

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Wednesday, September 11, 2013
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Wednesday, September 11, 2013 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, and Adolpho Telles.

Board Members Absent

Steve Strake and Scott Wise.

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; John Wright, Deputy 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; Wai Yee Cheng, Portfolio Manager; Adam Levine, Risk Manager; Nora Arredondo, Special Projects Coordinator; Gena Minjares, Director of General Ledger Accounting; Laura Montoya, Director of Administration; Jorge de Lafuente, Investment Analyst; Victor Scott, Director of Financial Reporting; Anco Ion, Portfolio Manager; and Corrine Hall, CAPCO Program Administrator.

Additional Participants

Lori Mills and Joe Nugent, Asset Consulting Group ("ACG"); Pam Sliman, State Street; and Samantha Levenstein and Bruce Ruehl, Aksia.

Call to Order

Comptroller Susan Combs declared that a quorum was present and called the meeting to order at 10:08 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 June 18, 2013 Meeting (Tab 1)

Ms. Laurie Dotter made a motion to accept and approve the minutes of the June 18, 2013 Comptroller's Investment Advisory Board meeting. The motion was seconded by Adolpho Telles and unanimously approved by the Board.

Discussion of Amendment to Endowment Investment Policy (Tab 2)

Mr. Paul Ballard explained that a change to a benchmark in the Endowment Investment Policy for real estate has become necessary because the previous version had stopped publishing. A draft of the policy was included behind Tab 2.

Mr. Tucker Bridwell made a motion to submit the recommended revision to the Comptroller for approval. The motion was seconded by Ms. Laurie Dotter and unanimously approved by the Board.

Annual Review of Comptroller's Investment Policy (Tab 3)

Mr. Paul Ballard explained that the Comptroller's Investment Policy is required to be reviewed annually and stated that no changes were being recommended at this time.

Broker/Dealer Update (Tab 4)

The Board was presented a list of broker/dealers with which the Trust Company is authorized to trade. Six new broker/dealers were added in June 2013 as noted behind Tab 4.

Capital Markets Outlook and Discussion (Tab 5)

Ms. Lori Mills presented an update on the capital market environment. She reviewed broad market returns where the equity markets showed positive returns and stated that U.S. small cap stocks hit an all-time high in July as the Russell 2000 Index closed for the month; up 7%. Emerging markets were down approximately 5% through early September, significantly different from developed markets which were up substantially. Both China's negative economic outlook and Brazil's currency issues were impacting emerging markets significantly. Ms. Mills reported that the International Monetary Fund ("IMF") forecast for economic growth was approximately 1% for Japan and Europe and approximately 2% - 2 ¾% for the United States. Ms. Mills explained that ACG does not expect the Fed to increase interest rates for the next 2-3 years. ACG also expects continued slow domestic economic growth. Ms. Mills reported that there were no changes to the tactical outlook for the quarter.

Mr. Joe Nugent reviewed the private equity, private credit and real estate market environments.

Economic Outlook, Investment and Review of Treasury Pool (Tab 6)

Mr. Mike Samples presented his perspective on economic growth. He reported that the U.S. economy continued to grow at a slow rate of approximately 1.5% during the quarter. The unemployment rate made some gains but not enough to demonstrate significant improvement in the unemployment outlook. He explained that older Americans are working longer and not retiring at previously expected rates constraining opportunities for the younger workforce. Mr. Samples also reported that auto industry sales pushed past the 16 million mark in August for the first time since the financial crisis hit. New home sales fell by approximately 11% - 13% as a result of current slightly higher interest rates. Mr. Samples expressed concern regarding how much debt households hold. He stated that the average household debt was approximately 85% - 90% (debt to income ratio) and had almost doubled since 1960.

Mr. Samples reviewed the Treasury Pool portfolio summary as of July 31, 2013 and stated that the value of the Pool was approximately \$36.6 billion. The net yield was approximately 0.30%, down slightly from the previous quarter. Mr. Samples explained the comparative benchmark yields chart and stated that the portfolio's return exceeded most of its benchmarks. 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 until later in 2015.

Endowment Portfolio Update and Related Matters (Tab 9)

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 June 30, 2013 the portfolio value was approximately \$3.20 billion. Mr. Ballard compared the actual vs. target asset allocations as of the second quarter of 2013. He reported that the portfolio was relatively unchanged from the previous quarter at approximately 33% allocated to fixed income, 47% equity, 16% real assets, and 4% strategic all asset. Mr. Ballard reviewed each asset class and the various asset strategies which demonstrated the portfolio's diversification. He reported on new fund managers and discussed those from whom investments were being redeemed. He stated that Perry Capital was added to alternative fixed income; NXT Capital Senior Loan II was added to private debt; and a commitment to the Harrison Street IV real estate fund had been made. Mr. Ballard explained the portfolio stress test scenarios that demonstrated expected performance during a crisis both in nominal terms and relative to the policy portfolio. He concluded with a review of the Trust Company performance table which spanned 2002 through June of 2013.

Lunch Speaker (Tab 7)

Ms. Meredith Whitney, CEO and Founder of Meredith Whitney Advisory Group and Author of "Fate of the States: The New Geography of American Prosperity," presented her view of the current U.S. macroeconomic environment.

Discussion of Hedge Fund Environment (Tab 8)

Mr. Bruce Ruehl with the Trust Company's hedge fund consultant, Aksia, reviewed the current hedge fund environment and discussed four themes they are recommending to clients. The first theme is to overweight event-driven strategies that have the ability to opportunistically invest in both equity and credit instruments. Second, they advocate increased weightings to activist equity strategies. Third; given the zero interest rate policy of the Fed and historically low interest rates, Aksia is advocating increased exposure to strategies that can serve as fixed income substitutes. Their fourth theme is to gain exposure to managers with expertise in Europe, as the opportunities for deep value-focused managers over the next few years in that region appear to be particularly promising.

Endowment Funds Investment Performance Review for the Quarter Ending June 30, 2013 and Related Matters (Tab 10)

Ms. Pam Sliman from State Street reviewed the investment performance of the endowment funds for the period ending June 30, 2013. She reported that the portfolio return was approximately -0.98% for the quarter and had underperformed its policy benchmark of -0.15%. The trailing one year performance however was approximately 9.05%, well in excess of its policy benchmark of 7.83%. The performance of each sector of the portfolio was reviewed in further detail. The portfolio produced a Sharpe ratio greater than its benchmark.

Discussion of Next Meeting and Agenda Items

The next meeting will be on Wednesday, December 18, 2013.

Public Comment

None.

Adjourn

The meeting adjourned at 1:34 p.m.