

## Washington State Investment Board Update



Theresa Whitmarsh, Executive Director  
Washington State Investment Board  
September 20, 2011

### Overview



- ❑ The Washington State Investment Board (WSIB) manages investments for over \$80 billion in state retirement and other public trust funds. The largest investment portfolio we manage is the Commingled Trust Fund (CTF) comprised of pension fund assets for the defined benefit retirement systems for public employees, teachers, firefighters, law enforcement officers, judges, and school employees.
- ❑ The assets in the CTF are held in trust and are not intended for any other purpose than to fulfill the state's contractual promise to pay pension benefits to fund beneficiaries. Our paramount responsibility is to manage and maximize returns for these funds at a prudent level of risk for the "exclusive" benefit of fund beneficiaries.

#### Value

- ❑ The lion's share – approximately 75-80% – of the state's cost for pension benefits is generated by investment returns.
- ❑ Maintaining our disciplined approach to investing with the highest standards of integrity enables us to have a positive and dramatic impact on the state's bottom-line.

## Governance Structure Ensures Independence



- ▣ Board comprised of 15 members
  - ▣ 10 voting – represent system stakeholders
  - ▣ 5 non-voting – selected by voting members for their investment expertise
- ▣ 79 staff

	Appointment Authority	Name	Position
10 Voting	Ex-Officio	Jim McIntire, 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	Natasha Pranger	Active Member, PERS
		George Masten	Retired Member, PERS
Patrick McElligott		Active Member, LEOFF	
Superintendent of Public Instruction	Judi Owens	Active Member, SERS	
	Mike Ragan, Vice Chair	Active Member, TRS	
5 Non-voting	Selected by the Board	Robert Nakahara	
		Jeffrey Seely	
		David Nierenberg	
		William A. Longbrake	
		Richard Muhlebach	

WSIB
Page 2

## WSIB Investment Responsibility

Retirement Funds	Permanent Funds
<ul style="list-style-type: none"> <li>▣ Public Employees' Plans 1, 2, 3 *</li> <li>▣ School Employees' Plans 2, 3 *</li> <li>▣ Teachers' Plans 1, 2, 3 *</li> <li>▣ Law Enforcement Officers' and Firefighters' Plans 1, 2</li> <li>▣ Judicial Retirement Account – Defined Benefit</li> <li>▣ Judicial Retirement Account – Defined Contribution</li> <li>▣ Washington State Patrol Plans 1, 2</li> <li>▣ Volunteer Firefighters' Relief and Pension Fund</li> <li>▣ Deferred Compensation Program</li> <li>▣ Public Service Employees' Plan 2</li> </ul>	<ul style="list-style-type: none"> <li>▣ Agricultural College</li> <li>▣ Common School</li> <li>▣ Normal School</li> <li>▣ Scientific</li> <li>▣ State University</li> <li>▣ Millersylvania Park Trust</li> <li>▣ American Indian Endowed Scholarship</li> <li>▣ Foster Care Endowed Scholarship</li> </ul>
<div style="background-color: #0056b3; color: white; padding: 2px; text-align: center; font-weight: bold; font-size: small;">Labor and Industries' Funds</div> <ul style="list-style-type: none"> <li>▣ Accident</li> <li>▣ Medical Aid</li> <li>▣ Pension Reserve</li> <li>▣ Supplemental Pension</li> </ul>	<div style="background-color: #0056b3; color: white; padding: 2px; text-align: center; font-weight: bold; font-size: small;">Other Trusts</div> <ul style="list-style-type: none"> <li>▣ Guaranteed Education Tuition</li> <li>▣ Developmental Disabilities Endowment</li> <li>▣ Game and Special Wildlife</li> <li>▣ State Employees' Insurance Reserve</li> <li>▣ Radiation Perpetual</li> <li>▣ Reclamation Revolving</li> <li>▣ Budget Stabilization</li> <li>▣ Family and Medical Leave Insurance Fund (unfunded)</li> <li>▣ Basic Health Plan Self Insurance Reserve (unfunded)</li> <li>▣ Pension Stabilization (unfunded)</li> </ul>

