



**Thursday, February 17, 2022
Board Meeting**

Webex

9:30 A.M.

Dial-in information provided upon request.

1. Call to Order/Roll Call (9:30a)

2. Adoption of Minutes (9:30-9:35)

A. Adoption of the December 16, 2021, meeting minutes.

3. CEO Report and Strategic Plan (9:35-10:20)

A. CEO Report - January/February 2022

B. 2022 Strategic Plan

4. Break 10:20-10:30

5. KKR Outlook for 2022 (10:30-11:30)

KKR Outlook for 2022

6. Quarterly Performance Reports (11:30-11:40)

A. Quarterly Performance Reports

7. Administrative Committee Report (11:40-12:00)

8. Break (12:00-12:30)

9. Fixed Income Review and Outlook (12:30-1:30)

A. Fixed Income Review and Outlook

10. Adjourn (1:30p)

APPROVED

**WASHINGTON STATE INVESTMENT BOARD
Board Meeting Minutes
February 17, 2022**

The Washington State Investment Board met in open session via Webex video conferencing, with dial-in access available to the public.

Members Present: Tracy Guerin
Ada Healey
Judy Kuschel
Liz Lewis
Bill Longbrake
Yona Makowski
Greg Markley
David Nierenberg
Treasurer Mike Pellicciotti
Mary Pugh
Joel Sacks

Members Absent: Sara Ketelsen
Senator Mark Mullet
Representative Timm Ormsby
George Zinn

Also Present: Allyson Tucker, Chief Executive Officer
Chris Hanak, Chief Investment Officer
Bobby Humes, Human Resource Director
Bill Kennett, Senior Investment Officer – Fixed Income
Donna May Ong, Senior Investment Officer – Fixed Income
Phil Paroian, Senior Investment Officer – Public Equity
Sherrie Trecker, Sustainability Officer
Mary Lobdell, Legal, Risk and Compliance Director
Stacy Conway, Executive Assistant

Tor Jernudd, Attorney General's Office
Henry McVey, KKR

CALL TO ORDER

Chair Guerin called the meeting to order at 9:30 a.m. and took roll call; all Board members listed as present were able to fully participate in the meeting.

ADOPTION OF MINUTES

Chair Guerin moved to adopt the December 16, 2021, meeting minutes. Mr. Sacks seconded, and the motion carried unanimously.

CEO REPORT TO THE BOARD

Ms. Tucker reminded the Board that the Public Disclosure Commission F-1 Statement of Financial Affairs filings are due by April 15. She discussed her transition activities and noted that she would schedule "meet and greet" sessions with new executive management team members and the Board. She acknowledged that the WSIB is experiencing staff turnover, like other organizations; however, the agency has been able to hire impressive new team

members. She introduced Joanna Bartnik and Paul Chapman and announced the appointment of Chris Hanak to Chief Investment Officer (CIO). She described the CIO search process, explaining that Mr. Hanak came as the clear top choice for the position. She shared his extensive investment background, noting that he has gained the trust and respect of the Investment Division and entire agency.

Mr. Hanak thanked Ms. Tucker and staff for their confidence in him, commenting that the culture of respect and expectation of excellence are front and center at the WSIB, and he is proud to be a part of it.

Ms. Tucker relayed that the legislative session has resulted in a record number of requests for agency fiscal notes this year. Multiple board members provided feedback about the WSIB's approach to fiscal notes, and the feedback has been incorporated.

2022 STRATEGIC PLAN

Ms. Tucker explained that former Chief Executive Officer (CEO) Theresa Whitmarsh prepared the draft Strategic Plan with Ms. Tucker's refinement, and she described the themes of culture, capacity, and discipline, noting of the limited number of initiatives. She highlighted "maintaining investment discipline," which is ongoing and a significant amount of work, along with WSIB culture, changing expectations for the workplace, pandemic challenges, retirements and resignations, and the Enterprise Risk Management (ERM) operational risk rating increase in this area last year. The focus on these areas provides an opportunity to talk openly about change management and the organization's vision, mission, and values. Capacity will be built through professional development.

Discussion ensued regarding the turnover the agency is experiencing and how it compares to historical levels, how the WSIB compares with its peer pension funds nationally, the impact of the ability to telework on recruiting, and the optimal amount of in-office time.

