COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Tuesday, June 23, 2020
Minutes

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Tuesday, June 23, 2020, via a WebEx virtual meeting due to COVID-19 restrictions. There was not an April meeting due to COVID restrictions.

Board Members ("The Board") Present

Comptroller Glenn Hegar, Laurie Dotter, Jim Hille, Steve Strake, Adolpho Telles, Sam Vinson and Ben Wall.

Board Members Absent

None.

Comptroller of Public Accounts Staff Virtually 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") Executive Staff and Presenters Virtually Present

Mike Reissig, Chief Executive Officer ("CEO"); Ruchit Shah, Chief Investment Officer ("CIO"); Anca Ion, Deputy Chief Investment Officer; Genoveva Minjares, Chief Financial Officer ("CFO"); Whitney Blanton, General Counsel; and Laura Montoya, Chief Operating Officer ("COO"). Other participants include Eduardo "Lalo" Torres, Portfolio Manager; Adam Levine, Chief Strategist; Chad Turner, Risk Manager; Jyoti Gupta, Portfolio Manager; Michael Leifeste, Portfolio Manager; Jorge de LaFuente, Director of Operational Due Diligence; Nora Arredondo, Program Specialist; and Shantel Geeslin, Program Specialist.

Additional Participants

Roger Willis and Joe Nugent, Asset Consulting Group ("ACG").

Call to Order

Comptroller Glenn Hegar asked Whitney Blanton to call roll. All members were virtually present. Comptroller Hegar declared that a quorum was virtually present and called the meeting to order at 10:00 a.m.

Approval of Minutes of February 6, 2020 Meeting (Tab 1)

A motion was made by Mr. Adolpho Telles to accept and approve the minutes from the February 6, 2020 meeting. The motion was seconded by Ms. Laurie Dotter unanimously approved by the Board.

Comptroller Hegar announced that Mike Reissig was no longer Acting CEO but instead was officially CEO. Also, Ruchit Shah was no longer Acting CIO but now CIO, and Anca Ion was now Deputy CIO.

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

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

Economic Outlook, Investment and Review of Treasury Pool (Tab 3)

Ms. Anca Ion recapped economic conditions for the first part of 2020 and reported on the current economic outlook. She reported that prior to the pandemic, the economy was going through a cooling off phase. During the first quarter of 2020, the economy contracted by approximately 5.0% as the Coronavirus became more prevalent. Productivity was negative and close to -1.0%. Globally, the health crisis morphed into an economic crisis at which point the Federal Reserve (the "Fed") intervened and cut interest rates from 1.75% to zero. This was the largest and fastest fall in history. The Fed also launched a massive $700 billion quantitative easing program. The Fed has expanded their balance sheet by approximately $3 trillion. Ms. Ion explained that in three months, from March to May, the Fed added more to its balance sheet than it did in six years, from 2008-2014. She reported that the Fed plans to reach 11 trillion by year end. That translates to the Fed owning almost half of the U.S. fixed income market by year end. The U.S. deficit is now at approximately 20%.

Ms. Ion reported that in the two months leading to the March crisis, the portfolio increased its treasuries allocation from $6.7 billion in December 2019, to $11 billion by the end of February. In her opinion, this gave the portfolio more flexibility for whatever lies ahead. The portfolio was well positioned in credit with ample liquidity at the onset of the crisis. She explained the strategy of the pool was trifold: 1) to provide as much liquidity as needed to cover state revenue shortfalls, therefore; having 30% of the portfolio in treasuries provided that confidence; 2) not selling any investments from the portfolio even though there were concerns during the peak of the crisis about possible downgrades and consumer credit performance in the ABS portfolio; and 3) to be active in parts of the market believed to offer value and able to sustain significant economic impact. She reported that overall in March the portfolio invested $4 billion in all asset classes. She reviewed further asset class allocations behind Tab 3. Ms. Ion reported that the Treasury Pool yield was approximately 1.1% as of May 31, 2020 and the current twelve-month yield was approximately 2.0%. The portfolio received approximately $8 billion from the CARES Fund Act which was invested in very liquid assets. The Treasury Pool balance was approximately $48 billion and continued to maintain a AAA rate by Standard & Poor's.

Ms. Ion explained that the Fed is not expected to raise interest rates anytime soon, rates are not expected to go into negative territory, and the Fed will place a floor on quantitative easing purchases. Also expected is a 6.5% contraction in GDP for 2020 and a 5% rebalance in 2021. On the positive side, she explained, the housing market remains resilient, mainly due to strong demand and limited supply, and the reduction in interest rates. Overall, Ms. Ion expects yields will go lower in the pool and challenging times lie ahead for short-term fixed income investments in the Treasury Pool.