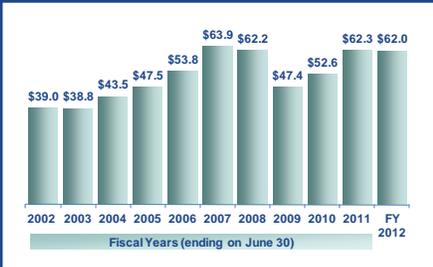
WSIB

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

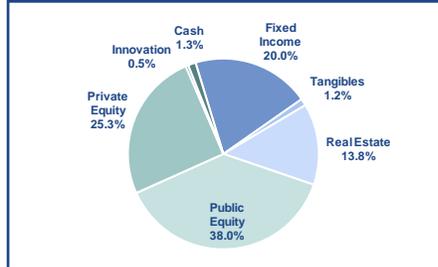
Page 3

## CTF Performance & Market Values – July 31, 2011

### Historical Market Value (billions)



### Actual Allocation



### Historical Fund Returns



### CTF Market Values and Returns

Since Inception of the CTF: 8.75% (June 1992)

	Market Value (000s)	1 Year	3 Year	5 Year	10 Year
Total CTF	\$61,953,704,664	16.31%	2.36%	4.62%	6.65%
Fixed Income	\$12,388,939,266	7.29%	9.30%	8.26%	6.86%
Tangibles	\$725,595,228	8.74%	2.41%	N/A	N/A
Real Estate	\$8,542,429,438	15.35%	-6.19%	2.63%	9.50%
Public Equity	\$23,571,170,120	19.58%	1.79%	2.80%	4.96%
Private Equity	\$15,650,612,661	20.79%	2.58%	6.54%	9.93%
Innovation	\$287,873,689	-22.52%	N/A	N/A	N/A
Cash	\$787,084,262	0.18%	0.49%	2.13%	2.07%

WSIB

## Current Outlook – Tougher Return Environment Going Forward

	2008 CMA	2009 CMA	2010 CMA	2011 CMA	2008 Standard Deviation	2009 Standard Deviation	2010 Standard Deviation	2011 Standard Deviation
TIPS	4.75	4.50	4.00	4.00	6.00	6.00	6.00	6.00
Fixed Income	5.25	4.75	4.25	4.25	5.00	4.75	5.00	5.00
Tangible Assets	6.50	6.50	6.50	6.50	8.00	8.00	8.00	8.00
Real Estate	8.00	8.00	8.00	8.00	15.00	15.00	15.00	15.00
Global Equity	8.50	9.25	8.65	8.65	16.75	16.90	17.62	17.62
U.S. Equity	8.50	9.25	8.50	8.50	17.00	17.00	17.00	17.00
International Equity	8.50	9.25	8.75	8.75	18.25	19.00	19.50	19.50
Private Equity	12.50	12.25	11.50	11.50	31.00	29.00	27.00	27.00
Cash	3.50	3.00	3.00	3.00	1.75	1.50	2.00	2.00
Inflation	2.50	2.50	2.50	2.50	2.50	2.50	1.75	1.75
Expected Return	7.85	7.98	7.68	7.52				

### Return expectations have come down from 2009

- ▣ Variation primarily due to reversion to the mean
  - ▣ Long-term trend has not significantly changed
  - ▣ Where you start each year is affected by short-term market volatility
    - ▣ If markets are down you expect a steeper recovery
    - ▣ If they are up, the growth is slower

WSIB



## Capital Markets Assumptions – Overview



### Statistical Estimate

- ❑ Capital market assumptions are a best forecast of CTF returns given available information and opinion and summarize a range of possible outcomes
  - ❑ For each asset class, expected return is average return over 15 years
  - ❑ Possible outcomes also include both lower and higher returns than expected return

