

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Wednesday, December 11, 2014
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, December 11, 2014 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members ("The Board") Present

Comptroller Susan Combs, Tucker Bridwell, Jim Hille, Steve Strake, and Scott Wise.

Board Members Absent

Laurie Dotter and Adolpho Telles.

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; Michael Anderson, Compliance Officer; 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; Adam Levine, Risk Strategist; Chad Turner, Investment Analysts; Harry Lindner, Investment Analyst; Anca Ion, Portfolio Manager; Nora Arredondo, Special Projects Coordinator; Genoveva Minjares, Director of General Ledger Accounting; Laura Montoya, Director of Administration; Victor Scott, Director of Financial Reporting; Jorge de Lafuente, Investment Analyst; Brandy Bianco, Graphic Designer and Corrine Hall, CAPCO Administrator.

Additional Participants

Mike O'Brien, Padgett, Stratemann & Co., LLP; 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 10:08 a.m. She thanked the Board for their service during her tenure.

Approval of Minutes of October 8, 2014 Meeting (Tab 1)

Mr. Jim Hille asked that the minutes presented be corrected to reflect his absence at the October 8, 2014 meeting. Mr. Scott Wise made a motion to correct and approve the minutes of the October 8, 2014 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Steve Strake and unanimously approved by the Board.

Presentation of Independent Auditor's Report for the Trust Company (handout)

Mr. Mike O'Brien summarized the audit reports and stated that Padgett, Stratemann & Co. had issued an unqualified financial audit opinion with respect to the Trust Company for the fiscal year ending August 31, 2014. Mr. O'Brien reported that no audit adjustments were recorded during the audit engagement that indicate deficiencies in the accounting process, nor was a management letter issued.

Economic Outlook, Investment and Review of Treasury Pool (Tab 2)

Mr. Mike Samples presented his outlook on the economy. He reported that the Federal Reserve ("the Fed") ended quantitative easing in October and is expected to meet next week. Mr. Samples believes the Fed will be preparing for an interest rate increase. He stated that the shorter the time frame over which the Fed resets interest rates, the more responsive the treasury pool can be. Mr. Samples explained that the Fed has a dual mandate: 1) stable prices and 2) full employment. By definition, we are closer to both now than we have been in the last fifty-five years. Mr. Samples believes the Fed will likely start raising interest rates in 2015 and could possibly reach 1% by the end of 2015. He expects that if the Fed starts to raise interest rates, they may start at .25%. If inflation ticks up or employment grows more rapidly, then the Fed could accelerate the pace. He explained that the portfolio is being defensively positioned for a rising rate environment.

Mr. Samples presented a summary of the Treasury Pool as of October 31, 2014. He reported that the pool had a market value of approximately \$31.6 billion and was producing an approximate net yield of 0.42%. This represents a \$3.1 billion increase in value and 0.04% increase in net yield from the same time last year. He expects 85% of the portfolio will mature or reset by the end of 2015. He believes the yield can still be enhanced by active management decisions that appropriately extend duration as demonstrated by the graph on page 6 that charts the Treasury Pool's yield over time relative to the Federal Funds rate.

Capital Markets Outlook and Discussion (Tab 3)

Ms. Lori Mills presented an update of the capital markets environment for the period ending September 30, 2014. She reported that there were mixed results in the equity markets as large cap equities demonstrated positive performance and small cap equities posted negative returns. The bond markets were flat for the quarter with positive performance year to date ("YTD"). The strength of the U.S. dollar caused some setback in non-U.S. equities for the quarter. Currently, there is a slight rebound but YTD negative performance for developed markets and positive performance for emerging markets. Commodities continued a downward trend with negative performance YTD. Ms. Mills noted that the endowment portfolio was structured to weather this type of volatility.

Ms. Mills reported on current economic data stating that economic growth in the U.S. was better but still sluggish. The labor market continued to improve but wages were lagging and consumers had less money to spend. Globally, the dollar had strengthened and the sluggish European economy continued to be a concern. ACG continues to expect slow economic growth. They also expect the Fed will start raising interest rates in 2015.

