

**COMPTROLLER'S  
INVESTMENT ADVISORY BOARD MEETING  
Thursday, April 10, 2008  
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, April 10, 2008 at the LBJ State Office Building, 111 E. 17<sup>th</sup> Street, Room 114, Austin, Texas.

**Board Members Present**

Comptroller Susan Combs; Steve Strake; Adolpho Telles; and Scott Wise.

**Board Members Present via Teleconference**

Laurie Dotter and Jim Hille.

**Board Member Absent**

Tucker Bridwell.

**Comptroller of Public Accounts Staff Present**

Martin Hubert, Deputy Comptroller.

**Texas Treasury Safekeeping Trust Company ("TTSTC") 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; Dan McNeil, Compliance Officer; Byron Beasley, Private Markets Manager; J. Germenis, Public Markets Manager; Lalo Torres, Investment Analyst; Kathy Buelteel, Program Specialist; Nora Arredondo, Special Projects Coordinator; and Laura Montoya, Communications Manager.

**Others**

Tom Margulis, Asset Consulting Group ("ACG"); Steven Pines and Amanda Golightly, Northern Trust; Mike O'Brien and Angela Dawson, Padgett Stratemann; and Chris Murphy, McLagan Partners.

**Call to Order**

Comptroller Combs declared that a quorum was present and called the meeting to order at 10:08 a.m. Comptroller Combs stated that because of extraordinary weather conditions, two board members were unable to attend but would be participating via teleconference (see § 551.125(b)(3), Texas Government Code). Mr. Jim Hille and Ms. Laurie Dotter joined the meeting via teleconference.

**Approval of Minutes of December 6, 2007 Meeting (Tab 1)**

Mr. Adolpho Telles requested that the minutes be amended to reflect that the Board had an extensive discussion on risk management prior to recommending approval of the revised endowment investment policy with the provision that a risk management platform be put in place in calendar year 2008.

*Mr. Scott Wise made a motion to accept and approve the minutes from the December 6, 2007 Board meeting as amended by Mr. Telles. Motion was seconded by Mr. Steve Strake and unanimously approved by the Board.*

### **Economic Update (Tab 2)**

Mr. Tom Margulis of ACG presented an economic update and reviewed the material behind tab 2. Mr. Margulis reported that during the first quarter of 2008 all financial markets were down with the exception of high quality U.S. treasury securities. ACG expects the Federal Reserve (the “Fed”) to continue to ease monetary policy and lower interest rates by ¼ to ½ percent. Mr. Margulis believes that the weakness in the housing market is still an unknown. Overall, the economy grew by 0.6% in the first quarter of 2008 and ACG believes economic growth is expected to continue but at a slow pace.

Mr. Margulis reviewed ACG asset class relative rankings as of first quarter 2008. ACG believes international and emerging markets will become more negative and U.S. equity markets will become more favorable followed by European markets. ACG remains positive on alternative investments believing that alternative investments reduce risk to the portfolio. He stated that ACG expects market volatility to continue. The portfolio is well positioned and diversified to take advantage of this distressed market cycle.

### **Endowment Portfolio Update (Tab 3)**

Mr. Paul Ballard presented the Board an overview of the endowment portfolio and reported that the portfolio was in compliance with the investment policy. He reviewed the asset allocations as of December 31, 2007 and reported that the portfolio was in alignment with investment targets. The board recommended and the Comptroller adopted a new asset allocation policy in December which went into effect at the end of December 2007. Mr. Ballard reported that the Trust Company has issued a request for proposal (“RFP”) for an active global real estate securities manager. The Board discussed leverage in the real estate portfolio. Mr. Leifeste stated that the portfolio had approximately 60% leverage, which was mostly in enhanced return investments.

Next, Mr. Danny Sachnowitz discussed the private equity and hedge fund portfolios. He discussed the portfolio’s tactical plan and reviewed the Private Markets handout, which illustrated private equity, enhanced real estate and stable real estate allocation targets and commitments. Ms. Laurie Dotter discussed real estate leverage and recommended that leverage levels be closely monitored.

### **Update on Risk Management System (Tab 4, handout)**

Mr. Ballard reviewed the Risk Management handout and discussed the characteristics and expectations of a risk management system. He emphasized the importance of a risk management system to improve diversification, expand investment opportunities and improve risk-adjusted returns. During the first quarter of 2008, the Trust Company assessed risk management systems and selected the RiskData FoFix System, which was originally designed for managing fund of hedge fund portfolios. It is a returns-based system and information is exported monthly into the system. The system was installed in April 2008.

