

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT
ADVISORY COMMITTEE
Friday, March 24, 2017
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Friday, March 24, 2017 at 10:00 a.m. in Room 320, Rusk State Office Building, 208 E. 10th Street, Austin, Texas.

Committee Members Present

Stuart Ford, Chairman; Judge Dan Gattis; Judge James Teal; Ms. Peggy Deming; Mr. Roy Browning; Mr. Noe Hinojosa; Mr. Fred Greene; Judge Woody Gossom; and Commissioner Byron Underwood.

Committee Members Absent

Commissioner Neil Fritsch and Mr. Chuck Norris.

Texas Treasury Safekeeping Trust Company (“Trust Company”) Staff Members Present

Paul Ballard, Chief Executive Officer and Chief Investment Officer; Danny Sachnowitz, Deputy Chief Investment Officer; Frank Zahn, Chief Financial Officer; Marianne S. Dwight, General Counsel; Laura Montoya, Chief Operations Officer; John Wright, Deputy General Counsel; Gena Minjares, Deputy Chief Financial Officer; Michael Anderson, Compliance Officer; Jorge de LaFuente, Director of Operational Due Diligence; Patrick Jue, Operational Due Diligence Analyst; Nora Arredondo, Special Projects Coordinator; and Susan Colletti, Director of Investment Accounting;

Additional Participants Present

Mike O’Brien, RSM & Co., LLP (formerly Padgett, Stratemann & Co.) and Tom Janisch and Alex Nixon, Asset Consulting Group (“ACG”).

Call to Order

Chairman Stuart Ford declared that a quorum was present and called the meeting to order at 10:01 a.m.

Approval of Minutes (Tab 1)

A motion to approve the October 14, 2016 meeting minutes was made by Judge Woody Gossom. The motion was seconded by Commissioner Byron Underwood and unanimously approved.

Presentation of Annual Audit (Handout)

Mr. Mike O’Brien reported RSM & Co. issued an unqualified audit opinion with respect to the Tobacco Settlement Permanent Trust Account (“Account”) for the year ending December 31, 2016. Mr. O’Brien affirmed that the account had been managed in compliance with the Investment Policy and the Distribution Policy. Mr. O’Brien reviewed the distribution calculation process as described in the distribution attestation report. He explained that the audit attests to the calculation process, not the decided distribution amount, since it has yet to be determined. No audit adjustments were recorded during the audit engagement, nor was a management letter issued.

Capital Markets Overview and Investment Performance Review for the Quarter ending December 31, 2016 and Related Matters (Tab 2)

Mr. Tom Janisch presented an economic summary. He began with an economic recap of 2016. He explained that 2016 began with global turmoil in the equity, credit and energy markets. Other surprises in 2016 included the election by the British to exit from the European Union (“Brexit”); the U.S. presidential election; and the OPEC deal to cut oil production. After the last Tobacco meeting and post-election, the U.S. economic environment was optimistic. The year ended with the highest consumer confidence index since 2001. Record highs were reported in all major indices. He reported that earlier this month, the Federal Reserve (the “Fed”) issued a qualitative assessment of the economic, banking, and financial conditions in each of the twelve Fed regions. Overall, the assessment was positive. Mr. Janisch reported that market volatility has been calm. Since the election there have been only three days where the market moved more than one percent. He reported that the Fed demonstrated their positive outlook on the economy by raising interest rates a quarter point for the second time in three months. He explained that with inflation close to its two percent target, there may be a potential rate increase announced at the next Fed meeting. Currently, market volatility is somewhat uncertain as healthcare reform and record high oil inventory looms. Mr. Janisch reported that earnings in Europe and Japan had outperformed the rest of the world. ACG is optimistic in European markets and this is reflected in the portfolio. Overall, the U.S demonstrated modest growth and stability and ACG remains positive but continues to expect slow domestic economic growth.

