

**MINUTES OF THE MEETING
OF THE
STATE TREASURER'S INVESTMENT COMMITTEE (STIC)
Bob Barth Conference Room
Wednesday, May 13, 2009**

CALL TO ORDER AND ROLL CALL

A regular meeting of the State Treasurer's Investment Committee was called to order by Mark Valdes, Chairman Designee, at approximately 9:00 a.m., at the Office of the State Treasurer, 2019 Galisteo, Building K, in the Bob Barth Conference Room. Roll call revealed a quorum of the membership in attendance as follows:

MEMBERS PRESENT

The Honorable James B. Lewis, State Treasurer
Mark Valdes, Chairman Designee and Deputy State Treasurer
Scott Newman, Interim Chief Investment Officer
Olivia Padilla-Jackson, State Board of Finance Director
Steve Bohlin, Public Member
Paul Cassidy, Public Member

STAFF PRESENT

Joaquin Lujan, BPIP Portfolio Manager
Orlando Romero, State Cash Manager

OTHERS PRESENT

Clarence Smith, State Treasurer's Office
Woody Barber, New Mexico Student Loans
Gillis Lang, DFA Economist
Dan White, LFC Analyst
Stephanie Schardin, Board of Finance
Melessia Helberg, Stenographer

NOTE: All items in the Committee packet for all agenda items are incorporated herewith to these minutes by reference. The original Committee packet is on file in the Office of the State Treasurer.

INFORMATIONAL

1. ACTION ITEM – APPROVAL OF MAY 13, 2009 AGENDA

MOTION: Member Cassidy moved, seconded by Member Bohlin, to approve the May 13, 2009 Agenda as presented.

VOTE: The motion was approved unanimously on a voice vote [6-0].

2. ACTION ITEM – APPROVAL OF APRIL 8, 2009 MINUTES

The following corrections were made to the minutes of April 8, 2009:

On page 3, Paragraph 3, line 4, correct as follows: “After slashing the target Fed Funds rate ~~went~~ to a range of 0 to 25 basis points and the Fed began a campaign of....”

Page 12, Paragraph 2, line 3, correct as follows: “He added that the investment guidelines are there so that the prudent man rule will be followed...”

MOTION: Member Padilla-Jackson moved, seconded by Member Bohlin, to approve the minutes of the meeting of April 8, 2009, as amended

VOTE: The motion was approved unanimously on a voice vote [6-0].

INVESTMENT REPORTS

3. INFORMATIONAL – GENERAL FUND INVESTMENTS

Scott Newman, Interim Chief Investment Officer, reported on General Fund Investments from the materials in the Committee packet under tab 3. Mr. Newman highlighted information as follows:

- The market value of the General Fund Investment Portfolio, net of TRANs, on April 30, 2009, was \$1.64 billion, down \$62.89 million or 3.70% from March 31 levels. At this point last year we were at \$2.24 billion and \$2.48 billion at the same point two years ago.
- Purchase yield was down to 1.58% at month end, from 1.72% in March. The weighted average term of the portfolio decreased to 459 days, and the effective duration of the CORE portfolio was 1.11 years, which is 56% of the benchmark duration of 1.97 years.
- During April, there were seven purchases in the CORE portfolio with an aggregate par value of \$350 million. We were active in buying bills and notes, and purchased bills and notes in the two and three year space. Additionally, we sold 13 securities during the period and realized gains of \$2.77 million on sales of \$366 million. We sold TLGP securities, agency securities and reinvested proceeds into those treasuries. We also purchased CDs for the liquidity portfolio in the amount of \$8.7 million.
- April earnings were \$4.49 million, representing a 36% decrease from March earnings of \$7.07 million. The reason this is less than last month is we took fewer gains than the previous month. Fiscal year earnings to date are \$69.87 million, compared to \$107.20 million through the same period of last year.
- The General Fund out performed its benchmark with an earned yield of 4.15%, compared to a 2.23% on the CMT 12 month moving average.

- The total return for the COR was 3.31% for the month, while the benchmark realized an annualized total return of -6.17%. We have exposure to non-guaranteed financial corporates which was “slaughtered” in March. The index does not hold similar securities and the reason we under-performed in March. In April, there was a dramatic tightening of those securities and the reason we out-performed. A lot of volatility we’ve been seeing in the portfolio has to do with that segment. Mr. Newman distributed a copy of the comparison of the treasury yield for the month, noting we sold off during the month which explains the negative return in the benchmark, but because of the tightening in the corporates, we were able to out-perform this month, and we’ve seen this throughout the past 12 months, based on the ebbs and flows of credit and how that tightens which is the major variation between us and the benchmark at this point.

Ms. Padilla-Jackson noted that Davidson continues to bring these financial securities up, hinting that we get rid of them, and asked the sense of the Committee and the recommendation on getting out of these securities. Mr. Newman said staff is looking at this, and the securities in question are a very, very small part of the portfolio which is creating this volatility. He said we have 3 positions of AIG and bid indications range from 40 to 60 cents on the dollar. The Genworth position has rallied from the high 60s into the low 80s and we’re looking at substantial losses on those positions, just on those \$25 million in bonds, \$10-12 million, if we were to take that. The question is, do we take that hit now, as opposed to the potential that AIG or Genworth would go down the tubes and we would get nothing. He noted credit has really rallied in the last month, and it may be an opportunity to take these losses now, clean up that portfolio now, and get rid of that exposure to riskier assets.

Mr. Newman said, in addressing the Board of Finance’s issues, as well as our own concerns with the FDIC, we lightened our exposure at TLGP quite a bit because of the uncertainty with the FDIC. It would seem consistent to lighten the exposure to non-guaranteed financials with which we aren’t comfortable.

