COMPTROLLER'S
INVESTMENT ADVISORY BOARD MEETING
Tuesday, April 27, 2021
Minutes

The Comptroller's Investment Advisory Board (the "Board") virtually met at 10:30 a.m. on Tuesday, April 27, 2021, via Microsoft Teams.

Board Members ("The Board") Present

Laurie Dotter, Jim Hille, Adolpho Telles, Ben Wall and Sam Vinson.

Board Members Absent

One vacant position.

Comptroller of Public Accounts Staff Presiding

Comptroller Glenn Hegar.

Texas Treasury Safekeeping Trust Company ("Trust Company") Executive Staff, Staff Presenters & Facilitators

Mike Reissig, Chief Executive Officer; Ruchit Shah, Chief Investment Officer ("CIO"); Anca Ion, Deputy Chief Investment Officer; Genoveva Minjares, Chief Financial Officer ("CFO"); Laura Montoya, Chief Operating Officer ("COO"); Whitney Blanton, General Counsel; Spencer Brown, Assistant General Counsel; Jyoti Gupta, Portfolio Manager; Michael Leifeste, Portfolio Manager; Adam Levine, Portfolio Manager; Bradley Davis, Portfolio Manager; Chad Turner, Director of Risk and Quantitative Analytics; Brad Davis, Portfolio Manager; Nora Arredondo, Program Specialist; and Shantel Geeslin, Program Specialist.

Additional Participants

Roger Willis, Asset Consulting Group ("ACG"); and Lynn O'Connell and Jennifer Wildeman, Aksia, LLC.

Call to Order

Comptroller Glenn Hegar declared that a quorum was present and called the meeting to order at 10:32 a.m.

Comptroller Hegar announced that Steve Strake withdrew from the Board on April 19, 2021.

Approval of Minutes of January 28, 2021 Meeting (Tab 1)

A motion was made by Mr. Jim Hille to accept and approve the minutes from the January 28, 2021, board meeting. The motion was seconded by Mr. Sam Vinson and unanimously approved by the Board.

Capital Markets Overview and Investment Performance Review for the Quarter Ending December 31, 2020, and Related Matters (Tab 2)

Mr. Roger Willis of ACG presented ACG's view of the economy and market environment. He reported that the Corona Virus data was generally improving as vaccinations were accelerating leading to reopening of economies. Additional stimulus in fiscal packages were pending which would help continue to support the monetary stimulus already experienced. Mr. Willis reported that job markets continued to strengthen, and economic and earnings forecasts were improving. The Federal Reserve Board (the "Fed") is expected to meet in the next few days and ACG does not anticipate any shift in their monetary policy, but inflation remains a key risk. The S&P 500 continues to reach new highs and cyclical sectors show signs of recovery. Overall, the economic outlook could be characterized as positive in the opinion of ACG, noting that valuations and credit spreads continue to be challenged. Potentially over the next decade and beyond, debt to Gross Domestic Product ("GDP") would likely be over 100% which would be an incentive to keep interest rates low in the U.S. and globally. Population growth in the U.S. has been the lowest in the last decade since the 1930s. Low population growth results in a lower tax base thus putting pressure on the ability to pay debt down. A primary risk concern in U.S. markets appears to be inflation with the impact being the Fed policy and rates moving higher. Relating to the portfolio construction, the focus remains maintaining a balance between the various asset classes and correlations between different components of the portfolio, ensuring that each segment is designed to produce a specific risk/return relationship. Mr. Willis noted that the International Monetary Fund ("IMF") raised their global growth forecast for 2021 to approximately 6.0%, 4.4% for 2022 and will likely revert to the range of 3.0% in 2023, which most likely would be the time monetary policy adjustments would be made.

