# OFFICE OF THE STATE TREASURER

## STATE TREASURER'S INVESTMENT COMMITTEE (STIC) MEETING MINUTES
**Wednesday, July 11, 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, July 11, 2007.

## I. CALL TO ORDER

**Roll Call**

**Members Present:**
Ms. Joelle Mevi, Chief Investment Officer (Chairperson Designee)
Mr. Orlando Romero, State Cash Manager (Member Designee)
Mr. Paul Cassidy, Public Member

**Members Absent:**
Mr. James Lewis, State Treasurer
Ms. Olivia Padilla-Jackson, State Board Finance Director
Mr. Steven Bohlin, Public Member

**Staff Present:**
Mr. Mark Canavan, Senior Investment Officer
Mr. Joaquin Lujan, Investment Officer
Ms. Vicki Brown, Special Assistant to the State Treasurer
Ms. Randilynn Lord, State Treasurer Attorney

**Guests:**
Ms. Stephanie Schardin, Legislative Finance Committee
Ms. Lisa Neil, Legislative Finance Committee Intern
Mr. Pat Wilkins, Meyners & Co
Mr. Mike Easely, Meyners & Co
Mr. Laird Grassaer, DFA
Two DFA Summer Interns

**Approval of July 11, 2007, Agenda**
Member Cassidy motioned for approval of the agenda; seconded by Mr. Romero. The motion carried.

**Approval of June 19, 2007 Minutes**
Member Cassidy motioned for approval of the minutes; seconded by Mr. Romero. The motion carried.

## II. INVESTMENT REPORTS- Month Ended June 30, 2007

**General Fund Report**

Mr. Canavan summarized the investment activity for the General Fund Portfolio.
The market value of the General Fund Investment Portfolio, net of TRANS, on June 30, 2007, was $2.63 billion compared to $2.76 billion at the same point last year and $2.22 billion at the same point two years ago. During the month the market value of the portfolio increased 3.5% to $2.63 billion from $2.54 at May 31. The June month-end balance represents a 6.05% increase from April's month-end $2.48 billion. The yield was 5.11% at month-end, down from 5.14% at the end of May. This drop was due to higher yielding TRAN-matched assets maturing for use in TRAN redemption. The average term of the portfolio increased to 268 days from 233 days May month-end.

The month-end portfolio holdings were 48.6% in U.S. Agency bonds, 19.8% in the overnight repurchase pool, 9.3% in certificates of deposit, 3.8% in money market mutual funds, 16.8% in commercial paper, 1.3% in municipal sponge bonds, and 0.4% in corporate bonds. $351.4 million of investments were purchased for the month: $56.5 million of certificates of deposit were purchased or renewed for the CD portfolio; $269.8 million of sponge bonds were purchased from the State and the City of Albuquerque; $15 million of U.S. Agency securities and $10 million of corporate bonds yielding over 5.50% were purchased for the Core portfolio with May and June 2010 maturities respectively. Earnings for June were $13.2 million, an increase of 2.6% from May earnings of $12.9 million and an increase of 6.2% over June 2006 earnings of $11.3 million. Fiscal year-to-date earnings totaled $149.3 million compared to $97.2 million through the same period last fiscal year.

*Investment Strategy Employed During the Past Quarter*

General Fund investments during the quarter were laddered for the Core segment and cash-matched to known liabilities for the liquidity segment. Investment in asset backed the portfolio. At Quarter end, liquidity was increased substantially to ensure timely TRAN redemption and execution of temporary financing for both state and municipal entities. For the core segment of the portfolio a disciplined approach of investing into sell-offs was used to lock in rates at the higher end of the yield range. Conversely, rallies have been avoided in light of underlying upward trend in rates. This has provided a stronger defensive posture to the portfolio should rates rise, while also optimizing the benefit of extending duration should rates fall. This strategy has served the portfolio well as the core segment outperformed its total return benchmark while generating lower volatility of return.

*Investment Strategy Plan For the Next Quarter*

As the new quarter begins, excess liquidity in the liquidity segment of the portfolio will be drawn down and investments will continue to be cash matched to liabilities. Occasional weighting to either side of the portfolio's maturity targets may occur as market or economic conditions warrant. Month in and month outflows the maturity of WAM of that particular portfolio fluctuates between anywhere from 17days to a high of 45-46 days. The Core segment will not be purchasing collateralized debt, loan, mortgage, or home equity obligations.

