

OFFICE OF THE STATE TREASURER

STATE TREASURER'S INVESTMENT COMMITTEE (STIC) MEETING MINUTES  
Wednesday, December 12, 2007

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 12, 2007.

**I. CALL TO ORDER**

**Roll Call**

**Members Present:**

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

**Staff Present:**

Mr. Mark Canavan, Senior Portfolio Manager  
Ms. Kirene Bargas, LGIP Portfolio Manager  
Mr. Joaquin Lujan, BPIP Portfolio Manager  
Mr. Victor Vigil, Cash Management Bureau Chief  
Ms. Randilynn Lord, Legal Council  
Mr. Arsenio Garduño, Collateral Manager  
Ms. Eliza Anaya, LGIP Accountant

**Guests:**

Ms. Stephanie Schardin, Legislative Finance Committee  
Mr. Gillis Lang, Department of Finance and Administration

**Approval of December 12, 2007, Agenda**

Member James Lewis motioned for approval of the agenda; seconded by Member Steven Bohlin. The motion carried.

**Approval of November 14, 2007, Minutes**

Member Steven Bohlin motioned for approval of the minutes: seconded by Member James Lewis. The motion carried

Treasurer Lewis began the meeting by acknowledging Mark Canavan's contributions and dedication to the Treasurer's Office and informed the Committee that Mr. Canavan has accepted a Portfolio Manager position with the Education Retirement Board effective December 31. The Treasurer expressed his thanks and appreciation on behalf of the Treasurer's Office to Mr. Canavan.

## **II. INVESTMENT REPORTS- Month Ended November 30, 2007**

### **General Fund Report**

Mr. Mark Canavan summarized the investment for the General Fund Portfolio. The market value of the General Fund Investment Portfolio, net of TRANs, on November 30, 2007 was \$2.44 billion compared to \$2.58 billion at the same point last year and \$2.26 billion at the same point two years ago. During the month the market value of the portfolio decreased 2.9% to \$2.44 billion from \$2.52 billion on October 30. The November month-end balance represents an increase of 2.89% over September's month-end balance of \$2.37 billion. The yield was 4.86% at month-end, down from 4.93% at October 31. The average term of the portfolio increased from 265 days to 271 days in November. Month end cash was allowed to build in anticipation of cash matching TRAN liabilities in December, and to compensate for the accelerated withdrawal of assets by state Agencies due to greater use of ACH. During the month of November the liquidity pool experienced significant withdrawals requiring the office to liquidate \$60mm out of the \$100mm in back-up reserves.

The month-end portfolio holdings were 48.31% in U.S. Agency bonds, 26.30% in the overnight repurchase pool, 9.49% in commercial paper, 9.85% in certificates of deposit, 4.64% in corporate bonds, and 1.41% of money market funds held in reserve. \$79.43 million of investments were purchased for the month: \$57.5 million of certificates of deposit were purchased in the CD program. \$21.93 million of corporate bonds were purchased for the Core portfolio. These corporate bond purchases focused on the pharmaceutical, retail and electric utility industries. November earnings were \$10.61 million a decrease of 6.1% from October's earnings from November 2006 earnings of \$11.39 million. Fiscal year-to-date earnings totaled \$55.9 million compared to \$59.16 million through the same period last fiscal year. The general fund yield-based remains above its yield-based benchmark with an earned yield of 4.92% and purchase yield of 4.85%. Unlike October, however, the total return for the Core substantially lagged its benchmark for November with an annualized total return of 19.614% for the benchmark and 10.85% for the Core. The trailing twelve month period, the Core portfolio has returned 5.71% versus the custom benchmark's 6.5% return.

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

Ms. Kirene Bargas informed the committee of the LGIP status. The year-over-year market value of the LGIP portfolio as of November 30 was \$1.12 billion, compared to a market value of \$712 million at the same period last year and \$869 million at the same period two years ago. During the month the market value of the portfolio increased

5.17%, from \$1.06 billion in October to \$1.12 billion. Participant contributions for November were \$110 million. Withdrawals during November totaled \$56.7 million. The gross yield was 4.89% at November 30, at 2.4% decrease from October month-end of 5.02% and reflective of the post-fed-fund rate-decrease interest rate environment. The weighted average maturity at November 30 was 19 days, down from the October 31 weighted average maturity of 37 days and within the S&P rating compliance limit of 60 days.

The month-end portfolio holdings were 18.04% in U.S. government agency securities, 14.1% in A-1+ commercial paper, 67.8% in AAA money market funds, and .06% in the bank account balance. November investment activity in the LGIP portfolio was comprised of the purchase of \$60 million in A1+ commercial paper with an annualized yield of 4.87% and average term of 100 days. LGIP earnings for November totaled \$4.44 million, a 2.0% decrease from October earnings of \$4.53 million. Fiscal year-to-date earnings totaled \$22.2 million compared to \$17.8 million through the same period last fiscal year. The 30-day net yield of the LGIP as of November 23 was 4.94%, outperforming the 30-day net S&P Rated Government Investment Pool (GIP) index (4.71%) by 23 basis points. The 30-day gross yield of the LGIP at November 23, 4.99%, surpassed the 30-day gross S&P Rated GIP index of 4.93%. The administrative fee assessed to participants for November was 3.6 basis points; fees collected through November 30 totaled \$160,002.