Mr. Bohlin said AIG and Genworth are “touch and go” as to whether the feds will keep AIG in play. The State Treasurer’s Office [STO] has one position of AIG, the other two are International Lease Finance which is significantly better than the AIG holding company, but AIG can upstream a fair amount. He feels it boils down to how the STO feels about AIG and Genworth. He believes the losses in the market value of the International Lease Finance is good money eventually.

Mr. Newman understands his point regarding the Lease Financing bonds. However, he has misgivings, because AIG has said it will withdraw cash flow support in March 2010 to Lease Financing. There is exposure to the aircraft industry, and he is uncomfortable with this asset right now. With regard to the AIG position, it actually is AIG funding, not the holding company, but it is a subprime lender part of AIG with which he is more comfortable, noting currently it is the only lender of non-prime mortgages, and it would be inconsistent for Congress to pull those purse strings right now. He suggested this Committee give thought to its comfort level and whether or not to go

ahead and pull those out. He said right now, all the bonds are money good and paying, and all three paid coupons on May 1st, so these are performing assets, but adding to volatility. Ms. Padilla-Jackson said she is split on this issue, and the State Treasurer should look, at minimum, at reducing exposure, if not eliminating it.

Responding to Chairman Valdes, Mr. Cassidy said we need to trust staff to give us direction. He said, personally, he is unsure whether we should be selling these types of assets at this time, because we are seeing bottoming for financials and such issues, but he can't dismiss Ms. Padilla-Jackson's remark that it is difficult to go against our investment advisor on this issue, commenting it is important to remember that we do protect taxpayer assets.

Mr. Lewis said staff is doing a serious evaluation of positions we currently hold, and we need to work with the investment advisor to be sure we are collaborating there, commenting that there is a lot of uncertainty. He noted the PERA met in emergency session and decided to withdraw in one area, but the next week it swung back up and they missed an opportunity. He said we need as much information as possible to make an objective, intelligent decision.

Mr. Bohlin noted that the total corporate position is 6% of the portfolio, and we don't have a huge exposure here.

4. INFORMATIONAL – LOCAL GOVERNMENT INVESTMENT POOL (LGIP)

Scott Newman, Interim Chief Investment Officer, reported on General Fund Investments from the materials in the Committee packet. Mr. Newman highlighted information as follows:

- The market value of the LGIP as of April 30 was \$1.17 billion, compared to a market value of \$1.67 billion at the same period last year and \$891 million at the same point two years ago.
- During the month, the market value of the portfolio decreased 2.5% from \$1.20 billion at the end of March to \$1.17 billion, and net withdrawals for the month were \$74 million. The decrease in the LGIP assets is its cyclical nature, with cash outflows outstripping inflows for our participants. He noted, as a subsequent event, roughly \$140 million flowed out of the LGIP last week, based upon two large participants withdrawing funds to pursue higher returns elsewhere.
- The gross yield was .3102% at April 30, a 35% decrease from March month-end of .48%. The weighted average maturity at April 30, was 50 days, up from 41 days and well within the 60 days or less requirement.
- In April, the STO continued its strategy of using notes and bills, and purchased \$591.6 million in a combination of bills and notes that have rolled down the curve. He asked Mr. Lujan to speak to the issue of spreading out our maturity

buckets based on cash flow needs.

Joaquin Lujan said on page 33, there is a graph of the maturity schedule which is fairly evenly laddered. He said the STO did give up a little liquidity to take on a little more yield to buy treasury coupons which have rolled into the one-year space. He said about \$100 million is maturing weekly, so the reinvestment risk is somewhat lower than when we had \$500 million in cash and \$500 maturing. He said there is a philosophical direction the STO can take either way at this point. Mr. Newman noted, in light of the two large withdrawals last week, we were able to meet those withdrawals just from maturing bills. He said it has been possible to keep the bank balances down, and feel no need to run after money funds to provide liquidity, so it seems to be working well.

- LGIP earnings for April totaled \$327,000, a 42% decrease from March earnings of \$573,000. Fiscal year-to-date earnings are \$18.3 million, compared to \$43 million through the same period last year.
- The net yield of the LGIP as of April 24, the S&P reporting date, was 0.33% which underperformed the S&P Rated Government Pool Index by 25 basis points. The 30-day gross yield at April 24, was 37 basis points, which underperformed the gross S&P Rated GIP index of 77 basis points.
- The administrative fee assessed for April was 3.2 basis points. The year-to-date fees collected through April 2009 are \$256,003.26. He noted we began collecting fees again in April. There was a distribution from The Reserve last month to bring us to 90 cents on the dollar. Those funds flowed through the Reserve Contingency Fund and were distributed to the participants, noted it went smoothly and people are happy with us. Subsequently the SEC filed charges against the management of The Reserve, contending fraud and asking for immediate release of all funds to participants, and staff is monitoring that.

Ms. Padilla-Jackson said she has several questions and comments on the General Fund. She said, with regard to the net outflow into the banking account, Mr. Newman noted there was no investment loss in April, so the decline in General Fund investment pool balance really is related to a net outflow of bank account for the month. She said the cash flow model suggests we would have seen a cash inflow to the bank account in April. She said we need to look at that closely to see which revenue was lower than expected. The second issue is that the overall balance is getting low. She asked what is the bank balance with which the Board of Finance would become concerned about the State Treasurer's ability to pay bills on a monthly basis, commenting there should be some standard formula, noting we are getting to that point with a \$1.6 billion balance. She asked the status of issuing TRANS to address shortfalls on a temporary basis.

Chair Valdes said the STO is in the RFP process to hire the consultants, bond counsel, disclosure counsel, and financial advisor, and once this is done we will have discussions with the financial advisor about the feasibility of doing that. He said they met with LFC who felt we shouldn't do that. They also are looking at the cash flow.

