

DRS Advisory Committee Public Equity



November 18, 2011

Phil Paroian

Senior Investment Officer – Public Equity



Topics to be Covered in This Presentation



Public Equity

- ▣ Who we are
- ▣ What we do
- ▣ Investment beliefs
- ▣ Selecting and Monitoring of managers
- ▣ Thoughts on performance



The Team – David Thatcher – Investment Officer



- ❑ Joined WSIB in June 2002
- ❑ B.S. from Washington State University in Police Science and Administration
- ❑ 17 years experience with six different state agencies
- ❑ Extensive background in contracting and procurement services, including at WSIB
- ❑ Joined Public Equity in March 2006
- ❑ Retired in December 2009 after 33 years duty in the U.S. Marines



The Team – Allyson Tucker – Assistant Senior Investment Officer



- ▣ Joined WSIB in December 2009
- ▣ 12 years industry experience
- ▣ B.A., Business Administration, Accounting from the University of Washington
- ▣ Chartered Financial Analyst (CFA)
- ▣ Former Board member, Magnum Coal
- ▣ Former Board member, Passages Northwest
- ▣ Previous experience at Ragen MacKenzie as a sell-side equity analyst and at the William H Gates III Investment Office/Cascade Investment
- ▣ Born and raised in Olympia
- ▣ Her daughter, Lyla, was born in January



The Team – Phil Paroian – Senior Investment Officer



- ❑ Joined WSIB in February 2008
- ❑ Far too many years doing this
- ❑ Bachelor of Mathematics (BMath Honours) from the University of Waterloo (ON Canada)
- ❑ Associate of the Society of Actuaries (ASA)
- ❑ Chartered Financial Analyst (CFA)
- ❑ Previous experience with the Ontario Municipal Employees Retirement System (OMERS), University of Toronto Asset Management Corp (UTAM), and the Ohio Public Employees' Retirement System (OPERS)
- ❑ Born in Toronto and grew up in Windsor (ON Canada)
- ❑ Has unfortunate and costly addictions to books, travel, and theater
- ❑ Sings when there are at least 100 other voices to cover his (most recently performing with the Seattle Men's Chorus)

Public Equity – What We Do



- ❑ Recommend hiring and termination of managers to the WSIB Board
- ❑ Monitor managers' organizations and actions against stated strategy
- ❑ Monitor aggregate exposures across managers
- ❑ Assess how the managers fit together and the program structure
- ❑ Research potential new strategies and managers
- ❑ Support DRS
- ❑ Coordinate cash flows
- ❑ Coordinate with other units – other investment teams, administrative staff, operations staff, accounting staff, compliance, IT, communication and public affairs
- ❑ Coordinate with the custodian
- ❑ Participate actively in Enterprise Risk Management and other risk management initiatives
- ❑ Participate actively in the data warehouse project
- ❑ Contact other leading public pension funds to stay current with best practices
- ❑ Hire and manage the Consultant Pool
- ❑ Hire and manage Transition Managers



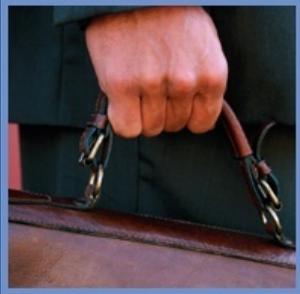
Key WSIB Investment Beliefs (TAP)



- ❑ The mission of the Fund is to maximize returns at a prudent level of risk
- ❑ The time horizon for this mission is long-term (i.e., 15+ years)
- ❑ A broadly diversified portfolio is preferable
- ❑ The relative performance of asset classes and investment styles is generally subject to reversion to the mean, although timing such moves is challenging
- ❑ Active management in an asset class is warranted if
 - ❑ The asset class, segment(s) of the asset class, or investment strategy is reasonably inefficient
 - ❑ There exist managers or partners with skill, persistent performance, and sufficient capacity to meet the WSIB's needs
 - ❑ The WSIB is able to cost-effectively identify and retain those skilled managers
- ❑ Investment manager performance in the most efficient public markets is generally subject to reversion to the mean



Fundamental Beliefs



- ❑ Keep it simple
- ❑ Keep an open mind; avoid pre-conceived notions
- ❑ Turnover is expensive (if it ain't broke, don't fix it)
- ❑ ALL managers go through periods of underperformance; must keep focus on the long term
- ❑ Risk is as important as return
- ❑ Diversification can only come from selecting managers with different approaches
- ❑ Crowd-following behavior is usually penalized and provides opportunity for investors with skill and **patience** to outperform
- ❑ Transparency is vital – must know and understand the “who, what, when, where , why, and how” of all managers

