

STATE INVESTMENT COMMISSION
MINUTES
SEPTEMBER 12, 2023
2:30 PM

The State Investment Commission (“SIC” or “the Commission”) meeting was called to order on Tuesday, September 12, 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, State Controller, Office of the Controller; Geri Grigsby, proxy for Holly M. Johnson, Secretary, Finance and Administration Cabinet (“FAC”); Paul Goodpaster, representing the Bluegrass Bankers Association; and Mark Johnson, representing the Kentucky 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; Richard Osborn; and Aubry McDonald.

Other Guests: Matt Frey, State Treasury and Brian Ingle, State Treasury.

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

Treasurer Ball conducts the swearing into office of Mr. Mark Johnson at 2:33 pm. She asks Mr. Johnson to raise his right hand as she read the Oath of Office; “I solemnly swear (or affirm, as the case may be) that I will support the Constitution of the United States and the Constitution of this Commonwealth, and be faithful and true to the Commonwealth of Kentucky so long as I continue a citizen thereof, and that I will faithfully execute, to the best of my ability, the office of the State Investment Commission according to law; and I do further solemnly swear (or affirm) that since the adoption of the present Constitution, I, being a citizen of this State, have not fought a duel with deadly weapons within this State nor out of it, nor have I sent or accepted a challenge to fight a duel with deadly weapons, nor have I acted as second in carrying a challenge, nor aided or assisted any person thus offending, so help me God”. Mr. Johnson responded with “I do” and Treasurer Ball confirms that he is now sworn in and a Commissioner of the Committee and confirms he can vote in the meeting today. She then welcomes Mr. Johnson.

Treasurer Ball called for a motion to approve the minutes from the June 20, 2023, meeting. A motion was made by Ms. Grigsby and was seconded by Mr. McDaniel to approve the minutes. Motion **CARRIED**. Mr. Johnson abstained from the minutes.

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 it had been a wild ride for treasury rates over the past 18 months and the previous quarter was no exception. Earlier in the year it appeared the two-year was headed back to lower levels as the widespread consensus view was that inflation was finally under control and

the current hiking cycle was over. As more economic data came in showing a hot job market enduring, it became clear that higher rates were going to stick around for a while and the two-year jumped back to cycle highs above 5%. He then directed the Commission to the following page showing information on what the current interest rate environment means for the portfolios. The chart showed the yield curve as it stood towards the end of August. It remained sharply inverted with rates peaking at the six-month mark and then steadily falling over 100 basis points as maturities increased. One notable development of the past quarter was yields increased across the curve, with the greatest increase being felt in the longer end. This reduced the inversion slightly but a 2/10 spread of nearly 80 basis points is still considered highly inverted. He then stated that higher yields mean even higher earnings for the portfolio. The projections for the current fiscal year predicted total portfolio earnings of more than \$600 million, a number hard to fathom even four years ago when total portfolio balances were a third of what they are today, and rates sat at 2%. The final page of Attachment C discusses where to go from here. The end of the current hiking cycle appears to be close with one more hike this year being seen and the first rate cut happening in 2024. On the right, he stated, was the current inflation chart and the Fed feels inflation is finally coming under control. After peaking at over 9% last year, the latest inflation numbers show the rate having dropped to around 3%. He stated 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 2024, represented by the red line, in August the average investable balance stood at about \$12 billion. She stated Fiscal year 2024 is following the typical downward trend that happens from July to August. This is due to spending at the beginning of the new fiscal year, which included debt payments and transportation projects. She also noted the receipts in the General Fund. For July, receipts rose 7.1% compared to July of 2022. For August, receipts rose 7.7% compared to August of 2022. This brings the year-to-date receipts up 7.4%. The Commission took no action.

