

Minutes of the October 19, 2023 Comptroller’s Investment Advisory Board Meeting

The Comptroller’s Investment Advisory Board met on Thursday, October 19, 2023 at the LBJ State Office Building, 111 E. 17th Street, Room 114, Austin, Texas, 78701.

Board Members present:

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

Absent: None.

Comptroller of Public Accounts Staff Presiding and Present:

Comptroller Glenn Hegar and Associate Deputy Comptroller Tom Currah.

Texas Treasury Safekeeping Trust Company (“Trust Company”) Executive Staff, Presenters & Facilitators:

Mike Reissig, CEO; Anca Ion, CIO; Gena Minjares, CFO; Laura Montoya, COO; Whitney Blanton, General Counsel; Spencer Brown, Deputy General Counsel; Brad Davis, Sr. Portfolio Manager; Jyoti Gupta, Sr. Portfolio Manager; Adam Levine, Sr. Portfolio Manager; Chad Turner, Director of Risk and Quantitative Analytics; Jacob Price, Jr. Portfolio Manager, Matt Connolly, Portfolio Manager; and Nora Arredondo, Program Specialist.

Additional Participants:

Roger Willis and Alex Nixon; Asset Consulting Group (“ACG”).

Call to Order

Comptroller Glenn Hegar declared that a quorum was present and called the meeting to order at 10:05 a.m.

Agenda Items:

1. Approval of Minutes of July 26, 2023 Meeting

On a motion by Ms. Laurie Dotter and seconded by Ms. Katie Hubbard, the Board voted unanimously to approve the July 26, 2023 proposed meeting minutes as presented.

2. Comptroller’s Investment Policy Review and Update

Ms. Anca Ion and Mr. Whitney Blanton explained the proposed revisions to the Comptroller’s Investment Policy as presented behind Tab 2. In summary the proposed changes were: 1) authorization of the Trust Company to conduct repurchase agreement transactions with eligible state agencies such as the Teacher Retirement System of Texas. This change also allows the Trust Company to enter a sponsored repurchase agreement; 2) extending the term of commercial paper maturities from 270 to 365 days; 3) allowing more flexibility by the Trust Company to the broker/dealer process; and 4) allowing more flexibility to the broker/dealer review process before presenting the recommended broker/dealer list annually.

On a motion by Mr. Ben Wall, and seconded by Mr. Adolpho Telles, the Board voted unanimously to recommend the proposed revisions to the Comptroller’s Investment Policy as presented to Comptroller Glenn Hegar for approval.

3. Presentation and Recommendation for the Texas University Fund (“TUF”) Investment Policy and Asset Allocation Plan (handout)

Ms. Ion directed the Board to the investment policy handout for TUF. The TUF will receive annual appropriations in an amount equal to the interest, dividends, and earnings from the TESTIF up to \$100 million. There were no donor contributions. Legislation also redesignated the National Research University Fund (“NRUF”) as part of the TUF and it is governed by the existing Endowment Policy until those assets are transferred over. Per statute, the maximum distribution rate is 7.0%. She explained that the TUF will follow the same processes and be governed by the same investment committee as the other investment pools managed by the Trust Company.

Ms. Ion reviewed the asset allocation analysis handout conducted in conjunction with ACG. The primary themes for TUF are income consistency, growth and real return. Some differences between the current Endowment and TUF: less hedge fund allocation, less long/short equity, and slightly higher risk than the current Endowments. Constitutional voter approval will be in November and, if approved, funding and investing could begin in January. The Board continued the TUF investment policy and asset allocation discussion.

On a motion by Mr. Jim Hille, and seconded by Mr. Ben Wall, the Board voted unanimously to recommend the proposed TUF investment policy as presented to Comptroller Glenn Hegar for approval.

4. Economic Outlook

Ms. Ion discussed the economy and reviewed the charts behind Tab 3. She explained two major economic themes: 1) higher interest rates would persist longer; and 2) higher resting rates for inflation. Importantly, in the previous month the market started to price in the Fed’s rate increases with no plans to cut rates any time soon. Inflation moved up to 3.7%. Non-recessionary indicators such as the labor market and retail sales are strong. Mortgage rates are at approximately 8.0% and consequently affecting the housing market. Consumer credit card debit is increasing and savings decreasing. Odds of a recession priced by the New York Fed or the Bloomberg Survey is between 50%-70%; however 75% of market active managers price a soft landing and no recession in the next few months.

