

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Monday, March 3, 2014
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Monday, March 3, 2013 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members ("The Board") Present

Comptroller Susan Combs, Tucker Bridwell, Laurie Dotter, Jim Hille, Adolpho Telles and Scott Wise.

Board Members Absent

Steve Strake.

Comptroller of Public Accounts Staff Present

Martin Hubert, Deputy Comptroller; and Robin Smith, CPA Internal Auditor.

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, Deputy General Counsel; Wai Yee Cheng, Portfolio Manager; Byron Beasley, Private Markets Manager; J. Germenis, Public Markets Manager; Michael Leifeste, Real Estate Portfolio Manager; Lalo Torres, Investment Analyst Jorge de Lafuente, Investment Analyst; Adam Levine, Risk Strategist; Chad Turner, Investment Analysts; Anca Ion, Portfolio Manager; Nora Arredondo, Special Projects Coordinator; Genoveva Minjares, Director of General Ledger Accounting; Victor Scott, Director of Financial Reporting; Laura Montoya, Director of Administration; Brandy Bianco, Graphic Designer; Corrine Hall, CAPCO Administrator; Monique Kollar, Director of Settlement and Custody Services; and Susan Colletti, Director of Investment Accounting.

Additional Participants

Lori Mills and Brad Davis, Asset Consulting Group ("ACG"); and Pam Sliman, State Street.

Call to Order

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

Approval of Minutes of December 18, 2013 Meeting (Tab 1)

Ms. Laurie Dotter made a motion to accept and approve the minutes of the December 18, 2013 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Tucker Bridwell and unanimously approved by the Board

Economic Outlook, Investment and Review of Treasury Pool (Tab 3)

Mr. Mike Samples presented his outlook on the economy. He reported that in December of 2013, the Federal Reserve (“the Fed”) decided to taper its stimulative quantitative easing policy and reduce bond purchases by \$10 billion per month, to \$74 billion. Mr. Samples explained that Fed Chairman Janet Yellen had expressed her expectation that the tapering would wind down steadily through 2014, assuming the economy remained healthy. He reported that current GDP growth is running at 2% - 2.5%. Mr. Samples believes the Fed is in no hurry to raise interest rates and may not do so until 2016.

Mr. Samples reviewed the Treasury Pool portfolio summary as of January 31, 2014 and stated that the value of the Pool was approximately \$29.5 billion with an approximate net yield of 0.42%, up slightly from the previous quarter. Mr. Samples reviewed the asset allocation and maturity structure of the portfolio. He explained that there were not many opportunities to increase yields without taking on unwarranted risk. Mr. Samples explained to the board that he would like them to consider modifying the Treasury Pool benchmark. When the benchmark was established the short-term interest rate environment was in the neighborhood of 300 to 400 basis points. The significant decline in rates since that time has had a material impact on the difference between gross and net money market fund yields. He would like to see the benchmark modified to use net instead of gross yields on the component of the benchmark comprised of money market funds. The Board will consider this at the next meeting.

Capital Markets Outlook and Discussion (Tab 4)

Ms. Lori Mills presented an update on the capital markets. She presented a performance recap for 2013 stating that risk assets did well. In general, domestic equities were up by 23% and emerging market equities and commodities were down. Rising yields led to negative total returns in the bond market. Ms. Mills reported that in January 2014, there was a sharp reversal in equity markets and bond markets improved. Also, emerging markets continued to decline while commodities showed slight improvement. She stated that European markets remained volatile during the quarter.

Ms. Mills reviewed Asset Consulting Group’s asset class relative rankings as of the first quarter of 2014. She reported that there were no changes to the tactical outlook for the quarter. She explained that in January, members of the Trust Company’s investment committee met with ACG in St. Louis to review diversification and investment themes and reaffirm target allocations. ACG and the Trust Company continue to focus on portfolio diversification, maintaining and/or enhancing exposure to fast growing regions such as emerging markets and maintaining diversified global fixed income exposure with a focus on real yields.