Mr. Lewis said at the LFC meeting, David Abbey indicated they were unsure we should be issuing TRANs, and we need to look at the impact of issuing TRANs on the General Fund. However, we are looking at the revenue shortfall on the DFA side, and we are looking to our consultants as well. He said State statutes provide three criteria to be met before making a decision. He said his office is weighing all factors and variables, commenting he wants to be inclusive and listen to all remarks from the LFC and DFA and then try to determine what is best for the State and the General Fund.

Ms. Padilla-Jackson said she believes it would be beneficial for Mr. Abbey to attend a meeting and explain his position in this regard. She said there is negative arbitrage on one side and running out of money on the other side which she believes is more serious, although we haven't gotten there yet. Mr. White said Mr. Abbey's largest concern is the risk of a negative arbitrage on that action and making up that lost revenue. He said we need to look at these issues closely. Mr. Lewis would like to set up a work group with Mr. White, Mr. Abbey and others he would like, Ms. Padilla-Jackson and people from DFA, to see what is for the common good of the State of New Mexico.

Mr. Cassidy said he is unfamiliar with the cash flow model. Mr. Lewis said the Cash Manager is looking at internal flows in and out for investment purposes, but are forecasting revenues coming in. He has directed staff to request information from Taxation & Revenue if there is a shortfall, so we can know where it is, GRTs or elsewhere. We need a cash management model to give us the inflows so we can predict the outflows. He thanked Ms. Padilla-Jackson for working with STO's staff to develop a model which is "workable and doable," which is a work in progress. Ms. Padilla-Jackson said this is correct.

Orlando Romero, State Cash Manager, said staff is monitoring the main account, and looking at that every day. Mr. Cassidy asked how many months does he project. Mr. Romero said it is on a monthly basis.

Ms. Padilla-Jackson invited everyone to the cash flow meeting following this Committee meeting. She said the model does take into account the lower tax forecast, but the overall budget projection is an average of the whole year. She said if you are just looking at the overall budget, as noted in the model, we will be overestimating payments in this part of the year, while the model would have underestimated in the beginning of the fiscal year, so an adjustment has to be made for this, and they will be working on that. She said they will be brainstorming at the meeting, how it can be adjusted, and unintended cash flow issues which may be happening, such as the federal government's suspension of payments to DOT.

Mr. Lewis said there is now a reaction to crisis, and he is being asked why the Treasurer's Office isn't reacting. He said we are now trying to determine whose role that is. He said the Treasurer's Office has been left out previously, but its role is now being questioned. He is concerned, as the State Treasurer, about even trying to define "shortfall," and the revenue not being there. Mr. Lewis noted there are severe legal

penalties for paying bills when there is no money in the State treasury. He said he takes this very seriously. He said we need to sit at the table and discuss this very seriously with the LFC and the DFA staff and decide what is best for the State. He said if it is determined that there is no money in the fund, the warrant will not be paid.

Chairman Valdes pointed out that our general fund portfolio includes the State general fund as well as 150 accounts which are designated for specific purposes, earn their own interest and don't revert at the end of the year, which currently total \$1.6 billion. He said the last time he checked those self earning funds, they had a total of about \$730 million. He said the net amount of the State general fund would be about \$900 million, which most people don't understand in looking at the general fund investment portfolio – of the \$1.6 billion, only about \$900 million is the State general fund, and the remainder can't be used to pay State bills.

Mr. Cassidy said the State's policy on cash for rating agency purposes is 8% of expenditures in the general fund, which is a target beyond which the balances won't fall below. He said above that we should start using tools such as short term notes. He said in time such as these, where our balances are falling, there is a reason to have actual firm policy reserves, whether cash, or fund balances in terms of best practices. He said this isn't an issue for the Treasurer's Office, but for the Legislature.

Mr. Lewis believes it is an issue for the Treasurer's Office as well, because as we get letters from the rating agencies, they are looking for us to report on the financials as well as DFA and we should equally be concerned about the bond rating of the State.

Ms. Padilla-Jackson asked what the current reserve balance is. Stephanie said, at the time of this fiscal year, the current general fund financial summary shows it is just under 10%. Ms. Padilla-Jackson asked the amount of monthly outflows that leave this office in the bank account. Mr. Romero said the average bank balance is about \$49 million a day. He said our target should be much higher than 8%, and we have to look at outflow and get reimbursement on federal funds as well, including any stimulus funds, and these need to be considered in the subcommittee the treasurer is suggesting. Mr. Lewis agreed, saying he met with Governor Anaya and members of DFA to talk about these items, and if they are reimbursable, we need to know. The two people we designated to work with DFA and the stimulus funds are the Cash Manager as well as the Deputy Treasurer. He commented that we have a lot on the table right now, and it is all about whether we have the cash, and if not, we need a contingency plan as to how to address these issues, and directed Chairman Valdes to get this moving as soon as possible. Chairman Valdes said he understands we will be getting \$3 billion in stimulus dollars over two fiscal years, which is a lot more than we thought, so if there are more projects on a cost reimbursement basis, then we really may be short of cash flow for that purpose.

Mr. Lewis said DFA or LFC is looking to hire someone to look at cash flow modeling relating to the stimulus package, so we might want to get a handle on that so we can coordinate that with what we're doing in this office. Mr. Romero said we need to

look at how quickly agencies draw down which will be a major issue. Mr. Lewis thanked Ms. Padilla-Jackson for bringing up these issues which should be discussed and embedded here, and we need to come up with a comprehensive plan as to how we address them.

Mr. Lewis noted that there have been three news articles, and every time we respond, it is necessary to spend a lot of time with the investment people and legal folks doing research to give people information for the article, but they always have their own slant which we can't control, and we're trying to disseminate the information as quickly as possible.

