

**COMPTROLLER'S  
INVESTMENT ADVISORY BOARD MEETING  
Wednesday, September 30, 2015  
*Minutes***

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Wednesday, September 30, 2015 at the LBJ State Office Building, 111 E. 17<sup>th</sup> Street, Room 114, Austin, Texas.

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

Comptroller Glenn Hegar; Tucker Bridwell; Jim Hille; Steve Strake; Adolpho Telles; and Scott Wise.

**Board Members Absent**

Laurie Dotter.

**Comptroller of Public Accounts Staff Present**

Mike Reissig, Deputy Comptroller; and Phillip Ashley, Associate 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; Gena Minjares, Deputy Chief Financial Officer; John Wright, Deputy General Counsel; Whitney Blanton, Assistant Deputy General Counsel; Michael Anderson, Compliance Officer; Byron Beasley, Portfolio Manager; Lalo Torres, Portfolio Manager; Jyoti Gupta, Portfolio Manager; Jorge de Lafuente, Director of Operational Due Diligence; Adam Levine, Risk Strategist; Chad Turner, Investment Analysts; Anca Ion, Deputy Director of Internal Investments; Laura Montoya, Director of Administration; Nora Arredondo, Special Projects Coordinator; Brandy Bianco, Graphic/Web Designer; and Susan Colletti, Director of Investment Accounting.

**Additional Participants**

Lori Mills, Asset Consulting Group ("ACG").

**Call to Order**

Comptroller Glenn Hegar declared that a quorum was present and called the meeting to order at 10:04 a.m.

**Approval of Minutes of July 14, 2015 Meeting (Tab 1)**

*Mr. Tucker Bridwell made a motion to accept and approve the minutes of the July 14, 2015 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Jim Hille and unanimously approved by the Board.*

## **Annual Review of the Comptroller's Investment Policy (Tab 2)**

Mr. Paul Ballard explained that the Trust Company is recommending a revision to the Comptroller's Investment Policy relative to the maximum allowable maturity of asset-backed securities. The policy pertains primarily to management of the Treasury Pool. The revision changes the maximum allowable maturity from "10-year final" to "weighted average duration of 5 years or less." The change is both consistent with statute and industry best practice. The purpose of the policy is to limit interest rate risk taken on asset-backed securities. Mr. Ballard pointed out that duration is a more reliable measure of the interest rate risk than final dated maturity. The Board discussed the recommendation.

*A motion was made by Mr. Steve Strake to recommend the proposed revision to the Comptroller's Investment Policy as presented by the Trust Company to Comptroller Glenn Hegar. The motion was seconded by Mr. Adolpho Telles and unanimously approved by the board.*

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

Mr. Mike Samples reported on current economic conditions. He reported that the Federal Reserve (the "Fed") opted not to raise interest rates at their last meeting. They meet again in October; however, based on measures of market expectations it is unlikely that an interest rate hike will be announced at that meeting. Expectations are greater for a rate hike in December. Mr. Samples believes that when the Fed begins to raise rates, it will be gradual and that they will probably have a "wait and watch" approach for quite some time after the first rate hike. He believes the uncertainty associated with when the Fed will raise rates is causing more volatility in the markets than the actual impact that will be manifested by the ultimate action of increasing short-term interest rates.

Mr. Samples presented a summary of the Treasury Pool as of August 31, 2015. He reported that the pool was producing a net yield of approximately 0.52%, had a market value of approximately \$35.2 billion, and continued to maintain a AAA rating by Standard & Poor's. He stated that the Tax Revenue Anticipation Notes ("TRAN") issued for fiscal year 2015 had been paid off with proceeds from the Treasury Pool. He further noted that Texas would not be issuing a TRAN for fiscal year 2016, so the Treasury Pool balance will be smaller in the current fiscal year. Mr. Samples reviewed comparative benchmark yields and noted that the Pool outperformed its benchmark for the quarter.

## **Capital Markets Outlook and Investment Performance for the Quarter Ending June 30, 2015 (Tab 4)**

Ms. Lori Mills of Asset Consulting Group provided a review of the market environment as of August 31, 2015. She reported that non-U.S. developed market equities continued to lead global equity markets. U.S. large and small cap equities experienced difficulty in the month of August and lost ground in 2015, whereas fixed income proved to be more stable than the previous quarter. Commodities remained in negative territory year to date, being drawn down primarily by the impact of falling oil prices. Ms. Mills reviewed the State Street performance report for the period ending June 30, 2015 and reported that the endowment portfolio produced a return of approximately .70% for the quarter, trailing the policy benchmark of .99%. With the exception of real assets, each asset class trailed their benchmarks in the quarter. However, she reported that the portfolio has outperformed the trailing one, two, three and five year policy benchmarks. Ms. Mills discussed the performance of each asset class in detail.

