



**Washington State  
Investment Board**

## **Washington State Investment Board: Focusing on Long-Term Results in a World of Discord and Distractions**



**Theresa Whitmarsh, Executive Director  
November 15, 2017**



## Our Purpose – Overview of the WSIB



### Asset Management

- ❑ Created by the Legislature in 1981 to manage retirement and public trust assets
- ❑ One of the largest and most diversified institutional investment managers in the United States
- ❑ \$120 billion assets under management as of September 30, 2017
- ❑ 17 pension funds
- ❑ 5 Labor and Industries' insurance funds
- ❑ 13 Permanent and other trust funds

### Success Benchmarks

- ❑ Meet or exceed the financial objectives of those we serve
- ❑ Maximize investment returns at a prudent level of risk
- ❑ Generate sustainable, long-term results for our beneficiaries

### Global Implementation

- ❑ Investing in 74 different countries, across 6 continents
- ❑ More than 12,000 investment holdings
- ❑ Large scale allows both access and cost-efficiency



## Our Investment Mandates

### Retirement Funds

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- ❑ Public Employees' Plans 1, 2, 3 \*
- ❑ School Employees' Plans 2, 3 \*
- ❑ Teachers' Plans 1, 2, 3 \*
- ❑ Law Enforcement Officers' and Firefighters' Plans 1, 2
- ❑ Judicial Retirement Account – Defined Contribution
- ❑ Washington State Patrol Plans 1, 2
- ❑ Volunteer Firefighters' Relief and Pension Fund
- ❑ Deferred Compensation Program
- ❑ Public Service Employees' Plan 2
- ❑ Higher Education Retirement Plan Supplemental Benefit Fund

### Labor and Industries' Funds

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- ❑ Accident
- ❑ Medical Aid
- ❑ Pension Reserve
- ❑ Supplemental Pension
- ❑ Industrial Insurance Rainy Day Fund (unfunded)

### Permanent Funds

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- ❑ Agricultural College
- ❑ Common School
- ❑ Normal School
- ❑ Scientific
- ❑ State University
- ❑ American Indian Endowed Scholarship
- ❑ Foster Care Endowed Scholarship

### Other Funds

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- ❑ Guaranteed Education Tuition
- ❑ Developmental Disabilities Endowment
  - ❑ Private
  - ❑ State
- ❑ Washington State Opportunity Scholarship Fund
  - ❑ Scholarship
  - ❑ Endowment
- ❑ Family and Medical Leave Insurance Fund (unfunded)

\* All Plan 1s are closed to new participants. The Plan 3s are hybrid plans with both defined benefit and defined contribution assets.



## Market Value of Retirement Plans

*September 30, 2017*

- Multiple plan types with investments structured in a commingled trust fund

Defined Benefit and Hybrid Defined Benefit/Defined Contribution Plans	Market Value
Public Employees' Retirement System Plan 1 (PERS)	\$7,328,539,674
Public Employees' Retirement System Plan 2/3	\$36,019,810,405
Teachers' Retirement System Plan 1 (TRS)	\$5,630,588,813
Teachers' Retirement System Plan 2/3	\$17,367,472,722
Volunteer Fire Fighters' Relief & Pension Fund (VOLFF)	\$206,103,138
Washington State Patrol Retirement System Plan 1 (WSPRS)	\$1,133,766,846
Washington State Patrol Retirement System Plan 2	\$54,453,851
Law Enforcement Officers' & Fire Fighters' Plan 1 (LEOFF)	\$5,638,430,679
Law Enforcement Officers' & Fire Fighters' Plan 2	\$11,553,553,165
School Employees' Retirement System Plan 2/3 (SERS)	\$6,168,765,042
Public Safety Employees' Retirement System Plan 2 (PSERS)	\$489,582,526
<b>Total</b>	<b>\$91,591,066,861</b>

Defined Contribution Plans	Market Value
Deferred Compensation Program (DCP)	\$4,222,522,840
Judicial Retirement Account (JRA)	\$10,294,455
<b>Total</b>	<b>\$4,232,817,295</b>



## Our Governance – WSIB Board Members



- Board comprised of 15 members
  - 10 voting members - elected/appointed
  - 5 non-voting members – investment professionals

