

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Thursday, December 16, 2010
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, December 16, 2010 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, and Scott Wise.

Board Members Absent

Adolpho Telles.

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; Gena Minjares, Director of General Ledger Accounting; Victor Scott, Director of Financial Reporting; Laura Montoya, Director of Administrative Services; Jorge de Lafuente, Investment Accountant.

Others

Lester Sprouse, Padgett, Stratemann & Co.; George Tarlas, 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 10:09 a.m.

Approval of Minutes of September 30, 2010 Meeting (Tab 1)

Mr. Steve Strake made a motion to accept and approve the minutes of the September 30, 2010 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Scott Wise and unanimously approved by the Board.

Presentation of Independent Auditor's Reports for the Trust Company (handout)

Mr. Lester Sprouse summarized the audit reports and reported that Padgett, Stratemann & Co., issued an unqualified financial audit opinion with respect to Trust Company for the fiscal year ending August 31, 2010. No audit adjustments were recorded during the audit engagement that would indicate deficiencies in the accounting process. No management letter was required.

Capital Markets Outlook and Discussion (Tab 2)

Mr. George Tarlas of ACG presented an economic update and reviewed the third quarter. He reported that although the financial markets had improved in the last twelve months, they remained uncertain and still faced many macroeconomic challenges. Overall there were declining investor concerns regarding an economic "double dip" recession. Mr. Tarlas reported that consumer spending was up and improved from the same time last year. Lagging economic indicators however, such as unemployment and housing had shown minimal improvement. ACG expects economic growth in the U.S. to be approximately 3% in 2011. They believe interest rates will remain low in the upcoming year. European sovereign debt and global economic issues continue to plague investor concerns. ACG expects economic growth in Europe to be between 1-2% in 2011. ACG continues to believe 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 fourth 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. ACG finds large cap equities attractive relative to other major asset classes. Mr. Tarlas stated that ACG believes the global real estate market appears to have stabilized across the majority of property types and has benefited from the low interest rate environment. 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. He stated that public sentiment had improved significantly the last quarter resulting in an increase in consumer spending. Macroeconomic advisors expect an approximate 4 – 4.5% growth in 2011. Mr. Samples reported that the current household debt to income ratio is approximately 98%. He explained that 80% would be a significant improvement, but he would prefer 60%. Mr. Samples expressed concerns with the current economy and deficit; however, he believes that the coming year could be a turning point and economic growth would definitely help reduce the deficit. In his opinion 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 portfolio asset summary as of November 30, 2010 and stated that the value of the Pool was approximately \$23.8 billion. He reported that the value as of the meeting date was approximately \$26 billion and he expected the value to increase to \$30 billion by year end. Mr. Samples stated the Treasury Pool was carrying approximately \$68 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. Treasuries now account for approximately 70% of the portfolio. Next, Mr. Samples reviewed comparative benchmark yields and stated that the Treasury Pool yield had outperformed or remained competitive with its benchmarks.

Endowment Portfolio Update and Related Matters (Tab 4)

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 began his presentation with a handout that demonstrated the current portfolio structure adapted to a more simplified approach focused on liquidity and flexibility. Mr. Ballard and Mr. Danny Sachnowitz discussed current liquidity and the fact that the portfolio remained very liquid. As of September 30, 2010 the portfolio value was approximately \$3.1 billion and was in alignment with its asset allocation targets. Mr. Sachnowitz reviewed the handout that illustrated current versus phased-in target allocation. He expects by January 2011 the portfolio will meet its long term allocation targets. Mr. Sachnowitz explained that approximately \$60 million was added to the commodity sector which increased inflation protection.

Mr. Ballard reviewed returns and performance of specific asset classes. He reported that offices of two hedge fund managers, Level Global and Diamondback, were being investigated by the FBI. The managers were cooperating and no charges have been filed. Mr. Ballard stated the Trust Company and its consultants would continue to follow up with both managers to carefully evaluate any changes in their organization, redemptions by clients, and their ongoing viability as investment managers in order to manage any potential risks to the endowment. Trust Company staff will update the board with any new developments.

Mr. Sachnowitz continued the returns and performance reviews of the specific asset classes. He noted that in the private equity sector, special situation funds had been driving performance. Overall, the private equity sectors had been profitable. 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. The policy compliance checklist was reviewed and the portfolio was in compliance with each category.

Endowment Funds Investment Performance Review for the Quarter Ending September 30, 2010 and Related Matters (Tab 5)

Mr. Rick Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending September 30, 2010. He reported that the portfolio participated in the rally in the stock market. The portfolio return was approximately 6.9% for the quarter which represented an approximate \$190 million increase. 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 experienced an overall positive result while assuming less risk. The Sharpe ratio outperformed its benchmark.

Discussion of Next Meeting and Agenda Items

The board will be contacted regarding the next meeting date. No agenda items suggested for next meeting.

Public Comment

None

Adjourn

The meeting adjourned at 1:50 p.m.