**POLICY NUMBER:** 2.10.100

**EFFECTIVE DATE:** 6/15/17

**TITLE:** Public Markets Equity – Retirement Funds

**SUPERSEDES:** 1/16/14

**BOARD ADOPTION:** 6/15/17

**APPROVED:**

## PURPOSE

This document outlines the investment policy and objectives for the Public Markets equity segment of the Washington State Investment Board (WSIB) Commingled Trust Fund (CTF). The policy and objectives allow for sufficient flexibility in the management process to capture investment opportunities, yet provide parameters that ensure prudence and care in the execution of the equity investment program.

## POLICY

### Standard of Care

Under RCW 43.33A.030, trusteeship of funds under the authority of the WSIB is vested within the voting members of the Board. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions and seeks to meet the investment objectives listed below.

### Strategic Objectives

Within the context of available investment opportunities, the Board's assessment of risk, and the principle of diversification, the WSIB's asset allocation is managed over time to maximize return at a prudent level of risk (RCW 43.33A.110 and 43.33A.140).

To achieve this objective, the Public Markets equity program seeks to:

1. Achieve the highest return possible consistent with prudent risk management and the desire for downside protection with passive equity strategies as the default whenever strategies with better risk/return profiles cannot be identified.

2. Provide diversification to the WSIB's overall investment program. Diversification is expected to provide protection against unintended concentrated risk in the portfolio. A mix of investment styles, markets, and approaches should be used to achieve appropriate diversification.

3. Maintain liquidity in public equity, given WSIB's allocation to illiquid markets and investment structures in other strategies and/or asset classes.

4. Maintain transparency into all public equity strategies, to the extent possible.

### General Strategies

1. The public markets equity portion of the CTF invests in publicly traded equities globally, including equity securities in the U.S., developed non-U.S., and emerging

markets. The program has a global benchmark, currently the MSCI All Country World Investable Market Index (MSCI ACWI IMI).

2. A mix of external managers approved by the Board will be used to implement the program.

3. Passive management delivers broad diversified equity market exposure at low cost and is used when high conviction active managers cannot be identified and monitored appropriately. Passive management is also used when it is considered an appropriate alternative to active management, typically in more efficient markets.

4. Active management is used when the staff, Public Markets Committee, and Board can identify, access, and monitor high conviction managers in markets that are less efficient. Active management should seek to enhance the risk/return profile of the program.

### Investment Approach and Objectives

The public markets equity investments are managed to a broad global equity benchmark using the following strategies with allocation targets and ranges adopted by the Board.

U.S. Equity Passive Management

Since active U.S.-only equity managers have traditionally found it difficult to outperform index funds net of fees, the CTF will use U.S. equity passive management to maintain broad exposure to this market. This strategy aims to:

1. Closely track the return of a specified broad U.S. market benchmark, currently the MSCI U.S. Investable Market Index (MSCI U.S. IMI).

2. Maintain a U.S. equity weight for the CTF within a range of +/-5 percent of the U.S. weight in the specified global benchmark for the program.

3. Maintain broad diversified equity market exposure at low cost.

4. Utilize passive mandates managed against both market capitalization-weighted and fundamental-weighted indices as appropriate to provide diversification benefits.

5. Facilitate efficient rebalancing.

Non-U.S. Equity Passive Management

Since active non-U.S. equity managers have had a difficult time outperforming index funds net of fees, the CTF will use non-U.S. passive equity management to maintain broad exposure to these markets. This strategy aims to:

1. Closely track the return of a specified broad non-U.S. benchmark, currently the MSCI World ex. U.S. Investable Market Index (MSCI World ex. U.S. IMI).
2. Maintain a non-U.S. equity weight for the CTF within a range of +/-5 percent of the non-U.S. weight in the specified global benchmark for the program.

3. Maintain broad equity market exposure at low cost.

4. Facilitate efficient rebalancing.

Passive mandates within the U.S. and non-U.S. equity markets, or segments thereof, such as emerging markets, may also be used to adjust risk exposures of the aggregate public equity program. For example, underweights in certain key geographic areas, market capitalization size segments, or to certain style tilts may arise in the aggregate portfolio from time to time and be adjusted using passive management.

Active Global Equity or Non-U.S. Equity Management

Active management appears to have the best chance of success when managers have the scope to select the best investment opportunities from the broadest universe possible. Therefore, the program maintains the flexibility to hire broad equity market managers when the WSIB can identify such managers. The preference is for global equity management in which managers can invest in the best equity securities wherever such opportunities are located, but the program may also hire broad non-U.S. mandates (balanced with passive U.S. equity management) if exceptional non-U.S. active managers are identified and accessible.

There is not a specified target allocation for active management. Passive management will be the default and active management employed only when and to the extent that high conviction managers can be identified and to the extent that the WSIB can appropriately monitor them with our available resources. It is anticipated that the active program should be diversified amongst managers, styles, and approaches, subject to the ability to identify and access high conviction managers. Passive management may be used in conjunction with active management to balance market segments in which the WSIB cannot identify enough high conviction managers to achieve appropriate diversification within the active program.