*Asset Mix and Maturity*

The liquidity segment of the portfolio will continue to target a weighted average maturity (WAM) from 21 to 45 days remaining either short or long that target as either the market or the state's liquidity needs require. Commercial paper will continue to be purchased for the portfolio, with a preference given to direct-offer CP. As opportunities arise, the fund may purchase agency callable securities, deep in the money, trading to the call as a means of diversifying asset mix while maintaining yield. The core segment of the portfolio was significantly under weight its maturity and duration targets. This condition should likely remain as the 4 to 5 year portion of the yield curve should continue to under perform. Laddering of the portfolio will continue with emphasis placed on selective buying into weakness and the higher end of rate bands. The portfolio should reach duration of 1.5 to 1.6 years during the upcoming quarter.

Member Cassidy asked about the status of reviewing brokers to make sure the brokers are doing what is expected in participating. Mr. Canavan informed the committee he had completed all sureties and provided all background information to Regulation and Licensing; waiting for a final go ahead after reviewing the policy and procedures with management. Member Cassidy asked if the thought process from staff is to do this process over a calendar year or calendar quarter or review them all at once. Member Cassidy recalled that the committee discussed that it would be best to spread the process over a year so there would not be a burden on the staff to review all the brokers at once. Mr. Canavan was not aware of this discussion and thought it was agreed that the process be tiered at once. Within the next few days a meeting will be set up with State Treasurer James Lewis to finalize this process. He also stated that he examined the brokers and there are no violations. All brokers have clear records, no violations, regulatory, or statutory issues. No benchmark or criteria is in place that defines an acceptable level of participation. It is in the process of being defined. Chairperson Mevi stated as previously discussed in last meeting, STO is to develop a process that is more formalized to evaluate existing broker dealers with RLD and Mr. Canavan's research. Need to define how to remove a broker from the broker dealer list; what is the criteria that is in place if there is not enough trades that have gone through with that particular broker. She further stated that currently 17 brokers are in place, with possibly increasing to twenty (20) or twenty-five (25). Where is the comfort level? This issue will be presented either in September or October's STIC meeting.

Member Cassidy stated that PFM was doing the quarterly performance benchmark computations, asked for reminder on how it will be done going forward. Mr. Canavan informed the committee that the computations are now calculated by Northern. The pricing data flows through Northern Trust and we're looking at Northern Trust to be able to obtain the computations. Currently the benchmark numbers are being obtained from Bloomberg and entered into an excel worksheet to calculate the yield.

**New *Mexi*GROW Local Government Investment Pool (LGIP) Report**

Chairperson Mevi informed the committee of the LGIP status. The year-over-year market value if the LGIP portfolio as of June 30 was $970 million, compared to a market value of $713 million at the same period last year and $1.38 billion at the same period two years ago. During the month the market value of the portfolio decreased .3% from $973 million in May to $970 million. Participant contributions were $86.3 million and withdrawals were $90.8 million. The gross yield was 5.33% at June 30, an increase from May month-end of 5.30%. The weighted average maturity at June 30 was 38 days, up from the May 31 weighted average maturity of 33 days and within the S&P-set limit of 50 days.

The month-end portfolio holdings were 6.6% in U.S. government agency securities, 33.3% in A-1+ commercial paper, 60% in AAA money market funds, and 0.1% in the bank account. June investment activity in the LGIP portfolio was comprised of the purchase of $187.6 million in A-1+ commercial paper with an annualized yield of 5.38% and average term of 74 days. LGIP earnings for June totaled $4.2 million, slight increase from May earnings of $4.1 million. Fiscal year-to-date earnings totaled $40.8 million compared to $31.8 million through the same period last fiscal year. The 30-day net yield of the LGIP as of June 30 was 5.25% outperforming the 30-day net S&P Rated Government Investment. Pool (GIP) index (5.1%) by 15 basis points. The 30-day gross yield of the

LGIP at month-end, 5.33% matched the 30-day gross S&P Rated. GIP index of 5.30%. The Administrative fee assessed to participants for May was 4 basis points; fees collected through June 30, the fiscal year-end, totaled $384,000.

*Investment Strategy Employed During the Past Quarter*
In Compliance with the S&P AAAm rating maintained 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% being A-1 (or AA) rated , the portfolio maintained at least 98% of A-1+ rated investments. The weighted Average maturity (WAM) was maintained at least 50 days or less, averaging a 27.5 day WAM during the quarter. Maturity dates of purchased securities were laddered by week to provide constant cash inflows: however, the money market funds continued to be the primary instrument used for liquidity needs due to their competitive short-term rates. Use of A-1+ commercial paper was maximized and longer-term callable agency securities with semi-annual or quarterly call features were reintroduced to the portfolio by quarter-end in order to enhance the overall pool yield.

