

STATE INVESTMENT COMMISSION
SEPTEMBER 25, 2009
MINUTES

The State Investment Commission Meeting was called to order on Friday, September 25, 2009 at 2:00 p.m. in Room 182 of the Capitol Annex by Todd Hollenbach, State Treasurer. Other members present were Ed Ross, proxy for Jonathan Miller, Secretary of the Finance and Administration Cabinet; Edmund Sauer, proxy for Governor Steve Beshear; and George Spragens, President, Farmers National Bank in Lebanon, Kentucky.

OFM Staff Present: Tom Howard, Executive Director, and secretary to the Commission, Steve Jones, Dwight Price, and Marcia Adams.

Other Guests: Mary John Celletti, Deputy Treasurer, Kristi Culpepper and Kelly Dudley from LRC.

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

Treasurer Hollenbach called for a motion to approve the minutes from June 12, 2009. A motion was made by Mr. George Spragens and seconded by Edmund Sauer to approve minutes as written. Motion **CARRIED**.

MARKET COMMENTARY – Mr. Dwight Price explained that market spreads are almost back to year ago levels. Treasuries rates are very low with two years down to 1%, thirty years down to 4% and T-bills as low as one basis point. Agency spreads are tight, and mortgage spreads are tightening. Mr. Steve Jones added that of all the Treasury issuance during the last year, the Federal Reserve has bought 60%. Of agency issuance, the Federal Reserve has purchased 80%, and of the agency mortgage-backed securities issued through the last year, the Federal Reserve has purchased 120%, or more than has been created.

Treasurer Hollenbach asked what was happening in the commercial real estate market. Mr. Price stated that it may be the next market affected by the downturn. Wall Street Journal articles are reporting that some banks have written down larger, \$20,000,000 plus size loans. Mr. Spragens added the FDIC wants the mid-sized banks to recognize their losses on loans by writing down loans that are not performing. State banks examinations are focusing more on safety and soundness of financials and compliance to regulations. Treasurer Hollenbach asked again if there was any thing the Commission needs to do to stay ahead of this issue. Mr. Jones answered that the Commonwealth has three Commercial Mortgage-Backed Securities (CMBS), of which two are performing perfectly while the third is in default, and will be discussed shortly. Mr. Price stated that the Commonwealth has very little exposure in this market. The U.S. may be out of recession according to Federal Reserve Chairman Bernake, but real economic growth will remain subdued at 1 to 2%. The U.S. will not see a significant improvement in unemployment for quite awhile. Mr. Price added that employment growth always lags after a recession with unemployment currently at 9.7%. On the other hand, the stock market is up 48% since March.

TRAN - Mr. Jones stated this would be the last TRAN (Tax Revenue Anticipation Note) for a while. The final income number of \$7.6 million for the FY 2009 TRAN, beating the projection of only \$5.9 million.

Securities Update - Mr. Price discussed the list of downgraded asset-backed securities that the Commonwealth holds. These securities continue to make full principal and interest payments every month. The unrealized market loss is \$2.3 million less than at the end of June. Mr. Jones continued with discussion of the thirteen downgraded securities. The par value outstanding has dropped from over \$100 million to \$84 million as securities make monthly paydowns. The Washington Mutual credit card deal is up for credit review for possible upgrade from the rating agencies. Treasurer Hollenbach asked if all the forbearance has been beneficial compared to liquidating these securities. Mr. Jones answered affirmatively as the market for these has improved. Several of these securities are in better shape than the ratings indicate. Mr. Ross asked what the maturity was on most of these. Mr. Jones responded anywhere from a month to about 4 years. Mr. Jones also pointed out that this list should be dwindling as securities mature and market conditions allow for gradual liquidations. By holding up until now, the Commonwealth has avoided realizing losses and has received principal at par. If the Federal Reserve pushes rates up in the next year, then market values should improve further as these securities are floating rate.

Mr. Spragens made the motion to extend forbearance for the Commonwealth to continue to hold the list of downgraded securities. The motion was seconded by Mr. Ross. Motion **CARRIED**.

Mr. Jones added that the overnight repo money has be redeployed into a government-backed NOW Account at nearly 50 basis points of yield. The program has been extended from December 31, 2009 to June 30, 2010. The Commonwealth will continue to use this investment approach.

Other Business – Next meeting date will be scheduled in December.

A motion was made by Edmund Sauer and seconded by Mr. Spragens to adjourn the meeting. Motion **CARRIED**.

Respectfully submitted,

F. Thomas Howard
Secretary