### Transparent process

- ❑ Updated annually by asset allocation staff
- ❑ Methodology fully documented in annual Capital Markets White Paper and presentation
- ❑ Adopted in an open public meeting

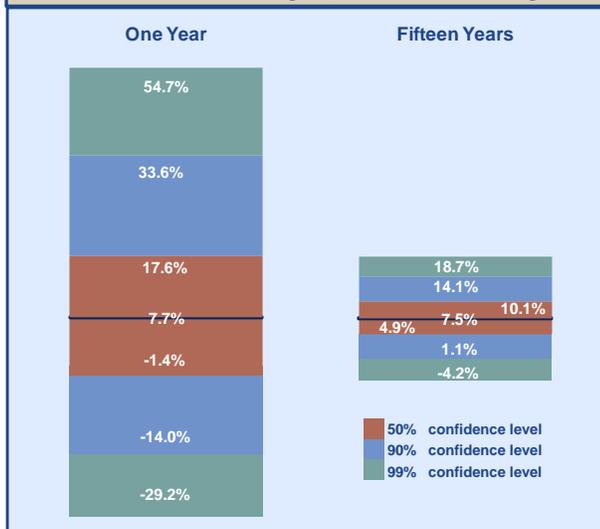
### “Point estimate”

- ❑ In any given year, actual asset class return is unlikely to equal expected return
- ❑ From statistical perspective, 8.00% and 7.50% may have very similar estimated likelihoods



## CTF Range of Return Expectations Using 2011 Capital Market Assumptions

1 Year: 49.2% chance of making 8%; 49.8% chance of making 7.5%  
 15 Years: 45.1% chance of earning 8%; 49.4% chance of making 7.5%





## Who Pays Attention to Capital Market Assumptions?



Prior to the recent recession, capital market assumptions have received little attention beyond WSIB, the State Actuary's Office, and the GET program

- ▣ Widespread confidence in economy and financial markets
- ▣ Strong investment performance, with CTF return since inception exceeding legislative mandate of 8%
- ▣ State economy and tax revenues growing

As a result, few external concerns about WSIB ability to meet 8% target and little interest in capital market assumptions

