COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Tuesday, October 24, 2017
Minutes

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Tuesday, October 24, 2017, at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members ("The Board") Present

Laurie Dotter, Jim Hille, Steve Strake, and Adolpho Telles.

Board Members Absent

Tucker Bridwell and Scott Wise.

Comptroller of Public Accounts Staff Present

Mike Reissig, Deputy Comptroller and Phillip Ashley, Associate 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; Anca Ion, Deputy Director of Internal Investments; Marianne S. Dwight, General Counsel; Mike Leifeste, Portfolio Manager; Byron Beasley, Portfolio Manager; Lalo Torres, Portfolio Manager; Jyoti Gupta, Portfolio Manager; Adam Levine, Risk Strategist; Nora Arredondo, Special Projects Coordinator; Brandy Bianco, Project Manager; Chad Turner, Risk Manager; Yunke Yu, Quantitative Data Analyst; Yunjing An, Quantitative Data Analyst; Corrine Hall, Program Administrator; and Molly Doherty, Paralegal.

Additional Participants

Tom Janisch, Asset Consulting Group ("ACG").

Call to Order

Deputy Comptroller Mike Reissig declared that a quorum was present and called the meeting to order at 10:13 a.m.

Approval of Minutes of July 28, 2017 Meeting (Tab 1)

Ms. Laurie Dotter made a motion to accept and approve the minutes of the July 28, 2017 Comptroller's Investment Advisory Board meeting.

The motion was seconded by Mr. Steve Strake and unanimously approved by the Board.

Annual Review and Recommended Revisions to the Endowment and SWIFT Investment Policies (Tab 2)

Mr. Paul Ballard explained the proposed revisions to the Endowment and SWIFT investment policies. Specific to the Endowment investment policy, the allocation range for the Strategic All Asset & Overlays strategy changes from the range of 0%-10%, to 0%-15%. A new Overlay Strategies category with a 3-month T-Bill benchmark is being added to account for a component of the portfolio being designed to produce relatively low, consistently positive returns. It will be funded with a portion of the cash set aside as margin for synthetic exposures to various public markets that are being utilized to improve cash management. In the Endowment Policy, Chapter II, section 2, Performance Expectations, Ms. Laurie Dotter suggested that the word "intends" be replaced with the word "may" when referring to utilizing strategies that invest in assets not included in the benchmark. It was determined that, in Chapter V, section 2-C, requiring the Alternative Fixed Income portfolio to maintain annualized volatility of returns of less than half of the equity index was not necessary since it is also expected to maintain correlation and beta of less than 0.5 to the equity index. The benchmark for Alternative Fixed Income was discussed. Mr. Ballard suggested that staff prepare a presentation on the benchmark for discussion at the January meeting of the Board. During the discussion of the SWIFT investment policy it was noted that cash flows required to support bonds issued by the TWDB was somewhat unpredictable. The Board recommended that the last sentence relating to liquidity expectations behind Chapter III, Section 3, be changed from "may impact fund return expectation" to "will likely impact fund returns."

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

Capital Markets Overview and Investment Performance Review for the Quarter Ending June 30, 2017, and Related Matters (Tab 4)

Mr. Tom Janisch of Asset Consulting Group provided a review of the market environment for the period ending September 30, 2017. He explained that all sectors, with the exception of commodities, experienced positive returns. Equity markets continued to make historical highs. He reported that the U.S. economy appears stable, despite a slow recovery period, and the typical signals for a prolonged downturn are not present. Unemployment continued to remain low and wage growth continued to trail the Federal Reserve's (the "Fed") expectations. Mr. Janisch explained that the Fed continues to work to normalize monetary policy. ACG anticipates that the Fed will raise interest rates again in December. They continue to expect slow and prolonged economic growth in the U.S. Data out of the Eurozone demonstrates comfortable levels of expansion which has caused the Euro to appreciate, may temper inflation, and improve competitiveness. The European Central Bank, however, remains cautious on the sustainability of the recovery. Japan's economy also appears to be on a more sustainable path and inflation remains low. Mr. Janisch reported that emerging markets economies have benefitted from stable global trade dynamics and currency appreciation has helped contain inflation.

