

## OFFICE OF THE STATE TREASURER

### STATE TREASURER'S INVESTMENT COMMITTEE (STIC) MEETING MINUTES Wednesday, May 9, 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 Street, Santa Fe, New Mexico, on Wednesday, May 9, 2007.

#### I. CALL TO ORDER

##### Roll Call

##### Members Present:

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

##### Staff Present:

Mr. Mark Canavan, Senior Investment Officer  
Mr. Joaquin Lujan, Investment Officer  
Mr. Orlando Romero, State Cash Manager  
Mr. Arsenio Garduno, Collateral Financial Analyst  
Ms. Vickie Brown, Special Assistant to the State Treasurer

##### Guests:

Ms. Stephanie Schardin, Legislative Finance Committee  
Mr. Patrick Wilkins, Meyners & Company  
Mr. Michael Easley, Meyners & Company  
Ms. Barbara Fava, PFM Asset Management (by telephone)  
Ms. Amy Chavez, State Board of Finance Deputy Director  
Mr. Gillis Lang, Department of Finance and Administration

##### Approval of May 9, 2007, Agenda

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

##### Approval of April 11, 2007 Minutes

Member Cassidy motioned for approval of the minutes; seconded by Treasurer Lewis. Member Bolin moved that the minutes be approved but pending correction of some typographical errors. The motion carried.

## **II. INVESTMENT REPORTS – Month Ended April 30, 2007**

### **General Fund Report**

Mr. Canavan summarized the investment activity for the General Fund portfolio. The market value, net of TRANs, on April 30, 2007, was \$2.48 billion compared to \$2.52 billion at the same point last year and \$2.12 billion at the same point two years ago. During April, the market value increased 3.33% to \$2.48 billion from \$2.40 billion in March. The April month-end balance represents a 13.12% decrease from February's month-end \$2.56 billion. The yield was 5.07% at month-end, up from 5.06% at the end of March. The average term of the portfolio increased to 191.2 days from 188.5 days at March month-end.

The month-end portfolio holdings were 55.5% in U.S. Agency bonds, 17% in the overnight repurchase pool, 7.5% in certificates of deposit, 3.1% in money market mutual funds, and 16.8% in commercial paper. \$685.5 million of investments were purchased for the month: \$48.8 million of certificates of deposit were purchased or renewed for the CD portfolio; \$536.7 million of commercial paper was purchased to cash match May and June disbursements in the Liquidity portfolio; \$100 million of U.S. Agency securities were purchased for the Core portfolio. April earnings totaled \$12.5 million, a decrease of 2.1% from March earnings of \$12.7 million and an increase of 30.5% over April 2006 earnings of \$9.57 million. Fiscal year-to-date earnings totaled \$123.1 million compared to \$75.0 million through the same period last fiscal year.

The Target Core Portfolio 0-12 month maturity goal is 15-40% of the portfolio but was 54.73%, partly due to legacy investments as well as residual cash of approximately \$300 million. The weighted average maturity was 1.087 years as opposed to 1.9-2.1 years of the benchmark. The asset types were heavily weighted in agency markets at approximately 81%.

Member Padilla-Jackson asked if the Core maturity target would benefit by deploying more aggressively than the \$100 to \$200 million per month as originally planned. Mr. Canavan informed the Committee that, due to mixed opinions about rates and the economy as well as a current low level of 4.50%, there should be no rush to deploy the funds. He stated further that it would be better to deploy the funds at the higher trading range level of 4.70% instead of the current low rate. Member Bohlin commented that, due to the current economic situation, there was no urgent need to go from the current overnight rates into 3-year or 5-year paper. However, at some point, the Committee will want to have a steady ladder for this portfolio as there is a large amount remaining liquid in the overnight repo. Member Bohlin further stated that, at this point, maturities are only being replaced and not actually working to extend the portfolio for the targeted segment of the General Fund core. Member Cassidy stated that he favored easing into the market over a number of months; however, the result is that the core segment is not meeting its benchmarks. Had it been deployed faster, the core segment would probably be meeting its benchmarks in some areas. He further stated that he is comfortable with the portfolio manager's investment strategies but is ready to reach the targets that the Committee has set forth.

Mr. Canavan presented General Fund portfolio monthly maturities information ranging from May 2007 to June 2010, stating the liquidity is primarily in the overnight repo as well as the TRANs pool. The General Fund total interest earned on investments was \$12,495,509 with an average yield of 5.0953%. The total year-to-date interest earned was \$123,152,247 with an average yield of 4.9363%. The calendar year total interest earned to date was \$51,150,679 with an average yield of 5.0716%.

Member Bohlin asked if total return benchmark comparisons will be included with the monthly Core portfolio report. Mr. Canavan confirmed that the total return information will be included in the Core portfolio each month but that the STO Investment Policy requires only quarterly reporting for total return.