Mr. Alex Nixon reviewed the total portfolio performance summary for the period ending December 31, 2020. He reported that for the fourth quarter ending December 31, 2020, the total portfolio produced an annualized return (over five years) of 7.82%, modestly outperforming the Endowment policy benchmark by 37 basis points. Relative to broad market benchmarks, the total portfolio generated 80% of the return with 52% of the risk/volatility. Over the last decade, the portfolio returned 6.01% annualized and outperformed the policy benchmark by 70 basis points but underperformed against the 65/35 benchmark by approximately 106 basis points. The fixed income composite significantly lagged the fixed blend in 2020, contributing to the underperformance over the three, five and ten-year periods. The equity strategies and real assets have outperformed over all time periods (last ten years).

Mr. Nixon reviewed the performance for the State Water Implementation Fund for Texas ("SWIFT"). He stated that the portfolio was a more defensively positioned portfolio with a lower return target, with the objective to exceed inflation and distributions while maintaining appropriate liquidity in the portfolio. Compared to the Endowment portfolio, the SWIFT portfolio is a bit more balanced portfolio with less expected volatility. The portfolio has annualized at a 5.89% return over the five-year period and has outperformed the dynamic benchmark and slightly underperformed the policy benchmarks over the same the five-year period with similar returns and slightly lower risk. The portfolio produced a 4.88% return for the quarter. The equity portion of the portfolio fared well relative to the benchmark over the one, three and five-year periods. Real assets outperformed the benchmark by 132 basis points over the last five years. The fixed income portion of the portfolio has underperformed over all reported time periods against the benchmark.

Mr. Willis reviewed the Texas Economic Stabilization Investment Fund ("TESTIF") portfolio. He explained that this portfolio has the lowest risk profile of the three portfolios and its primary objective is to seek returns higher than inflation and remain highly liquid. This portfolio generated slightly higher returns and risk relative to the dynamic benchmark over the past five years, and slightly lower returns relative to the policy benchmark. For the quarter the portfolio produced a return of 1.17% and a five-year annualized return of 2.88%. Overall, the portfolio produced solid returns on a risk-adjusted basis.

Fixed Income and Alternative Fixed Income Portfolio Review (Tab 3)

Mr. Mike Reissig reminded everyone that the philosophy of the management team at the Trust Company is to be transparent, rigorous and thorough and therefore should be responsive in a timely manner to the Legislature, the Comptroller, the boards, staff and other interested outside parties. He explained that the beneficiaries of the work by the Trust Company and all involved provide health care for the indigent, help provide funding for water projects and depend on a reliable and available economic stabilization fund. The analysis that will be discussed represents efforts of the Trust Company, ACG and Aksia to achieve those goals and standards.

Mr. Willis began the discussion with a review of ACG's material. He explained the general objectives, risk and return expectations and policy objectives for the three portfolios. Detailed data is contained in the materials behind Tab 3. The observations noted were that through December 13, 2019, the global fixed income and alternative fixed income ("AFI") portfolios were generally achieving objectives over the long-term, but the dislocation of certain AFI strategies in the first quarter of 2020 negatively impacted the long-term returns. Also, he noted that the AFI policy language in the Endowment portfolio is broad and there are some inconsistencies in the policy language between Endowment, SWIFT and TESTIF, and that the latter two portfolio objectives were less specific than the Endowment objectives. Mr. Willis explained that a review of peer group investment policy statements specific to fixed income did not reveal any material findings. He discussed that possibly the metrics across the three portfolios could be more consistent in regard to the way that return and risk are measured.

The Board and staff continued the discussion relating to the investment with Allianz.

Ms. Lynn O'Connell with Aksia, the hedge fund consultant for the Trust Company, presented a comprehensive review of their material from a quantitative perspective. She explained that the AFI portfolio is intended to act as a traditional fixed income replacement portfolio, exhibiting low correlation and beta to equity markets, with moderate volatility. She reviewed the performance metrics of the AFI Endowment portfolio versus the benchmark over the one and five-year marks and life to date. The portfolio has outperformed the benchmark, life to date, and was in line with beta targets. Over the short-term, the difference between the five-year and one-year period changed with the one-year volatility increasing significantly, primarily due to Allianz as well as the beta increasing dramatically and shifting assets to the Persistence Pool. Mr. Ruchit Shah remarked that the Persistence Pool is part of the portfolio. In reviewing the objectives some observations emerged, mainly that the portfolio morphed somewhat into less of a fixed income replacement portfolio and more of an absolute return portfolio.

