

**COMPTROLLER'S  
INVESTMENT ADVISORY BOARD MEETING  
Thursday, June 12, 2014  
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, June 12, 2014 at the LBJ State Office Building, 111 E. 17<sup>th</sup> Street, Room 114, Austin, Texas.

**Board Members ("The Board") Present**

Comptroller Susan Combs, Tucker Bridwell, Laurie Dotter, Jim Hille, Steve Strake, and Adolpho Telles.

**Board Members Absent**

Scott Wise.

**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, 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; Harry Lindner, Investment Analyst; Nora Arredondo, Special Projects Coordinator; Victor Scott, Director of Financial Reporting; Oscar Ramirez, Trust Services Director; Laura Montoya, Director of Administration; Corrine Hall, CAPCO Administrator; Monique Kollar, Director of Settlement and Custody Services; and Susan Colletti, Director of Investment Accounting.

**Additional Participants**

Lori Mills, 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 March 3, 2014 Meeting (Tab 1)**

*Mr. Jim Hille made a motion to accept and approve the minutes of the March 3, 2014 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)**

Ms. Lori Mills presented an update on the capital markets. She reported that all asset classes were doing well, with the exception of the small cap sector. For the period ending May 31, 2014, Ms. Mills reported that the equity markets continued to move higher, reaching record levels; the bond markets were demonstrating positive performance across segments such as treasury and credit; and there was a sharp reversal in emerging markets which now were positive. She reported that the S&P 500 advanced nearly 1% for the month of May on stronger than expected earnings. Ms. Mills stated it was the first time that U.S. markets, non-U.S. developed markets and emerging markets were all somewhat positive and on the right track. Current economic data indicated growth was recovering following a first quarter slowdown caused by harsh winter weather. ACG expects approximately 3% economic growth in 2015. Latest unemployment numbers showed unemployment dropped to 6.3%, the lowest since September 2008. Ms. Mills also reported that inflation dropped during the fourth quarter of 2013 and the first quarter of 2014. ACG does not expect the Federal Reserve (the "Fed") to start raising interest rates until 2015.

Ms. Mills reviewed Asset Consulting Group's asset class relative rankings as of the second quarter of 2014. She reported that there were three changes to the tactical outlook for the quarter. She explained that the absolute return/opportunistic credit class and the U.S. large cap equity class tactical outlooks changed from overweight to neutral; and the U.S. high yield fixed income class changed from neutral to underweight. 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.

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

Mr. Mike Samples presented a summary of the Treasury Pool as of April 30, 2014. He reported that the pool was producing a net yield of approximately 0.41% and had a market value of approximately \$34 billion. He discussed the fact that the Treasury Pool had an appropriately broader investment opportunity set than cash-equivalent money market funds including the ability to extend duration. Active management decisions to extend duration have successfully added to the Treasury Pool's returns in the past. To demonstrate that fact, he reviewed the Treasury Pool's yield over time relative to the Federal Funds rate and noted that when short-term interest rates fell, the incremental yield produced by the Treasury Pool widened relative to the Federal Funds rate. Mr. Samples reviewed the dollar and yield benefit to the state generated by the Treasury Pool relative to TexPool, the state's largest local government investment pool since 2007.

Mr. Samples presented his outlook on the economy. He reported that the Fed is expected to continue its quantitative easing policy and tapering would wind down steadily throughout 2014. According to current estimates, the gross domestic product ("GDP") for the second quarter is expected to increase. The labor market demonstrates signs of improvement as did retail sales. Mr. Samples explained his belief that the economy could not sustain a sharp interest rate increase. A drastic increase could put the economy back into recession. He believes the Fed would completely end quantitative easing and begin raising rates very gradually sometime next year. He explained that he and his team remain focused on seeking higher relative yields.

## **Review and Recommended Revisions to Treasury Pool Benchmark (Tab 4)**

Mr. Paul Ballard discussed the recommended revision by the Trust Company to the Treasury Pool performance benchmark. This represents the second revision to the Pool's benchmark made necessary by the changing market environment. He explained that 70% of the benchmark is comprised of yields available on liquid money market instruments. The Trust Company is recommending that this component

of the benchmark be modified to reflect net, rather than gross yields on money market funds since only net yields are available to investors and benchmarks should be comprised of investable indices.

