

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT  
ADVISORY COMMITTEE  
Friday, October 9, 2009  
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Friday, October 9, 2009 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; Judge Dan Gattis; Judge Wayne Gent; Judge David Silva; Commissioner Roger Galvan; Faraz Khan; and Chuck Norris.

**Committee Members Absent**

Judge Giles Dalby, Noe Hinojosa, Joe McComb, 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. Germeis, 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”); Rick Pokorny, 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 10:10 a.m.

**Approval of Minutes (Tab 1)**

*Motion was made by Chuck Norris to approve the March 30, 2009 meeting minutes. Motion was seconded by Commissioner Roger Galvan and unanimously approved.*

**Economic Update (Tab 2)**

Mr. Tom Margulis of ACG presented an economic update and reviewed the second and third quarter economic market environments. He reported that the financial markets had improved over the previous quarters with a substantial improvement in the equity and fixed income markets. He reported that the S&P 500 was presently up 19%, and up approximately 50% from its March 9<sup>th</sup> low. He also reported that the overseas and emerging markets had substantially improved.

Mr. Margulis reported that unemployment numbers were currently between 9.5% – 10%. Unemployment continues to worsen, but at a slower rate. He reports that for long term economic recovery to occur, unemployment needs to decrease and consumer spending increase. Although third quarter earnings for

some large companies were good, mainly due to cost-cutting measures, the market needs to see a growth in revenue.

Mr. Margulis reviewed the asset class relative rankings as of the third quarter of 2009 behind Tab 2. ACG believes that emerging markets will continue to grow robustly. ACG continues to view absolute return strategies favorably. They also believe that continued weakening of the U.S. dollar and the projected continued recovery of the global economy makes exposure to commodities desirable. Mr. Margulis explained that the portfolio positions reflected these expectations. He stated that ACG believes that this challenging environment requires investors to be opportunistic and to seek managers with the ability to take advantage of changing market conditions. Overall, ACG believes that 2010 will present significant challenges for investors and they expect a low growth economic environment in the United States and Western Europe. They are, however, modestly bullish for the upcoming new year.

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

Mr. Paul Ballard presented the Committee an overview of the endowment portfolio. He reviewed the asset allocations as of June 30, 2009 as illustrated in the report behind Tab 3 and reported that the portfolio was in alignment with asset allocation targets. Mr. Ballard reported that as of June 30, 2009, the total portfolio value was approximately \$1.7 billion. He discussed the importance of risk allocations associated with the asset classes and stated that Trust Company uses a quantitative risk management system called Risk Data.

Mr. Danny Sachnowitz continued the review of the endowment portfolio. He reviewed the various asset classes and the evolution of the portfolio since 2003. He explained the various investment strategies within the portfolio and discussed new portfolio managers, such as more opportunistic fixed income managers. Mr. Sachnowitz reviewed absolute return and enhanced return strategies. He stated that performance was in line with expectations, given the current economic conditions.

### **Presentation and Discussion of Investment Performance for Period ending 6/30/09 (Tab 4)**

Mr. Rick Pokorny 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. He reported that as of June 30, 2009 the portfolio's total rate of return was approximately 3.05% and the market value was approximately \$1.7 billion. Mr. Pokorny discussed how asset allocation related to the portfolio performance. He explained that the benchmark was extremely difficult to surpass; however, the portfolio ranked well above median and almost in the top quartile relative to its peers. In July and August, the portfolio trailed the benchmark for the year by 4%, but was well above the median in the peer group universe. More current numbers reflect as of August 31, 2009, the total rate of return was approximately 8.51% and the portfolio had grown to approximately \$1.8 billion.

### **Discussion of 2010 Annual Distribution and Possible Action Regarding Distribution Stabilization Account Rule (Tab5 and handout)**

Mr. Ballard discussed the Trust Account Distributions Rule, under Texas Administrative Code, Title 34, Chapter 18, Rule § 18.2. He explained that drafted revisions to the rule would limit withdrawals from the Distribution Stabilization Account ("DSA") in any year to 50% of its balance, which will ensure that there will always be a balance in the account. It would also provide a safeguard from over-spending in years in which the value of the account is less than the inflation adjusted value of the corpus. Mr. Ballard reviewed the events of last year and noted that the DSA balance was reduced by 57% (from \$101 million to \$44 million) and that as of August 31, 2009, the Trust value stood at \$1.826 billion, which is less than the inflation-adjusted corpus. It is also expected that the Trust value at the end of 2009 will be less than corpus.

Mr. Ballard reviewed the proposed amendment to the Trust Account Distribution Rule as outlined in the handout. The proposed amendment would apply when the year-end Trust value net of the annual distribution is less than corpus. It would limit the distribution to the lesser of: the calculated distribution amount (4.5% x 5-year average market value); 4.5% of the year-end market value; or 80% of the prior year's distribution. It would also limit the withdrawals from the DSA to 50% of its balance. Mr. Ballard explained that if it chose to support this change, the Committee would be making a recommendation to the Comptroller. If the Comptroller approved the recommendation, then it would get posted in the Texas Register and be up for 90 days for comment before it becomes effective. The Committee discussed the options and several scenarios.

Mr. Stuart Ford suggested more discussion was needed and asked to table the decision until March or hold for another meeting.

Mr. Ballard discussed Mr. Noe Hinojosa's suggestion of the DSA being a separate investment.

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

Committee members will be contacted to determine the best date for the next meeting in March 2010.

### **Public Comment**

None.

### **Adjourn**

*Motion was made by Mr. Chuck Norris to adjourn the meeting. Motion was seconded by Ms. Faraz Khan and unanimously approved. The meeting adjourned at 12:47 pm.*