

OFFICE OF THE STATE TREASURER

STATE TREASURER S INVESTMENT COMMITTEE (STIC) MEETING MINUTES Wednesday, January 10, 2007

The State Treasurer's Investment Committee (STIC) meeting convened at approximately 10:00 a.m. in the Bob Barth Conference Room at the Office of the State Treasurer, 2019 Galisteo Street, Santa Fe, New Mexico, on Wednesday, January 10, 2007.

I. CALL TO ORDER

Roll Call

Members Present:

Mr. James B. Lewis, State Treasurer
Mr. Orlando Romero, State Cash Manager
Ms. Olivia Padilla-Jackson, State Board of Finance Director
Mr. Steven Bohlin, Public Member

Member(s) Absent:

Mr. Paul Cassidy, Public Member

Staff Present:

Mr. Mark Valdes, Deputy State Treasurer
Ms. Joelle Mevi, Chief Investment Officer
Mr. Mark Canavan, Investment Officer
Mr. Joaquin Lujan, Investment Officer
Mr. Victor Vigil, State Accounts Bureau Chief
Mr. Steve Gonzales, State Accounts Deputy Bureau Chief
Ms. Jane Tabor, Public Information Officer
Ms. Randilynn Lord, Attorney
Mr. Arsenio Garduño, Collateral Financial Analyst

Guests:

Ms. Amy Chavez, State Board of Finance Deputy Director
Ms. Stephanie Schardin, Legislative Finance Committee
Mr. Laird Graeser, Department of Finance and Administration
Mr. Gillis Lang, Department of Finance and Administration

Chairman Lewis designated Chief Investment Officer Joelle Mevi as Chair for this meeting.

Approval of January 10, 2007, Agenda

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

Approval of December 13, 2006, Minutes

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

II. INVESTMENT REPORTS Month Ended December 31, 2006

General Fund Report

Mr. Canavan summarized the investment activity for the General Fund portfolio. The market value, net of TRANs, was \$2.55 billion, compared to \$2.34 billion at the same point last year and \$1.94 billion at the same point two years ago, and was a decrease of 0.77% from November's \$2.58 billion and a decrease of 1.5% from October's \$2.60 billion. The yield was 5.01% at month-end, up from 4.93% in November. (Legacy investments at lower rates of return continue to mature in the portfolio and are reinvested at higher rates.) The average term of the portfolio increased to 156.8 days from 122.1 days in November. At month-end, the dollar-weighted asset mix was comprised of 56.4% in U.S. agency bonds, 3.2% in the overnight repurchase pool, 7.6% in certificates of deposit, 29.8 in commercial paper, and 3.07% in money market mutual funds. Investment activity in December totaled \$1.4 billion: \$35.5 million of certificates of deposit were purchased or renewed for the CD portfolio; \$1 billion of commercial paper was purchased to both cash match disbursements in the Liquidity Portfolio and to continue building the Core Portfolio; \$200 million of U.S. Agency securities with maturities ranging from September 2008 to December 2009 were also added to the Core Portfolio during December. Earnings for December were \$12.21 million, an increase of 6.8% over November's earnings of \$11.4 million and an increase of 70.5% over December 2005 earnings of \$7.16 million. Fiscal year-to-date earnings totaled \$71.37 million compared to \$39.19 million through the same period last fiscal year.

Regarding the General Fund investment strategy for the past quarter, Mr. Canavan reported the continued implementation of a portfolio ladder strategy for the Core Portfolio. Agency purchases were equally dollar weighted at \$20 million each and ranged in maturity from September 2008 to December 2009. Core benchmark indices were finalized during the quarter and a benchmark with 5-year final maturities was approved by the State Board of Finance. The Liquidity Portfolio continued to cash match commercial paper investment to known cash disbursement dates. High levels of excess reserves were held in the portfolio during the quarter to buffer against unforeseen draws or cash flow timing issues and were held in the money market mutual fund and overnight repurchase agreement.

