

OFFICE OF THE STATE TREASURER

STATE TREASURER'S INVESTMENT COMMITTEE (STIC) MEETING MINUTES
Wednesday December 10, 2008

The State Treasurer's Investment Committee (STIC) meeting convened at approximately 9:00 a.m. in the Bob Barth Conference Room at the Office of The State Treasurer, 2019 Galisteo St., Bldg. K, Santa Fe, New Mexico, on Wednesday, December 10, 2008.

I. CALL TO ORDER

Roll Call

Members Present:

Ms. Joelle Mevi, Chairperson Designee, Chief Investment Officer
Ms. Olivia Padilla-Jackson, Board of Finance Director
Mr. Steven Bohlin, Public Member
Mr. Paul Cassidy, Public Member

Members Absent:

The Honorable James B. Lewis, State Treasurer

Staff Present:

Mr. Victor Vigil, Cash Management Bureau Chief
Mr. Scott Newman, General Fund Portfolio Manager
Mr. Joaquin Lujan, BPIP Portfolio Manager
Ms. Kirene Bargas, LGIP Portfolio Manager
Mr. Arsenio Garduño, Collateral Manager
Ms. Hannah Chavez, LGIP Accountant
Mr. Clarence Smith, Chief Operations Officer

Guests:

Ms. Becky Gutierrez, LFC analyst
Mr. Dan White, LFC analyst
Mr. Gillis Lang, DFA analyst
Ms. Stephanie Schardin, Board of Finance Deputy Director

Approval of December 10, 2008 Agenda

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

Approval of November 12, 2008 Minutes

Chairperson Mevi noted a correction to the date of the next meeting being December 10th in the minutes. Member Bohlin motioned for approval of the minutes as corrected; seconded by Member Cassidy. The motion carried.

II. INVESTMENT REPORTS- Month ending November 30, 2008

General Fund Report

Mr. Scott Newman presented a summarization of the market value, change in balance, investment activity, and interest earnings for the General Fund Investment Portfolio for the month ended November 30, 2008.

Mr. Newman noted that the decrease in market value of the General Fund portfolio was representative of cash outflows exceeding inflows, and not due to decreased security values. The increased duration of the CORE segment is due to the necessity to sell very short-duration securities during September and October, which effectively lengthened duration. The \$7.86 million in General Fund purchases were for taxable Albuquerque Airport bonds. November investment earnings increased due to receipt of some of the frozen Reserve Primary Fund holdings, which were previously not earning interest. Mr. Newman noted that overnight repurchase yields have decreased significantly.

Member Bohlin requested an update about the Reserve Primary Fund. Mr. Newman informed the committee that another distribution was received from The Reserve Primary fund on December 3 and that the liquidation plan was also released detailing how future distributions would be handled. Member Cassidy inquired about the estimated recovery percentage. Mr. Newman clarified that an article in the WSJ reported a share price valuation of 98.5 cents, which agreed to the Reserve Fund's liquidation plan. STO has received approximately 80% of the 9-14-08 Primary Fund holdings.

***New MexiGROW* Local Government Investment Pool (LGIP) Report**

Ms. Kirene Bargas presented a summarization of the market value, change in balance, investment activity, and interest earnings for the LGIP portfolio for the month ended November 30, 2008.

Member Bohlin inquired about the LGIP holding 50% of the portfolio in money market funds. Ms. Bargas informed the committee that money market funds continue to outperform other short-term investment options and the governmental money market funds offer a safer alternative to prime funds or commercial paper. Member Cassidy asked if the LGIP money market positions are guaranteed. Ms. Bargas informed the committee that all LGIP money market funds are "governmental" funds and that the LGIP is researching the new temporary liquidity guarantee program (TLGP) commercial paper. Member Cassidy asked when yields on the LGIP will begin to increase. Chairperson-designee Mevi informed the committee that there is still a balance in the frozen Reserve Governmental fund which isn't paying interest and has the effect of weighting down the LGIP yield. The accrued interest owed is estimated to be approximately \$400,000. It is anticipated that the final distribution on January 9th will include all accrued interest. Committee discussion regarding LGIP asset yields ensued. Member Cassidy impressed upon the committee and Ms. Bargas that it is imperative that the delayed interest earnings, when received, be distributed to the participants based on their average daily balances for months when the interest wasn't being paid out in month-end apportionments. Ms. Bargas will research

the apportionment of Reserve Government Fund interest for September through November and provide an update via email to the STIC committee.

Bond Proceed Investment Pools (BPIP)

Mr. Joaquin Lujan presented a summarization of the market value, change in balance, investment activity, and interest earnings for the Tax-Exempt and the Taxable Bond Proceed Investment Pools for the month ended November 30, 2008.