Mr. Lewis said the New Mexico Municipal League [NMML] just held eight regional meetings after the Legislature, and our offices attended all except one. The Association of Counties met with all of its financial people and elected officials, and Chairman Valdes addressed that group in Silver City. He said he and his staff spoke to these associations about the status of the LGIP. He said his staff is working to put together a stakeholder group to review, evaluate and assess the status of the LGIP and what we want it to be. He said the feedback is that they don't want the LGIP to be eliminated because it is needed as a vehicle, and on the other side, they're looking for additional opportunities, and they indicated we weren't taking enough risks to get enough of a return. He said Member Cassidy has indicated to him that we need to be proactive instead of reactive, and get out and tell them our story. He said he is using the website and direct mail to do this. He said his staff continues to work very hard to address these issues. Mr. Cassidy commended the State Treasurer and his staff for actively talking to all of its constituents, and he continues to hear good feedback from local governments to whom he has spoken.

Mr. Newman said it seems a certain amount of misinformation has been addressed, and people are beginning to understand the facts, and as that has happened they are receiving less pushback, saying he believes we have turned the corner on that.

Mr. Lewis met with the Attorney General's Office, the Finance Authority, and the Directors of the NMML and the Association of Counties here in this office. He said the NMML and Association of Counties want to decide what they can do to help the Treasurer's Office. The Attorney General indicated that the Treasurer's Office is the client as a State entity and the cities and counties probably don't have a standing because they are investing through the State treasury. He said Attorney General's Office has filed a demand letter and looking to follow up on other action next week. He also talked with our Congressional members and asked them to oversee the SEC, saying we are hoping SEC didn't approve the plan which the primary money market money wanted to do saying it's okay to withhold the \$3.5 billion. However, they have turned around and said they are going after them. He said we have recovered close to 90% of the \$38 million, being discussed in the news article. He said we won't know the final outcome until they work through all of this. He said it is difficult to disseminate information when we just don't know.

5. INFORMATIONAL – BOND PROCEEDS INVESTMENT POOL (BPIP)

Joaquin Lujan, BPIP Portfolio Manager, reported on the Tax Exempt Bond Proceeds Investment Pool from materials in the Committee packet under tab 4, page 39. Mr. Lujan highlighted information as follows:

- The market value of the tax-exempt BPIP at month end was \$533.5 million, which compares to the market value of \$534.8 million one year ago and \$560.1 million two years ago. The fund decreased during April which was the net result of project expenditures and interest earnings.
- Fluctuation in the market value is more a function of net flows (i.e., new issue proceeds, project expenditures, etc.) more than it is a function of gains or losses on portfolio holdings, although this is a piece of this.
- The month-end purchase yield was 1.72% and the 1.48 years. The month end yield is well below the 2-year constant maturity agency index, which is a 12 month moving average at 2.55%.
- There was a substantial shift away from FDIC insured corporate bonds into treasuries and cash, and on these trends, the portfolio realized some gains, noting the graph indicates the TLGP concentration is about 21% in the tax exempt pool. He said the STO was comfortable with the investments when they made them and with selling them which was done. He said the TLGP market has kind of continued to rally. The spread has come in very closely, just above treasuries, and the market perception is that there is no more supply for TLGP papers, so people are paying more for it since it may be a “dinosaur” pretty soon. We still have the 20% exposure, so we have realized some gains in the tightening but we are comfortable in holding this amount with all of the uncertainty surrounding the FDIC guarantees in other sectors.

Mr. Newman said, with reducing the exposure to the TLGP paper, the spread has tightened and, especially in the two year area, we were able to sell bonds inside of 20 basis points over a two year note. We felt this was a very good opportunity to unload those positions and reinvest directly into treasuries. Mr. Lujan said the market was in favor at the time, so we were able to sell a total of \$750 million of TLGP across all portfolios.

- Earnings for the month totaled \$3.41 million, an increase over March of \$1 million, which is a function of normal interest earnings and the gains we took on the sales. Fiscal year to date earnings totaled \$25.3 million.
- On page 42 there are monthly, three month, FYTD, one year and three year total returns versus the three year highest true interest costs of proceeds. He said year to date you can see we are basically earning a positive return above the cost to issue bonds. There are contracts in place to estimate rebate payments going forward, because we are earning positive arbitrage and we will start to put that money away, so when the IRS asks to pay it back we will have money in our accounts to pay it.

Mr. Cassidy asked what is the chance, for this fund as well as the taxable BPIP, of the fund balances beginning to be drawn down faster, with the emphasis by the Treasurer's Office and the Legislature to spend money. The balances continue to be stable on this fund over \$500 million and asked if we are going to see this coming down. Mr. Lujan, referring the Committee to page 39, said it is his feeling that they do see an emphasis on spending down the money, but because of all the levers in State government, it would take a while, and before that happens there is a new issue. He noted the graph indicates that we expect new proceeds in June, and his observation is that there won't be a rapid increase in projects being spent.

Ms. Padilla-Jackson said there are a few things which will impact overall spending, and doesn't know we will see a significant change in spending patterns. However, the Public Schools Facilities Authority and the PSCOC have been spending very aggressively, and Mr. Lujan is working with them. She said the Spaceport has about \$60 million which we've issued for them, and she understands they expect to spend this down soon within the next year, and we need to work with them to come up with a cash flow forecast on when the money will be drawn down. Also, she said the Committee needs to pay attention to the results of HB-9, noting the Legislature deauthorized 50-100 severance tax bonds projects that weren't moving, in order to cover the General Fund shortfall for FY 2009. We need to consider how this will impact general fund balances overall as well as STB balances. It basically will be a shift of funds to the general fund, noting she doesn't know how that will work exactly. Lastly, because tax revenues in the bonding fund have declined significantly from FY 2008, we are seeing, and will see a declining capacity for bonding purposes. She said in FY10, going forward, the bonds issued will be significantly lower, and the STO should plan for that as well.