Ms. Ion reported that the Treasury Pool balance was approximately \$90 billion at the end of August 2023, 10% higher than the previous quarter. The yield was approximately 4.90%, a 35 basis points increase from the previous period. She reported that the Treasury Pool kept up with the pace of the interest rate hikes. The Pool generates approximately \$4 billion annually.

Mr. Matt Connolly reported on asset-backed instruments and noted that they have seen a bit of an up-tick in delinquencies, but views as a normalization back to pre-COVID years. They will continue to monitor the rate of change. Higher yields are expected to remain for a longer period.

5. Capital Markets Overview and Investment Performance Review for Quarter Ending June 30, 2023 and Related Matters

Mr. Willis presented ACG's view of the economy, market conditions and material behind Tab 4. He reported that in general, inflation was declining, the labor market was stable and interest rates were higher. The current 10-year Treasury yield is 4.9% and the break-even inflation level is approximately 2.4%. The target inflation rate of 2% may not be attainable in the very near term. In the current market environment, global equities and high-yield bonds delivered positive returns whereas core bonds and global real estate were negative. He reviewed the wide divergences within the financial market returns. The current consensus view is that inflation will continue to fall toward 2% and a slow reduction in interest rates is expected. A mild recession or soft landing continues to loom.

Mr. Nixon reviewed the Endowment, SWIFT and TESTIF performance for the periods ending June 30, 2023, as presented behind Tab 4. He reported that the five-year annualized return for the Endowment portfolio was 7.41%, outperforming the policy benchmark of 6.82% and the 65/35 benchmark of 4.80%. Relative to broad market benchmarks, the Endowment portfolio generated a significantly higher return with less than half of the risk. Despite underperformance over the past year in the broad asset classes, the portfolio has outperformed its policy benchmark and 65/35 benchmark over the longer-term periods. Through August the portfolio was up 2.30%.

The SWIFT portfolio continued to outperform the dynamic and policy benchmarks over the first quarter, and the one, three, and five-year periods. The portfolio returned 1.46% for the quarter and 5.00% over the five-year period. The total portfolio generated higher return and similar risk relative to the dynamic benchmark over the past five years. Equity investments have significantly outperformed its asset class benchmark for the quarter, and the trailing one, three and five-year periods. Through August the portfolio's return was 3.70%.

The TESTIF portfolio is the lowest risk portfolio of the three. It has generated higher return with slightly lower risk as compared to the dynamic benchmark over the last five years. The returns for the quarter predate some of the asset allocation changes that are in process over the next coming quarters. During a challenging broad market environment for fixed income, the portfolio produced positive returns over the last five years and outperformed both the dynamic and policy benchmarks over the quarter and trailing one, three and five-year periods. The five-year annualized rate of return was 1.86%.

6. Endowment, SWIFT and TESTIF Portfolio Updates and Related Matters

Ms. Ion reviewed the material behind Tab 5 and provided an in-depth review of the **Endowment** and its performance for the quarter ending June 30, 2023. The Endowment returned 1.3% for the quarter bringing the one-year trailing to 1.8%. The stronger performance was derived from the global public equity, hedged equity and private debt portfolios for the quarter and year. The portfolio lagged the benchmark for the quarter due to underperformance in alternative fixed income, private equity and real estate. No significant changes to the asset allocation. The portfolio remains slightly underweight in equities and overweight in private equities and real

estate. Alternative fixed income will continue to remain underweight as less-complex opportunities exist in the higher interest rate environment. She continued an in-depth review of asset allocations. Ms. Ion reported that assets under management was approximately \$5.02 billion, net of an \$85 million distribution from the Tobacco fund in April. Total distributions were shown as approximately \$2.55 billion since inception. No significant changes to the portfolio.

Ms. Ion asked each portfolio manager to review in more detail the strategies they managed.

Mr. Davis reported on the fixed income portion of the Endowment portfolio. He explained that the second quarter was challenging and although risk assets performed well and exposure to credit helped, a negative return for the quarter was unavoidable. The real return, the return over inflation, is extending out the yield curve and presents a headwind to the economy. The alternative fixed income in the portfolio failed to offset traditional fixed income. He reported that alternative fixed income is experiencing a better third quarter and most of the managers were in positive territory. The fixed income asset class has a current yield of 5.23%.

