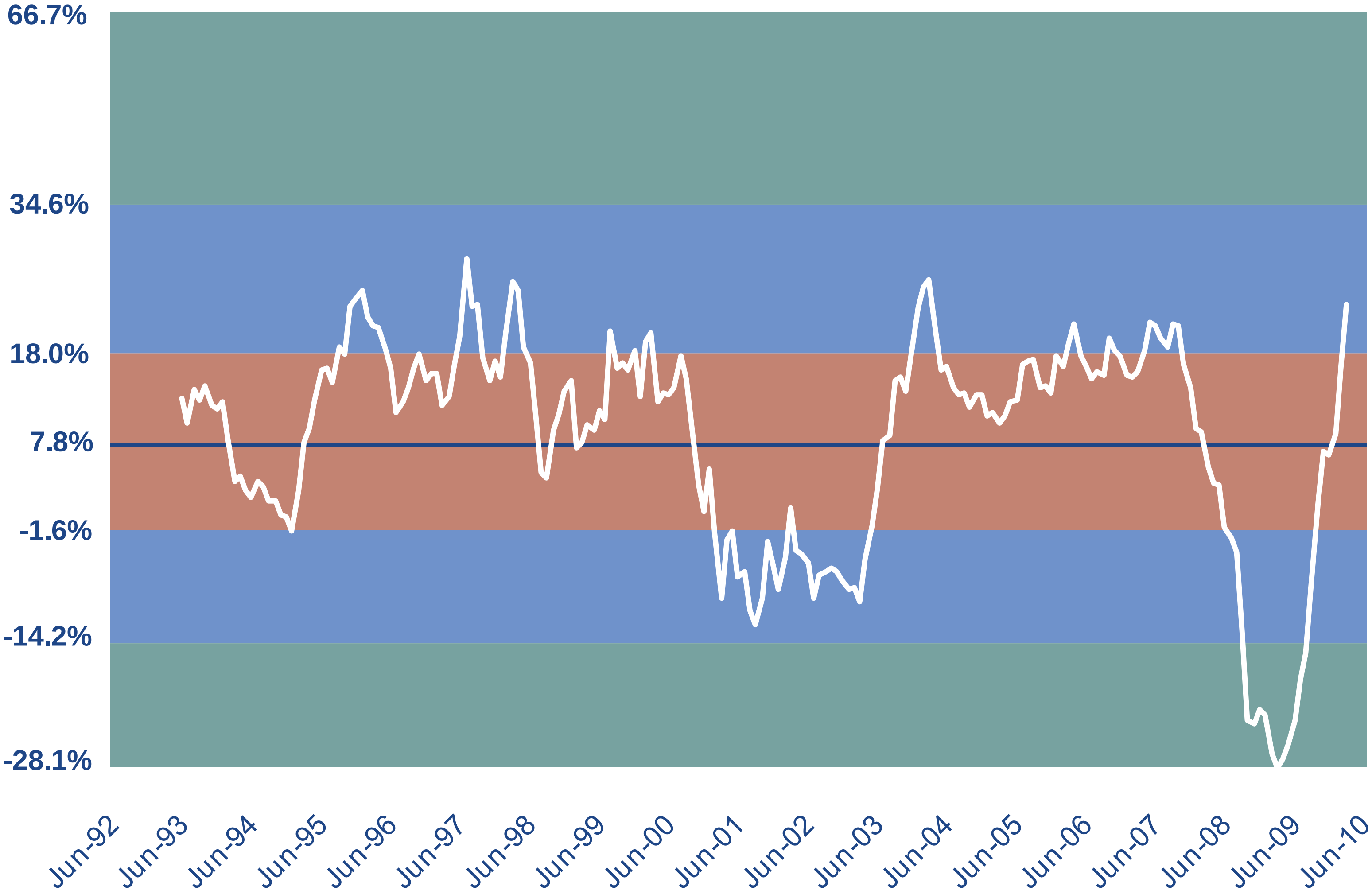






Asset Allocation Review – Capital Market Assumptions

*CTF Rolling One Year Returns Since Inception**



***These are returns above and below the 7.8% mean return.**

The Board has adopted 16 investment beliefs that guide staff in the areas of:

- Risk
- Asset Allocation
- Performance Measurement
- Organizational Core Competencies

Two of the 16 pertain to asset allocation. The two brought into question during the financial crisis included:

- The relative performance of asset classes and investment styles is generally subject to reversion to the mean, although timing such a move is challenging
- A broadly diversified portfolio is preferable to a liability driven portfolio because it offers higher expected returns while also offering benefit security over the long run

While both beliefs were tested during the financial crisis, the Board affirmed these and used these as fundamental principles when reviewing asset allocation

Asset Allocation Review – Risk Preferences

Tested the Boards preferences through use of model that allowed them to allocate their risk preferences across the following