Joaquin Lujan, BPIP Portfolio Manager, reported on the Taxable Bond Proceeds Investment Pool from materials in the Committee packet under tab 4, page 57. Mr. Lujan highlighted information as follows:

- The Taxable portfolio was \$800.2 million, compared to \$740.0 million one year ago, and \$726.1 million two years ago. During April, the decrease in the fund was about \$30 million, mainly attributable to project expenses going out, noting nothing unusual on the high or low end.
- The Taxable BPIP month-end purchase yield and term were 2.09% and 1.44 years. The purchase yield was 46 basis points below 2.55% which is the month-end yield for the Constant Maturity Agency 12 month moving average index.
- There is a substantial shift away from FDIC paper, currently holding 20% of the portfolio, as opposed to last month which was 75%. There were gains on these sales. There was one sale of non-guaranteed Bank of America debt which formerly was a Merrill Lynch bond, which was sold at a loss, because he was uncomfortable with Bank of America's balance sheets and cash flows as well as the process the work-out could possibly take if Bank of America couldn't perform on its debt, or its capital cushion was too low.
- April interest earnings totaled \$3.41 million, an increase from March earnings of

\$1.279 million. Fiscal year to date earnings total \$25.31.

- Mr. Lujan noted the comparisons on page 60, and there was a rally in risk with 10% of the portfolio in corporates, and a lot of the portfolio total return gain was from that exposure. He noted, as an aside, the taxable portfolio has held its exposure since 2007. He said there were many months it hurt us and going forward, there will be many months where it will help us. He believes this is mainly because it is in JPMorgan, Goldman Sachs, Morgan Stanley which have proved for now to be the winners of the groups.

Chairman Valdes acknowledged the hard work of Mr. Newman and Mr. Lujan. He said these two have been overwhelmed with communication with LGIP participants, dealing with the media and legal issues. He said Mr. Newman has been on the road constantly talking LGIP participants, and Mr. Lujan has shouldered the burden while Mr. Newman is out. He spoke about their particular work in streamlining the office, and the development of a teamwork approach for young, bright staff persons.

Ms. Padilla-Jackson asked for an update on filling the vacant position. Mr. Lewis said he is working with Mr. Newman and Mr. Lujan to assess the position and what is needed, commenting that he doesn't want to fill this position with someone who wouldn't be a good fit.

6. INFORMATIONAL – SUMMARY OF BROKER PARTICIPATION.

Scott Newman, Interim Chief Investment Officer, presented the Summary of Broker Participation, under tab 6. Mr. Newman highlighted information as follows:

- We are starting to see much greater concentrations among the primary dealers, which is a matter of process. Treasury trades are being done electronically through Bloomberg Fixed Income Trading in block sizes such that there are a handful of dealers that make active markets and are willing to take positions.
- We are seeing concentrations with Bank of America, CitiGroup, Morgan Stanley, Barclay's and Deutsche Bank, which reflect primarily treasury trades. The reasons we are comfortable with this is the audit trail and transparency we are getting through this system, as well as the execution and efficiency, and being able to place large sums of money this quickly. We are getting executions right on top of where the screens are.

7. INFORMATIONAL – ECONOMIC AND INVESTMENT OUTLOOK

Scott Newman, Interim Chief Investment Officer, distributed copies of the Comparison Yield Curve between the beginning and the end of the month. He said two areas which "jump out," which influence the market, are the fed stance with quantitative easing and it being an active participant in the treasury market as well as its support for the GSC and mortgage markets. This has created downward pressure on interest

rates, taking into account that we also finally had the results of the over-publicized stress test, which gave some market participants some comfort that the “doomsday” scenario of all the banks failing wasn’t going to happen. The result is that people are a lot more comfortable with credit now, which explains the tightening of the credit we’ve seen over the past two months. However, the economic statistics aren’t really encouraging right now, other than what we’ve seen from government intervention. He said Ben Bernanke has said he is expecting recovery in the 3rd or 4th quarter. However, until we see statistics that this trend is not completely government stimulated, and there are hard numbers to recovery, we will be in this place for a while.

Mr. Newman said we are fairly comfortable holding treasuries now, and we’ve been more active in taking advantage of the fact that we are range bound. Currently, there are some fairly good established ranges in 2 and 3 year notes, and we’ve been trading those positions a little bit to enhance our yield there. We are comfortable holding those positions at these levels to maturity.

Joaquin Lujan, BPIP Portfolio Manager, said in his opinion, the government has taken the stance that “the only thing we have to fear is fear itself.” The government stress tested Bank of America and said it has sufficient capital. He has fears about disclosure and transparency, so we won’t be going into credit in the way that the market is going into credit right now, which is rallying pretty substantially. However, insofar as there are products coming to market with a credit element, with a good structure and a good collateral maintenance, transparency, we are looking at those opportunities. One such opportunity is asset backed commercial paper, which is funding student loans but has the federal put option to the Education Department as its guarantee.

Mr. Newman said, right now the government is creating a trust and will be issuing asset backed commercial paper that looks very much like what we did with New Mexico EAF last year with the Series 2008 D&E bonds. The difference is that this trust is going to be taking the place of what we were doing in the structure of it. We are comfortable with the FFELP Program, enough that we were able to help EAF. We are looking at this program as a way to enhance yield. It is treasury guaranteed, and they will be issuing anywhere from the one month to the one year area, and we are looking at that across all the portfolios. The first yield is expected sometime next week.

Deanne Woodring, Davidson Fixed Income Management, Inc, joined the meeting telephonically. Ms. Woodring reviewed the *Quarterly Investment Report for the Quarter Ending 2009, State of New Mexico Investment Portfolio Analysis*, which is in the Committee notebook. Please see this Report for specifics of this presentation. Ms. Woodring highlighted information as follows:

Executive Summary

- In the Executive Summary, she listed the successes based on the project list.
- Reporting: she now has access to the STO portfolio activity information and is comfortable in verifying the numbers and breaking down the numbers coming

through the Northern Trust account.

