

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Tuesday, June 14, 2011
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Tuesday, June 14, 2011 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 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; John Wright, Assistant General Counsel; Michael Anderson, 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; Erin Corley, Private Markets Analyst; Nora Arredondo, Special Projects Coordinator; Gena Minjares, Director of General Ledger Accounting; Victor Scott, Director of Financial Reporting; Laura Montoya, Director of Administrative Services; Jorge de Lafuente, Investment Accountant; and Ruth Baker, Director of Information Technology.

Others

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

Call to Order

Comptroller Susan Combs declared that a quorum was present and called the meeting to order at 10:08 a.m.

Comptroller Combs read a statement regarding the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that requires municipal advisors to register with the SEC. The temporary ruling resulted in a disagreement of what a municipal advisor is. The Comptroller does not believe the usually activities of this board constitute municipal advisory activities and is working the the Attorney General's office to clarify its application Comptroller Combs asked the Trust Company's General Counsel, Marianne Dwight, to monitor the board's discussions and to advise them to stop if they began to engage in anything that would be considered municipal advisory activities.

Approval of Minutes of March 21, 2011 Meeting (Tab 1)

Mr. Jim Hille made a motion to accept and approve the minutes of the March 21, 2011 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Tucker Bridwell and unanimously approved by the board

Capital Markets Outlook and Discussion (Tab 2)

Mr. George Tarlas of ACG presented an economic update for the period ending May 31, 2011. He reported that the economy was still growing, but at a slower pace as higher energy costs and the aftermath from the Japan disaster both took a toll. ACG believes there will be slower economic recovery over the next few years, approximately 2% annually. Unemployment continues to be a concern with expected minimal improvement. The housing market remained depressed and is expected to drag during the next 12-24 months. Mr. Tarlas recapped market returns and performance breakdown of sectors for the period as illustrated in the material behind Tab 2, noting that the domestic and foreign markets were relatively flat. For the year, the S&P 500 has gained 7.8% this year due to higher than forecasted corporate profits. The second round of quantitative easing ("QE2") is expected to diminish by the end of June, and ACG expects a spike in treasury yields. ACG continues to believe 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 the asset class relative rankings and illustrated by the stop-light charts behind Tab 2. He explained that overall there was no change in the tactical outlook for the quarter.

Economic Outlook and Review of Treasury Pool (Tab 3)

Mr. Mike Samples reviewed the Treasury Pool portfolio asset summary as of April 30, 2011 and stated that the value of the Pool was approximately \$26.2 billion. Currently the approximate value is \$30 billion with approximately \$70 million in unrealized gains. The net yield as of April 30, 2011 was approximately .6%. He stated that there were not many opportunities in the marketplace to replace the portfolio's higher yielding assets that are maturing with equal or better yields. His team is actively searching for low risk opportunities to add yield to the portfolio. Mr. Samples reviewed charts behind Tab 3 and stated that treasuries now account for approximately 55% of the portfolio. Next, Mr. Samples reviewed comparative benchmark yields and stated that the Treasury Pool yield outperformed most of its benchmarks but was slightly lagging behind its custom benchmark for the quarter and the twelve month period.

Mr. Mike Samples continued to review the information behind Tab 3 and presented his perspective on economic growth. He expects the Federal Reserve (the "Fed") will not start raising interest rates until 2013. Debt is a primary concern and the federal deficit continues its rapid growth. In his opinion it is best to assume that if rates start to rise the pool would be prepared. Mr. Samples reported that economic recovery was slower than expected. Job growth and the housing market continued showing weaknesses. He reported that Congress is expected to raise the debt ceiling by August 2, 2011. In the event that the treasuries did not mature by August 31, 2011, the portfolio was prepared and would have the cash available.

Annual Review and Recommended Modifications to Endowment Investment Policy (Tab 4)

Comptroller Combs stated that this board is an advisory board and no formal vote will be taken. She asked the Board to discuss the revisions and informally decide whether to move forward with the recommendations or make any amendments.

Mr. Paul Ballard reviewed the modifications to the Endowment Investment Policy detailed behind Tab 4. He explained that the recommended modifications reflect the new asset allocation mix that was discussed

and agreed to by the Board at the March 21, 2011 meeting. In addition to those revisions, the Trust Company has refined the policy and eliminated any constraints or definitions that were not essential to managing the Funds from a policy perspective. Benchmarks have also been modified to better represent each investment strategy. The Board continued its review and discussion of the proposed modifications.

Endowment Portfolio Update and Related Matters (Tab 5)

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. As of March 31, 2011 the portfolio value was approximately \$3.3 billion and was in alignment with its asset allocation targets. Mr. Ballard and Mr. Danny Sachnowitz discussed current liquidity and the fact that the portfolio remained very liquid. Mr. Sachnowitz compared the actual vs. target allocations for the first quarter of 2011 to the actual vs. target allocations as of June 1, 2011 and noted that the asset classes were very near their target ranges. He also reviewed the new target allocations that should be in place by October 1, 2011.

Mr. Sachnowitz reviewed the various asset classes and informed the Board of new managers added to the portfolio: Stone Harbor Emerging Market Corporate Fund, Addison Clark, Abry VII, Asia Century Quest, Standard Pacific, Blackstone Resources Select, and SPDR Gold ETF. He reported that the portfolio performance was in line with expectations, given the current economic conditions. The policy compliance checklist was reviewed and the portfolio was in compliance with each category. Mr. Sachnowitz also reported that the portfolio's VaR ("Value at Risk") was well below a traditional portfolio's risk.

Mr. Ballard continued the review of returns and performance of specific asset classes. He reported that the Level Global redemptions had essentially been completed and the money reallocated. He also reported that Diamondback was remaining steady and had a strong compliance system in place.

Endowment Funds Investment Performance Review for the Quarter Ending March 31, 2011 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, 2011. The portfolio return was approximately 2.92% for the quarter which represented an approximate \$85 million increase. He reported that the portfolio continued to participate in the bull market. He reported that the enhanced return and inflation protection asset classes outperformed their Trust Company custom benchmarks. He also reported that direct hedge funds outperformed fund of fund hedge funds. Overall however, the portfolio performed like 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 portfolio experienced an overall positive result while assuming less risk. The Sharpe ratio outperformed its benchmark.

Mr. Pokorny reported through the month of April the portfolio return was approximately 2.1%; however, for the month of May the portfolio return was approximately -0.5% while the policy benchmark was approximately -1.2%.

Legislative Update

Mr. Ballard reported that the Texas Legislature directed the Trust Company to liquidate for appropriation four of their twelve endowment funds totally approximately \$385 million. The funds set for liquidation were: the Permanent Funds of Health & Tobacco Education & Enforcement (\$185 million), Children & Public Health (\$94 million), EMS & Trauma Care (\$94 million), and the Historic Preservation Trust Fund (\$11 million).

Broker/Dealer Update (Tab 7)

Mr. Ballard reviewed the recommended broker/dealer list behind Tab 7. He noted that eight new broker/dealers were added to the list and one, Cabrera Capital Markets, LLC, will be removed due to its affiliation with a broker involved in a scandal in New Mexico.

Discussion of Next Meeting and Agenda Items

The Board has decided that the next meeting will be September 8, 2011. No agenda items suggested for next meeting.

Public Comment

None

Adjourn

The meeting adjourned at 1:45 p.m.