*Investment Strategy Plan For the Next Quarter*
Compliance with rating criteria will continue to mandate the investing strategy for the LGIP. Investment in commercial paper and agency discount notes will be utilized for shorter-term investments. Callable agency securities will be utilized to enhance yields and extend WAM. AAA rated money market funds will continue to be used for investment, taking advantage of the favorable short-term rates while they last. Additionally, the overnight repurchase pool will be re-introduced to the LGIP.

*Asset Mix and Maturity Targets*
The WAM for the LGIP will be maintained at 50 days or less, but primarily staying within 30 days while short term rates are favorable. Asset allocation will fluctuate between commercial paper, agency discount notes and callable bonds, money market funds, and the overnight repurchase pool depending on the most favorable yield and portfolio investment compliance limits. Commercial paper and agency discounts will be utilized for shorter-term maturities, agency callable securities for longer-term maturities, and money markets for liquidity and investment when advantageous.

**Bonds Proceeds Investment Pools (BPIP) Report**
Mr. Lujan reported that the market value of the Tax-exempt BPIP as of June 30,2007 was $673.4 million. During June the market value of the fund increased 22.9% from $547.76 million to 673.4 million. The approximate $126 million increase was the net result of new issue proceeds ($136 million), property tax revenues, interest earnings, and project expenditures. Earnings for the month were $2.23 million. The month-end yield was 5.15% and the term was 168 days. The Tax-exempt BPIP yield at June 30, 5.15%, was 52 basis points above 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 51.5% in the overnight repurchase pool, 28.1% in U.S. Treasury notes and bills, 19.2% in U.S. Agency bonds, and 1.2% in commercial paper. There were no purchases during June.

**Taxable Bond Proceeds Investment Pool (BPIP)**
Mr. Lujan reported that the market value of the taxable BPIP as of June 30 was $902 million. During June the market value of the fund increased 32.9%, from $678.7 million to $902 million. The approximate $233 million increase was a result of new issue proceeds ($233 million) and project expenditure draws. Interest earnings for the month totaled $2.8 million. The month-end

yield was 5.15% and the term was 226 days. June 30 benchmark yields were: 5.09%: 2-year Constant Maturity Agency 12-month moving average; and, 5.10% Merrill Lynch custom index: 10% of 0-3 year treasury and 90% of the 1-3 year Agency. The breakdown of the month-end portfolio holdings was 37.2% in the overnight repurchase pool, 1.5% in flex repurchase agreements, 40.7% in U.S. Agency notes and bonds, 1.6% in U.S. Treasury notes, and 18.8% in money mutual fund shares. There were no purchases during June.

*Investment Strategy Employed During the Past Quarter*
Both Bond Proceeds Investment Pools invested assets to either a) match debt service liabilities, or b) match estimated project draw liabilities. The amount and timing of outstanding bond issues determines the 'liability' schedule, which in turn, determines the maturity schedule (i.e. ladder) as well as the target weighted average maturity (WAM) of the portfolio. At the end of the quarter both pools were fully invested. That is, all proceeds were invested in the amount up to, and as far as out as, the longest dates liability, thus meeting their WAM targets (320-390 days).

*Investment Strategy Plan for the Next Quarter*
Mr. Lujan mentions that the new quarter brings new bond issue proceeds into the pool, both in the Tax-exempt Pool ($136 million) and the Taxable Pool ($233 million), totaling $369 million. The total of these proceeds will be invested within the next three to six months to match the new issuance-associated liabilities along the entire 0-3 year yield curve.

*Asset Mix and Maturity Targets*
The weighted average maturity of each portfolio met its respective target during the quarter. With new bond issuance, however, both portfolios are once again short to their targets and in need of further investment. Much of the planned investment will be in treasury and agency securities as well as corporate bonds and certain asset-basked securities/ Almost nine months since inception, it should be noted that most of the legacy flexible repurchase agreements (often yielding as low as 2%) have matured and been reinvested in higher yielding securities (between 4.8% and 5.3%), making a large difference between the current quarter-end yield of approximately 5.15% and the approximately 4.6% yield at the inception date.

**Economic and Investment Outlook**
Mr. Mark Canavan presented June's Economic and Investment Outlook stating the economy would continue to expand and that the most likely path for rates was up. As outlined in the report, Merrill Lynch, Goldman Sachs, UBS and others all predicted the Federal Reserve would have to reduce Fed Funds as low as 4.5% by the end of 2007 to fend off a real estate triggered U.S. recession. The market showed an 82.7 percent likelihood of at least one rate cut prior to the end of the year, and a 24.8 percent likelihood of two rate cuts. Market expectations have shifted from an 82.7 percent likelihood of a rate cut to an 84.3 percent expectation that rates will remain the same or go higher. Two year Treasury notes hit an intra-day high of 5.10 in mid June. This was followed by a rally back to 4.84 with a subsequent sell off ending June at 4.95 percent.

