

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT  
ADVISORY COMMITTEE  
Monday, March 25, 2019  
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Monday, March 25, 2019, at 10:00 a.m. in Room 320, Rusk State Office Building, 208 E. 10<sup>th</sup> Street, Austin, Texas.

**Committee Members Present**

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

**Committee Members Absent**

Judge Bill Gravell, Mr. Stephen Bowerman, and Judge Ben Zeller.

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

Paul Ballard, Chief Executive Officer and Chief Investment Officer; Genoveva Minjares, Chief Financial Officer; Marianne S. Dwight, General Counsel; Hugh Ohn, Director of Accounting Strategy and Planning; Spencer Brown, Compliance Officer; Whitney Blanton, Deputy General Counsel; Nora Arredondo, Program Specialist; Laura Montoya, Chief Operating Officer; Ruchit Shah, Portfolio Manager; and Jorge de LaFuente, 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 10:05 a.m. Mr. Ford announced the appointment of a new Committee member, Judge Bill Gravell, who will be replacing Judge Dan Gattis.

**Approval of Minutes (Tab 1)**

*A motion to approve the November 2, 2018 meeting minutes was made by Commissioner Byron Underwood. The motion was seconded by Mr. Ted Matthews and unanimously approved by the Committee.*

**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, 2018. 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, 2018 and Related Matters (Tab 2)**

Mr. Tom Janisch presented an economic overview. He reported that in the fourth quarter of 2018, there was a slowdown in European and Chinese economies. There were trade tensions between China and the U.S., and in the U.S. there was a government shutdown for 35 days. Throughout 2018 almost all market returns were in negative territory. Market volatility in 2018 was somewhat normal but felt higher since volatility in 2017 was abnormally low. Year-to-date market returns were positive as depicted in the graph behind Tab 2. Mr. Janisch reported that the S&P 500 in the beginning of year had the best returns since 1987 and year-to-date reported returns were approximately 13.8%. He reported that the Russell 2000 Index was up almost 15% through March thus far. If this economic run continues, it will be the longest economic recovery in history. Mr. Janisch reported that the third quarter annualized GDP grew at 3.4%. Projections for the fourth quarter are between 2.5% and 3.0%. The labor sector of the economy remained robust reflecting a 3.9% unemployment rate. The Federal Reserve (the "Fed") increased short-term interest rates on December 19, 2018, to a targeted range of 2.25% to 2.50%, and signaled there would possibly be two more interest rate hikes in 2019, which led to a spike in market volatility. In January the chairman of the Fed, Jerome Powell, decided to pause more interest rate increases. ACG is forecasting global economic growth of 2.5% - 3.5%, they expect developed market inflation to remain centered around 2.0% target, they expect equities to perform slightly below earning growth and also short-term bond yields to lose upward momentum (part of the end of tightening). ACG believes that in the long-term, the biggest driver of growth will be in emerging markets. They expect market volatility to continue and they do not expect a recession in 2019. Overall, the U.S. continued to demonstrate modest economic growth and stability. ACG remains positive and expects domestic growth to continue at a modest, slow rate.

Mr. Alex Nixon of ACG summarized the investment performance of the portfolio for the quarter ending December 31, 2018. He explained that the total portfolio generated a higher return with similar risk compared to the endowment policy benchmark over the last five years. Relative to broad market benchmarks, the portfolio generated 151% of the return with 46% of the risk. He reported that the annualized return for the portfolio was 4.86% over the last five years and outperformed the endowment policy benchmark and significantly outperformed the 65% ACWI/ 35% Barclays Global Aggregate benchmark. Despite lagging in the fourth quarter, the fixed income portion of the portfolio outpaced the fixed blend benchmark over the one, three, and five-year time periods. Equity strategies outperformed its benchmark by 1.10% for the quarter and produced an annualized return for the five-year period of 5.26%. Real assets continued to demonstrate strong relative results longer term, annualizing 1.70% of outperformance over the trailing five-year period.

## **Discussion and Approval of Annual Trust Distribution (Tab 3)**

Mr. Paul Ballard reviewed the corpus versus market value of the Trust. He reported that 1) the market value was \$2.517 billion, 2) that as of December 31, 2018, the inflation-adjusted corpus was \$2.40 billion, 3) the Trust corpus was \$1.683 billion, 4) total earnings were \$834 million and, 5) total distributions since inception have totaled approximately \$958 million. He reminded the Committee that the calculation is based the revised rule and is 3% of the 20-quarter moving average value of the Trust ending December 31, 2018. The recommended distribution amount is therefore \$71,912,881.

***Mr. Ted Williams made a motion to approve the distribution of \$71,912,881 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, 2018 the portfolio value was approximately \$2.52 billion. The portfolio posted an annualized return of -3.0% for the quarter. Mr. Ballard recapped the executive summary behind Tab 4 and reported that the portfolio was performing as expected. For the trailing one-year period, the portfolio returned 1.0% and the best performing asset classes were private equity (16.9%), real estate (8.6%), and private debt (4.3%).

Mr. Ballard reviewed the asset allocation summary chart which demonstrates how the portfolio was positioned relative to its allocation targets. He explained that the portfolio is highly diversified, and is invested in 253 different funds and 115 different managers. Mr. Ballard reviewed each asset class and the various investment strategies utilized to diversify returns within the portfolio. He explained which asset classes were overweight or underweight and how that related to the target allocations and returns. He noted that the real estate asset target moved to 20% and it would take a while to increase allocations up to that target. Mr. Ballard explained that the portfolio is put through multiple stress test scenarios and that its construction has proven to be resilient. The objective continues to be consistency of performance with downside protection. Given the current economic market environment, he explained that the portfolio was performing in line with expectations.

### **Discussion of Next Meeting and Agenda Items**

Chairman Ford announced that Commissioner Rick Bailey would be replacing Byron Underwood at the next meeting. The tentative date for the next meeting is October 2019, and the Committee will be contacted for confirmation.

### **Public Comment**

None.

### **Adjourn**

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