

**COMPTROLLER'S  
INVESTMENT ADVISORY BOARD MEETING  
Thursday, September 30, 2010  
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, September 30, 2010 at the LBJ State Office Building, 111 E. 17<sup>th</sup> 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; Michael Anderson, Compliance Officer; Byron Beasley, Private Markets Manager; J. Germenis, Public Markets Manager; Michael Leifeste, Real Estate Portfolio Manager; Lalo Torres, Investment Analyst; Perry Wang, Risk Analyst; Wai Yee Cheng, Portfolio Manager; Adam Levine, Portfolio Manager; Erin Corley, Private Markets Analyst; Nora Arredondo, Special Projects Coordinator; John Wright, Assistant General Counsel; Victor Scott, Financial Reporting Manager; and Laura Montoya, Director of Administrative Services.

**Others**

George Tarlas, Asset Consulting Group ("ACG"); and Rick Pokorny, Northern Trust.

**Call to Order**

Martin Hubert declared that a quorum was present and called the meeting to order at 10:10 a.m.

**Approval of Minutes of July 22, 2010 Meeting (Tab 1)**

*Mr. Jim Hille made a motion to accept and approve the minutes of the July 22, 2010 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Steve Strake and unanimously approved by the Board.*

**Capital Markets Outlook and Discussion (Tab 2)**

Mr. George Tarlas of ACG presented an economic update and reviewed the second quarter to date. He reported that although the financial markets had improved in the last twelve months, they remained

uncertain and still faced many macroeconomic challenges. May and June proved to be difficult months; however, July and September demonstrated stronger economic growth. The corporate environment experienced a strong second quarter earning period. Lagging economic indicators such as unemployment and housing had shown minimal improvement. Economic growth was reported at approximately 1.6% for the quarter. ACG expects a low growth economic environment in the United States and Western Europe for the remainder of 2010 and into 2011. They believe the next 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.

Mr. Tarlas reviewed asset class rankings as of the third quarter of 2010 behind Tab 2. ACG believes emerging markets will continue to grow robustly but fixed income markets present more of a challenge in the event of a rising interest rate environment. ACG continues to view absolute return strategies favorably. They offer greater inflation protection. Mr. Tarlas stated that ACG believes the global real estate market appears to have stabilized across the majority of property types. He commented that the portfolio positions reflected these observations and expectations.

### **Economic Outlook and Review of Treasury Pool (Tab 3)**

Mr. Mike Samples reviewed the information behind Tab 3 and presented his perspective on economic growth. In his opinion, the economy remained weak with current domestic economic growth at approximately 1.5% - 2% and expected economic growth to be approximately 2.5% - 3%. Mr. Samples explained that 4% is needed to meaningfully reduce the unemployment rate. He believes it will be two to three years before there will be monetary tightening by the Federal Reserve (the "Fed"). He expects the Fed will keep interest rates low for at least the next year.

Mr. Samples reviewed the Treasury Pool asset summary as of August 31, 2010 and stated that the value of the Pool was approximately \$30 billion, up from \$26 billion last quarter, and had an approximate .75% yield. He stated the Treasury Pool currently is carrying approximately \$109 million in unrealized gains. He stated that there were not many opportunities in the marketplace to replace the portfolio's higher yielding assets that are maturing with equal or better yields. His team is actively searching for low risk opportunities to add yield to the portfolio. Mr. Samples reviewed the sand chart on page three that illustrates the portfolio asset summary. He explained the portfolio shift from agencies into treasuries which began in 2008. Now treasuries account for approximately 70% of the portfolio. The one-year trailing Treasury Pool yield was approximately 1.5%. He stated that 1% equated to \$225 million/year in income. Next, Mr. Samples reviewed comparative benchmark yields and stated that the Treasury Pool yield had outperformed its benchmarks.

### **Review and Recommend Modifications to Endowment Investment Policy (Tab 4)**

Mr. Paul Ballard explained that at the previous board meeting, the board reviewed and recommended modifications to the endowment investment policy, and asked to revisit the Value at Risk (VaR) language and portion of the policy. Other modifications for review include added language indicating that all investment managers be held to appropriate benchmarks and a change in the overall policy portfolio benchmark as it relates to the absolute return asset class. Mr. Ballard reviewed the proposed changes as presented in the redlined copy of the endowment policy behind Tab 4. He explained that the recommended modifications would be consistent with the direction of the Trust Company's objective to earn superior risk-adjusted returns over the long run and better protect capital in stressed markets. The Board discussed the recommended modifications as presented by the Trust Company.

*Mr. Jim Hille made a motion to recommend to the Comptroller the proposed amendments to the endowment investment policy as presented by the Trust Company. The motion was seconded by Mr. Scott Wise and unanimously approved by the Board.*

#### **Endowment Portfolio Update and Related Matters (Tab 5)**

Mr. Ballard presented the Board an overview of the endowment portfolio and reported that it was in compliance with the asset allocation and investment policies. He reported that the economic growth expectation of approximately 1% - 2% affects how the portfolio is positioned. Mr. Ballard reviewed the handout that illustrated current versus phased-in target allocations. He explained the flexibility and liquidity of the portfolio. Mr. Ballard stated that he is pleased with the asset allocation of the portfolio and the portfolio was in alignment with its asset allocation targets. He stated that emerging markets currently accounted for one-third of global gross domestic product (“GDP”) and two-thirds of global GDP growth. He noted that the private equity asset class was the best performer over the last year. Mr. Ballard reviewed new portfolio managers with the board.

Mr. Danny Sachnowitz reviewed returns and performance of specific asset classes. He continued with a review of current and new managers within the various asset classes and explained the investment strategies for each. Mr. Sachnowitz noted that large cap domestic growth manager, Intech had been terminated. He explained current commitments to the various fund managers. He reported that the portfolio performance was in line with expectations, given the current economic conditions.

Mr. Ballard continued the presentation and reviewed stress test scenarios and VaR history as illustrated in the report. He reviewed the policy compliance checklist and stated that the portfolio was in compliance with each category.

#### **Endowment Funds Investment Performance Review for the Quarter Ending June 30, 2010 and Related Matters (Tab 6)**

Mr. Rick Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending June 30, 2010. He explained that in the quarter ending June 30, 2010 risk got punished. 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. The portfolio total return was approximately -3.93 for the calendar quarter, which outperformed the policy benchmark of -5.08% and ranked in the top quartile among its public fund peers. Domestic stocks fell 11.4%. The private equity portfolio had a 3.5% return and an overall positive result on the portfolio. Currently the endowment portfolio is up 2.66% while assuming less risk. At the board’s request, Northern Trust will add real estate benchmarks in their report.

#### **Discussion of Next Meeting and Agenda Items**

The board was previously polled and decided that the next meeting date will be December 16, 2010.

#### **Public Comment**

None

#### **Adjourn**

The meeting adjourned at 1:36 p.m.