- Reporting: Mr. Newman and Mr. Lujan met with QED on the reporting functionality which was improved.
- LGIP Pool Fund Procedures draft has been completed, and you should continue to focus on how this should be distributed to participants and what part should go to participants.
- LGIP Pool Fund Policy: A draft has been submitted. It is important to define how you want the pool to look going forward.

Key Points of Focus

- Objectives: Safety, Liquidity and Return.
- Risk associated with the portfolios.
- DFIM – Observations & Recommendations
 - 1) Look at how much of the TLGP you want to hold in each portfolio, DFIM recommends 50%, in this environment focusing on maintaining diversification within all asset classes is important.
 - 2) Continue to focus on the strategy, policy and procedures for the LGIP.
 - 3) Continue to work with Northern Trust to improve its portfolio data.
 - 4) Continue to review legislative changes to add your liquidity components to the LGIP, and continue to focus on that.
 - 5) Focus on the benchmark review in the next quarter.
 - 6) Recommends continuing to evaluate or look at selling some of the corporate securities which are dragging on the portfolio performance. Continue to be extremely volatile, and have recovered some from the March 31st dates, particularly since you have taken so many profits this FY, and there may be an opportunity to take those losses against those profits for the FY and balance that out.
 - 7) Be prepared for much lower interest rates going forward, at least lower than today.
 - 8) Safety and liquidity should continue to be a priority as there are higher risks in the market.

Market Overview

- The main significance is on page 6, to keep an elevated perspective on higher rates, that since the end of your FY, the six month bill was at 2.15, and as of March 31 it was down to 0.42, but it did come up from year-end a little bit, and the two-year note has declined from 2.62 to 0.80, so we are still significantly below historical averages. It is not known how long this pressure will take. The outlooks and things we're seeing in the market will tell us we're in this low environment into the 1st to 2nd quarter of next year. Having the portfolios positioned as they are in a conservative manner, and available funds to reinvest at a higher rate is very important.
- The spreads at month's end were not that much tighter from previous months.

Since March 31, there has been a significant tightening in the agency spread as well as the TLGP spreads and the corporate spreads. We are seeing that people are finally saying I give to these low treasury rates, we can't go there any more, they're adding to the agency bullets, there is more confidence in the agency names and in all of the credit paper, and people are just having to add to those sectors. In the short sector for the LGIP, the spreads are basically non-existent.

LGIP New MexiGROW.

- The biggest issue is the agency filing, and bodes well to get some resolution of what is going to be paid out on the Reserve fund, and hopefully get this settled sooner than later. She said they are targeting, within the lawsuit, to have some resolution by October 2009 when the final maturity takes place. She supports how the restructuring was handled, commenting it took great effort to maintain the AAAM rating with S&P, which is huge, and managing the participants and the concern was a big hurdle. She said acting fast was significant to maintain the integrity of the pool, and doing what you did immediately on the quality of the pool which, although it certainly significantly impacted the yields, was necessary to maintain the integrity. She noted that not a great number of people have pulled out which is very big.
- The biggest challenge for the LGIP going forward is how it should look, and if there should be corporate exposure in it, should there be prime funds, or should it be a clean portfolio. She said there are several State pools which are just treasury agency pools. She said your yield at quarter end was 0.48%, compared to those, is pretty consistent. At this point there aren't a lot of options to enhance that without taking on significant risk again.
- Regarding the interest rate in this pool, it is maintained short, and she would advocate keeping the duration short while we are in this continued low rate environment and hold the course. She said right now there is no opportunity to add yield in it through agencies, but suggested focusing on this to see if there is any spread anywhere.
- Regarding the Advisory Committee. They did outreach to some of the other State fund members and talked about the different roles of advisory committees. She said the key with your fund is that it is not a fiduciary responsibility of the advisory committee, but it is more of input on policy and what participants need. She believes pursuing this is a great idea.

Chair Valdes said the State Treasurer has approved the concept of the stakeholder committee and we have identified 11 members – 2 municipal, 2 county, 1 university, 1 community college, 2 quasi governmental agencies, 2 school districts, Administrative Office of the Courts, and we are considering meeting twice annually – one at the end of the fiscal year, probably tied to the STIC Committee, and invite them to attend the STIC committee, and the second meeting in early January after the end of the calendar year. He will prepare letters requesting the associations to name participants. He said we will be moving forward quickly, after speaking with the NMML

and the Association of Counties which provided positive feedback. Ms. Woodring said this is excellent and will improve communication between the representatives and the STO.

- Continue to focus on the procedures manual, which is a communications tool, which would be incorporated into the first meeting to have it reviewed to be sure this is what people want.
- Focus on a specific investment policy for the pool, and have some drafts ready for the first meeting and get input from the participants.

General Funds – Core Fund

- There were liquidity needs, and securities were liquidated to provide for the liquidity as well as some adjustments from and taking advantage of the tightening of spreads. Additions were made to the TLGP paper and two mortgage backed securities shorter than five years. The overall risk in the portfolio has been reduced with the added TLGP and the elimination of the prime funds as much as possible. The selling of securities and the high profits we're taking has reduced the earnings yield on the portfolio which is the right way to go. She noted Mr. Newman has emphasized the present value of the profits and it's just communication and making sure it is clear that the value of the profits aren't forgotten.
- The biggest thing to watch out for is, if the portfolio is not allowed to take losses, then when rates do pull up, and your hands become tied, then it is more difficult to move the yield back up. You are doing part of that in keeping the duration shorter and keeping the liquidity. She said it sounds as if the restriction on losses is pretty tight here, so you won't be able to sell the securities through lost positions to rebalance the portfolio. Member Bohlin said it is a reticence and not an actual policy.
- Within the TLGP paper, the duration has been shortened because the floating rate TLGPs have been added to the portfolio, and the floaters will add value through the resets which will occur and the rate spreads they have. Technically, even though these are calculated to the stated maturity, because of the resets, they will not price to the stated maturities, so this is a protective position for the portfolio to protect against the mark to market decline which will happen when rates move up. Keep an eye on the corporate notes, noting Mr. Newman indicated those have recovered significantly since March 31, and Mr. Newman said this is correct. She said these continue to be volatile just because of the uncertainty.

