COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Wednesday, October 17, 2019
Minutes

The Comptroller's Investment Advisory Board (the "Board") met at 10 a.m. on Wednesday, October 17, 2019, at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas.

Board Members ("The Board") Present

Laurie Dotter, Jim Hille, Steve Strake, Adolpho Telles and Ben Wall.

Board Members Absent

Tucker Bridwell.

Comptroller of Public Accounts Staff Present

Comptroller Glenn Hegar; and Phillip Ashley, Associate Deputy Comptroller.

Texas Treasury Safekeeping Trust Company ("Trust Company") Staff Present

Mike Reissig, Acting Chief Executive Officer ("CEO"); Ruchit Shah, Acting Chief Investment Officer ("CIO"); Genoveva Minjares, Chief Financial Officer ("CFO"); Anca Ion, Head of Internal Investments; Whitney Blanton, General Counsel; Laura Montoya, Chief Operating Officer; Spencer Brown, Assistant General Counsel; Jorge de LaFuente, Director of Operational Due Diligence; Hugh Ohn, Director of Accounting Strategy and Planning; Steve Rohrich, Investment Analyst: Lalo Torres, Portfolio Manager; Jyoti Gupta, Portfolio Manager; Adam Levine, Chief Strategist; Chad Turner, Risk Manager; Mat Williams, Investment Analyst; Jacob Price, Investment Analyst; Nora Arredondo, Program Specialist; Brandy Bianco, Project Manager; Yunke Yu, Quantitative Data Analyst; and Corrine Hall, Program Administrator.

Additional Participants

Roger Willis, Brad Davis, and Joe Nugent, Asset Consulting Group ("ACG").

Call to Order

Comptroller Glenn Hegar declared that a quorum was present and called the meeting to order at 10:00 a.m.

Approval of Minutes of July 17. 2019 Meeting (Tab 1)

Mr. Steve Strake made a motion to accept and approve the minutes of the July 17, 2019 Comptroller's Investment Advisory Board meeting. The motion was seconded by Mr. Jim Hille and unanimously approved by the Board.

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

Ms. Anca Ion reported on current economic conditions. She reported that since the last board meeting the Federal Reserve (the "Fed") had lowered interest rates by 25 basis points in July and again in September. Fed Chairman Jerome Powell characterized the cuts as a midcycle adjustment in a maturing economic expansion. Ms. Ion suggested there could be another possible rate reduction before the end of the year, but it was not expected. She explained that the U.S. economy continued to grow but at a slower, moderate pace. Although consumer spending was robust and was the main driver in economic growth, exogenous factors such as global weakness, the U.S.-China tariff issues and uncertainties associate with Brexit could affect an otherwise strong economy. Manufacturing continued to struggle due to discouraging trade discussions, but retail sales were recently up. Ms. Ion reported that the U.S. deficit was as high as $1 trillion in August but was reduced a bit in September. The U.S. deficit remains a looming issue.

Ms. Ion reviewed the Treasury Pool portfolio as of September 30, 2019. She reported that the portfolio yield for said quarter was 2.26%. As of October 16, 2019, the Treasury Pool yield was 2.28%. Ms. Ion explained that the portfolio was short in overnight repos and treasury bills and added duration in agency mortgages, which limited downside risk and continued to generate income. Agency mortgages went from 5% to 8%, and that 3% equates to approximately $1 billion. Ms. Ion reviewed the portfolio allocation and reported that Treasuries and Commercial Paper accounted for approximately 56% of the portfolio. She reported that the portfolio has managed to stay ahead of the Fed funds yield since about the middle of 2008 and had produced yields higher than comparative benchmark yields for the quarter. Ms. Ion explained that during this quantitative easing phase by the Fed, spreads should be tight; therefore, the portfolio is positioned accordingly. She stated that she remains cautiously optimistic going into 2020.

Capital Markets Overview and Investment Performance Review for the Quarter Ending June 30, 2019, and Related Matters (Tab 3)

Mr. Roger Willis of ACG presented ACG's view of the economy and market environment. He stated that the second quarter of 2019 real Gross Domestic Product (GDP) grew at an annualized rate of 2.0%, which slightly exceeded original estimates. Consumer spending and labor conditions remained strong, with the unemployment rate at a 50-year low of 3.5% in September. He explained that we continue to reside in a slow growth economic environment. Overall, inflation is not likely a problem in the U.S. or global economy in the near foreseeable future. The challenge remains reaching the 2% inflation target. ACG does not foresee a recession in the near term; however, they are aware of factors that could change this. ACG expects a slow growth environment for the next 5-10 years.

Mr. Willis explained that globally, the European economy continues to show signs of weakness, notably relating to export-dependent manufacturing and weak inflation. Global currencies, apart from the Japanese Yen, have fallen versus the U.S. Dollar.

Ms. Willis reviewed the total portfolio summary for the period ending June 30, 2019. He reported that the total portfolio returns outperformed the Endowment policy benchmark over the past quarter, one-year, three-year, and five-year periods. Relative to broad market benchmarks, the total portfolio generated 112% of the return with 45% of the risk. The portfolio produced a 2.32% return for the quarter and 5.00% return over the five-year period. The fixed income portion of the portfolio has modestly lagged the fixed blend over the past year, but continued to outperform over the trailing three and five-year periods. Equity and real assets strategies outperformed their benchmarks over the same time periods. Real assets demonstrated stronger relative results in the long term, annualizing 125 basis points of outperformance over the trailing five-year period. The objective of the portfolio is to provide predictable and stable distributions with minimum downside risk and inflation protection.