Investment Searches



- ❑ Conducted in tandem with, and peer reviewed by, consultant(s)
- ❑ What are we looking for?
 - ❑ Staff develops objectives, profile, scope of work, criteria
- ❑ Identifying candidates
 - ❑ Publicly advertised
 - ❑ Consultant does preliminary screening
 - ❑ Staff leads discussion of firms to proceed
- ❑ Further due diligence
 - ❑ Additional questions
 - ❑ Teleconference and videoconference
- ❑ On-site visits of finalists, if necessary
- ❑ Staff makes recommendation to:
 - ❑ Chief Investment Officer
 - ❑ Investment Committee (Executive Director, Chief Investment Officer, all Senior Investment Officers)
 - ❑ Public Markets Committee
 - ❑ Board
- ❑ Contract negotiation
 - ❑ Guidelines
 - ❑ Fees
 - ❑ Other terms

Investment Searches – Typical Criteria



Organization

- ❑ Stability
- ❑ Depth of resources
- ❑ Ownership

People

- ❑ Experience
- ❑ Team structure
- ❑ Succession plan
- ❑ Alignment of incentives and compensation

Process

- ❑ Team, individuals, or process?
- ❑ Innovation and adaptability
- ❑ Consistency
- ❑ Competitive advantage
- ❑ Success

Portfolio

- ❑ Implementation
- ❑ Positioning
- ❑ Turnover
- ❑ Fit and correlation

Risk Management

- ❑ Their definition of “risk”
- ❑ Managed how?

Trading

- ❑ Methods and efficiency

Operations

- ❑ Proper audit controls, oversight, ethics

Fees

EXAMPLE: Total Allocation Portfolio

Active Global/Non-U.S. Equity Markets Search – Process



Preliminary Research

Advertising

Initial Screening

- ▣ **Minimum standards**
- ▣ **Elimination criteria**
- ▣ **Tiering**
 - ▣ **Significant competitive advantages**
 - ▣ **Modest competitive advantages**
 - ▣ **Solid but fewer sustainable advantages**
- ▣ **Discussed with consultants on July 12, 2010**
- ▣ **Search narrowed to 33 strategies with 31 firms**



EXAMPLE: Total Allocation Portfolio Active Global/Non-U.S. Equity Markets Search – Process



Initial Evaluation

- ❑ Consultants independently crafted analyses of all candidates, which were then forwarded and independently scored by three WSIB evaluators
- ❑ Criteria included firm background and stability, experience of key decision makers, depth of team, business profile, assets, philosophy and process, idea generation, portfolio construction, implementation, business management, and risk management
- ❑ Evaluators met to discuss manager selection on August 9, 2010
- ❑ Nineteen firms/strategies were chosen for semi-finalist videoconferences

EXAMPLE: Total Allocation Portfolio Active Global/Non-U.S. Equity Markets Search – Process



Semi-finalist Video Conferences

- ▣ More in-depth discussions and ability to have a back-and-forth question and answer discussion with firms in addition to reading profiles and analyses on paper
- ▣ Videoconference conducted from August 16 to September 2, 2010
- ▣ Evaluators met to discuss manager selection on September 3, 2010
- ▣ Each candidate was independently scored

Thirteen firms were chosen for further due diligence

EXAMPLE: Total Allocation Portfolio Active Global/Non-U.S. Equity Markets Search – Process



Olympia Meetings

- ❑ Candidates asked to come to Olympia for a full-day meeting to thoroughly review investment process in detail with all three evaluators present
- ❑ Two stocks chosen by WSIB from each candidate's portfolio
- ❑ Focus of meeting was understanding analysis of those stocks and understanding the firm's research and process through those examples
- ❑ Meetings conducted from September 21 to October 8, 2010
- ❑ Staff met on October 11, 2010, after independently ranking candidates using the same five-point scale used for semi-finalists
- ❑ During October, further meetings with the WSIB Chief Investment Officer, initial style research analysis, scenario testing
- ❑ On October 26, 2010, nine firms chosen for on-site due diligence

EXAMPLE: Total Allocation Portfolio Active Global/Non-U.S. Equity Markets Search – Process



Onsite Due Diligence

- ❑ Phil Paroian, David Thatcher, plus Kris Logan, WSIB Investment Accounting Controller
- ❑ Any outstanding investment questions
- ❑ Operational issues including regulatory review, firm financial conditional, compliance monitoring, broker selection, internal audit and SAS 70 reporting, trade processing and best execution, accounting systems and controls, cash management including foreign exchange, and disaster recovery
- ❑ Sample contract
- ❑ Proxy voting questionnaire
- ❑ UK onsites conducted December 6-10, 2010
- ❑ CA onsites conducted December 20-21, 2010
- ❑ Eastern U.S. onsites conducted January 10-15, 2011
- ❑ Presented to WSIB Public Markets Committee March 1-2, 2011
- ❑ Approved by WSIB Board April 23, 2011
- ❑ Contract and fee negotiations completed early May 2011
- ❑ Managers funded in June 2011



Manager Monitoring



- Face-to-face meetings at least twice a year
- On-site visit at least once a year
- Daily performance available for CTF segregated accounts
- Monthly performance from our custodian on all mandates

- Watching for yellow flags:
 - Changes
 - Distractions
 - What's working
 - What isn't
 - WHY?

