

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT  
ADVISORY COMMITTEE  
Friday, November 2, 2018  
*Minutes***

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Friday, November 2, 2018 at 10:00 a.m. in Room 320, Rusk State Office Building, 208 E. 10<sup>th</sup> Street, Austin, Texas.

**Committee Members Present**

Stuart Ford, Chairman; Noe Hinojosa; Hon. James Teal; Hon. Dan Gattis; Mr. Reed Hurley; Mr. Ted Matthews; and Hon. Mark Beachamp.

**Committee Members Absent**

Mr. Stephen Bowerman, Mr. Fred Greene, Hon. Byron Underwood and Hon. Ben Zeller.

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

Paul Ballard, Chief Executive Officer and Chief Investment Officer; Danny Sachnowitz, Deputy Chief Investment Officer; Frank Zahn, Chief Financial Officer; Marianne S. Dwight, General Counsel; Genoveva Minjares, Deputy Chief Financial Officer; Laura Montoya, Chief Operations Officer; Jorge de LaFuente, Director of Operational Due Diligence; Patrick Jue, Operational Investment Analyst; Chad Turner, Risk Manager; Adam Levine, Risk Strategist; Nora Arredondo, Program Specialist; and Susie Knight, Program Specialist.

**Additional Participants Present**

Lori Mills and Alex Nixon, Asset Consulting Group (“ACG”).

**Call to Order**

Chairman Stuart Ford declared that a quorum was present and called the meeting to order at 10:05 a.m.

**Approval of Minutes of March 29, 2018 meeting (Tab 1)**

Chairman Ford called for a motion to accept the minutes from the March 29, 2018 meeting.

*A motion to approve the March 29, 2018 meeting minutes was made by Judge Dan Gattis. The motion was seconded by Commissioner Mark Beauchamp and unanimously approved by the Committee.*

**Capital Markets Overview and Investment Performance Review for the Quarter Ending June 30, 2018 and Related Matters (Tab 2)**

Ms. Lori Mills of ACG reviewed market returns for different asset classes. She reported that for the most part, September provided positive returns and markets seemed to be rebounding. However, in October the equity markets were down anywhere from 7% - 11%, almost erasing the positive performance from the first nine months, which equated to almost \$5 trillion of market value. The only major equity asset class that was positive through the end of October was the U.S. large cap markets, which was up approximately 3%. Ms. Mills reviewed the market returns for the ten year period ending September 30, 2018. Most of the sectors

experienced positive returns even with the downturn that began in 2008. She reported that in late 2009 unemployment was as high as 10% and currently sits at 3.7%. Overall, the U.S. economy is demonstrating modest growth and stability. ACG expects domestic economic growth to continue at a modest, slow rate.

Mr. Alex Nixon of ACG summarized the investment performance of the portfolio for the quarter ending June 30, 2018. He explained that the objective of the portfolio is to provide predictable and stable distributions. The total portfolio generated a higher return with slightly higher risk compared to the endowment policy benchmark over the last five years. Relative to broad market benchmarks, the portfolio generated 97% of the return with 47% of the risk. The annualized return for the total portfolio was 6.60%, while the endowment policy portfolio produced an annualized return of 5.90%. The portfolio slightly underperformed the endowment policy benchmark over the past year, but continued to outperform significantly over the longer-term trailing three and five year periods. Mr. Nixon reported that the fixed income portion of the portfolio outperformed its benchmark over the trailing one, three and five year periods. Equity strategies trailed their benchmark over the past year, but posted positive excess returns above their benchmark over the three and five year periods. Real assets continued to demonstrate strong relative results longer term, annualizing 1.26% of outperformance over the trailing five year period.

### **Update on Revisions to Endowment Investment Policy (Tab 3)**

Mr. Paul Ballard reported that some minor modifications were made to the asset allocation targets contained in the investment policy. Mr. Nixon of ACG reviewed the asset allocation analysis and model behind Tab 3 and he explained that this change is expected to slightly increase the return and decrease risk. Initially, the allocation to commodities was to serve as an inflation hedge and ACG believes the same goal is achievable with less price volatility and more consistent return through investments in real estate.

### **Endowment Portfolio Update and Related Matters (Tab 4)**

Mr. Ballard presented an overview of the endowment portfolio and reported that it was in compliance with the asset allocation and investment policies. He reported that as of June, 30, 2018 the portfolio value was approximately \$2.55 billion. The portfolio produced a 1.3% return for the quarter, exceeding its policy benchmark by 0.21%. He recapped the executive summary behind Tab 4 and reported that the portfolio was performing as expected. For the trailing one-year period, the portfolio returned 8.0% and the best performing asset classes were Private Equity (12.8%), Real Estate (9.5%) and Private Debt (9.2%).

Mr. Ballard reviewed the performance summary charts and explained that in the second quarter of 2018, the top performing strategies were Equities, Alternative Fixed Income and Real Estate. He reviewed the asset allocation summary chart, which demonstrates how the portfolio was positioned relative to its allocation targets. He noted that the reason the Global Fixed Income asset class was below its target was because of the \$70 million distribution made in April which comes from this class, but that condition is temporary.

Mr. Ballard reviewed each asset class and the various investment strategies utilized to diversify returns within the portfolio. He explained which asset classes were overweight or underweight and how that related to the target allocations and returns. He reviewed the portfolio characteristics and stated that the portfolio was sufficiently liquid, is positioned opportunistically, and is extremely diversified. Mr. Ballard explained that the portfolio is put through multiple stress test scenarios and that its construction has proven to be resilient. The objective continues to be consistency of performance with downside protection. He reported that the portfolio was performing in line with expectations, given the current economic environment. Mr. Ballard reported that the portfolio produced a return of 1.3% for July and 0.3% for August, bringing the year to date return to approximately 3.8%.

### **Discussion of Annual Distribution (Tab 5)**

Mr. Paul Ballard reported that based on the revised rule, the estimated distribution that will be made by April 1, 2019 is approximately \$72 million, representing an approximate \$3 million, or 4.3% increase over the 2018 distribution. The distribution calculation is based on 3% of the 20-quarter moving average value of the Trust as of June 30, 2018. He said the final calculation will be based on the 20-quarters ending December 31, 2018. He explained that we are meeting our objective of growing the distribution at the rate of inflation. The expected actual distribution should not differ greatly from the \$72 million estimate because the calculation is based on a long-term average and 18 of the 20-quarter values are already known.

Mr. Ballard reviewed the “Corpus vs. Market Value” chart behind Tab 5. He explained that at the end of the third quarter of 2018, the market value of the Trust was approximately \$2.6 billion and the expected inflation adjusted corpus value was approximately \$2.4 billion. He reported that total distributions to date were approximately \$958 million as detailed in the report at Tab 5. Mr. Ballard stated that the Committee will decide on the amount of next year’s distribution at its next meeting.

Mr. Danny Sachnowitz reviewed the 2017 year end Tobacco expense summary handout chart

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

Committee members will be contacted to determine the best date in March for the next meeting, when a vote on the annual distribution will be taken.

### **Public Comment**

Judge Dan Gattis announced he would not be running for re-election and this would be his last meeting. The Texas Conference of Urban Counties would be appointing his successor.

### **Adjourn**

*A motion for adjournment was made by Mr. Noe Hinojosa. The motion was seconded by Mr. Reed Hurley and unanimously approved. Chairman Stuart Ford adjourned the meeting at 12:04 p.m.*