

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Monday, March 21, 2011
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Monday, March 21, 2011 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members Present

Comptroller Susan Combs, Adolpho Telles; Tucker Bridwell, Laurie Dotter, Jim Hille, Steve Strake, and Scott Wise.

Board Members Absent

None.

Comptroller of Public Accounts Staff Present

Martin Hubert, 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; Marianne S. Dwight, General Counsel; Michael Anderson, Compliance Officer; Byron Beasley, Private Markets Manager; J. Germenis, Public Markets Manager; Michael Leifeste, Real Estate Portfolio Manager; Lalo Torres, Investment Analyst; Perry Wang, Risk Analyst; Wai Yee Cheng; Portfolio Manager; Adam Levine, Portfolio Manager; Erin Corley, Private Markets Analyst; Nora Arredondo, Special Projects Coordinator; John Wright, Assistant General Counsel; Gena Minjares, Director of General Ledger Accounting; Laura Montoya, Director of Administrative Services; and Jorge de Lafuente, Investment Accountant.

Others

George Tarlas, Asset Consulting Group ("ACG"); Lori Mills, ACG; and Rick Pokorny, Northern Trust.

Call to Order

Comptroller Susan Combs declared that a quorum was present and called the meeting to order at 10:05 a.m.

Comptroller Combs read a statement regarding the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that requires municipal advisors to register with the SEC. Comptroller Combs does not believe the requirement applies to this board and is working with the Attorney General's office to clarify its application. Comptroller Combs asked the Trust Company's General Counsel, Marianne Dwight, to monitor the board's discussions and to advise them to stop if they began to engage in anything that would be considered municipal advisory activities.

Approval of Minutes of December 16, 2010 Meeting (Tab 1)

The Board requested the endowment portfolio update portion of the minutes be revised to state that Trust Company and its consultants would continue to follow up with Level Global and Diamondback to carefully evaluate any changes in their organization, redemptions by clients, and their ongoing viability as investment managers in order to manage any potential risks to the endowment.

Ms. Laurie Dotter made a motion to accept and approve the revised minutes of the December 16, 2010 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Jim Hille and unanimously approved by the board

Economic Outlook and Review of Treasury Pool (Tab 3)

Mr. Mike Samples reviewed the Treasury Pool portfolio asset summary as of February 28, 2011 and stated that the value of the Pool was approximately \$25.1 billion. He reported that currently the Treasury Pool was carrying approximately \$20 million in unrealized gains. He stated that there were not many opportunities in the marketplace to replace the portfolio's higher yielding assets that are maturing with equal or better yields. His team is actively searching for low risk opportunities to add yield to the portfolio. Mr. Samples reviewed charts behind Tab 3 and stated that treasuries now account for approximately 61% of the portfolio. Next, Mr. Samples reviewed comparative benchmark yields and stated that the Treasury Pool yield remained competitive with most of its benchmarks but was slightly lagging behind its custom benchmark.

Mr. Mike Samples continued to review the information behind Tab 3 and presented his perspective on economic growth. He expects the Federal Reserve (the "Fed") will not start raising interest rates until 2013. Debt is a primary concern and the federal deficit continues its rapid growth. Mr. Samples stated that the economy was in the second round of quantitative easing ("QE2"), which began in November, and is expected to diminish by the end of June. In his opinion it is best to assume that if rates start to rise we are prepared. Mr. Samples reported economic growth was slowing during this first quarter; however, the long-term expected sustainable growth of above 3 percent remains intact. Consumer spending growth held up well, but consumer confidence needs to maintain an upward trajectory in order to have a positive impact on housing.

Capital Markets Outlook and Discussion (Tab 2 and handout)

Mr. George Tarlas of ACG presented an economic update and reviewed the first quarter of 2011 asset class relative rankings. He reported that fourth quarter 2010 gross domestic product ("GDP") was revised from 3.2% to 2.8%. The expectation for economic growth in Europe is between 1-1.5%. Lagging economic indicators such as housing and unemployment had shown modest improvement. Corporate profitability had also shown improvement and is expected to grow 16% over the next twelve months. Mr. Tarlas reported that ACG expects continued U.S. economic growth of 3% for 2011. ACG continues to believe that this challenging environment requires investors to be opportunistic and to seek managers with the ability to take advantage of changing market conditions.

