

**TOBACCO SETTLEMENT
PERMANENT TRUST FUND**

Basic Financial Statements

December 31, 2009

(With Independent Auditors' Report Thereon)

TOBACCO SETTLEMENT PERMANENT TRUST FUND

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Padgett Stratemann & Co. LLP
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS

Independent Auditors' Report

The Honorable Susan Combs
Texas Comptroller of Public Accounts:

We have audited the accompanying statement of fiduciary net assets of the Tobacco Settlement Permanent Trust Fund (the "Fund"), a private purpose trust fund of the State of Texas, as of December 31, 2009 and the related statement of changes in fiduciary net assets for the year then ended. These basic financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the basic financial statements present only the Tobacco Settlement Permanent Trust Fund and do not purport to, and do not, present fairly the financial position of the State of Texas as of December 31, 2009, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of December 31, 2009 and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Padgett, Stratemann & Co., LLP

Certified Public Accountants
March 4, 2010
Austin, Texas

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis

December 31, 2009

The Tobacco Settlement Permanent Trust Fund (the "Fund") management's discussion and analysis is designed to assist the reader in focusing on significant financial issues and provide a performance overview of the Fund's operations for the year ended December 31, 2009. Please read this analysis in conjunction with the basic financial statements which follow this section. The Texas Treasury Safekeeping Trust Company ("Texas Trust") administers and manages the assets of the Fund.

Financial Highlights

- The total net assets of the Fund increased \$185.8 million or 10.6% during the year 2009.
- The Fund provided \$92.3 million to political subdivisions for health care. This was identical to the prior year's distribution.

Overview of the Basic Financial Statements and Condensed Financial Information

The discussion and analysis is an introduction to the Fund's basic financial statements. The Fund has only one fund and therefore the government-wide and fund financial statements are the same since the Fund reports all of its activity as a fiduciary fund, which uses the same measurement focus for all statements.

The Statement of Fiduciary Net Assets provides information about the nature and amounts of the Fund's cash, investments and receivables (assets), and their management fees (liabilities). The Statement of Changes in Fiduciary Net Assets reports the additions to, deductions from, and net increases or decreases in net assets.

This annual financial report consists of two parts:

- Management's discussion and analysis
- Basic financial statements
 - Statement of Fiduciary Net Assets
 - Statement of Changes in Fiduciary Net Assets
 - Notes to Basic Financial Statements

The Statement of Fiduciary Net Assets presents the financial position of the Fund at the end of the fiscal year and includes all assets and liabilities of the Fund. The difference between total assets and total liabilities equals the Fund's net assets. At December 31, 2009 and 2008, Net Assets was calculated as follows:

	<u>2009</u>	<u>2008</u>	<u>Amount of Increase (Decrease)</u>	<u>Percent Change</u>
Investments, at Fair Value	\$ 1,936,470,603	\$ 1,751,054,842	\$ 185,415,761	10.6%
Other Assets	6,787,821	5,530,666	1,257,155	22.7%
Total Assets	<u>1,943,258,424</u>	<u>1,756,585,508</u>	<u>186,672,916</u>	<u>10.6%</u>
Total Liabilities	<u>6,357,953</u>	<u>5,515,934</u>	<u>842,019</u>	<u>15.3%</u>
Net Assets Held in Trust	<u>\$ 1,936,900,471</u>	<u>\$ 1,751,069,574</u>	<u>\$ 185,830,897</u>	<u>10.6%</u>

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis (Continued)

December 31, 2009

During the period, other assets increased by \$1.3 million dollars while total liabilities also increased by \$842 thousand. These increases in other assets are attributable to an increase in trades pending settlement of \$839 thousand and an increase in interest and other receivables of \$419 thousand.

The Statement of Changes in Fiduciary Net Assets presents the activity within the Net Asset balance for the year ended. Significant activity accounts include net investment income and distributions to local governments. The change in net assets for the years ended December 31, 2009 and 2008 is as follows:

	<u>2009</u>	<u>2008</u>	<u>Amount of Increase (Decrease)</u>	<u>Percent Change</u>
Net Investment Income	\$ 283,511,894	\$ (587,713,426)	\$ 871,225,320	148.2%
Distributions to Local Governments	92,303,845	92,303,845	-	0.0%
Expenses	5,377,152	6,358,887	(981,735)	-15.4%
Net Increase (Decrease) in Net Assets	185,830,897	(686,376,158)		
Net Assets Held in Trust, Beginning of Period	1,751,069,574	2,437,445,732		
Net Assets Held in Trust, End of Period	<u>\$ 1,936,900,471</u>	<u>\$ 1,751,069,574</u>		

Net Investment Income increased by \$871.2 million compared to the previous year as a result of the higher investment returns earned by the Fund. During the year ended December 31, 2009, the total rate of return for the Fund was 14.99% while the total rate of return for the previous year was -23.62%. The global equity portfolio was the primary driver of the increase in investment returns as the return on global equity was 33.86% at year end. The allocation to global equity was 29.83%. The distributions to Local Governments reflected no change from the prior year due to the decision to distribute the same amount as the 2008 distribution. Finally, the expenses of the Fund decreased by \$982 thousand. These expenses represent the fees paid by the Fund to the Texas Trust which charges the Fund 0.30% of the net asset value of the Fund.

