

OFFICE OF THE STATE TREASURER

STATE TREASURER'S INVESTMENT COMMITTEE (STIC) MEETING MINUTES
Wednesday, January 9, 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, January 9, 2008.

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. Steven Bohlin, Public Member

Staff Present:

Ms. Kirene Bargas, LGIP Portfolio Manager
Mr. Joaquin Lujan, GF, BPIP Portfolio Manager
Mr. Orlando Romero, State Cash Manager
Ms. Randilynn Lord, Legal Counsel
Mr. Arsenio Garduño, Collateral Manager
Ms. Eliza Anaya, LGIP Accountant

Members Absent:

Mr. Paul Cassidy, Public Member

Guests:

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

Approval of January 9, 2008 Agenda

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

Approval of December 12, 2007 Minutes

Member Steven Bohlin motioned for approval of the minutes with noted typographical errors to be corrected; seconded by Member James Lewis. The motion carried

II. INVESTMENT REPORTS- Month Ended November 30, 2007

General Fund Report

Mr. Joaquin Lujan summarized the market value of the General Fund Investment Portfolio, net of TRANs, on December 31, 2007 was \$2.25 billion compared to \$2.55 billion at the same point last year and \$2.31 billion at the same point two years ago. During the month the market value of the portfolio decreased 7.6% to \$2.25 billion from \$2.44 billion on November 30. Fund yield was 4.73% at month-end, down from 4.86% at November 30. The average term of the portfolio increased to 340 days from 271 days in November. CORE WAM was increased significantly with the purchase of four and five year Treasury securities totaling \$130 million.

Month-end holdings included U.S. Agency bonds (55.5%), units of the overnight repurchase pool (8.3%), certificates of deposit (10.2%), money market funds (17%), US Treasury Bills and Notes (4.4%) and corporate bonds (4.43%).

\$130 million in US Treasuries were purchased during December for the CORE portfolio. December earnings were \$11.03 million, a 4% increase from November's earnings of \$10.60 million. Fiscal year-to-date earnings totaled \$66.94 million compared to \$71.36 million through the same period last fiscal year. On a yield basis, the General Fund remains above its yield-based benchmark with an earned yield of 4.65% and a purchase yield of 4.73% (this compares to a 4.53% 2yr CMA/CMT month-end yield). On a total return basis, the Core lagged its benchmark for December with an annualized total return of 5.54% versus the benchmark's 5.75%.

Mr. Lujan reported General Fund core investments during the quarter were 'laddered out' to five years and liquidity portfolio investments were generally cash-matched to known liabilities. For the core portfolio, extending duration by purchasing longer dated high quality assets took precedence and directed much of the trading activity, especially in December. As the New Year and quarter begin, core investments beyond 3yrs will continue, mainly by purchasing high quality assets such as Agency bullets and Treasuries. As the economic and corporate environment evolves, credit assets and spreads will likely cheapen/widen and core money will slowly buy into corporate securities on a very selective basis. The liquidity portfolio will carry excess dollar reserves for the next quarter as it is anticipated that the CD program, which draws cash out of the liquidity pool, will grow to its limit of \$350mm and b) State agencies utilize new SHARE based ACH functions, which can cause unexpected draws on the liquidity pool's cash. The end of December's trades have taken WAM (effective duration) to 1.8 yrs (1.39) from 1.4 yrs (1.06) at the end of September. A more timely extension of duration and an even distribution of assets along the targeted ladder is enabled by the decision to purchase large quantities of high quality assets during a period that promises a continued flight to quality trade, and by waiting to purchase credit assets until the economic/corporate picture stabilizes somewhat.

Member Lewis asked member Bohlin and Mr. Lujan if they had a forecast on the economic environment and if they foresee stabilization. Member Bohlin commented that the economy is moving along. In terms of perception that there is difficulty with the subprime market, it is close to the end of big losses but there is about a 50%/50% chance of the economy coming into a recession.

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 December 31 was \$1.25 billion, compared to a market value of \$730 million at the same period last year and \$815 million at the same period two years ago. During the month the market value of the portfolio increased 10%, from \$1.12 billion in November to \$1.25 billion. Participant contributions for December were \$165 million; withdrawals totaled \$36 million for the month. The gross yield was 4.83% at December 31, a 1.24% decrease from November month-end of 4.89%. The weighted average maturity at December 31 was 10 days, down from the November 30 weighted average maturity of 19 days and within the S&P rating limit of 60 days.