In regard to portfolio implications, Mr. Janisch explained that ACG continues to favor equities and real assets over fixed income. They employ actively managed strategies in less efficient asset classes while still utilizing more opportunistic managers when appropriate, and hedged strategies continue to be essential for downside protection. He reported that Trust Company staff and ACG continually monitor and evaluate the portfolio for compliance and strategic objectives.

Next, Mr. Janisch reviewed the total portfolio summary for the period ending June 30, 2017. He reported that total portfolio returns significantly outperformed the Endowment policy benchmark over the past year, contributing to longer-term outperformance over the past three and five years. Relative to broad market benchmarks, the total portfolio has generated 92% of the return with 51% of the risk. He reported that for the quarter ending June 30, 2017, the portfolio produced a positive return of 2.06% compared to 1.63% for the policy benchmark, and an annualized rate of return of 6.70% over the previous five year, compared to 5.71% for the policy benchmark. He explained that each broad asset class (fixed income, equity and real assets) had contributed positively over the one, three and five year periods. Fixed income lagged modestly for the second quarter of 2017 whereas equity and real assets strategies produced positive returns for the same quarter.

Mr. Janisch reported on the performance of the State Water Implementation Fund of Texas ("SWIFT"). He stated that the portfolio generated higher returns with lower risk than the policy and dynamic benchmarks since inception. For the quarter ending June 30, 2017, the portfolio produced a positive return of 1.80%, outperforming its benchmark by 0.26%. The fixed income portion generated a modest return of 0.98%, lagging slightly behind its benchmark return of 1.62%; however, it has produced strong relative results since inception. The equity and real assets broad classes have significantly exceeded their benchmarks for the quarter and since inception. Overall the SWIFT portfolio returns have exceeded the policy and dynamic benchmarks since inception.

Lunch Speaker – Sandeep Bordia, Amherst Capital Management (Tab 5, handout)

Mr. Bordia is a Managing Director and Head of Research and Analytics at Amherst Capital Management. He presented the results of research that supported Amherst's positive outlook for single-family rental properties ("SFR"). SFRs have become an accepted institutional real estate asset class. Institutional ownership of what has previously been an asset class owned and managed by retail investors was rapidly growing. Mr. Bordia explained that the supply of multifamily units has picked up but growth in the supply of single family rental units has not kept pace. The housing demands of Millennials, the fastest growing age group in the U.S. (24yrs – 33yrs), are changing as they begin having children of their own. Typically families with children desire more room, outdoor living space, the availability of public education, and their preference moves from multifamily to single family noting that only10%-15% of multifamily units have three or more bedrooms. Amherst anticipates that the SFR asset class will continue to grow as will market acceptance of institutionally managed single family rental properties.

Economic Outlook, Investment and Review of Treasury Pool (Tab 3)

Mr. Mike Samples reported on current economic conditions and noted that there had been improvement since the last quarter and that year-to-date economic conditions were better than the previous year. The Gross Domestic Product (GDP) is expected to post an annualized positive 2.7% for the quarter. The unemployment rate was at 4.2% and there was a slight uptick in wages. He reported that auto sales, new home sales and existing home sales all lagged during the quarter. Mr. Samples explained that the Fed remains cautious and sensitive to current market conditions in the U.S. and Europe and they are also sensitive to market expectations. Inflation has still not reached 2% and that is also a concern of the Fed. Mr. Samples believes the Fed will likely raise interest rates in December. He believes economic growth will continue at a pace of 1.0% - 2.0% annually.

Mr. Samples presented a summary of the Treasury Pool portfolio as of September 30, 2017. He reported that the portfolio produced a yield of 1.35%, up slightly from the previous quarter, with a market value of approximately $28.8 billion. He noted that the Pool continued to maintain a AAA rating by Standard & Poor's. Commercial paper continued to be the largest exposure in the portfolio, and accounted for approximately 29% of the total. Since the expectation is that future interest rate increases will be nominal and gradual, the Treasury Pool management team expects to maintain an average maturity neutral to its benchmark.