Asset Allocation

The Texas Trust continued its efforts to implement the asset allocation structure adopted on January 1, 2008. As shown in the chart entitled Phased-In Asset Allocation Targets, the portfolio's asset allocation structure consists of four macro strategy allocations; stable return (low beta), market return (beta), enhanced return and inflation protection (real assets). Stable return (low beta) assets are defined to be strategies that generate relatively consistent returns without dependency on the equity markets. The stable return strategy includes global fixed income and absolute return sub-allocations. Market return (beta) assets are public equities and asset classes that are highly correlated to global equity markets. The market return strategy includes global equity and hedged equity sub-allocations. Enhanced return strategies take advantage of the illiquidity premium and informational inefficient securities. The enhanced return strategy includes private equity and value added/opportunistic real estate sub-allocations. Inflation protection (real assets) serves primarily as inflation hedges and provides benefits of non-correlation. The inflation protected strategy includes stable value real assets, global inflation protected securities and commodities. The chart also defines the target weights to each category through January 1, 2011 when the phase-in period will be complete.

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis (Continued)

December 31, 2009

Phased-In Asset Allocation Targets							
Strategy	Prior	Phase 1	Phase 2	Phase 3	Phase 4	Phase 5	Phase 6
	12/31/2007	1/1/2008	4/1/2008	7/1/2008	1/1/2009	1/1/2010	1/1/2011
Stable Return	25.50	25.50	40.50	42.00	39.00	39.00	39.00
Cash	0.50	0.50	0.50	-	-	-	-
US Investment Grade Fixed Income	15.00	15.00	15.00	13.00	-	-	-
Global Investment Grade Fixed Income	-	-	-	4.00	11.00	11.00	11.00
US High Yield Fixed Income	5.00	5.00	5.00	-	-	-	-
Global High Yield Fixed Income	-	-	-	5.00	8.00	8.00	8.00
Absolute Return	5.00	5.00	20.00	20.00	20.00	20.00	20.00
Market Return	70.50	68.50	53.50	49.00	45.50	42.00	38.00
US Small Cap Equity	-	-	-	-	-	-	-
US Mid Cap Equity	-	-	-	-	-	-	-
US Small/Mid Cap Equity	15.00	15.00	-	-	-	-	-
US Large Cap Equity	32.50	32.50	-	-	-	-	-
US All Cap Equity	3.00	1.00	29.50	25.00	21.50	18.00	14.00
Non-US Developed Equity	15.00	15.00	-	-	-	-	-
Non-US Developed Equity	-	-	-	-	-	-	-
Non-US Developed Equity	-	-	9.00	9.00	9.00	9.00	9.00
Emerging Market Equity	-	-	5.00	5.00	5.00	5.00	5.00
Hedged Equity	5.00	5.00	10.00	10.00	10.00	10.00	10.00
Enhanced Return	3.80	4.50	4.50	5.00	9.00	12.00	15.00
Private Equity	2.00	3.00	3.00	3.00	6.00	8.00	10.00
Enhanced Real Estate	1.80	1.50	1.50	2.00	3.00	4.00	5.00
Inflation Protection	0.20	1.50	1.50	4.00	6.50	7.00	8.00
Stable Real Estate	-	1.50	1.50	2.00	2.50	3.00	4.00
Global REITS	0.20	-	-	-	-	-	-
Global Inflation Protected Securities	-	-	-	0.50	1.00	1.00	1.00
Commodities	-	-	-	1.50	3.00	3.00	3.00
	100.00	100.00	100.00	100.00	100.00	100.00	100.00

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis (Continued)

December 31, 2009

The chart entitled Asset Allocation Summary shows the market value and percentage of total portfolio for each macro strategy and sub-strategy as of December 31, 2009.

