

**COMPTROLLER'S  
INVESTMENT ADVISORY BOARD MEETING  
Monday, January 23, 2017  
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Monday, January 23, 2017, at the LBJ State Office Building, 111 E. 17<sup>th</sup> Street, Room 114, Austin, Texas.

**Board Members ("The Board") Present**

Comptroller Glenn Hegar, Tucker Bridwell, Laurie Dotter, Jim Hille, Steve Strake, Adolpho Telles and Scott Wise.

**Board Members Absent**

None.

**Comptroller of Public Accounts Staff Present**

Mike Reissig, Deputy Comptroller.

**Texas Treasury Safekeeping Trust Company ("Trust Co.") 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; Gena Minjares, Deputy Chief Financial Officer; Laura Montoya, Chief Operating Officer; Anca Ion, Deputy Director of Internal Investments; Whitney Blanton, Assistant Deputy General Counsel; Michael Anderson, Compliance Officer; Byron Beasley, Portfolio Manager; Michael Leifeste, Portfolio Manager; Lalo Torres, Portfolio Manager; Jyoti Gupta, Portfolio Manager; Ruchit Shah, Portfolio Manager; Adam Levine, Risk Strategist; Chad Turner, Risk Manager; Yunke Yu, Quantitative Data Analyst; Susan Colletti, Director of Investment Accounting; Nora Arredondo, Special Projects Coordinator; Corrine Hall, Program Administrator; and Elizabeth Moreno, Manager of Financial Accounting.

**Additional Participants**

Mike O'Brien, RSM & Co., LLP; and Lori Mills and Alex Nixon, Asset Consulting Group ("ACG").

**Call to Order**

Comptroller Glenn Hegar declared that a quorum was present and called the meeting to order at 10:03 a.m.

**Approval of Minutes of September 21, 2016 Meeting (Tab 1)**

*Mr. Scott Wise made a motion to accept and approve the minutes of the September 21, 2016 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Steve Strake and unanimously approved by the Board.*

### **Presentation of Independent Auditor's Report for the Trust Company (handout)**

Mr. Mike O'Brien summarized the audit reports in the handout and reported that RSM & Company issued an unqualified financial audit opinion with respect to the Trust Company and the SWIFT for the fiscal year ending August 31, 2016. Mr. O'Brien reported that no audit adjustments were recorded during the audit engagement that indicate deficiencies in the accounting process, nor was a management letter issued.

### **Economic Outlook, Investment and Review of Treasury Pool (Tab 2)**

Mr. Mike Samples reported on current economic conditions. He explained that economic growth had not expanded meaningfully during the fourth quarter. He expects the economy's trajectory going forward will basically be unchanged and believes growth prospects in the next several years will be similar to what we have experienced over the last several years. He explained that meaningful economic growth could not be further driven by low interest rates. Further, the labor market is tightening and the unemployment rate stands at approximately 4.7%. He believes economic growth is stable but not robust. A tax cut could not be expected to lead to greater economic growth as those who benefit would be unlikely to spend more while, at the same time, government funded health and retirement benefits will continue to rise, adding to record deficits. He expects the Federal Reserve to continue to raise interest rates very cautiously, noting the fragility of the economy and that the Fed has consistently been overly optimistic in their forecasts of economic and employment growth.

Mr. Samples reported that for the quarter ending 2016, the portfolio produced a net yield of approximately 1.08%, had a market value of approximately \$21.4 billion, and continued to maintain a AAA rating by Standard & Poor's.

### **Capital Markets Outlook and Investment Performance for the Quarter Ending September 30, 2016 (Tab 3)**

Ms. Lori Mills of Asset Consulting Group (ACG) provided a review of the capital markets. She explained that U.S. consumers remained the primary driver of economic growth in the last quarter of 2016 versus corporate spending, which fell during the same period. In December 2016, the Fed raised interest rates for the first time in ten years by a quarter of a percentage point. ACG projects more rate increases next year. Ms. Mills stated that possible changes to trade policies under the new President could affect the U.S. dollar, the value of which is still a bit of a wild card. ACG believes Gross Domestic Product for the fourth quarter 2016 will probably be in the neighborhood of 2%.

Ms. Mills reported that the global equity asset class produced the highest returns in 2016 with the largest gains in riskier segments of the market like U.S. Small Cap and Emerging Markets. Global Fixed Income produced strong returns year-to-date, but rising interest rates in the last quarter slowed its rally. Returns during the fourth quarter of 2016 were generally positive overall. Global Equities continue to post positive returns led by a post-Presidential-election rally in U.S. stocks. A recent OPEC announcement stating plans to manage the oil supply led to a jump in the price of oil and triggered a broad rebound in commodity prices overall.

Ms. Mills reviewed the total portfolio summary for the period ending September 30, 2016. She reported that the portfolio had produced an annualized rate of return of approximately 5.90% over the previous five-years, compared to 5.38% for the policy benchmark. She explained that over the past five years the total portfolio had generated 10% more return than the policy benchmark with just 3% more risk. In short, it produced a better risk-adjusted return than the benchmark.

She reported that the portfolio outperformed the policy benchmark over the most recent quarter as well as the one, three, and five year periods. The third quarter return was approximately 3.15%, 0.57% above the policy benchmark. The broad asset classes of fixed income, equity and real assets each outperformed their benchmarks for the quarter ending September 30, 2016.