The issue of volatility was discussed in detail. Ms. O'Connell continued with a detailed review of Aksia's presentation relating to performance. She explained that in March 2020 there was a drastic downturn regarding the equity beta, credit beta and specifically volatility. Aksia believes this could be improved by making resizing and rebalancing a more integral part of portfolio management.

Aksia noted that the AFI portfolio had disappointing 2020 performance largely due to outsized underperformance from a few holdings and lack of balance to mitigate the increased beta to equity and credit markets. Recent portfolio beta is above investment policy statement ("IPS") targets and they would like to see beta revisited and decreased. Aksia believes the portfolio could benefit from more turnover activity such as rebalancing, adding managers or removing managers that have unsatisfactory performance. Volatility is higher than desirable in the portfolio. There is not a volatility target in the IPS; therefore, Aksia believes that framing that target range and having a number to manage would be beneficial.

Mr. Shah reviewed the TESTIF AFI portfolio and noted that the portfolio outperformed the benchmark amid market volatility and basically had the same annualized volatility as the benchmark. The portfolio did well and did not contain an investment in the Allianz strategy.

Mr. Willis summarized items to consider going forward (details behind Tab 3):

- Revise fixed income policy language to ensure consistent descriptions of risk/return objectives and quantitative metrics across all three pools of capital. Eliminate the correlation objective from the Endowment AFI objectives
- Continue to allocate to fixed income strategies consistent with relevant benchmarks and ACG's capital market assumptions
- Maintain flexibility to purchase niche investments going forward while adding more detailed language to the investment policy that establishes sizing constraints and rebalancing triggers and also limits AFI strategies to 15
- Ensure at least a semi-annual formal review of AFI strategies and potential rebalancing
- Add volatility target (4-8%)
- Reduce beta target to (<0.3)

In the near term, it is expected that the TTSTC staff will continue with their manager searches currently in progress and explore the addition of new strategies.

Jennifer Wildeman continued the discussion and reviewed suggested new strategies:

- Develop the global macro strategies into less systematic approaches and more discretionary approaches
- Quantitative strategies – potential to add exposure to high conviction funds
- Add convex strategies
- Idiosyncratic strategies
- Credit

In addition, Ms. Wildeman explained that Aksia and TTSTC staff agreed that the portfolio could benefit from semi-annual rebalancing, review position sizing, IPS modifications and complete an annual portfolio review and tactical plan.

The Board advised TTSTC staff to be cautious of strategies with opaque risk and they should have a sound selection process. Whatever changes are made to the investment policy should also address the processes and controls and the timing of monitoring of those processes and controls.

Mr. Shah stated that TTSTC staff does indeed have in-depth semi-annual reviews with ACG for portfolio review, as well as other ongoing reviews with both Aksia and ACG.

Economic Outlook, Investment and Review of Treasury Pool (Tab 4)

Ms. Anca Ion presented an economic update since the last board meeting in January. She reported that the sell-off in the fixed income market has continued, leading to the ten-year treasury to get as high as 175 basis points, currently a little lower at about 160 basis points, which is higher than in January. As economic recovery continues, she expects the steepening of the yield curve to go even higher. She reported that the total COVID-19 relief thus far is approximately $5.5 trillion, which is three times more than the government did after the financial crisis in 2008. As a percentage of GDP, it's approximately 25% - 26% of GDP. There is indication of fiscal stimulus to continue well into the economic recovery. She reported that there is speculation of round four of stimulus and more on infrastructure stimulus over a ten-year period. Ms. Ion reported that current U.S. debt is approximately $8 trillion, which is almost double than the high of the 2008 crisis.