Review and Recommendation of Investment Policy - Phase II for the State Water Implementation Fund of Texas “SWIFT” (Tab 2 & handout)

The statute establishing the SWIFT specifies that the Trust Company will manage the fund on behalf of the Texas Water Development Board (“WDB”). Phase I of the SWIFT investment policy was discussed at the previous board meeting.

Mr. Paul Ballard presented a draft for Phase II of the SWIFT investment policy. He reviewed the recommended the asset allocation targets and benchmarks as outlined in the model on page 10 behind Tab 2. He explained that the Water Development Board may adopt its long-term model for the SWIFT soon and will be anxious for the Trust Company to begin moving to a long-term investment structure quickly thereafter. The Trust Company needs to be flexible in anticipation of the WDB actions. Phase II incorporates some long-term, higher returning strategies. It is anticipated they will ultimately be needed to meet the Fund’s longer-term investment objectives. The SWIFT portfolio design is an evolving process. Until the Trust Company receives greater guidance from the WDB on its cash flow needs, the

SWIFT will remain invested predominantly in fixed income and credit related strategies that target low to moderate volatility.

Mr. Scott Wise made a motion to recommend to the Comptroller the adoption of Phase II of the Investment Policy for the State Water Implementation Fund for Texas. The motion was seconded by Ms. Laurie Dotter and unanimously approved by the board.

Endowment and SWIFT Portfolio Updates and Related Matters (Tab 6)

Mr. Paul Ballard presented the Board an overview of Phase I of the SWIFT investment implementation strategy. He stated that the objective was to obtain a net return of CPI-U while remaining liquid. Deployment into Phase I was initiated on February 3, 2014 and funding will be in level installments over six months. He reviewed the investment strategies currently approved for Phase I and the target funding amounts for each strategy. Mr. Ballard discussed the low volatility and highly liquid nature of the various strategies funded thus far and that all may hedge against rising interest rates.

Next Mr. Ballard reviewed the endowment portfolio and reported that it was in compliance with its investment policy. As of December 31, 2013 the portfolio value was approximately \$3.52 billion. He reviewed each asset class and the various investment strategies that represent the portfolio's diversification. Mr. Ballard and Mr. Sachnowitz discussed new fund managers and those from whom capital was being redeemed. Mr. Ballard stated that distributions from the private equity portfolio are increasing substantially. He explained the stress test scenarios as they relate to performance of the total portfolio in a crisis relative to the policy portfolio.

Lunch speakers (Tab 5)

Mr. Alfred Gantner and Mr. Scott Higbee of Partners Group presented the board their perspective on global private markets. Mr. Alfred Gantner is Co-founder and Executive Chairman of the Board of Directors of Partners Group. Mr. Scott Higbee is a Partner and head of the firm's New York office and head of the investment solutions business unit in the Americas. Partners Group is a global private markets investment management firm with over EUR 30 billion under management.

Endowment Funds Investment Performance Review for the Quarter Ending December 31, 2013 and Related Matters (Tab 7)

Ms. Pam Sliman reviewed the investment performance of the endowment funds for the period ending December 31, 2013. She reported that the portfolio had produced a return of 3.32% for the quarter, slightly below its benchmark by 0.06%. The trailing one year return was approximately 9.79%, which exceeded its policy benchmark of 9.68%. The performance of the different sectors of the portfolio was reviewed in further detail. Each sector produced positive returns during the quarter with the exception of strategic all asset and overlays which posted a -0.27% return. More recently, Ms. Sliman reported that in January the portfolio outperformed its policy benchmark by 0.47%. The portfolio produced a Sharpe ratio greater than its benchmark.

Discussion of Next Meeting and Agenda Items

The next meeting will be scheduled in June. Nora Arredondo will be in contact with the board.

Public Comment

None.

Adjourn

The meeting adjourned at 1:31 p.m.