STATE INVESTMENT COMMISSION
MINUTES
DECEMBER 13, 2023
2:30 PM

The State Investment Commission ("SIC" or "the Commission") meeting was called to order on Wednesday, December 13, 2023, in Conference Room C106 of the Transportation Cabinet Office Building by Lorran Ferguson, proxy for Kentucky State Treasurer Allison Ball. Ms. Ferguson asked for a roll call. Other members present were Mr. Joe McDaniel, State Controller, Office of the Controller; Geri Grigsby, proxy for Holly M. Johnson, Secretary, Finance and Administration Cabinet ("FAC"); and Paul Goodpaster, representing the Bluegrass Bankers Association.

Office of Financial Management ("OFM") Staff Present: Ryan Barrow, Executive Director of OFM; Kim Bechtel, Deputy Executive Director of OFM; Amber Lee; Daniel Auxier; Richard Osborn; and Aubry McDonald.

Other Guests: Matt Frey, State Treasury.

Ms. Ferguson verified a quorum was present, and the press was notified of the meeting.

Ms. Ferguson called for a motion to approve the minutes from the September 12, 2023, meeting. A motion was made by Mr. McDaniel and was seconded by Ms. Grigsby to approve the minutes. Motion **CARRIED**.

Compliance Reporting – Mr. Barrow referred to the letter in the packet and stated there were no Statute or Administrative Regulation violations during the reporting period.

Market Overview – Mr. Auxier directed the Commission's attention to Attachment C, Market Overview. He stated for the first time since presenting the market overview at the beginning of the year, he could finally report that the rate hiking cycle appears to be over and rate cuts are on the horizon for next year. At least that's the current consensus with inflation hovering around 3% and the job market finally beginning to show signs of softening. Usually a chart of the 2-year treasury would be included because it's more relevant to our portfolios, but this time he wanted to highlight the 10-year treasury, because of how clearly it demonstrates the fall in long-term interest rates over the past quarter. After topping 5% in October, the 10-year yield has plummeted 85 basis points, a remarkable drop for a short period of time. He then directed the Commission to the following page showing information on the current yield curve. While the curve remained inverted and shorter-term yields continued to outpace longer-term, there was some noticeable flattening over the past three months. While yields on both ends of the curve have fallen recently, the drop was larger on the short end, meaning a less-inverted curve overall. This can be seen in the 2-10 spread benchmark, which narrowed 35 basis points over the past quarter. A drop in yields across the curve was mentioned, but they remained extremely high by recent historical standards. Because of this, our portfolios have posted over $275 million in earnings FYTD with seven months remaining. This compares to $344 million in earnings for all of FY23 fiscal year to date. These earnings are substantial and make a material difference to state revenue calculations but they will not last forever, at least not at this level. When the Federal Reserve finally does begin to cut rates, portfolio earnings will begin to fall. This will also result in a normalization of the yield curve, which means longer duration securities, such as those found in the Intermediate portfolio, will begin to earn more than those on the shorter end. The final page of Attachment C a graph of the headline inflation rate was presented showing how dramatically it's fallen in the past year. Despite this sudden drop, it wasn't until this current quarter that a broad consensus was reached that the threat of high inflation was finally extinguished from the current economic cycle. He stated, arguably the most difficult part for the Fed begins now. Cutting too soon could spur spending and reignite inflation, especially since the job market has remained surprisingly resilient. However, leaving rates too high for too long could tip the economy into a recession. The goal is the so-called "soft-landing" where the Fed manages to reduce interest rates without triggering a recession. Time will tell if that goal can be achieved. The Commission took no action.

Cash Flow – Mr. Osborn presented the Monthly Average Investable Balances Cash Flow Summary. Looking at the fiscal year 2024, represented by the red line, the average investable balance stood at about $12.5 billion. He noted the receipts in the General Fund, September, receipts rose 6.1% compared to September of 2022. October, receipts rose 1.9% compared to October of 2022. November, receipts fell 2.7% compared to November of 2022. This brings the year-to-date receipts up 3.9%. The Commission took no action.

Short Term Pool – Ms. Lee directed the Commission to Attachment E, stating a few changes were made to the Short-Term Portfolio attachment since the September meeting to include more information. On PDF page 17, you can see the Average Investable Balances for fiscal years 2022 to 2024. Looking at fiscal year 2024, represented by the red bar, you can see that the average investable balance for November was just under $6 billion and has hovered around $5.8 billion since July. The next page shows the Short Term Pool Portfolio Composition as of November 30th. US Treasury Debt made up about 30% of the portfolio, US Government Agency Debt 49%, Government Money Market Funds 19%, and Repurchase Agreements less than 2%. Since the September meeting, the money market fund allocation decreased by nearly 11% allowing an increase to be made to the allocation in US Government Agency Debt by 11%, which extended duration and increased yields. She then directed the Commission to page 19 of the PDF, Portfolio Performance and showed numbers as of November 30th. The orange bar represents the Short Term Pool and the dark blue bar represents the benchmark, which is the Fed Funds Rate Index. As you can see, the portfolio has outperformed the benchmark for all time periods listed. She also noted that the inception date is July 2022 and would be added to the axis label for the next meeting. The Commission took no action.

