

OFFICE OF THE STATE TREASURER

STATE TREASURER'S INVESTMENT COMMITTEE (STIC) MEETING MINUTES

Wednesday, July 12, 2006

The State Treasurer's Investment Committee (STIC) Meeting convened at approximately 10:00 a.m. in the conference room at the office of the State Treasurer, 2019 Galisteo Street, Santa Fe, New Mexico, on Wednesday, July 12, 2006.

I. CALL TO ORDER

Roll Call

Members Present:

Mr. Douglas Minge Brown, State Treasurer
Mr. Scott Stovall, Deputy State Treasurer
Ms. Olivia Padilla-Jackson, State Board of Finance Director
Mr. Steven Bohlin, Public Member
Mr. Paul Cassidy, Public Member

Staff Present:

Mr. Mark Valdes, Assistant State Treasurer
Mr. Arsenio Garduno, Collateral Compliance Bureau
Mr. Mark Canavan, Portfolio Management Bureau Chief
Ms. Joelle Mevi, Local Government Investments Bureau Chief
Mr. Joaquin Lujan, Investment Officer
Ms. Jane Tabor, Public Information Officer
Ms. Laura Montoya, Executive Assistant

Guests:

Ms. Amy Chavez, State Board of Finance Deputy Director
Ms. Stephanie Schardin, Legislative Finance Committee
Ms. Meg McKuen, Legislative Finance Committee
Mr. Victor Montoya, Santa Fe County Treasurer

Approval of July 12, 2006, Agenda

Member Padilla-Jackson motioned for approval of the agenda; seconded by Member Cassidy, the motion carried.

Approval of June 14, 2006, Minutes

Member Bohlin motioned for approval of the minutes; seconded by Member Cassidy, the motion carried.

II. INVESTMENT REPORT

A. June 30, 2006, General Fund Monthly Report

Mr. Canavan gave an executive summary of the General fund Investment Portfolio stating: the market value of the General Fund Investment Portfolio on June 30, 2006, was \$2.76 billion, compared to \$2.65 billion in the previous month as shown in graph one of the Treasurer's Report to the State Board of Finance; the yield of the General Fund Investment Portfolio was 4.58%, up from 4.33% in May. The average term of the

portfolio increased to 163 days, up from 105 days in May (graph 2) as longer term securities were purchased at the end of June; The June 30, 2006, asset allocation of the General Fund was comprised of 63.8% in U.S. agencies, 1.8% in flex repurchase agreements, 25.4% in the overnight repurchase pool, 8.8% in certificates of deposit, and 0.2% in Corporate Bonds (table1); In June, investment activity included the purchase of \$616.2 million in commercial paper with an average yield of 5.12% and a term of less than 30 days, \$741.3 million in U.S. agency obligations with an average yield of 5.12% and terms ranging from 60 to 360 days, and \$35.5 million in Certificates of Deposit with an average yield of 5.15% and a term not exceeding 180 days. In addition, the General fund purchased \$123.5 million in one-day Severance Tax Notes at a rate of 4.88 percent and a three-day \$37 million note from the City of Albuquerque also at a rate of 4.88%; The total General Fund earnings for June were \$11.34 million, an increase of 4.3 percent over May earnings of \$10.87 million. The fiscal year-to-date earnings totaled \$97.3 million compared to \$56.2 at the same point last fiscal year.

B. Quarter Ended June 30, 2006, General Fund Report

The discussion above included this topic.

C. June 30, 2006, Local Government Investment Pool Monthly Report

Ms. Mevi informed the Committee of the LGIP status: the market value of the LGIP as of June 30, 2006, was \$712.0 million, compared to a market value of \$728.3 million in the previous month (graph 4). The small drop in the fund level can be attributed to fiscal year-end adjustments by local governments. The average yield of the LGIP portfolio at month-end was 4.84%, up from 4.71% in May, gaining approximately 11 basis points in May. The average term of the portfolio decreased from approximately 65 days to 44 days at the end of June. The asset allocation of the fund was comprised of 7% in flex repurchase agreements, 64.2% in agencies, 26.9% in commercial paper, 0.2% in overnight repurchase agreements, and two certificates of deposit that make a little over 1.6%. In June, investment activity included the purchase of \$132.5 million in commercial paper with an average yield of 5.42% with a term of 60 days. In addition, \$162.9 million in U.S. agency obligations were purchased with an average yield of 5.23 percent and an average term of less than 90 days. Total LGIP earnings for June were \$2.8 million, a 4.0% decrease from May earnings of \$2.93 million. The decline in earnings was attributed to the lower balance amount to invest. Fiscal year-to-date earnings for the LGIP totaled \$31.9 million compared to \$27.6 million at the same time last fiscal year.

