

**COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Tuesday, June 30, 2016
Minutes**

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Thursday, June 30, 2016 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members ("The Board") Present

Comptroller Glenn Hegar, Tucker Bridwell, Laurie Dotter, Jim Hille, Steve Strake and Adolpho Telles.

Board Members Absent

Scott Wise.

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; Gena Minjares, Deputy Chief Financial Officer; Mike Samples, Director of Internal Investments; Marianne S. Dwight, General Counsel; Laura Montoya, Chief Operating Officer; John Wright, Deputy General Counsel; Michael Anderson, Compliance Officer; Ruchit Shah, Portfolio Manager; Byron Beasley, Portfolio Manager; Michael Leifeste, Portfolio Manager; Lalo Torres, Portfolio Manager; Jyoti Gupta, Portfolio Manager; Jorge de Lafuente, Director of Operational Due Diligence; Patrick Jue, Operation Due Diligence Analyst; Adam Levine, Risk Strategist; Anca Ion, Deputy Director of Internal Investments; Nora Arredondo, Special Projects Coordinator; Brandy Bianco, Project Manager; Chad Turner, Risk Manager; Yunke Yu, Quantitative Data Analyst; Yunjing An, Quantitative Data Analyst; Corrine Hall, Program Administrator; and Brent Turner, Intern.

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 10:05 a.m.

Approval of Minutes of March 29, 2016 Meeting (Tab 1)

Mr. Tucker Bridwell made a motion to accept and approve the minutes of the March 29, 2016 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Steve Strake and unanimously approved by the Board.

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

Mr. Paul Ballard reported that there were no recommended revisions to the Comptroller's Investment Policy at this time.

Annual Review of Texas Economic Stabilization Investment Fund ("TESTIF") (Tab 3)

Mr. Ballard reported that there were no recommended revisions to the TESTIF Investment Policy at this time.

Discussion of Portfolio Hedging & Overlays Policy (Tab 4 & handout)

Mr. Ballard stated that the Portfolio Hedging and Overlays Policy was designed to help the Trust Company more efficiently manage cash, add incrementally to portfolio returns, and more effectively manage risk in the portfolios. It is appropriate due to the higher cash levels the Trust Company is required to hold to meet capital calls on growing allocations to private investments and a lower overall return environment anticipated in the next decade. The portfolio strategy and risk management team at the Trust Company has introduced a strategy they are calling "Smart Leverage." It is designed to add modest, incremental returns without adding meaningfully to risk. The strategy will limit the leverage it employs to a maximum of 10% of the value of the portfolio. Leverage will be a product of utilizing synthetic instruments like futures to more efficiently gain exposure to asset classes such as equity. A portion of the cash retained by utilizing futures will be invested in a low risk portfolio designed to produce persistent, positive returns. He reported that a risk management platform has been built by the team which allows greater visibility into investment risks embedded in portfolios. It will provide managers a more accurate view of the risk exposures in their portfolios and an overall view of where desired risk exposures are not in line with actuals. The program will provide a mechanism to reduce or remove undesired risks, rebalance risks to target risk weights, and/or change the structure of the risks.

The Board reviewed and discussed the policy extensively. They concurred that the maximum amount of leverage allowed by the policy is 10% of portfolio value.

Ms. Laurie Dotter made a motion to recommend the proposed portfolio hedging and overlay policy with the non-substantive change of the fund leverage limit be restated as a percentage of the total portfolio market value (10%). The motion was seconded by Mr. Jim Hille and unanimously approved by the Board.

Economic Outlook, Investment and Review of Treasury Pool (Tab 5)

Mr. Mike Samples reported on current economic conditions. He reported that on June 23rd, British citizens voted to exit the European Union ("Brexit"). This caused the British pound to fall to its lowest level in decades. Also, British Prime Minister David Cameron, who supported remaining in the European Union, announced he would resign in October. Mr. Samples explained how economic uncertainty in Britain strains not only the global economy but may also have a negative impact on the U.S. economy. He explained that other countries such as France and Italy are also considering a referendum to exit the European Union.

Mr. Samples does not expect the Federal Reserve (the "Fed") to raise interest rates in the next three quarters. He explained that GDP for the first quarter of 2016 was 1.1%. He reported that retail and home sales rose during the months of April and May, but job growth lagged. Economic growth was also constrained by a strong dollar and sluggish global demand, together with lower oil prices. He explained that the Fed remains cautious and is very sensitive to European conditions. Mr. Samples reported that the unemployment rate was approximately 4.9%. He expects economic growth to continue at a pace of 1%-2% annually.