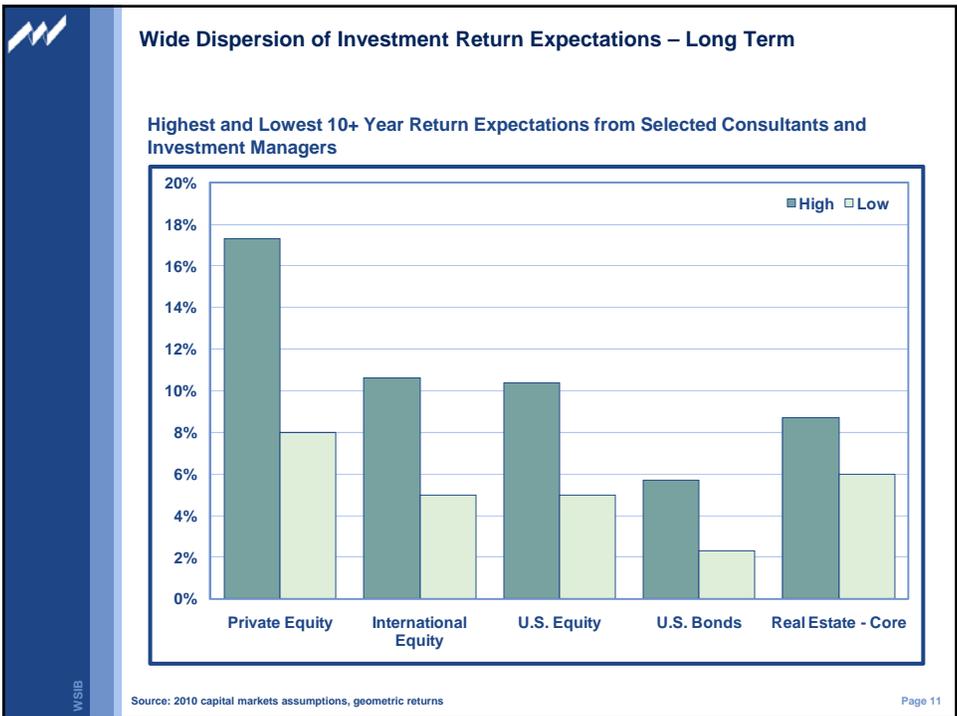
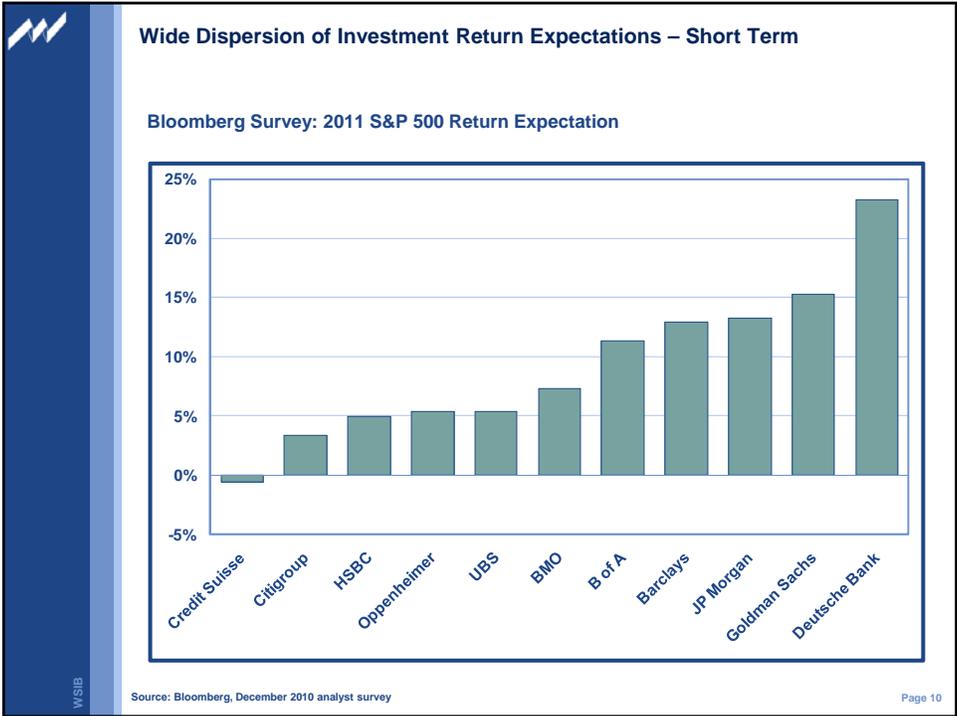


## Who Pays Attention to Capital Market Assumptions?



This year is proving to be different:

- ▣ Concerns about the future of financial markets
  - ▣ "The New Normal"
  - ▣ Market volatility
  - ▣ European sovereign debt crisis
  - ▣ Middle East turmoil
- ▣ Funding status of state pensions has received national media attention
  - ▣ New Jersey is not making pension contributions this fiscal year
  - ▣ Illinois is selling pension assets to make pension benefit payments
  - ▣ Recent research by financial economists arguing that true pension liabilities are understated
  - ▣ State bankruptcy proposals as a tool to reduce pension benefits
- ▣ Impact of pension funding on Washington State's budget
- ▣ State Actuary's risk model has highlighted the potential for undesirable pension system outcomes



**WSIB Strategy Going Forward During These Uncertain Times**



Diversification, not only by asset class, but also by geography, sector, and sub-sector