Ms. Mills reported on the performance of the State Water Implementation Fund for Texas ("SWIFT") for the quarter ending June 30, 2015. She explained that this is a draw down fund, meaning that it is expected to make annual distributions in excess of its expected return. The purpose of the SWIFT is to be a source of capital to facilitate local government water projects. The SWIFT produced a negative return

of -0.10% for the quarter trailing its policy benchmark of 0.77%, but exceeded its one year benchmark of -5.24% with a positive return of 0.18%.

Ms. Mills reviewed Asset Consulting Group's asset class relative rankings for the third quarter of 2015. She reported that there were two changes to the tactical outlook for the quarter. U.S. high yield fixed income was upgraded from underweight to neutral, as high yield bonds tend to perform better relative to other fixed income instruments in a rising interest rate environment. The commodities asset class was also upgraded from underweight to neutral. ACG believes commodities price stabilization should begin to occur as global growth, particularly in China, remains positive. She noted that Chinese crude oil imports are at an all-time record high which could draw down large global inventories and begin to bring supply back into balance with demand. 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.

### **Update on Economic Stabilization Fund and Emerging Technology Fund**

Mr. Paul Ballard reported that the Trust Company invested approximately \$245 million in September and, in October, expects to invest another \$265 million of the \$1.4 billion available for the Texas Economic Stabilization Fund (TESTIF) component of the Economic Stabilization Fund. The Trust Company understands that approximately \$1 billion in additional funds will be made available for investment in the TESTIF by the end of the calendar year.

Mr. Ballard informed the board that in the previous Texas Legislative Session, the Trust Company had been assigned responsibility for managing the state's Emerging Technology Fund ("ETF") effective September 1, 2015. The Fund had previously been managed as an early stage venture capital/economic development tool by the Office of the Governor. The Legislature ended the program, assigned its assets to the Trust Company, and directed that it be wound down and monetized in a prudent fashion. Mr. Ballard informed the board that the Trust Company had not previously managed direct investments in companies; rather it invests in venture capital funds run by specialist managers. He noted that the ETF was comprised of approximately 100 early stage portfolio companies representing an investment by the Governor's Office of between \$100 and \$140 million. He further informed the board that the Legislature had appropriated \$12 million for the purpose of making follow-on investments in companies to defend the state's ownership interests as appropriate. The Trust Company intends to manage the ETF following the venture fund investment model and will bring in specialized expertise to help oversee, manage, and advise on any follow-on investments.

### **Lunch Speaker – John Ryding, RDQ Economics, LLC ( Tab 5 & handout)**

Mr. John Ryding is the Chief Economist and a founding partner of RDQ Economics. Mr. Ryding presented his views on the economy and interest rates. He believes the economy is stronger than most believe and that the U.S. is close to full employment. In his opinion, the risk of higher inflation is being underestimated. Since the Fed did not raise interest rates at their last meeting, he believes it is highly likely that they will in December. The Fed will likely be focused on the pace of rate hikes and ultimate terminal target rate. In his opinion, market expectations are not aligned with Fed policy thinking. He believes emerging market currencies and commodities are most at risk to an interest rate increase. He expects a higher overall level of interest rates and a flatter yield curve next year. Mr. Ryding reviewed the charts in his handout with the Board.

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

Mr. Ballard presented the Board an overview of the endowment portfolio and reported that it was in compliance with its investment policy. He reported that as of June 30, 2015, the portfolio value was approximately \$3.68 billion. He reviewed each asset class and the various investment strategies utilized

to diversify and enhance the risk-adjusted returns of the portfolio. Mr. Ballard and Mr. Sachnowitz discussed new fund commitments added to various asset classes as well as funds that are being redeemed. Mr. Ballard explained the stress test scenarios performed on the portfolio. He compared the expected performance of the total portfolio in various crises relative to a portfolio allocated 65% to global equities and 35% to global fixed income. The analysis continues to demonstrate that the policy portfolio is expected to protect value better than a traditional 65/35 stock/bond portfolio in times of market drawdowns.

Mr. Ballard presented an overview of the SWIFT investment fund which is divided into three investment strategies: Treasury Pool/cash, fixed income, equity and real assets. He reported that the portfolio value as of June 30, 2015 was approximately \$2.02 billion. He reviewed the various asset classes and managers for the quarter and informed the Board of new strategies and commitments that were being funded. He reported that the SWIFT was meeting its performance objectives.

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

Comptroller Hegar announced that the next meeting would be scheduled for December 16, 2015. No future agenda items were suggested.

### **Public Comment**

None.

### **Adjourn**

The meeting adjourned at 1:29 p.m.