Member Bohlin inquired on whether STO was calculating both total return and arbitrage liability for the BPIP tax-exempt portfolio in-house. Mr. Lujan informed the committee that the total return calculation is currently being done in-house but that STO's new investment advisor, Davidson Fixed Income, will take that process over in December and that arbitrage rebate is being calculated by BondLogistics, contracted through the Board of Finance. Member Cassidy asked about the BPIP levels being held in the low-yielding overnight repurchase agreement. Mr. Lujan explained to the committee that the overnight repo levels are necessary for keeping sufficient liquidity available and should continue until research into satisfactory money market fund alternatives is complete before shifting funds back into those securities. Member Padilla-Jackson requested an additional disclosure of a monthly total BPIP interest earnings deposited in the Severance Tax Bonding Fund to assist the Board of Finance track the balance available for bonding. Member Cassidy inquired of Member Padilla-Jackson about the status of the State's attempt to use, or reclaim unused, bond funding. Member Padilla-Jackson informed the committee about the move to larger project appropriations, such as spaceport, which put newer bond proceeds in line for immediate use.

Summary of Broker Participation

Chairperson-designee Mevi presented a summarization of the broker participation for security purchases for November and the fiscal year to date, with additional breakdown by asset type and market.

Economic and Investment Outlook

Mr. Joaquin Lujan provided a brief overview of the economy. A lot of information is being published regarding the new federal programs, which STO is busy analyzing. Mr. Lujan presented a twelve month graph of the effective Fed fund rate compared to policy rates, which tracked each other until Sept, when effective Fed funds rate became much lower than the policy rate. Monetary policy in December will probably go lower to ½ percent or even zero but the effective rates have already priced in extremely low rates; currently at .06%, or 6 basis points. Extreme risk aversion has forced Treasury rates into negative yield territory. Negative GDP growth in the 3rd quarter is likely to carry into the 4th quarter without effective lending through financial intermediaries. Absent government intervention in nationalizing one of the financial intermediaries, how do we get them to lend? The alternative is fiscal policy, which appears to be the government's direction in promoting infrastructure spending and other proposed programs. Mr. Lujan reminded the committee that even though we're experiencing a low-rate environment, the CORE and BPIP have the ability to invest longer term and continue to see higher market values. These portfolios should be able to take advantage of opportunities for profit taking over the next few months. Higher interest rates are on the horizon and could occur very quickly, so STO will keep apprised of market influences to assess opportunity and risk. Mr. Newman briefly outlined recent December investment activity in the TGLP corporate

bond market; being top-tier, most-liquid names of full-faith-and-credit securities. Mr. Newman listed several issuers in the TLGP: Goldman Sachs, Morgan Stanley, GE, HSBC, Wells Fargo, American Express. Member Cassidy asked about the pricing of these issues and Mr. Newman informed him that the new issues sold at approximately +80 with some widening out to +90. STO is concentrating on adding these securities in the two-year area. Member Cassidy asked if the broker/dealers are able to fill all of STO bids and Mr. Newman responded that the dealers are being very supportive of STO, as an early and active buyer in this market, and have even begun to survey our areas of interest. Committee discussion regarding the corporate market outlook ensued. Mr. Newman and Mr. Lujan informed the committee that STO will be lightening agency allocations by utilizing the federal buy back program through the coming months. Chairperson-designee Mevi recognized the Investment Bureau staff for their exceptional effort in educating themselves and STO on the multiple new federal programs and for their ability to recognize opportunities that these new investment options offer STO portfolios.

III. CASH MANAGEMENT & COLLATERAL REPORTS: October 31, 2008

Cash Management Report

Mr. Victor Vigil reported that, pursuant to section 8-6-3.1 NMSA 1978, the State Cash Manager shall submit to the State Board of Finance a report showing state fund balances in each financial institution established pursuant to this section. He presented a summary of state agency accounts in each institution though the month ended October 31, 2008.

Mr. Vigil informed the committee that the Cash Management Division continues to work with various state agencies to consolidate multiple accounts.

Collateral Report

Mr. Arsenio Garduño reported that all financial institutions met their minimum collateral requirements for October 31, 2008. The ratio of collateral required by each institution is a result of a quarterly risk assessment analysis. Mr. Garduño also presented the September 2008 quarterly risk assessment results. Collateral requirements as follows: Bank 34 unchanged from prior quarter at 100%; Bank of the West unchanged from prior quarter at 100%; Compass Bank decreased from prior quarter to 75%; Bank of America unchanged from prior quarter at 75%; First Community Bank unchanged from prior quarter at 100%; Charter Bank unchanged from prior quarter at 75%; all other financial institutions remain at 50%. Mr. Garduno noted that the quarter's analysis revealed declining earnings, increasing non-performing loans, and decreasing total assets. FDIC is reporting 171 banks on their "problem bank list". 73 financial institutions were absorbed through mergers and nine failed during the quarter. So far in the 4th quarter, nine more financial institutions have failed, bringing the total for 2008 to twenty two failures.

