

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT
ADVISORY COMMITTEE
Monday, March 30, 2009
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Monday, March 30, 2009 at 10:00 a.m. in Room 227, Rusk State Office Building, 208 E. 10th Street, Austin, Texas.

Committee Members Present

Stuart Ford, Chairman; Judge Dan Gattis; Judge Wayne Gent; Judge David Silva; Commissioner Roger Galvan; Noe Hinojosa; Faraz Khan; Joe McComb; and Phillip Rivera.

Committee Members Absent

Judge Giles Dalby and Chuck Norris.

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; and Victor Scott, Financial Reporting Manager.

Additional Participants Present

Tom Margulis, Asset Consulting Group (“ACG”); Steve Pines, Northern Trust Company; and Mike O’Brien, Padgett, Stratemann & Co., LLP.

Call to Order

Chairman Stuart Ford declared that a quorum was present and called the meeting to order at 10:14 a.m.

Approval of Minutes (Tab 1)

Motion was made by Faraz Khan to approve the October 31, 2008 meeting minutes. Motion was seconded by Judge Dan Gattis and unanimously approved.

Presentation of Annual Audit (Tab 2, handout)

Mr. Mike O’Brien reported that Padgett, Stratemann & Co. issued an unqualified audit opinion with respect to the Tobacco Settlement Permanent Trust Account (“Account”) for the year ending December 31, 2008. Net assets held in trust were approximately \$1.75 billion as of December 31, 2008. Mr. O’Brien affirmed that the account had been managed in compliance with the Investment Policy and the Distribution Policy. No audit adjustments were made, nor was a management letter issued.

Presentation and Discussion of Investment Performance for Period ending 12/31/08 (Tab 5)

Mr. Steven Pines of Northern Trust reviewed the investment performance and stated that quarterly and annual rates of return for the portfolio were competitive in this volatile economic environment. The

portfolio ranked in the first quintile relative to other plans greater than 1 billion dollars year to date through December 31, 2008. The total rate of return was approximately -11.6% for the quarter ending December 31, 2008, finishing first among its local peers. The current portfolio market value as of December 31, 2008 was approximately \$1.7 billion. Mr. Ballard added that the seizing up of the credit markets combined with a significant down cycle of the economy resulted in universally negative returns.

Economic Update (Tab 3)

Mr. Tom Margulis of ACG presented a capital markets update and reviewed a timeline of economic events for the year 2008. He stated that the economy was in its sixteenth month of this current recession. He reported the unemployment rate was at 8.1% and job losses were at 4.4 million since the onset of the recession. Constricted credit flows continue to remain problematic but there appear to be some signs that restrictions are easing slightly. Mr. Margulis stated that disruptions in the financial sector were major drivers of the market contraction and cited three major events that unfolded in 2008: the Bear Stearns buyout by JP Morgan, the Merrill Lynch buyout by Bank of American and the Lehman Brothers bankruptcy.

Mr. Margulis reviewed more current market returns as illustrated on page 4 of his report. He believes there are still many unknown economic factors that are likely to contribute to asset price volatility in 2009. Although volatility exists in every investment sector, ACG continues to believe there are unprecedented opportunities for long-term investors to find value in the fixed income, equity, and emerging markets. Mr. Margulis reviewed the “quilt” chart on page 17 and stressed the importance of diversification, rebalancing and risk management.

Discussion of Current Market Value vs. Invested Corpus and Approval of Annual Trust Distribution (Tabs 6 & 7)

Mr. Ballard presented the Committee three distribution options as outlined in the report behind Tab 7. He explained that despite these difficult economic times, the Trust Account had since its inception distributed \$380 million to its beneficiaries and still had a remaining value that was approximately \$100 million greater than the corpus market value as of December 31, 2008 (not adjusted for inflation). More difficult economic times are expected for 2009 and in light of these uncertain conditions, he explained that it may be appropriate to consider not increasing, or possibly decreasing this year’s distribution. The three options explained were as follows:

- 1) A \$96,310,308 distribution, which represents the maximum amount calculated in accordance with the formula in the Texas Administrative Code, Title 31, Part 1, §18.2. This represents a 4.3% increase from the previous year but would deplete the Distribution Stabilization Account (“DSA”) by 61%.
- 2) A \$92,804,656 distribution, which is a slightly modified representation of the previous calculation. It is approximately the same amount as the previous year and would deplete the DSA by 57%.
- 3) A \$85,539,619 distribution which is 7.3% less than the previous year and would deplete the DSA by 50%.

The Committee discussed the DSA and expressed their concern about the depletion of the DSA and the protection of the corpus. Some Committee members stated they had already budgeted approximately the same distribution amount as the previous year and that a decrease would be disruptive to the budget planning of beneficiaries of the Trust. The Committee agreed to distribute the same amount as the previous year, \$92,303,845, but to prepare recipients for a decrease in 2010. A memorandum from Chairman Ford

will be distributed to all Trust beneficiaries putting them on notice that a reduced distribution was likely next year.

Motion was made by Judge Wayne Gent to approve the distribution of \$92,303,845 to the Political Subdivisions thus depleting the Distribution Stabilization Account by approximately 57%. Motion was seconded by Judge David Silva and unanimously approved.

The Committee discussed the Distribution Stabilization Account (“DSA”) and agreed to specifically address the DSA and the rule regarding the DSA at the next meeting.

Discussion of Next Meeting and Agenda Items

Committee members will be contacted to determine the best date for the next meeting in September or October 2009.

Public Comment

None.

Adjourn

Chairman Stuart Ford adjourned the meeting at 1:00 pm.