What it is

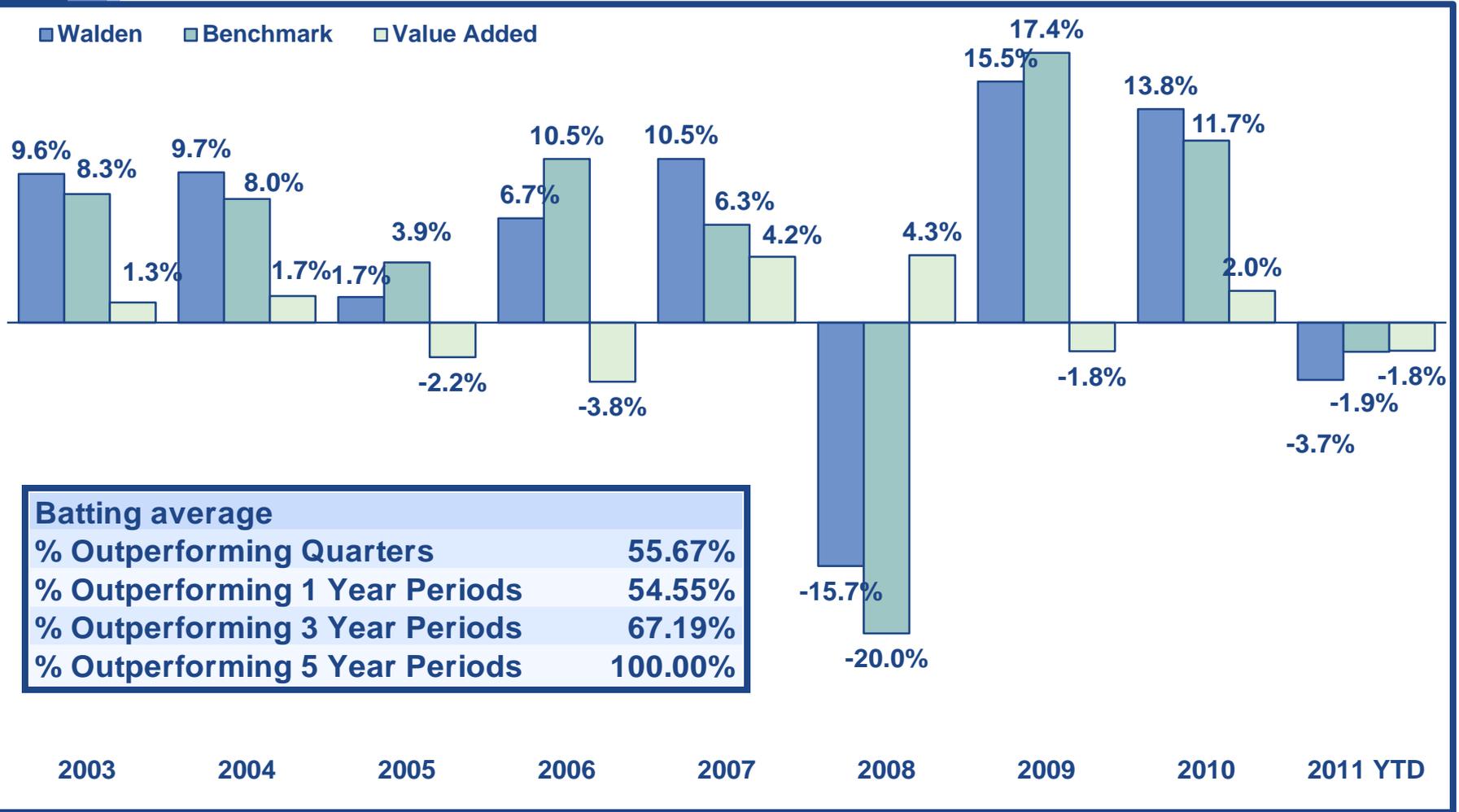
- ❑ Concrete
- ❑ The first thing most people look at
- ❑ The ultimate measure of success
- ❑ The result of all the process and all the criteria discussed so far
 - ❑ **It's an outcome, not something on its own**
- ❑ Time specific...be very careful

What it is not

- ❑ Definitive
- ❑ Explanatory
 - ❑ **It's a symptom, not the cause**
- ❑ A single number
- ❑ Something you can buy



Walden Socially Balanced Fund – Calendar Year Performance versus Batting Average – July 2003 to Sept 2011



Batting average	
% Outperforming Quarters	55.67%
% Outperforming 1 Year Periods	54.55%
% Outperforming 3 Year Periods	67.19%
% Outperforming 5 Year Periods	100.00%