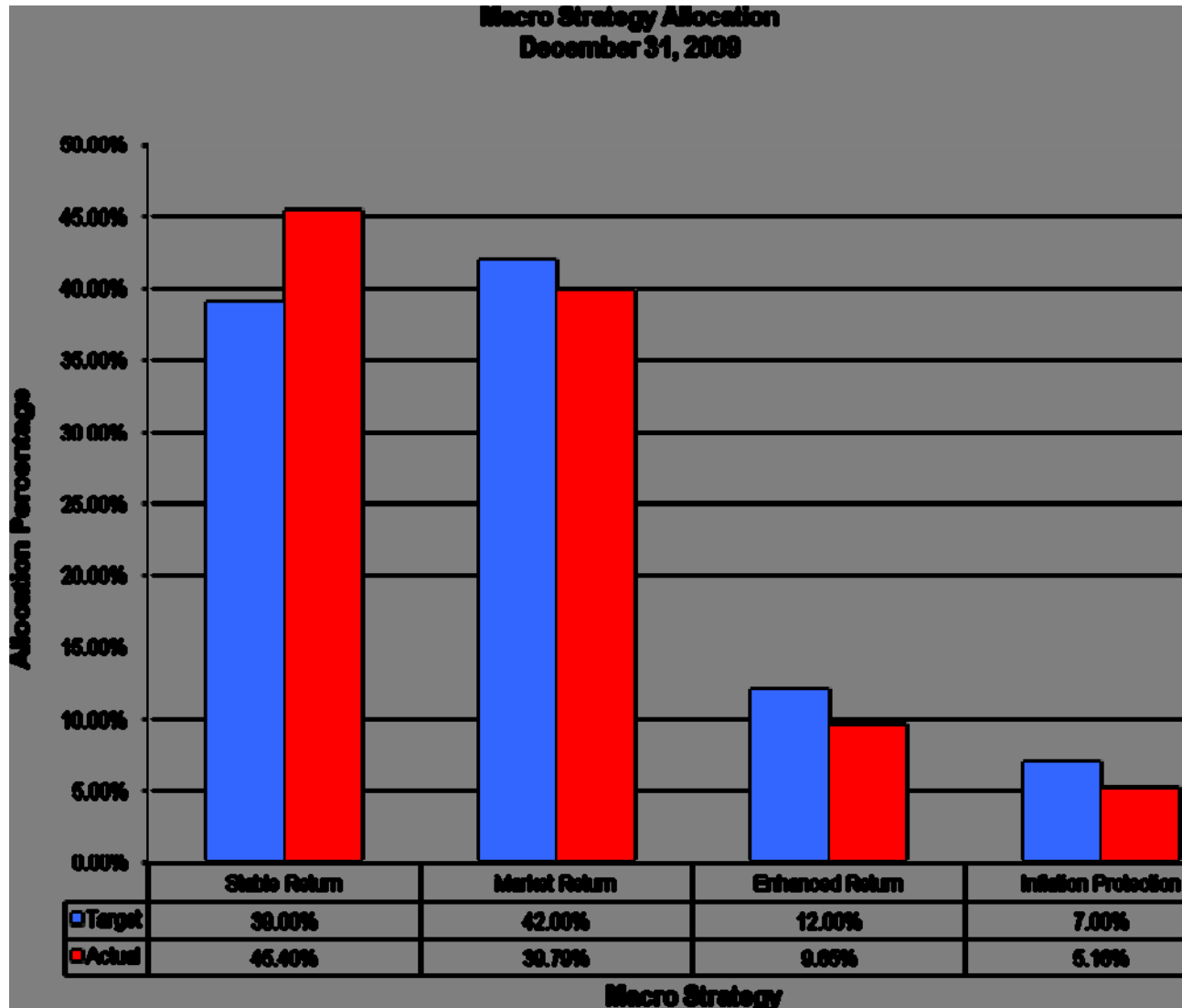
Asset Allocation Summary							
as of December 31, 2009							
Asset Class	Strategy	Style	Market Value (000's)	Current %	Long-Term Target (%)	Policy Range (%)	Phase-In Target
STABLE RETURN (Low Beta)			\$879,306	45.40%	39.0	29 - 49	39
	Global Investment Grade Fixed Income		322,765	16.66%	11.0		
	Global High Yield Fixed Income		171,936	8.88%	5.0		
	Emerging Markets		55,401	2.86%	3.0		
	Absolute Return		329,204	17.00%	20.0		
MARKET RETURN (Beta)			\$770,602	39.79%	38.0	28 - 48	42
	Global Equity		577,748	29.83%	28.0		
		US Equity	382,023	19.72%	14.0		
		Non-US Developed	112,105	5.79%	9.0		
		Emerging Markets	83,620	4.32%	5.0		
	Hedged Equity		192,854	9.96%	10.0		
ENHANCED RETURN			\$186,991	9.65%	15.0	7 - 23	12
	Private Equity		141,883	7.32%	10.0		
	Real Estate		45,108	2.33%	5.0		
INFLATION PROTECTION (Real Assets)			\$100,001	5.16%	8.0	3 - 13	7
	Stable Value Real Estate		38,056	1.96%	4.0		
	TIPS		-	0.00%	1.0		
	Commodities		61,945	3.20%	3.0		
Total			\$1,936,900	100.00%	100.0		

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis
(Continued)