	Appointment Authority	Name	Position
10 Voting	Ex-Officio	Duane Davidson	State Treasurer
		Tracy Guerin	Director, DRS
		Joel Sacks	Director, Labor & Industries
	Senate President	Sen. Mark Mullet	State Senator
	House Speaker	Rep. Timm Ormsby	State Representative
	Governor	Judy Kuschel, Vice Chair	Active Member, PERS
		Yona Makowski	Retired Member, State Pension System
		Greg Markley	Active Member, LEOFF
	Superintendent of Public Instruction	Arlista D. Holman	Active Member, SERS
		Stephen Miller	Active Member, TRS
5 Investment Professionals	Selected by the Board	David Nierenberg	President, Nierenberg Investment Management Co.
		William A. Longbrake	Retired CFO; member of Governor's Council of Economic Advisors
		Richard Muhlebach	Real Estate Executive; past president Institute of Real Estate Management
		Mary Pugh	Founder and CEO, of Pugh Capital
		George Zinn	Vice President and Treasurer, Microsoft



## Our Distinctions – What Makes WSIB Different?



### Our Investment Strategy

- ❑ Leader in institutional private markets investing in U.S.
  - ❑ 23 percent private equity; 18 percent real estate; 5 percent tangible assets
- ❑ Fixed income is internally managed and 100% actively managed program
- ❑ Public equity is externally managed and a blend of active/passive strategies

### Our Focus

- ❑ Diversification globally and across all major asset classes
- ❑ Use discriminating approach to find quality managers with cultural fit
- ❑ Long-term discipline to avoid behavioral whipsaw during volatile markets
- ❑ Use scale to achieve cost-effective implementation

### Our People

- ❑ Highly skilled investment team with multi-asset class experience
- ❑ 40+ Investment Officers and Senior Investment Officers
  - ❑ 20 Certified Financial Analysts (CFAs)
  - ❑ 31 with advanced degrees
- ❑ 400+ years of combined tenure with the WSIB
- ❑ Average experience of 20+ years in the investment industry



## The Investment Environment – No Shortage of Mixed Messages



### Capital Markets

- ❑ Unexpectedly strong performance across all asset classes
- ❑ Valuations not always supported by fundamentals
- ❑ Markets awash in cheap capital; capacity constraints for private markets
- ❑ Corporations favoring share buybacks rather than growth capitalization

### Monetary Policy

- ❑ Divergent central banks; U.S. tightens while Europe continues easing
- ❑ Interest rates finally on the move upward in U.S.
- ❑ Modest inflation despite strong markets

### Fiscal Policy

- ❑ U.S. tax policy changes in play
- ❑ Worldwide debt levels of governments highest ever seen

### Social/Political/Technology Tensions

- ❑ Divisive populist movements (U.S., Brexit, France, Spain)
- ❑ Geopolitical tensions in SE Asia, Russia, Middle East
- ❑ Cyber “war” threatens commerce and politics



## Our Updated Capital Market Assumptions



- ▣ Modest adjustments to reflect current market expectations

	2015 Geometric Return	2017 Geometric Return	Standard Deviation
Fixed Income	3.8	3.8	5.3
Tangible Assets	6.3	6.4 	8.6
Real Estate	6.9	7.1 	15.7
Global Equity	7.2	7.0 	18.9
U.S. Equity	6.7	6.4 	18.0
Non-U.S. Equity	7.3	7.7 	20.7
Private Equity	9.0	8.8 	25.0
Cash	2.3	2.3	2.0
Inflation	2.2	2.2	1.5