The month-end portfolio holdings were 11.45% in U.S. government agency securities, 9.53% in A-1+ commercial paper, 78.97% in AAA money market funds, and .05% in the bank account balance. There were no purchases during the month of December. LGIP earnings for December totaled \$4.93 million, a 9.9% increase from November earnings of \$4.44 million. Fiscal year-to-date earnings totaled \$27 million compared to \$18 million through the same period last fiscal year. The 30-day net yield of the LGIP as of December 7 was 4.87%, outperforming the 30-day net S&P Rated Government Investment Pool (GIP) index (4.63%) by 24 basis points. The 30-day gross yield of the LGIP at December 7, 4.92%, surpassed the 30-day gross S&P Rated GIP index of 4.86%. The administrative fee assessed to participants for December was 3.2 basis points; fees collected through December 31 totaled \$192,013.

Ms. Bargas reported that the asset mix and asset types purchased for the portfolio maintained a 99% level of A-1+ rated investments. The weighted average maturity (WAM) was maintained at 50 days or less, averaging a 22 day WAM during the quarter. Money market funds have outperformed the overnight repo rate, therefore money market funds were utilized for investment and, as a result, the LGIP WAM decreased. In mid-October STO analyzed and compiled an approved DOCP list for LGIP investment. The list is systematically reviewed and submitted to a due diligence process in order to provide the highest possible safety level for LGIP investment. As a result of headlines regarding the Florida LGIP program, STO received numerous inquiries during the quarter concerning credit risk within the NM LGIP. Two published articles (Albuquerque Journal and Business Week) emphasized that the *New MexiGROW* LGIP does not invest in sub-prime investments. An announcement was also sent to all LGIP participants providing information of the types of investments held in the *New MexiGROW* LGIP and indicating that *New MexiGROW* LGIP does not invest in any type of sub-prime investment or any type of mortgage security. Compliance with rating criteria will continue to mandate the investing strategy for the LGIP. Investment in agency discount notes will be utilized for shorter-term investments, callable agency securities will be utilized to enhance yields and extend WAM, and AAA rated money market funds will continue to be used for liquidity cash flows. On-going investment training of the LGIP Portfolio Manager will continue into the second quarter. STO has contracted with PFM for investment advisory services and the LGIP will be utilizing their services for direction during this turbulent market.

Member Lewis asked Member Mevi to elaborate on the response of the LGIP participants regarding the Florida issue. Ms. Mevi commented that only a few of the participants had called in regard to the issue but that she explained the situation and calmed the waters, so to speak.

Tax Exempt Bonds Proceed Investment Pool (BPIP)

Mr. Joaquin Lujan report that the market value of the Tax-exempt BPIP as of December 31, 2007, was \$518.4 million. This compares to a market value of \$547.6 million one year ago. During December, the market value of the fund decreased 2.1%, to \$518.4 million from \$529.8 million at November month end. The approximate \$11 million decrease was the net result of property tax revenues, interest earnings, project expenditure draws, project reversions. The Tax-exempt BPIP month-end yield and term were 4.90% and 307 days. The month-end yield was 54 basis points above the selected benchmark yield, 4.36%, the highest arbitrage yield limit of any bond issue in the fund.

Month-end portfolio holdings included U.S. Agency Bonds (47.8%); shares in AAA rated institutional money market funds (25.0%); U.S. Treasury bills and notes (17.5%); U.S. corporate bonds (5.7%); and units in the overnight repurchase pool (3.7%). \$38.9 million in US Agency callables were purchased during December. The purchases were characterized by coupons trading to the call dates in late 2008 to early 2009. Interest earnings for the month totaled \$2.16 million, down from November earnings of \$2.18 million. Fiscal year to date earnings totaled \$14.19 million.

Taxable Bond Proceed Investment Pool (BPIP)