Ms. Mevi gave a brief outlook on the investment strategy and how S&P's rating agency is reviewing the portfolio to give it a rating. To adhere to their recommendations, the certificates of deposits have been collateralized at 110%. The LGIP is considering couple of money market funds as investment alternatives until a third repurchase agreement is in place so as not to use Cantor Fitzgerald.

The committee discussed the rating and when Ms. Mevi told the committee she is under the impression that it will occur in August.

D. Quarter Ended June 30, 2006, Local Government Investment Pool Report

Ms. Mevi stated that the LGIP is leaning more toward AAA investments and A1+ commercial paper. The LGIP need to target creating an eligible lift of commercial paper and money market funds that will bring some credit quality criteria to select commercial paper not using expendable commercial. Almost all of it is in place.

E. Bond Proceeds Investment Pool (BPIP) Report

Mr. Joaquin Lujan reported to the committee that the accounting structure has been created for the BPIP; it will be structured similarly to the LGIP. By the next meeting, Mr. Lujan will have a formal investment objective and the investment strategy. Chairman Brown said the BPIP needs to make reference to the Investment Policy in regard to the coverage. Mr. Lujan stated that they will be going live with it by the next STIC meeting. The BPIP will not be making investments yet and, when it does, it will be on a limited basis.

Mr. Stovall mentioned that the BPIP is comprised of bond issuance and general obligation bonds, supplemental severance tax bonds and the E911. The E911 is now paid off. The BPIP will have two accounts, "debt service account" and the "proceeds account." The debt service account makes the debt service payments is made or cashed in. The "proceed account" is money received from the sales of bonds and that money goes out for projects. STO determines draw downs in terms of how much is drawn per month and has a sense of what our liquidity needs are. Mr. Lujan will manage the account in the context of the Investment Policy. The big improvement is additional revenues going to the severance tax bonds which could increase capacity in the sponge issues on an annual basis.

Mr. Cassidy mentioned that it would be nice for the treasurer to get involved in the discussion of the allocation of money and the bank's expectation and investment of funds for local governments. Mr. Stovall stated that the STO is looking into these ideas. The committee members mentioned the positive contribution it will offer to smaller communities.

F. Economic and Investment Outlook

Ms. Mevi compiled a brief economic report based on recent data from the prior week. One of the bigger items that came out was the ***** payroll number which came in a little less than estimated however, the hourly earnings were increasing. That is significant in the sense that it will probably lead to us being an eighteen rate increase from the FIC??? in early august. The payrolls have met their estimates for three consecutive months. We are approaching a slow down. The non-manufacturing sector also saw a little bit of a decline from June to May, the index flipping a couple of points. Retail sales are cooling off their pace, especially since their first quarter. It may be that were seeing a lot of the higher hourly wages being spent on higher fuel costs and some concern over rate increases so were not seeing them on the tenure which is usually what the mortgages are based off of but there is still some concern that that could be damaging to consumer confidence. Retailing happens to be one of the sectors that is cutting payroll. We are looking at an economy that is growing at approximately 3 percent compared to the first quarter, flying above 5 percent. We are probably at the peak of increases. After the wage number the job data was released on Friday. Some economists believe that we may

see a pull back in early 2007 in the rate. As far as looking forward for the LGIP portfolio a lot of what investments will be dictated by appliance to money market funds type criteria. Perhaps we can take advantage of the rates out to a year but ultimately depend on the weighted average maturity of the portfolio. The general fund is already utilizing some of their funds out to one year and once the core is identified, which Mr. Canavan is working on, we'll be able to identify some of the funds that come in that portfolio that can be expended.

III. CASH MANAGEMENT REPORT

A. State Agency Deposit Balances in Financial Institutions

Mr. Arsenio Garduno reported to the board on behalf of Mr. Victor Vigil. He referred to the State Treasurer's Report to the State Board of Finance: State Agency Depository Account Summary of state funds and non-state funds (p. 92); There was a total of 497 accounts, 299 being state funds accounts totaling \$14,507,709 and 198 accounts that are non-state funds accounts totaling \$27,883,513. As far as the depository and equity ratios, there were no financial institutions that exceeded those statutes;

B. Collateral Report

Collateral Bureau State Agency and Department of Insurance Accounts (p.93); There were no banks under for the month of May.

