

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Thursday, August 23, 2012
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, August 23, 2012 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; John Wright, Assistant General Counsel; Michael Anderson, Compliance Officer; Byron Beasley, Private Markets Manager; J. Germenis, Public Markets Manager; Michael Leifeste, Real Estate Portfolio Manager; Erin Corley, Private Markets Analyst; Lalo Torres, Investment Analyst; Perry Wang, Risk Analyst; Wai Yee Cheng, Portfolio Manager; Adam Levine, Portfolio Manager; Nora Arredondo, Special Projects Coordinator; Gena Minjares, Director of General Ledger Accounting; Laura Montoya, Director of Administration; Jorge de Lafuente, Investment Analyst; and Brandy Bianco, Graphic Designer.

Additional Participants

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

Call to Order

Comptroller Susan Combs declared that a quorum was present and called the meeting to order at 10:06 a.m.

Comptroller Combs read a statement regarding the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that requires municipal advisors to register with the SEC. The temporary ruling resulted in a disagreement over what constitutes a municipal advisor. The Comptroller's office does not believe the usual activities of this board constitute municipal advisory activities and they are working with the Attorney General's office to clarify its application. Comptroller Combs asked the Trust Company's General Counsel, Marianne Dwight, to monitor the board's discussions and to advise them to stop if they began to engage in anything that would be considered municipal advisory activities.

Approval of Minutes of June 5, 2012 Meeting (Tab 1)

Mr. Jim Hille made a motion to accept and approve the minutes of the June 5, 2012 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Tucker Bridwell and unanimously approved by the Board.

Capital Markets Outlook and Discussion (Tab 2)

Ms. Lori Mills presented an update on the capital market environment. She reviewed how the portfolio was positioned in relation to the current market environment. She explained that the U.S. economy expanded more than previously estimated during the second quarter at a rate of 1.7%, reflecting stronger consumer spending and U.S. exports. The unemployment rate fell slightly to 8.1% and continued to be a major concern for the economic recovery. Globally, the European debt crisis and the instability of the Euro continued to hinder the global economy. Ms. Mills explained that ACG does not expect the Fed to increase interest rates for the next 2-3 years. ACG also expects continued slow domestic economic growth.

Ms. Mills reviewed the general performance of various sectors of the portfolio. She reported that U.S. equities rallied as better than expected second quarter corporate earnings were reported. The global equity market had also risen and was up 11% through August 21, 2012. She explained that the investment strategies being implemented by the Trust Company continue to focus on portfolio diversification, maintaining and/or enhancing exposure to fast growing regions such as emerging markets, maintaining diversified global fixed income exposure with focus on real yields and considering increasing exposure to equity markets. Ms. Mills reported one change to the tactical outlook for the quarter. The emerging market fixed income asset class was changed from overweight to neutral.

Economic Outlook, Investment and Review of Treasury Pool (Tab 3)

Mr. Mike Samples presented his perspective on economic growth. He reported that the U.S. economy continues to grow at a slow rate. The housing market showed signs of stabilization but the unemployment rate made no significant gains and he believes there is no reason to expect any significant improvement in the unemployment outlook. As previously reported, the U.S. economy is slowly healing and continues to improve at a slow pace. He expressed concerns over the underfunded liabilities of Medicare and Social Security. He reported that in the opinion of some investment managers, it would take approximately 8% nominal GDP growth in order to deal with these unfunded liabilities. Mr. Samples expects complete resolution of the fiscal cliff would be delayed another six months to a year. Mr. Samples explained that he and his team remain focused on seeking higher yields; however, he does not expect the Federal Reserve to raise interest rates for 2-3 years.

Mr. Samples reviewed the Treasury Pool portfolio asset summary as of July 31, 2012 and stated that the value of the Pool was approximately \$31.8 billion. The net yield was approximately 0.42%. Mr. Samples reviewed the charts behind Tab 3 and noted that U.S. Treasury securities accounted for the largest portion of the portfolio. He stated that his team was seeking options to add a few more basis points to the yield as they replace maturing assets. He explained that five year treasury yields have decreased quite a bit so now he and his team are beginning to write covered call options on new seven year treasuries. He also stated that he and his team are looking at treasury inflation-protected securities ("TIPS"). The principal value of TIPS increases with inflation and decreases with deflation. When TIPS mature, the adjusted principal or original principal, whichever is greater, is paid.

Mr. Samples reviewed comparative benchmark yields and stated that the yield on the Treasury Pool exceeded most of its benchmarks but was lagging behind its custom benchmark for the quarter and the twelve month period.

Endowment Portfolio Update and Related Matters (Tab 4)

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. As of June 30, 2012 the portfolio value was approximately \$3.08 billion. Mr. Ballard and Mr. Sachnowitz discussed the portfolio's liquidity profile and pointed out that the portfolio remained very liquid. Mr. Ballard compared the actual vs. target asset allocations as of the second quarter of 2012. He reported that the portfolio was 34% allocated to fixed income, 45% equity, 17% real assets, and 4% strategic all asset and overlays. Mr. Ballard reviewed each asset class and the various asset strategies which demonstrated the portfolio's diversification. He reported on new fund managers and discussed the ones the portfolio was terminating.

Following the asset class review, Mr. Ballard explained how the portfolio performed relative to its benchmark. He reported that the portfolio had lagged slightly behind its benchmark and that performance was in line with expectations, given the current economic conditions. Mr. Ballard explained the stress test scenarios as they relate to performance in a crisis relative to policy portfolio and absolute numbers.

Endowment Funds Investment Performance Review for the Quarter Ending June 30, 2012 and Related Matters (Tab 5)

Mr. Rick Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending June 30, 2012. The portfolio return was approximately -1.57% for the quarter and was slightly lagging its policy benchmark of -1.01%. The trailing one year performance however was approximately -2.31 which fared better than its policy benchmark of -4.71. Mr. Pokorny reported that the portfolio shrunk slightly over the quarter from \$3.2 billion to approximately \$3.08 billion. Unlike the previous quarter, risk was not rewarded. Private debt and private equity were the best performers, both averaging over 3% for the quarter. Each sector's performance was reviewed in further detail. The portfolio produced a Sharpe ratio greater than its benchmark for the one and three-year periods.

Mr. Pokorny gave an update through the first three weeks of August. The portfolio was producing a return in excess of 1% and had gained approximately \$40 million in value.

Discussion of Next Meeting and Agenda Items

The next meeting is scheduled for Monday, December 17, 2012.

Public Comment

None.

Adjourn

The meeting adjourned at 1:13 p.m.