

Minutes of the January 18, 2023, Comptroller’s Investment Advisory Board Meeting

The Comptroller’s Investment Advisory Board met on Wednesday, January 18, 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, Ben Wall

Absent: None

Comptroller of Public Accounts Staff Presiding and Present

Comptroller Glenn Hegar and Tom Currah, Associate Deputy Comptroller

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

Mike Reissig, CEO; Anca Ion, CIO; Laura Montoya, COO; Gena Minjares, CFO; Whitney Blanton, 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, Sr. Investment Analyst; Mathew Williams, Sr. Investment Analyst; Matt Connolly, Portfolio Manager; and Nora Arredondo, Program Specialist.

Additional Participants

Joel Perez, Tino Robledo and Heath Jackson; Auditors, RSM US, LLP
Roger Willis and Joe Nugent; Asset Consulting Group (“ACG”)

Call to Order

Comptroller Glenn Hegar declared that a quorum was present and called the meeting to order at 10:00 a.m.

1. Approval of Minutes of September 28, 2022 Meeting

On a motion by Mr. Adolpho Telles, and seconded by Ms. Laurie Dotter, the Board voted to approve the September 28, 2022 proposed meeting minutes as presented.

2. Presentation of Independent Auditor’s Report for the Trust Company (under separate cover)

Mr. Perez, Mr. Jackson and Mr. Robledo summarized the audit reports and reported that RSM issued an unmodified financial audit opinion with respect to the Trust Company for the fiscal year ending August 31, 2022. They reported that no audit adjustments were recorded during the audit engagement that would indicate deficiencies in the accounting process, nor were any management letter comments issued.

3. Annual Review of Endowment, SWIFT and TESTIF Investment Policies

Ms. Ion directed the Board to the proposed revisions up for discussion for the Endowment, SWIFT and TESTIF investment policies behind Tab 2. No vote was asked at this meeting. She explained that the goals of the revisions for the Endowment policy were to better reflect expectation of asset levels by setting general terms overall in the asset class and being very specific at sub-asset levels. The first recommendation relates to fixed income and equity strategies. The second recommendation relates to hedged equity and changes the language to better reflect that it is a directional hedged equity portfolio. The last revision is to improve the governance by introducing ranges at sub-strategy levels.

The same changes are recommended to the language relating to hedged equities in the SWIFT investment policy as in the Endowment policy.

There were two minor revisions in the TESTIF investment policy: the first to leave a broad range of the full market cycle, and the second relating to the calculation of the dynamic benchmark.

4. Market Update, Investment and Review of Treasury Pool

Ms. Ion discussed market events and reviewed the charts behind Tab 3. She noted that bonds were not a diversifier over the last year, and the historical returns of the 60/40 portfolio were dismal for 2022. She reported on U.S. Treasury yields and the Fed Fund interest rate increases over the previous year and noted that the current Fed Fund rate was approximately 4.5%, and she expects more increases as the Fed attempts to bring down inflation. In December, inflation was 6.5%. She reported that GDP growth is expected to be approximately 1.5% for the fourth quarter of 2022.

Ms. Ion reported that the Treasury Pool value as of September 30, 2022, was approximately \$65 billion, approximately \$5 billion less than the previous quarter due to seasonal outflows. Overall, assets under management were approximately \$84 billion for the third quarter. As of January 17, 2023, the Treasury Pool yield was approximately 3.7% and captured approximately 85% of the move in the Fed Funds rate. She reported that 26% of the portfolio has a seven-day liquidity.

5. Capital Markets Overview and Investment Performance Review for Quarter Ending September 30, 2022

Mr. Willis presented ACG's view of the economy and market conditions behind Tab 4. He reported that Treasury yields have declined in anticipation of a weakening economy. ACG expects continued tightening by the Fed, more interest rate hikes, and market volatility to continue. Overall, risk assets rallied, stocks were generally higher, bond yields lower, and spreads fairly contained; returns generally better.

Mr. Willis reported that the capital market assumptions were revised and the return expectation for a traditional 65/35 portfolio increased from 5.8% to 7.5%.

Mr. Nugent reviewed the Endowment, SWIFT and TESTIF performance for the third quarter of 2022 as presented behind Tab 4. He reported that for the quarter the Endowment returned -1.88% versus its policy benchmark of -2.25% and had returned 7.0% annualized over the last ten years. The real assets class was the strongest performer for the quarter.

The SWIFT portfolio outperformed the SWIFT dynamic benchmark over the one, three, and five-year periods but underperformed by 61 basis points for the quarter, producing a -0.71% return for the quarter, bringing the one-year return to approximately 0.50%.

The TESTIF portfolio outperformed the dynamic and policy benchmarks over all time periods. Despite a challenging twelve-month period, the TESTIF portfolio produced positive returns over the three and five-year periods.

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

Ms. Ion reviewed the **TESTIF portfolio** for the quarter ending September 30, 2022. The portfolio value was approximately \$12.4 billion. She reported that the TESTIF portfolio is most affected by the fixed income market and was most challenged in 2022, but continues to outperform the Treasury Pool and is underperforming inflation, except for the previous two months when it outperformed. If inflation continues to decline, TESTIF is positioned to outpace 2% inflation.