Capital Markets Overview and Investment Performance Review for the Quarters Ending March 31, 2020 and December 31, 2019, and Related Matters (Tab 4)

Mr. Roger Willis of ACG presented ACG's view of the economy and market environment. He stated that during this economic crisis and low interest rate environment, ACG remains focused on planning, modeling and accessing risk, while also not relinquishing the overarching objective to grow the portfolio and generate returns in excess of inflation and spending. He reviewed the graph depicting exogenous shocks affecting the market and the waning of economic growth. He explained that growth will likely be below average for some time given the challenge in the low interest rate environment, the excessive saving by consumers, high unemployment and the disruption to supply chains. The yield environment is also stressed and does not offer much opportunity for fixed income investors. On the positive side, inflation of any magnitude is not expected in the foreseeable future, but of course that could change with the velocity of money back into the economy.

Mr. Willis presented potential scenarios behind Tab 4 for the construction of the portfolio over the next three to five years. In general, there are three probabilities: an optimistic case (20%), a base case (60%) and a pessimistic case (20%). The base case scenario eventually gets through the pandemic and sees a slow but likely move toward reopening globally and the potential for a vaccine in early 2021. ACG and the Trust Company believe the base case scenario is the more likely. Although the path to economic recovery depends on many factors, ACG anticipates consumer spending will increase modestly, inflation will remain low and more there may be volatility in the near term. Given the current economic environment, ACG firmly believes in strategic asset allocation, reevaluating the opportunity set under each asset class and ensuring the portfolio is well positioned. ACG and the Trust Company will continue to monitor the opportunity set for each asset class.

Mr. Willis reviewed the total portfolio performance summary for the period ending March 31, 2020. He explained that underperformance in the first quarter caused the total portfolio returns to underperform the Endowment policy benchmark over the one, three and five-year periods. Returns for the total portfolio outperformed the 65/35 benchmark over the same time periods and significantly in the first quarter of 2020. The annualized return of the portfolio was approximately 3.47% with a slightly higher standard deviation than the policy benchmark and a Sharpe Ratio of .46. Real assets provided a positive return for the portfolio of 2.93% and outperformed its benchmark. Fixed income and strategic all asset and overlays had a significant material impact on the overall portfolio. Given the low and declining interest rate environment and tight spreads, the fixed income portion of the portfolio was the most challenging.

Board member Jim Hille asked for more clarification regarding the fixed income portfolio. Mr. Ruchit Shah addressed the questions and explained that fixed income was indeed an issue; so too was the all asset and overlays portion of the portfolio. There was some permanent impairment with two volatility strategies and those were unwound. He explained that volatility strategies were within the alternative fixed income portfolio. Mr. Adam Levine further explained the volatility strategies.

Mr. Willis reported that the State Water Implementation Fund for Texas ("SWIFT") portfolio produced a rate of return of -7.50% for the quarter ending March 31, 2020, but had an annualized return of 2.88%, outperforming its annualized policy benchmark by fifty-five basis points. For the quarter there were negative returns and underperformance of policy benchmarks respectively for each major asset class, with the exception of real assets. Real assets maintained positive returns over the one, three and five-year periods and has outperformed its policy benchmark since inception. Overall, the SWIFT portfolio generated higher returns and similar risk relative to the policy and dynamic benchmarks over the past five years.

Mr. Willis reported that the Texas Economic Stabilization Investment Fund ("TESTIF") portfolio generated slightly lower returns and lower risk than the policy benchmark since inception. Relative to the policy and dynamic benchmarks, the portfolio has delivered lower returns since inception. For the quarter ending March 31, 2020, the portfolio generated -0.93% return. Since inception, the portfolio has produced a return of 2.05%, about 33 basis points behind the benchmark. As the economy improves so too should the portfolio.

Endowment, SWIFT and TESTIF Portfolio Updates, Current Performance Updates and Related Matters (Tab 5)

Mr. Shah informed the Board of the aggressive monitoring the Trust Company is conducting over existing and new managers. The pace has increased by approximately 40-50%. Mr. Shah summarized the performance summary charts and noted the large spike in the down capture was largely due to the volatility strategies. Also noted was that some of the macro funds did not perform as expected. They have regained some momentum and have recaptured approximately 50% of their losses. Mr. Shah presented an overview of actual versus target allocations for the portfolio. He reported that global fixed income allocations were close to target, so too was private debt. Alternative fixed income was under-weight partly due to a loss in the volatility strategy, and some of the funds were moved to overlays. He reported that the portfolio maintained a slight equity over-weight position. Mr. Shah reported that as of March 31, 2020, the portfolio has distributed approximately $2.08 billion and in April made another $74 million distribution to the Tobacco Endowment. Mr. Shah reviewed the portfolio liquidity chart and explained that the liquidity position in the portfolio was strong through most of March and there was sufficient liquidity to meet margin requirements and capital calls. He noted that liquidity guidelines may be revisited another time.

