

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT
ADVISORY COMMITTEE
Thursday, March 29, 2018
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “Committee”) met on Thursday, March 29, 2018, at 10:00 a.m. in Room 320, Rusk State Office Building, 208 E. 10th Street, Austin, Texas.

Committee Members Present

Stuart Ford, Chairman; Commissioner Mark Beauchamp; Mr. Stephen Bowerman; Judge Dan Gattis; Mr. Fred Greene; Mr. Noe Hinojosa; Mr. Reed Hurley; Mr. Ted Matthews; Judge James Teal; and Commissioner Byron Underwood.

Committee Members Absent

Judge Ben Zeller.

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

Paul Ballard, Chief Executive Officer and Chief Investment Officer; Danny Sachnowitz, Deputy Chief Investment Officer; Frank Zahn, Chief Financial Officer; Marianne S. Dwight, General Counsel; Gena Minjares, Deputy Chief Financial Officer; Hugh Ohn, Director of Accounting Strategy and Planning; Spencer Brown, Compliance Officer; Nora Arredondo, Program Specialist; Susan Colletti, Director of Investment Accounting; and Jorge deLaFuente, Director of Operational Due Diligence.

Additional Participants Present

Mike O’Brien, RSM & Co., LLP; and Tom Janisch and Alex Nixon, Asset Consulting Group (“ACG”).

Call to Order

Chairman Stuart Ford declared that a quorum was present and called the meeting to order at 10:02 a.m.

Approval of Minutes (Tab 1)

A motion to approve the November 3, 2017 meeting minutes was made by Judge Dan Gattis. The motion was seconded by Commissioner Byron Underwood and unanimously approved.

Presentation of Annual Audit (Handout)

Mr. Mike O’Brien reported that RSM & Co. issued an unqualified audit opinion with respect to the Tobacco Settlement Permanent Trust Account (“Account”) for the year ending December 31, 2017. Mr. O’Brien affirmed that the account had been managed in compliance with the Investment Policy and the Distribution Policy. Mr. O’Brien reviewed the distribution calculation process as described in the distribution attestation report. He explained that the audit attests to the calculation process, not the decided distribution amount, since it has yet to be determined. No audit adjustments were recorded during the audit engagement, nor was a management letter issued.

Capital Markets Overview and Investment Performance Review for the Quarter ending December 31, 2017 and Related Matters (Tab 2)

Mr. Tom Janisch presented an economic overview of 2017. He reported that the new Federal Reserve Board Chairman, Jerome Powell had indicated more rate hikes were justified. Chairman Powell stated that the Fed believes the domestic economic outlook has strengthened in the recent months. Mr. Janisch reported that rising rates had made the fixed income sector more challenging; however, having managers in the Endowment who have the flexibility to seek other opportunities in the credit area has proven beneficial. Mr. Janisch stated that ACG believes there will be a total of three interest rate hikes in 2018; so far only one has occurred. Mr. Janisch reported that annualized growth in real GDP had surpassed 3% for two consecutive quarters, the unemployment rate was at a 17-year low, and corporate earnings growth was aiding in driving equity markets to all-time highs. He explained that the protectionist trade policy was currently the biggest risk facing the stock market. He believes that the long-term positive market may be winding down. Overall, the U.S. demonstrated modest economic growth and stability and ACG remains positive but continues to expect slow domestic economic growth.

Mr. Janisch presented an update on capital markets. He reported that for the one-year period ending December 31, 2018, market returns for major asset classes were positive, with the exception of U.S. Treasuries. Currently, returns have been retracing some of their gains. Over the three and five year periods, commodities was the only sector that produced a negative return. Mr. Ballard stated that the portfolio allocation to commodities is currently underweight. Emerging markets was one of the higher performing markets that produced a return of almost 38% for 2017.