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

Chairperson Mevi informed the committee of the LGIP status. The year-over-year market value as of April 30 was \$891 million, compared to a market value of \$777.3 million at the same period last year and \$1.30 billion at the same period two years ago. During April the market value of the portfolio increased 3.4% from \$861.6 million in March to \$891 million. Participant contributions were \$60.9 million and withdrawals were \$33.2 million. The gross yield was 5.30% at April 30, a decrease from the 5.32% at March 31. The weighted average maturity at April 30 was 12 days, down from the March 31 weighted average maturity of 16 days and within the S&P-set limit of 50 days.

The month-end portfolio holdings were 9.4% in U.S. government agency securities, 22.5% in A-1+ commercial paper, 67.8% in AAA money market funds, and 0.2% in the bank account balance. April investment activity in the LGIP portfolio included the purchase of \$91.8 million in A-1+ commercial paper with an annualized yield of 5.36% and average term of 68.4 days, and \$19.3 million in agency discount notes with an annualized yield of 5.25% and average term of 27.5 days. LGIP earnings for April totaled \$3.8 million, a 3% increase from March earnings of \$3.7 million. Fiscal year-to-date earnings for the LGIP totaled \$32.4 million compared to \$26 million through the same period last fiscal year. The 30-day net yield of the LGIP as of April 30 was 5.24%, outperforming the 30-day net S&P Rated Government Investment Pool (GIP) index (5.14%) by 10 basis points. The 30-day gross yield of the LGIP at month-end, 5.30%, trailed the 30-day gross S&P Rated GIP index of 5.34% by 4 basis points. The administrative fee assessed to participants for March was 4.5 basis points; fees collected through April totaled \$320,000. Chairperson Mevi also offered information from a detailed listing of the LGIP participants, specifically identifying the top contributors during the month.

### **Bond Proceeds Investment Pools (BPIP) Report**

Mr. Lujan reported that the market value of the Tax-exempt BPIP as of April 30, 2007, was \$560.1 million. During April the market value of the fund decreased 0.9% from \$565.4 million to \$560.1 million. Earnings for the month were \$2.36 million. The April 30 yield was 5.03% and the term was 188 days. The Tax-exempt BPIP yield at April 30, 5.03%, was 41 basis points above the highest arbitrage yield limit of any bond issue in the fund, 4.62%, which is also the selected benchmark. The breakdown of month-end portfolio holdings was 31.6% in the overnight repurchase

pool, 1.2% in flexible repurchase agreements, 54.6% in U.S. Treasury notes and bills, and 5.3% in U.S. Agency bonds. Purchases included approximately \$55.5 million in U.S. Treasury notes and \$39.7 million in U.S. Agency bonds, ranging in maturity from March 2008 to February 2010. As a result, weighted average maturity increased to 188 days from 90 days and yield decreased to 5.03% from 5.07%

#### **Taxable Bond Proceeds Investment Pool (BPIP) Report**

The market value of the Taxable BPIP as of April 30, 2007, was \$726.1 million. During April the market value of the fund decreased 0.3% from \$729.9 million to \$726.1 million. Interest earnings for April totaled \$2.86 million. The month-end yield was 5.03% and the term was 292 days. April 30 benchmark yields were: 5.03%: 2-year Constant Maturity Agency 12-month moving average; and, 4.88%: Merrill Lynch custom index 10% of the 0-3 year Treasury and 90% of the 1-3 year Agency. The breakdown of month-end portfolio holdings was 17% in the overnight repurchase pool, 4% in flex repurchase agreements, 49.3% in U.S. Agency notes and bonds, 2.0% in U.S. Treasury notes, and 27.5% in money market mutual fund shares. No purchases were made in April.

Member Padilla-Jackson asked if there was an increase in draw downs from the public schools. Mr. Lujan informed the Committee that the public schools have drawn down large amounts of funds and that he has revised the target portfolio to be more heavily weighted in the 0-6 month maturity range in order to accommodate these draws.

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

Mr. Canavan reported that the General Fund core investments will continue to be laddered and remain within the 3-year time horizon. Retracements into the higher rate bands will be used as buying opportunities, while rallies below 4.65% will be avoided when possible. The General Fund Liquidity portfolio will continue to cash match expenditures of the State, and the Bonds Proceeds Investment Pool will continue asset-liability matching and reducing excess liquidity in a prudent and systematic manner. Both the Taxable Bond Proceeds Investment Pool and the General Fund Core are considering entering the credit markets through the use of either corporate or asset-backed investments. The LGIP will continue maintaining duration at the long end of allowed limits. The LGIP will redeploy excess cash back into commercial paper instruments as staff increases the number of qualifying programs under the STO credit review process.

### **III. CASH MANAGEMENT REPORT – Month Ended March 2007**

#### **State Fund Deposit Activity for the month ended March 2007**

Mr. Orlando Romero reported that 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 ended March 31, 2007. State funds included 295 funds with a total balance of \$59,388,505; the non-State funds totaled 206 accounts with a total balance of \$26,406,972. State agency balances totaled \$85,795,477, and accounts totaled 501; six (6) accounts opened and one (1) account closed during the month.