Ms. Bargas reported the portfolio diversification summary as: commercial paper at 14.12%, Money Market Funds at 67.79%, LGIP bank account at .06% and U.S. Agencies at 18.04%. LGIP has maturities laddered through August 2008. For the month of November LGIP investment purchases by type/broker were \$60,000,000.

Member Lewis commented on the newspaper headlines regarding subprime mortgage exposure being experienced by other state LGIPs and informed the committee that the *New MexiGROW* LGIP is not exposed to subprime losses because it doesn't hold the types of securities causing the defaults and losses. He mentioned several states and counties which have either experienced defaults or have been rumored to be experiencing difficulties or potential downgrades. The Treasurer's Office is available to speak with LGIP participants to alleviate concerns about potential risk in the portfolio.

#### **Tax Exempt Bonds Proceed Investment Pool (BPIP)**

Mr. Joaquin Lujan report that the market value of the Tax-exempt BPIP as of November 30, 2007, was \$529.8 million. This compares to a market value of \$474.9 million one year ago. During November the market value of the fund decreased 1.9%, from \$540.2 million at October 31 to \$529.8 million at November 30. The approximate \$10 million decrease was the net result of property tax revenues, interest earnings, and project expenditure draws. The tax-exempt BPIP month-end yield and term were 4.96% and 230 days. The month end yield was 60 basis points above the selected benchmark yield, 4.36%, which is the highest arbitrage yield limit of any bond issue in the fund. The month end portfolio holdings including U.S. Agency Bonds (44.9%); shares in AAA rated institutional money market funds (24.5%); U.S. Treasury Bills and Notes (19.0%); U.S. Corporate Bonds (5.6%) and units in the overnight repurchase pool

(5.8%). Interest earnings for the month totaled \$2.18 million, down from October earnings of \$2.34 million. Fiscal year to date earnings totaled \$12.03 million.

Member Bohlin commented that large, unexpected withdrawals in the tax exempt pool were becoming predictable as they seem to be happening regularly. Mr. Lujan clarified that in the tax-exempt pool cash flow is more predictable than in the taxable pool where wide swings from month to month occur, as happened again during November. But, he stated, there is still a relatively reliable cash flow pattern in the tax-exempt BPIP.

#### **Taxable Bond Proceed Investment Pool (BPIP)**

Mr. Lujan included in his report that the market value of the Taxable BPIP as of November 30, 2007, was \$ 698.2 million. This compares to a marked value of \$647.0 million one year ago. During the month the market value of the fund decreased 8.0%, from \$759.6 at October 31 to \$698.2 million at November 30. The approximate \$61 million decrease was the result of monthly project expenditure draws; this includes a single unexpectedly large draw totaling \$59 million. The taxable BPIP month-end yield and term were 5.02% and 340 days. The month-end yield was 20 basis points above the 2-year CMA 12 m.a. index (4.82%); and 127 basis points above the Merrill Lynch 10% 0-3 year Treasury/90% 1-3 year Agency custom index (3.75%).

The month-end portfolio holdings included U.S. Agency Notes and Bonds (66.2%); AAA rated institutional money market fund shares (18.6%); corporate bonds (9.9%); U.S. Treasury bills and notes (2.1%); Asset Backed Securities (1.5%); and units of the overnight repurchase pool (1.5%); Investment activity during November included the purchase of \$30 million in U.S. corporate bonds. Interest earnings for the month totaled \$3.09 million, down from October earnings of \$3.13 million. Fiscal year to date earnings totaled \$16.63 million.

Member Joelle Mevi acknowledged Mr. Lujan's efforts at successfully transitioning the Treasurer's Office into the reporting and performance tracking capabilities offered by the State's custody bank, Northern Trust. November is the first month that the BPIP was able to provide Northern reports, which offer daily pricing, in place of QED reports, which only offer weekly pricing. Going forward, the General Fund can also be reported utilizing the Northern Trust reporting and performance capabilities.

#### **Economic and Investment Outlook**

The STO Economic and Investment Outlook for June 2007 projected that problems in residential real estate would result in roughly \$250 billion of mortgage foreclosures and \$100 billion of lost liquidity across the American financial system.

Reports from numerous parties including the Federal Reserve and Alan Greenspan, the former Chairman of the Federal Reserve, confirmed STO estimates of the magnitude of loss in system liquidity. It appears now that these estimates are low.

By October 30<sup>th</sup> 2007 over \$40 billion of write-downs were already reported by the Nation's major banking, brokerage and insurance institutions. The impact of this loss can be seen in the reluctance of banks and brokerages to lend to one another. With only

40 percent of STO estimated losses already in place, the tightening of credit is trickling down into the broader economy effecting ever wider swaths of the borrowing public. The most recent FRB reports show that 40 percent of responding banks are tightening credit standards for even prime borrowers.

