

STATE INVESTMENT COMMISSION
MINUTES
SEPTEMBER 10, 2024
2:30 PM

The State Investment Commission (“SIC” or “the Commission”) meeting was called to order on Tuesday, September 10, 2024, in Conference Room C106 of the Transportation Cabinet Office Building by Mark Metcalf, Kentucky State Treasury. Treasurer Metcalf asked for a roll call. Other members present were Geri Grigsby, proxy for Secretary Holly M. Johnson, Finance and Administration Cabinet (“FAC”); Controller Joe McDaniel, Office of the Controller; Mark Johnson, representing the Kentucky Bankers Association; and Paul Goodpaster, representing the Bluegrass Bankers Association.

Office of Financial Management (“OFM”) Staff Present: Kim Bechtel, Deputy Executive Director of OFM; Amber Lee; Daniel Auxier; and Aubry McDonald.

Other Guests: Robert Gullette and Sam Burchett, Kentucky State Treasury; and Ryan Barrow, Executive Director of Kentucky Public Pensions Authority.

Treasurer Metcalf verified a quorum was present, and the press was notified of the meeting.

Treasurer Metcalf called for a motion to approve the minutes from the June 18, 2024, meeting. A motion was made by Ms. Grigsby and was seconded by Mr. Goodpaster to approve the minutes. Motion **CARRIED**.

SIC Resolution Honoring Ryan Barrow – Treasurer Metcalf presented Resolution 2024-01 of the State Investment Commission of the Commonwealth of Kentucky for recognition of outstanding service by Ryan Barrow, Secretary to the Commission and as Executive Director of the Office of Financial Management.

Treasurer Metcalf called for a motion to approve Resolution **2024-01**. Mr. McDaniel made a motion to approve which was seconded by Mr. Johnson. The motion **CARRIED** and Resolution **2024-01** was **ADOPTED**.

Appointment of Secretary, Chelsey Couch – Treasurer Metcalf presented Resolution 2024-02 of the State Investment Commission of the Commonwealth of Kentucky appointing a Secretary of the Commission. As the new Executive Director of OFM, Ms. Chelsey Couch was appointed as Secretary.

Treasurer Metcalf called for a motion to approve Resolution **2024-02**. Ms. Grigsby made a motion to approve which was seconded by Mr. Johnson. The motion **CARRIED** and Resolution **2024-02** was **ADOPTED**.

Compliance Reporting – Ms. Bechtel 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 E, Market Overview. He stated the economic mood had certainly shifted since the second quarter and the catalyst for that was the July jobs report. For months the Fed have been looking for weakness in the job data to justify cutting rates and it finally showed up when July job creation came in at only 114,000 and was subsequently revised downward to 89,000. Immediately it became an almost certainty that federal funds rate would be cut at the September 18th meeting and there was a decent possibility of 50 basis point cut. Traders priced in a 29% possibility of the cutting cycle kicking off with a double cut. By the end of the year, nearly four and a half cuts have been priced in over only three meetings, so the belief is that if a 50 basis point cut doesn’t occur this month, it will happen at either or possibly both the November and December meetings. The effect of this change in expectations can be seen in the chart on the right which shows the yield of a two-year treasury. Since the packet was finalized, the yield has dropped even further than the chart shows and currently sits at 3.66%, the lowest it’s been since September of 2022. He then directed the Commission to the following page, you will see a chart of the entire yield curve as it was at the end of August. While the short-end remains elevated and will continue to do so until rates are actually cut, the inversion on the longer end has all but reversed itself with the two/ten spread sitting very close to even at the moment. Despite significant drops in the medium to long-term, yields overall remain high and the earnings of our portfolios reflect this. For FY2024 total earnings more than \$670,000,000 were posted, nearly double FY2023. In July the General Fund alone posted an investment gain of \$37,600,000, the highest ever recorded. He then directed the Commission to the next page chart of the headline consumer price index. Mr. Auxier stated that, while enormous progress has been made since 2022, you can clearly see that the decent stalled this year between 3% and 3.5%. Considering the long-term inflation goal is 2%, this explains the Fed’s hesitation to begin cutting rates and why the first cut keeps getting pushed back. While at least one cut is all but guaranteed at next week’s meeting, it remains to be seen just how fast rates will normalize and what effect that will have on the job and inflation data going forward.

The Commission was then directed to page 18, shown there was an additional topic that was included for the meeting. He then discussed market shocks and what effects they have on the portfolios. About a month ago, a great example of this occurred. What’s called the Japanese yen carry trade began to unwind, and the effects on global markets was immediate and significant. The short version is because the Bank of Japan kept interest rates at zero for so long, a popular trade was to borrow cheap yen and then reinvest that money into higher yielding securities. This worked right up until the Bank of Japan unexpectedly raised the interest rate and suddenly traders around the globe were forced to sell securities to pay back a now more expensive yen. The Japanese market dropped 12% in a day and the Dow lost over 1000 points. The biggest effect was seen in the two-year treasury, which dropped a remarkable 50 basis points over a three-day span. Because this event coincided with the very poor July jobs report, overnight market participants became convinced a recession was on the horizon and yields began to reflect that belief. While there was a sharp bounce-back afterwards, the two-year yield never fully recovered to where it was the beginning of August. Page 19 showed an example of what effect something like this has on portfolios. With such a steep drop in bond yields over a short period of time, the Intermediate Pool saw large unrealized gains that day. The \$11,600,000 gain equates to a nearly 26% annualized yield if it was maintained for an entire year, which it of course is not. This illustrated an important point that while market shocks can seem dramatic at the time, because of the buy-and-hold strategy

and a longer time frame, in the end they don't matter a whole lot. Simply any chaos can be waited out in the market. The Commission took no action.