For the next quarter, Mr. Canavan reported that the STO will continue to extend portfolio duration in both the Core and Liquidity portfolios, with the anticipation that excess reserves will be drawn down in favor of building the Core Portfolio, thereby protecting the State from a falling interest rate environment. Investment for the Core Portfolio will place maturities to fill in a portfolio ladder slightly biased to a 2- to 3-year time horizon. At this juncture, STO will not deploy assets into the 4- and 5-year time horizon. The Liquidity Portfolio will continue cash matching recurring monthly expenditures while maintaining a \$100 million to \$200 million buffer.

New MexiGROW Local Government Investment Pool (LGIP) Report

Chairperson designee Mevi informed the committee of the LGIP status. The market value was \$730.54 million (a 2.5% increase over November), compared to a market value of \$815.72 million at the same period in the prior fiscal year and \$1.46 billion at

the same period two years ago. Increase in the Pool balance is attributable to the positive response to the improving yield which is very competitive to the marketplace. (Today, the Pool has \$785 million.) The gross yield of the LGIP portfolio increased 1 basis point to 5.31%. The weighted average maturity was 32 days, down from the November weighted average maturity of 34 days, within the allowable limit of 50 days. The portfolio was comprised of 30.1% in U.S. government agency securities, 36.7% in A-1+ commercial paper, 33.1% in AAA money market funds, and 0.3% in the bank account balance. December investment activity included: \$112 million in A-1+ commercial paper with an average yield of 5.39% and average term of 93.7 days; \$93.16 million in agency discount notes with an average yield of 5.27% and average term of 101 days. LGIP earnings totaled \$3.25 million, up from November earnings of \$3.03 million. Fiscal year-to-date earnings totaled \$18.2 million compared to \$15.2 million through the same period last fiscal year. The 30-day net yield of the LGIP was 5.26%, outperforming the 30-day net S&P Rated Government Investment Pool (GIP) index (5.13%) by 13 basis points. However, the 30-day gross yield of the *New MexiGROW* LGIP, 5.31%, trailed the 30-day gross S&P Rated GIP index of 5.33% by 2 basis points. The administrative fee assessed to participants for December was 5.2 basis points, with a total fiscal year-to-date fee collected of \$192,000. Participant contributions totaled \$64.5 million and withdrawals totaled \$32.2 million.

The LGIP investment strategy for the previous quarter was in compliance with the S&P AAAM rating maintenance criteria that the asset mix and asset types purchased for the portfolio be at least 50% A-1+ (or AAA) rated with the remaining 50% A-1 (or AA) rated; the portfolio maintained at least 95% of A-1+ rated investments. The weighted average maturity was maintained at 50 days or less. Maturities were laddered by week to provide constant cash inflows and were used in combination with the money market funds for liquidity needs.

Bond Proceeds Investment Pools (BPIP) Report

Mr. Lujan reported that the Tax-Exempt BPIP had a market value of \$457.6 million. During December the market value of the fund decreased 3.5% from \$474.9 million to \$457.6 million. At month-end, the yield and term were 4.97% and 134.7 days, respectively. The breakdown of month-end portfolio holdings was 56.7% in U.S. Treasuries, 11.9% in U.S. Agency securities, 23.6% in the overnight repurchase pool, and 7.7% in flexible repurchase agreements. Approximately \$30 million was invested in U.S. Agency bonds (two \$15 million increments) maturing December 2007 and January 2008 and yielding 5.23% and 5.19%, respectively. Earnings for the month were \$1.88 million. The yield at December 31 was 4.97%, 35 basis points above the highest arbitrage yield limit of any bond issue in the fund, 4.62%, which is also the selected benchmark.

The market value of the Taxable BPIP was \$813 million. During December the market value of the fund increased 25.6%, from \$647.0 million to \$813.0 million. The dramatic rise in market value is primarily explained by a \$170 million cash infusion from December's sponge bond issuance. At month-end, the yield and term were 4.83% and 251.9 days, respectively. The breakdown of month-end portfolio holdings was 39.2% in money market mutual fund shares, 36.4% in U.S. Agency bonds, 16.1% in flex repurchase agreements, 5.1% in the overnight repurchase pool, and 3.2% in commercial

paper. Approximately \$130 million of U.S. Agency bonds was purchased during December. Maturities were laddered in \$10 million (par) increments over thirteen months October 2008 through December 2009 with the yield on these investments ranging from 4.83% to 5.06%. Interest earnings for December totaled \$2.68 million.

