

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Tuesday July 14, 2015
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Tuesday, July 14, 2015 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members ("The Board") Present

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

Board Members Absent

Steve Strake.

Comptroller of Public Accounts Staff Present

Mike Reissig, Deputy Comptroller; Phillip Ashley, Associate Deputy Comptroller; and Robin Smith, Director of Internal Audit.

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; Whitney Blanton, Assistant Deputy General Counsel; Michael Anderson, Compliance Officer; Byron Beasley, Portfolio Manager; J. Germenis, Portfolio Manager; Michael Leifeste, Portfolio Manager; Ruchit Shah, Portfolio Manager; Lalo Torres, Portfolio Manager; Jorge de Lafuente, Director of Operational Due Diligence; Adam Levine, Risk Strategist; Chad Turner, Investment Analysts; Anca Ion, Deputy Director of Internal Investments; Gena Minjares, Director of General Ledger Accounting; Laura Montoya, Director of Administration; Nora Arredondo, Special Projects Coordinator; Brandy Bianco, Graphic/Web Designer; and Corrine Hall, CAPCO Administrator.

Additional Participants

Lori Mills, Asset Consulting Group ("ACG"); and Robert Moles, State Street.

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 December 11, 2014 Meeting (Tab 1)

Mr. Tucker Bridwell made a motion to accept and approve the minutes of the December 11, 2014 Comptroller's Investment Advisory Board meeting. The motion was seconded by Ms. Laurie Doter and unanimously approved by the Board

Legislative Update

Comptroller Glenn Hegar reported on two matters decided during the 84th legislative session. The first matter was the assignment of a portion of the Economic Stabilization Fund (“ESF”) that granted the Comptroller authority to invest a portion of the ESF to earn a higher return than can be earned under the existing Treasury Pool investment policy. The second matter relates to the Emerging Technology Fund (“ETF”). The ETF was previously under the domain of the Governor’s office but will now under the Comptroller’s office. The funds are expected to be transferred to the Trust Company by September 1, 2015.

Annual Review of Endowment Investment Policy (Tab 2)

Mr. Paul Ballard reported that the changes being recommended to the endowment investment policy are mainly perfunctory. The Trust Company is recommending the investment performance benchmarks for private debt and equity be changed to better reflect investment opportunity sets. He stated that the DJ-UBS Commodity Index had been purchased by Bloomberg resulting in a name change. A change to the fund’s liquidity requirements was also recommended, which would ensure adequate liquidity for distributions, capital calls, and rebalancing but allows for the portfolio to be slightly less liquid.

A motion was made by Mr. Jim Hille to recommend the proposed revisions to the Endowment Investment Policy as presented by the Trust Company to Comptroller Glenn Hegar. The motion was seconded by Mr. Tucker Bridwell and unanimously approved by the board.

Review and Recommended Revisions to the State Water Implementation Fund for Texas (“SWIFT”) Investment Policy (Tab 3)

Mr. Ballard explained that we now have sufficient information from the Texas Water Development Board to develop asset allocation targets. Ms. Lori Mills reviewed the recommended asset allocation targets for the SWIFT detailed in the draft behind Tab 3. She explained ACG’s approach using key inputs to the asset allocation model, developing a simulation analysis and in each asset class a custom distribution analysis. Ms. Mills reviewed various input assumptions to some of the asset classes included in the SWIFT and the simulated distributions that corresponded. The Trust Company recommended a few changes to asset allocation targets and benchmarks and included additional benchmark descriptions.

A motion was made by Mr. Tucker Bridwell to recommend the proposed revisions to the SWIFT Investment Policy as presented by the Trust Company to Comptroller Glenn Hegar. The motion was seconded by Ms. Laurie Dotter and unanimously approved by the board.

Recommended Investment Policy for the Texas Economic Stabilization Investment Fund “TE-StIF” (Tab 4)

Mr. Ballard explained that the Economic Stabilization Fund (“ESF”) Investment Policy is new and that its investment objective is preserving the purchasing power of this component of the ESF. The target return is the rate of inflation. Ms. Lori Mills reviewed asset allocation targets and explained ACG’s 2015 capital market assumptions for asset classes included in the analysis. She reviewed the asset allocation construction process and the portfolio allocation (strategic target) details. The new TE-STIF investment policy is presented behind Tab 4.

A motion was made by Ms. Laurie Dotter to recommend the proposed new Texas Economic Stabilization Investment Fund as presented by the Trust Company to Comptroller Glenn Hegar. The motion was seconded by Mr. Adolpho Telles and unanimously approved by the board.

Economic Outlook, Investment and Review of Treasury Pool (Tab 5)

Mr. Mike Samples reported on current economic conditions. He explained Bridgewater's analysis of "The End of the Monetary Super-Cycle". He explained that the debt super cycle cannot keep expanding, that there are limits but no one knows what the limits are. Mr. Samples reviewed the U.S. Treasury debt chart which illustrates debt held by public vs. the debt held by the Fed. He also reviewed the real and nominal gross domestic product charts which illustrate much lower growth now than ten years ago.

Mr. Samples presented a summary of the Treasury Pool as of May 31, 2015. He reported that the pool was producing a net yield of approximately 0.43% and had a market value of approximately \$40.8 billion, and a AAA rating. Standard & Poor's require no more than 30-35% of assets be invested for more than a year unless they are AAA rated. He discussed the fact that the Treasury Pool had an appropriately broader investment opportunity set than cash-equivalent money market funds including the ability to extend duration. Active management decisions to extend duration have successfully added to the Treasury Pool's returns in the past.