Mr. Janisch reviewed the information provided by ACG behind Tab 2. He reported that for the period ending February 28, 2017, global equities led the way within all major indices year to date. Global fixed income and commodities produced marginally positive returns year to date. The S&P 500 pulled back slightly, at 5.5% and emerging markets were up almost 12.5%. Mr. Janisch reported that for 2016 all sectors produced positive returns with the exception of the healthcare sector.

Mr. Alex Nixon of ACG summarized the investment performance of the portfolio for the quarter ending December 31, 2016. He reported that the total portfolio exceeded the endowment policy benchmark not only for the quarter, but also for the trailing one, three, and five year periods. Fixed income significantly outperformed for the year ending 2016 and continues to outperform its benchmark for the trailing one, three, and five year periods. Equities have slightly outperformed its benchmark for the same trailing periods. Real assets underperformed for 2016 but outperformed its benchmark for the quarter as well as the trailing three and five year periods. Mr. Nixon reviewed the risk vs. return analysis portion of the report. He reported that the total portfolio generated greater returns with similar risk than the endowment policy portfolio over the last five years. The annualized return for the total portfolio was 6.2% while the endowment policy portfolio produced an annualized return of 5.5%. Standard deviation for the portfolio was 4.0% and the standard deviation for the policy was 3.9%. The Sharpe ratio for the portfolio was 1.5 vs. a 1.4 Sharpe ratio for the policy. Relative to broad market benchmarks, the total portfolio has generated slightly lower returns with less than half the risk.

Mr. Janisch summarized ACG’s forward looking view of various asset classes. The overall market outlook is mixed. The outlook for cash and global fixed income remains challenging. Expectations for global equities are neutral to overweight, which reflects a modest positive view. Global equity markets are likely to continue to provide positive, albeit modest, returns going forward. ACG continues to support fixed income strategies with greater flexibility to better navigate volatility, therefore changing their outlook from underweight to neutral. ACG continues to recommend an overweight to emerging market equities.

Discussion and Approval of Annual Trust Distribution (Tab 3)

Mr. Paul Ballard began the discussion by reviewing the basics of the portfolio’s rate of return and corpus versus market value. He explained that the Trust was initially given \$1.682 billion and had distributed to date approximately \$820 million. The Trust value as of December 31, 2016 was approximately \$2.37

billion, and the inflation adjusted corpus was approximately \$2.32 billion. Total earnings (value in excess of corpus) were approximately \$690 million, as of December 31, 2016.

Mr. Ballard and Chairman Ford reminded the Committee that the distribution calculation is a twenty quarter moving average value of the fund times three percent, as demonstrated on page two behind Tab 3. The recommended distribution amount is therefore \$67,155,876.

A motion to approve the distribution of \$67,155,876 to the beneficiaries of the Tobacco Settlement Permanent Trust Account was made by Mr. Roy Browning. The motion was seconded by Mr. Noe Hinojosa, and unanimously approved by the Committee.

Endowment Portfolio Update and Related Matters (Tab 4)

Mr. Paul Ballard presented an overview of the endowment portfolio and reported that it was in compliance with the asset allocation and investment policies. He reported that as of December 31, 2016 the portfolio value was approximately \$2.37 billion. The portfolio produced a quarterly return of 2.6%, out-performing its benchmark by 1.2%. For the trailing one-year period, the portfolio returned 7.5%, exceeding its policy benchmark by 1.6%. Mr. Ballard reported that all asset classes produced positive returns for the quarter and also for the trailing one-year period. The best performing classes were natural resources (+19.8%), private debt (+11.3%), and global public equity (+10.4%). Mr. Ballard and Mr. Sachnowitz reviewed the portfolio's various investment managers, their strategies and performance within each asset class. Mr. Ballard explained that the portfolio is put through several stress test scenarios and that the construction of the portfolio has proven to be resilient. The objective continues to be consistency of performance with downside protection. He reported that the portfolio was performing in line with expectations, given the current economic environment.

Discussion of Next Meeting and Agenda Items

Committee members will be contacted to determine a date to meet in the fall.

Public Comment

None.

Adjourn

Chairman Stuart Ford adjourned the meeting at 12:05 p.m.