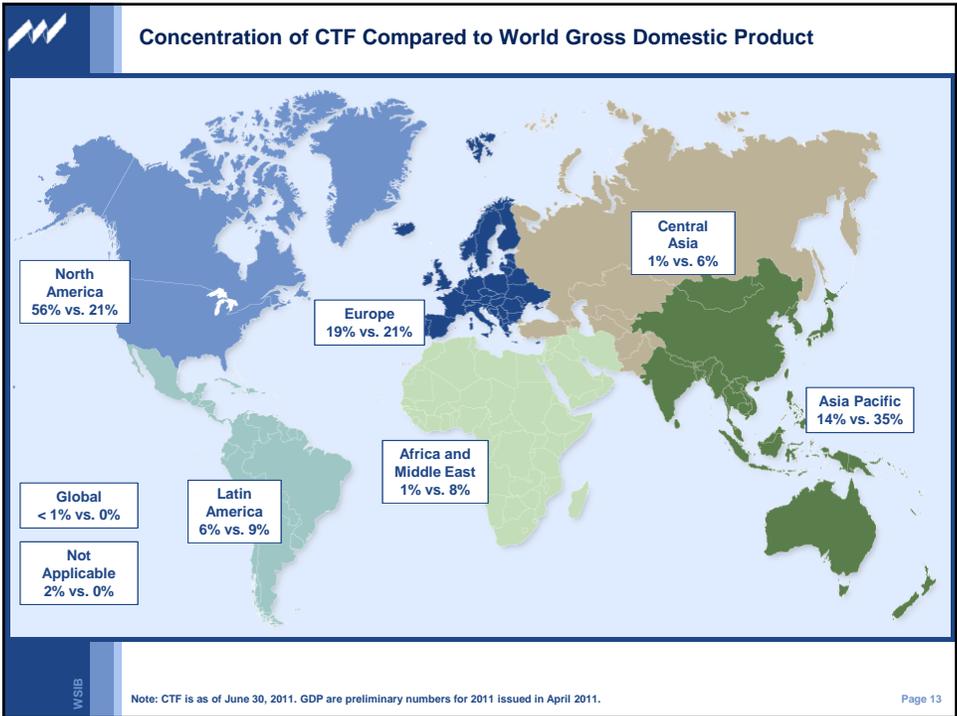
Look for economies that are growing

- ▣ Positive demographics
- ▣ Low debt to GDP ratios and strong:
  - ▣ Economic freedom
  - ▣ Rules of law
  - ▣ Property rights

Requires “boots on the ground” and flexible investment strategies

Continued focus on selecting “best of class” investment managers and investments with strong fundamentals

