

STATE INVESTMENT COMMISSION
MINUTES
MARCH 14, 2023
2:30 PM

The State Investment Commission (“SIC” or “the Commission”) meeting was called to order on Tuesday, March 14, 2023, in Conference Room C106 of the Transportation Cabinet Office Building by Allison Ball, Kentucky State Treasurer. Treasurer Ball asked for a roll call. Other members present were Mr. Joe McDaniel, Acting 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; Steve Starkweather, Deputy Executive Director of OFM; Kim Bechtel; Amber Lee; Daniel Auxier; Bethany Padgett and Aubry McDonald.

Other Guests: Brittany Warford, Special Assistant, State Treasurer and Mr. Ed Ross.

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

Treasurer Ball called for a motion to approve the minutes from the December 6, 2022, meeting. A motion was made by Mr. Goodpaster and was seconded by Mr. McDaniel to approve the minutes. Motion **CARRIED**.

Treasurer Ball presents **Resolution 2023-01**:

A RESOLUTION OF THE STATE INVESTMENT COMMISSION OF THE COMMONWEALTH OF KENTUCKY FOR RECOGNITION OF LONG AND OUTSTANDING SERVICE BY EDGAR C. ROSS, AS A MEMBER TO THE COMMISSION AND AS STATE CONTROLLER OF THE OFFICE OF THE CONTROLLER.

Treasurer Ball presented Resolution 2023-01 for the approval of the State Investment Commission of the Commonwealth of Kentucky honoring Mr. Edgar C. Ross, recognizing that he has dedicated his time and energy on behalf of the Commonwealth, fifty-five years in State Government, with responsibility as a member to the Commission from June 2021 to November 2022. She expressed her sincerest appreciation to Mr. Ross for his dedication, valued advice, and professionalism during his service with the Office of the Controller and assistance to the Commission and wished him best wishes in his retirement. Staff recommends approval.

A motion to approve the Resolution 2023-01 was made by Mr. McDaniel and was seconded by Ms. Grigsby. Motion **CARRIED**.

Compliance Reporting – Stated within the packet there were no Statute or Administrative Regulation violations during the reporting period.

Cash Flow – Ms. Lee presented the Monthly Average Investable Balances Cash Flow Summary. The dark blue line is fiscal year 2023, at the end of February, we stood at about \$11.5 billion. The General Fund receipts rose 3.3% for December, compared to December 2021. For January they increased 6.2%, compared to February 2022. This brought the year-to-date receipts up 6.4%. The Commission took no action.

Short Term Pool – Mr. Barrow gave a brief introduction and Ms. Lee presented the Short Term Pool. Ms. Lee explained that in January, the team decided to adjust the investment strategy of the Short Term Pool portfolio by investing in two additional sectors, Short Treasury and Government Agency Securities, to increase yields while maintaining liquidity for the pool. Treasury Bills and Discount Notes will make up around 50% of the portfolio. The remainder will be held in Government Money Market Funds and Repurchase Agreements. The intention is to treat the portfolio similar to a Government Money Market Fund and will make further adjustments as needed. Prior to this adjustment, two different sectors made up the portfolio. As of December 31, 2022, Government Money Market Funds made up 108.4% of the portfolio and Repurchase Agreements were negative 8.4%. At that time, there was nearly \$5.5 billion invested across 14 different money market funds and the Short Term Pool's allocation of the Repurchase Agreement was negative \$500,000,000. She stated that as you can see in the attachment on February 28, 2023, the portfolio included four different sectors with higher yields in the new sectors. These being the Government Money Market Funds made up 77.89% of the portfolio, Treasury Bills 23.6%, Discount Notes 9.19%, and Repurchase Agreements negative 10.68%. Investing in these new sectors has created an additional \$4,900,000 in earnings annually, at current rates and if they continue investing this way with up to 50% of the portfolio, it will create an additional \$7,800,000 in earnings annually.

