

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT
ADVISORY COMMITTEE
Friday, November 3, 2017
*Minutes***

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Friday, November 3, 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 James Teal; Commissioner Byron Underwood; Judge Dan Gattis; Judge Woodrow “Woody” Gossom, Jr.; Mr. Reed Hurley (new); Mr. Stephen Bowerman (new); Mr. Chuck Norris; and Judge Ben Zeller (new).

Committee Members Absent

Mr. Fred Greene and Mr. Noe Hinojosa.

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; Genoveva Minjares, Deputy Chief Financial Officer; John Wright, Deputy General Counsel; Whitney Blanton, Associate Deputy General Counsel; Jorge de LaFuente, Director of Operational Due Diligence; Patrick Jue, Operational Investment Analyst; Chad Turner, Risk Manager; Ruchit Shah, Portfolio Manager; Byron Beasley, Portfolio Manager; Nora Arredondo, Special Projects Coordinator; and Susan Colletti, Director of Investment Accounting.

Additional Participants Present

Lori Mills 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 10:04 a.m.

Chairman Ford introduced the newest members to the Committee: Judge Ben Zeller, Mr. Stephen Bowerman, and Mr. Reed Hurley.

Approval of Minutes of March 24, 2017 meeting (Tab 1)

A motion to approve the March 24, 2017 meeting minutes was made by Judge Woody Gossom. The motion was seconded by Judge James Teal and unanimously approved.

Update on Revisions to the Endowment Investment Policy (Tab 3)

Mr. Paul Ballard reported to the Committee that there were a few revisions to the Endowment Investment Policy, but none were particularly substantive. He explained that the changes were made for purposes of clarity and to reflect evolving practices. He stated that no revisions were made to the asset allocation policy. Also, the position of Chief Strategist was officially added to the internal investment committee.

Chairman Ford suggested that the term “fund” be used instead of “portfolio” for consistency purposes. These and other revisions are included in the detailed draft behind Tab 3.

Capital Markets Overview and Investment Performance Review for the Quarter Ending June 30, 2017 and Related Matters (Tab 2)

Ms. Lori Mills of ACG presented an economic summary. She reported that market returns for major asset classes for the quarter ending September 30, 2017 were positive. In reviewing market returns over the last few years, those higher performance markets, such as emerging markets and developed markets outside of the United States, were lagging a few years ago and are now rebounding. She explained that global diversification is essential to reducing risk.

Ms. Mills explained that ACG does not believe there will be a protracted downturn in the markets in the near term. However, they believe a recession will eventually occur but the portfolio is constructed to mitigate volatility. ACG believes that the Federal Reserve is likely to raise interest rates again in December. Overall, the U.S demonstrated modest growth and stability and ACG remains positive but continues to expect slow domestic economic growth.

Mr. Alex Nixon of ACG summarized the investment performance of the portfolio for the quarter ending June 30, 2017. The total portfolio generated a higher return with slightly higher risk compared to the endowment policy benchmark over the last five years. Relative to broad market benchmarks, the portfolio generated 94% of the return with 50% of the risk. The annualized return for the total portfolio was 6.82%, while the endowment policy portfolio produced an annualized return of 5.71%. The portfolio significantly outperformed the policy benchmark over the past year, contributing to longer-term outperformance over the trailing three and five year periods. Mr. Nixon reported that the fixed income portion of the portfolio lagged modestly in the second quarter, but continued to outperform its benchmark over the trailing one, three and five year periods. Equity strategies posted positive excess returns above their benchmark over each of the trailing periods, annualizing at more than 140 basis points over the past five years. Real assets also had positive excess returns year to date and lead benchmarks over all periods.

Discussion of 2018 Annual Distribution (Tab 5)

Mr. Paul Ballard explained that based on the revised rule, the estimated distribution that will be made by April 1, 2018 is approximately \$69.59 million, representing an approximate \$1.37 million increase over the prior year. That calculation is based on 3% of the 20-quarter moving average value of the Trust as of June 30, 2017. He said the final calculation will be based on the 20-quarters ending December 31, 2017. The expected actual distribution should not differ greatly from the \$69 million estimate because the calculation is based on a long-term average and 18 of the 20-quarter values are already known.

Mr. Ballard reviewed the “Corpus vs. Market Value” chart behind Tab 5. He explained that at the end of the third quarter of 2017, the market value of the Trust was approximately \$2.5 billion and the expected inflation adjusted corpus value was approximately \$2.36 billion. He reported that total distributions to date were approximately \$888 million as detailed in the report at Tab 5. Mr. Ford stated that with the new rule, the inflation adjusted corpus would be eliminated when calculating the distribution but would still be tracked. Mr. Ballard stated that the Committee will decide on the amount of the 2017 distribution at its next meeting.

Endowment Portfolio Update and Related Matters (Tab 4)

Mr. 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 June, 30, 2017 the portfolio value was approximately \$2.44 billion. The portfolio produced a 2.1% return for the quarter, exceeding its policy benchmark by 0.5%.

Mr. Ballard reviewed the performance summary charts and explained that in the previous three months, most of the positive returns came from the equity strategies. Over the previous three years, the biggest driver of return was real estate, where the investment of single-family rental properties posted excellent returns. He reviewed the asset allocation summary chart, which demonstrates how the portfolio was positioned relative to its allocation targets. Mr. Ballard reported that as of September 30, 2017, the portfolio value was approximately \$2.5 billion, which represented an approximately \$65 million increase during the quarter.

Mr. Ballard reviewed each asset class and the various investment strategies utilized to diversify returns within the portfolio. He explained which asset classes were overweight or underweight and how that related to the target allocations and returns. He reviewed the portfolio characteristics and stated that the portfolio was very liquid, is positioned opportunistically, and is extremely diversified. Mr. Ballard explained that the portfolio is put through multiple stress test scenarios and that its construction 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. Mr. Ballard reported that the portfolio produced a return of 1.3% for July, 0.7% for August, and 0.8% for September, bringing the year to date return to approximately 8.4%.

Discussion of Next Meeting and Agenda Items

Committee members will be contacted to determine the best date in March for the next meeting, when a vote on the annual distribution will be taken.

Public Comment

Jim Allison, General Counsel for the County Judges and Commissioners Association of Texas, was pleased to learn that the expected distribution amount to be decided at the next meeting may be an increase over the prior year. He urged the Committee and Trust Company to report the actual cost of management fees on their reports. Chairman Ford stated that the rate of return is net of management expenses of 30 basis points. Mr. Ballard said that 30 basis points is what is charged to manage the endowment fund and at the end of the year, the Trust Company rebates the difference between what is actually needed and the 30 basis points.

Adjourn

Chairman Stuart Ford adjourned the meeting at 11:50 a.m.