



Washington State Investment Board: Focusing on Long-Term Results in a World of Transition and Disruption



**Theresa Whitmarsh, Executive Director
December 19, 2018**

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

WSIB Investment Responsibility (34 Funds Managed)

Retirement Funds

17

- ❑ 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 & Industries' Funds

5

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

Permanent Funds

7

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

Other Funds

5

- ❑ Guaranteed Education Tuition
- ❑ Developmental Disabilities Endowment
 - ❑ Private
 - ❑ State
- ❑ Washington State Opportunity Scholarship Fund
 - ❑ Scholarship
 - ❑ Endowment

* 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, 2018

- 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)	\$7,605,001,269
Public Employees' Retirement System Plan 2/3	\$41,108,482,141
Teachers' Retirement System Plan 1 (TRS)	\$5,720,893,070
Teachers' Retirement System Plan 2/3	\$19,910,945,161
Volunteer Fire Fighters' Relief & Pension Fund (VOLFF)	\$227,455,338
Washington State Patrol Retirement System Plan 1 (WSPRS)	\$1,219,644,289
Washington State Patrol Retirement System Plan 2	\$74,838,253
Law Enforcement Officers' & Fire Fighters' Plan 1 (LEOFF)	\$5,886,938,508
Law Enforcement Officers' & Fire Fighters' Plan 2	\$13,177,726,832
School Employees' Retirement System Plan 2/3 (SERS)	\$7,051,371,869
Public Safety Employees' Retirement System Plan 2 (PSERS)	\$616,197,828
Total	\$102,599,494,559

Defined Contribution Plans	Market Value
Deferred Compensation Program (DCP)	\$4,551,229,714
Judicial Retirement Account (JRA)	\$10,167,478
Total	\$4,561,397,193

Organizational Structure

- ▣ Board comprised of 15 members
 - ▣ 10 voting
 - ▣ 5 non-voting
- ▣ 95 staff



	Appointment Authority	Name	Position
10 Voting	Ex-Officio	Duane Davidson	State Treasurer
		Tracy Guerin	Director, DRS
		Joel Sacks, Vice Chair	Director, Labor & Industries
	Senate President	Sen. Mark Mullet	State Senator
		House Speaker	Rep. Timm Ormsby
	Governor	Judy Kuschel, 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.
- ❑ Policy asset allocation updated in September 2017:
 - ❑ 23 percent private equity
 - ❑ 18 percent real estate
 - ❑ 7 percent tangible assets
 - ❑ 32 percent public equity
 - ❑ 20 percent fixed income
- ❑ Fixed income is internally managed and 100% actively managed program
- ❑ All others employ external investment managers or general partners

Private markets

Public markets

Our Focus

- ❑ Diversification globally and across all major asset classes
- ❑ Long-term discipline avoids “fear and greed” behavior in risk cycles
- ❑ Large scale allows cost-effective implementation
 - ❑ WSIB costs are 15.5 basis points lower than peer pension funds*

Our People

- ❑ Highly skilled investment team with multi-asset class experience



* Source: 2017 CEM Benchmarking Analysis, September 20, 2018

The Market Environment – Prospects for 2019



U.S. equity markets trading at rich valuations

- ❑ Corporate earnings growth expected to moderate

Potential threats to markets and global growth are numerous

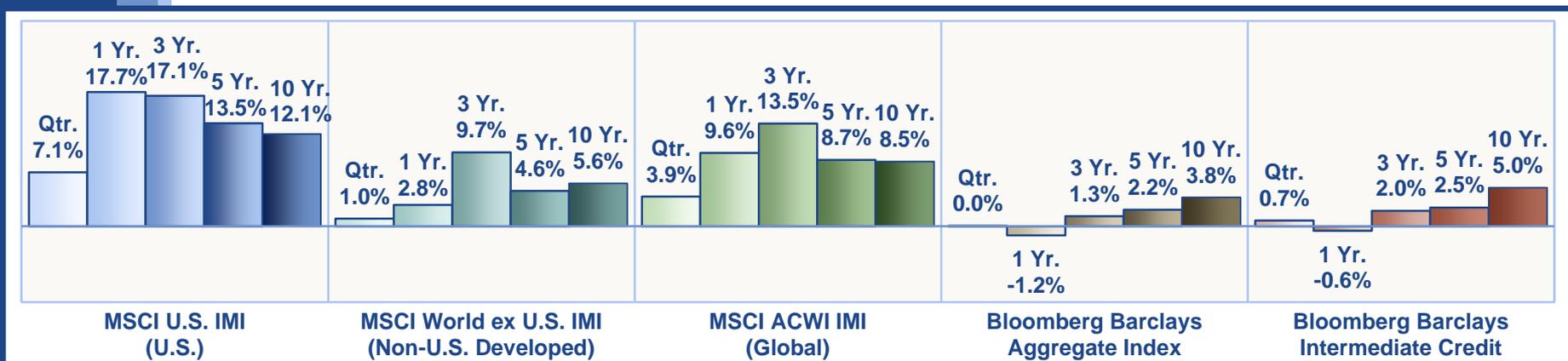
- ❑ Uncertainties and unknowns are very high
- ❑ Political and policy uncertainty in the U.S.
- ❑ Global trade wars and new tariffs
- ❑ Outlook and pace for interest rate rises
- ❑ Unclear outlook for inflation
- ❑ Uncertainty and political risks around the world, including:
 - ❑ UK – Brexit
 - ❑ New leader in Brazil
 - ❑ Angela Merkel in Germany will not seek re-election
 - ❑ Potential slowdown in China