As was outlined, the General Fund Core Portfolio will continue to be laddered. Investments will begin to be purchased in the 24 to 46 month time horizon to further extend portfolio duration. It is anticipated portfolio duration will be extended to 1.5 years during the next 30 days, but will remain short the benchmark duration as the 2 to 3 year portion of the curve exhibits the best risk return profile. As credit spreads have widened significantly, STO will continue to look for opportunities to enhance yield using high-grade corporate bonds.

General Fund Liquidity Portfolio will continue to be cash matched. Commercial paper investments will show a preference toward direct corporate obligations and Asset Backed CP programs with high levels of credit enhancement. The Bond Proceeds Investment Pool is currently analyzing the liability structure of recently received bond proceeds and will be layering liability matching investments over current pool assets commensurate with new debt service and cash draw requirements. The Local Government Investment Pool is actively pursing a pool specific overnight repurchase agreement program for yield enhancement and diversification. It is anticipated that once this program is in place a percentage of mutual fund assets will be drawn down and redeployed into the overnight program.

## III. CASH MANAGEMENT REPORT- Month Ended May 2007

**State Fund Deposit Activity for the month ending May 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 ending May, 2007. State Funds for the month ending May 2007 included 293 funds with a total balance of $78,989,794; non-State funds totaled 198 funds with a total balance of $27,080,018; total State Agency balances were $106,069,812, totaling 491 accounts. There were 10 State funds that were closed and 2 non-State funds were opened during the month.

**Collateral Report**

Mr. Mark Canavan reported one financial institution was out of compliance for the month: Century Bank was under collateralized by $36,727. The lack of collateral was due to an increase of deposits. All other institutions met the minimum collateral requirement of their quarterly risk assessments. At month end, no flexible repurchase agreement counterparties were out of compliance with their agreements which require 102% collateral. During the month of June, Morgan Stanley was four (4) days out of compliance; meanwhile, Citigroup was in full compliance during the month.

## IV. STAFF REPORTS

**Quarterly Ended March 31, 2007 Investment Audit- Meyners & Co.**

Meyners & Co representatives, Pat Wilkins and Mike Easely, summarized performed procedures, which were similar to those of the prior two quarters. Reviewed all trades and all reconciliations, in addition, the scope of work did not change. Meyners & Co findings consisted of: all purchases of securities were allowed by policy. Bids were obtained on all purchases. Transactions paperwork was properly signed by the trader and approved; however, three transactions exceeding $25 million did not have the proper second approval. Investment ratings were in compliance on all purchases. Maturity dates were in compliance on all purchases. The requirements for the second approval on all trades were overlooked on the three executed trade documents during the quarter. Going forward, the Treasurer or designees will perform the correct number of reviews on all executed trade documents. MCO reviewed the controls in place to ensure compliance with policy. MCO noted that all policy criteria were met, except for the finding noted concerning second approval on purchases exceeding 25 million.

Mr. Canavan asked if there will be another review to check the trade pricing. MCO stated the test has not been done with this quarterly review but will be analyzed in the next quarter (Year End) Audit. Chairperson Mevi requested an update in regard to the out of state banks issue. MCO informed the committee that they spoke with Harvest Investments and a list of designated banks was supplied. It is valid to use these banks but the specific banks were not chartered in New Mexico. Chairperson Mevi informed the committee that Regulations and Licensing was contacted and information was provided to MCO that charter is recognized on a federal level for financial institutions. A bank can be chartered within one of the states in the U.S. and is recognized to do business within all fifty (50) states.

**Investment Policy**

Chairperson Mevi informed the committee that, by policy, it is required to revisit the investment policy internally once year as well as externally to the Board of Finance every two years. Proposed revisions may clarify some issues and also include some language that is statutory allowed but not included in previous policy. Chairperson Mevi presented the revisions and discussed changes from the redlined investment policy. In discussion, questions were asked as to why such changes are proposed. One of the changes, under Internal Controls (D) number 3, was modified by the State Treasurer so that actions which may impact the agency's budget can be left to his judgment, in the best interest of the Treasurer's Office, even when line item appropriation is in place. Chairperson Mevi will inform State Treasurer on STIC members concerns regarding this change. Some of the other recommended attempt to include in policy what is statue. Request for review and changes to the Investment Policy will be accepted until August 15, 2007. It was agreed that action on the approval of revisions be posted to the September STIC meeting.

**V. NEXT MEETING**

Wednesday, September 12, 2007 9:00 a.m.

**VI. ADJOURNMENT**

Chairperson Mevi motioned to adjourn the meeting; seconded by Mr. Romero, the meeting was adjourned at 10:50 a.m.