Ms. Mills reviewed Asset Consulting Group's asset class relative rankings as of the fourth quarter of 2014. She reported that there was one change to the tactical outlook for the quarter. The Commodities tactical outlook was changed from neutral to underweight. Commodity prices in U.S. dollar terms are projected to ease over the next twelve months and oil prices have declined. Commodities remain important to diversification in the portfolio and 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.

Endowment and State Water Implementation Fund of Texas (SWIFT) Portfolio Updates and Related Matters (Tab 4)

Mr. Paul Ballard presented the Board an overview of the endowment portfolio and reported that it was in compliance with its investment policy with the exception that the liquidity of 43% of the portfolio's assets is greater than 185 days versus the policy limit of 40%. This is attributable to manager turnover. New managers typically have lock-up terms of at least one year, while managers being redeemed generally have 90-day liquidity. Liquidity of the portfolio is more than sufficient to meet needs for capital calls, rebalancing, and distributions. As of September 30, 2014 the portfolio value was approximately \$3.68 billion. He explained that third quarter performance was led by the private debt, private equity and real estate portfolios. All other sub-strategies were negative for the quarter. Mr. Ballard reviewed each asset class and investment strategy in the portfolio. Mr. Danny Sachnowitz reviewed the investment managers and noted new strategies added to the portfolio and managers that were redeemed or those where exposure was reduced. Mr. Ballard reviewed the stress test scenarios demonstrating how the endowment model portfolio would perform relative to a traditional portfolio allocated 65% to global equities and 35% to global fixed income. The endowment would perform better than a traditionally allocated portfolio in each of the simulated market crisis situations.

Mr. Ballard presented the Board with an overview of the SWIFT Investment Fund. He explained that the Trust Company has most recently begun building out the longer term components of the fund. Currently, approximately 80% of the fund remains very liquid with maturity between 0-7 days. He reported that performance has been better than expected and has outperformed its policy benchmark.

Lunch Presentation

Sean Dobson, CEO of Amherst Asset Management, is regarded as one of the country's leading experts in the area of single-family real estate. He shared his views with the Board on the macro economy and, in particular, single-family real estate and the real estate finance complex. He discussed the long term effects of decreased mortgage access and the single family rental market. Mr. Dobson updated the Board on two Amherst-managed strategies in which the endowments are invested: the single family "buy to rent" strategy (Main Street Redevelopment) and the non-agency RMBS "put-back" strategy. Both strategies were uniquely opportunistic. The buy-to-rent strategy was implemented post financial crisis as housing prices were bottoming. It served to both help reduce excess housing supply in the market, buy assets at less than replacement cost, and initiate a new business concept of building a geographically diversified portfolio of professionally managed rental homes. The "put back" strategy was initiated immediately following the 2008 collapse of the non-agency RMBS market. The strategy purchased non-agency RMBS securities wherein issuers had misrepresented the underlying collateral of the bonds. The securities were purchased at cents on the dollar. Amherst then established a specialized legal team to present detailed, trial-ready evidence of misrepresentation to issuers of the bonds who are legally obligated to purchase the securities back at par. Both strategies are performing in line with expectations.

Endowment Funds Investment Performance Review for the Quarter Ending September 30, 2014 and Related Matters (Tab 5)

Ms. Pam Sliman reviewed the investment performance of the endowment funds for the period ending September 30, 2014. She reported that the portfolio had produced a return of -0.95% for the quarter, underperforming its benchmark by -0.28%. The trailing one year return was approximately 8.13%, which exceeded its policy benchmark of 7.95%. The portfolio also exceeded the benchmark return for two, three, and five-year periods. Each asset class produced negative returns for the quarter. The performance of the different sectors of the portfolio was reviewed in further detail. The portfolio produced a Sharpe ratio greater than its benchmark.

Discussion of Next Meeting and Agenda Items

Given the forthcoming transition to a new Comptroller in January, no date was set for a subsequent meeting.

Public Comment

None.

Adjourn

The meeting adjourned at 1:00 p.m.