

## **Minutes of the April 18, 2023 Comptroller’s Investment Advisory Board Meeting**

The Comptroller’s Investment Advisory Board met on Tuesday, April 18, 2023 at the LBJ State Office Building, 111 E. 17<sup>th</sup> Street, Room 114, Austin, Texas, 78701.

### **Board Members present:**

Laurie Dotter, Jim Hille, Adolpho Telles, Sam Vinson, Ben Wall

**Absent:** Katie Hubbard

### **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; 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:**

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.

### **Agenda Items:**

#### **1. Approval of Minutes of January 18, 2023 Meeting**

On a motion by Ms. Laurie Dotter, and seconded by Mr. Adolpho Telles, the Board voted unanimously to approve the January 18, 2023 proposed meeting minutes as presented.

#### **2. Review and Vote on Recommended Revisions to Endowment, SWIFT and TESTIF Investment Policies**

Ms. Ion directed the Board to the proposed revisions recommended by Trust Company staff for the Endowment, SWIFT and TESTIF investment policies, details behind Tab 2. She explained that the goals of the first revisions for the Endowment policy were to better reflect expectations of performance and risk by setting general terms overall for the broad asset classes (fixed income and equity strategies) and being more specific at sub-asset levels. The second recommendation relates to hedged equity and changes the language to better reflect that it is a directional hedged equity portfolio. A recommendation to adjust the allocation between global public equity (from 15% to 20%) and hedged equity (from 20% to 15%) was proposed, in accordance with prior

discussion relating to portfolio risk and liquidity. The last revision is designed to improve the governance by introducing ranges at sub-strategy levels.

Similar changes were recommended to the language relating to the directionality of 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 measure outperformance to inflation over a full market cycle, and the second relating to the calculation of the dynamic benchmark.

**On a motion by Mr. Jim Hille, and seconded by Mr. Sam Vinson, the Board voted unanimously to recommend the proposed changes to Comptroller Glenn Hegar for approval.**

### **3. Market Update, Investment and Review of Treasury Pool**

Ms. Ion discussed market events and reviewed the charts behind Tab 3. She explained the significant move in the U.S. yield curve which continued to stay approximately 150 bps inverted. She reported that in March, year-over-year inflation was 5.0% down from a 9.0% peak. The Bloomberg consensus estimates, and the New York Fed yield curve models demonstrate a 60%-70% probability for a recession. The higher interest rates have also affected the U.S. budget since the U.S. debt interest payments are predicted to increase from approximately \$478 billion to approximately \$700 billion. Overall the government expenses have increased and led to the discussion in Congress to increase the debt ceiling.

Mr. Connolly reported on asst-backed instruments and stated that although the consumer is showing signs of a weakening trend, prime and super prime consumers remain stronger than they were pre-pandemic whereas sub prime consumers have weakened to recessionary levels. The Treasury Pool's ABS holdings are only exposed to the prime and super-prime consumers and remains well positioned.

The Board discussed the possibility of a recession and hard landing. Ms. Ion explained how the portfolios are positioned and allocated.

Ms. Ion reported that the Treasury Pool value was approximately \$77 billion, which was \$12 billion more than the previous quarter primarily due to seasonal inflows. As of February 28, 2023, the Treasury Pool yield was approximately 4.06% and has captured 85% - 90% of the move in the Fed Funds rate. She reported that the most notable change to allocation was the decline in cash and cash equivalents by 5.0% which is offset by a 6.0% increase to treasuries. Approximately \$33 billion, or 45% of the Pool is liquid within three months.

Mr. Reissig updated the Board on a few legislative issues. Given the large Texas budget surplus, he expects that the Trust Company will be tasked with creating new pools of capital

and would also be allocated more money to existing pools of capital. Possibly an inflow of \$6-\$9 billion to be invested in the longer term.

#### **4. Capital Markets Overview and Investment Performance Review for Quarter Ending December 31, 2022 and Related Matters**

Mr. Willis presented ACG's view of the economy and market conditions behind Tab 4. He reported that overall, stocks and bonds ended the first quarter of 2023 with solidly positive returns. The ACWI index was up about 9.0% and the aggregate bond index was up about 2.5%. ACG's forecast for U.S. economic growth for the next year or two hovers around 1.0%. Although the portfolios are adequately positioned for a downturn, they should have enough beta to participate in the upside.

Mr. Nugent presented a private equity market update. He reported that broad market returns were off for the year, and venture and growth equity were the worst performers last year. Buyouts did reasonably well, and the energy sector did well with robust activity in the private and public markets.

Mr. Nugent reviewed the Endowment, SWIFT and TESTIF performance for the periods ending December 31, 2022, as presented behind Tab 4. He reported that for the quarter the Endowment returned 1.89%. The one-year annualized return was -1.74% versus its policy benchmark of -4.19%, and the 65/35 benchmark of -17.47. Relative to broad market benchmarks, the total portfolio generated significantly higher return with less than half the risk. The portfolio outperformed its benchmark over the three, five and ten-year periods.

The SWIFT portfolio outperformed the SWIFT dynamic benchmark over the one, three, and five-year periods and produced a 2.03% return for the quarter. The fixed income and equity investments continued to deliver positive longer-term results and fared well relative to the benchmark.

