



**Annual Report of the Southern Boundary Restoration and Enhancement Fund and
Northern Boundary and Transboundary Rivers Restoration and Enhancement Fund to the
Pacific Salmon Commission for the year
2002**

Introduction

In June of 1999, the United States and Canada reached a comprehensive new agreement (the “1999 Agreement”) under the 1985 Pacific Salmon Treaty. Among other provisions, the 1999 Agreement established two bilateral funds: the Northern Boundary and Transboundary Rivers Restoration and Enhancement Fund (Northern Fund); and the Southern Boundary Restoration and Enhancement Fund (Southern Fund). The purpose of the two funds is to support activities in both countries that develop improved information for resource management, rehabilitate and restore marine and freshwater habitat, and enhance wild stock production through low technology techniques. Subject to Congressional appropriations, the United States agreed to capitalize the Northern and Southern funds in the amounts of \$75 million U.S. and \$65 million U.S. respectively, over a period of up to four years. The 1999 Agreement also established a Northern Fund Committee and a Southern Fund Committee, each comprised of three nationals from each country, to manage the funds.

Committee Members

Northern Fund Committee

Canada:

John Lubar, Co-Chair
Gord Zealand
Ron Fowler

United States:

Jim Balsiger, Co-Chair
Kevin Duffy
Jev Shelton

Southern Fund Committee

Canada:

Ron Kadowaki, Co-Chair
Don Hall
Bill Otway

United States:

Rollie Rousseau, Co-Chair
Larry Rutter
Don Sampson

Executive Summary

- Northern and Southern Fund Committee members met jointly five times in all; three times in person and twice via conference call.
- One U.S. committee member from the Southern Fund Committee resigned and another was appointed.
- A Fund Coordinator was hired and began work in January, 2002.
- It was another poor year for investments. The third such year in a row.
- Contributed capital at year end was \$CDN 154,564,191. Actual fund asset value at year end was \$CDN 137,406,512. A difference of \$CDN 17,157,679; a drop of 11% overall.
- The Fund received a third installment; this time in the amount of \$40M U.S. in the last week of February, 2002.
- The portfolio's asset investment mix was rebalanced.
- A global value manager search was initiated in anticipation of the last installment in 2003.

Committee Meetings

In 2002 the Northern and Southern Fund Committees agreed that given the congruent nature of their agendas; global economic conditions and the status of the Fund, it was appropriate to meet not separately, but together as a Joint Fund Committee. Thus the Joint Fund Committee met in person on three occasions (February 15, 2002; May 14-15, 2002 and November 18-19, 2002) and by telephone conference call twice (March 4, 2002 and August 16, 2002). In addition, a four person Global Value Manager Search Sub-Committee met via conference call on November 6, 2002.

At the first meeting of the Joint Committee in February 2002 in Vancouver BC, the Committee considered a calendar of scheduled meetings. The consensus was for a schedule of four meetings annually, one of which would be a conference call and the fourth meeting in November should be considered the occasion for an annual financial review. The Committee also reviewed a draft application package and considered project priority setting; concluding that for this year at least, an ad hoc approach would be appropriate. There was discussion on the status and market entry timing of the impending third installment of the Fund (\$40M U.S.) and the possibility of changing the Fund's equity investment mix. Specifically increasing the allocation of equities in the U.S. and proportionally reducing international equity holdings as a risk mitigation strategy. Altering the overall bond/equity asset mix was also discussed and a conference call to debate the issue further with Fund Investment Advisors Hewitt Associates was scheduled for March.

At the conference call in March, Perry Teperson from Hewitt Associates presented a document titled "Investment Policy and Deployment Considerations". Following a spirited debate it was decided that the asset class weights would remain at 50% U.S. and 50% EAFE (international). It was further decided with regard to the entry timing of the latest \$40M tranche, that it be released to the fund managers on a one-time basis allowing them some discretion on tactical deployment within a two week period. Mr. Teperson also counseled the Committee to consider hiring a global value manager to diversify the style of the Fund's management, thereby further reducing risk to the investment.