December 31, 2009

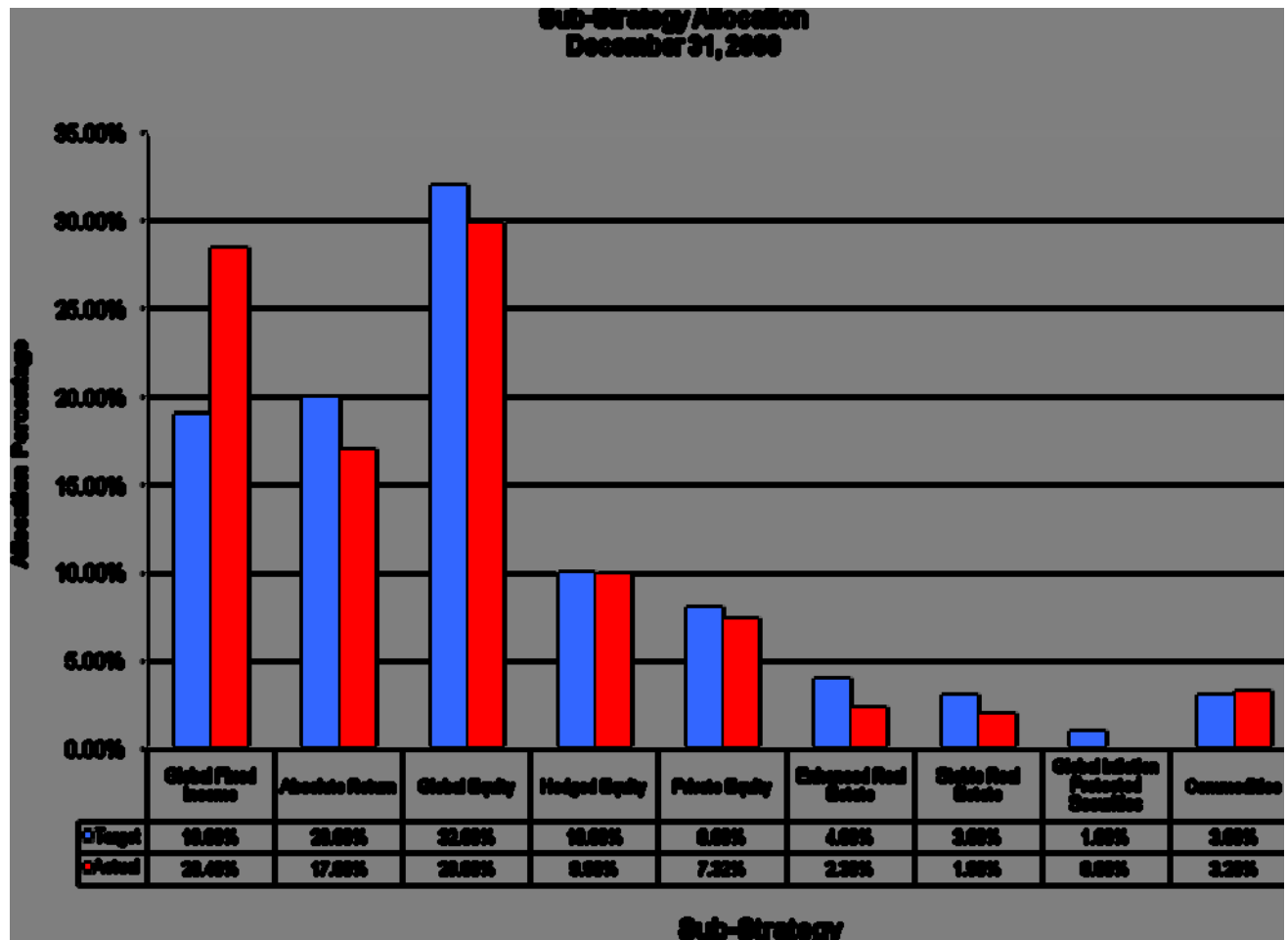
The following charts compare the Fund's macro strategy target asset allocation as of January 1, 2010 with its actual allocation as of December 31, 2009 and the Fund's sub-strategy asset allocation as of January 1, 2010 with its actual allocation as of December 31, 2009.



TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management’s Discussion and Analysis
(Continued)

December 31, 2009



At year end the Fund’s target allocation to Global Fixed Income was 19% and its actual allocation at year end was 28.40%, an overweight of 9.40%. The Fund’s target allocation to Global Equity was 32.00% while its actual allocation was 29.83%, an underweight of 2.17%.

Unfunded Commitments

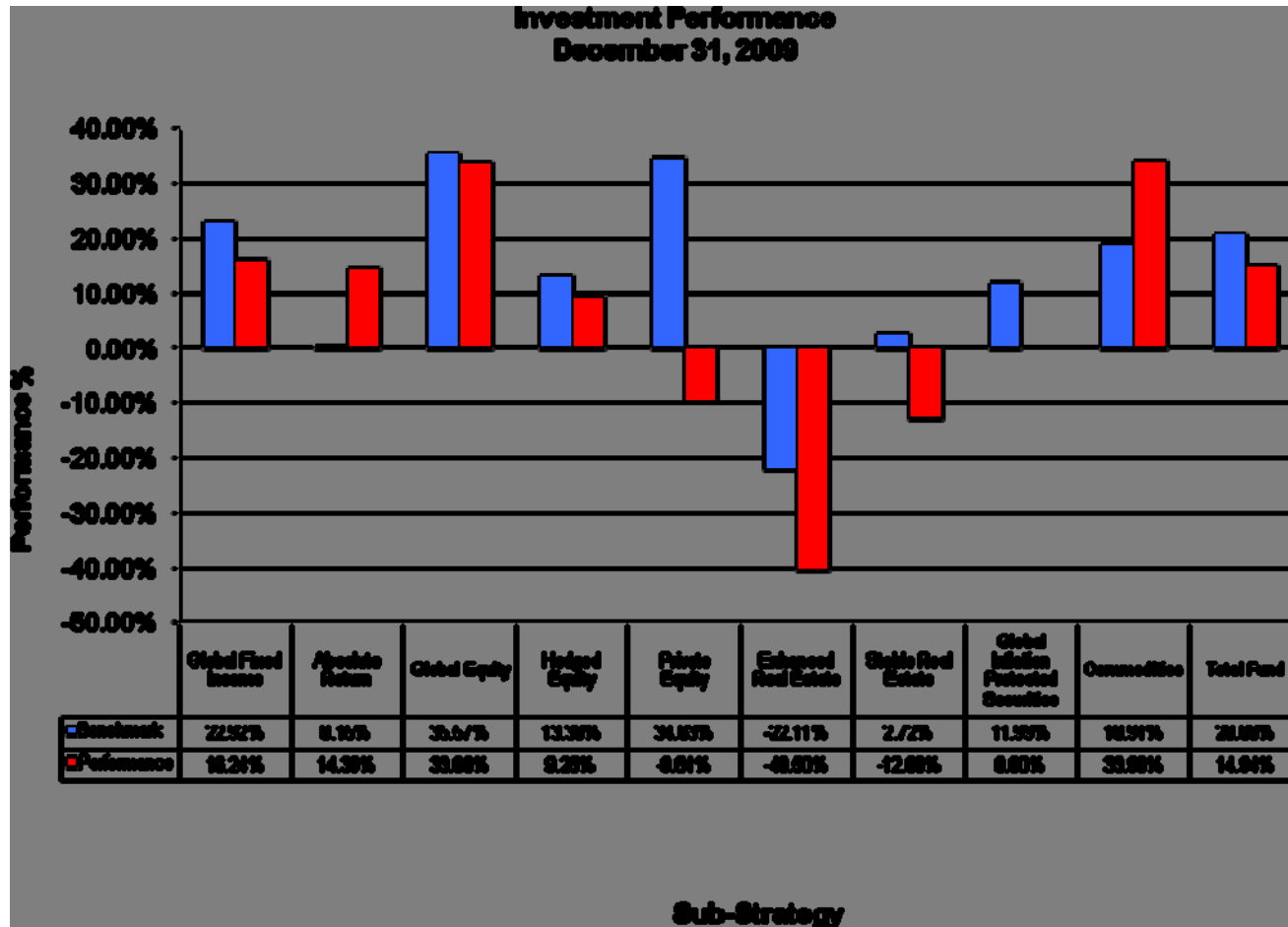
As of December 31, 2009, the Tobacco Fund’s outstanding unfunded commitments in the private equity portfolio totaled \$155.9 million. Outstanding unfunded commitments in the real estate allocations totaled \$88.2 million.