IV. STAFF REPORTS

None

V. COMMITTEE REPORTS

Discussion of potential legislation for 2009 session

Chairperson-designee Mevi presented an overview of several items of concern to the Treasurer's Office, which may require statutory change in the future but at the present time are in the process of being assessed to determine if statutory change is the only option; such items include changes in business practices resulting from the implementation of the statewide accounting system SHARE.

Chairperson-designee Mevi then presented to the committee proposed changes to section 6-10-10.1 NMSA 1978, "The participating government investment fund" for their review and comment. One recommended change is to eliminate the 5% limit for participation by the state General Fund investment pool in the LGIP. The proposal also recommends replacing the credit quality rating requirement with an "objective standard" requirement. The objective standard being recommended is rule 2a-7 of the federal Investment Company Act of 1940. The final proposed change to the statute is to expand the section which allows participants to designate the term of their LGIP investment to include a reference to procedural rules promulgated by the Treasurer's Office regarding withdrawals.

Member Bohlin inquired on whether STO has notified participants of the proposed business rules regarding withdrawals. Chairperson-designee Mevi responded that the participants have not yet been given notice but that a NMAC rule to define procedures related to the statutorily allowed administrative fee has been drafted and this rule will be expanded to include fund withdrawal procedures. The new rule will then be opened for public comment from the participants. Member Bohlin expressed concern about implementing withdrawal limitations and also removing the strict AA or AAA rating requirement; he noted that the fund may not be attractive to participants any longer. Member Cassidy agreed, but noted that STO would need to exercise care when marketing this rule to participants. He also asked if S&P had been notified about the change. Chairperson-designee Mevi responded that S&P had been consulted regarding participation limits on the General Fund investment pool (and that they didn't see a problem with removing the 5% limit) but not with regard to the redemption limits. She also informed the committee that STO intends to maintain the AAA rating for the LGIP regardless of the proposed change in objective standard within the statute. The potential for immediate credit downgrade is the issue behind the proposed change; without the statutory requirement for a rating, if the LGIP was suddenly downgraded as a result of an unanticipated market event (such as in September) then losing the rating wouldn't violate statute. The change is proposed for the purpose of affording flexibility in portfolio management when and if extreme and sudden market events adversely effect the LGIP. The usefulness and purpose for a credit quality rating for the LGIP was discussed by the committee. Member Bohlin stressed that thorough discussion with LGIP participants regarding these proposed changes is necessary. Member Cassidy asked if other state LGIPs impose fund withdrawal limits, or "gates". Chairperson-designee Mevi confirmed that most other state LGIPs impose some type of limit on amount and notice time for participant redemptions. Member Bohlin and Member Cassidy expressed concern that removing the credit quality rating requirement and implementing stricter withdrawal notice rules may negatively impact participation in the LGIP.

Chairperson-designee Mevi stated that she will take the committee's comments to Treasurer Lewis for his consideration about proceeding with these proposed changes to statute.

Member Cassidy stated that he had been informed about STO's presentation by Chairperson-designee Mevi at the annual NM GFOA conference recently. He noted that one item mentioned in the presentation was the possible bond proceeds LGIP and that he

had received a lot of interest from local governments and debt-issuing state agencies regarding this type of investment. He asked when that type of pool will be available. Chairperson-designee Mevi confirmed that a bond proceeds investment pool for local governments is authorized by Section 6-10-10.1 as it was amended in 2008 legislation but that budget for advisory services necessary to assist in developing this pool wasn't incorporated in the FY09 budget. STO is planning to develop this pool beginning in the FY10 fiscal year when budgeted funds for this service are available.

VI. NEXT MEETING

The next STIC meeting will be held on Wednesday, January 14, 2008 at 9:00 a.m. *Note: subsequent to this meeting, the January Board of Finance meeting was rescheduled to January 14th, which required that the January STIC meeting be rescheduled to January 13th.*

VII. ADJOURNMENT

Member Cassidy motioned to adjourn the meeting, seconded by Member Bohlin. The motion carried. The meeting adjourned at 10:30 a.m.

Respectfully submitted by:
Joelle Mevi, Investment Division Director