Mr. Alex Nixon of ACG summarized the investment performance of the portfolio for the quarter ending December 31, 2017. He reviewed the risk vs. return analysis chart and reported that the portfolio generated a higher return with slightly higher risk compared to the endowment policy benchmark over the last five year. Relative to broad market benchmarks, the portfolio generated 89% of the return with 50% of the risk. The annualized return for the total portfolio was 11.57%, while the endowment policy portfolio produced an annualized return of 10.64%. The portfolio significantly outperformed the policy benchmark over the past year, contributing to longer-term outperformance over the trailing three and five year periods. Mr. Nixon reported that the fixed income portion of the portfolio outperformed its benchmark for the quarter, three, and five year periods but lagged modestly in the past year. Equity strategy returns lagged in the fourth quarter but generated positive returns over the trailing one, three, and five years. Real assets also produced positive returns year to date and lead over all periods.

Mr. Janisch summarized ACG's forward looking view of various asset classes. The overall market outlook is mixed. The outlook for cash and global fixed income remains challenging. Expectations for global equities are neutral to overweight, which reflects a modest positive view. Global equity markets are likely to continue to provide positive, albeit modest, returns going forward. ACG continues to support fixed income strategies with greater flexibility to better navigate volatility, therefore changing their outlook from underweight to neutral. ACG continues to recommend an overweight to emerging market equities.

Discussion and Approval of Annual Trust Distribution (Tab 3)

Mr. Paul Ballard began the discussion by reviewing the 2018 distribution calculation behind Tab 3. The calculation is based on the revised rule and is 3% of the 20-quarter moving average value of the Trust ending December 31, 2017. That 20-quarter average value is \$2,322,996,002 and 3% of that is \$69,689,880.

Mr. Ballard reviewed the basics of the portfolio's rate of return and corpus versus market value. He explained that the Trust was initially funded with \$1.683 billion and had distributed to date approximately \$888 million. The Trust value as of December 31, 2017 was approximately \$2.568 billion, and the inflation adjusted corpus was approximately \$2.36 billion. Total earnings (value in excess of corpus) were approximately \$885 million, as of December 31, 2017.

Mr. Jim Allison initiated the discussion regarding the management fee of 30 basis points charged by the Trust Company. Mr. Ballard explained the portfolio is on a cost recovery basis and the maximum the Trust Company could charge is the 30 basis points. Whatever difference is unneeded is rebated back to the portfolio. Last year \$600,000 was rebated back to the portfolio.

Mr. Ballard and Chairman Ford reminded the Committee that the distribution calculation is a twenty quarter moving average value of the fund times three percent, as demonstrated on page two behind Tab 3. The recommended distribution amount is therefore \$69,689,880.

Mr. Fred Greene made a motion to approve the distribution of \$69,689,880 to the beneficiaries of the Tobacco Settlement Permanent Trust Account. The motion was seconded by Mr. Byron Underwood and unanimously approved by the Committee.

Endowment Portfolio Update and Related Matters (Tab 4)

Mr. Paul Ballard presented an overview of the endowment portfolio and reported that it was in compliance with the asset allocation and investment policies. He reported that as of December 31, 2017 the portfolio value was approximately \$2.57 billion. The portfolio produced an approximate annualized return of 11.6%, out-performing its benchmark by 0.93%.

Mr. Ballard noted that the executive summaries behind Tab 4 provided information regarding each asset class for the quarter and the year. He explained that the portfolio was performing as expected and staff is continually reviewing strategies and always searching for new and better managers. He reviewed the performance summary charts and explained that in the previous three months, most of the positive returns came from equity strategies. Over the previous three years, the biggest drivers were almost even and were real estate, hedged equity and global public equity. Mr. Ballard reviewed the asset allocation summary chart, which demonstrates how the portfolio was positioned relative to its allocation targets. Other charts and graphs were reviewed that illustrated liquidity and asset class characteristics. Mr. Ballard and Mr. Danny Sachnowitz reviewed further each asset class and the various investment strategies utilized to diversify returns within the portfolio. Mr. Ballard explained that the portfolio is put through several stress test scenarios and that the construction of the portfolio has proven to be resilient. The objective continues to be consistency of performance with downside protection. He reported that the portfolio was performing in line with expectations, given the current economic environment. The portfolio produced a return of 2% for January and less than 1% for February.

Discussion of Next Meeting and Agenda Items

The tentative date for the next meeting is November 2, 2018, and the Committee will be contacted for confirmation.

Public Comment

None.

Adjourn

Chairman Stuart Ford adjourned the meeting at 12:00 p.m.