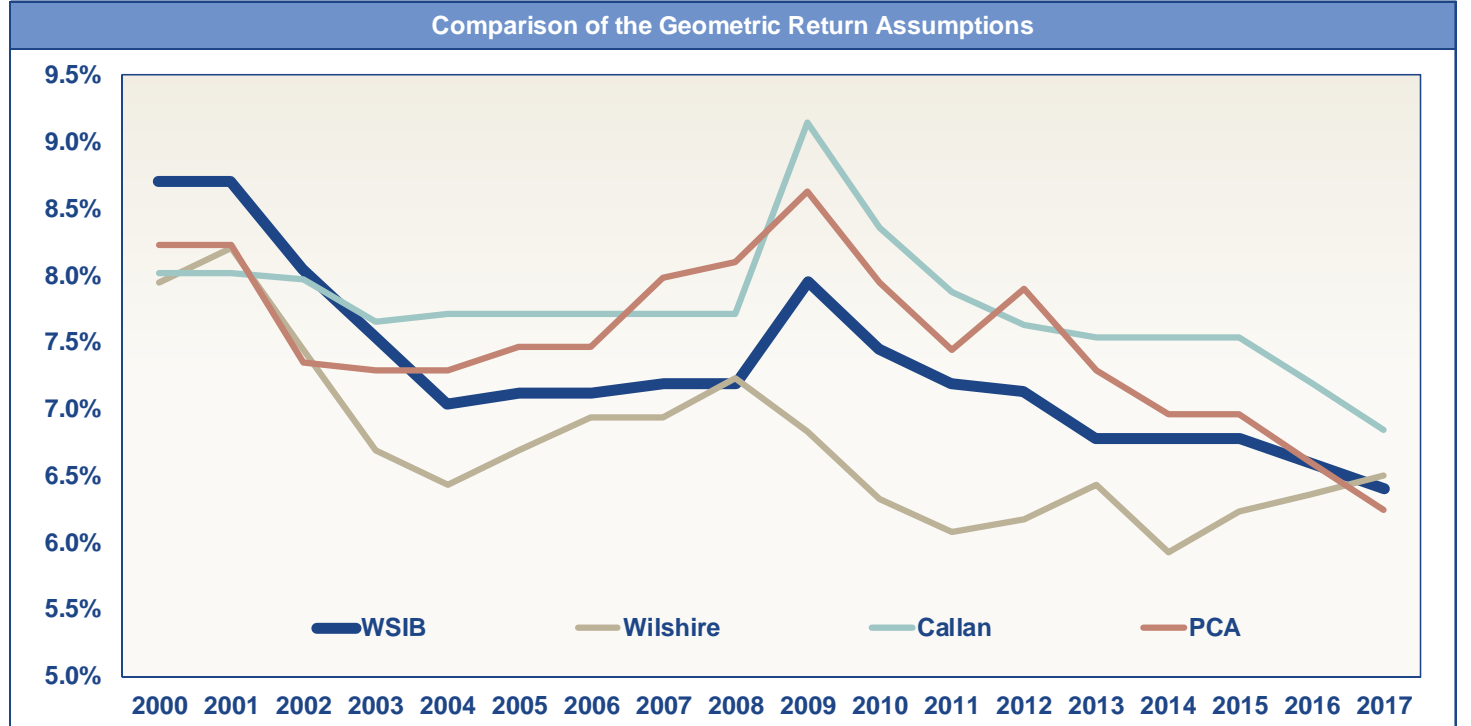


# U.S. Equity Market Assumptions Over Time



- Consistent downward trend in return assumptions for past decade

WSIB U.S. Equity Arithmetic Return Assumptions																		
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return	10.0%	10.0%	9.5%	9.0%	8.5%	8.5%	8.5%	8.5%	8.5%	9.3%	8.8%	8.5%	8.6%	8.2%	--	8.3%	--	7.8%
Risk	17.0%	17.0%	18.0%	18.0%	18.0%	17.5%	17.5%	17.0%	17.0%	17.0%	17.0%	17.0%	18.0%	18.8%	--	18.0%	--	17.5%

