

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT
ADVISORY COMMITTEE
Friday, November 1, 2019
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “**Committee**”) met on Friday, November 1, 2019 at 10:00 a.m. in Room 320, Rusk State Office Building, 208 E. 10th Street, Austin, Texas.

Committee Members Present

Stuart Ford, Chairman; Hon. Bill Gravell; Mr. Fred Greene; Mr. Reed Hurley; Mr. Rick Bailey; Mr. Ted Matthews; Hon. Mark Beauchamp; Stephen Bowerman and Hon. Ben Zeller.

Committee Members Absent

Mr. Noe Hinojosa and Hon. James Teal.

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

Mike Reissig, Acting Chief Executive Officer; Ruchit Shah, Acting Chief Investment Officer; Genoveva Minjares, Chief Financial Officer; Whitney Blanton, General Counsel; Laura Montoya, Chief Operations Officer; Jorge de LaFuente, Director of Operational Due Diligence; Patrick Jue, Operational Investment Analyst; and Nora Arredondo, Program Specialist.

Additional Participants Present

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 10:00 a.m.

He introduced two new Committee members: Commissioner Rick Bailey, who replaces Byron Underwood and Judge Bill Gravell, who replaces Dan Gattis.

Approval of Minutes of March 25, 2019 meeting (Tab 1)

Chairman Ford called for a motion to accept the minutes from the March 25, 2019 meeting.

A motion to approve the March 25, 2019 meeting minutes was made Commissioner Mark Beauchamp. The motion was seconded by Commissioner Rick Bailey and unanimously approved by the Committee.

Capital Markets Overview and Investment Performance Review for the Quarter Ending June 30, 2019 and Related Matters (Tab 2)

Mr. Alex Nixon presented the Committee a brief overview of the current global economic environment. He explained that the economy continued to grow albeit at a slower pace. For example, in 2017 global Gross Domestic Product (GDP) was shy of 4%. For the second quarter of 2019 global GDP growth was 2.6%. In the United States, the longest expansion period on record was 123 months and counting. The average GDP during this expansion period was 1.9%. ACG believes the biggest contributor to the global

slowdown is the trade policy and trade uncertainty between China and the U.S. No long-term resolution is expected any time soon, especially going into an election year in the U.S. This uncertainty has led to a steep drop in manufacturing globally and is beginning to trickle in the U.S. The European Central Bank as well as the Federal Reserve (the “Fed”) has been cutting interest rates. The Fed has cut rates by 25 basis points at each meeting: July, September and March. Mr. Nixon explained the goal of the Fed is to re-stimulate the economy and try to offset some of the uncertainty relating to trade policy. He reviewed the graphs that depicted how important the U.S. consumer is to overall GDP growth. The U.S. consumer contributes nearly 70% to the overall economic output. Globally, the U.S. consumer contributes more than all of China and all of the top five Eurozone countries combined. Mr. Nixon reported that the unemployment rate in the U.S. was at a 50 year low of 3.5% as of September 2019. ACG believes that, on a global scale, the economy should continue to grow at a 2.0%-3.0% pace. Domestically, the trend is about 1.5%-2.0% over the next twelve months. Overall, ACG expects domestic economic growth to continue at a modest, slow rate.

Mr. Nixon reviewed the investment themes over the intermediate period of three to five years. He specifically reviewed return expectations and stated that bond yields have dropped. Ten-year Treasury yields were at 2.7% at the beginning of the year and now they are at 1.7%. With the drop in yields and a slowing economic environment the result is a challenging or muted return environment ahead. He reminded the Committee to set realistic expectations and be mindful of the risk. The Trust Company has been diligent in setting a reasonable return target rate of 6.0%–7.0%. The Committee discussed the strategic allocation targets. Mr. Nixon and Mr. Ruchit Shah explained that keeping close to those targets gives the portfolio the best opportunity to achieve its objective over the long-term.

