

STATE INVESTMENT COMMISSION
MINUTES
JUNE 20, 2023
2:30 PM

The State Investment Commission (“SIC” or “the Commission”) meeting was called to order on Tuesday, June 20, 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, Deputy Executive Director of OFM; Amber Lee; Daniel Auxier; Aubry McDonald; and Summer Intern Story Miller.

Other Guests: Matt Frey, State Treasury; Brian Ingle, State Treasury; and Teresa Lajara, FAC.

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 March 14, 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 past three months, the economic picture remained largely the same as the previous quarter. Inflation remains well above the long-term goal of 2% and in response, the Federal Reserve has raised interest rates to over 5%. He pointed out that you could see the effect of this in the two-year yield in the graph on the right, which fell below 4% early in the quarter but now sits around 4.75%. The following page listed what that meant for the portfolios. He pointed out the biggest takeaway is that the yield curve remains sharply inverted, with money market instruments yielding significantly higher than longer term securities. The graph showed the common 2/10 spread metric sitting at 78 basis points at the end of May. Until the Fed finally begins easing rates, the inverted yield curve is likely to persist. Mr. Auxier noted that higher yields across the board of course means higher income produced by the portfolios. To illustrate the Office of the State Budget director has begun including investment income as part of the monthly tax receipts report. In the April 2023 report, investment income fiscal year to date was reported to be over \$106,000,000, a number that has only climbed since then. The final page of the market overview shows the effect that the current hiking cycle has had on inflation. He stated although there’s still work to be done and the Fed has implied more hikes are on the way, the effect on inflation has been dramatic. The chart on the right shows how the consumer price index has fallen from a high of 9% down to 4.9% at the end of May. 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.

Cash Flow – Ms. Lee presented the Monthly Average Investable Balances Cash Flow Summary. Looking at fiscal year 2023, represented by the red line, at the end of May the average investable balance stood at about \$12.3 billion, an increase in about \$2 billion compared to May of last year, fiscal year 2022, represented by the dark blue line. She stated an additional trend line was added, which showed the average of the three fiscal years prior to 2020, represented by the teal line at the bottom of the chart. Ms. Lee stated that since billions of dollars have been received in Federal Covid Relief Aid over the last few years along with some of the highest revenues in years, she thought this would be nice to compare. When comparing the three-year average line to the current fiscal year, they follow closely. More spending typically happens from July to November with less spending for the remainder of the year. Ms. Lee noted that while you still see the same thing happening for fiscal years 2021 and 2022, you see an even greater increase in balances for May in both years and this is because we received over \$1 billion in relief money during that month each of those years. She also noted the receipts in the General Fund. For March, receipts rose 0.5% compared to March of 2022. For April, while receipts fell 2.7% compared to April of 2022, collections for the month were the second largest ever reported. For May, receipts fell 7.2% compared to May of 2022. This brings the year-to-date receipts up 3.4%. The Commission took no action.

Short Term Pool – Ms. Lee explained that as presented in March, 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. Listed in attachment E, you can see the sector distribution over the past three months and the yields for those sectors as well as for the total portfolio. As of May 31st, about 39% of the portfolio was held in money market mutual funds, Treasury Bills made up 22.5% of the portfolio, Discount Notes 36.9% and 1.6% was allocated to Repurchase Agreements. Market yield has risen from 4.65% in March and 4.64% in April to 5.02% in May. 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, page 21. 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 22 of the PDF, detailing the current list of securities for the Limited Pool as of the end of May. Ms. Bechtel stated that all securities are all high quality which includes the Government Money Market Funds. The total portfolio is approximately \$2.7 billion for the end of May, which is a decrease of approximately \$300 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 May, the Weighted Average Maturity was around

38 days, and the last three-month average being around 39 days. She stated they continue to purchase securities to mature in the next several months to cover outflows. The daily liquidity was around 33% and weekly around 36% for May which is above the requirements. Ms. Bechtel directed the Commission to page 25 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 F showing the memo detailing transactions and largest accounts in the portfolio. The largest daily withdrawals listed were outgoing wires, and Medicaid wires in March and May. The largest weekly withdrawals were also outgoing wires for Medicaid in March and May and to the University of Kentucky in March. The largest accounts being 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 29 of Attachment G, titled Intermediate Term Pool Fundamentals. He reported the market value of the pool averaged \$4 billion for the past three months. He discussed in the market overview, shorter duration portfolios are outperforming with the current inverted yield curve, and this can be clearly seen in the yields of the benchmarks, with the shorter duration Benchmark B carrying the highest yields. On the bottom half of the page, you can see the portfolio sector allocation, compared to the benchmarks. The following page has the performance of the Intermediate Pool compared to the two benchmarks. He stated that during a time of great volatility with interest rates, the pool continues to perform as expected, falling in between the two benchmarks based on their duration. 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 in this quarter, the removal of US Bank, which was downgraded by Moody's in April to a P-2 short-term rating and therefore below the minimum standard. 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 Ms. Grigsby. Motion **CARRIED**.

Approval of NRSROs – Mr. Auxier directed the Commission to Attachment I and stated that the next two items were presented for approval once a year during the June meeting in preparation for the upcoming new fiscal year. Attachment I on page 34 shows the NRSRO summary. He stated there were no surprises and Moody's, S&P, and Fitch remain by far the largest rating agencies and were therefore their recommendation to be adopted for FY2024. Treasurer Ball called for a motion. A motion was made by Mr. McDaniel and was seconded by Mr. Goodpaster. Motion **CARRIED**.

Review of Qualification and Approval of Broker-Dealer List – Mr. Auxier directed the Commission to page 36, Attachment J, the approved Broker-Dealer list for FY2024. He stated there were new additions this year, Truist Securities, MBS Securities, and Stephens all requested to be on their approved list as non-primary dealers and since they meet the requirements, they have added to the bottom of the list. One other thing noted was a name change for Amherst Pierpont, which is now known as Santander and remains a primary dealer. Treasurer Ball called for a motion. A motion was made by Mr. Goodpaster and was seconded by Mr. McDaniel. Motion **CARRIED**.

New Trading Limits – Ms. Bechtel stated that because of staffing and responsibility changes within the investment group, they decided that an update was needed regarding the new trading limits. She presented Attachment K, showing what was approved in December of 2018 and a proposal which listed Daniel Auxier, Amber Lee and herself as Portfolio Managers. An increase was made to the US Treasury Note, US Agency Note and Money Market Securities, from 200 million for each Portfolio Manager listed, to 250 million. This was due to an increase in the funds from 2018. She stated that currently larger treasuries and agencies are being bought. It is also easier to buy one large piece than several small pieces. A change was also made to the Money Market Trader, reducing the replacement down to 75 million from 150 million, to gain experience and acclamation in the process.

Mr. Goodpaster asked if the increase was sufficient for each trader. Ms. Bechtel, along with Mr. Barrow both confirmed. Mr. McDaniel then expressed his concern about reducing the Money Market Trader amount to 75 million and that he was hesitant but if the manager felt that was best to protect the institution that he would concur. Ms. Lee, Mr. Barrow and Ms. Bechtel presented Mr. McDaniel with clarification for their decision. With no further discussion, Treasurer Ball called for a motion. A motion was made by Mr. McDaniel and was seconded by Mr. Goodpaster. Motion **CARRIED**.

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