

**COMPTROLLER'S  
INVESTMENT ADVISORY BOARD MEETING  
Wednesday, July 22, 2010  
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, July 22, 2010 at the LBJ State Office Building, 111 E. 17<sup>th</sup> 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 Members 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; J. Germenis, Public Markets Manager; Michael Leifeste, Real Estate Portfolio Manager; Lalo Torres, Investment Analyst; Perry Wang, Risk Analyst; Wai Yee Cheng; Portfolio Manager; Adam Levine, Portfolio Manager; Nora Arredondo, Special Projects Coordinator; John Wright, Assistant General Counsel; Gena Minjares, Director of General Ledger Accounting and Audit Liaison; Laura Montoya, Director of Administrative Services; and Oscar Ramirez, Director of Trust Operations.

**Others**

George Tarlas, Asset Consulting Group ("ACG"); and Rick Pokorny, Northern Trust.

**Call to Order**

Comptroller Combs declared that a quorum was present and called the meeting to order at 10:03 a.m.

**Approval of Minutes of March 3, 2010 Meeting (Tab 1)**

*Mr. Steve Strake made a motion to accept and approve the minutes of the March 3, 2010 Comptroller's Investment Advisory Board meeting. Motion was seconded by Ms. Laurie Dotter and unanimously approved by the Board.*

## **Capital Markets Outlook and Discussion (Tab 2)**

Mr. George Tarlas of ACG presented an economic update and reviewed the first quarter to date. He reported that although the financial markets had improved in the last twelve months, they remained uncertain and still faced many macroeconomic challenges. Lagging economic indicators such as unemployment and housing had shown minimal improvement. Economic growth was reported at approximately 2.5% for the quarter. ACG expects a low growth economic environment in the United States and Western Europe for the remainder of 2010 and into 2011. They believe the next twelve months will be a subdued inflationary environment and interest rates are expected to remain low, but U.S. Treasury yields could rise to above 1% by the second quarter of 2011. ACG believes that this challenging environment requires investors to be opportunistic and to seek managers with the ability to take advantage of changing market conditions.

Mr. Tarlas reviewed asset class rankings as of the second quarter of 2010 behind Tab 2. ACG believes emerging markets will continue to grow robustly but fixed income markets present more of a challenge in the event of a rising interest rate environment. ACG continues to view absolute return strategies favorably. They offer greater inflation protection. Mr. Tarlas stated that ACG believed the global real estate market was beginning to rebound; however, there was still a surplus in commercial real estate. He commented that the portfolio positions reflected these observations and expectations.

## **Economic Outlook and Review of Treasury Pool (Tab 3)**

Mr. Mike Samples reviewed the information behind Tab 3 and presented his perspective on economic growth. He explained how other countries are experiencing the limits on what the government can do to keep their economies going. The United States is not at this crossroad yet. Current domestic economic growth is at approximately 1.5% – 2%. Mr. Samples explained that 4% is needed to meaningfully reduce the unemployment rate. He noted that the current aging population coupled with the slowing population growth the U.S. is experiencing, slows economic growth. Mr. Samples discussed monetary policy and his expectation that the Federal Reserve (the “Fed”) will keep interest rates low for at least the next year. In his opinion, interest rates won’t rise until 2012.

Mr. Samples reviewed the Treasury Pool asset summary as of June 30, 2010 and stated that the value of the Pool was approximately \$26 billion and had an approximate .88% yield. He stated the Treasury Pool currently is carrying approximately \$109 million in unrealized gains. Mr. Samples reviewed the sand chart on page three that illustrates the portfolio asset summary. He explained the portfolio shift from agencies into treasuries which began in 2008. Now treasuries account for approximately 70% of the portfolio. The deflated housing market was a major factor contributing to the downturn in the housing agencies’ profits. Next, Mr. Samples reviewed comparative benchmark yields and stated that the Treasury Pool yield had outperformed its benchmarks.

## **Annual Review and Recommend Modifications to Endowment Investment Policy (Tab 4)**

The Endowment Investment Policy contains a requirement that it be reviewed annually. Mr. Paul Ballard reviewed the proposed changes to the Endowment Investment Policy as presented in the redlined copy of the Endowment Policy behind Tab 4. He explained the modifications recommended that would be consistent with the direction of the Trust Company’s objective to earn superior risk-adjusted returns over the long run and better protect capital in stressed markets.

The Board discussed risk management and Value at Risk (“VaR”) as presented in Chapter VI of the Endowment Policy. The Board asked for new language pertaining to VaR and suggested that they adopt the recommended amendments to the Endowment Investment Policy with the exception of the section pertaining to VaR. The Board would further review VaR and recommend any changes at the next board meeting.

*Mr. Jim Hille made a motion to recommend to the Comptroller the proposed amendments, excluding the VaR proposed modifications, as presented by the Trust Company. The motion was seconded by Mr. Tucker Bridwell and unanimously approved by the Board.*

#### **Endowment Portfolio Update and Related Matters (Tab 5)**

Mr. Ballard introduced two new members to the portfolio investment team: Mr. Adam Levine and Ms. Wai Yee Cheng. Mr. Ballard presented the Board an overview of the endowment portfolio and reported that it was in compliance with the asset allocation and investment policies. The portfolio value as of June 30, 2010 was approximately \$2.9 billion. He reviewed the asset and risk allocations as of June 30, 2010, as illustrated in the report behind Tab 5 and reported that the portfolio was in alignment with asset allocation targets. He reported that the VaR for the portfolio was at approximately 5.5% which is slightly below policy VaR.

Mr. Danny Sachnowitz reviewed the phase-in target asset allocations. He reviewed current and new managers in the various asset classes. He discussed returns and performance as it pertained to specific asset classes. Mr. Ballard reviewed the market return summary and stated that the Trust Company is working on expanding the emerging markets portfolio. Mr. Ballard introduced some new metrics that were added to add greater clarity to the portfolio's investment characteristics. He continued the review of various investment strategies within the asset classes and stated that performance was in line with expectations, given the current economic conditions.

#### **Endowment Funds Investment Performance for the Quarter Ending March 31, 2010 and Related Matters (Tab 6)**

Mr. Rick Pokorny of Northern Trust reviewed the investment performance of the endowment funds for the period ending March 31, 2010. He explained that for the period ending March 31, 2010 risk was being rewarded. The portfolio total return was approximately 2.59%, which surpassed the policy benchmark by 68 basis points, but lagged public fund peers for that period. The equity markets had a sustained upward movement and most public fund peers had a larger exposure to equities. 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. Mr. Pokorny reported the portfolio's return for the quarter ending June 30, 2010 was approximately -3.66%, and that the year-to-date return was approximately -1.2%.

#### **Broker/Dealer Update (Tab 7)**

Mr. Ballard reported that no new Broker/Dealers were added, but three Historically Underutilized Businesses ("HUBs") were deleted because they had either closed their business or failed to respond to requests to reapply for inclusion on the approved list.

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

The board will be contacted with suggested meeting dates for September.

#### **Public Comment**

None

#### **Adjourn**

The meeting adjourned at 1:55 p.m.