Cash Flow – Ms. Lee presented the Monthly Average Investable Balances Cash Flow Summary. A change was made and the FY 2017 - 2019 trend line was removed as the total average balance has remained well above those numbers and continued to grow. Looking at the fiscal year 2025, represented by the red line, the average investable balance for the month of July stood at nearly \$14.8 billion. This is an increase in over \$2 billion compared to last July. She noted the receipts in the General Fund for July, rose 12.2% compared to July of 2023. The Commission took no action.

Short Term Pool – Ms. Lee directed the Commission to Attachment G, on PDF page 23, you can see the Average Investable Balances Graph. The average investable balance in the Short Pool was just over \$6.2 billion, which is about \$1.2 billion less than June. This was due to more spending that typically happens at the beginning of the fiscal year and a billion dollar transfer from the short-term to the intermediate pool related to House Bill 1 spending. She then directed the Commission to the next page showing the Short Term Pool Portfolio Composition as of July 31st. US Treasury Debt made up 44.3% of the portfolio, US Government Agency Debt 33.1%, Government Money Market Funds 16.6%, Repurchase Agreements 4.5% and Commercial Paper 1.5%. Due to the large cash transfer, the allocation to money market funds decreased about 7%, increasing the percent allocated to the other groups when compared to the composition since the last meeting. Page 25, the Portfolio Performance, the orange bar represents the Short Term Pool and the dark blue bar represents the benchmark, which is the Fed Funds Rate Index. As of July 31st, the short-term portfolio outperformed the benchmark for all time-periods listed. 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 H on page 28. She stated for July the one month return of 0.453% slightly underperformed the benchmarks. The next page, the Limited Pool Holdings Summary, the total amortized cost as of July 31, 2024, was slightly over \$2.7 billion with a net outflow of approximately \$232 million for the month.

Ms. Bechtel directed the Commission to page 30 which detailed the Pool Ratings and Sector Distribution. The credit rating distribution percentages based on short term and long term ratings are on the left side of the page. The right side of the page, the distribution was mainly invested in U.S. Treasuries at 24%, government agencies at 40% and money market funds at 24% of the Pool. Moving forward to the Liquidity and Maturity page, the Limited Pool continued to stay within guidelines. As of July 31, 2024, the Weighted Average Maturity was 26 days with the last three-month average at 30 days. The daily liquidity was 34.6% with weekly at 41.9% and remained above requirements. She then directed the Commission to page 32 for the Limited Pool, Net Asset Value graph. The line of the shadow NAV continued to show slight fluctuations in value but has not exceeded 0.0025 level to trigger a notification to SIC.

The final document under attachment H is the Limited Pool Liquidity Analysis detailing transactions and largest accounts in the portfolio. The largest daily withdrawals occurred in the Medicaid Trust and Benefits, Turnpike Authority and University of Kentucky Accounts in June and July. The largest accounts for July were University of Kentucky, Personnel Self-Insurance and

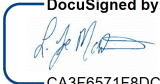
Medicaid Benefits Fund. The staff will continue to maintain daily and weekly liquidity of 15% and 30%, respectively. The Commission took no action.

Intermediate Pool Performance – Mr. Auxier directed the Commission to page 36 of Attachment I, titled Intermediate Term Pool Fundamentals. There had been quite a bit of cash flow activity in the past three months with over \$1 billion being transferred from the short-term pool in intermediate at the beginning of July. This resulted with House Bill 1 authorizing large one-time spending from the budget reserve trust fund for numerous projects. This inflow of cash caused a significant change in sector allocation. Due to uncertainty on how long the new money would remain in the pool, nearly all of it was placed into money market funds. This not only keeps it liquid in case it's withdrawn, but with the yield curve still inverted, also yields more than investing it further out the curve. This change can be seen in the portfolio duration which dropped to .74 in July compared to .96 the month before. On the following page you can see intermediate pool performance. The pool continues to perform as expected, falling in between both benchmarks and even exceeding them both for the six-month and one-year time frames. The Commission took no action.

Credit Considerations – Mr. Auxier directed the Commission to the first page of Attachment J and stated that it was very simple this time, there were no changes this quarter. This item will require approval from the Commission. Treasurer Metcalf called for a motion. A motion was made by Mr. Goodpaster and was seconded by Mr. McDaniel. Motion **CARRIED**.

There being no further business, Treasurer Metcalf called for a motion to adjourn. Mr. Goodpaster made a motion to adjourn which was seconded by Mr. Johnson. With no further business before the Commission, the meeting adjourned at 3:00 PM ET.

Respectfully submitted,

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Secretary