Mr. Samples presented a summary of the Treasury Pool as of May 31, 2016. He reported that the Pool was producing a net yield of approximately 0.78%, up slightly from the previous quarter, had a market value of approximately \$31.3 billion, and continued to maintain a AAA rating by Standard & Poor's. Since the expectation is that future interest rate increases will be nominal and gradual if any, the Treasury Pool management team expects to maintain an average maturity neutral to its benchmark of approximately 310 days. Mr. Samples reviewed comparative benchmark yields and noted that the Pool had outperformed its benchmark for the quarter and the previous twelve months.

Capital Markets Outlook and Investment Performance for the Quarter Ending March 31, 2016 (Tab 6)

Ms. Lori Mills of Asset Consulting Group provided a review of the market environment for the period ending March 31, 2016. Emerging markets led the global equities turnaround during the first quarter. Global fixed income produced positive returns led by the safety of U.S. Treasuries. Driven by a jump in oil prices and a weaker U.S. dollar, commodities were slightly positive year to date. For the period ending May 31, 2016, global equities demonstrated some recovery from a volatile first quarter with most major indices producing positive returns. Global fixed income continued to produce broadly positive returns and commodities was the best asset class performer year-to-date following a recovery in oil prices.

Ms. Mills reviewed the total portfolio return over the trailing one, three, and five year periods for the quarter ending March 31, 2016. She reported that the endowment portfolio produced an annualized return of approximately 3.58%. Although the endowment returns have underperformed the endowment policy benchmark over shorter time periods, they continue to outperform over a five year annualized basis. She explained that the total portfolio has generated higher returns with lower risk than the benchmark over the last five years. Ms. Mills discussed the performance of each asset class in detail as described in the presentation.

Ms. Mills reported on the performance of the State Water Implementation Fund for Texas ("SWIFT"). The SWIFT portfolio outperformed its policy benchmark for the period ending March 31, 2016 by sixty one basis points. Fixed income and real assets components of the portfolio have outperformed their respective benchmarks, but equities have lagged over the past year. Overall the SWIFT portfolio returns have exceeded the policy and dynamic benchmarks since inception.

Lunch Speaker – Nic Johnson, Managing Director, PIMCO (Tab 7, handout)

Mr. Johnson presented PIMCO's macroeconomic views of the economy. He stated that since March 31, 2009 (the bottom of the financial crisis), most asset classes have delivered exceptional returns. PIMCO believes most asset classes are now priced to deliver lower long-term returns with significant variation within asset classes and sectors. PIMCO also believes that typical recession indicators are not suggesting an imminent recession. Mr. Johnson continued his presentation by reviewing the handout provided to the board.

Endowment and SWIFT Portfolio Updates and Related Matters (Tab 8)

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 March 31, 2016, the portfolio value was approximately \$3.7 billion. First quarter and trailing one-year period performance were in negative territory, -0.3% and -3.0% respectively, trailing the policy benchmark. For the quarter, real assets made the most positive contribution to returns and hedged equity was the greatest detractor. He reviewed each asset class and the various investment strategies utilized to diversify and enhance the risk-adjusted returns of the portfolio. Mr. Ballard explained which asset classes were overweight or underweight and how that related to the target allocations. He called attention to page six of the endowment presentation and noted that the one-year risk parity return should be stated at -8.1%, not 8.1%. Mr. Ballard and Mr. Sachnowitz

discussed new fund commitments to private equity and real estate asset classes and new funds added to natural resources and all asset strategies sectors. 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 updated the performance table and stated that April performance was 1.2% and May was 0.6% for 2016.

Mr. Ballard presented an overview of the SWIFT investment fund. The portfolio value as of March 31, 2016 was approximately \$1.85 billion and its value as of this meeting date is approximately \$1.89 billion. The portfolio is comprised of four investment strategies: fixed income, equity, real assets and strategic all asset and overlays. The fixed income allocation accounts for approximately 67% of the portfolio and was the main driver in keeping the quarterly performance out of negative territory. Mr. Ballard reported that the portfolio return in April was approximately 1.2 %, .08% in May, and approximately 1.9% year-to-date. The portfolio continues to be funded in a systematic manner until it reaches its target asset allocation. He reported that the SWIFT was meeting its performance objectives.

Mr. Ballard reviewed the Texas Economic Stabilization Investment Fund (“TESTIF”). Its primary performance objectives are to maintain purchasing power and deliver returns greater than are available in the Treasury Pool. The portfolio is divided into three asset strategies: Treasury Pool/cash (41%), fixed income (55%), and alternative fixed income (4%). A second tranche of \$1.14 billion was transferred into the TESTIF in December 2015. As of April 30, 2016 the TESTIF portfolio value was approximately \$2.6 billion. The portfolio has produced positive returns throughout 2016 and the year-to-date return is approximately 1.15%. The portfolio remains highly liquid.

Discussion of Next Meeting and Agenda Items

Comptroller Hegar announced that the next meeting will be scheduled for September. The Board will be contacted to set a date. No future agenda items were suggested.

Public Comment

None.

Adjourn

The meeting adjourned at 1:46 p.m.