

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT
ADVISORY COMMITTEE
Friday, March 26, 2010
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Friday, March 26, 2010 at 10:00 a.m. in Room 320, Rusk State Office Building, 208 E. 10th Street, Austin, Texas.

Committee Members Present

Stuart Ford, Chairman; Judge Dan Gattis; Judge Wayne Gent; Noe Hinojosa; Faraz Khan; Joe McComb; Chuck Norris; and Phillip Rivera.

Committee Members Absent

Judge Mike Brown; Commissioner Roger Galvan; and Judge David Silva.

Texas Treasury Safekeeping Trust Company (“Trust Company”) Staff Members Present

Paul Ballard, Chief Executive Officer and Chief Investment Officer; Frank Zahn, Chief Financial Officer; Marianne S. Dwight, General Counsel; Dan McNeil, Compliance Officer; Byron Beasley, Private Markets Manager; Mike Leifeste, Real Estate Investment Manager; J. Germenis, Manager of Marketable Investments; Nora Arredondo, Special Projects Coordinator; Gena Minjares, Director of General Ledger Accounting; and Victor Scott, Financial Reporting Manager.

Additional Participants Present

Tom Janisch, Asset Consulting Group (“ACG”); Rick Pokorny, Northern Trust Company; and Lester Sprouse, Padgett, Stratemann & Co., LLP.

Call to Order

Chairman Stuart Ford declared that a quorum was present and called the meeting to order at 10:03 a.m.

Approval of Minutes (Tab 1)

Motion was made by Chuck Norris to approve the October 9, 2009 meeting minutes, with one non-substantive change: under “other participants”, change the name from Steve to Rick Pokorny. Motion was seconded by Judge Dan Gattis and unanimously approved.

Presentation of Annual Audit (Tab 2, handout)

Mr. Lester Sprouse reported that Padgett, Stratemann & Co. issued an unqualified audit opinion with respect to the Tobacco Settlement Permanent Trust Account (“Account”) for the year ending December 31, 2009. Net assets held in trust were approximately \$1.9 billion as of December 31, 2009. Mr. Sprouse affirmed that the account had been managed in compliance with the Investment Policy and the Distribution Policy. No audit adjustments were made, nor was a management letter issued.

Economic Update (Tab 2)

Mr. Tom Janisch of ACG presented a capital markets outlook and reviewed the first quarter economic market environments. He began with a review of the table behind Tab 2 illustrating ACG's 2010 long-term capital market assumptions for asset classes. He explained the likely returns and probabilities shown on pages 8-10 based on the 2010 assumptions and target allocations. There was some concern expressed by the Committee regarding the 8% target the Tobacco portfolio tries to achieve.

Mr. Janisch reported that the financial markets had improved over the previous quarters. The S&P 500 was presently up 5.8% and the emerging markets were up 6%. He anticipates inflation to be subdued and does not anticipate a double dip recession.

Mr. Janisch reviewed the asset class relative rankings as of the first quarter of 2010 behind Tab 2. ACG expects interest rates will remain low in the near term. ACG also believes that emerging markets will continue to grow robustly and present opportunities faster than developed markets. ACG continues to view absolute return strategies favorably. Mr. Janisch explained that the portfolio positions reflected these expectations.

Endowment Portfolio Update and Related Matters (Tab 3 & handout)

Mr. Paul Ballard presented a macroeconomic overview of today's market environment illustrated in a handout provided by Pacific Investment Management Company ("PIMCO"). The data demonstrated the effects of the U.S. Government stimulus programs and inventory adjustments toward economic recovery. It is estimated that economic growth will be approximately 2%–2½% in 2010.

Mr. Ballard reviewed the endowment portfolio report behind Tab 3. He reviewed the asset allocations as of December 31, 2009 and reported that the portfolio was in alignment with asset allocation targets and in compliance with asset allocation policy. As of December 31, 2009, the total portfolio value was approximately \$1.9 billion. Mr. Ballard further reviewed the asset classes and current vs. phase-in target allocations. He stated that the Trust Company was working on direct hedge funds investments.

Presentation and Discussion of Investment Performance for Period ending 12/31/09 (Tab 4)

Mr. Rick Pokorny of Northern Trust reviewed the investment performance and stated that quarterly and annual rates of return for the portfolio were competitive in this volatile economic environment. He reported that as of December 31, 2009 the portfolio's total rate of return was approximately 3.38% and the market value was approximately \$1.9 billion. The portfolio outperformed the policy benchmark primarily because of the stable return investments. Currently, the portfolio was outperforming the benchmark as well. Mr. Pokorny discussed how the portfolio took on less risk than the policy benchmark yet still outperformed the benchmark. The portfolio Sharpe Ratio ranked in the top quintile relative to other plans greater than 1 billion dollars for the year.

Presentation of Current Market Value vs. Invested Corpus (Tab 5)

Mr. Ballard stated that as of December 31, 2009, the current market value of the portfolio was approximately \$1.9 billion. The inflation adjusted corpus was approximately \$2.0 billion. The invested corpus vs. the market value was approximately (\$136) million.

Discussion and Approval of Annual Trust Distribution (Tab 6)

Mr. Ballard reviewed the updated Trust Account Distribution presentation. He explained the distribution process when the market value is less than the corpus, stating that only current earnings may be distributed and the distribution may be supplemented with funds from the Distribution Stabilization Account (“DSA”). He reminded the Committee that Trust beneficiaries were notified not to expect more than half of the amount distributed in 2009, which would approximate to \$46 million. Mr. Ballard stated that the DSA was drawn down to \$44 million and no additional funds would be added to its balance in 2010. He reviewed market events that occurred in 2008 and 2009 and suggested that there may be a need to codify a formula to determine distribution limits when the Trust value is less than corpus, and to also include in that formula a limit on withdrawals from the DSA so as to maintain a sufficient balance.

The Committee had an opportunity to review two distribution options listed behind Tab 6.

Motion was made by Judge Dan Gattis to approve the distribution of \$46,151,923, representing 50% of the prior year’s distribution, to the political subdivisions. Motion was seconded by Mr. Noe Hinojosa and unanimously approved.

Discussion and Possible Action Regarding Distribution Stabilization Account Rule (Tab 7)

At this time committee members Faraz Khan and Phillip Rivera excused themselves from the meeting. Chairman Ford noted the time of 12:35pm and suggested that a special meeting be held in May or June to discuss modification to the Trust Account Distributions Rule. After further discussion, the Committee decided to hold a special meeting to specifically address the Trust Account Distributions Rule.

Discussion of Next Meeting and Agenda Items

Committee members will be contacted to determine the best date for the next meeting in May or June of 2010.

Public Comment

None.

Adjourn

Motion was made by Judge Wayne Gent to adjourn the meeting. Motion was seconded by Mr. Noe Hinojosa and unanimously approved. The meeting adjourned at 12:40 pm.