

**TOBACCO SETTLEMENT PERMANENT TRUST ACCOUNT INVESTMENT
ADVISORY COMMITTEE
Friday, October 30, 2020
Minutes**

The Tobacco Settlement Permanent Trust Account Investment Advisory Committee (the “Committee”) conducted a virtual WebEx meeting on Friday, October 30, 2020 at 10:00 AM.

Committee Members Present

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

Committee Members Absent

Mr. Noe Hinojosa.

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

Mike Reissig, Chief Executive Officer; Ruchit Shah, Chief Investment Officer; Laura Montoya, Chief Operating Officer; Genoveva Minjares, Chief Financial Officer; Whitney Blanton, General Counsel; Chad Turner, Risk Manager; Michael Leifeste, Portfolio Manager; Brad Davis, Portfolio Manager; Nora Arredondo, Program Specialist and Shantel Geeslin, Program Specialist.

Additional Participants Present

Alex Nixon, Asset Consulting Group (ACG).

Call to Order

Chairman Stuart Ford called roll and declared that a quorum was present. He called the meeting to order at 10:08 AM.

Approval of Minutes of March 27, 2020 meeting (Tab 1)

Chairman Ford called for a motion to accept the minutes from the March 27, 2020 meeting.

A motion to approve the March 27, 2020 meeting minutes was made by Mr. Ted Matthews. The motion was seconded by Commissioner Rick Bailey and unanimously approved by the Committee.

Discussion of Annual Distribution (Tab 5)

The Committee decided to discuss the estimated annual distribution. Mr. Ruchit Shah led the discussion and reviewed the information behind Tab 5. He reported that based on the rule, the estimated distribution that will be made by April 1, 2021 is approximately \$74.9 million, representing an approximate \$1.1 million, or an approximate 1.5% increase over the 2020 distribution. The estimated distribution calculation is based on 3% of the 20-quarter moving average value of the Trust as of September 30, 2020. The actual calculation will be based on the 20-quarters ending December 31, 2020. 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 \$74.9 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 2020 the market value of the Trust was approximately \$2.492 billion and the expected inflation adjusted corpus value was approximately \$2.497 billion. He reported that total distributions to date were approximately \$1.1 billion.

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

Capital Markets Overview and Investment Performance Review for the Quarter Ending June 30, 2020 and Related Matters (Tab 2)

Mr. Alex Nixon of ACG presented to the Committee 1) a global economic update; 2) a portfolio performance update; and 3) discussed the change to the strategic asset allocation. He reported that the economy was no longer in a technical recession as the third quarter GDP was slightly over 33% annualized, which was the highest ever recorded. Economic recovery gained momentum in the summer and early fall and risk assets, in particular equities, rallied substantially during this period. Momentum seems to be slowing as winter approaches and there is still a long road to economic recovery and the key to recovery remains the path of the Corona Virus. Experts expect a vaccine within the next twelve months. Mr. Nixon reported that the Federal Reserve (the Fed) is committed to remaining accommodative for the foreseeable future. The economic markets will be sensitive to any news relating to fiscal stimulus and the Corona Virus. Assuming that a vaccine is produced and distributed, Mr. Nixon reported that ACG expects the economy to recover in full and trend towards growth over the next couple of years. ACG does not expect widespread permanent damage to future economic growth prospects over the long run. Mr. Nixon reviewed the charts behind Tab 2 depicting potential scenarios for the path to recovery from COVID-19. He reported that twenty-two million jobs were lost in the first two months of the pandemic. Almost half of those have yet to return, mostly in industries most suppressed by the virus. On a better note, auto and home sales were positive and retail sales were on the upside. ACG expects the Fed to keep interest rates low until at least 2023. The Fed has put programs in place to help support markets in the economy. The results of the Presidential election will most likely have an impact on fiscal stimulus and monetary policy. More market volatility could be expected. Mr. Nixon noted that throughout history, markets have risen under Republican control, Democratic control and even in divided governments. ACG and the Trust Company believes the best advice is to invest consistently with the strategic plan and not through a political lens. However, ACG believes another round of fiscal stimulus is necessary to keep the economy on track.