The Joint Committee's second meeting in person was held at the Pacific Salmon Commission's Boardroom in Vancouver, BC in May. Perry Teperson presented a document titled "U.S. versus Non-North American Equities. May 2002". J. Shelton presented a document titled "Index Analysis. April 2002". The pros and cons of rebalancing the 50:50 US:EAFE equity asset ratio were then debated in detail. This led to consideration of the Fund Manager Structure and the possible inclusion of a third equity Fund Manager with a global value style to diversify the growth styles of the other two. Mr. Teperson presented a document titled "Manager Structure Considerations; US and Global Equities; May 14, 2002". In the debate that followed the further issue of changing the Fund's equity/bond position came under discussion. Mr. Teperson presented a document titled "Extract from the Initial Report on Investment Policy; PSC; July 20, 2000". The inter-related nature of all three of these items made for a lengthy and wide ranging debate that culminated in a discussion of what protocols do or should govern Joint Fund Committee decision making with regard to investment policies. This final item led to a motion that established procedure for changing investment policy in the future. The meeting adjourned for the day with the other issues unresolved. On day two, discussion of the three inter-related investment policy issues continued with the Northern and Southern Fund Committees caucusing separately as they sought consensus. Eventually a motion was passed to rebalance the equity/bond ratio from 60:40 to 70:30. The 70% equities should be divided among the US:EAFE:Global fund manager in the ratio 45:30:25. Also Hewitt Associates were instructed to begin the search for a global value manager. The Committee then went on to consider and then approve the allowance to purchase BBB bonds by Barclays.

In August the Joint Committee met via conference call. The status of the Fund was reviewed including present standing, current expenses and outlook for project funding. The question of launching Fund activities by sponsoring a few modest projects in the short term by accessing the principal was debated. The Committee agreed the idea was worth further analysis, but recognized that various Congressional and other legal checks and balances probably made the idea impractical.

The last meeting of the year was held at the PSC offices in Vancouver, BC in mid-November. The principal agenda item was the annual performance evaluation of the Fund Managers. Hewitt Associates led a review of the Fund's overall investment strategy and asset mix before suggesting some points for the Committee to consider during the performance reviews that followed. Presentations were made by Barclays Global Investors, Putnam Investments and the following day by MFS Institutional Advisors Inc. A number of concerns were raised about the performance of MFS. These were recorded and a motion was passed to include them in a letter to MFS requiring a written answer by mid-January. Perry Teperson presented a summary of progress to date on the search for a global value manager and the Committee recommended that the hiring sub-committee press ahead with interviews. Sean Macaulay from Hewitt Associates led the Committee through a spreadsheet-based potential funding forecast model. A position statement regarding the outlook for the Fund was called for based on the forecasts in the model.

Committee Appointments

Don Sampson of the Umatilla tribe of Oregon and Executive Director of the Columbia River Inter-Tribal Fish Commission and an alternate Commissioner of the PSC was appointed to the Southern Boundary Restoration and Enhancement Fund Committee in May 2002. He took over from Arthur Taylor Jr who resigned from the Committee due to other commitments.

Fund Coordinator

Angus Mackay was appointed as Fund Coordinator following an open job competition and took up that position with the PSC Secretariat in Vancouver in mid-January.

Investment Review

“A year to forget. Gloom pushes the markets down for the third year running. In 2002 global stockmarkets fell for the third consecutive year, dragged down by corporate scandals and fears about the health of the global economy”. (Haydon Davis, Chief Economist. Barclays Global Investors).

“This has been the year of Enron and WorldCom, of Dennis Koslowski and Martha Stewart, of Jack Grubman and Arthur Anderson”. (Dr David Kelly Senior Vice President and Economic Advisor, Putnam Investments).

“The stock market’s plunge in the third quarter ranked among the most severe downturns in post-World War II history. The fact that this sour quarter extended a bear market that has already stretched across multiple years makes it more a 1930’s-style decline than a 1987-style short-lived downturn. In short, we are in the grips of an old school, no-holds-barred bear market”. (Putnam Capital Markets Outlook Oct/Nov 2002).