Mr. Price reported on the private debt portfolio. He explained that this portfolio underperformed the benchmark by approximately 90 basis points for the quarter but returned 5.70% for the trailing one-year period. The distressed portion of the portfolio returned 1.50% for the quarter bringing the one-year performance to 6.40%. He reported that the private debt asset class continues to expand at a rapid pace. There were no notable changes in asset allocation and no new commitments.

Ms. Gupta reported that the equity markets experienced robust positive returns with global markets up almost 6.0% led by large cap growth and technology. The U.S. led the developed markets at approximately 8.0% for the quarter. In emerging markets, India performed well, up 13.4% for the second quarter. China was trailing and down almost 10.0%. The global equity sector returned 6.0% for the quarter and 17.0% for the year, slightly ahead of the benchmark. She reported that the hedged equity portfolio was up 4.8% for the quarter versus the benchmark at 2.0%. For the year, hedged equity was up 11.0% versus the 4.0% benchmark. Apart from a health care manager, every active long-only manager experience positive performance.

Ms. Gupta reviewed the private equity portfolio. She reported that buyouts did well, but limited partnerships that had energy assets or secondary exposures, helped lift the overall performance of the private equity portfolio. Capital deployment from private equities was down approximately 50% and exits were down approximately 70% from their peaks in 2021. The venture portion of the portfolio was down approximately 2.2%, while the blended benchmark was up 90 basis points for the quarter. For the year, this sector was down 17.7% and the benchmark was down almost 11.0%. She explained that the top five drivers of the negative performance account for approximately 65% of the difference between this sector and the benchmark.

Ms. Levine reviewed the real estate portfolio and stated that this sector continues to be overweight but underweight in the office space sector. He explained that as redemptions occur, the

overweight status should decline over time. Mr. Levine reported that the Persistence Pool is performing well as is the insurance sector, despite the multiple hurricanes.

Mr. Turner reported no meaningful changes to leverage levels or derivative allocations within strategic all asset and overlays. He reported that for the quarter ending June 30, 2023, the Value at Risk (VaR) for the Endowment portfolio was 3.78%, and slightly over the policy VaR of 3.42%, a 13 basis points increase from the previous quarter but comfortably below the policy maximum of 4.1%. The portfolio risk measured on a long-term basis is slightly riskier than the policy portfolio, but much less risky than the traditional 65/35 portfolio.

Ms. Ion reported that the Endowment returned 0.89% in July, -0.36% in August, bringing the year-to-date return to 2.33%. Not all numbers were in for September.

Ms. Ion reviewed the **SWIFT** portfolio and reported that the portfolio returned 1.5% for the second quarter of 2023, bringing the trailing one year to 4.4%. The fund's hedged equity, global public equity and private credit portfolios were the leading performance contributors. Modest drawdowns were in real estate, alternative fixed income and very modest in global fixed income. Cash levels in this portfolio increased to 14.5% versus the target of 10%, in preparation for a distribution of approximately \$98.8 million in October. She reported that investment policy changes implemented in June would be reflected as of September. Total assets under management as of August 30, 2023, was \$1.78 billion. Including the \$98.8 million distribution for October. The cumulative distribution in this portfolio is approximately \$1 billion. There were no significant changes in the portfolio's liquidity or geographic allocation. The portfolio returned 0.71% in July and -0.09% in August, bringing the year-to date return to 3.71%.

Ms. Ion reviewed the **TESTIF** portfolio for the quarter ending June 30, 2023. She reported that the portfolio received approximately \$3.0 billion in September from a new severance tax, taking to total invested balance to approximately \$16.6 billion. On a year-to-date basis through the first half of the year, the portfolio has returned 2.8% ahead of the 1.7% benchmark return. She reported that in September the portfolio began allocating 5% to equities and will continue to do so over the next five to six months. The cash component of the portfolio peaked to approximately 37% at the end of September. The goal is to draw that down to approximately 15% by mid-February. The TESTIF performance for August was 0.23%, and -0.41% for September, bringing the year-to-date return down slightly with rising rates. The portfolio remains very liquid and conservative relative to allowed guidelines.

9. Next Meeting and Agenda Items

Next meeting will be scheduled for January 24 or 25, 2024. Ms. Arredondo will contact the Board for confirmation. No new agenda items discussed.

10. Public Comment

No public comments.

Meeting adjourned at 12:20 p.m.