Member Cassidy asked if we were to take loss, he presumes the gains have been distributed to the various funds and Mr. Newman said yes. Member Cassidy said then we would have to withhold earnings and that becomes fairly significant to recognize a loss for a full fiscal year. Mr. Newman said those losses would be allocated across the funds, in the same way the gains are. Ms. Woodring said if you are looking at quarter to quarter basis, it would impact them next quarter, but if you look at them on

a fiscal year basis which you could support, the profits have enhanced those returns over those periods significantly.

- Overall performance on a total return basis: the portfolio was impacted by the pricing of the corporate security rather significantly, and those will continue that volatility. The corporate securities are not in the benchmark, so we will see this skewedness as those continue to perform differently than the treasuries and agencies. The treasury agency component of the portfolio is very strong this quarter.
- The strategy on the portfolio is to continue to focus on high quality security, shorter duration. The fact that there have been no callable securities in this portfolio has been significant. The callable securities are being called away, so not having this exposure has allowed the portfolio manager to stay consistent on track to the duration management. It appears balances are increasing overall and the liquidity is becoming a higher priority again, and you are needing to meet liquidity needs and Mr. Newman said yes.
- Continue to balance at low yield and return, continue to manage the expectations that we will be in this lower rate environment, and continue to have the duration shorter to prepare for the time when the rates will come back up. She continues to watch the two-year treasury note, relative to Fed funds which is the measure of the direction of rates. The two-year treasury note is trading at about 75 basis points over fed funds, which normally trades at 50 basis points, which indicates the next move is higher, it is just the timing of when that will happen.
- She will be providing three tables quarterly. The first is the portfolio compared to the benchmark which is a blend. The second focuses on the duration strategy and the strategy implemented to protect the principal against mark to market value risk. The portfolio posture duration was at 1.51 at quarter end relative to the benchmark at 2.15, which shows the defensive posture of the portfolio against the benchmark. The corporate component has been downgraded and deteriorated more this quarter, but the addition of the TLGP paper and the reduction of agencies theoretically increased the quality. The third is the quarter change so you can review what dynamics happened in the market, noting the portfolio declined from \$1.3 billion to \$1.2 billion and there was an adjustment from the liquidity to the investment component.
- She noted that she didn't comment on the liquidity component of the general fund.

BPIP – Taxable and Tax-Exempt

- Significant shifts occurred in these portfolios. Liquidation of the prime funds and addition of the TLGPs were the most significant. The taxable fund holds 58.3% and the Tax Exempt is at 71.2%, suggesting focusing on reducing both to less than 50%. The liquidity seemed to be significantly reduced in both bond funds to 5%. The yield was significantly reduced because of the profit taking and was replaced with lower securities.
- Interest Rate Risk: the maturity is reflected longer, and floating rate notes were

added to the portfolio and the limited corporate exposure in both portfolios were impacted with the downgrade. The reinvestment rate risk has been significantly reduced due to the reduction of liquidity funds.

- The strategy should be a defensive position to rates moving higher. She was not able to get the total return numbers on this fund before the report was written.
- Recommendations are to focus on the TLGP weightings and balance that, and keeping that portfolio position in shorter durations is important. She said there are the same quarter change report, the risk and return report and the review.
- The pool report for the benchmarks are her targets which she discussed with Mr. Newman, which would be a worksheet on the strategic quarter review to begin with the advisory committee and staff to determine how that portfolio should look. She made some assumptions to have a starting point of how the portfolio should look.

Chairman Valdes said previously we had a lot of holdings in money markets, but now portfolio staff is buying short term treasuries and laddering them out, and asked Ms. Woodring her opinion on money markets for liquidity purpose. Ms. Woodring said the money market funds for liquidity purposes can be replicated internally by laddering them. There are fees associated with the money market instruments and you lose some control in the types of securities. There is some need in the government funds to have that immediate next day liquidity for using some of those to balance. She agrees with the strategy that is being implemented. She said you can do the same thing internally at a lower fee because you aren't being charged the fees that the money market funds charge. She said there is a balance, and you look internally at what you truly need to have available for the next day and use money market funds for those needs. Chairman Valdes said her advice is consistent with what some of the STIC members have suggested.

Mr. Lewis asked, as we labor in this market and try to ascertain the best approach, in looking at liquidity in the portfolio, the concept of buy and hold, and looking at laddering, how do you perceive the buy and hold as we're purchasing and buying and selling. Ms. Woodring said, given the dynamics and shifts in the market place, having a pure buy and hold strategy restriction is constraining to a portfolio. If you look at how much interest rates move in a six month or one-year cycle, you want the flexibility to adjust the portfolio as needed, given the changes in the market. With that, you could have guidance as to what is the reason to sell a security – to change the duration of the portfolio, or change the quality and to change the overall asset allocation. Typically you will be guided by more of a buy and hold, but with the market changing quickly, you don't want to tie your hands with that because there are opportunities with bonds to sell the security and buying another for the benefit of the portfolio as a whole.

Mr. Lewis asked if she is saying that with the buy and sell we are optimizing, noting that the in-house investment staff is concerned about how to optimize the portfolio as opposed to locking ourselves into buy and hold. Ms. Woodring said they need to be agile to be able to shift the portfolio and when the market outlook changes

which is happening right now. There has been a lot of buying and selling, and the question is whether this much needs to be occurring to adjust the portfolio, reiterating the opportunity to buy and sell is critical to managing in these markets as well as historic markets.