Sentiment can swing from positive to disappointment very quickly

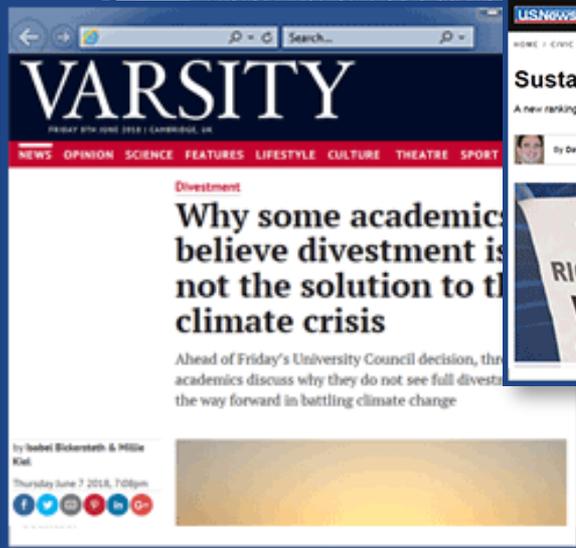
- ❑ Expect volatility and more muted equity returns
- ❑ Risks may be asymmetrical (more downside risks than upside)

The Markets at a Glance Through 3Q

- Third quarter saw new highs in developed equity markets despite market volatility, trade wars, and ongoing geopolitical risk; now volatility is taking hold
- Global index (MSCI World Developed IMI) was up 0.28% in September and 4.56% for the third quarter as strong fundamentals continued to support stocks.
- Geopolitical risk and trade wars had a cooling effect on emerging markets, with the MSCI Emerging Markets IMI index returning -1.45% for the quarter.
- The Fed raised interest rates 0.25% in September; this marked the eighth increase since the current hiking cycle began back in 2015.
- Unemployment continued to drop, reaching 3.7% in September -- the lowest unemployment rate since December 1969.
- 10-year Treasury rate ended September at 3.06%, up 0.20% for the quarter -- the first month-end closing above 3% since July 2011.



External Issues: A Growing Focus on Sustainability



Environmental, social and governance (ESG) factors are increasingly part of the investment process

Climate change risks gets the headlines but social and governance issues are prevalent within due diligence

Addressing sustainability through investment discipline helps us keep fiduciary duty and long-term investing as the key driver to strategy

How the WSIB is Keeping Pace with Sustainability Drivers

Enhanced Asset Stewardship

- ❑ Pursuing four priorities for how we vote our corporate proxies
 - ❑ Sustainability
 - ❑ Diversity
 - ❑ Executive Compensation
 - ❑ Governance practices that focus on building long-term value
- ❑ Enabling customized proxy voting to flag our specific priorities
- ❑ Posting all WSIB proxy voting results twice per year on our website
- ❑ Engaging directly and selectively with Washington-based companies on climate change risks and governance practices





How the WSIB is Keeping Pace with Sustainability Drivers

Enhanced Integration and Transparency Around Sustainability

- ❑ Investment research on the ongoing energy transition
- ❑ Each asset class is evaluating ESG risks and opportunities
- ❑ Focused education/updates for our Board members
- ❑ Responsive/respectful handling of activists, media, and interest groups
- ❑ Annual Sustainability (ESG) Report posted on our website

Collaborative Industry Leadership

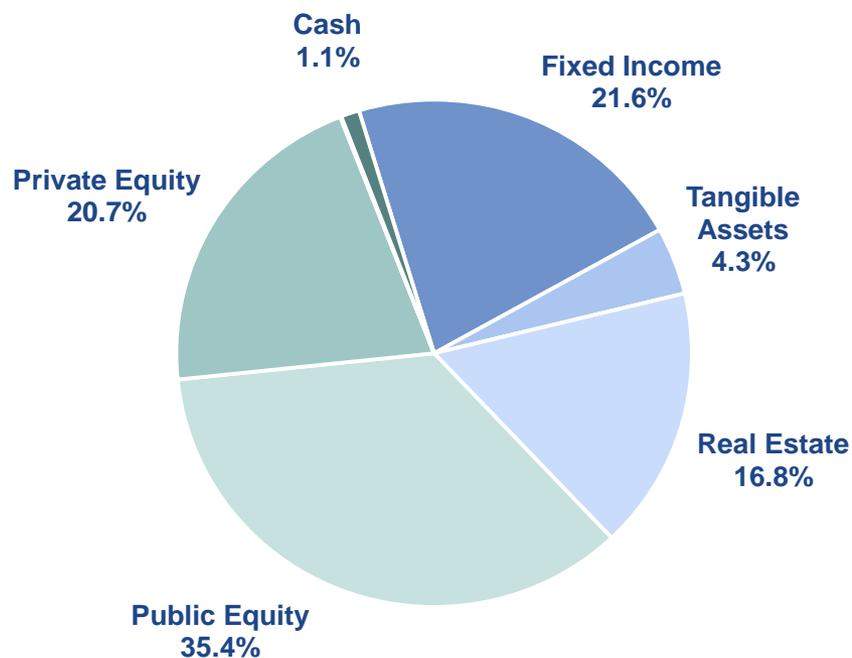
- ❑ Promoting effective ESG metrics, industry standards, and transparency
- ❑ Advocating efficient processes for companies and investors
- ❑ Advocating shareholder rights



