

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Friday, December 9, 2011
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Friday, December 9, 2011 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, Adolpho Telles and Scott Wise.

Board Members Absent

None.

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; John Wright, Assistant 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; Nora Arredondo, Special Projects Coordinator; Gena Minjares, Director of General Ledger Accounting; Victor Scott, Director of Financial Reporting; Laura Montoya, Director of Administration; Jorge de Lafuente, Investment Accountant; and Brandy Bianco, Graphic Designer.

Additional Participants

Mike O'Brien, Padgett, Stratemann & Co.; George Tarlas, Asset Consulting Group ("ACG"); Rick Pokorny, Northern Trust.

Call to Order

Comptroller Susan Combs declared that a quorum was present and called the meeting to order at 10:06 a.m.

Comptroller Combs read a statement regarding the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that requires municipal advisors to register with the SEC. The temporary ruling resulted in a disagreement over what constitutes a municipal advisor. The Comptroller's office does not believe the usual activities of this board constitute municipal advisory activities and they are working with the Attorney General's office to clarify its application. Comptroller Combs asked the Trust Company's General Counsel, Marianne Dwight, to monitor the board's discussions and to advise them to stop if they began to engage in anything that would be considered municipal advisory activities.

Approval of Minutes of September 8, 2011 Meeting (Tab 1)

Mr. Jim Hille made a motion to accept and approve the minutes of the September 8, 2011 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 and reported that Padgett, Stratemann & Co., issued an unqualified financial audit opinion with respect to the Trust Company for the fiscal year ending August 31, 2011. No audit adjustments were recorded during the audit engagement that indicate deficiencies in the accounting process nor was a management letter issued.

Capital Markets Outlook and Discussion (Tab 2)

Mr. George Tarlas of ACG presented an economic update for the period ending October 31, 2011. He reported that the European debt crisis depressed results initially in peripheral countries such as Greece, Italy, Spain and Portugal, and ultimately depressed the activity in the core economies of Germany and France. He reported that ACG believes the European debt issues will continue to hinder global economic growth for some time. In the U.S., the economy continues its modest recovery. Economic growth was approximately 2%. Unemployment remains high at a rate of approximately 8.5%. Housing prices and sales have stabilized since 2008 and 2009 lows. ACG expects a slow pace growth rate during the next year and they continue to believe that this challenging environment requires investors to be opportunistic and to seek investment managers with the ability to take advantage of changing market conditions.

Mr. Tarlas reviewed the information behind Tab 2 relating to broad market returns and performance for the period ending October 31, 2011. In general, macroeconomic events have been the dominating driving factor in all markets. Investors continue to move back into the relative safety of U.S. government debt. He continued his review of the asset class relative tactical allocation rankings illustrated by the stop-light charts behind Tab 2. He explained a few changes in the tactical outlook for the quarters. Global equity long/short and global private equity went from overweight to neutral.

Economic Outlook and Review of Treasury Pool (Tab 3)

Mr. Mike Samples presented his perspective on economic growth. He reported that the U.S. economic recovery was occurring slower than most had expected. Job growth and the housing market continue to show weaknesses even though prices and sales in the housing market have improved. He explained stock market performance from 2000 to present has averaged a dismal 1.5% annual return which equates to about 11 years of no real return. He referred to that as a lost decade. He reported that the U.S. has not had a robust economy in over a decade. Mr. Samples believes the next 2-3 years will remain stagnant and he does not expect the Federal Reserve to begin raising interest rates until 2015, although most believe it will be 2014. He also stated that current economic growth was approximately 2%.

Mr. Mike Samples reviewed the Treasury Pool portfolio asset summary as of October 31, 2011 and stated that the value of the Pool was approximately \$23.6 billion and had \$47 million in unrealized gains. The net yield as of October 31, 2011 was approximately 0.55%. He stated his team was seeking options to add a few more basis points to the pool as they replaced maturing assets. Mr. Samples reviewed the charts behind Tab 3 and noted that U.S. Treasury securities now account for approximately 66% of the portfolio. He reviewed comparative benchmark yields and stated that the yield on the Treasury Pool exceeded most of its benchmarks but was slightly lagging its custom benchmark for the quarter and the twelve month period.

Comptroller Combs briefly reviewed economic indicators demonstrating that the state's economy was healthy. She reported that sales tax collections had steadily increased over the last twenty months and oil and gas production tax collections were significantly higher than this same time last year. The Comptroller also stated that 93% of unemployment had been recaptured and \$1.1 billion had been added to the Rainy Day Fund. Overall, Texas provided a healthier economic growth environment than most of the country.

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. As of October 31, 2011 the portfolio value was approximately \$3.1 billion and was in alignment with its asset allocation targets. Mr. Ballard and Mr. Sachnowitz discussed the portfolio's liquidity profile and pointed out that the portfolio remained very liquid. Mr. Sachnowitz compared the actual vs. target asset allocations as of the end of the second quarter of 2011 and as of October 31, 2011, which conformed to the newly adopted asset allocation policy. He noted that the asset classes were currently very near their target ranges.

Mr. Sachnowitz continued the review of the various asset strategies and the portfolio diversity. He and Mr. Ballard reviewed each asset class and informed the Board of any new managers and any terminating relationships associated with each sector. Mr. Sachnowitz explained how the portfolio performed relative to its benchmark. He also reported that the portfolio performance was in line with expectations, given the current economic conditions. Mr. Ballard explained the stress test scenarios as they relate to performance in a crisis relative to policy portfolio and absolute numbers. He reviewed the policy compliance checklist demonstrating that the portfolio was in compliance with the investment policy. Mr. Sachnowitz reported that the portfolio's VaR ("Value at Risk") was well below that of a more traditional balanced institutional portfolio and this low risk profile had been particularly beneficial this quarter.

Endowment Funds Investment Performance Review for the Quarter Ending September 30, 2011 and Related Matters (Tab 5)

Mr. Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending September 30, 2011. The portfolio return was approximately -6.41% for the quarter. The sectors that outperformed their benchmarks were enhanced return and market return. Overall the portfolio outperformed the policy benchmark for the quarter by approximately 2.3%.

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 tracked in the Northern Trust database. The portfolio experienced an overall positive result while assuming less risk than its peers. The portfolio produced a Sharpe ratio greater than its benchmark for the one and two-year periods.

Mr. Pokorny reported that in October, while in an up market, the portfolio was up at approximately 3.05% and the benchmark was approximately 3.00%. Comparatively, the portfolio outperformed its benchmark in an up and down market.

Discussion of Next Meeting and Agenda Items

The next meeting will be scheduled for March, 2012. No new agenda items.

Public Comment

None.

Adjourn

The meeting adjourned at 1:49 p.m.