

**COMPTROLLER’S
INVESTMENT ADVISORY BOARD MEETING
Wednesday, July 17, 2019
*Minutes***

The Comptroller’s Investment Advisory Board (the “Board”) met at 10 a.m. on Wednesday, July 17, 2019 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members (“The Board”) Present

Comptroller Glenn Hegar, Tucker Bridwell, Jim Hille, Steve Strake and Adolpho Telles.

Board Members Absent

Laurie Dotter and Benjamin Wall.

Comptroller of Public Accounts Staff Present

Phillip Ashley, Associate Deputy Comptroller; Lisa Craven, Deputy Comptroller and Chief of Staff; and Cheryl Scott, Internal Auditor.

Texas Treasury Safekeeping Trust Company (“Trust Company”) Staff Present

Paul Ballard, Chief Executive Officer and Chief Investment Officer (“CEO”); Genoveva Minjares, Chief Financial Officer; Anca Ion, Head of Internal Investments; Whitney Blanton, General Counsel; Laura Montoya, Chief Operating Officer; Michael Leifeste, Portfolio Manager; Lalo Torres, Portfolio Manager; Ruchit Shah, Head of External Investments; Jyoti Gupta, Portfolio Manager; Adam Levine, Chief Strategist; Mohamed Elkordy, Portfolio Manager; Nora Arredondo, Program Specialist; Brandy Bianco, Project Manager; Chad Turner, Risk Manager; Mathew Williams, Investment Analyst; Jacob Price, Investment Analyst; Susie Knight, Program Specialist; Corrine Hall, Program Administrator; Hugh Ohn, Director of Strategy and Planning; Spencer Brown, Assistant General Counsel; and Steve Rohrich, Investment Analyst.

Additional Participants

Lori Mills and Roger Willis, Asset Consulting Group (“ACG”).

Call to Order

Comptroller Glenn Hegar declared that a quorum was present and called the meeting to order at 10:00 a.m.

Approval of Minutes of April 16, 2019, 2019 Meeting (Tab 1)

Ms. Laurie Dotter made a motion to accept and approve the minutes of the April 16, 2019 Comptroller’s Investment Advisory Board meeting. The motion was seconded by Mr. Tucker Bridwell and unanimously approved by the Board.

Annual Review of Comptroller's Investment Policy (Tab 2)

Mr. Paul Ballard reported that there were no recommended revisions to the Comptroller's Investment Policy at this time.

Review of Endowment, State Water Implementation Fund of Texas (SWIFT) and Texas Economic Stabilization Investment Fund (TESTIF) Portfolio Updates and Related Matters (Tab 3)

Mr. Ballard presented an overview of the Endowment portfolio for the first quarter of 2019 and reported that the portfolio was in compliance with its investment and allocation policies. He reviewed the historical overview of the evolution of the endowment investments. He reported that as of March 31, 2019 the Endowment portfolio value was approximately \$4.15 billion and produced a 4.7% return. The portfolio distributed approximately \$70 million from the Tobacco Distribution Fund. Mr. Ballard reported that the hedged equity portion of the portfolio was the leading performance driver, while the global public equity portion closely followed. Mr. Ballard noted that the return for April was up approximately 1.5%; however, in May the portfolio returned -1.0%. The year to date return as of the end of May was a little over 5%.

Mr. Ballard reviewed the SWIFT portfolio and reported that the portfolio was in compliance with its investment policy for the quarter. The portfolio value as of March 31, 2019 was approximately \$1.7 billion and produced a 3.8% return for the quarter. He explained that the portfolio began with \$2 billion and has distributed over \$600 million since inception. The portfolio has recovered approximately 57% of the distributions made since inception. A \$130 million distribution is expected in October at the request of the Water Board. Mr. Ballard reported that the portfolio remained highly liquid and was meeting its investment objectives.