Ms. Mills reported that the State Water Implementation Fund for Texas (“SWIFT”) portfolio produced a 2.83% return for the quarter ending September 30, 2016, outperforming its policy benchmark by 1.06% and outperforming its dynamic benchmark by 1%. Performance for the broad asset classes of fixed income, equity and real assets all exceeded their benchmarks for the quarter and have significantly outperformed since inception. She reported that the returns for November and December were 0.39% and 1.08% respectively. Overall, the portfolio has generated higher returns with lower risk than either the policy or dynamic benchmarks.

### **Lunch Speaker – Reva Goujon and Brent Boyd, Stratfor (Tab 4 bio)**

Stratfor is a geopolitical intelligence and advisory firm. Mr. Bret Boyd leads Stratfor’s enterprise business and Ms. Reva Goujon is Vice-President of Global Analysis. They spoke to the Board about geopolitical conditions in areas including the U.S., China, Germany, Italy, Mexico and Russia. They believe the U.S. will have more space to selectively impose trade barriers with China, particularly in the metals sector. Stratfor expects that 2017 will be a critical year for Europe. Potential outcomes from elections in France, Germany and Italy will affect one another and could threaten unification of the Eurozone. The elections may produce what Stratfor believes is the inevitable dissolution of the European Union. Ms. Goujon expressed the view the U.S. would not completely disengage from the North American Free Trade Agreement (“NAFTA”) as has been suggested by President Trump, given the complex integration of the existing multi-national supply chains. She stated that demonetization and the streamlining of India’s complex tax system would continue to have positive effects on its economy, but that rising oil prices and protectionist policies of developed countries could produce headwinds.

### **Endowment and SWIFT Portfolio Updates and Related Matters (Tab 5)**

Mr. Ballard presented the Board an overview of the Endowment portfolio and reported that it was in compliance with its investment policy. He reported that as of September 30, 2016, the portfolio value was approximately \$3.79 billion. He recapped the executive summary pages and noted the top three performing managers in each asset class. Mr. Ballard explained that event-driven manager, Perry Capital, is winding down its fund. As of January 1, 2017, Perry had returned more than 50% of capital to its investors. He reviewed each asset class and the various investment strategies utilized within each that are designed to better diversify and improve risk-adjusted returns. Mr. Ballard explained why different asset classes were overweight relative to target allocations and which were underweight. Mr. Ballard and Mr. Sachnowitz discussed new fund commitments as well as funds that are being redeemed.

Mr. Ballard introduced Trust Company portfolio managers. Each discussed their area of responsibility and engaged with the Board in discussions. Mr. Eduardo “Lalo” Torres discussed the role of traditional fixed income to protect and stabilize the overall portfolio and how it is currently positioned considering the prevailing macroeconomic environment. Mr. Ruchit Shah discussed the alternative fixed income and private credit portfolios. He stated that his objective for alternative fixed income hedge funds is to select those capable of producing excess returns over benchmarks, providing uncorrelated returns, and reducing overall portfolio volatility. Ms. Jyoti Gupta discussed the hedged and global public equity portfolios. She explained that the hedged equity portfolio had been pruned in 2016, which had the effect of increasing its overall net exposure to equity markets. She reported that energy and health care sector-focused managers had been recently added to the portfolio mix. Mr. Adam Levine and Dr. Chad Turner discussed their focus on risk management and some ways that their team produces actionable quantitative market and manager analysis. Mr. Levine explained that they are currently focused on volatility-based

investment strategies, which have the potential to generate alpha and uncorrelated sources of return. Mr. Byron Beasley discussed how the private equity portfolio had evolved over the last 10-12 years. He stated that private equity accounts for approximately 10% of the total Endowment portfolio and that the commitment pace for private equity is approximately \$100 million each year. The private equity portfolio is diversified by both sector and geography. Mr. Mike Leifeste reported that returns on real estate had been good in 2016 and his belief that returns will be lower in 2017 due to simple supply/demand dynamics. There exists an excess supply of quality multi-family residential properties which should present a drag on performance in that sector; however, the balance of the commercial real estate market is relatively supply/demand neutral. The long-term nature of real estate investing requires a need to underwrite to future trends such as urbanization, water conservation, smart buildings, an aging population, and so forth.

Mr. Ballard presented an overview of the SWIFT portfolio. The portfolio value as of September 30, 2016 was approximately \$1.94 billion and remains very liquid. He reported that the Water Development Board withdrew from the fund approximately \$108 million in 2015, \$75 million in 2016, and is expected to draw approximately \$180 million in October of 2017. The estimated portfolio performance of the SWIFT for the calendar year ending December 31, 2016 is approximately 6.47%. Mr. Ballard reported that the SWIFT was meeting its investment objectives.

Mr. Ballard reviewed the TESTIF portfolio and reported that it was performing as designed by outperforming the Treasury Pool and preserving its purchasing power. The portfolio has produced an annualized return from inception through November of approximately 1.75%.

#### **Discussion of Next Meeting and Agenda Items**

Comptroller Hegar suggested that the next meeting would be scheduled sometime around March 2017. No future agenda items were suggested.

#### **Public Comment**

None.

#### **Adjourn**

The meeting adjourned at 1:59 p.m.