Ms. Tucker discussed the implementation of asset class annual plans, the Risk Management and Asset Allocation Unit (RMAA) initiatives, including expansion of the Innovation Portfolio, and the partner environmental, social, and governance (ESG) assessment tool, increasing the WSIB's ability to measure ESG risk across the portfolio. She noted that ESG is a large topic; however, the Board has delivered its priorities of climate change and diversity, equity, and inclusion (DEI).

Ms. Trecker commented that the ESG tool will allow staff to ensure partner capabilities on ESG are appropriately considered relative to all the other investment capabilities that are critical to the investment due diligence process and should allow the transfer of WSIB institutional knowledge around ESG.

Ms. Tucker described the pending development of the Climate Blueprint, a governance framework that will consist of six key components, within which staff will prioritize action as an agency, within the portfolio, and within the industry, with goals and metrics that will be

reported to the Board. The blueprint is being developed as a tool to help navigate the issue of climate change – not to solve it.

Ms. Trecker noted that the ESG partner assessment tool, also under development, will tie into the blueprint framework.

Discussion ensued regarding the Board's ability to provide input to the Climate Blueprint, including the scope of advocacy; desire for Board education on ESG assessment in the investment industry; and relatively slow pace of the development of meaningful standard ESG disclosures.

[Ms. Lewis arrived at 10:15 a.m.]

Mr. Humes shared his background and work while leading the Human Resources functions for the City of Seattle and its Parks and Recreation Department. He addressed the goal of alignment across ESG and DEI outcomes, noting the participation by DEI Committee and engaged staff.

He discussed described the pending development of the of the DEI Blueprint, including the proposed six key components, noting the agency's anticipated activities in each. He advised that DEI efforts and strategy should be slow enough that everyone on the journey is given space and grace to grow and low as to the depths of what it means individually and collectively to be part of the working system of the WSIB.

Discussion ensued regarding the relationship among the Board, staff, and partners with regard to DEI; the selection of partners who share values around DEI and climate as a possible outcome of the strategy; WSIB impact on partners by virtue of the questions posed to them by the Board; and more education and focus on the equity and inclusion part of DEI.

Ms. Tucker commented on the Board education focus for the coming year, noting that the topics are derived from both Board and Committee meeting discussions as well as Board member one on one meetings. Staff will work to present education sessions on as many of the topics as possible.

[The Board recessed at 10:25 a.m. and reconvened at 10:33 a.m.]

KKR 2022 OUTLOOK

Ms. Tucker introduced Mr. McVey to present an economic outlook for 2022.

Mr. McVey addressed the differences between today's economic backdrop and that following the 2008 downturn and the implications for the investment portfolio. He discussed increased volatility, lower multiples need for both growth and value in the portfolio; central banks tightening; earnings per share beginning to slow, all indicating a midcycle slowdown, but no recession. Volatility is expected to increase, particularly in speculative parts of the

market; inflation issues are unlikely to abate in the near-term – real wages contracted last year leading to demand for higher wages in the coming years; input costs are rising faster than the Consumer Price Index (CPI) globally. The U.S. is still in a mid-cycle expansion phase, looking for a transition toward more late cycle characteristics sometime around 2024. Consumer sentiment is down due to inflation. There is an expectation for the digital economy to remain robust, but a shift to services from goods in 2022. The global energy transition will be a defining feature of this recovery. Looking ahead, it will be all about pricing power and earnings per share growth. KKR moved toward a more thematic approach due to the amount of liquidity in the system.

Discussion ensued regarding the impact on markets in light of the activity in Ukraine; the era of large ego resulting in higher geopolitical tensions; potential for a more regional world; increased market volatility; potential for more of the federal budget to defense spending and the impact on other areas; and the convergence between defense spending and industrials.

Mr. McVey projected near-future returns from earnings growth, rather than multiple expansion; an expectation for equities to return 6.7 percent in 2022, including dividends; an increased projected U.S. 2022 10-year target to 2.25 percent from 2.0 percent reflecting accelerated Federal Reserve expectations; and earnings yield on stocks ahead of 10-year bond returns.

Mr. McVey discussed concerns, including a sharp, unexpected move in real and/or nominal rates; out-of-position retail, with equity allocations at decade highs and investors much more vulnerable to volatility in 2022; risks surrounding geopolitics in a changing global landscape; and input prices, including labor and commodities due to rising wages, as well as supply chain disruptions due to Omicron.