Mr. Nixon summarized the investment performance of the portfolio for the quarter ending June 30, 2020. He reported that the Tobacco Settlement Permanent Trust (TSPT) portfolio produced an annualized return of 4.32%, slightly lower than TSPT endowment policy benchmark of 4.43%. He reported that the last time the portfolio lagged the policy benchmark was in 2014. For the quarter, the TSPT portfolio generated a 4.07% return, which outpaced the TSPT policy benchmark by 0.36%. Relative to broad market benchmarks, the TSPT portfolio generated 79% of the return with 50% of the risk. Over the last ten years, the TSPT portfolio returned 5.9% annualized, modestly outperforming the endowment policy benchmark over the same period.

Mr. Nixon reviewed the material relating to the endowment asset allocation material behind Tab 2. He explained that the investment objectives were to earn an annual total return that would provide predictable, stable stream of distributions; ensure that the inflation-adjusted value of distributions be maintained over the long-term; ensure that the inflation-adjusted value of the corpus, after distribution and fund expenses, be maintained over the long-term; and achieve the desired portfolio

volatility minimizing downside risk through diversification and risk management. He stated that over the ten-year period, the endowment portfolio has met its investment return objective. He compared the current target portfolio against a proposed portfolio which has a 5% increased allocation to private equity and a 5% reduction in real assets (2.5% reduction from core real estate and 2.5% reduction in opportunistic real estate). It reduces core and opportunistic in real estate and reallocates to private equity. The results would be a slightly higher return and risk with similar liquidity relative to the current target allocation. Over the next ten years under the current policy the expected return would be approximately 5.88% but with the change the expected return would be approximately 5.97%. Mr. Shah commented that the change in the real estate exposures would be gradual.

Update on Endowment Investment Policy (Tab 3)

Mr. Shah reported that the Trust Company recommended a few revisions of the Endowment Investment Policy to the Comptroller's Investment Advisory Board at their October 15, 2020 meeting. He explained that there hasn't been a natural resource allocation for two or three years and the removal of this asset class was recommended. Other recommended revisions include increasing the total equity portion of the portfolio from 45% to 50%, which includes increasing the private equity portion from 10% to 15%. By doing so, the real assets portion of the portfolio would decrease from 20% to 15%, with the stable value real estate decreasing from 10% to 7.5% and the enhanced real estate decreasing from 10% to 7.5%. The Comptroller's Investment Advisory Board agreed to recommend to Comptroller Glenn Hegar the proposed 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, 2020 the portfolio value was approximately \$2.5 billion and produced a 4.1% return for the quarter. Mr. Shah reviewed each asset class in detail and the various investment strategies utilized to diversity returns within the portfolio. He noted that the hedged equity portion of the portfolio was the leading performance driver, followed by global public equity.

Mr. Shah reviewed the performance summary and asset allocation summary charts. He informed the Committee that one area that was materially underweight was in the alternative fixed income class. Alternatively, the private equity class was slightly overweight. Mr. Shah reported that total assets under management plus distributions was approximately \$3.6 billion.

Mr. Shah introduced a new portfolio manager to the Trust Company, Mr. Brad Davis. Mr. Davis reviewed the fixed income summary. He explained that although there is clearly rate sensitivity in the global fixed income portion, the portfolio has tried to enhance total return and yield through the use of both the alternative fixed income and private debt assets. Another way to look at this is the trade-off of some liquidity for some additional complexity.

Mr. Mike Leifeste reviewed the real assets portion of the portfolio. He explained that the reason the asset allocation to the stable value strategy is weighted higher than the allocation to the enhanced return strategy is because there are more opportunities in the latter and it is less risky. The portfolio is positioned in sectors that are performing well through this pandemic crisis. Less exposure to retail, hospitality and more exposure to industrial and multifamily. He reported that real estate has outperformed its benchmark for the one-year, three-year, five-year and ten-year time periods by over one hundred points. Office space is one sector that has an uncertain future for now.

Mr. Chad Turner reviewed the Value at Risk (“VaR”) analysis. He reported that as of June 30, 2020, the VaR was 3.6% and slightly higher than the policy VaR of 3.5%. The portfolio risk measured in the long-term basis is a bit riskier than the policy portfolio but quite a bit less risky than the traditional 65/35 portfolio.

Mr. Shah reviewed the performance table and noted that the portfolio was down 5.8% through June. In July the portfolio was up 2.89%, in August it was up 1.9% and year to date through September, the portfolio was down 1.25% for the year.

Discussion of Next Meeting and Agenda Items

Chairman Ford suggested Friday, March 26, 2021 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

None.

Adjourn

Chairman Stuart Ford adjourned the meeting at 12:00 PM.