Market Overview – Mr. Auxier explained going forward they've decided to add a new agenda item to SIC meetings. He directed the Commission's attention to Attachment F, Market Overview. He stated this highlights changes in the broader economic picture since the last meeting that have had an effect on our portfolios. The specific focus will be interest rates, as that overwhelmingly affects performance data. The primary purpose of this overview is to provide context to the performance and liquidity information presented since our numbers don't exist in a vacuum, they are primarily determined by overall market forces and trends. For fixed income portfolios, you aren't picking winners and losers like you would in equities. It's entirely dependent on interest rates and how they affect fixed income yields and prices. Mr. Auxier then discussed one item that happened too late to include in the presentation since they already had the packet finalized. The largest bank failure since 2008 occurred when Silicon Valley Bank, the 16th largest lender in the US, was taken over by the federal government following a bank run spurred on by ill-advised bond sales. This had massive repercussions in the market as bets on further Fed hikes evaporated and yields across the curve plummeted by as much as 50 basis points. While these developments are still being digested by market participants, and rate expectations have recovered a bit today, it does appear that Fed hiking will at least slow from what was anticipated even just a week ago. Closer to home, he discussed the effect this could have on J.P. Morgan Chase, our depository bank. The usual meeting with bank representatives was held and they confirmed that not only are they in excellent financial standing right now, but they're also seeing a large cash inflow as customers seek out the safest port in the current storm. He stated our deposits are J.P. Morgan Chase and are

fully collateralized and entirely safe. He was happy to answer any questions about the market overview and was open to any suggestions about items to include going forward. The Commission took no action.

Intermediate Pool Performance – Mr. Auxier directed the Commission to page 20 of Attachment G, titled Intermediate Term Pool Fundamentals. He reported the market value of the pool averaged \$3.8 billion for the past three months. The average credit quality of the portfolio remains AAA as rated by Moody’s and duration has hovered just over the 1-year mark, placing the portfolio in between the two benchmarks as expected. The large negative net cash flows out of the pool were caused by COVID funds being moved out of the Intermediate pool into the short-term pool. He then directed the Commission to the next page, the portfolio sector allocation for the intermediate pool which gives a visual representation of how the portfolio is diversified across different sectors and compares to the two benchmarks. He stated there haven’t been any major changes since the previous meeting. Agency allocation increased by 3% as MMKT allocation dipped by 4% as we moved funds into higher yield securities. The final page in Attachment G details portfolio performance over a series of time periods and compares it to the two benchmarks. The blue bar represents the Intermediate Pool, the red bar represents the longer duration benchmark A, and the green bar is the shorter duration benchmark B. The bottom line is that the portfolio continues to perform as expected during turbulent times and remains comfortably between the two benchmarks. While returns remain negative out to the one and three-year mark, you can see that things began to turn around over the past six months as the pace of rate hikes began to slow and on-paper losses began to diminish. With bond prices rising rapidly in response to recent financial turmoil, it seems at the moment that positive returns for the pool have made a comeback, however, as always, this is subject to change. The Commission took no action.

Credit Considerations – Mr. Auxier directed the Commission to the first page of Attachment H and presented that there was one change this quarter, in early February Intel was downgraded by Fitch below the minimum level and was dropped from the approved list. This marks the 6th name dropped from the list since the beginning of 2020, which has been a difficult time for corporate credit. He asked for the Commission’s approval as presented. Treasurer Ball called for a motion. A motion was made by Mr. Goodpaster and was seconded by Mr. McDaniel. Motion **CARRIED**.

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 I, page 27. 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 underperformed for both. She then directed the Commission to page 28 of the PDF, detailing the current list of securities for the Limited Pool as of the end of February. Ms. Bechtel stated that all securities are all high quality which includes the Government Money Market Funds. The total portfolio is approximately \$3.0 billion for the end of February, which is an increase of approximately \$100,000,000 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 points out the Liquidity and Maturity page, the Limited Pool continues to stay within the guidelines for Maturity and Liquidity. For February, the Weighted Average Maturity was around 35 days, and the last three-month average being around 32 days. She stated they continue to purchase securities to mature in the next several months to cover outflows. The daily liquidity was around 36% and weekly around 41% for August which is above the requirements. Ms. Bechtel directed the Commission to page 31 of the PDF, showing the Net Asset Value graph of the Limited Portfolio. The line of the shadow NAV continues to show fluctuations in value but has not exceeded 0.0025 level to trigger a notification to SIC. She stated the maximum divergence is 0.000574 but, is still within guidelines. This divergence occurred on July 18, 2022. She then directed the Commission to the final document under attachment I showing the memo detailing transactions and largest accounts in the portfolio. The largest daily withdrawals listed were outgoing wires, Medicaid wires in December and February and the University of Kentucky in January. The largest weekly withdrawals were also outgoing wires for Medicaid in December and February and to the University of Kentucky in December. The largest accounts being the University of Kentucky, Medicaid, and Personnel Health Self Insurance account. She ended with stating the staff will continue to maintain daily and weekly liquidity of 15% and 30% respectively. The Commission took no action.

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

Respectfully submitted,

Ryan Barrow

Ryan Barrow
Secretary