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis (Continued)

December 31, 2009

Investment Performance



The above chart presents the Endowment Pool performance as of December 31, 2009. During the year the Endowment Pool's overall performance was 14.94% while the policy benchmark return was 20.80%. During the year, the Absolute Return and Commodities allocation outperformed their respective benchmarks. All other strategies underperformed their respective benchmarks.

Below is the performance comparison of the Tobacco Trust to the Endowment Pool for the preceding 1 year, 2 year and 3 year periods.

	1 Year	2 Year	3 Year
Total Endowment Pool	14.94%	-6.43%	-1.95%
Tobacco Trust Fund	14.99%	-6.32%	-1.90%

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis (Continued)

December 31, 2009

Traditional Asset Managers

The following table displays the performance of the Fund's equity and fixed income asset managers relative to their respective benchmarks for the preceding 1 year, 2 year and 3 year periods.

External Manager Investment Performance				
Asset Class	Manager Name	% Rate of Return		
		1 year	2 year	3 year
Large Cap Core Equity				
	Batterymarch	23.23%	-11.72%	-5.58%
	Biscayne	22.30%	-14.04%	-6.20%
	Northern Trust (S&P 500)	26.83%	-10.62%	-5.53%
	<i>Benchmark (S&P500)</i>	26.46%	-10.74%	-5.63%
Large Cap Growth Equity				
	Intech	28.34%	-8.01%	-3.00%
	Northern Trust Russell 1000	37.46%	-8.03%	-1.84%
	<i>Benchmark (S&P 500 Barra/Citigroup Growth)</i>	31.57%	-7.47%	-2.24%
Large Cap Value Equity				
	Northern Trust Russell 1000 Value	20.26%	-12.77%	-8.70%
	<i>Benchmark (Russell 1000 Value)</i>	19.69%	-13.06%	-8.96%
Mid Cap Core Equity				
	Northern Trust S&P 400	37.75%	-6.30%	-1.74%
	<i>Benchmark (S&P MidCap 400)</i>	37.38%	-6.40%	-1.84%
Small Cap Core Equity				
	Northern Trust S&P 600	26.48%	-6.71%	-4.59%
	<i>Benchmark (S&P 600)</i>	25.57%	-6.97%	-4.80%
Non US Developed Markets				
	BGI ACWI ex US Alpha Tilts	39.64%	-12.38%	-4.27%
	<i>Benchmark (MSCI ACWI ex USA GD)</i>	41.45%	-12.22%	-3.49%
	BGI International Small Cap Fund	45.80%	-12.12%	NA
	<i>MSCI EAFE Small Cap</i>	47.32%	-11.46%	NA
Emerging Markets				
	BGI Emerging Markets Fund	77.34%	NA	NA
	BGI Emerging Markets ETF*	25.60%	NA	NA
	<i>Benchmark MSCI Emerging Markets</i>	78.51%	NA	NA
Global Investment Grade Fixed Income				
	BGI Core Bond	10.68%	7.69%	6.97%
	Airto Total Return Bond Fund*	6.85%	NA	NA
	<i>Benchmark (Barclays US Aggregate)</i>	5.93%	5.58%	6.04%
Global High Yield Fixed Income				
	Fountain Capital	39.27%	5.28%	5.05%
	Airto Global High Yield Bond*	22.88%	NA	NA
	Stone Harbor High Yield Bond*	18.39%	NA	NA
	<i>Benchmark (BC High Yield Corporate Index)</i>	58.21%	8.09%	5.98%
Emerging Markets Fixed Income				
	Lazard Emerging Income	11.46%	NA	NA
	Stone Harbor Emerging Market*	19.38%	NA	NA
	<i>Benchmark (Barclays Emerging Market Index)</i>	34.23%	NA	NA