Mr. McVey reported that KKR remains pro risk in positioning with increased inflation hedges, and he addressed the firm's general investment strategy.

2022 STRATEGIC PLAN (continued)

Chair Guerin redirected the agenda to the Strategic Plan discussion, noting that the progress relative to ESG and DEI is exciting, and it is important to keep front and center the Board's fiduciary responsibility to beneficiaries. Mr. Nierenberg followed with an example of a well-known investment that was both good for the country and had strong returns.

Chair Guerin moved that the Board approve the 2022 Strategic Plan as presented, with the acknowledgement that there will be a few tweaks on some language related to climate action. Ms. Kuschel seconded, and the motion carried unanimously.

Mr. Sacks acknowledged Allyson and staff for their work on the Strategic Plan.

CEO REPORT (continued)

Public Comment was received expressing concern that some private equity funds may enable new fossil fuel infrastructure and that private investments can be less transparent than public investments. The information will be included in the Board member materials, and staff will work through these issues with partners.

Ms. Tucker announced that Mary Lobdell, Legal, Risk, and Compliance Director, will retire in March, and after a search process, Liz Smith was selected as her replacement. Ms. Lobdell addressed the Board, expressing her support of Ms. Smith. Ms. Tucker also expressed her support for Ms. Smith.

QUARTERLY INVESTMENT REPORTS

Ms. Tucker shared the quarterly performance report for the last quarter of 2021, noting that markets closed the quarter strong. The Commingled Trust Fund (CTF) returned 4.74 percent for the quarter and 22 percent for the year and outperformed benchmarks for all reported time periods. She detailed the performance of individual asset classes, noting that the fixed income and public equity portfolios underperformed slightly, and the private market portfolios outperformed their benchmarks for the quarter. Since inception the CTF has returned 9.38 percent and has generated returns above the long-term assumed rate of return for all time periods other than the quarter. Compared to other large U.S. state pension funds the WSIB was in the 50th percentile for the quarter, top decile for the 1-year period, and one of the top-performing funds for the 5-year period and beyond.

Discussion ensued regarding performance of active management versus index funds; public markets performance in 2020 following the March 2020 downturn; factors contributing to short-term performance and importance of a long-term outlook; early 2022 performance; and implications of current public market performance on long-term strategy in private equity and public equity.

ADMINISTRATIVE COMMITTEE REPORT

Chair Guerin reported that the Administrative Committee met before the Board meeting. The Committee received the quarterly budget report. Ms. Verme reported the appropriated budget has a projected balance of \$2.7 million, or 8.4 percent savings, and the non-appropriated budget has a projected balance of \$109.4 million, or 14.8 percent savings. The Committee discussed the impact of inflation on the cost of travel, and staff will consider this in the development of the 2022-2024 biennial budget.

Chair Guerin reported that there was also an *ad hoc* committee update, and she requested that *ad hoc* committee chair Markley provide the update directly to the Board.

Mr. Markley commented the committee met on January 28 for its first meeting to discuss the addition of racial justice language to the CTF Investment Beliefs.

The *ad hoc* committee discussed the historical context of the WSIB's Investment Beliefs, WSIB culture, and other initiatives that the Board has valued, such as corporate Board diversity and women in finance, particularly private equity. Several committee members

shared their experience with other organizations and Boards in this area, and Ms. Tucker addressed examples of internal WSIB team discussions and pursuits already taking place.

Ms. Tucker described the work underway by staff on DEI and Climate blueprints that would provide a framework and alignment of organization, portfolio, and industry efforts, which was presented in the Strategic Plan. There was discussion by the committee around leading with the blueprints, with the Investment Belief language following, and several potential additional Investment Belief language options were suggested and discussed; however, there was no consensus reached and more work would be done.

The committee acknowledged that concessionary returns are not acceptable, and the racial equity/justice Investment Belief under consideration needs to fit within the context of the way the WSIB operates. There was agreement that staff needs the time necessary for thoughtful consideration around the implementation and implications of any additional provision. The *ad hoc* committee will continue its discussions at its next meeting on March 23.

Ms. Guerin acknowledged the work of the committee and the importance of the Investment Beliefs, their alignment with the blueprints, and staff's ability to implement them.