Mr. Ballard reviewed the TESTIF portfolio and reported that it was performing as designed by preserving its purchasing power by earning more than inflation. The portfolio value as of April 30, 2019 was approximately \$4.8 billion. The portfolio has produced an annualized return from inception through April of approximately 2.18%. Since inception, the portfolio has earned approximately \$110 million over the Treasury Pool. The portfolio has earned approximately \$67 million in excess of inflation. The TESTIF portfolio remains highly liquid and continues to stay ahead of inflation.

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

Ms. Anca Ion reported on current economic conditions. She reported that the current economic expansion has entered its 121st month, the longest in modern American history. The most recent expansion started in 2009, after the global financial crisis in 2008. She explained that economic growth was slowing down but not coming to a complete halt. She believed that fiscal stimulus did not produce the result hoped for. The labor market was strong: 200 jobs added in June. The unemployment rate was 4.2% but growth in wages was not very high. There was a definite weakening in the manufacturing sector mainly due to discouraging trade discussions. Consumer confidence in June had a significant drop and the markets were reacting accordingly. Ms. Ion explained the Federal Reserve Board (the "Fed") is expected to reduce interest rates during the year.

Ms. Ion reviewed the Treasury Pool portfolio as of June 30, 2019. She reported that the portfolio yield for said quarter was 2.5%. The portfolio reached a market value of approximately \$45 billion and continued to maintain a AAA rating by Standard & Poor's. She explained that over the last several months the value of the pool increased by \$7-\$8 billion. The pool produces approximately \$1 billion in income annually for the state. Ms. Ion reviewed the portfolio allocation and reported that Treasuries and Commercial Paper accounted for approximately 60% of the portfolio. Ms. Ion explained that until there is quantitative easing by the Fed, spreads should be tight; therefore, the portfolio is positioned accordingly.

Capital Markets Outlook and Investment Performance for the Quarter Ending March 31, 2019 By Asset Consulting Group (Tab 5)

Ms. Lori Mills and Mr. Roger Willis represented ACG and spoke of the economic market environment and performance. Mr. Willis presented ACG's view of the economic market environment. He reported that overall, there was a healthy global environment. There is a primary focus on U.S.– China relations that goes beyond unresolved trade and tariff issues that could produce volatile markets. The European economy continues to show signs of weakness especially when relating to export-dependent manufacturing. Leading economic indicators are trending lower in most major economies. Recently, heightened tensions with Iran impacted oil markets. He reported that the U.S. dollar had been appreciating and therefore staying with non-U.S. equities made sense. Mr. Willis explained that there has been long and shallow growth cycle driven by monetary stimulus in the U.S. This has been the longest expansion in U.S. history. The challenge remains reaching the 2% inflation target. ACG expects a slow growth environment for the next 5-10 years.

Mr. Willis reviewed investment themes, key considerations, and implementation strategies as outlined behind Tab 5. In summary, he explained that inflation has not been a big hurdle in the last cycle. ACG capital markets assumptions are based on low inflation expectations. Global diversification and disciplined rebalancing have helped minimize risk and uncertainty. ACG also believes risk-reducing hedged strategies are essential to diversification. Mr. Willis reported that ACG and the Trust Company investment staff will continue to closely monitor overall portfolio allocations relative to strategic objectives.

Ms. Lori Mills reviewed the total portfolio summary for the period ending March 31, 2019. She reported that the total portfolio returns outperformed the Endowment policy benchmark for the quarter and the one, three, and five-year periods. The portfolio lagged the 65/35 benchmark in the first quarter but outperformed over longer term periods. The portfolio produced a 4.7% return for the quarter and has generated a higher return with similar risk compared to the Endowment policy benchmark over the last five years. Relative to broad market benchmarks, the total portfolio has generated 112% of the return with 46% of the risk. The fixed income portion of the portfolio lagged behind the fixed blend benchmark over the first quarter, but outpaced the fixed blend over the one, three, and five-year periods. Equity strategies have outperformed its benchmark over all time periods. Real assets continued to have strong relative results longer term, resulting in outperformance by 1.28% over the trailing five year span.