* indicates that the strategy was started during the reported year and that the returns presented are reported since the inception date of the portfolio

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Management's Discussion and Analysis (Continued)

December 31, 2009

Distribution and Contribution History

The Distribution for 2010 is calculated based on the average market value of \$2,120,940,738. The Trust Account uses the most recent twenty (20) calendar quarter end market values to calculate the average market value. Based on these values, the amount eligible for distribution under the rules is \$95,442,333. The following chart reflects the Tobacco Settlement Trust Fund's distribution and contribution history.

Distribution & Contribution History:

Contribution Month	Total	Distribution Month	Total Distribution from Tobacco Fund	Direct Distribution	Total Distribution
		Jan-99	\$ -	\$ 300,000,000	\$ 300,000,000
Jan-00	\$ 444,581,000	Apr-00	-	100,000,000	100,000,000
Dec-00	433,888,365		-	-	-
Jan-01	67,523,342		-	-	-
Jun-01	43,407,228		-	-	-
Dec-01	491,573,700	Apr-01	14,306,508	50,000,000	64,306,508
May-02	19,317,882	Apr-02	17,760,000	-	17,760,000
Dec-02	26,914,041		-	-	-
Dec-02	148,494,658		-	-	-
Apr-03	7,264,688	Apr-03	22,041,497	-	22,041,497
		Apr-04	28,515,957	-	28,515,957
		Apr-05	50,282,384	-	50,282,384
		Apr-06	72,070,600	-	72,070,600
		Apr-07	82,691,441	-	82,691,441
		Apr-08	92,303,845	-	92,303,845
		Apr-09	92,303,845	-	92,303,845
Totals:	<u>\$1,682,964,904</u>		<u>\$ 472,276,077</u>	<u>\$ 450,000,000</u>	<u>\$ 922,276,077</u>

Contacting Texas Trust's Financial Management

This financial report is designed to provide the Fund's beneficiaries, business partners and creditors with a general overview of its finances. Questions about this report can be directed to Texas Trust's Chief Financial Officer, at (512) 463-3129.

BASIC FINANCIAL STATEMENTS

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Statement of Fiduciary Net Assets

December 31, 2009

Assets	
Trades pending settlement	\$ 3,943,121
Interest and other receivables	2,844,700
Investments	<u>1,936,470,603</u>
Total assets	<u>1,943,258,424</u>
Liabilities	
Trades pending settlement	5,393,499
Accounts payable	<u>964,454</u>
Total liabilities	<u>6,357,953</u>
Net Assets	
Held in trust for other governments	<u><u>\$ 1,936,900,471</u></u>

SEE ACCOMPANYING NOTES TO BASIC FINANCIAL STATEMENTS

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Statement of Changes in Fiduciary Net Assets

Year Ended December 31, 2009

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Statement of Changes in Fiduciary Net Assets

Year Ended December 31, 2009

Additions

Investment income:

Net increase in fair value of investments	\$ 254,763,657
Interest and investment income	<u>28,748,237</u>
Total income from investing activities	<u>283,511,894</u>

Total additions 283,511,894

Deductions

Professional fees and services	5,377,152
Disbursements to local governments	<u>92,303,845</u>
Total deductions	<u>97,680,997</u>
Change in net assets held in trust for other governments	185,830,897

Net assets - beginning of year 1,751,069,574

Net assets - end of year \$ 1,936,900,471

SEE ACCOMPANYING NOTES TO BASIC FINANCIAL STATEMENTS

NOTES TO BASIC FINANCIAL STATEMENTS

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to Basic Financial Statements

December 31, 2009

(1) Reporting Entity

The Tobacco Settlement Permanent Trust Fund (the “Fund”), was established under the authority of House Bill 1161 (the “Act”) enacted by the 76th Regular Session of the 1999 Texas Legislature. The purpose of the Fund is to collect monies from the tobacco companies, and distribute the funds to eligible local governmental units for reimbursement of previous healthcare costs associated with tobacco related illness. The Fund was organized on July 24, 1998, and commenced operations on December 31, 1998.

The Act establishes the Fund with the Texas Comptroller of Public Accounts (the “Comptroller”), who is required to administer and manage the assets of the Fund with the advice of, and in consultation with, the appointed Tobacco Settlement Permanent Trust Account Investment Advisory Committee (“Investment Advisory Committee”). The Comptroller is also required to make annual distributions to eligible governmental units and to prepare and distribute annual reports regarding the Fund’s assets and investments. The Investment Advisory Committee consists of 11 members from the largest governmental units affected by the Act. The Comptroller, with the advice of, and in consultation with, the Investment Advisory Committee, has developed an Investment Policy which guides the investments of the Fund.