Mr. Willis reported that the SWIFT portfolio produced solid returns since inception, with a 3.67% rate of return since inception and 2.17% for the quarter. The portfolio outperformed its policy benchmark and its dynamic benchmark over quarter, one-year, three-year and five-year periods. The fixed income portion of the portfolio underperformed for the quarter, one-year, and three-year periods. Despite this underperformance, the portfolio produced strong relative results since inception. Equity and real assets outperformed their benchmarks since inception. Overall, the SWIFT portfolio generated higher returns and lower risk than the policy and dynamic benchmarks since inception.

The TESTIF portfolio produced a 1.34% return for the quarter, underperforming the policy benchmark by -0.20%; however, outperforming its dynamic benchmark by 0.10%. The TESTIF portfolio has generated slightly lower returns and lower risk than the policy benchmark since inception. Relative to the policy and dynamic benchmarks, the portfolio has delivered a higher risk-adjusted return.

Annual Review of Endowment, SWIFT and TESTIF Investment Policies (Tab 4)

Endowment Investment Policy: Mr. Ruchit Shah reported that there were no proposed revisions to the Endowment Investment Policy at this time.

SWIFT and TESTIF Investment Policies: Mr. Shah reported that the Trust Company and ACG recommended two asset class benchmark changes; one for the SWIFT Investment Policy and one for the TESTIF Investment Policy. He explained that the new benchmarks would represent a more realistic investment opportunity-set given the more conservative statutory and policy objective of both policies. Relating to the SWIFT Investment Policy, the private debt portfolio is constructed with higher quality assets than the benchmark, which is embedded with a high degree of equity exposure. The recommendation is that the Trust Company employ as its benchmark for the aggregated private debt asset class a 50/50 mix of the Credit Suisse Leveraged Loan Index and Bloomberg Barclays U.S. Corporate High Yield Bond Index plus 100 basis points. This benchmark best represents the objectives of the private debt allocation.

The objectives of TESTIF are to preserve purchasing power and outperform the Treasury Pool. The TESTIF portfolio is constructed with short-intermediate credit and opportunistic fixed income strategies, that price on a mark-to-market basis. However, the benchmark is yield based, and conflicts with the only way the portfolio can be invested, which is on a total-return basis. ACG has included a presentation behind Tab 4(d) which provides further details and illustrates the need for these changes.

The recommendations to the SWIFT and TESTIF Investment Policy benchmarks were as follows:

1) SWIFT - Private Debt Asset Class - Replace Cambridge Associate Custom Private Debt Index with 50% U.S. Credit Suisse Leveraged Loan Index & 50% Bloomberg Barclays U.S. Corporate High Yield Bond Index, plus a premium of 1% per annum.

2) TESTIF - Fixed Income Asset Class - Replace the 90 Day T-Bill + 200 basis points benchmark with the Bloomberg Barclays 1-5 Year U.S. Credit Index

The Board discussed the recommended revisions and reviewed the presentation behind Tab (4).

Mr. Steve Strake made a motion to recommend the proposed revisions to the SWIFT and TESTIF Investment Policy benchmarks as presented by the Trust Company. The motion was seconded by Ms. Laurie Dotter and unanimously approved by the Board.

Endowment, SWIFT and TESTIF Portfolio Updates and Related Matters (Tab 5)

Mr. Shah presented an overview of the Endowment portfolio for the second quarter of 2019 and reported that the portfolio was in compliance with its investment and asset allocation policies. He reported that in the second quarter of 2019, the Endowment returned 2.3%, and the value of the Endowment portfolio was approximately $4.17 billion. He explained that the portfolio performed as expected. The best performing strategies were Hedged Equity followed closely by Private Equity. He explained that the real activity for the year and the quarter was in the private markets where nine new commitments were added. More commitments were considered for sector specialist managers. The portfolio was slightly overweight in equity exposure. Mr. Shah reported that the portfolio has distributed over $2.03 billion and as previously reported, asset under management are approximately $4.17 billion. The portfolio performance return for July was 0.75%, August -0.84% and current year to date return is approximately 7.00%.

Mr. Shah reviewed the SWIFT portfolio and reported that the portfolio was in compliance with its investment policy for the quarter. The portfolio value as of June 30, 2019 was approximately $1.75 billion and produced a 2.00% return for the quarter. He reported that as of June 2019 the portfolio distributed approximately $620 million and an approximate $130 million distribution is expected in October at the request of the Water Board. The leading performance driver was Hedged Equity followed by Private Debt and Real Assets. The portfolio performance return for July was 0.80%, for August it was -0.13%, bringing in the year to date return of 6.8%. Mr. Shah reported that the portfolio remained highly liquid and was meeting its investment objectives.

Mr. Shah reviewed the TESTIF portfolio and reported that it was performing as designed by preserving its purchasing power by earning more than inflation. The portfolio value as of July 31, 2019 was approximately $4.75 billion. The portfolio has produced an annualized return through August 2019 of approximately 3.64%.

Broker/Dealer Update (Tab 6)

Mr. Shah presented the current broker/dealer list to the Board. He noted that Coastal Securities, Inc. and Hilltop Securities were added to the list this year. None were removed.

Discussion of Next Meeting and Agenda Items

Comptroller Hegar announced that the next meeting would be scheduled for some time in January. No future agenda items were suggested.

Public Comment

None.

Comptroller Hegar stated the next board meeting would probably be scheduled for some time in January. Ms. Nora Arredondo will be contacting the Board.

Adjourn

The meeting adjourned at 12:14 p.m.