

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Thursday, December 15, 2008
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Monday, December 15, 2008 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, Steve Strake, Adolpho Telles, and Scott Wise.

Board Member Absent

None.

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; Dan McNeil, Compliance Officer; Byron Beasley, Private Markets Manager; Mike Leifeste, Real Estate Portfolio Manager; J. Germenis, Public Markets Manager; Lalo Torres, Investment Analyst; Perry Wang, Risk Analyst; Kathy Bueltel, Program Specialist; Nora Arredondo, Special Projects Coordinator; Gena Minjares, Audit Liaison; Oscar Ramirez, Trust Operations Manager; Victor Scott, Financial Reporting Manager; and Laura Montoya, Communications Manager.

Others

Tom Margulis, Asset Consulting Group ("ACG"); Paul Crotty, Portfolio Advisors, LLC; Lester Sprouse, Padgett, Stratemann & Co., LLP; and Steven Pines, Northern Trust

Call to Order

Comptroller Combs declared that a quorum was present and called the meeting to order at 10:07a.m.

Approval of Minutes of September 18, 2008 Meeting (Tab 1)

Mr. Adolpho Telles made a motion to accept and approve the minutes from the September 18, 2008 meeting. The motion was seconded by Mr. Steve Strake and unanimously approved by the Board.

Presentation of Independent Auditor's Reports for the Trust Company (Tab 2)

Mr. Lester Sprouse summarized the audit reports behind Tab 2 and reported that Padgett, Stratemann & Co., issued an unqualified financial audit opinion with respect to Trust Company for the year ending August 31, 2008. No audit adjustments were recorded during the audit engagement that would indicate

deficiencies in the accounting process. No management letter was required. Mr. Sprouse reported that the Trust Company revenue was approximately \$20 million for the year. Mr. Ballard explained that some investors were struggling with implementation of FAS 157 in the coming year. FAS 157 requires that investments be categorized based on their liquidity characteristics. He also mentioned that the Trust Company was working with its asset valuation committee to develop a methodology for valuing private investments in a more timely fashion to satisfy future audit requirements and stated that he would update the board on progress at its next meeting. Mr. Telles asked that a more extended discussion of the Trust Company business, including going-concern structural issues such as succession planning be added to a future board agenda.

Review of Treasury Pool (Tab 3)

Mr. Mike Samples reviewed the Treasury portfolio asset summary as of November 30, 2008 and stated that the value of the Treasury Pool was approximately \$26 billion with an approximate 2.53% yield. Mr. Samples stated that in these uncertain economic times, he wanted ample liquidity in the Pool and therefore the Pool would hold more US Treasury securities. Mr. Martin Hubert and Mr. Samples discussed the importance of providing liquidity when needed and of maintaining the Treasury Pool's AAA rating.

Mr. Samples discussed the portfolio composition and maturity structure of the pool as illustrated in the report. He reviewed comparative benchmark yields and stated that the Treasury Pool outperformed its other benchmarks and remains competitive. Mr. Samples stated that the economy was well into a recession. He suggested modifying the custom benchmark that had been established for the incentive compensation plan.

Recommendation to Revise Performance Benchmarks for Treasury and Endowment Pools (Tab 4)

Mr. Paul Ballard explained the need to revise the current benchmark for the Treasury Pool due to the economic downturn. Currently the benchmark is comprised of two components weighted 70% to liquidity and 30% to core, which reflects the characteristics of the Treasury Pool. The liquidity portion of the benchmark is based on the Federal Funds Rate which was reduced in October to between 0.25% and zero, making it unacceptably low for the purpose of a benchmark.

Mr. Ballard stated that the Trust Company recommends that the liquid component of the benchmark be comprised of a blend of prime and government money market fund indexes to better reflect the investment opportunities available to the Treasury Pool. He recommended that the 70% liquid component of the benchmark be comprised 40% of institutional prime and 30% government money market funds effective October 1, 2008. More specifically: 40% iMoneyNet First Tier Institution Money Market Fund Index gross of fees (Prime Funds) and 30% iMoneyNet Government and Agency Money Fund Index gross of fees (Government Funds). No change is recommended to the 30% core component of the benchmark.

