

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Wednesday, December 18, 2013
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Monday, December 17, 2012 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members ("The Board") 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, Deputy General Counsel; Michael Anderson, Compliance Officer; Wai Yee Cheng, Portfolio Manager; Byron Beasley, Private Markets Manager; J. Germenis, Public Markets Manager; Michael Leifeste, Real Estate Portfolio Manager; Lalo Torres, Investment Analyst; Adam Levine, Portfolio Manager; Chad Turner, Investment Analysts; Babatunde Oguntade, Investment Analyst; Anca Ion, Portfolio Manager; Nora Arredondo, Special Projects Coordinator; Genoveva Minjares, Director of General Ledger Accounting; Elizabeth Moreno, Accounting Supervisor; Victor Scott, Director of Financial Reporting; Laura Montoya, Director of Administration; Jorge de Lafuente, Investment Analyst; Brandy Bianco, Graphic Designer and Corrine Hall, CAPCO Administrator.

Additional Participants

Angela Dawson, Padgett, Stratemann & Co., LLP; Joe Nugent and Scott Solsvig, Asset Consulting Group ("ACG"); and Pam Sliman, State Street.

Call to Order

Comptroller Susan Combs declared that a quorum was present and called the meeting to order at 10:04 a.m.

Approval of Minutes of September 11, 2013 Meeting (Tab 1)

Mr. Jim Hille made a motion to accept and approve the minutes of the September 11, 2013 Comptroller's Investment Advisory Board meeting. The motion was seconded by Ms. Laurie Dotter and unanimously approved by the Board

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

Ms. Angela Dawson 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, 2013. Ms. Dawson 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 presented his outlook on the economy. He reported that the Federal Reserve ("the Fed") could be deciding today whether to begin tapering its quantitative easing program; however, they are committed to holding rates near zero as long as the unemployment rate remains above 6.5%. The unemployment rate currently stands at 7%. Mr. Samples explained that the labor market has had 0% growth in the last five years, 1-1.5% growth in the 90's and 1.5-2% growth in the 70's and 80's. Although the unemployment rate made some gains, it was not enough to demonstrate significant improvement in the unemployment outlook. He reported promising housing, auto and retail sales. He reported that the U.S. economy continues to grow at a moderate rate and he believes economic growth will be between 1.5% and 2%. Mr. Samples believes deflation is not an issue at this time but believes inflation remains a concern.

Mr. Samples reviewed the Treasury Pool portfolio summary as of November 30, 2013 and stated that the value of the Pool was approximately \$28.5 billion with an approximate net yield of 0.38%, up slightly from the previous quarter. Mr. Samples reviewed the asset allocation and maturity structure of the portfolio. He expects interest rates to remain low and does not currently believe the Fed will begin to raise rates for 2 to 3 years.

Review and Recommendation of Investment Policy for the State Water Implementation Fund of Texas "SWIFT" (Tab 3)

Mr. Paul Ballard explained that in November, Texas voters approved a \$2 billion appropriation from the state's Economic Stabilization Fund to the newly created SWIFT. The statute establishing the SWIFT specifies that the Trust Company will manage the fund on behalf of the Texas Water Development Board ("WDB"). The goal is to provide distributions from the fund that will stimulate approximately \$27 billion in Texas water supply projects over the next fifty years. The WDB will work with its financial advisors to develop a financial model to achieve that objective. That model will specify the return and cash flows needed from the SWIFT. The investment policy being proposed is for the interim period until the WDB adopts a permanent financial model. The Phase I investment policy has a target rate of return equivalent to the rate of inflation (1.5% to 2%). Implementation will involve moving funds from the Treasury Pool into a diversified mix of lower to medium volatility, and predominantly liquid credit-related strategies designed to earn the rate of inflation after expenses. Unlike an endowment, the SWIFT is not expected to preserve corpus. Its corpus will be drawn down over time and, at some point in the future, the funds will flow back into the SWIFT. The Trust Company's job will be to deliver the return and liquidity necessary for the model to work. A draft of the recommended Phase I investment policy for the SWIFT was reviewed.

Mr. Steve Strake made a motion to recommend to the Comptroller the adoption of Phase I of the Investment Policy for the State Water Implementation Fund for Texas. The motion was seconded by Mr. Scott Wise and unanimously approved by the board.

Lunch Speaker (Tab 4)

Mr. Howard Marks, Chairman of OakTree Capital Management spoke on the current investment environment. He explained that in his opinion the world is in an economic recovery; however, the recovery is half-hearted. Investors should experience lower returns and elevated risks.

Capital Markets Outlook and Discussion (Tab 5)

Mr. Joe Nugent presented an update on the capital markets. He reviewed investment performance for the period ending November 30, 2013 and reported that U. S. stocks closed November with eight consecutive weekly gains, driving the S&P 500 and the Dow Jones Industrial Average to new record highs. U.S. small caps posted strong gains; however bond and emerging markets showed negative returns.

Mr. Scott Solsvig reviewed Asset Consulting Group's asset class relative rankings as of the fourth quarter of 2013. He reported two changes to the tactical outlook for the quarter. Emerging market fixed income and non-U.S. developed equity asset classes were changed from neutral to overweight. ACG and the Trust Company continue to focus on portfolio diversification, maintaining and/or enhancing exposure to fast growing regions such as emerging markets and maintaining diversified global fixed income exposure with a focus on real yields.

Endowment Portfolio Update and Related Matters (Tab 6)

Mr. Paul Ballard presented the Board an overview of the endowment portfolio and reported that it was in compliance with its investment policy. As of September 30, 2013 the portfolio value was approximately \$3.27 billion. He reviewed each asset class and the various investment strategies that represent the portfolio's diversification. Mr. Ballard and Mr. Sachnowitz discussed new fund managers and those from whom capital was being redeemed. Mr. Ballard stated that the private debt portion of the portfolio had done very well. He explained the stress test scenarios as they relate to performance in a crisis relative to the policy portfolio.

Endowment Funds Investment Performance Review for the Quarter Ending September 30, 2013 and Related Matters (Tab 7)

Ms. Pam Sliman reviewed the investment performance of the endowment funds for the period ending September 30, 2013. She reported that the portfolio had produced a return of 3.76% for the quarter, outperforming its benchmark by 0.40%. The trailing one year return was approximately 8.34%, which exceeded its policy benchmark of 7.87%. The performance of the different sectors of the portfolio was reviewed in further detail. Each sector produced positive returns during the quarter. The portfolio produced a Sharpe ratio greater than its benchmark.

Discussion of Next Meeting and Agenda Items

The next meeting will be scheduled in March. Nora Arredondo will be in contact with the board.

Public Comment

None.

Adjourn

The meeting adjourned at 1:58 p.m.