C. Interest Bearing vs. Non-Interest Bearing Accounts

State Agency Account Balances (p. 94); Non-interest bearing totaled 15,472,134 as of May 2006 and Interest bearing totaled 26,919,085.

Mr. Stovall stated that one benefit of SHARE will be to minimize the non-interest bearing accounts and maximize the interest bearing accounts based on agency deposits. As SHARE kicks in we should start seeing these numbers dwindling on non-interest bearing accounts. Member Padilla asked if Mr. Vigil could find out what impact that the Bank of America has had on these numbers. The banks that had CD's with local government were required to pledge at 110% and they have complied with that request.

IV. OTHER BUSINESS

1. Selection of Money Market Mutual Funds-General Fund and LGIP

Investment Policy Guidelines (checklist) was distributed to the committee. Ms. Mevi stated that STO wanted to introduce one or two money market funds to the local government investment pool and to the general fund as an alternative for use of the overnight repurchase agreement. The reason was because for our ratings Cantor Fitzgerald is not a rated counter party. We do have three counter parties that bid every time on our overnight repo. If we stop using Cantor, that only leaves two and our investment policy requires three. We are forced to receive offers from Cantor Fitzgerald until we get more counter parties on board. For the general fund its fine, for the LGIP, it becomes an issue. That is what led us to introducing money market funds. Mr. Canavan and I went from the I money net index and ratings of the top institutional funds to try and establish this list as well as some that we have most recently had solicitation from brokers. We took a

handful of them and Mr. Lujan put this together in terms of compiling the information. The promotional fees are what are being currently being offered. We compiled a comparison of **dailies** for the past three years comparing them to our overnight repo to decipher which would be the best option. The reserve sign came out to be the best. The other promotional fees, some are contractually in place with terms, some have past their term and still being offered credit ******* in their reserve to fight for top position on the I money net. LGIP will probably use two. Once we do get another counter party in place, use the overnight repo and then the money market fund. Mr. Lujan did a longitudinal analysis to look at money market funds. None of them are assessing any **12 fee one fees???** or deferred sales charges which is a requirement of our investment policy. They are all AAA funds and OCC registered. This is the recommended list to the members. Mr. Stovall stated that the handout shows each of these funds in compliance with the criteria listed in statute and in the investment policy.

Member Stovall motioned to approve the Investment Policy Guidelines; seconded by Member Padilla-Jackson. All members were in favor.

Mr. Stovall stated that this is a result of the legislation passed by the LFC Finance Investment Consultant that recommend mutual funds be a component of the State Treasurer's Office under these criteria. As a result, we are incorporating that. A number of things have occurred in the office. We have three overnight repurchase broker/dealers right now and we are trying to expand that but it is not an easy process. Since Cantor is not rated for the LGIP, we can not use Cantor as a participant which limits us to two broker/dealers which we would like to get three or four more bids per the investment policy minimum. Something occurred at quarter end where we had a really low bid. In the event we have a low bid, we have the opportunity now to pull the money out of the repo pool and into a money market mutual fund which will help us tremendously as another investment tool.

2. Approval of Local Government Investment Pool Benchmark

(Tab 2, p. 104) Ms. Mevi stated there were three indexes recommended for use of the benchmarks for LGIP. They were the Standards & Poors rated GIP index and I money net indexes. Ms. Mevi recommended the S&P rated GIP index because it is made up of exactly the same kind of ingredients that our pool is made up of. The I money net has a government taxable index, the other one is institutional which does not correlate to a government type investment fund. Additionally, the S&P has historical rates to do a comparison. The yields were compared and S&P tracked closely.

Member Stovall motioned to approve the recommendation of S&P to the Board of Finance. Member Cassidy second the motion. All members were in favor. A request from Member Padilla-Jackson to include the numbers in a graph format for visual consideration was agreed upon by the board.

3. Background Checks for employees

The three executive members of the State Treasurer's Office are looking at efforts regarding background checks of employees.

4. Discussion of Maturity State Audit

The state auditing department reviewed STO's audit. There were eight findings in the report. They wanted to add six more findings from the forensic report and other issues that have already been corrected.

V. NEXT MEETING

Wednesday, September 13, 2006, 10:00 a.m.

VI. ADJOURNMENT

Member Stovall motioned for adjournment; seconded by Member Cassidy, the meeting adjourned at 11:40 a.m.