*Mr. Steve Strake made a motion to recommend to the Comptroller modifying the liquid portion of the Treasury Pool benchmark to reflect net money market yields rather than gross. Mr. Jim Hille seconded the motion and the board unanimously approved.*

#### **Annual Review of Endowment Investment Policy (Tab 5)**

A draft of the recommended changes to the Endowment Investment Policy was included behind Tab 5. The most substantive is a change in the benchmark for Value Added Real Estate. The previous National Council of Real Estate Investment Fiduciaries (“NCREIF”) benchmark is no longer being published. The Trust Company is recommending a new benchmark published by Cambridge Associates that includes a broader survey of funds. Other changes included in the recommendation are intended to clarify expectations and improve the utility of the policy. Also, information pertinent to new and some existing endowments covered by the policy have been added or modified. In Section 2 Part B under Enhanced Return Real Estate, board member Laurie Dotter advised that the maximum aggregate portfolio leverage should be consistent with leverage in the benchmark. The Trust Company will make the change to the Endowment Policy draft presented.

*Ms. Laurie Dotter made a motion to recommend to the Comptroller the proposed changes to the Endowment Investment Policy as presented by the Trust Company as amended regarding allowable leverage for the Enhanced Return Real Estate portfolio. Mr. Steve Strake seconded the motion and the board unanimously approved.*

#### **Recommended Revisions to the State Water Implementation Fund of Texas “SWIFT” Investment Policy (Tab 6)**

Mr. Paul Ballard reported that the Trust Company will not be recommending any revisions to the SWIFT Investment Policy at this time.

#### **Endowment and SWIFT Portfolio Updates and Related Matters (Tab 7)**

Mr. Paul Ballard presented the Board an overview of the SWIFT Investment Fund which is divided into three investment strategies: Treasury Pool/cash, fixed income, and alternative fixed income. He reported that the fund was invested in approximately 64% Treasury Pool/cash, 33% in fixed income, and 4% alternative fixed income. He explained that allocations away from the Treasury Pool began in February 2014 (Phase I) and that the Trust Company is slowly diversifying into the different higher returning strategies. He stated that Phase I investment strategies have low volatility, are highly liquid, and may all 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 March 31, 2014 the portfolio value was approximately \$3.64 billion. He reviewed each asset class and the various investment strategies that represent the portfolio’s diversification. Mr. Ballard and Mr. Sachnowitz discussed new funds added to fixed income and private debt. Mr. Ballard stated that the private equity portfolio was maturing and had produced a positive net cash flow for six consecutive quarters. He explained the stress test scenarios as they relate to performance of the total portfolio in a crisis relative to the policy portfolio and a portfolio allocated 65% to global equities and 35% to global fixed income.

## **Endowment Funds Investment Performance Review for the Quarter Ending March 31, 2014 and Related Matters (Tab 8)**

Ms. Pam Sliman reviewed the investment performance of the endowment funds for the period ending March 31, 2014. She reported that the portfolio had produced a return of 2.57% for the quarter, slightly outperforming its policy benchmark. The trailing one year return was approximately 8.88%, which was below its policy benchmark of 9.31%. However it exceeded the benchmark return for two and three-year periods and slightly lagged its five-year benchmark. The performance of the different sectors of the portfolio was reviewed in further detail. Each sector produced positive returns during the quarter. The portfolio produced a Sharpe ratio exceeding that of its benchmark.

## **Broker/Dealer Update (Tab 9)**

Comptroller Combs reviewed the broker/dealer list behind Tab 9. She noted the BNY Mellon Capital Markets, Mitsubishi UFJ Securities, and Samuel Ramirez & Company were added as of June 2014.

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

Comptroller Combs announced that the next meeting would be scheduled in September or October of 2014 and that Nora Arredondo would be in contact with board members to find a time that worked for everyone.

## **Public Comment**

None.

## **Adjourn**

The meeting adjourned at 12:56 p.m.