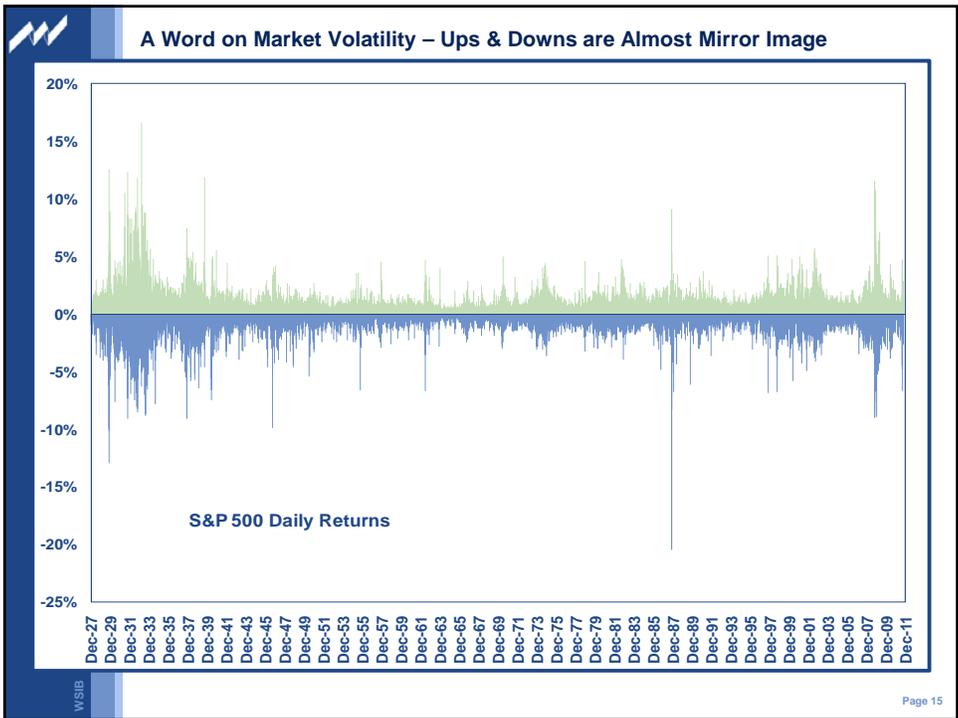
Page 12

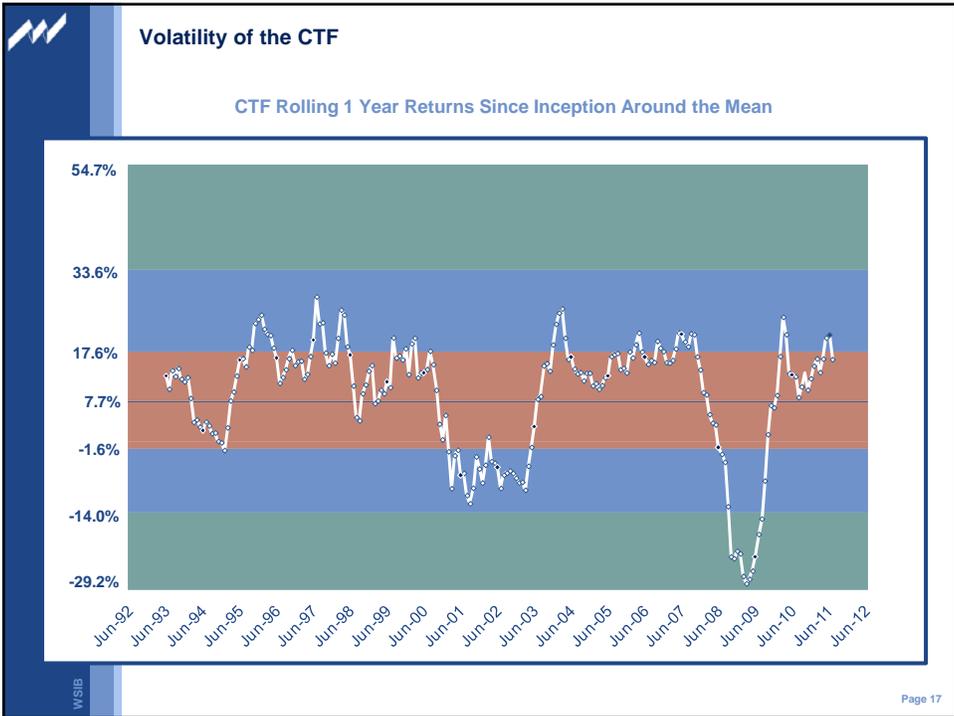
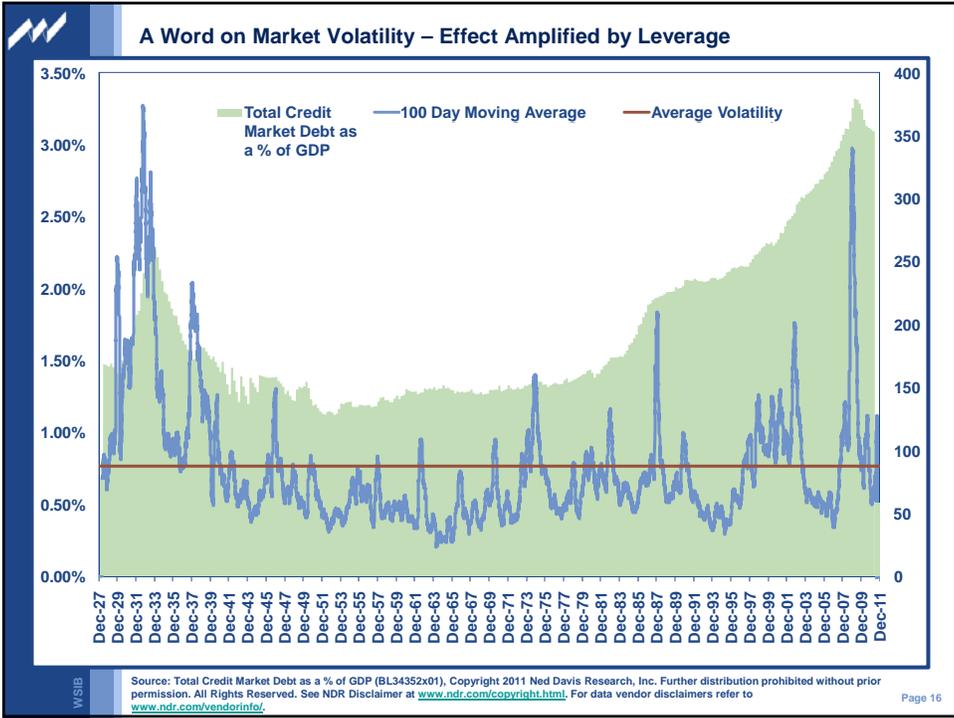


