

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Thursday, September 10, 2009
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, September 10, 2009 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members Present

Comptroller Susan Combs, Laurie Dotter, Jim Hille, Steve Strake, Adolpho Telles, and Scott Wise.

Board Member Present via Teleconference

Tucker Bridwell.

Comptroller of Public Accounts Staff Present

Martin Hubert, Deputy Comptroller.

Texas Treasury Safekeeping Trust Company ("TTSTC") 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; Michael 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; Oscar Ramirez, Trust Operations Manager; and Victor Scott, Financial Reporting Manager.

Others

Tom Margulis, Asset Consulting Group ("ACG"); Rick Pokorny, Northern Trust.

Call to Order

Comptroller Combs declared that a quorum was present and called the meeting to order at 10:04 a.m.

Approval of Minutes of July 8, 2009 Meeting (Tab 1)

Mr. Jim Hille made a motion to accept and approve the minutes of the July 8, 2009 Comptroller's Investment Advisory Board meeting. Motion was seconded by Mr. Scott Wise and unanimously approved by the Board.

Economic Update (Tab 2)

Mr. Tom Margulis of ACG presented an economic update and reviewed the third quarter to date. Mr. Margulis reported that since March 9, 2009 there has been a rally in the markets. The Dow Jones Industrial Average is up 46%, the S&P 500 is up 53% and the NASDAQ is up 62%. Unemployment numbers remain high but are slowly improving. ACG projects 2%-3% economic growth for the third and

fourth quarters of 2009. Mr. Margulis commented that revenue growth and inflation should continue to be monitored closely. Mr. Margulis reviewed the asset class relative rankings as of the third quarter of 2009 behind Tab 2. ACG continues to believe the most significant opportunities are in the distressed investments sector of the private equity markets. ACG expects U.S. markets to continue to outperform developed international markets. ACG continues to view absolute return strategies favorably. Mr. Margulis explained that although most strategies did well this quarter, ACG believes that 2010 will present significant challenges for investors.

Endowment Portfolio Update (Tab 3 and handout)

Mr. Paul Ballard presented the Board an overview of the endowment portfolio and reported that the portfolio was in compliance with the investment policy. The portfolio value as of June 30, 2009 was approximately \$2.70 billion and the current value was approximately \$2.85 billion. He reviewed the asset allocations as of June 30, 2009, as illustrated in the report behind Tab 3 and reported that the portfolio was in alignment with investment targets.

Mr. Danny Sachnowitz reported that the allocation of the portfolio's total risk to market return strategies had been reduced from 58% to 53%. Mr. Sachnowitz discussed the portfolio's asset allocation relative to targets. He stated that the Trust Company was continuing to receive redemptions from the Rock Creek Potomac and Austin Capital Management funds of hedge funds and that redemptions would be used primarily to fund direct hedge fund investments. He informed the Board that a full redemption was being made from fund of funds, Entrust Capital.

Next, Mr. Sachnowitz discussed the absolute return portfolio performance. He reviewed handout with an absolute return model listing hedge fund managers the Trust Company was considering. Mr. Sachnowitz reviewed the private equity and real estate portfolios. He stated that performance was in line with expectations, given the current economic conditions. He concluded the presentation with a review of portfolio stress test scenarios as illustrated on pages 28 and 29.

Review and Recommendation of Placement Agent Policy (Tab 4)

Paul Ballard explained that Comptroller Combs directed Trust Company to develop a third-party placement agent policy to ensure that the funds managed by the TTSTC are able to stand the highest level of ethical scrutiny for proper dealing. Mr. Ballard then explained the current ethics policy that is followed by the investment staff. Mr. Telles observed that the proposed Placement Agent Policy did not address the issue of materiality and suggested that, in the interest of keeping compliance with the policy manageable, that disclosure be limited to political contributions over \$500. Mr. Hille stated his understanding that the intent of the policy was to require disclosure of political contributions to state level officials and suggested that the policy exclude reporting of contributions to local government officials.

The Board recommended the adoption of the proposed Placement Agent Policy with two caveats: (1) that the term "Texas elected officials" exclude local governmental officials; and (2) that the policy include a disclosure materiality limitation. Mr. Adolpho Telles made a motion to recommend the policy to the Comptroller. The motion was seconded by Mr. Steve Strake and unanimously approved.

Review of Treasury Pool (Tab 5)

Mr. Mike Samples reviewed current economic conditions impacting the fixed income market. He said there was some improvement in the economy for the quarter and that the pace of job losses was slowing. He noted that U.S. exports had been up for three consecutive months and that imports had been up for two consecutive months. Mr. Samples stated his belief that improving economic conditions were largely attributable to government stimulus. He also stated his expectation that the Federal Reserve would keep interest rates low for some time to come. He noted that there was still a small chance that we could see

another leg down in the economy. He noted that, with interest rates at these low levels and real estate values declining, that home affordability was about as high as it has ever been.

Mr. Samples reviewed the Treasury Pool asset summary as of July 31, 2009 and stated that the value of the Pool was approximately \$31 billion and had an approximate 1.34% yield. He stated the Treasury Pool currently has \$190 million in unrealized gains. He reviewed Treasury Pool yields relative to short-term Treasury and money market rates. Mr. Samples discussed the portfolio composition and maturity structure as illustrated in the report. Next, Mr. Samples reviewed comparative benchmark yields and stated that the Treasury Pool yield remained competitive.

Annual Review and Recommendation of Comptroller's Investment Policy (Tab 6)

The Trust Company recommended two substantive changes to the Comptroller's Investment Policy. Mr. Ballard explained that the Treasury Pool performance benchmark that was officially revised in December should be added to the investment policy. Also, he recommended that references to economic development-related programs known as "linked deposits" be removed from the investment policy. While these programs are funded with monies from the Treasury Pool, they are not managed by the Trust Company so should not be included in the investment policy.

Ms. Laurie Dotter made a motion to recommend that the Comptroller accept the revisions to the Comptroller's Investment Policy as presented. Motion was seconded by Mr. Jim Hille and unanimously approved by the Board.

Endowment Funds Investment Performance for the Quarter Ending June 30, 2009 and Related Matters (Tab 7)

Mr. Ballard introduced the new Northern Trust performance consultant, Mr. Rick Pokorny. Mr. Pokorny reviewed the investment performance of the endowment funds for the year ending June 30, 2009. He stated that the market environment was improving, noting that for the first six months of the year the portfolio value was down, but for the last six months the portfolio was up approximately 3%. The Trust Company endowment fund lagged the policy benchmark for the quarter. Mr. Pokorny reviewed the endowment portfolio's returns versus a universe of other public funds and endowments and foundations with asset values greater than \$1 billion that are tracked in the Northern Trust database. The Trust Company endowment performance was above median for the year versus both the universe of public funds and endowments and foundations. He pointed out that the portfolio's risk, measured by the standard deviation of returns, was among the lowest relative to its peers. Mr. Pokorny stated that the total portfolio return for the month of July was approximately 3.99%.

Update on Broker/Dealer List (Tab 8)

Mr. Ballard reported one broker/dealer was added to the list: Jefferies & Company.

Discussion of Next Meeting and Agenda Items

The board will be contacted with suggested meeting dates.

Public Comment

None

Adjourn

The meeting adjourned at 1:26 p.m.