Mr. Shah asked the portfolio managers to summarize the information relating to their asset class. Mr. Lalo Torres, fixed income portfolio manager, reported that the sector allocation remains stable: it is the yield on the portfolio that has moved. This is a product of wider spreads in corporates and in the securitized space. He estimates that most of the losses that occurred in the global fixed income sector will be reversed by the end of the second quarter. He reported that April, May and June performance so far have rebounded. Next, Mr. Adam Levine reported on the volatility market. He explained that the speed at which the market reacted to the pandemic greatly affected volatility. The spike in both realized and implied volatility exceeded anything experienced since the Great Depression. In addition, liquidity in the volatility and options market almost completely contracted. Levels of VVIX (volatility of volatility) rose to levels far beyond 2008 or anything ever seen.

Ms. Laurie Dotter began a discussion regarding the portfolio position for the expected base case scenario. Mr. Shah stated that the portfolio would continue to examine the types and amounts of alternative fixed income, and more fixed income; however, fixed income did not offer much protection given the illiquidity in investment grade credit markets and other fixed income markets. Mr. Ben Wall continued the portfolio allocation discussion and unfunded commitments. Mr. Joe Nugent of ACG explained how the portfolio handles unfunded commitments and capital calls and is positioned to maintain liquidity.

Ms. Jyoti Gupta reviewed the global equity and hedged equity portion of the portfolio. She reported that this sector performed as expected during the first quarter and in line with how the markets reacted. To date, there has been a recovery by almost 50%. She explained the goal was to remove the passive exposure and bring in active management and make up ground between the benchmark and the global equity portfolio. In the hedged equity portfolio, there were managers that posted positive returns, but the small-cap activist manager was down over 30%. She reported that capital was protected in the hedged equity portfolio and the portfolio was rebounding.

Mr. Shah reported that the private equity portfolio was doing well and co-investments within the portfolio were beginning to gain momentum. The commitment pace will most likely be slower than that of the previous year.

Mr. Michael Leifeste reviewed the information related to real assets. He reported that he expects to see write-downs in retail and hospitality exposure, but the portfolio does not have a great deal of exposure to those sectors. The portfolio is currently positioned to have 10% in stable value and 10% in enhanced return; however, current allocations are 14% and 6% respectively. The single-family sector is expected to lag due to initial set-back in collecting rents, but the future for single-family rentals is good. Overall, he believes the residential sector is well positioned. The industrial sector is doing well also with an emphasis on e-commerce. Mr. Leifeste explained that he encouraged the funds' portfolio managers to begin taking the mark downs now and not procrastinate. He reported that exposure to the commercial real estate debt may be slightly decreased.

Mr. Shah reviewed strategic all asset and overlays portion of the portfolio. The volatility strategies were also in the strategic all asset portion of the portfolio. These strategies observed drawdowns. He reported that the portfolio no longer has positions in dedicated equity volatility strategies in its entirety.

Mr. Chad Turner reviewed the Value at Risk ("VaR") analysis. He explained that the measure of VaR used is very stable. He reported that as of March 31, 2020, the VaR was 3.5% and slightly higher than the policy

VaR of 3.4%. The portfolio risk measured in the long-term basis had not changed meaningfully between March and February and even December.

Mr. Shah reported that the portfolio returned .96% for April and 1.99% for May. Year to date, the rate of return was -7.07%.

Mr. Shah 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, 2020 was approximately $1.58 billion and produced a -7.5% return for the quarter. The real estate sector was the leading performance driver. He explained there were volatility strategies in SWIFT as well. The portfolio began with $2 billion and distributed approximately $700 million since inception. The portfolio generated approximately $303 million since inception. The portfolio produced a 0.89% return for April, 1.56% for May and year to date annualized rate of return of -5.22%. Mr. Shah reported that the portfolio remained highly liquid.

Mr. Peter Lake of the Texas Water Development Board reported that the Water Development Board issued guidance on the potentially reduced pace of water infrastructure projects going forward, at least relative to recent history

Mr. Shah reviewed the TESTIF portfolio and reported that it was performing as designed by preserving its purchasing power and earning more than inflation. The portfolio value as of April 30, 2020 was approximately $7.93 billion, approximately $ 1.89 billion more than in October 2019. The portfolio has produced an annualized return through May 2020 of approximately 1.00%. The portfolio remains extremely liquid.

Discussion of Next Meeting and Agenda Items

No future agenda items were suggested. Ms. Arredondo will contact the Board for the next meeting sometime in October.

Public Comment

No

Adjourn

The meeting adjourned at 12:53 p.m.