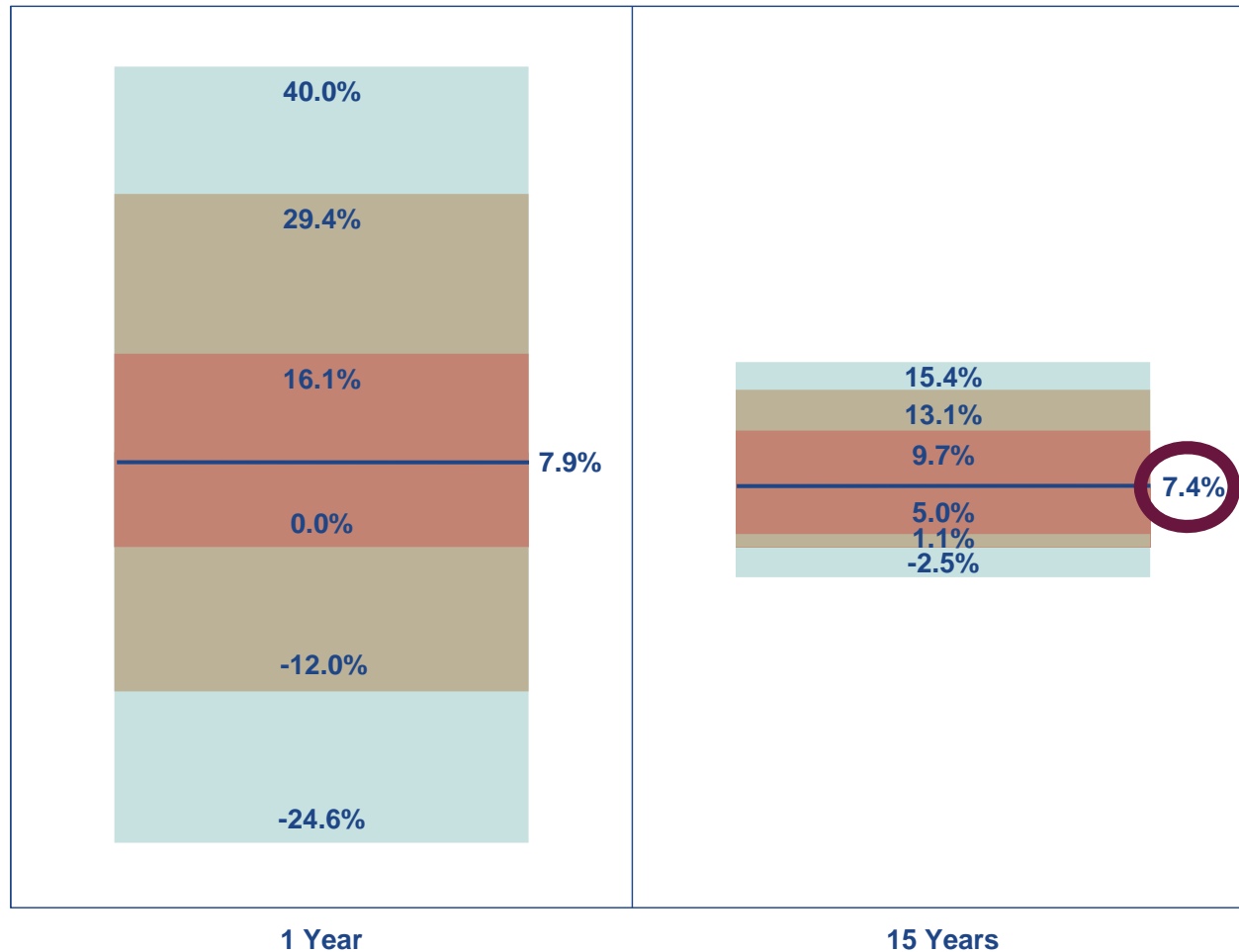




# Calculating Realistic Return Assumptions for Retirement Plans



- 7.9 percent is median assumption for 1 year period
- 50 percent chance of earning actuarial assumption of 7.7 percent in any 1 year
- 7.4 percent is a realistic assumption for a 15-year time horizon





## Maintaining Our Competitive Advantages

### As a Fiduciary

**Independent**  
**Transparent**  
**Impeccable integrity**

### As an Asset Manager

#### Global

- ▣ International relationships
- ▣ Expertise in multiple markets

#### Cost Effective

- ▣ Lean operation

#### Scale

- ▣ Access to attractive investments, managers, and negotiating leverage

#### Multi Asset Class Expertise

- ▣ Customized asset allocation
- ▣ Custom portfolio construction

### As an Organization

#### Mission driven

- ▣ Singularity of purpose across entire organization

#### Strong Culture

- ▣ Committed to excellence
- ▣ Open and honest
- ▣ Long-term focus
- ▣ Rigorous analysis
- ▣ Commitment to continuous learning

#### Best in class systems and processes

- ▣ Investment
- ▣ Internal controls
- ▣ Data and analytics
- ▣ Risk and compliance
- ▣ Financial management and reporting