Mr. Tarlas reported that the only change in asset class rankings during the first quarter was transitioning emerging markets from overweight to a neutral tactical outlook. Next, Mr. Tarlas explained the portfolio themes handout by ACG.

Ms. Lori Mills continued the discussion and reviewed the intermediate-term (2-5yrs) themes and potential portfolio responses as referenced in the handout. She explained the four themes: 1) moderate growth environment (developed markets); 2) credit dislocation/rate environment; 3) high inflation; and 4) rising middle class in developing nations.

Review and Discussion of Asset Allocation Targets and Benchmarks (Tab 4)

Mr. Paul Ballard and Mr. Danny Sachnowitz reviewed the three portfolio mix examples over a ten-year median return that represented total fixed income, total equity, and total real assets. Under the current policy, the ten-year median return is approximately 7.65%. Under the new policy, the ten-year median return would be approximately 7.85%. Ms. Laurie Dotter expressed concern over flexibility. Mr. Ballard stated they were not moving away from a strategy of more flexibility. The Board discussed the differences among the three portfolio mixes. Mr. Ballard and Mr. Sachnowitz described the various risk measures for the mixes considered in the analysis, including simulated performances during past crisis events. Mr. Ballard stated that mix 2 did a little better in preserving value and produced a higher Sharpe Ratio than the current portfolio. He explained that the portfolio could afford to be less liquid than it currently is. The Board discussed the long-term capital market assumptions for the asset classes included in the analysis. Each assumption considered risk and worse case scenarios.

Mr. Ballard stated that the Trust Company favored mix 2. The Board agreed and said it also favored mix 2.

Endowment Portfolio Update and Related Matters (Tab 5)

Mr. Ballard presented the Board an overview of the endowment portfolio and reported that it was in compliance with the asset allocation and investment policies. As of December 31, 2010 the portfolio value was approximately \$3.2 billion and was in alignment with its asset allocation targets. Mr. Ballard and Mr. Danny Sachnowitz discussed current liquidity and the fact that the portfolio remained very liquid. Mr. Sachnowitz compared the actual vs. target allocations for the 4th quarter of 2010 to the actual vs. target allocations as of March 18, 2011 and noted that the March allocations were closer to the benchmark. The largest move was in the inflation protection category. Mr. Sachnowitz reviewed the various asset classes and informed the Board of new managers added to the portfolio. He reported that the portfolio performance was in line with expectations, given the current economic conditions. The policy compliance checklist was reviewed and the portfolio was in compliance with each category.

Mr. Ballard continued the review of returns and performance of specific asset classes. He reported that the Trust Company should be receiving its remaining redemptions from Level Global by the first of the month and that money would be reallocated. He also reported that Diamondback was remaining in business and was improving their compliance monitoring systems. There have been some redemptions from Diamondback. Mr. Ballard reported that Shumway was closing and would no longer manage outside capital.

Endowment Funds Investment Performance Review for the Quarter Ending December 31, 2010 and Related Matters (Tab 6)

Mr. Rick Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending December 31, 2010. The portfolio return was approximately 4.66% for the quarter which represented an approximate \$223 million increase. He reported that the portfolio participated in the rally in the stock market in 2010. The U.S. equity markets led the way while the emerging markets began to slow down a bit. Mr. Pokorny reviewed the endowment portfolio's returns versus a universe of other public funds and endowments and foundations with asset values greater than \$1 billion that are tracked in the Northern Trust database. The portfolio experienced an overall positive result while assuming less risk. The Sharpe ratio outperformed its benchmark.

Mr. Pokorny reported that the portfolio grew by \$67 million for the first two months of 2011. Through the end of February 2011, the portfolio's approximately rate of return is 2.3% and the policy benchmark is approximately 2.4%.

Discussion of Next Meeting and Agenda Items

The board will be contacted regarding the next meeting date. No agenda items suggested for next meeting.

Public Comment

None

Adjourn

The meeting adjourned at 1:41 p.m.