Next, Mr. Nixon reviewed market returns for the different asset classes. He reported that the first nine months provided positive returns and strong markets. The S&P 500 hit another record high earlier in the week. The bond markets were strong and up 8.52% year to date which benefited the portfolio. Mr. Nixon summarized the investment performance of the portfolio for the quarter ending June 30, 2019. He explained that the objective of the portfolio is to provide predictable and stable distributions. The total portfolio generated a higher return with similar risk compared to the endowment policy benchmark over the last five years. Relative to broad market benchmarks, the portfolio generated 114% of the return with 44% of the risk. The annualized return for the portfolio was 5.11%, while the endowment policy portfolio produced an annualized return of 4.42%. The total portfolio returns outperformed the endowment policy benchmark over all time periods: second quarter 2019, one-year, three-year and five-year periods. Mr. Nixon reported that the fixed income portion of the portfolio modestly lagged its benchmark over the past year but continues to outperform over the trailing three and five-year periods. The equity strategies have outperformed over all time periods

Update on Endowment Investment Policy (Tab 3)

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

Endowment Portfolio Update and Related Matters (Tab 4)

Mr. Shah 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, 2019 the portfolio value was approximately \$2.62 billion and produced a 2.3% return for the quarter. He recapped the executive summary behind Tab 4 and reported that the portfolio was performing as expected. For the trailing one-year period, the portfolio returned 5.7% and the best performing asset classes were Private Equity (16.3%), Real Estate (8.4%) and Global Fixed Income (6.3%).

Mr. Shah reviewed the performance summary charts and explained that in the second quarter of 2019, the portfolio was capturing more of the upside than the downside. He reviewed the asset allocation summary

chart, which demonstrates how the portfolio was positioned relative to its allocation targets. He noted that the portfolio was slightly overweight in the Equity, Strategic All Asset, and Overlays strategies.

Mr. Shah 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. The Committee discussed the strategies in greater detail. He stated that not many changes were made in the Public Equity, Public Fixed Income or the Hedge Fund portfolios. More work was done in the Private Market portfolios with nine new commitments. He reviewed the portfolio characteristics and stated that the portfolio was sufficiently liquid, is positioned opportunistically, and is extremely diversified. Mr. Shah 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. The portfolio produced a return of .75% for July and -0.84% for August, bringing the year to date return to approximately 7.2%.

Discussion of Annual Distribution (Tab 5)

Mr. Shah reported that based on the rule, the estimated distribution that will be made by April 1, 2020 is approximately \$74 million, representing an approximate \$1.8 million, or 2.5% increase over the 2019 distribution. The distribution calculation is based on 3% of the 20-quarter moving average value of the Trust as of September 30, 2019. The final calculation will be based on the 20-quarters ending December 31, 2019. He explained that we are meeting our objective of growing the distribution at the rate of inflation. The expected actual distribution should not differ greatly from the \$74 million estimate because the calculation is based on a long-term average and 18 of the 20-quarter values are already known.

Mr. Shah reviewed the “Corpus vs. Market Value” chart behind Tab 5. He explained that at the end of the third quarter of 2019 the market value of the Trust was approximately \$2.62 billion and the expected inflation adjusted corpus value was approximately \$2.46 billion. He reported that total distributions to date were approximately \$1,030 million.

Chairman Ford stated that the Committee will decide on the amount of next year’s distribution at its next meeting.

Discussion of Next Meeting and Agenda Items

Chairman Ford suggested Friday, March 27, 2020 for the next Tobacco meeting. 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

Mr. Jim Allison, General Counsel of the County Judges and Commissioners Associates of Texas, gave the Committee a brief background of how the Tobacco Settlement was established. He spoke of possible new litigation involving new companies that purchased companies or brands of cigarettes, thereby purchasing the settlement linked to those brands. There could be additional payments to the State. He will be monitoring the situation.

Adjourn

Chairman Stuart Ford adjourned the meeting at 12:01 p.m.