The final Administrative Committee discussion item was consideration of the timing to come back to in-person Board meetings. One of the challenges is that the WSIB Boardroom is not currently equipped to handle hybrid meetings. There was a suggestion for alternative locations to meet in person that are larger to be able to meet in person sooner. The Committee is committed to coming together in person for an in-person meeting in July that would provide for outdoor activities. Will give plenty of notice before meeting in person.

[The Board recessed at 11:36 and reconvened at 12:11 p.m.]

FIXED INCOME REVIEW AND OUTLOOK

Mr. Kennett noted that there have been a couple of changes following publication of the presentation, including higher inflation than expected and the decline of COVID cases in the last two weeks.

Ms. Ong listed the Fixed Income Team and addressed the role of fixed income in the portfolio, sharing highlights from 2021. She discussed historical and current Bloomberg U.S. Aggregate corporate average option-adjusted spreads and the change from 2020 to 2021 in 10-year government bond yields for selected countries. She also noted that the majority of total return over 10 years is coupon return.

Mr. Kennett discussed the decision-making framework; performance of the fixed income portfolios; and the portfolios' actual and target durations. He summarized key portfolio statistics, noting the effective duration for the retirement funds is below that of the Bloomberg U.S. Universal, and he presented attribution as compared to the Bloomberg U.S. Universal index by both sector allocation and returns.

Discussion ensued regarding opportunity to purchase mortgage-backed securities in 2022.

Ms. Ong shared a global review of 2021 and outlook for 2022, noting that the biggest stories of 2021 were the pandemic, rising inflation, and slowing growth in China, commenting that the global recovery has been strong and sharing highlights. She presented a global Gross Domestic Product (GDP) forecast from J.P. Morgan, detailing global GDP figures for select countries and markets in 2020 and 2021, along with a forecast for 2022 and 2023, detailing select factors for the resulting and forecasted GDP. She discussed the COVID-19 impact on real GDP for select countries.

Mr. Kennett shared a review and outlook for the U.S., noting that the economy grew 6.9 percent quarter over quarter in the fourth quarter. Home sales remained strong and home prices jumped sharply in 2021. Interest rates will rise, mortgage rates will rise, and affordability of homes should decline. JP Morgan is forecasting growth of 3.7 percent in 2022 and 2.5 percent in 2023, both above trend for the U.S of 1.5 to 2 percent. Growth is above trend resulting from the severe recession of 2020 and a reflection of the massive monetary and fiscal stimulus; the labor market is tight and wage growth is accelerating, but not keeping up with inflation; quit rates are at record levels; the CPI rose 7.5 percent year over year in December, with the core rate up 5.5 percent due to large gains in shelter, vehicles, energy; and the U.S. Personal Consumption Expenditure Core Price Index increased 4.9 percent in December, well above the Federal Reserve's 2 percent target.

Mr. Kennett discussed risks of the Federal Reserve raising rates too quickly or too slowly, the impact of higher inflation on markets during 2021, amount of liquidity injected into the economy, non-farm payrolls, fall of the unemployment rate, increase in average hourly earnings, participation rate, job vacancies, quit rate, decline of fiscal stimulus, and reasons for both higher inflation and lower inflation. He addressed Federal Reserve activities, noting the anticipation of seven rate hikes over the next 2 years.

Ms. Ong presented a review and outlook for China, noting the slowed growth in 2021 and highlighting the policy-induced economic slowdown. She discussed China's actions to stabilize its economy, the property debt crisis, COVID policies, leadership reshuffle, tensions and competition between China and the U.S., digital currencies, and projected growth.

Ms. Ong also shared a brief review and outlook for emerging markets, noting that 2022 is expected to be a tough year due to pandemic uncertainties, slower growth in China, and tighter monetary policy in the U.S.

Mr. Kennett shared a high-level overview of potential risks and discussed portfolio implications of the current and projected economic indicators, including projected higher interest rates, leading to shorter durations; belief in credit due to coupon return; opportunity in mortgage-backed securities; and the expectation for negative returns for 2022.

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Discussion ensued regarding the impact of widening credit spreads on specific sectors; strategy of investing with top companies in the countries in which the WSIB invests; portfolio implications of widening corporate spreads; impact of fiscal stimulus on disposable personal income and GDP; differences between response following the 2008 decline and that of 2020; impact of anti-immigration policies on the U.S. labor force.

ADJOURNMENT

There were no other items to come before the Board, and the Board adjourned at 1:26 p.m.