

STATE INVESTMENT COMMISSION

June 19, 2006

MINUTES

The State Investment Commission was called to order by Jonathan Miller, State Treasurer, on Monday, June 19, 2006 in Room 76 of the Capitol Annex at 2:00 p.m. Members present were John Farris, Secretary, Finance and Administration Cabinet; Libby Milligan, proxy for Governor Ernie Fletcher; and Jonathan Miller, State Treasurer.

Treasurer Miller verified that a quorum was present and that the press had been notified of the meeting.

A motion was made by Mr. Farris and seconded by Ms. Milligan to accept the minutes of the March 20, 2006 meeting. Motion CARRIED.

Dwight Price, Portfolio Manager, Office of Financial Management, distributed a handout to the members which illustrated the market value of the Commonwealth's portfolio in over a six year period. Mr. Price pointed out in May 2004 the market value decreased because Tax and Revenue Anticipation Notes (TRAN) were not issued that year. He further noted that the portfolio has increased and the present value is approximately \$4.5 billion. Mr. Price predicted that value would decrease in July 2006 as the TRAN decreased for this year. Mr. Price pointed out that all of the General Fund accounts were moved from the Intermediate Pool in May 2006 to the Short-Term Pool. He added that the balance in the Short-Term Pool is approximate \$1.6 billion.

Secretary Farris asked how much of the \$4.5 billion was invested. Mr. Price indicated that all of the \$4.5 billion is invested daily. Steve Jones, Portfolio Manager, Office of Financial Management, pointed out that the cash balance in the portfolio at the end of the day is less than one million dollars. Mr. Price stated that the Commonwealth earns money on the balance each day because the bank is required to pay the Commonwealth fed funds minus twenty- five basis points on the balance in the portfolio.

Mr. Jones presented an update on the TRAN and the interest rate swap. Mr. Jones stated that TRANs were issued in July 2005 and will be outstanding until June 28, 2006. Mr. Jones stated that the Commonwealth entered into an interest rate swap to hedge the assets and all of the funds were invested. Mr. Jones indicated that the net earnings through May 31, 2006 are approximately \$6 million. Mr. Jones added that in addition, \$300,000 in fees will be available to cover expenses for the Commonwealth. Mr. Jones expects that the TRANs will earn approximately \$6 million by the end of the fiscal year. He indicated that \$150,000,000 in Tax and Revenue Anticipation Notes are expected to be issued in FY 2007. He added that the TRANs are expected to be priced the week of June 21, 2006 with a settlement date of July 3, 2006, and a maturity date of June 28, 2007. Mr. Jones indicated the Commonwealth will enter into an interest rate swap to hedge the assets and expect to receive a fixed rate of 5.60 percent on the fixed side of the swap and pay LIBOR (flat) on the floating side of the swap. He further

indicated that the assets are expected to be invested at LIBOR (flat) as well. Mr. Jones noted that on the asset side to the floating side of the swap no earnings are expected, but on the fixed debt to the fixed side of the swap net earnings are expected to be approximately \$2 million. Mr. Jones noted, however, that these projections are subject to market conditions and could change.

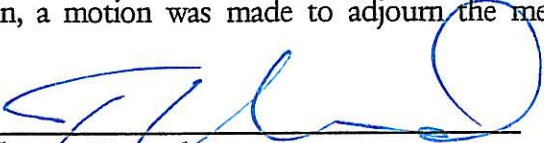
Treasurer Miller asked why the net earnings were less than last year. Mr. Jones noted that it was due to the size of the TRAN. Treasurer Miller asked why the TRAN was smaller this year. F. Thomas Howard, Executive Director, Office of Financial Management stated that the year end balance will be greater than in past years reducing the amount of the projected deficit.

Mr. Jones discussed the Interest Rate Steepener. He explained that in December 2005, the treasury yield curve inverted from two years to five years (two year rate was higher than five year rate) and the Commonwealth executed two swaps with Goldman Sachs. Mr. Jones stated that the situation continued and in February 2006 the Commonwealth executed two swaps with Merrill Lynch. In April 2006 the swap positions were unwound for net earnings of approximately \$70,000 which provided a hedge against a portion of the portfolio. Mr. Jones informed the members that since the swap was unwound, the yield curve had again inverted. As a result, it was decided to reload the swap position. Mr. Jones stated that a swap with Wachovia was executed where the Commonwealth was the fixed rate payer on a five-year swap and the fixed rate receiver on a two-year swap. Mr. Jones noted these were offsetting positions where if interest rates go up or down at the same steepness, the position should not be affected. He continued that if the yield curve steepens, the Commonwealth would net earnings much like the previous swaps. Mr. Jones stated that, in addition, the Commonwealth is earning approximately \$4,000 a year for having the position in place. Mr. Jones noted that since the trade was executed last week, earnings of \$8,000 have been accrued.

Mr. Price discussed the proposed list of broker dealers. He noted that this list is approved each year at this time for the coming fiscal year. He indicated that Cantor Fitzgerald, HSBC Securities Inc, and Raymond Jones have been added as non-primary dealers. Mr. Price noted that if firms meet the criteria set forth in 200 KRS 14.011(9) they are added to the list, but he pointed out that the Commonwealth does not have a relationship with all of the firms on the list.

A motion was made by Secretary Farris and seconded by Ms. Milligan to approve the Broker-Dealer List for FY 2007. Motion CARRIED and the Broker/Dealer List for FY 2007 was approved.

With no further business before the Commission, a motion was made to adjourn the meeting. Motion CARRIED.



F. Thomas Howard, Secretary
State Investment Commission