Ms. Mills reviewed the performance for the SWIFT portfolio and reported that the portfolio produced a 3.80% return for the quarter ending March 31, 2019 and outperformed its policy and dynamic benchmarks. The portfolio's annualized return since inception was 3.43%, outperforming its policy benchmark by 2.05% and outperforming its dynamic benchmark by 2.16%. Despite underperformance over the one and three-year periods, the fixed income portion of the portfolio produced strong relative results since inception. Equity investments continue to perform well over all time periods since inception and has outperformed its benchmark as well. With the exception of the first quarter of 2019, real assets outperformed its benchmark over the one and three-year periods and also since inception. Real assets lagged the benchmark by -0.25% for the quarter. Overall, the total portfolio generated higher returns and lower risk than the policy and dynamic benchmarks since inception.

Ms. Mills reported that the TESTIF portfolio produced a 1.36% return for the quarter ending March 31, 2019. The portfolio lagged its policy benchmark by -0.37% and also lagged its dynamic benchmark by -0.01% for the quarter. Relative to both policy and dynamic benchmarks, the TESTIF portfolio has delivered a higher risk-adjusted return. Overall, the portfolio has generated similar returns and lower risk than the policy benchmark since inception in September 2015.

Discussion of Asset Allocation of Endowment and TESTIF Portfolios (Tab 7)

Mr. Ballard and Ms. Mills reviewed the asset allocation presentation. Relating to the Endowment portfolio, Ms. Mills explained that are three main considerations: 1) the Endowment is expected to provide inter-generational equity; a perpetual pool of capital; 2) the portfolio must provide regular distributions; and 3) the portfolio receives no additional contributions. Given these considerations, Ms. Mills explained that the investment objective would be to provide predictable, inflation-adjusted distributions while minimizing downside risk through diversification and risk management. Mr. Ballard reviewed the TESTIF portfolio considerations: 1) 25% of the fund's balance must be maintained in short-term cash equivalents; and 2) the fund is subject to large and unpredictable cash flows, including appropriations from the legislature. He explained that the investment object would be to earn an annual total return that would maintain the fund's purchasing power and exceeds the return on short-term cash equivalents.

The Board discussed the various allocation mix models illustrated behind Tab 7. In reference to the Endowment portfolio, a traditional stock/bond mix (65/35) is used as a starting point to approximate the allocation needed to achieve the desired expected return. The portfolio can be further diversified by adding alternative assets and different degrees of liquidity. The end result is a portfolio that has a higher expected return, less volatility, and better downside measures. Mix #1 demonstrated a diversified portfolio utilizing only long-only public and private asset classes. Mix #2 demonstrated a diversified portfolio utilizing a reduced amount of hedged strategies relative to the current target. In reference to the TESTIF portfolio, the target TESTIF allocation utilizes a diversified fixed income asset classes with an expected result that more than achieves the state return and risk objectives. By implementing a more conservative manner, the portfolio can expect results that still achieve the return objectives in the current market environment. The Mix 1 and Mix 2 examples illustrated the effect of increasing exposure to asset classes with higher return expectations and therefore increasing the portfolio's overall expected return, risk, and potential downside.

Lunch Speaker: Tony Crescenzi, PIMCO (Tab 6 handout)

Mr. Tony Crescenzi is an Executive Vice-President, market strategist and generalist portfolio manager in the New York office with PIMCO. He regularly appears on CNBC and Bloomberg television and in financial news media. Mr. Crescenzi reviewed the handout and presented a global macroeconomic and investment outlook. He believes that low global yields will persist but also expects resilience in the global economy, and advises to invest cautiously, mindful of downside risks and current valuations. Mr. Crescenzi believes interest rates will remain low and expects the Fed to lower yields 0.50% for the year.

Discussion of Next Meeting and Agenda Items

No future agenda items were suggested. The next meeting will be scheduled sometime in October.

Public Comment

None.

Adjourn

The meeting adjourned at 1:37 p.m.