### **Collateral Report**

Mr. Garduno stated that no financial institutions were out of compliance for the month ended March 31, 2007. Portales National Bank was under-collateralized by \$38,000 but pledged additional collateral to cover this deficiency subsequent to month-end. One institution required a change in the percentage ratio for required collateral during the quarter ended March 31, 2007. First National Bank in Las Vegas was changed from a 50% to a 75% requirement due to a decrease in the bank's net income.

Member Padilla-Jackson asked how staff became aware of the First National Bank requirement change from 50% to 75%. Mr. Garduno informed the Committee that banks are required to submit a quarterly risk assessment to the State Treasurer's Office (STO) and, through an analysis of First National Bank's assessment report, STO staff became aware that the increase was necessary.

Mr. Garduno further informed the Committee that at month-end, no flexible repurchase counterparties were out of compliance with their agreements which require 102% collateralization. Citigroup was out of compliance two (2) consecutive days during the month and Morgan Stanley was in compliance during the entire month.

### **Quarterly Investment Report – April 30, 2007**

Ms. Barbara Fava, PFM Asset Management, LLC informed the Committee of its Quarterly Investment Review. Treasury yields fluctuated within a 50 basis point "trading range." Two-year treasury yields, between January 1, 2006 and April 30, 2007, fluctuated between 4.50% and 5.0% because of economic factors and the uncertainty of the economy. The present Fed Funds rate is 5.25%. *New MexiGROW* LGIP performance, on a gross yield basis, during the first quarter averaged 0.04% less than the S&P LGIP Index. This compares favorably to the significant underperformance of 0.47% by the LGIP in the first quarter 2006. On a net basis, the LGIP outperformed the S&P LGIP Index by 0.12% during the first quarter. After improving dramatically in early 2006, the gross LGIP return is now within the range of returns generated by professional money managers. The low expense ratio for the LGIP allows the fund to generate very good net performance. The Treasurer's outreach efforts appear to have an impact; during the first quarter of 2007, assets increased 15% over the fourth quarter of 2006. The weighted average maturity of the LGIP was 16 days as of March 31, 2007, well within the 50 day constraint set by S&P; the longest maturity in the portfolio on December 31 was 3.5 months. The LGIP is well diversified among Federal Agencies, commercial paper, and money market mutual funds. Ms. Fava recommended increased exposure to commercial paper, use of repurchase agreements, and extending the weighted average maturity of the LGIP.

Treasurer Lewis asked Ms. Fava for her thoughts about how the STO portfolio would perform if it were managed by an outside firm versus by STO staff. Ms. Fava informed the Committee that experienced internal managers with access to market information and resources including credit analysis and investment guidelines should perform as well as professional investors. Ms. Fava further stated that, because professional investors have larger investment funds, they are better able to invest in

more staff, systems, and analytical tools which give them more attention from the brokerage community.

The General Fund consists of 4 components: Core Segment - \$1.3 billion; CD Program - \$350 million; TRANS – recently \$400-\$550 million; Liquidity Segment – remainder of funds (\$350-\$800 million). During the first quarter, the STO made selective purchases in the 1- to 3-year maturity range: purchased \$60 million of 1- to 1.5-year Federal Agencies at an average yield of 5.14%; purchased \$80 million of 1.5 to 2-year Federal Agencies at an average yield of 5.03%; and purchased \$140 million of 2- to 3-year callable Federal Agencies at an average yield of 5.42%. During the first quarter, an additional \$300 million was transferred to the Core Portfolio. The duration of the General Fund was 0.84 years which compared to the duration of the custom benchmark of 1.89 years. PFM recommended targeting a minimum portfolio duration of 75% of the benchmark by the end of the second quarter and extending the portfolio when rates return to the mid to upper end of this trading range. STO should consider increasing the allocation in callables to 20%-25% of the Core Segment; and the STO should consider a small initial allocation into corporate securities of 5%.

**Quarter Investment Audits – September 30, 2006 and December 31, 2006**

Mr. Michael Easley, Meyners & Company (MCO) presented the Committee an update of audit findings and recommendations. The scope of work performed included reviews of all quarterly transactions, reconciliations of the QED system, monthly reconciliation of the LGIP net asset values to participant balances, corporate bond and commercial paper ratings, and a review of controls in place to ensure compliance with policies. During the July 2006–September 2006 period, Mr. Easley noted that all purchases were of securities allowed by policy; bids were obtained on all purchases; transaction paperwork was properly signed by the trader and approved; investment ratings were in compliance with policy on all purchases and maturity was in compliance on all purchases. MCO further noted that the check of collateral is not documented on the CD rollover paperwork unless there is a change in the bank’s status; some LGIP reconciliations are not being completed in a timely manner. MCO recommends that the check of collateral be documented on the CD rollover paperwork and the LGIP reconciliations be completed and corrections made in a timely manner. Additional findings for the October 2006-December 2006 period were discussed and recommendations noted.

**IV. NEXT MEETING**

Wednesday, June 13, 2007, 9:00 a.m.

**V. ADJOURNMENT**

Treasurer Lewis motioned to adjourn the meeting; seconded by Member Cassidy, the meeting adjourned at 10:55 a.m.

Respectfully submitted by Vickie Brown

Date:

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