Motion was made by Ms. Laurie Dotter to accept the recommended changes to the Treasury Pool performance benchmark effective October 1, 2008 regarding the 70% liquidity component as follows: 40% iMoneyNet First Tier Institutional Money Fund Index gross of fees and 30% iMoneyNet Government & Agency Money fund Index gross of fees. The motion was seconded by Mr. Jim Hille and unanimously approved.

Discussion: Investment Strategy/Private Equity (handout)

Mr. Paul Crotty of Portfolio Advisors reviewed the scope of services provided by Portfolio Advisors to the Trust Company. He gave an overview on the background of Portfolio Advisors. Mr. Crotty reviewed

the handout and discussed the state of the private equity market. He commented that historically, some of the best returns in private equity have been generated from investments made during recessionary and recovery periods, similar to what the economy is experiencing now. Portfolio Advisors is advising existing clients to stay on pace with planned private equity investment programs.

Capital Markets Outlook (Tab 5)

Mr. Tom Margulis of ACG reviewed the sequence of economic events from September 7, 2008, when the U.S. Government seized control of Fannie Mae and Freddie Mac, through October 29, when the Federal Reserve cut the Federal Funds Rate target to between zero and 0.25%. Although volatility exists in every investment sector, ACG believes there are unprecedented opportunities for long-term investors to find value in the fixed income and equity markets. Mr. Margulis reviewed the information behind Tab 5 and stressed the importance of diversification, rebalancing, and risk management. ACG believes that 2009 will continue to be a difficult economic environment until credit markets begin to function more normally.

Endowment Portfolio Update (Tab 6)

Mr. Paul Ballard presented the Board an overview of the endowment fund and reported that the portfolio was in compliance with the investment policy. He reviewed the asset allocations as of September 30, 2008 and reported that the portfolio was in alignment with investment targets.

The Board discussed a loss sustained by a Trust Company fund of hedge funds manager. Mr. Ballard commented that because the Trust Company currently invests in hedge funds via funds of funds, the hedge fund exposure is spread across approximately 250 hedge funds, so this loss is immaterial to the endowment fund as a whole. He explained that the Trust Company initially deployed into hedge funds using a fund of funds approach to gain exposure to hedge funds with the least possible risk. As the Trust Company gained experience and developed its own monitoring and risk management systems that it would systematically replace the fund of funds managers, eliminate their layer of fees and move to a direct investment model. Mr. Wise confirmed that the direct investment model was the more traditional approach and one with which he was comfortable. Other board members agreed. The board then discussed the hedge fund due diligence process.

Mr. Danny Sachnowitz discussed hedge funds further and stated that the Trust Company was currently receiving responses to a Request for Proposals for a specialist hedge fund investment consultant. Mr. Sachnowitz continued with a review of the private equity and real estate portions of the portfolio as illustrated in the information behind Tab 5.

Mr. Wise asked that a schedule of unfunded commitments for all private investment strategies be added to the next report.

Endowment Funds Investment Performance for the Quarter Ending September 30, 2008 and Related Matters (Tab 7)

Mr. Steve Pines of Northern Trust reviewed the investment performance of the endowment funds for the period ending September 30, 2008. Mr. Pines reviewed Trust Company returns versus other public funds and endowments with values greater than \$1 billion that are tracked in the Northern Trust database. Mr. Pines reported that the market value for the Trust Company Total Plan was approximately \$3.1 billion, with a -8.57% return for the quarter ending September 30, 2008.

Update on Broker/Dealer List (Tab 8)

Mr. Ballard reviewed the approved broker/dealer list as illustrated behind Tab 8.

Discussion of Next Meeting and Agenda Items

The Board would like unfunded commitments added to the portfolio update presentation. The Board would also like a Trust Company organizational update.

Public Comment

None

Adjourn

The meeting adjourned at 2:09 p.m.