

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Wednesday, March 3, 2010
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Wednesday, March 3, 2010 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members Present

Comptroller Susan Combs, Tucker Bridwell, Laurie Dotter, Jim Hille, Steve Strake, Adolpho Telles, and Scott Wise.

Board Members Absent

None.

Comptroller of Public Accounts Staff Present

Martin Hubert, Deputy Comptroller.

Texas Treasury Safekeeping Trust Company ("Trust Company") Staff Present

Paul Ballard, Chief Executive Officer and Chief Investment Officer ("CEO"); Danny Sachnowitz, Deputy Director and Deputy Chief Investment Officer; Frank Zahn, Chief Financial Officer; Mike Samples, Director of Internal Investments; Marianne S. Dwight, General Counsel; Dan McNeil, Compliance Officer; Byron Beasley, Private Markets Manager; Michael Leifeste, Real Estate Portfolio Manager; Lalo Torres, Investment Analyst; Perry Wang, Risk Analyst; Nora Arredondo, Special Projects Coordinator; Michael Anderson, Assistant General Counsel; Victor Scott, Financial Reporting Manager; Gena Minjares, Audit Liaison; and Laura Montoya, Communications Manager.

Others

Tom Margulis, Asset Consulting Group ("ACG"); and Rick Pokorny, Northern Trust.

Call to Order

Comptroller Combs declared that a quorum was present and called the meeting to order at 10:03 a.m.

Approval of Minutes of December 16, 2009 Meeting (Tab 1)

Mr. Jim Hille made a motion to accept and approve the minutes of the December 16, 2009 Comptroller's Investment Advisory Board meeting. Motion was seconded by Mr. Adolpho Telles and unanimously approved by the Board.

Capital Markets Outlook and Discussion (Tab 2)

Mr. Tom Margulis of ACG presented an economic update and reviewed the first quarter to date. He reported that the financial markets had improved substantially over the past 12 months. However, lagging economic indicators such as unemployment and housing had shown minimal improvement. There had

been a rally in the U.S. dollar, especially against the Euro. ACG expects a low growth economic environment in the United States and Western Europe in 2010 and 2011. They believe the next six to twelve months will be a subdued inflationary environment and interest rates are expected to remain low. ACG believes that this challenging environment requires investors to be opportunistic and to seek managers with the ability to take advantage of changing market conditions. They believe emerging markets will continue to grow robustly but fixed income markets present more of a challenge in a rising interest rate environment. Mr. Margulis explained that the portfolio positions reflected these expectations.

Mr. Margulis reviewed asset class rankings and ACG's long-term capital market assumptions for asset classes. He explained that expected long-term returns used in their model are research and historically based and correlations are historical. He stated that low quality assets had led the rally to date, but that ACG believes that the next leg of the cycle will be led by higher quality assets. Mr. Margulis reviewed a table illustrating the value of reducing portfolio volatility. It demonstrated that a portfolio with the same annual return as another, but with less volatility as measured by standard deviation, produced a higher compound rate of return. He reminded the board that less volatile returns was one of the objectives of the endowment portfolio. Finally, Mr. Margulis stated that while ACG is modestly bullish, the firm believes that 2010 will present significant challenges for investors.

Endowment Portfolio Update and Related Matters (Tab 3)

Mr. Paul Ballard presented the Board an overview of the endowment portfolio and reported that it was in compliance with the asset allocation and investment policies. The portfolio value as of December 31, 2009 had increased from the previous quarter and was approximately \$3.0 billion. He reviewed the asset allocations as of December 31, 2009, as illustrated in the report behind Tab 3 and reported that the portfolio was in alignment with asset allocation targets.

Mr. Ballard stated that eight direct hedge fund managers had been added since the last report in September. The focus has been on reducing risk and seeking an 8-9% total portfolio return with limited downside risk. Mr. Danny Sachnowitz reviewed the phase-in target asset allocations and distributed corrected pages 7, 14, and 20 of the presentation. He continued the discussion with a review of specific fund managers and noted some fund of hedge fund redemptions that had occurred since December 2009. Mr. Ballard discussed three new hedged equity funds: HealthCor, Shumway, and Kingdon. Mr. Ballard continued the review of various investment strategies within the asset classes and stated that performance was in line with expectations, given the current economic conditions.

Endowment Funds Investment Performance for the Quarter Ending December 31, 2009 and Related Matters (Tab 4)

Mr. Rick Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending December 31, 2009. He stated that there were no significant changes in the market environment from the previous quarter. The fourth quarter endowment fund return was approximately 3.36%, which surpassed the policy benchmark by 42 basis points. Mr. Pokorny reviewed the endowment portfolio's returns versus a universe of other public funds and endowments and foundations with asset values greater than \$1 billion that are tracked in the Northern Trust database. Over the past year the Trust Company endowment performance lagged the policy benchmark but took on less risk. He pointed out that the portfolio's risk, measured by the standard deviation of returns, was among the lowest relative to its peers.

Review of Treasury Pool (Tab 5)

Mr. Mike Samples reviewed the information behind Tab 5 and presented his perspective on economic growth. He explained that the economy was operating at a significantly lower level than its pre-2008 size.

He explained that the Gross Domestic Product (“GDP”) would need to grow at an annualized 6% for a few years to get it back to its pre-2008 size and growth trajectory. He contrasted that need to the fact that the economy grew at an average of just 2.9% during the last expansion phase of the economic cycle. Mr. Samples reviewed the impact of government spending, inventory restocking, and consumer spending on recent GDP growth. He explained that, while these factors had provided a tailwind to recent economic growth, he viewed their wind-down as headwinds to future growth. He said there had been some improvement in the economy for the quarter and that the pace of job losses was slowing. He explained his concern that despite the fact that housing affordability measures have been at their highest levels in history over the past six months, home sales have been down. Finally, he stated his expectation that the Federal Reserve would keep interest rates low for some time to come.

Mr. Samples reviewed the Treasury Pool asset summary as of January 31, 2010 and stated that the value of the Pool was approximately \$23.9 billion and had an approximate 1.11% yield. He stated the Treasury Pool currently is carrying approximately \$150 million in unrealized gains. He reviewed Treasury Pool yields relative to short-term Treasury and money market rates. Mr. Samples discussed the portfolio composition and maturity structure as illustrated in the report. Next, Mr. Samples reviewed comparative benchmark yields and stated that the Treasury Pool yield had outperformed its benchmarks.

Discussion of Next Meeting and Agenda Items

The board will be contacted with suggested meeting dates.

Public Comment

None

Adjourn

The meeting adjourned at 1:58 p.m.