The Act requires the Texas Department of Health to collect information regarding the amount of each governmental unit’s un-reimbursed health care expenditures, and to certify to the Comptroller the percentage payable from the Fund to each governmental unit.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The State of Texas reports the Fund as a private-purpose trust fund in its basic financial statements. Private-purpose trust funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the time of the related cash flows.

(b) Restrictions

In accordance with the Act, the Fund is composed of money paid to the Fund in accordance with the Tobacco Settlement Agreement, assets purchased with that money, earnings of the Fund, and any other contributions made to the Fund. These amounts represent the corpus of the Fund and shall remain in the Fund and may not be distributed for any purpose that is not in accordance with the approved spending policy. The money and other assets contained in the Fund are not a part of the general funds of the State of Texas.

The Comptroller, with the advice and consultation of the Investment Advisory Committee, may use the earnings of the Fund for investment expense. Upon certification in accordance with the Health and Safety Code, Subchapter J, Chapter 12, the Comptroller shall make an annual distribution from the net earnings from the Fund, to each eligible political subdivision as provided in the agreement regarding disposition of settlement proceeds.

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to Basic Financial Statements

December 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(c) Investments

Investments with a readily determinable fair value are reported at fair value based upon quoted market prices, or when quoted market prices are not readily determinable, estimated fair values based on market conditions and information provided by the investment administrators are used. For investments in limited partnerships where no readily determinable fair value exists, the fair value of the investment is based on the most recent capital account balance of each limited partnership as communicated by the investment administrator, adjusted for subsequent contributions, distributions, and withdrawals, or based upon their evaluation of estimated changes in values from the date of the most recent capital account balance. For investments in fund of hedge funds, the fair value is based on net asset value information provided by the designated fund administrator. The Texas Treasury Safekeeping Trust Company ("Texas Trust") reviews fair values and makes adjustments as necessary based on their evaluation.

According to the Act, the Comptroller is to administer and manage the assets of the Fund using the specified fiduciary standard of care and with the advice of, and in consultation with, the Investment Advisory Committee. The Fund is authorized to invest its funds according to the approved Investment Policy. The type of investments allowed by the Investment Policy includes:

- Common stock
- Derivative securities
- Foreign currency forwards or futures contracts
- Unaffiliated liquid investment funds
- Commercial paper
- Negotiable certificates of deposit
- Bankers acceptances
- Repurchase agreements and reverse repurchase agreements
- Mortgage backed securities dollar rolls
- Fixed income securities which are components of the Lehman Brothers Aggregate Bond Index ("LBAGG")
- U.S. domestic bonds
- Floating rate securities
- Medium term notes issued by investment grade corporations
- Zero coupon bonds and stripped treasury and agency securities
- Structured notes and multi-family mortgage-backed securities
- Hedge funds
- Real estate
- Private equity

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to Basic Financial Statements

December 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(c) Investments (continued)

The following table reflects the Fund's asset class target allocation and the tolerance range per the Fund's Investment Policy.

Strategy	Target %	Range (+/-)
<i>Stable Return (Low Beta)</i>	39%	10%
Global Investment Grade Fixed Income	11%	
Short-term Investment Funds	0%	
US Core	7%	
Non-US Developed	4%	
Global High Yield Fixed Income	8%	
US High Yield	5%	
Emerging Market	3%	
Absolute Return	20%	
<i>Market Return (Beta)</i>	38%	10%
Global Equity	28%	
Domestic	14%	
Non-US Developed	9%	
Emerging Market	5%	
Hedged Equity	10%	
<i>Enhanced Return</i>	15%	8%
Private Equity	10%	
Enhanced Return Real Estate	5%	
<i>Inflation Protection (Real Assets)</i>	8%	5%
Stable Value Real Estate	4%	
Global Inflation Protected Securities	1%	
Commodities	3%	

(d) Custodian

The Fund contracts services to a custodian to discharge certain of its responsibilities. The custodian performs the duties involving the acquisition, sale and holding of fixed income and equity investments in the Fund's name.

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to Basic Financial Statements

December 31, 2009

(2) Summary of Significant Accounting Policies (continued)

(e) *Income Tax*

The Fund is exempt from federal income tax on its operations in accordance with Internal Revenue Code Section 115.

(f) *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ significantly from these estimates.

(3) Investments

The Fund applies Governmental Accounting Standards Board (“GASB”) Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This statement requires that governmental entities report investments at fair value on the balance sheet, and that all investment income, including changes in the fair value of investments, should be reported in the operating statement.

The Texas Trust administers and manages the assets of the Fund using the specified fiduciary standard of care and with the advice of, and in consultation with, the Investment Advisory Committee. The Fund is authorized to invest its funds according to the approved Investment Policy. The Fund’s investments as of December 31, 2009 are as follows:

Corporate obligations	\$ 77,968,513
International corporate obligations	11,335,065
Equities	123,365,243
International equities	2,774,175
Mutual funds - domestic equities	254,392,716
Mutual funds - global equities	195,440,513
Mutual funds - fixed income	378,126,481
Mutual funds - commodities	61,944,975
Hedge funds - absolute return	224,922,784
Hedge funds - equities	191,966,969
Alternative investments domestic	325,282,485
Alternative investments international	37,701,030
Investment in short-term investment fund	51,249,654
Total Endowment Fund Investments	<u>\$ 1,936,470,603</u>

Consisting of the following:

Fiduciary Funds Investments	<u>1,936,470,603</u>
Total as presented on the Financial Statements	<u>\$ 1,936,470,603</u>

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to Basic Financial Statements

December 31, 2009

(3) Investments (continued)

Credit Risk. Corporate obligations must be rated investment grade by at least one nationally recognized statistical rating organization (“NRSRO”) and not rated below investment grade by any NRSRO. Short-term securities must be rated in the highest rating category by an NRSRO. The average quality rating of the high-yield fixed income portfolio shall be B1/B+ or higher. All high-yield securities when purchased must be rated at least CCC. The following schedule lists Standard & Poor’s credit rating by investment type for the Fund. The high-yield securities not rated by Standard & Poor’s are rated Ba or B by Moody’s.