Short Term Pool –Ms. Lee directed the Commission to Attachment E, showing the sector distribution over the past three months and the yields for those sectors as well as for the total portfolio. As of August 31st, about 29.6% of the portfolio was held in money market mutual funds, Treasury Bills made up 32.4% of the portfolio, Discount Notes 37.1% and 0.9% was allocated to Repurchase Agreements. Market yield has risen from 4.71% in June and 5.09% in July to 5.14% in August. 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 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 is slightly higher when compared to both benchmarks for the month of August. 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 August. The total portfolio is slightly under \$3 billion for the end of August, which is an increase 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 August, the Weighted Average Maturity was around 40 days, and the last three-month average being around 31 days. She stated they continue to purchase securities to mature in the next several months to cover outflows. The daily liquidity was around 30% and weekly around 46% for August 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 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 June, Turnpike in July and University of Kentucky in August. The largest weekly withdrawals all occurred in July in the University of Kentucky and Turnpike Authority Accounts. 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. Cash flows in and out of the pool were as expected and the pool continued to perform as it should. The allocation chart remained largely the same with 2/3 of the portfolio invested in U.S. Treasuries and around 20% invested in agency notes. The corporate allocation, after approaching zero a few months ago, had rebounded to nearly 2% as corporate bonds from highly rated companies were found that gave a small yield bump over treasuries. He then directed the Commission to the next page, showing more detail on the pool performance with data for several time periods and comparing performance to the longer duration benchmark A and the shorter duration benchmark B. Despite some wild swings in rates over the past year, overall, the Intermediate Pool performed as expected with results falling in between the two benchmarks, based on duration. 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. Treasurer Ball called for a motion. A motion was made by Mr. Goodpaster and was seconded by Ms. Grigsby. Motion **CARRIED**.

New Trading Limits – Ms. Bechtel stated that the Money Market Trader position was no longer vacant and Richard Osborn had been hired for the position. She then asked the Commission to approve for him to start trading with his daily limit at \$75 million. Mr. Barrow then touched on a question asked at the last meeting by Joe McDaniel on upping the trading limits. He gave confirmation that once they went back and researched a few things they were still happy with the decision to increase the limits at the last meeting after looking at the trade data and not cash invested. Mr. Osborn was introduced in which he gave a little background on himself. 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**.

SEC Money Market Reform – Ms. Bechtel stated on July 12, 2023, the U.S. Securities and Exchange Commission adopted Money Market Fund Reforms and Form Amendments. She then pointed out some highlights of the changes; increase the liquidity requirements for daily liquidity from 10 percent to 25 percent and weekly from 30 percent to 50 percent, remove temporary redemption gates, require a mandatory liquidity fee if daily net redemptions exceed five percent of net assets, and the amendments regarding government money market funds to convert from a stable share price to a floating share price and modifying certain reporting forms. She stated the Limited Pool is not a SEC registered fund but an internally managed fund that reports money market investments at amortized cost as permitted by GASB Statement No. 31. Since the Limited Pool is not an SEC registered large liquidity fund, it would not be subject to large redemptions based on market stress and would not need to increase liquidity or impose a liquidity fee. The current liquidity requirements of 15% for daily and 30% for weekly continue to be adequate for the Limited Pool.

Excess Liquidity Account – Mr. Barrow and Ms. Bechtel directed the Commission to Attachment K, the Excess Liquidity Account. Mr. Barrow stated the Earnings Credit Rate (“ECR”) had increased above the bank fees and the Excess Liquidity Account was created to receive paid interest. He then directed the Commission to some projections within the packet. The target was \$100-125 million, which we are above currently. If the liquidity is not needed in the accounts, then the account will be swept at the end of the day and then swept back the following morning. This allows for account balances, late in the day to be processed in cash. The initial hesitancy of doing this was the netting feature at the state depository and wanting to keep a positive balance. Discussion took place on the procedures but overall, the Commission had no further questions on the additional account implementations.

There being no further business, Treasurer Ball called for a motion to adjourn. Mr. Johnson made a motion to adjourn and was seconded by Mr. Goodpaster. With no further business before the Commission, the meeting adjourned at 3:07 PM ET.

Respectfully submitted,

Ryan Barrow

Ryan Barrow
Secretary