- Maximize real rate of return
- Minimize return volatility
- Minimize costs volatility
- Minimize fund ratio volatility
- Minimize cash flow stress

Not surprisingly, based on the Board's support for capital market assumptions, its understanding of the volatility inherent in its asset allocation, and its affirmation of its investment beliefs, the Board determined that maximizing real rate of return would continue to be its focus

Bottom line: our long horizon allows us to weather volatility and to seek an illiquidity premium, consistent with our legislative mandate to maximize return at a prudent level of risk

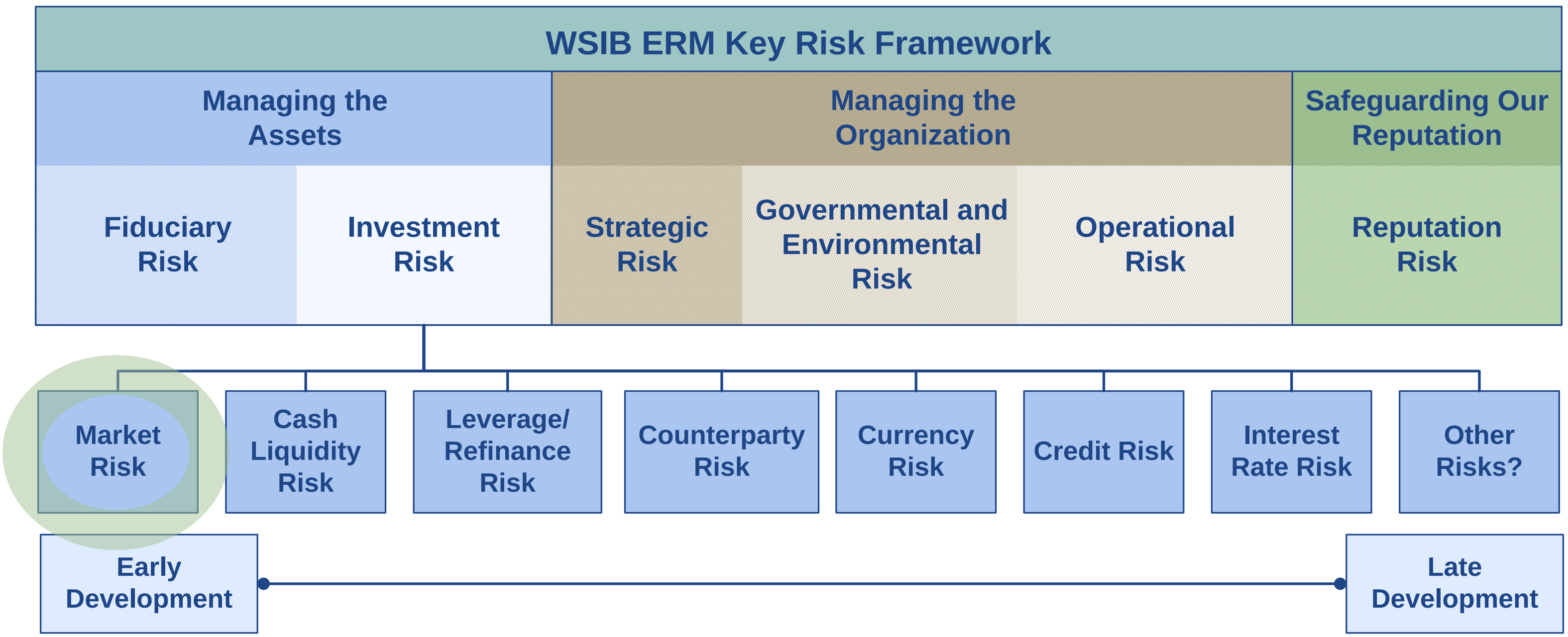
Asset Allocation – Implementation within Risk Framework

Maximizing Return Within Prudent Level of Risk: Risk Framework Expanded

Risk work started long before the crisis – now yielding insights useful in managing post crisis