Mr. Lewis said as we begin work with the stakeholders and define where we are today, we need to decide what it will look like in the near future. Mr. Lewis gave a brief history of the LGIP over the past 20 years as the needs have changed over the year. We need to bring the stakeholders to the table and get input because it is for their benefit. He said the State Treasurer really doesn't make any money on this, because the money goes to the State fund and not the State treasury and it is work on behalf of the staff of the State treasury. Ms. Woodring said this is the reason it is good to have the advisory committee. She said, with regard to the use of these funds, if participants are using this as their ongoing vehicle, there is the opportunity on the pool to extend the average maturity. There are a lot of significant issues to hammer out and review at the outset and this is a great opportunity to do that.

Mr. Lewis said originally, everything was in the overnight repo program which was collateralized at 102%, and they were doing the money market, and his question is why - in looking at safety, liquidity and yield. As we are looking at where we are going in the future, they need to take responsibility for what they are putting money into and when they really need it out. Ms. Woodring agreed, and there needs to be something which works and forces them to be accountable to that. She said she would be happy to come down for the meeting. Mr. Lewis believes it would be beneficial to go over the recommendations and to have her analysis and evaluation as an independent party.

CASH MANAGEMENT AND COLLATERAL REPORTS

8. INFORMATIONAL – STATE AGENCY DEPOSIT BALANCES IN FINANCIAL INSTITUTIONS AND INTEREST VS NON-INTEREST BEARING ACCOUNTS – MARCH 31, 2009.

Orlando Romero, State Cash Manager, read his Memorandum of May 1, 2009, to the State Treasurer, into the record, noting there is a summary of the accounts following the memorandum. He said they moved the LGIP accounts to the non-state fund balance. On the State fund side there are 286 accounts with a total value of \$20,360,918 and in Non-State funds there is a balance of \$148,899,834. There are a total of 462 accounts with a total value of \$169,260,752, with two accounts closed and two accounts opened. He will continue to do an analysis on the State accounts in terms of the movements of those accounts from other accounts, other institutions to the State Fiscal Agent, and he will have that by the next meeting.

9. INFORMATIONAL – COLLATERAL REPORT ON AGENCY DEPOSITS & CDs – MARCH 31, 2009

Scott Newman, Interim Chief Investment Officer, reviewed the Collateral Report, under tab 10. For the month ending March 2009, all depository institutions met minimum collateral requirements as required. He noted one of the custodial banks has two consecutive quarters of not meeting the NLI to average asset ratio, and staff is monitoring that.

Mr. Newman noted as of May 1st there have been 32 bank failures this year, which is more than in all of 2008. He noted the statistics are in the report as to where those occurred, noting Georgia leads the pack, and the cost to the FDIC at this point is about \$21.5 billion. Arsenio, our collateral manager, has looked at the 32 bank failures and run them through our model. He said, based on that analysis, all of those banks, under our policy, would have been required to be collateralized at 100% going into the bank failure.

Mr. Lewis said the Board of Finance is requesting that all of the monies from the State are safe and in the banks. He said currently staff is reviewing what policies and procedures need to be in place. He said we established a cash management bureau with four people looking at S&Ls, who went to banks and found that some of the collateral which was pledged, was double pledged or not worth the paper it was written on. He said staff will be following up on some of this and you will be seeing changes made sometime in the near future. He is meeting with all division directors to get a layout of all staffing patterns, shortfalls, and what we need to do to address some of these issues.

Mr. Cassidy said he recalled in a previous situation that the Treasurer had to notify the custodial bank of the discrepancy, and asked the process to do this.

Mr. Newman said that custodial bank was Bank of America, and we notified them they were in violation and no longer eligible to act as the custodial bank. The State Treasurer sent them a letter as required by statute, advising that they were no longer eligible, and we worked with them to find a replacement custodial institution which was acceptable to all parties, which has been completed. He said this is another one, but the process is now in place to handle that.

Mr. Cassidy asked how many custodial banks we have. Mr. Newman believes we are down to three.

Mr. Lewis said these are some things which are happening in the banking industry, and we have other entities which prefer not to be depositories any more. He said he is weighing these things and trying to figure out what policies need to be in place.

COMMITTEE REPORTS

10. ACTION ITEM

OTHER

11. INFORMATIONAL – STO: INVESTMENT POLICY (SIGNED AND DATED FOR 4/21/09)

12. INFORMATIONAL – STO: OPEN MEETINGS RESOLUTION

Chairman Valdes said the Investment Policy was signed on April 21, 2009, noting a copy is provided for the Committee members which they approved previously. Under Tab No. 12, the Open Meetings Resolution was updated as required by Statute and is available for anyone that wants a copy of it.

QUESTION PERIOD

Mr. Lewis thanked Clarence Smith for giving his time to attend some of the NMML meetings on our behalf.

Mr. Lewis said we have been asked by the LFC if we have been working with the tribes to get them to participate in the pool. He said a news article said we were out marketing, but we were trying to instill confidence with the municipalities and the counties on what we are doing in the office. He said there is a performance measure which provides we should be out trying to get new participants in the pool. He will be visiting with DFA and others on this measure, because this shouldn't be a driver.

Mr. Farber said they are seeing the same kind of squeeze in Student Loan funds that you are seeing in the State Treasurer's Office. Mr. Lewis said he has been invited to visit with President Obama when he comes to town tomorrow, and he will ask him about that.

NEXT MEETING – WEDNESDAY, JUNE 10, 2009, 9:00 A.M.

ADJOURNMENT

Member Bohlin moved, seconded by Member Newman, to adjourn the meeting. The motion was approved on a voice vote [5-0-- Absent: Member Padilla-Jackson]. The meeting was adjourned at 11:15 a.m.

Respectfully submitted by MARK VALDES
CHAIRMAN DESIGNEE AND DEPUTY STATE TREASURER

ATTEST:

Submitted electronically
Melessia Helberg, Stenographer