#### Skilled professional staff

- ▣ Workforce development focus



## Our Latest Initiatives



### Successful transition in Board membership

- ▣ 7 of our 15 members joined the Board since mid-2016
- ▣ Highly engaged, fresh insight, proven experience

### Real Estate investments added to Labor and Industries' insurance funds

- ▣ Culmination of an independent analysis
- ▣ Leverages WSIB's experienced staff and approach
- ▣ Potential for incremental long-term returns at lower overall risk levels

### Asset allocation updated for all retirement funds

- ▣ Comprehensive study done every 4 years
- ▣ Maintaining firm commitment to private market investments
- ▣ Modest increases to real estate and tangible assets

### Support for healthy, fully functional capital markets

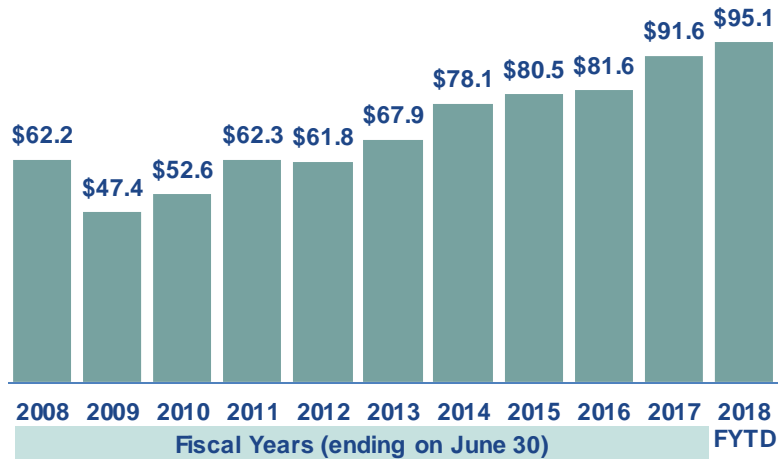
- ▣ Advocating long-term investment practices across the value chain
- ▣ Level playing field for investors (opposing dual-class share structures)
- ▣ Favoring greater diversity within industry and on company boards



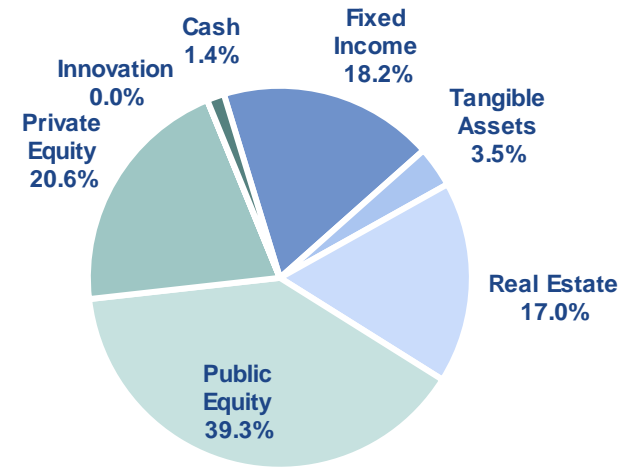
# Commingled Trust Fund Performance and Market Values

September 30, 2017

## Historical Market Value (billions)



## Actual Allocation



## Historical Fund Returns

Return Since Inception of the  
Commingled Trust Fund (CTF)  
(Since June 1992):

**8.81%**

## 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	\$95,119,873,209	14.11%	8.25%	9.91%	5.45%
Fixed Income	\$17,276,566,721	2.56%	3.15%	2.53%	5.23%
Tangible Assets	\$3,289,651,512	9.60%	3.91%	4.40%	N/A
Real Estate	\$16,179,908,233	12.78%	12.11%	13.00%	5.92%
Public Equity	\$37,392,972,165	19.02%	8.29%	11.10%	4.46%
Private Equity	\$19,584,345,916	18.48%	11.05%	13.82%	7.48%
Innovation	\$21,418,719	-12.39%	-10.38%	4.78%	-0.04%
Cash	\$1,375,009,943	0.95%	0.50%	0.35%	0.65%



