

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT  
ADVISORY COMMITTEE  
Friday, October 31, 2008  
*Minutes***

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Friday, October 31, 2008 at 10:00 a.m. in Room 227, Rusk State Office Building, 208 E. 10<sup>th</sup> Street, Austin, Texas.

**Committee Members Present**

Stuart Ford, Chairman; Dan Gattis; Wayne Gent; Jack Harris; Faraz Khan; Joe McComb; and Chuck Norris.

**Committee Members Absent**

Giles Dalby; Roger Galvan; Noe Hinojosa; and Phillip Rivera.

**Texas Treasury Safekeeping Trust Company (“Trust Company”) Staff Members Present**

Paul Ballard, Chief Executive Officer and Chief Investment Officer; Danny Sachnowitz, Deputy Director and Deputy Chief Investment Officer; Frank Zahn, Chief Financial Officer; Marianne S. Dwight, General Counsel; Dan McNeil, Compliance Officer; Byron Beasley, Private Markets Manager; Mike Leifeste, Real Estate Investment Manager; J. Germenis, Manager of Marketable Investments; Nora Arredondo, Special Projects Coordinator; Kathy Bueltel, Program Specialist; Gena Minjares; Audit Liaison; and Oscar Ramirez, Trust Operations Manager.

**Comptroller of Public Accounts (“CPA”) Staff Present**

None.

**Additional Participants Present**

Tom Margulis, Asset Consulting Group (“ACG”); Don Lee, Texas Conference of Urban Counties; Steve Pines, Northern Trust Company; Peggy Belcher and Kim Gold, Department of State Health Services (“DSHS”).

**Call to Order**

Chairman Stuart Ford declared that a quorum was present and called the meeting to order at 10:03 a.m.

**Approval of Minutes (Tab 1)**

*Motion was made by Chuck Norris to approve the March 7, 2008 meeting minutes. Motion was seconded by Joe McComb. Motion carried unanimously.*

**Economic Update (Tab 2)**

Mr. Tom Margulis of ACG reviewed the sequence of economic events from September 7, 2008, when the U.S. Government seized control of Fannie Mae and Freddie Mac, through October 15, 2008 when the Dow dropped over 733 points, the second largest point drop ever. Although volatility exists in every investment sector and it is impossible to time the market, ACG believes there are unprecedented opportunities for long-term investors to find value in the fixed income and equity markets. Mr. Margulis reviewed the information behind Tab 2 and stressed the importance of diversification, rebalancing, and risk management. ACG

believes that 2009 will continue to be a difficult economic environment until credit markets begin to function more normally.

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

Mr. Paul Ballard reviewed the asset and risk allocations as of June 30, 2008 as illustrated in the graphs behind Tab 3 and stated that the Trust Company had implemented a risk management system over the course of the past year. Mr. Danny Sachnowitz explained that the Trust Company has been reducing the equity risk in the portfolio or the market return risk at a measured pace and shifting that exposure to other asset classes in the last year. Mr. Sachnowitz reviewed actual asset allocations versus target asset allocations illustrated on pages 7 and 8.

Mr. Sachnowitz reviewed the phased-in asset allocation targets on page 9 and explained how ACG and the Trust Company ran simulations and models to develop these targets and also had taken into consideration the current economic environment. These targets relate to long term strategies. Mr. Ballard further reviewed the target and current allocations for the various asset classes (fixed income, public equity and alternative strategies) and stated that the portfolio was in compliance with the asset allocation policy. Mr. Sachnowitz concluded the presentation and reviewed the performance returns of the various asset classes.

### **Presentation and Discussion of Investment Performance (Tab 4)**

Mr. Steven Pines of Northern Trust presented current investment performance information as requested by the committee and noted that quarterly and annual rates of return for the portfolio were competitive. The portfolio ranked in the top quintile relative to other plans greater than 1 billion dollars year to date through 9/30/08. The total rate of return was approximately -5.57% for the quarter ending 6/30/08, -13.7% for the quarter ending 9/30/08, and approximately -19.8% as of 10/30/08. The current portfolio market value as of 10/30/08 was approximately \$1.8 billion.

### **Estimate of 2009 Annual Distribution (Tab 5)**

Mr. Ballard stated that the annual distribution amount is calculated as 4.5% of the 20 quarter moving average value of the Trust Account as of the year ending December 31, 2008. Given the current economic conditions and the decline in the portfolio, Mr. Ballard presented various scenarios for the Committee to consider prior to the March meeting. He discussed a possible 10% reduction from the previous year distribution amount. Some committee members expressed concern that the distribution amount should not be less than the previous year's distribution. Mr. Ford asked Mr. Ballard to review the Distribution Stabilization Account ("DSA") concept and purpose. The Committee discussed the possibility of using a portion of the DSA to complete the annual distribution if they decide to distribute the same amount (approximately \$92 million) as last year. The Committee will make a decision at its March meeting.

### **Discussion Regarding the Tobacco Settlement Permanent Trust Account Administration Advisory Committee**

Mr. Don Lee informed the Committee that the Administration Advisory Committee has assumed a more active role and greater commitment to make quorums; therefore, the merger of the two committees is no longer being requested.

### **Update on Ethics Commission Directive (Tab 6)**

Mr. Ford directed the Committee to the letter from the Attorney General's office behind Tab 6 and asked if there were any questions. No questions or discussion ensued.

### **Discussion of Next Meeting and Agenda Items**

Committee members will be contacted to determine the best date for the next meeting in March of 2009.

### **Public Comment**

Mr. Lee encouraged the Committee to send a thank you letter (see Tab 6) to the Hon. Wayne Smith regarding the opinion request on behalf of the Committee to the Attorney General.

Mr. Lee also asked the Committee to consider making the same distribution as last year and to advise their constituents that the following years could be considerably less. This would provide them the opportunity to take expected smaller revenues into account when budgeting for future years.

### **Adjourn**

*Motion was made by Dan Gattis to adjourn. Motion was seconded by Wayne Gent and carried unanimously. Meeting adjourned at 12:40 pm.*