Investment Type	AAA	BBB	BB	B	CCC	Not Rated
Corporate Obligations		\$ 2,201,892	\$ 27,251,556	\$ 42,559,384	\$ 3,778,410	\$ 2,177,271
International Corporate Obligations			5,137,103	6,197,962		
Mutual Funds - Fixed Income						378,126,481
Investments in Short-Term Investment Fund	51,249,654					
Total Endowment Funds	\$ 51,249,654	\$ 2,201,892	\$ 32,388,659	\$ 48,757,346	\$ 3,778,410	\$ 380,303,752

Concentration Risk: As of December 31, 2009 no more than 5% of the portfolio was invested in securities of one issuer.

Interest Rate Risk: The Fund does not have a formal investment policy that limits investment maturities. The following schedule reflects the average modified duration of the endowment funds by investment type. The investments in the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

Modified Duration	
Investment Type	(Years)
Corporate obligations	4.73
International corporate obligations	4.56
Mutual funds – fixed income	3.86
Weighted Average Maturity	
	(Days)
Investment in short-term investment fund	47

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to Basic Financial Statements

December 31, 2009

(3) Investments (continued)

Foreign Currency Risk: The Fund's investment policy does not limit investments in any single foreign currency. The Fund's exposure to foreign currency risk derives from its position in foreign currency-denominated investments in limited partnerships.

Currency	Investment type	Fair Value
European Euro	Limited Partnership	\$37,701,030

Treasury Pool

The Fund may participate in the Treasury Pool, which is an internal investment pool. The Comptroller maintains oversight responsibility for the Treasury Pool. This responsibility includes the ability to influence operations designation of management, and accountability for fiscal matters. The Treasury Pool operates in accordance with the Comptroller's Investment Policy. The Fund receives allocated earnings based on its percentage share of the Treasury Pool, but its overall value remains the same as the initial deposit into the Treasury Pool plus accrued income. The Fund was not invested in the Treasury Pool at December 31, 2009.

(4) Annual Distribution from the Fund

The Comptroller is required by Government Code, §403.1041, to administer the Tobacco Settlement Permanent Trust Account ("Trust Account") and manage the assets of the Trust Account with the advice of, and in consultation with, the Investment Advisory Committee. The Comptroller is also required to adopt rules necessary to implement the Comptroller's duties under Government Code, §403.1041, including rules distinguishing the net earnings of the Trust Account that may be distributed from earnings used for investment expenses and from the money and assets that are the corpus of the Trust Account.

A rule revision was adopted by the Comptroller with the advice and approval of the Investment Advisory Committee, and became effective for the actual distribution amount from the Fund for 2006 and for reserving an allocation for the distribution stabilization account ("DSA"), the calculations of which are based on these basic financial statements.

The prior years' calculated distribution amount under the rules was \$96,310,308. The board elected to distribute \$92,303,845 in April 2009. The distribution was funded from the following sources, \$34,816,835 from current earnings less investment expenses and \$57,487,010 from the DSA. The current balance in the DSA is \$43,958,555.

The inflation adjusted corpus for the year ending December 31, 2009, was \$2,069,592,227. The Distribution was calculated based on the average market value of the Trust Account using the most recent twenty (20) calendar quarter-end market values of \$2,120,940,738. Based on these values, the maximum amount eligible for distribution in April 2010 under the rules is \$95, 442, 333. Because the net earnings are less than the calculated distribution amount, the distribution will be funded from the following sources, \$74,816,584 from current earnings less investment expenses and \$20,625,749 from the DSA.

TOBACCO SETTLEMENT PERMANENT TRUST FUND

Notes to Basic Financial Statements

December 31, 2009

(4) Annual Distribution from the Fund (continued)

With the maximum current allowable deduction to the DSA, the total DSA reserve is \$23,332,806. This reserve is intended to be used to facilitate the objectives of providing a predictable, stable stream of distributions over time and to ensure that the inflation-adjusted value of the distributions is maintained over the long-term.

(5) Related Parties

Prior to September 1, 2001, the Comptroller provided financial and staff support to conduct and administer the day-to-day operations of the Texas Trust, including the Fund. Those expenses were neither recorded nor allocated to the Fund's basic financial statements and were paid through the General Fund of the Comptroller's Office.

Beginning September 1, 2005, the contract and agreement between the Comptroller and the Texas Trust allows the Texas Trust to charge a flat fee of 30 basis points to recover all costs associated with the management of the Fund. The Fund was charged \$5,377,152 for the months of January 2009 through December 2009.