Ms. Ion explained that economic data for April so far showed a significant uptick as a result of weather normalization, stimulus and reopening of the economy. Almost one million jobs were added in March, however that is still about 8.5 million lower than pre-pandemic levels. Overall, jobs creation is returning and there is a constant rate of improvement. Retail sales were 15% higher than pre-pandemic levels. The continued government support had a positive impact on personal savings and personal income. She reported that the Fed upsized the GDP growth for this year to 6.5% which is the highest since 1984. Unemployment is expected to reduce to 4.5%. The increase in GDP is not proportional to the decrease in unemployment which is not the norm and signifies that the stimulus is not producing jobs but instead is replacing lost income. Ms. Ion believes the Fed will continue to keep interest rates low and not do any tightening anytime soon.

Ms. Ion reviewed the Treasury Pool portfolio and reported that the current value was approximately $45 billion, and the yield was approximately 0.40%. She expects that given the new stimulus package; the balance could be 25% - 30% higher by the next quarter. She reported that the six-month treasury bill was lower by approximately 4 or 5 basis points since the previous quarter. The pool is not increasing their exposure to treasuries but will increase their commercial paper allocation. By doing this she believes that in three to six months the portfolio could gain 10-15 basis points. Ms. Ion reported that asset backed securities have performed well and able to gain some positive returns. As of March 31, 2021, the Treasury Pool portfolio composition was 28% commercial paper, 33% treasuries, 14% agencies, 6% each in asset backed securities and cash equivalents, 5% corporate bonds and 2% other. Ms. Ion expects to see some volatility in mortgages when the Fed begins to taper. Ms. Ion believes there will be little room for any upside surprises. She believes that there are several risks going forward: 1) if there is more government stimulus it will not be as fast or big and any stimulus relating to infrastructure will be over a long period of time 2) geopolitical risks and 3) the virus mutation and the effectiveness of the vaccines. Given these risks and economic conditions, Ms. Ion believes the U.S. has done a good job in economic recovery and she expects the economy will continue to reopen but the pace will curb.

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

Mr. Ruchit Shah reviewed the private markets section of the presentation. He reported that distributions or capital calls were steady and manageable. Staff continues to monitor and ensure that they are pacing private markets exposures appropriately. Mr. Shah reviewed the equity summary and reported that the hedged equity portion of the portfolio was up 23%. For comparison, S&P index was up 18% and ACWI was up 16%. Private equity continued to do well. Mr. Shah explained that multiple times over the last six months, redemptions in hedged equity and long-only equity were made in order to align the exposures closer to policy. Overall performance for the Endowment portfolio was strong.

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 December 31, 2020 was approximately $1.7 billion and produced a 4.9% return for the quarter, bringing performance for the calendar year up to 3.4%. He reported that commitments in the private market sector was increasing since there was a more stable and steadier pace of distributions. Mr. Shah noted that a dislocation fund manager was added to the portfolio and they were finding more opportunities in performing credit. The hedged equity portfolio was up 20% despite less exposure in emerging markets and much less in tech equity exposure. He reported that through March 2021, the portfolio performance was 2.09%. The portfolio remained highly liquid and was meeting its investment objectives.

Mr. Shah reviewed the TESTIF portfolio for the quarter ending December 31, 2020 and reported that it was performing as designed and preserving its purchasing power by earning more than inflation. Since inception, the portfolio has returned 2.61% annualized, while earning over $360 million in excess returns over the state's Treasury Pool. During the same period, the portfolio has earned nearly $250 million over inflation. Despite COVID related market volatility, the portfolio's 2020 performance was a steadfast 3.93%, building upon a 4.10% return in 2019. The portfolio remains highly liquid with approximately 85% able to be delivered as cash within one month.

Discussion of Next Meeting and Agenda Items

Comptroller Hegar announced that the next meeting would be scheduled for some time in July and will likely be virtual. Ms. Arredondo will be contacting the Board. No future agenda items were suggested.

Public Comment

None

Adjourn

The meeting adjourned at 1:10 p.m.