Limited Term Pool – Ms. Bechtel presented the Limited Term Pool monthly report and directed the Commission to the Limited Term Pool monthly performance graph, Attachment F on page 22. She stated that the performance graph compares the performance of the portfolio to the Benchmarks. This being the Local Government Investment Pool and the Fed Funds Rate Index. The portfolio performance is lower than Benchmark A but slightly higher than Benchmark B in the month of November. She then directed the Commission to page 23 of the PDF, detailing the current list of securities for the Limited Pool as of the end of November. The total portfolio is slightly under $3.0 billion which is an increase of approximately 30 million from the previous month.

The next page illustrated the Pool Ratings and Sector Distribution. The portfolio is invested in high quality assets and the Sector Distribution shows that the portfolio continues to be invested in Treasury and Government Agency Securities.

Ms. Bechtel pointed out the Liquidity and Maturity page, the Limited Pool continues to stay within the guidelines for Maturity and Liquidity. For November, the Weighted Average Maturity was 24 days, and the last three-month average being around 30 days. The daily liquidity is 36% and weekly 46% for November which is above the requirements. Ms. Bechtel directed the Commission to page 26 of the PDF, showing the Net Asset Value graph of the Limited Portfolio. The line of the shadow NAV continues to show slight fluctuations in value but has not exceeded 0.0025 level to trigger a notification to SIC. She stated the maximum divergence is 0.0005871 which occurred on November 23, 2022, and is still within guidelines. She then directed the Commission to the final document under Attachment F showing the memo detailing transactions and largest accounts in the portfolio. The largest daily withdrawals occurred in the Medicaid Benefits Account in September and the University of Kentucky in September and October. The largest accounts were the University of Kentucky, Medicaid, and Personnel Health Self Insurance account. She ended by stating the staff will continue to maintain daily and weekly liquidity of 15% and 30% respectively. The Commission took no action.

Intermediate Pool Performance – Mr. Auxier directed the Commission to page 30 of Attachment G, titled Intermediate Term Pool Fundamentals. The past quarter has seen the usual rise in balances as inflows into the portfolio increased as they typically do towards the end of the calendar year. Sector allocation remained roughly the same, with the only significant difference being the continued rise in corporate allocations which stood at 0.2% this time last year and now sitting at 3.6%. On the next page is the Intermediate Pool Performance. The portfolio continues to perform as expected, largely ending up in between the two benchmarks based on duration. Year to date, the Intermediate Portfolio outperformed both benchmarks. The Commission took no action.

Credit Considerations – Mr. Auxier directed the Commission to the first page of Attachment H and presented that there were no changes in this quarter, and he asked for the Commission's approval as presented. Ms. Ferguson called for a motion. A motion was made by Mr. Goodpaster and was seconded by Ms. Grigsby. Motion **CARRIED**.

Repurchase Agreement Amount – Ms. Bechtel directed the Commission to page 35, a memo regarding Repurchase Agreement Amounts. She then gave some background stating that Repurchase Agreements were overnight investments where cash is sent to a counterparty in exchange for securities. The total repurchase amount is then allocated in processing. Staff is documenting a new internal guideline of $400 Million per counterparty in the Investment Manual and implementing the increase in repo with the current counterparties. She stated the total average portfolio amount for FY2015 to FY2019 was approximately $3.5 billion with an exposure rate per counterparty of 5.7%. Now, the total portfolio amount is approximately $12 billion with an exposure rate of 1.6%. By increasing the limit to $400 million, it will be slightly above 3%. The increase in repo will reduce the likelihood of a negative repo allocation for an individual portfolio. The current counterparties are The Bank of Nova Scotia and Cantor Fitzgerald LP. Scotia is a strong financial institution and the collateral pledged at Bank of New York is Agency Mortgages.

Cantor is privately owned, and the collateral pledged at Bank of New York is U.S. Treasuries. Staff will continue to monitor the counterparty's financials and pledged collateral. If there are concerns about a repo counterparty, staff will reduce the amount or completely exit the transaction. Ms. Grigsby asked if the update would be temporary or permanent and Mr. Barrow stated that it would be permanent. Some additional discussion took place on the update and the Commission took no action.

FHLB Cincinnati Letter of Credit Program – Mr. Barrow directed the Commission to Attachment J, the FHLB Cincinnati Letter of Credit Program. Mr. Barrow stated that due to the concerns on the Letter of Credit from the last meeting they included information on FHLB Cincinnati providing an overview and to help with any additional questions/concerns. Additional discussion took place on the Letter of Credit, but the Commission took no action.

There being no further business, Ms. Ferguson called for a motion to adjourn. Mr. Goodpaster made a motion to adjourn which was seconded by Mr. McDaniel. With no further business before the Commission, the meeting adjourned at 2:54 PM ET.

Respectfully submitted,

Ryan Barrow

Ryan Barrow
Secretary