Mr. Samples does not expect the Fed to raise interest rates anytime soon and when they do, he does not believe it will be more than .5%. He and his team remain focused on seeking higher relative yields.

Lunch Speaker – Rick Rieder, CIO Fundamental Fixed Income, BlackRock (Tab 7 – Handout)

Mr. Rick Rieder Managing Director and CIO of Fundamental Fixed Income at BlackRock, Co-head of Americas Fixed Income and a member of the Executive Committee of the firm-wide Alpha Strategy business, a member of BlackRock's Global Operating Committee and Chairman of the BlackRock Investment Council. BlackRock is one of the largest fixed income managers in the world. Mr. Rieder presented his views on the economic environment. He reviewed the various charts included in his handout. He believes the Fed may start to raise long term interest rates in September but rates will remain low and rise gradually. Mr. Rieder was optimistic about the U.S. economy and stated that European economic growth was improving.

Capital Markets Outlook and Discussion (Tab 6)

Ms. Lori Mills presented an update on the capital markets. For the period ending March 31, 2015, she reported that all asset classes were positive with the exception of the commodities market, where crude oil was down approximately 15%. For the period ending June 30, 2015, the equity markets continued to show positive performance; however, the bond markets were demonstrating a downturn and had fallen into negative territory. Commodities remained down but showed some recovery over the past three months. Overall, Mr. Mills reported that the outlook for the U.S. economy improved in June as business activity and job growth indicated a rebound during the second quarter. Increases in employment and rising home prices led to the largest gain in consumer spending in almost six years. ACG believes the Fed may start raising interest rates towards the end of 2015.

Ms. Mills reported that for the month, global markets declined with developed markets outperforming emerging markets. European markets declined amid fears that Greece's debt situation could spread to other debt laden countries in the region.

Ms. Mills reviewed Asset Consulting Group's asset class relative rankings for the second quarter of 2015. She reported that there were no changes to the tactical outlook for the quarter. 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 and SWIFT Portfolio Updates and Related Matters (Tab 8)

Mr. Ballard reviewed the endowment portfolio and reported that, with the exception of liquidity restrictions, it was in compliance with its investment policy. As of March 31, 2015 the portfolio value was approximately \$3.72 billion. He reviewed the portfolio's liquidity and reported that the portfolio was approximately 3% outside policy limits but with the adoption of the new policy, this will no longer be the case. He reviewed each asset class and the various investment strategies that represent the portfolio's diversification. He reported that alternative fixed income and hedged equity strategies each had produced an approximate 4% return. Mr. Ballard informed the Board of a commitment made to Amherst for a joint venture between Amherst Asset Management and BNY Mellon Asset Management which was designed as a vehicle for Amherst to manage various real estate and real estate credit strategies. This commitment would entitle the Endowment and SWIFT to a 10% participation in the profits of the joint venture. Current investments with Amherst are performing at or above expectations.

Mr. Ballard and Mr. Sachnowitz discussed new fund commitments added to various asset classes as well as funds that are being redeemed. Mr. Ballard explained the stress test scenarios performed on the portfolio. He compared the expected performance of the total portfolio in a crisis relative to a portfolio allocated 65% to global equities and 35% to global fixed income. The policy portfolio is expected to protect value better than a traditional 65/35 stock/bond portfolio blend.

Next, Mr. Paul Ballard presented an overview of the SWIFT investment fund which is divided into three investment strategies: Treasury Pool/cash, fixed income, equity and real assets. He reported that the portfolio value as of March 31, 2015 was approximately \$2.003 billion but at the time of this meeting stands at approximately \$2.035 billion. It is anticipated that after the first draw the portfolio will be taken below \$2 billion. The fund is sufficiently liquid to meet its first draw in the fall. Mr. Ballard reviewed the various asset classes and managers for the quarter ending March 31, 2015. He informed the Board of new fundings and commitments. He reported that for the quarter and one year periods, the SWIFT met its performance objective.

Investment Performance Review for the Quarter Ending March 31, 2015 and Related Matters (Tab 9)

Mr. Robert Moles reviewed the investment performance of the endowment funds and SWIFT for the period ending March 31, 2015. He reported that the endowment portfolio produced a return of approximately 2.11% for the quarter, outperforming the policy benchmark by 82 basis points. The endowment portfolio has outperformed the trailing one, two, three and five year policy benchmarks. For the quarter, each asset class outperformed their benchmarks with the exception of real assets.

Ms. Moles reviewed the investment performance of the SWIFT for the period ending March 31, 2015 and reported that the portfolio outperformed its policy benchmark and met its performance objective.

Broker/Dealer Update (Tab 10)

Mr. Ballard presented the Board a list of approved broker/dealers behind Tab 10. He reported that no one was removed for cause, some simply did not reapply.

Discussion of Next Meeting and Agenda Items

Comptroller Hegar announced that the next meeting would be scheduled for September 29th or 30th and that Nora Arredondo would be in contact with board members to find a time that worked for everyone. No future agenda items were suggested.

Public Comment

None.

Adjourn

The meeting adjourned at 2:19 p.m.