As of November 30, 2007 interest rate markets projected a 100 percent probability of Fed Funds dropping to 3.75 percent or lower by August of 2008, with a 58 percent probability of Fed Funds reaching 3.25 percent or lower.

Given the current economic environment and expectations for future interest rates it is reasonable to assume that the General Fund's overall blended yield will drop from the current 4.92 percent to roughly 4 percent over the course of 2008. Recent market volatility provides opportunity, however, and as such, the STO is selectively purchasing in the corporate bond and asset backed markets where spreads have widened dramatically.

The LGIP will continue purchasing direct obligation commercial paper, and may transfer current money market funds into the government fund alternatives in their respective families. While staff considers this move unnecessary on an investment basis, such a move will remove all headline risk associated with sub-prime and asset backed commercial paper and will therefore alleviate concerns of LGIP participants. As the LGIP has significantly shorter WAM, LGIP yield will fall at a faster pace than other STO managed funds.

In late December the Bond Proceeds Investment Pool will be receiving roughly \$150mm in bond proceeds, therefore the BPIP will see increasing trade activity. As with the General Fund, as opportunities arise and credit analysis is performed there will be selective purchase of spread product in both the corporate and asset backed segments of the market.

### **III. CASH MANAGEMENT REPORT: Month Ended October 31, 2007**

Mr. Victor Vigil reported 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 ending October, 2007.

Additionally, the State Treasurer's Office is required to report to the State Board of Finance any financial institution that exceeds certain equity capital and deposit ratios and notify all state agencies who maintain state fund deposits within those institutions of the violation. The agencies are advised not to make any new deposits to those accounts until the violations are corrected. Pursuant to section 6-10-24.1 NMSA 1978 there were no

financial institutions exceeding the statutory limitations on equity capital and deposit ratios for the month ending October, 2007.

State funds were held in a total of 287 accounts with a combined balance of \$65,704,910. 188 non-state fund accounts totaled a balance of \$26,284,018. There were six accounts closed and one account opened for the month ending October 31, 2007.

Member Padilla-Jackson inquired on the number of non fiscal agent accounts and questioned whether the fiscal agent was not located where the agency opened the accounts. Mr. Vigil offered to provide more analysis on the non fiscal agent accounts and the positioning of Bank of America facilities in cities where these accounts were opened.

### **Collateral Report**

Mr. Arsenio Garduño reported that there were two financial institutions out of compliance for the month ending October 31, 2007: Compass Bank was under collateralized by \$4,261 and pledged additional collateral to cover this deficiency on November 1, 2007. Union Savings Bank was under collateralized by \$1,123,403 due to a change in the collateral required for this quarter. Union Savings Bank pledged additional collateral to cover this deficiency on November 1, 2007. All other institutions holding public funds met the minimum collateral requirements. The ratio of collateral requirement by each institution is a result of a quarterly risk assessment analysis.

Mr. Garduno informed the committee that Compass Bank requested clarification on collateral reporting and pledge requirements in the event of a bank merger or acquisition. Compass Bank was purchased by Banco Bilbao Vizcaya Argentina, S.A. on September 7 and, therefore, was unable to submit a full quarter financial condition report for the new entity. The partial quarter financial data forced STO collateral calculations to require an increase in collateral from 50% to 100%. Compass Bank requests that STO revisit the requirements in light of this situation and consider reclassifying Compass Bank to the 50% level. Mr. Garduno will meet with Member Padilla-Jackson and legal counsel to resolve this issue.

## **IV. STAFF REPORTS**

### **Investment Policy**

Chairperson Joelle Mevi presented changes to the State Treasurers Investment Policy for approval at the Board of Finance September meeting and received some comments specifically regarding securities lending and broker/dealer disclosure requirements. The securities lending language was removed from the policy and was submitted for approval at the November meeting. The policy was approved. The current changes address ethics and disclosure requirements for broker/dealers and contractors. Legal Counsel Randilynn Lord presented the language for disclosure that should satisfy the concerns and goals for both the Board and the Treasurer. The changes include expanding the Ethics section of the policy. The rewording of the disclosure and ethics sections was a joint effort between STO's and Board of Finance's legal counsel. Included with the Investment Policy are the three appendices that were approved last year: the Employee Code of Conduct, the Campaign Contribution policy and the Whistleblower policy.

Member Padilla-Jackson motioned to approve the Investment Policy as revised, and member Lewis seconded the motion. The motion carried.

**V. NEXT MEETING**

The January Board of Finance meeting is scheduled for Tuesday January 8<sup>th</sup> in order to convene prior to the 2008 legislative session. The next STIC meeting, therefore, will be Monday January 7, 2008, 11:00 a.m. *UPDATE: The January Board of Finance meeting has been rescheduled to Monday January 14 and the January STIC meeting has, therefore, been rescheduled to Wednesday January 9<sup>th</sup> at 9:00 a.m.*

**VI. ADJOURNMENT**

Member Paul Cassidy; motioned to adjourn the meeting, seconded by Member Olivia Padilla-Jackson. The meeting adjourned at 10:35 a.m.