### **Review of Treasury Pool (Tab 5)**

Mr. Mike Samples reviewed the portfolio asset summary as of February 29, 2008 and stated that the value of the Treasury Pool was approximately \$25 billion. He reviewed Treasury Pool yields relative to Federal Funds rates through March 2008 and also explained the maturity structure of the Pool and that it was well positioned with an expectation that the Federal Reserve would be lowering interest rates. Mr. Samples noted that the portfolio had no exposure to Bear Stearns. Mr. Samples reviewed the unemployment

signals and in his opinion it is no longer a question as to whether the economy was going into a recession, but instead the question is for how long. He believes the degree of recession will be relatively mild.

Next, Mr. Samples reviewed comparative benchmark yields and stated that Treasury Pool remained competitive. Mr. Samples discussed a Treasury Pool benchmark and stated that since the Treasury Pool distributes yield, the benchmark should be yield based. He recommended a custom benchmark comprised of a five year laddered treasury portfolio yield (30%) combined with a fed funds yield (70%).

#### **Endowment Funds Investment Performance for the Quarter Ending December 31, 2007, Phase In of Revised Asset Allocation Policy Benchmark and Related Matters (Tab 6)**

Mr. Steve Pines of Northern Trust reviewed the investment performance of the endowment funds for the period ending December 31, 2007. Mr. Pines reviewed TTSTC returns versus other public funds and endowments with values greater than \$1 billion that are tracked in the Northern Trust database. He also reviewed Trust Company returns versus Wilshire's Trust Universe Comparison Service ("TUCS"). The TTSTC Total Plan performed in line with the policy benchmark. Mr. Pines reported the TTSTC plan was down approximately 1.5% for the fourth quarter of 2007 and had produced an annualized net return of approximately 9.0% since inception.

Next, Mr. Sachnowitz reviewed the Asset Allocation Evolution report behind tab 6. He reviewed previous policy targets and the phase-in of asset allocation targets. Mr. Sachnowitz explained that target allocations would be phased in, since private equity and real estate must be deployed systematically over time, the structure should be fully funded by 2012.

#### **Discussion and Review of Incentive Compensation Plan (Tab 7 and handout)**

Mr. Ballard discussed the proposed incentive compensation program for the Trust Company. He explained that the Trust Company is concerned about the risk of losing its investment professionals to public and private competition. Mr. Ballard introduced Mr. Chris Murphy of McLagan Associates, a compensation consultant who was engaged to conduct a salary survey and review the compensation proposal. Mr. Murphy explained that the incentive compensation plan is designed to reward investment performance in excess of benchmarks. The plans being proposed would promote higher returns and appropriate risk-taking, encourage teamwork and employee retention, increase professionalism, and be self-supporting. Mr. Murphy reviewed the proposal and plan options behind tab 7 and the executive summary handout. Comptroller Combs encouraged the Board to review and think about the information provided and to expect more information from Mr. Ballard and staff before finalization at the next board meeting.

#### **Discussion and Recommendation of Endowment Investment Policy Revisions (Tab 8)**

Mr. Sachnowitz explained that the Endowment Investment Policy had been revised in 2007 to more closely conform to the asset allocation policy adopted in December of 2007. Proposed new revisions would emphasize risk control and monitoring processes related to the endowment portfolios while also improving diversification in an increasingly competitive market. He explained that some investment restrictions were outdated and would work against the objective of controlling risk in the portfolio so they had been eliminated. Mr. Sachnowitz suggested that the Board review the proposed revisions and then vote on the changes at the next board meeting.

**Update on Broker/Dealer List**

Mr. Ballard reported that there were three additions to the broker/dealer list. These broker/dealers met the criteria set forth in the Comptroller's Investment Policy: Fortis Securities, LLC; Jackson Securities, LLC; and RBC Dain Rauscher.

**Discussion of Next Meeting and Agenda Items**

Comptroller Combs asked that the Compensation Incentive Plan Proposal and the Endowment Investment Policy action items be placed first on the June 2008 meeting agenda. The next meeting is tentatively scheduled for June 5, 2008.

**Public Comment**

None

**Adjourn**

Comptroller Combs adjourned the meeting at 2:25 pm.