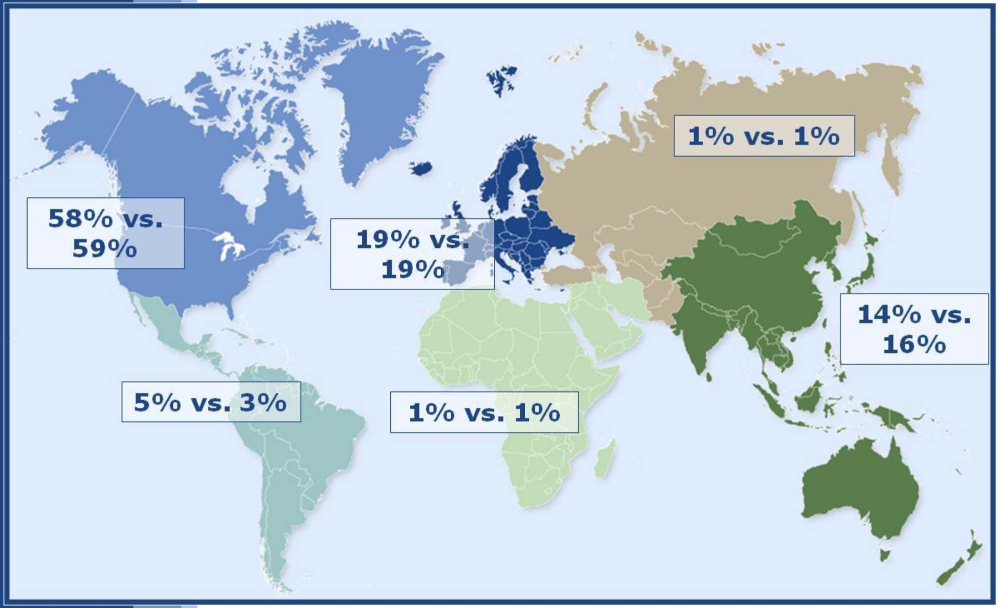
- Data warehouse came on line January 2010
  - Ability to see across all holdings and identify potential risks
- Private equity annual plan built with help from data warehouse
- CTF concentration risk analysis presented to Board in June
  - Geography and industry
- Additional Board risk reports under construction

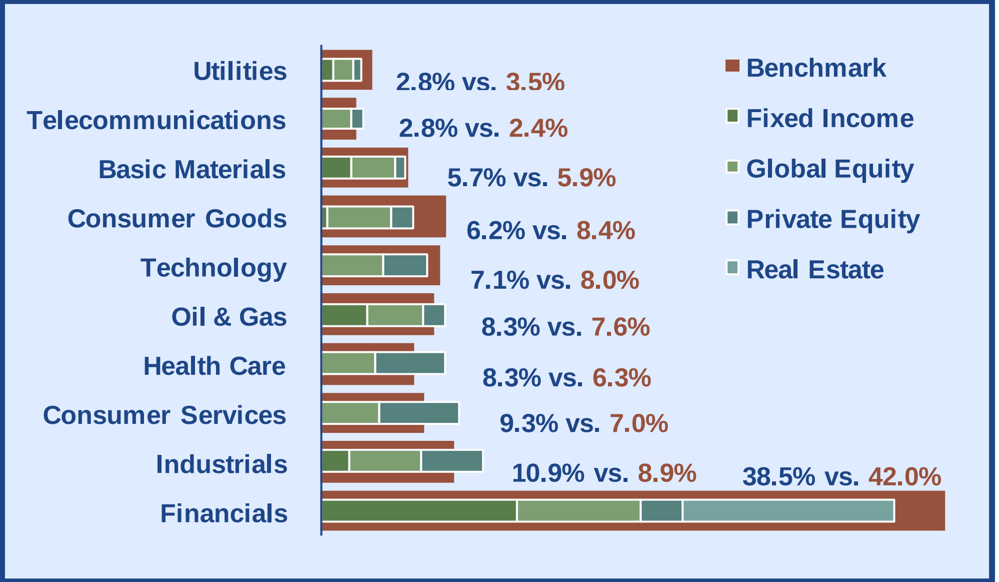
WSIB Risk Management/Measurement Framework



WSIB Risk Management/Measurement Framework – Market Risk

Concentration Risk by Geography and Industry – March 31, 2010





The CTF is in line with the policy benchmark

- At a country level, the CTF is slightly underweight
  - North America
  - Asia Pacific
- And overweight
  - Latin America
- At a industry level, the CTF is slightly underweight
  - Financials
  - Consumer Goods
  - Technology
- And overweight
  - Health Care
  - Consumer Services
  - Industrials

The CTF policy benchmark is 69% Dow Jones Global TSMI and 31% Barclays Capital Universal

WSIB Risk Management/Measurement Framework

Board Report Development Schedule

Risk Report	Source	Planned Dates	Planned Venue
CTF concentration Industry, geography	Data Warehouse	June 1, 2010	Board
Top 10 industry within country		September 1, 2010	Staff Investment Committee, then roll up to Board in January
Issuer concentration		November/December 2010	
Value At Risk (VAR) Implied risk tolerance	Barra Risk System	April 1, 2011	Staff Investment Committee, then Board
Volatility attribution analysis		May 1, 2011	
Stress testing		June 1, 2011	
Scenario analysis		July 2011 off-site	
Other risks, including asset class specific risks: Leverage and refinancing, counter party and credit, currency, interest rate, etc.	Data Warehouse, Risk System, Ad Hoc Research	2011-2015 as capabilities become available	Public and Private Markets Committee annual asset class planning sessions; Board

Future Challenges

- Managing investment return expectations
- Meeting the 8% assumed rate of return in tough environment
- Pressure to use pension fund money for economic development