

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Tuesday, June 18, 2013
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Tuesday, June 18, 2013 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members Present

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

Board Members Absent

Tucker Bridwell.

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, Deputy General Counsel; Michael Anderson, Compliance Officer; Byron Beasley, Private Markets Manager; Wai Yee Cheng, Portfolio Manager; J. Germenis, Public Markets Manager; Erin Corley, Private Markets Analyst; Lalo Torres, Investment Analyst; Anca Ion, Portfolio Manager; Adam Levine, Risk Manager; Nora Arredondo, Special Projects Coordinator; Victor Scott, Director of Financial Reporting; Laura Montoya, Director of Administration; Jorge de Lafuente, Investment Analyst; Elizabeth Moreno, Accounting Supervisor; Oscar Ramirez, Director of Trust Services; and Brandy Bianco, Graphic Designer.

Additional Participants

Lori Mills, Asset Consulting Group ("ACG"); and Pam Sliman, State Street.

Call to Order

Comptroller Susan Combs declared that a quorum was present and called the meeting to order at 10:09 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 March 5, 2013 Meeting (Tab 1)

Mr. Jim Hille made a motion to accept and approve the minutes of the March 5, 2013 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Steve Strake and unanimously approved by the Board.

Trust Company Overview (Tab 2)

Mr. Paul Ballard reviewed the presentation behind Tab 2 which outlined the full range of Trust Company clients and services. He explained that the Trust Company manages investment strategies for over \$50 billion in assets for the state, local governments, and endowments created by the Texas legislature. Investment strategies are tailored to investor needs and range from highly liquid portfolios to more complex portfolios designed for long-term growth and principal preservation. The investment strategies fall into six general categories: 1) Treasury Pool 2) Trust Accounts 3) TexPool 4) TexPool Prime 5) Endowment Funds and 6) Texas Lottery. Mr. Ballard reviewed each category detail.

Capital Markets Outlook and Discussion (Tab 3)

Ms. Lori Mills summarized economic events for the quarter. She reported that economic conditions continued to improve modestly. The strengthening housing market and the slight improvement in the labor market have raised the outlook for the U.S. economy over the upcoming months. Ms. Mills stated that the Federal Reserve (the "Fed") indicated that tapering of stimulus policies could begin soon. The Fed indicated that the central bank may start scaling back its \$85 billion of monthly bond purchases this year and next if the Fed's economic growth objectives are achieved. Globally, Ms. Mills reported that the European Central Bank kept its benchmark interest rate at a record low of 0.5%. Emerging markets struggled during the last quarter with slowing growth and falling commodity prices. ACG expects the Fed to keep interest rates near zero as long as the jobless rate was above 6.5%. ACG also expects continued slow domestic economic growth.

Ms. Mills reviewed the asset class relative rankings as of the second quarter 2013. She explained that the absolute return / opportunistic credit asset class was overweight because the portfolio wants to participate in the market but have appropriate risk management. She reported three changes to the tactical outlook for the quarter. The U.S. high yield fixed income class was changed from overweight to neutral. Low U.S. treasury yields force investors further out the risk spectrum causing a demand for high yield debt. The global equity long/short class was changed from neutral to overweight. Managers see future opportunity due to the high levels of cash on balance sheets and the low cost of capital. Lastly, the global private equity class was changed from underweight to neutral.

Economic Outlook, Investment and Review of Treasury Pool (Tab 4)

Mr. Samples reviewed the Treasury Pool portfolio summary as of April 30, 2013 and stated that the value of the Pool was approximately \$31 billion. The net yield was approximately 0.35%, down slightly from the previous quarter. Mr. Samples explained that a few years prior a new Treasury Pool benchmark was established and in the previous five years the yield on that benchmark had outperformed the yield on cash balances by approximately eighty basis points each year. Mr. Samples reviewed the asset allocation and maturity structure of the portfolio. He explained that U.S. treasuries still account for approximately 50% of the portfolio's allocation. Mr. Samples explained the comparative benchmark yields chart and stated that the portfolio's return was competitive to the custom benchmark and exceeded most of its benchmarks.

Mr. Mike Samples presented his perspective on economic growth. He reported that the U.S. economy continues to grow at a modest pace. The housing market was still improving and looking favorable and auto industry sales were up as well. Mr. Samples believes that any real monetary tightening will occur when the Fed starts raising short term interest rates. He does not expect the Fed to raise interest rates in the near future. The Fed however, is expected to taper its pace of asset purchases soon. Mr. Samples explained that he and his team is focused on seeking higher yields and is selective in where risk is taken.

Lunch Speaker – Diane Swonk- bio and June economic commentary (Tab 6)

Annual Review and Recommended Changes of Endowment Investment Policy (Tab 5)

Mr. Ballard explained the non-substantive recommended changes to the Endowment Investment Policy as shown in the draft behind Tab 5. He explained that because the Trust Company had changed its custodial banking relationship from Northern Trust to State Street, the custom benchmarks for the private debt and private equity strategies needed to be revised.

Ms. Laurie Dotter made a motion to submit the recommended revisions to the Comptroller for approval. The motion was seconded by Mr. Adolpho Telles and unanimously approved by the Board.

Endowment Portfolio Update and Related Matters (Tab 7)

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 March 31, 2013 the portfolio value was approximately \$3.29 billion. Mr. Ballard compared the actual vs. target asset allocations as of the first quarter 2013. He reported that the portfolio was relatively unchanged from the previous quarter at approximately 32% allocated to fixed income, 46% equity, 17% real assets, and 5% strategic all asset. 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 those from whom investments were being redeemed. He stated that Amherst MBS Opportunities I was added to global fixed income; Ellis Lake and Pangaea were added to alternative fixed income; AKO European Long Only was added to global public equity; and White Elm Capital was added to hedged equity. For private equity, the new funds that closed in the prior quarter were Permira V and Partners Group Direct 2012. Also for 2013, new to the real estate strategy was Mesa West. Mr. Ballard concluded with a review of the Trust Company performance table which spanned 2002 through March of 2013.

Endowment Funds Investment Performance Review for the Quarter Ending March 31, 2013 and Related Matters (Tab 8)

Mr. Ballard reported that State Street was the new custodian bank chosen to replace Northern Trust. Ms. Pam Sliman from State Street reviewed the investment performance of the endowment funds for the period ending March 31, 2013. She reported that the portfolio return was approximately 3.42% for the quarter and outperformed its policy benchmark by approximately .56% while assuming less risk. The trailing one year performance was approximately 8.40% which also outperformed its policy benchmark of 6.72%. 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.

Broker/Dealer Update

No updates to report at this time.

Legislative Update

Mr. Ballard reported on legislation that would have an impact on the Trust Company. He explained that legislation was passed to create a water development fund that requires a constitutional amendment to approve the appropriation of \$2 billion from the Economic Stabilization Fund which will fund water projects under the direction of the Water Development Board. This constitutional amendment is scheduled to be presented to the voters in November. The Trust Company will invest the funds in accordance with statutory guidelines. Also, the most recent legislative session restored the authority of the monies in the Texas Preservation Trust Fund to be invested like an endowment by the Trust Company.

Discussion of Next Meeting and Agenda Items

The next meeting will be on September 11, 2013.

Public Comment

None.

Adjourn

The meeting adjourned at 1:38 p.m.