Mr. Lujan included in his report that the market value of the Taxable BPIP as of December 31, 2007, was \$851.4 million. This compares to a market value of \$813.02 million one year ago. During December, the market value of the fund increased 21%, to \$851.4 million from \$698.27 million at November 30. The approximate \$153 million increase was the net result of monthly project expenditure draws; project reversion, and new issue proceeds that totaled \$153.7 million. The Taxable BPIP month-end yield and term were 4.99 % and 291 days. The month-end yield was 127 basis points above the 2-year CMA 12 m.a. index (3.72%); and 135 basis points above the Merrill Lynch 10%, 0-3 year Treasury/90%, 1-3 year Agency custom index (3.64%). Month-end portfolio holdings included U.S. Agency notes and bonds (54.5%); AAA rated institutional money market fund shares (34.1%); corporate Bonds (8.1%); U.S. Treasury bills and notes (1.7%); asset backed securities (1.1%); and units of the overnight repurchase pool (.2%); Investment activity during December included the purchase of one \$5mm Agency bullet and \$21 million in agency purchases. As with the tax-exempt trades, these callables are generally characterized by coupons trading to call dates in late 2008 and early 2009. Interest earnings for the month totaled \$3.03 million, down from November earnings of \$3.09 million. Fiscal year to date earnings total \$19.66 million.

Mr. Lujan included in his report that both Bond Proceeds Investment Pools invested assets to either a) match debt service liabilities, or b) match estimated project draw liabilities. By the end of the quarter both pools met or exceeded their WAM targets. The overarching investment consideration during the last quarter was to lock in rates on short, high quality government securities as a) investors flocked to quality during this time and b) the FOMC implemented a series of rate cuts with the promise of more to come.

The end of December brought \$154 million of new issue proceeds into the Taxable BPIP. The investment strategy for the next quarter is to abide by the disciplined approach outlined in the BPIP's investment plan, which is to take new issue proceeds and invest along the entire 0 – 3 year curve in proportions matching projected or cash outflows for projects. The Taxable BPIP targets will be recalibrated to reflect the new bond issue's projected liabilities. In early January this process will be complete. The Tax-exempt BPIP will be paying a large debt service liability in March. The pool has received a proportional cash infusion from the severance tax bonding fund to pay for this as well as the July and Sept. debt service liabilities. Aside from matching this money to the next debt service payment, assets are invested or matched to their farthest liability with yields are well above arbitrage limits. As a result, future work on this portfolio will include estimating and reserving amounts for arbitrage rebate liabilities expected to come due over the next few years.

Economic and Investment Outlook

Mr. Joaquin Lujan reported that the nation's unemployment rate jumped to 5.0% in December from 4.7% in November and from its low of 4.4% just nine months ago. All previous increases of this magnitude over a span of nine months occurred either during or in the immediate aftermath of a recession. The short term funding market and inter-bank liquidity has improved somewhat coming into the new year but will be tested during January, no amount of liquidity injections will get us back on the path of normal economic activity what rings true throughout is that no amount of central bank intervention and liquidity infusion can make bad loans good again and no amount of central bank intervention can direct money to productive uses. The market will have to slog through its overdue corrections on its own, since TAF redirects money infusions through an alternative vehicle it is not money supply net positive and thus inflationary. During the first half of 2008 the market will remain volatile, highly sensitive to headline risk, and characterized by continued flight to quality trading sessions. Spot rates will continue to decline and STO portfolios should be long duration (buying bullets versus callables) and increasing convexity (buying zero/low coupons versus high coupons).

Member Mevi asked how the presidential election was affecting the economy. Mr. Lujan replied that the markets would most likely respond, on a fundamental basis, to a candidate's stance on trade. Any serious retrenchment from global trade would likely hurt the economy in the long term. Of course, candidates' fiscal stimulus proposal as we enter a period of economic weakness would likely dominate headlines but will be largely ignored by the markets.

III. CASH MANAGEMENT REPORT: Month Ended November 30, 2007

Mr. Orlando Romero 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 November, 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 November, 2007.

State funds were held in a total of 288 accounts with a combined balance of \$64,596,159. 188 non-state fund accounts totaled a balance of \$26,734,347. There were two accounts closed and two account opened for the month ending November 30, 2007.

Collateral Report

Mr. Arsenio Garduño reported that all depository institutions holding public funds for the month ending November 2007 met the minimum collateral requirements. The ratio of collateral required by each institution is a result of a quarterly risk assessment analysis.

IV. STAFF REPORTS

Member Mevi informed the committee that the Treasurer's Office had contracted with PFM as investment advisor for FY 12008. Member Padilla-Jackson reminded the committee that the professional services contract for investment advisor must be approved by Board of Finance per the investment policy. Member Mevi will schedule the contract on the next board agenda.

V. NEXT MEETING

Wednesday February 13, 2008 at 9:00 a.m.

VI. ADJOURNMENT

Member Steven Bohlin motioned to adjourn the meeting, seconded by Member James Lewis. The meeting adjourned at 10:10 a.m.