These strategies aim to:

1. Outperform a specified benchmark – the MSCI All Country World Investable Market Index (MSCI ACWI IMI) or the MSCI World ex U.S. Investable Market Index (MSCI World ex U.S. IMI) over longer periods of time.

2. Improve the risk/return profile of the overall program.

Emerging Markets Equity Management

Emerging markets are thought to be somewhat less efficient and have unique characteristics that may require specialized knowledge and management, such as a higher degree of political risk. Therefore, the program seeks to implement an active emerging markets equity strategy whenever the WSIB can identify and monitor managers that are suitable alternatives to passive management.

The program has a bias to be overweight in emerging markets long term, but may move to neutral or modest underweight during periods when opportunities appear limited and/or valuations appear rich.

The strategies aim to:

1. Outperform their specified benchmark, currently the MSCI Emerging Markets Investable Markets Index (MSCI EM IMI), over longer periods of time.

2. Improve the risk/return profile of the overall program.

3. Maintain an aggregate emerging markets exposure (all public equity including passive and active) of -5 percent to +10 percent of the overall global benchmark specified for the program.

Rebalancing

The U.S. and non-U.S. allocations are managed within the ranges presented below:

| | |
|---|---|
| United States | benchmark weight +/- 5 percent |
| Non-U.S. Markets (developed and emerging) | benchmark weight +/- 5 percent |
| Emerging Markets | benchmark weight -5 percent to +10 percent |

The public equity asset mix is reviewed at least quarterly by the staff and Board. The Board delegates to the executive director the authority to rebalance the public equity asset mix as needed. These targets are long term and may deviate in the short term as a result of interim market conditions. Deviations outside the range may require rebalancing. The portfolio will be rebalanced as soon as it is practical, with consideration given to market impact and minimizing the transaction costs of implementation. Rebalancing within public equity will be consistent with the targets set forth in the Retirement Commingled Trust Fund (CTF) Asset Allocation Policy 2.10.050.

**Equity Manager Guidelines**

Each equity manager shall have guidelines that describe the general investment approach and strategy to be used in the management of the WSIB assets. These guidelines are general targets and not hard and fast restrictions. Equities are invested based on general allocation targets and market conditions, in accordance with the standard of fiduciary duty to which all managers must agree.

Permissible public market equity investments include the common and preferred stock of publicly-traded companies in global markets or as outlined in the manager's individual guidelines. Managers may use other instruments only in accordance with state law, WSIB policies, contracts, and manager guidelines.

The Board allows individual managers to manage the currency exposures related to their portfolios.

**Risk Constraints**

1. All assets under management by the WSIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of RCW 43.33A.110.
2. No common stock holding's cost shall exceed 3 percent of the Common Trust Fund's (CTF) market value at the time of purchase, nor shall its market value exceed 6 percent of the CTF's market value at any time (RCW 43.33A.140).
3. The portfolio shall maintain appropriate diversification.

**Due Diligence and Monitoring**

Staff has established a policy for the monitoring of external public equity managers, Policy 3.30.100.

**Reporting**

1. WSIB staff reports equity investments and allocations to the Board quarterly.
2. Staff reports investment structure and performance to the Board quarterly.
3. Staff will report key issues related to the investment managers and significant deviations in performance as warranted.

**RESPONSIBILITIES**

**Washington State Investment Board**

1. Monitor the performance of the overall public equity investment program.
2. Approve Board public equity policies.
3. Approve the Public Equity Annual Plan.
4. Approve or delegate pursuant to Board-adopted Delegation of Authority
5. Approve recommendations of public equity investment managers for hire or for termination.

**Public Markets Committee**

1. Recommend to the Board changes to Board public equity policies
2. Recommend to the Board public equity investment managers for hire or for termination.
3. Provide oversight and review of the public equity program in order to report and provide recommendations to the full Board.

**WSIB Staff**

1. Recommend and implement Board-adopted public equity policies.
2. Develop and implement public equity strategies.
3. Develop and implement the Public Equity Annual Plan.
4. Conduct public procurements as required to recommend new public equity investment managers.

5. Conduct due diligence and monitoring consistent with policy to oversee public equity investment managers and recommend termination when necessary.
6. Ensure compliance of all contractual public equity obligations.

**POLICY REVIEW**

The Board shall review this policy at least once every three (3) years to ensure that it remains relevant and appropriate.

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Original Policy Adopted 6/29/81
Revised 8/9/82
Revised 11/14/83
Revised 9/15/92
Revised 11/18/93
Revised 7/21/94
Revised 9/16/99
Revised 10/25/01
Revised 7/1/02
Revised 7/17/03
Revised 5/30/04
Revised 9/15/05
Revised 5/17/07
Revised 9/20/07
Revised 1/21/10
Revised 12/15/11
Revised 9/19/13
Revised 1/16/14
Revised 6/15/17