Ms. Ion then asked each portfolio manager to review their strategies:

Mr. Davis reported that \$1.8 billion was invested in the TESTIF throughout 2022, with another \$400 million on track to be invested through February 2023. In this worse-case market environment for interest rates, credit spreads remained relatively well behaved and helped the TESTIF portfolio. Beyond the large influx from the severance tax in September, it is expected that approximately \$380 million will be returned from ERCOT in February. Mr. Davis reported that there are currently 27 managers deployed across this portfolio in 37 different strategies. According to fund terms, roughly eighty-four percent of this portfolio is liquid within a week. For the calendar year the TESTIF portfolio returned approximately -3.0%.

Ms. Ion reviewed the **SWIFT portfolio** for the quarter ending September 30, 2022. The strongest contributor to the performance was the alternative fixed income class. She reported on asset allocation and stated that the 5% overweight in cash will be reallocated to equities and fixed income. She indicated the team would continue to add to private debt but in a very measured way. As of December 2022, the portfolio value was approximately

\$1.73 billion. She explained if the portfolio had only invested in the benchmark its value would be approximately \$1.48 billion. The portfolio is very liquid and the 0-3 month liquidity portion increased to 40% from 35% as a result of the higher cash balance. She reported that continued work is being done to reduce emerging market exposure.

Mr. Davis reported on the fixed income portion of the SWIFT portfolio and noted that in the fixed income space the portfolio performed well. More exposure to core bonds is being added.

Ms. Gupta reported on equity markets, and stated that hedge funds protected capital meaningfully. The hedged equity portion of this portfolio was -1.3% versus -1.5% for the benchmark and -6.6% for the broader market. Negative performance derived from global and emerging market managers. Outperformance was derived from U.S. and European focused managers.

Mr. Levine reported on the real assets sector of the SWIFT portfolio and noted that performance was coming in ahead of the benchmark and some real estate debt funds had underperformed. Third quarter performance was -0.29%.

Mr. Turner reviewed the Value at Risk (“VaR”) analysis for SWIFT for the quarter ending September 30, 2022. The portfolio VaR was 1.4% versus the policy VaR of 1.9%, which indicates the portfolio’s risk is considerably lower than the policy portfolio. The 1.4% VaR is below the policy minimum; however, Mr. Turner noted that October numbers are in and the portfolio VaR should reverse itself given the annual cash distribution.

Ms. Ion reported performance for October was 0.72%, November was 1.84% and December was -0.36%, bringing the year-to-date number to 0.35%.

Comptroller Hegar excused himself from the meeting and Associate Deputy Comptroller Tom Currah facilitated.

Ms. Ion reported on the **Endowment portfolio** and noted the portfolio returned approximately -1.90% for the quarter and had a value of approximately \$4.97 billion. The strongest performer was the real estate sector.

Mr. Davis reviewed public fixed income. He stated that derivatives are used to get more core bond exposure. Alternative fixed income allocation decreased to 12.6%, even as this part of the portfolio was up 2.43% and outperformed the benchmark. Most of the outperformance was driven by macro managers. Within global fixed income, some credit exposure is being reduced.

Mr. Price reviewed the information relating to private credit. He reported that the distressed strategy outpaced the performing strategy. Performance for the quarter was approximately 0.3% and 9.7% for the one-year period. He reported there were no new

allocations in the third quarter. There was a shift towards heavier distressed strategies over the past few years.

Ms. Gupta continued the discussion with a review of private and global equities. She reported that the global public equity portfolio was down 5.0% for the quarter, but outperformed its benchmark. Hedged equity performance was -1.3% for the quarter versus -1.5% for the benchmark and versus -6.6% for ACWI. She stated the portfolio did well protecting capital. Meaningful performance was from biotech-focused and U.S.-focused managers. She reported that they are actively reducing emerging markets fund-of-fund exposures. Within hedged equity, the portfolio has fully redeemed from the Pan-Asia focused manager, which had significant exposure to China and consistently underperformed.

Mr. Turner reported no meaningful changes to leverage levels or derivatives allocations within strategic all asset and overlays. He reported that for the quarter ending September 30, 2022, the VaR for the Endowment portfolio was 3.6% and slightly over the policy VaR of 3.5%, but comfortably below the policy maximum of 4.2%. The overweight allocation to private equity and real estate have been adding risk to asset allocation. 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 performance for October was -0.04%, November was 2.20% and December was -0.21%, bringing the year-to-date number to -1.65%.

7. Persistence Pool Review

Mr. Levine reviewed the Persistence Pool presentation behind Tab 6. He explained the All Assets and Overlays portfolio structure and classification. He stated that the Persistence Pool's objective was to provide a diversified and low volatility source of incremental returns with a low correlation to equity markets. Mr. Levine reviewed the history and current construction of the Pool.

8. Broker/Dealer Update

Mr. Blanton reviewed the Broker/Dealer list as presented to the Board. The only recommended change to the list submitted to the Comptroller was the removal of UBS Securities, an affiliate of UBS Group AG.

9. Discussion of Next Meeting and Agenda Items

None.

10. Public Comment

No public comments.

Associate Deputy Comptroller Tom Currah declared the Comptroller's Investment Advisory Board meeting adjourned at 12:25 pm.