“Looking ahead, we believe it is unlikely we’ll see a ‘V-shaped’ recovery, or a sharp run-up in the market. Our expectation is that the market will experience a long, gradual recovery marked by fits and starts until investors become convinced the recovery is for real”. (The MFS Investment Perspective. Dec 2002).

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Fund Capitalization

A third installment of funds, in this instance in the amount of \$40M U.S., was made in late February. This brought the total contributed capital to date to \$100M U.S. A fourth and final installment in the amount of \$40M U.S. is anticipated in 2003. Canada also contributed \$500,000 CDN in 1999.

Portfolio Balance

At the May meeting the Joint Committee passed a motion to change the equity to bond ratio in the investment portfolio from 60:40 to 70:30. The additional 10% in the equity portfolio thus achieved was to be divided 50:50 between U.S. and EAFE equities and would remain like that until the equity portfolio becomes rebalanced following the final payment of funds into the endowment. This change went into effect at the beginning of June. The Committee was clear that their decision to increase the equity weight by 10% was part of a long term strategy intended to further the Fund’s objective of beating inflation by 5% and should not be misconstrued as being a market timing decision.

Global Value Manager

A global value manager hiring sub-committee was struck in August. On the committee representing the Southern Fund were Rollie Rousseau and Bill Otway and for the Northern Fund Jev Shelton and Ron Fowler. The hiring sub-committee met via conference call on November 6, 2002. Perry Teperson presented a document titled "Comparison of Global Equity Value Managers". Three firms were analyzed in the document, Morgan Stanley, Sprucegrove and Templeton. In the discussion that followed it was agreed that the best time to hire the manager would be at a time that coincided with the arrival of the final installment of \$40M into the Fund. However there was some uncertainty as to when those funds might arrive. It was therefore decided to postpone any interviews with the candidates until after all Joint Fund Committee members could be consulted on timing at the upcoming meeting on November 18 and 19.

Fund Related Meetings Attended by Coordinator in 2002

- Pacific Coastal Salmon Recovery Fund. Jan 29-31. Portland. OR.
The workshop in Portland was designed to give funded States and Tribes the opportunity to share their processes and successes in using the Fund for salmon recovery; to showcase a full range of PCSRF funded projects; to discuss possibilities for better coordination and consistency in monitoring project outcomes; and to discuss sharing and reporting project information.
- 2002 BC Interior Watersheds Conference. March 13-14. Kamloops. BC
Day one keynote speaker was Dr John Buckhouse of Oregon State University. His message was that successful habitat restoration and stewardship projects shared three key characteristics. Ecological realism, economic viability and social acceptability. The keynote speaker on day two was Dr Hamish Kimmins of UBC. His presentation was on the stewardship, ethical conservation and management of water.
- Salmon Recovery Funding Board. April 11-12. Olympia. WA
Annual meeting of the SRF Board to select projects for the year.
- Vancouver Foundation / Moore Foundation. Vancouver. May 14. Vancouver. BC
The meeting was arranged as an opportunity for the Moore Foundation to meet with representatives from some of the principal funders of salmon recovery related projects in BC.
- Joint meeting of the Exxon Valdez Oil Spill Trustee Council, the North Pacific Research Board, The University of Alaska and the Northern Boundary and Transboundary River Restoration and Enhancement Fund. October 29. Anchorage. AK
The meeting was held to discuss issues of mutual concern in the North Pacific Ocean. It was chaired by J. Balsiger of the Northern Fund and attended also by J. Lubar of the Northern Fund who gave a presentation on the status of the Northern and Southern Funds. (*Coordinator did not attend this meeting*).
- Pacific Coastal Salmon Recovery Fund Workshop II. December 12-13. Seattle. WA
This was the second Pacific Coastal Salmon Recovery Fund workshop hosted by NOAA and was a follow up to the first held last January in Portland. The intent of the workshop was to provide an opportunity for NOAA Fisheries and the Fund's State and tribal co-managers to discuss PCSRF accomplishments; to work towards a stronger set of performance standards, better monitoring and evaluation protocols and more uniform reporting approaches.