1. **CALL TO ORDER/ROLL CALL**
Chair Wustenberg called the meeting of the Investment Committee to order at 10:00 a.m.

On roll call, the following Investment Committee members answered present:
- Mr. Kerry Barnett
- Ms. Leslie Lehmann
- Ms. Phyllis Wustenberg

Absent: None.

**Other Board Members Present:** Rachel Pilliod (arrived at 11:00 a.m.)

**Chancellor’s Office staff present:** Tom Anderes (arrived at 11:30 a.m.) and Mike Green.

**Others:** Marcia Beard, RV Kuhns; Mary Gregory, T. Rowe Price (via telephone); Richard Moreland, T. Rowe Price; Kevin Nordhill, State Treasury; Gary Slavin, Western Asset Funds; and Kurt Umbarger, T. Rowe Price (via telephone).

2. **APPROVAL OF MINUTES**
   - **September 19, 2002, Investment Committee Meeting Minutes**

The Committee dispensed with the reading of the September 19, 2002, Committee meeting minutes. Director Lehmann moved and Director Barnett seconded the motion to approve the minutes as submitted. The following voted in favor: Directors Barnett, Lehmann, and Wustenberg. Those voting no: none. Motion approved unanimously.

3. **REPORT ITEMS**
   a. **Investment Manager Report—T. Rowe Price**

Richard Moreland, CFA, reviewed his qualifications and experience with T. Rowe Price and introduced, via telephone, Kurt Umbarger and Mary Gregory who, he explained, will serve as the new primary contact for OUS, and briefly discussed their credentials. He presented an overview of T. Rowe Price's performance over the past year.

Mr. Moreland explained T. Rowe Price’s investment strategy, which has a growth bias, noting that the objective is to capture a broad universe of non-U. S. stocks, primarily to develop a market. He noted that there is some ‘emerging markets' exposure but explained that they only invest if there is an opportunistic basis. He stated that the
T. Rowe Price firm remains strong and that the firm remains diversified as a class as well as distribution channel.

Mr. Moreland noted that the portfolio is heavily invested in larger companies. Referring to the international investments, he discussed country and sector weightings noting that regional politics and economics affect the investment approach. He defined growth as average, sustained earnings growth over time.

Kurt Umbarger discussed performance, both long term and recent performance. He noted that recent performance has been challenging, but pointed out that the market has started to turn more positive once again. Emerging markets have been the better place to be over the last 18 months, which has been helpful for the international portfolio. He noted that the U.S. dollar has been unhedged and they will not have hedging in the portfolio.

Director Barnett questioned the practice of non-hedging against declines in U.S. currency and asked if it was a strategic decision to remain unhedged. Mr. Umbarger noted that when the U.S. dollar is weak, it is good for U.S. investors overseas. He explained that they have that ability to hedge in the portfolio, but it is rare since doing so will not consistently add value.

Director Barnett asked what the assumption is regarding the future strength of the dollar. Mr. Umbarger predicted that the Euro will continue to remain stronger relative to the U.S. dollar. He noted that the current account deficit in the U.S. is in excess of 5 percent of GDP (Gross Domestic Product), which historically has signaled a level by which the currency is likely to experience a downward adjustment. Therefore they aren’t contemplating changing their currency assumption or the hedging policy in the portfolio.

Mr. Umbarger noted that growth stocks had been doing poorly relative to value stocks, but are now beginning to recover. He opined that there is greater parity now between value and growth stocks in terms of their outlook and valuations. Leslie Lehmann asked how technology will change the world of investment in terms of U.S. versus international investments and what to expect in the next 10-15 years. Mr. Umbarger explained that the recent spike in technology returns was primarily due to corporate investment expenditures in Information Technology and the Y2K scare. He explained that one of the drivers of equity returns and also higher-end, service-oriented jobs, comes from those companies and countries that are able to generate innovative and new technology related products and services and the U.S. is still the leader in that area of technology. He stated that there has been an expansion of a number of high quality tech companies overseas, especially in Asia. However, the true innovation continues to originate in the U.S. and most of Asia is still primarily manufacturing.

Director Barnett referred to the reduced performance and asked if the change was due to the vagaries of the market or a different strategy. Mr. Umbarger explained the changes in performance between quarters but noted that there has been no change in
T. Rowe Price’s strategy. He explained that, over time, their long-term performance accumulates in the top third against peers.

Director Barnett asked why the industry is doing so poorly against the benchmark. Marcia Beard explained that active management typically pays off and that this current situation is an anomaly. Director Lehmann reiterated her earlier question about future assumptions and asked whether the trend will go back or do whether OUS needs to rethink its strategies.

b. Investment Manager Report—Western Asset

Gary Slavin, Vice President, Client Services Western Asset Funds, presented his report. He noted that the company headquarters will be moving. He provided an updated in the report since May and noted that scandals have forced corporations to get their balance sheets in order and lower debt, which has contributed to the change in the market. He suggested that the current bear market is due to scares and scandals, which explains why they underperformed in first few months and outperformed greatly since. He noted that in September 2001, Western took a different approach, opposing the view of the anticipated trend, and subsequently it was a good investment opportunity.

He discussed the weighting of the portfolio and explained that lower rated bonds are cheap in an improving economy. Responding to concerns, he briefly discussed risk factors and explained that, over time, the standard deviation is good because they are well diversified.

Director Wustenberg noted that the Board is risk averse and asked whether higher returns for higher risk were prudent. Mr. Slavin noted that only a portion of the portfolio is diversified and that 15 percent of the entire fund is the maximum allowed in this prospective, although it is usually 10 to 11 percent. He discussed emerging markets and noted that in the high-risk yields, Western holds many names and are well diversified, thus reducing the risk factor. He stated that the only change Western has taken in its strategy was to move to neutral in mortgages. He expects gradual improvement in the economy.

c. Third Quarter Investment Report for FY 2003

The Committee did not hear a report on the third quarter investments; however, the report was made available for reading.

d. International Equity Manager Search

The Committee discussed their concerns regarding the performance of T. Rowe Price. Ms. Beard noted that, because T. Rowe Price is a growth investor, it is a style issue. She recommended the Board either add a value manager to the portfolio or replace T. Rowe Price with a manager that invests both ways. Mr. Nordhill pointed out that if the economy continues to grow, T. Rowe Price will improve. Mr. Nordhill and Ms. Beard
hesitated to recommend letting T. Rowe Price go, arguing that it is important to keep style neutrality. They suggested that the Board add a relative, not high, value manager. They agreed that the long-term concern is the need for style neutrality. Ms. Beard recommended, however, that ultimately the Board not work solely with T. Rowe Price. Director Wustenberg asked staff to draw up a rationale setting out the options and to have it ready for the next meeting.

e. Asset Allocation Study

Ms. Beard briefly reviewed the preliminary numbers. She noted that, especially given the current economy, the net year-to-date assets are positive. She explained that absolute returns provide equity-like return for bond-like risk thus reducing the volatility of the portfolio. Ms. Beard offered to bring some managers in to provide further education for the Committee.

The Committee agreed to meet again in September.

4. ADJOURNMENT

The meeting adjourned at 12:10 p.m.