The TESTIF portfolio outperformed the dynamic and policy benchmarks over the one, three and five-year periods. The one-year return was -2.46% versus -4.80% and -5.20% for the dynamic and policy benchmarks respectively. The annualized five-year return was 1.51%.

#### **5. Endowment, SWIFT and TESTIF Portfolio Updates and Related Matters**

Ms. Ion provided an in-depth review of the **Endowment** and its performance for the quarter ending December 31, 2022. The stronger performance was derived from the global public equity and hedged equity portfolios, up 10.0% and 4.9% respectively. The portfolio lagged the benchmark by 20 basis points due to underperformance in the private equity and alternative fixed income portfolios. No significant changes in asset allocation to report. Overall allocations in Endowment portfolio remaining close to the target, slightly reducing our underweight to duration. Assets under management as of February, \$5.78 billion.

Ms. Ion asked each portfolio manager to review the strategies they managed. Each manager reviewed the material behind Tab 5.

Mr. Davis reported on the fixed income portion of the Endowment portfolio. The three-year standard deviation for global fixed income was 5.6%. A higher quality benchmark and a few lower quality credit active managers contributed to the slight underperformance to the benchmark. Adding more treasuries and derivatives has helped global fixed income prepare for a hard landing and has brought duration up slightly. In reference to alternative fixed income, Mr. Davis reported that the portfolio is working toward reducing beta to 0.3 to comply with the investment policy. Macro managers were down 5.0% - 6.0% for the first quarter of 2023.

Mr. Price reported that the private debt portfolio returned 2.5% for the quarter. The distressed portfolio returned 8.8% for the one-year period and performance drivers were European and U.S. special situations distressed funds. One new allocation was made in the fourth quarter to an existing European distressed special situations fund.

Ms. Gupta explained that the fourth quarter of 2022 was the first positive quarter in 2022 for equities. The global public equity portfolio returned 10.1% for the quarter, moderately outperforming its benchmark. The hedged equity portfolio returned approximately 5.0% for the quarter, versus 2.7% for the benchmark. For the year, the portfolio returned -13.8% versus the benchmark of -11.8%. She noted that hedged equity managers were beginning to increase their net exposure and get more comfortable in the broader market.

Mr. Gupta reviewed the private equity portfolio. This portfolio returned -2.8% for the quarter and -2.5% for the year. The buyout portion of this portfolio was flat for the quarter and 6.2% for the year. The venture capital portion of the portfolio returned -5.3% for the quarter and -9.7% for the year, modestly lagging its benchmark. Underperformance was derived from two key areas: public securities that recently went public within the venture funds, and with venture managers actively marking down challenged companies within their portfolios. She also reported that the venture portion of the portfolio was down approximately -6.0% for the quarter.

Ms. Ion reported that the Endowment returned 1.74% in January, -0.72% in February, bringing the year-to-date return to 1.02%.

Ms. Ion reviewed the **SWIFT** portfolio and reported that the portfolio returned 0.2% for the year which far exceeded the -3.2% return for the benchmark. Ms. Ion discussed the allocations within the portfolio and noted the cash allocation had decreased after a \$97 million distribution, and the global fixed income allocation had increased and was now slightly above target. Total assets under management as of December 2022, \$1.72 billion and \$1.74 billion as of February 2023. Cumulative distributions have totaled \$904 million. The portfolio remains very liquid and with a slight decline in the 0-to-3 month range.

Ms. Gupta reported on equities within this portfolio and stated that portfolio is built with less risk than the Endowment and has outperformed its benchmark for the fourth quarter of 2022 and thus far this year. This portfolio had no dedicated exposure to China or bio-tech funds.

Within the fixed income sector of SWIFT, Mr. Davis reported that some of the more opportunistic managers that tended to have lower duration were replaced with more benchmark-centric managers; therefore, the duration was brought up to 5.5 years versus the 6-year benchmark.

Mr. Turner reviewed the Value at Risk (“VaR”) analysis for SWIFT for the quarter ending December 31, 2022. The portfolio VaR was 1.7% versus the policy VaR of 1.9%, which indicates the portfolio’s risk is slightly lower than the policy portfolio but comfortably above the policy minimum. Regarding the Endowment analysis, the portfolio VaR was 3.6% versus the policy VaR of 3.5%, but comfortably below the policy maximum of 4.2%.

Ms. Ion noted the performance in the SWIFT portfolio in January was 1.91%,-0.64 in February, and year-to-date 1.27%.

Ms. Ion and Mr. Davis reviewed the TESTIF portfolio for the quarter ending December 31, 2022. She explained that the plan is to reach 25% required cash within the portfolio by June. Roughly \$500 million is being put to work every month. Investments in alternative fixed income were increased and also investing in treasury bills up to six months where the yields are approximately 5.0%. There has also been the purchase of treasury notes in the two-to-five year range within the absolute return sector with the expectation to increase the pace of these purchases by June.

Mr. Davis reported that for 2022 the TESTIF portfolio was down -2.9%. Year-to-date performance was 1.68%. The investment pace has increased but cash remains above the 25% target at 31.7% on a \$13.2 billion portfolio. The portfolio remains very liquid and conservative.

TESTIF performance for January was 1.3%, February -0.3%, March 0.7% and year-to-date 1.65%.

## **6. Next Meeting and Agenda Items**

Next meeting will be scheduled for mid to late July. No agenda items discussed.

## **7. Public Comment**

No public comments.

**Meeting adjourned at 12:21p.m.**