## Our Peer Comparison – Performance and Costs



### Our Investment Strategies

- ❑ Public Equity – passive public equity provides market-level returns at lower cost than active management
- ❑ Private Equity – above-average allocation and deep relationships generate consistent return advantage
- ❑ Fixed Income – 100 percent internal management allows the WSIB to tailor its portfolio in distinct areas (e.g., emerging market debt)
- ❑ Tangible Assets – customized investment in non-financial real assets
- ❑ Real Estate – direct ownership; close ties to global operating companies

### Investment Performance vs. Pension Plan Peers\*

	WSIB	Peer Median	U.S. Public Pension Median
5 Year Net Return	9.5%	8.4%	8.7%
20 Year Net Return	8.1%	7.4%	7.3%

### Total Investment Costs\*

WSIB Costs	Peer Group Costs	Total Savings
55.6 basis points	67.6 basis points	12.1 basis points (\$99.3 million per year)

\*CEM Investment Benchmarking Analysis for WSIB, September 21, 2017

Performance data are for periods ending December 31, 2016

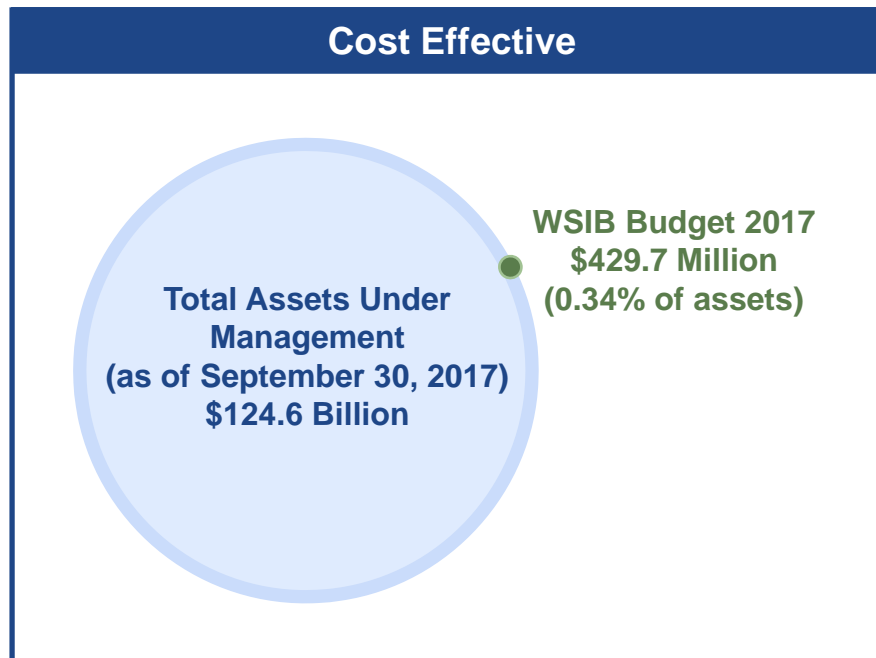
Peer Group includes 19 U.S. public pensions ranging in asset size from \$24 billion to \$188 billion



## Keeping Costs Low via Investment Style and Implementation



- ❑ WSIB's expenses are funded from investment earnings
- ❑ WSIB ranked as low-cost, high-performing institutional investor by CEM Benchmarking
- ❑ WSIB's excellent investment performance dramatically contributes to the state's bottom line by earning the lion's share of money needed to cover state pension benefits



**“Your fund was low cost because you had lower cost implementation style and you paid less than peers for similar services.”**

***CEM Benchmarking Report,  
September 15, 2016***



## Conclusion – Our Plan for Continued Success



### Retain a mission focus

- ❑ Fiduciary role comes first
- ❑ Maximize returns at a prudent level of risk
- ❑ Build on longstanding trust relationships
- ❑ Ensure transparency; address the uncomfortable questions
- ❑ It's about the beneficiaries

### Expect the unexpected

- ❑ Markets don't grow to the sky
- ❑ Stay in tune with changing risk factors (climate, corporate governance)
- ❑ Respond rather than react to market trauma or exuberance
- ❑ Continue building and recruiting talent

### Diversify for risk; discriminate for quality

- ❑ Focus on what we know and understand
- ❑ Walk away from strategies that do not fit
- ❑ Negotiate acceptable terms and conditions
- ❑ Get paid for risks taken
- ❑ Engage to advocate for long-term investment disciplines