Commingled Trust Fund (CTF) Performance and Allocation

September 30, 2018

	1 Year	3 Year	5 Year	10 Year	20 Year
Total Fund	8.53%	10.61%	9.11%	7.79%	7.71%
Passive Benchmark	6.51%	10.12%	7.08%	7.69%	6.19%



Currently 69% MSCI ACWI IMI w/ U.S. Gross, 31% Bloomberg Barclays Universal. Over time the benchmark has been adjusted by changing both benchmarks and percentages.



CTF Public Equity Performance

September 30, 2018

10 years of performance demonstrates effort and diligence can pay dividends

	1 Year	3 Year	5 Year	10 Year	20 Year
Public Equity	10.93%	14.17%	9.48%	8.96%	7.03%
Custom Benchmark	9.94%	13.83%	9.02%	8.81%	6.79%

CTF public equity continues to outperform

- ▣ Adding value across all periods; execution/trading efficiency monitored by Zeno AN Solutions (Zeno)
- ▣ Execution and trading of the WSIB's public equity managers, as measured by Zeno as of September 30, 2018, on a rolling 4-quarter basis, ranked in the first quartile of Zeno's Total Cost universe and in the first quartile in Zeno's Execution Efficiency universe



CTF Private Equity Performance

September 30, 2018

Focus on quality generates long-term value

	1 Year	3 Year	5 Year	10 Year	20 Year
Private Equity	16.97%	13.24%	13.90%	10.30%	11.03%
Custom Benchmark	14.47%	11.68%	12.93%	9.45%	8.01%

- ▣ Relatively concentrated portfolio among high quality investment partners
- ▣ Early commitment to private equity (1980) has resulted in longstanding relationships in a marketplace where demand outstrips supply
- ▣ Our Board is very comfortable with private equity when compared to many peer funds

Private Equity benchmark is a custom historical blend. Historically it was the Russell 3000 (Lagged One Quarter) +300bps. As of April 1, 2008 it changed to the MSCI ACWI IMI w/U.S. Gross (Lagged One Quarter) +300bps.



CTF Real Estate Performance

September 30, 2018

Real estate performance has been very good

	1 Year	3 Year	5 Year	10 Year	20 Year
Real Estate	8.20%	10.01%	12.02%	6.27%	10.53%
Benchmark	1.81%	7.19%	8.25%	9.77%	6.22%

- ❑ Net returns for the real estate portfolio have outperformed the NCREIF gross returns over 1, 3, 5, 10, and 15 years
- ❑ 10-year performance is below our benchmark (8 percent over a rolling 10 years) due to large write-downs in the fourth quarter of 2008
- ❑ The WSIB portfolio has continued to appreciate more quickly as the broad market's appreciation has slowed the past couple of years
- ❑ Annualized returns since the beginning of the market's recovery (second quarter of 2010) have been 13.5 percent for the real estate portfolio

Real Estate benchmark is 8% Return Over Rolling 10 Years and for comparison purposes, the NCREIF (Lagged One Quarter)

Peer Comparison – Performance and Cost



Investment Performance vs. Pension Plan Peers*

	WSIB	Peer Median	U.S. Public Pension Median
5-year net return	9.50%	9.00%	9.00%
20-year net return	8.50%	7.60%	7.60%

Total Investment Costs*

WSIB costs	Peer group costs	Total savings
55.4 basis points	70.8 basis points	15.5 basis points (\$142 million/year)

- ❑ 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

*CEM Investment Benchmarking Analysis for WSIB, September 5, 2018

Performance data are for periods ending December 31, 2017

Peer Group includes 19 U.S. public pensions ranging in asset size from \$24 billion to \$218 billion

Conclusion – Staying focused on the long term, for our beneficiaries



- ❑ Retain focus on mission while investing in the face of economic transition
- ❑ Maintain strict investment discipline while integrating ESG risks and opportunities in each asset class
- ❑ Withstand the test of market decline when (not if) it arrives
- ❑ Rely on high-integrity, long-standing relationships in the investment community
- ❑ Represent the best interest of all beneficiaries, in every decision, always