### Expected Equity Returns Higher for Emerging Markets

	Real GDP Growth Trend	Real Earnings Growth	+ Dividend Yield	= Expected Real Return	- Real Bond Yield	= Implied ERP	Expected Inflation	Expected Nominal Return
US	2.5	2.5	2.2	4.7	0	4.7	2	6.7
UK	2.3	2.3	3.5	5.8	-0.7	6.5	2	7.8
Europe ex UK	2	2	3.9	5.9	0.6	5.3	2	7.9
Japan	1.5	1.5	2.4	3.9	1.2	2.7	0.5	4.4
Brazil	5	5	4	9	5.6	3.4	4.5	13.5
China	8	8	3.5	11.5	1.1	10.4	3	14.5
India	8	8	1.3	9.3	4.3	5	4	13.3
Russia	5	5	2.3	7.3	2	5.2	6	13.3
<b>GDP-Weighted</b>								
Advanced	2.2	2.2	2.9	5.1	0.4	4.7	1.8	6.8
BRICs	7	7	3.1	10.1	2.5	7.6	3.8	14
World	3.4	3.4	3	6.3	0.9	5.4	2.3	8.6

Source: Goldman Sachs Asset Management. Data as of September 6, 2011





## Changes to Our Self-Directed Plan Options

*Defined Contribution and Deferred Compensation*



**Policies and investment beliefs guiding new menu selection**

- ❑ “The WSIB has a fiduciary duty to ensure that each Plan’s self-directed program offers a balance of options that will allow employees an asset allocation suitable for a range of participants, from employees early in their career to those in retirement. The investment options must cover a broad spectrum of funds from low risk/low return to high risk/high return.”
- ❑ “The number of options should be broad enough to offer a comprehensive set of options, yet be limited in number to make the programs simple to understand and offer the participant the ease of creating a diverse portfolio.”
- ❑ “In keeping with these objectives and to offer an efficient and cost-effective investment menu, it must be understood that not every participant’s unique desire or request can be met. Participants’ requests for specialized funds or highly focused investment strategies are best obtained through their own personal investments.”
- ❑ WSIB investment belief in passive management for U.S. equities also guided selection of domestic equity options

WSIB
Page 18