Mr. Lujan informed the Committee that the BPIP investment strategy for the previous quarter involved both bond pools (Taxable and Tax-exempt) moving from all cash positions to partially invested positions. Approximately \$195 million of the Tax-exempt pool was invested, primarily in U.S. Treasury bills and notes. This investment was both an asset-liability match for scheduled 2007 debt service payments and a one-year ladder of maturities for expected project draws. Additionally, \$378 million of the Taxable pool was invested in U.S. Agency bonds over a three-year maturity ladder. The target weighted average maturity for the Tax-exempt pool increased over the quarter and will approach its one-year target WAM within the next two quarters. The asset mix is largely U.S. Treasury securities as returns in this sector have been sufficient to earn enough positive arbitrage in excess of the maximum pool's maximum arbitrage yield limit of 4.623%. Similarly, the target get WAM for the Taxable pool increased over the quarter and will approach its 18-month target within the next two quarters. The asset mix is largely U.S. Agency securities and future investment will include the purchase of securities paying liquidity premiums, as the portfolio is "buy and hold." Consideration also will be given to the introduction of one-time callable agency securities to the portfolio.

Member Padilla-Jackson mentioned the Treasurer's Office's misreporting of the Severance Tax Bonding Fund balance at the end of June and that the amount transferred to the Permanent Fund in was approximately \$23 million less than it should have been. She asked for assistance in understanding how that happened.

Economic and Investment Outlook

Mr. Canavan reported that December economic releases continued to show weakness in manufacturing and non-manufacturing sectors (only 10% of the economy) along with corresponding Treasury rallies. The rallies are being offset, however, as income growth, employment, and consumer confidence all remain strong.

III. CASH MANAGEMENT REPORT Month Ended November 30, 2006

State Agency Deposit Balances in Financial Institutions

Mr. Victor Vigil stated that there were no financial institutions exceeding the statutory limitations on equity capital and deposit ratios. There were 505 accounts with a balance of \$100 million; 8 accounts were closed and 4 were opened. Member Padilla-Jackson asked if accounts are reviewed to ensure they are used as originally intended; Mr. Vigil informed her that they are regularly monitored and evaluated for compliance to all statutory guidelines. Chairman Lewis informed the Committee that he and Mr. Romero would meet with Bank of America on operational issues related to these accounts later in the week.

Collateral Report

Mr. Vigil further reported that at the end of November, First National Bank of Ruidoso and Western Bank of Lordsburg were under collateralized; they are now in compliance.

Member Padilla-Jackson informed the Committee that the new State Board of Finance collateral policy would be approved at its meeting next week and that no public comment was received. Mr. Garduno reported that STO currently enforces the Collateral Policy that went into effect in August 2006 and that notice of the change in depository and equity ratios was provided to the financial institutions via mail at that time. Member Padilla-Jackson stated that the policy approved by the Board of Finance and implemented in August was being modified. The new policy is in the lengthy finalizing process which involves other agency input, including NMAC.

IV. STAFF REPORTS

Investment Policy Change STIC Definition

Chairperson designee Mevi referred the Committee to the memo discussing the suggested change to the composition of the State Treasurer's Investment Committee membership –from the State Cash Manager (who is now responsible for banking, reconciliation, and CMIA audits) to the Chief Investment Officer (who is now responsible for investing, investment accounting, and the Local Government Investment Pool). Member Padilla-Jackson motioned for acceptance of the change; seconded by Member Romero, the motion carried.

V. NEXT MEETING

Wednesday, February 14, 2007, 9:00 a.m.

VI. ADJOURNMENT

Member Bohlin motioned to adjourn the meeting; seconded by Chairperson designee Mevi, the meeting adjourned at 11:40 a.m.