Endowment, SWIFT and TESTIF Portfolio Updates and Related Matters (Tab 6)

Mr. Ballard presented an overview of the Endowment portfolio for the second quarter of 2017 and reported that the portfolio was in compliance with its investment policy. He reported that as of June 30, 2017, the value of the Endowment portfolio was approximately $4 billion. He explained that the portfolio performed as expected. The best performing strategies were public equity (4.3%), hedged equity (3.8%), and stable value real estate (3.5%). Mr. Ballard reviewed the asset allocation summary.

Mr. Lalo Torres reported on global fixed income. He explained that the portfolio's relative underperformance was due to its shorter duration. It carries a 2-3 year duration whereas the duration of its benchmark's is 5-8 years. Performance was enhanced by the higher exposure to credit securities as corporate spreads tightened and investor demand increased.

Ms. Jyoti Gupta discussed the hedged and global public equity portfolios. The global equity portfolio returned 2.8% for the quarter, underperforming its benchmark return of 4.2%. She reported that for the year, its return was 19.3%, which was slightly higher than its benchmark 19.0%. Ms. Gupta explained that the actively managed component of the equity portfolio was comprised primarily of activist managers. Exposure to activists will be reduced as part of a restructuring plan. The hedged equity portfolio returned 3.8% for the quarter, outperforming its benchmark by 2.0%. Hedged Equity contributed 2.6% toward the one-year performance of the total Endowment. Ms. Gupta reported that she met with over thirty managers on her recent due diligence trip to Singapore and Hong Kong in an effort to identify local institutional quality advisors in Asia for possible future inclusion in the portfolio. She stated that other areas of focus will include event driven and healthcare strategies.

Mr. Byron Beasley reviewed the private equity portion of the portfolio. He reported that the private equity portfolio was well diversified as evidenced in the chart on page 21. Market valuations remain high, encouraging managers to sell assets. As a result, distributions currently exceed capital calls and the allocation to private equity remains at 9%, just shy of its 10% target. Mr. Beasley reported on new commitments made in the third quarter which include a commitment to a co-investment fund as discussed at the last board meeting. The private equity portfolio produced a return of 4.3% for the quarter versus its benchmark rate of 3.7%.

Mr. Mike Leifeste reported that no new commitments were made in the real estate portion of the portfolio during the first quarter. Stable value investments produced a return of over 12% for the year. Real assets performance, with the exception of commodities, has led all sectors over the one, three, and five year periods. Mr. Leifeste explained that retail space demand was changing as people do more shopping via e-commerce rather than visiting brick and mortar locations. He added that apartment demand remains solid and there was not much surplus in the supply of housing. The Trust Company has meaningful exposure to single family rentals, senior housing, and apartments.

Mr. Ballard reported that the all asset strategies performed well for the quarter. There were no new commitments in this sector. The single manager in this sector continued to deliver on both an absolute and relative basis.

Mr. Ballard updated the Board on the current performance of the Endowment portfolio. The return for July was 1.3%, and August posted a 0.7% return, bringing the year-to-date performance to 7.7%.

Mr. Ballard presented an overview of the SWIFT portfolio. The portfolio value as of September 30, 2017 was approximately $1.99 billion. For the quarter, the portfolio produced a 1.8% return, outperforming its dynamic benchmark by 0.4% and its policy benchmark by 0.3%. The portfolio is within its asset allocation target ranges. The portfolio's top performing strategies were hedged equity (3.8%), global equity (3.1%) and all asset strategies (3.4%). The portfolio's trailing one year return was 8.8%, exceeding its dynamic and policy benchmarks. Mr. Ballard reported that the portfolio return in July was 0.7% and in August it was 0.6%, bringing the year-to-date approximate return to 5.5%. He stated that the SWIFT was meeting its performance objectives.

Mr. Ballard reviewed the TESTIF portfolio and reported that it was performing as expected. The portfolio value as of August 31, 2017 was approximately $3.2 billion. He explained that the portfolio had earned approximately $84 million more than it would have had it remained exclusively invested in the Treasury Pool. The portfolio remains highly liquid and its performance estimate for September is approximately ten basis points, bringing its year-to-date return to 2.3%.

Discussion of Next Meeting and Agenda Items

Deputy Comptroller Mike Reissig announced that the next meeting will be scheduled for some time in January of 2018. The Board will be contacted to set a date. No future agenda items were suggested.

Public Comment

None.

Adjourn

The meeting adjourned at 2:00 p.m.