

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Monday, December 17, 2012
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Monday, December 17, 2012 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members Present

Comptroller Susan Combs, Tucker Bridwell, Laurie Dotter, Jim Hille, Steve Strake, Adolpho Telles 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; Erin Corley, Private Markets Analyst; Lalo Torres, Investment Analyst; Adam Levine, Portfolio Manager; Nora Arredondo, Special Projects Coordinator; Gena Minjares, Director of General Ledger Accounting; Victor Scott, Director of Financial Reporting; Laura Montoya, Director of Administration; Jorge de Lafuente, Investment Analyst; Ruth Hooks, Director of Information Technology; and Brandy Bianco, Graphic Designer.

Additional Participants

Mike O'Brien, Padgett, Stratemann & Co., LLP; Tom Janisch, Asset Consulting Group ("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 10:02 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. The temporary ruling resulted in a disagreement over what constitutes a municipal advisor. The Comptroller's office does not believe the usual activities of this board constitute municipal advisory activities and they are 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 August 23, 2012 Meeting (Tab 1)

Mr. Tucker Bridwell made a motion to accept and approve the minutes of the August 23, 2012 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Adolpho Telles and unanimously approved by the Board.

Presentation of Independent Auditor's Report for the Trust Company (handout)

Mr. Mike O'Brien summarized the audit reports and reported that Padgett, Stratemann & Co., issued an unqualified financial audit opinion with respect to the Trust Company for the fiscal year ending August 31, 2012. No audit adjustments were recorded during the audit engagement that indicate deficiencies in the accounting process nor was a management letter issued.

Overview of the Trust Company Enterprise Risk Management (Tab 2)

Mr. Frank Zahn explained to the board how the Trust Company is addressing enterprise risk management ("ERM"). He stated that ERM includes the methods and processes used to manage business risks and seize opportunities related to accomplishing daily objectives. ERM provides a framework to identify risks, assess the likelihood of their occurrence and their impact on the organization. ERM sets out response strategies and a monitoring process. He reviewed the Comptroller's secure network as illustrated in the chart behind Tab 2 and explained that the Trust Company also employs its own information technology division and discussed the organization's disaster recovery plans.

Capital Markets Outlook and Discussion (Tab 3)

Mr. Tom Janisch presented an update on the capital markets. He reviewed how the portfolio was positioned in relation to the current market environment. He reported that unemployment had declined slightly and that the housing market had grown stronger, personal income had increased and consumer prices declined. He reported that the looming fiscal cliff was still having negative effects on the economy as was the economic uncertainty in Europe. Mr. Janisch explained that ACG does not expect the Federal Reserve to increase interest rates for the next 2-3 years. ACG also expects continued slow domestic economic growth.

Mr. Janisch reviewed broad market returns and reported that the S&P 500 year to date return was approximately 15%. He reviewed domestic and foreign performance for various market sectors illustrated in the graphs behind Tab 3. Mr. Janisch noted that in emerging markets, Brazil stood out with a reported 12% return. In the fixed income market environment, U.S. treasuries underperformed while high-yield fixed income securities performed best. Mr. Janisch explained that the Trust Company continues to focus on portfolio diversification, maintaining and/or enhancing exposure to fast growing regions such as emerging markets, maintaining a diversified global fixed income portfolio with a focus on real yields.

Mr. Janisch reviewed the asset class relative rankings as of the fourth quarter 2012. He reported one change to the tactical outlook for the quarter. The global private equity asset class was changed from neutral to underweight.

Economic Outlook, Investment and Review of Treasury Pool (Tab 4)

Mr. Mike Samples reviewed the Treasury Pool portfolio summary as of October 31, 2012 and stated that the value of the Pool was approximately \$25.9 billion. The net yield was approximately 0.46%, up slightly from the previous quarter despite the declining yield of U.S. Treasuries. Mr. Samples reviewed the asset

allocation and maturity structure of the portfolio. He stated that since interest rates are expected to remain unchanged in the near future, buying slightly longer dated assets makes some sense for the portfolio. Mr. Samples explained the comparative benchmark yields chart and stated that for the five year period the portfolio's return was approximately equal to the custom benchmark, which was instituted six years ago. The custom benchmark does not face the same challenges as the Treasury Pool, such as managing around outsized cash flows for tax revenue anticipation notes or conforming to the requirements of maintaining a AAA-rating by Standard and Poor's. He stated that the yield on the Treasury Pool exceeded most of its benchmarks.

Mr. Samples presented his perspective on economic growth. He reported that the U.S. economy continues to grow at a slow rate. The housing market is in recovery and looking favorable and auto industry sales were up dramatically. Mr. Samples believes the unresolved issue of the fiscal cliff is slowing economic growth. He does not believe inflation is an issue at this time but could possibly become a concern; therefore, the portfolio owns some treasury inflation-protected securities ("TIPS") as insurance. Mr. Samples explained that he and his team remain focused on seeking higher yields; however, he does not expect the Federal Reserve to raise interest rates for 2-3 years.

Lunch Speaker Presentation by Diane Swonk Cancelled (Tab 5)

Endowment Portfolio Update and Related Matters (Tab 6)

Mr. Paul 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 September 30, 2012 the portfolio value was approximately \$3.2 billion. Mr. Ballard and Mr. Sachnowitz discussed the portfolio's liquidity profile and pointed out that the portfolio remained very liquid. Mr. Ballard compared the actual vs. target asset allocations as of the third quarter of 2012. He reported that the portfolio was relatively unchanged from the previous quarter at approximately 34% allocated to fixed income, 45% equity, 17% real assets, and 4% strategic all asset and overlays. Mr. Ballard reviewed each asset class and the various asset strategies which demonstrated the portfolio's diversification. He explained how he and his staff were exploring single family housing strategies such as converting single family housing into rentals and investing in non-agency residential mortgage backed securities. He reported on new fund managers and discussed those from whom investments were being redeemed.

Following the asset class review, Mr. Ballard explained how the portfolio performed relative to its benchmark. He reported that the portfolio had lagged slightly behind the Northern Trust peer universe but that performance was in line with expectations, given the current economic conditions. He reminded the board that unlike peer portfolios the Trust Company endowments received no new cash flows so was managed more defensively. Mr. Ballard explained the stress test scenarios as they relate to performance in a crisis relative to policy portfolio and absolute numbers.

Endowment Funds Investment Performance Review for the Quarter Ending September 30, 2012 and Related Matters (Tab 7)

Mr. Rick Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending September 30, 2012. The portfolio return was approximately 4.43% for the quarter and outperformed its policy benchmark by 1.1%. The trailing one year performance was approximately 9.01% which fared better than its policy benchmark of 7.57%. Mr. Pokorny reported that the portfolio value increased slightly over the quarter from \$3.08 billion to approximately \$3.2 billion. Unlike the previous quarter, risk was rewarded. Natural resources were the best performers, with gold up over 10%. Each sector's performance was reviewed in further detail. The portfolio produced a Sharpe ratio greater than its benchmark for the one and three-year periods.

Mr. Pokorny gave an update through October reporting that the portfolio returned .18% for the month. He stated that preliminary indications are that the portfolio is expected to slightly outperform its benchmark for November.

Discussion of Next Meeting and Agenda Items

The next meeting will be scheduled in March. Nora Arredondo will be in contact with the board.

Public Comment

None.

Adjourn

The meeting adjourned at 1:30 p.m.