

**Dan Schwartz**  
*State Treasurer*



STATE OF NEVADA  
OFFICE OF THE STATE TREASURER

TO: Board of Finance (BoF) Members

FROM: Tara Hagan, Chief Deputy Treasurer

SUBJECT: 3-13-18 BoF Agenda Item #8– State Treasurer Investment Report

DATE: March 6, 2018

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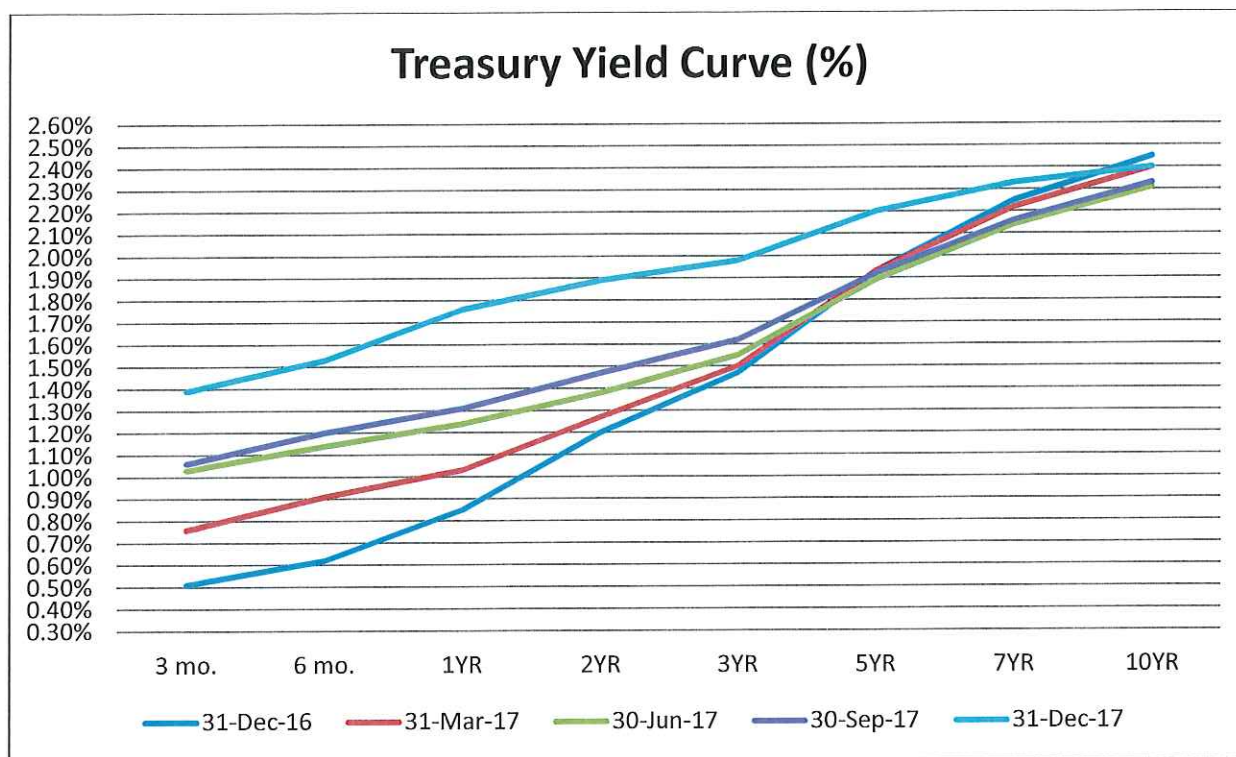
**Agenda Item #8**

Discussion and possible action (a) regarding the State Treasurer's quarterly investment report for the quarter ending December 31, 2017 and (b) to approve or disapprove the Treasurer's investment policies for the General Portfolio and the Local Government Investment Pool (LGIP).

**Fixed Income Markets**

During the fourth quarter calendar year (October 1 through December 31, 2017), the Federal Reserve increased the Federal Funds rate 25 basis points, bringing the rate up to 1.25% - 1.50%, the third increase in 2017. Yield on the US Treasuries rose from the front-end of the yield curve (shorter maturities) with the two-year note increasing 40 basis points while the ten-year yield increased 7 basis points and the thirty-year dropped 12 basis points. US corporate spreads tightened 8 basis points during the quarter to finish the year at 93 basis points above comparable duration US Treasuries. Lower quality, longer duration bonds generally fared better. Finally, the US Treasury Yield curve flattened (see chart on top of page 2) another 52 basis points during the quarter, as measured by the difference between the 2-year Treasury note and 30-year long bond.

The Federal Reserve (Fed) began the slow process of unwinding its balance sheet during the fall of 2017. While the market was expecting three interest rate hikes in 2018, the new Fed Chair Jerome Powell's comments in late February noted that economic projections could potentially mean four rate hikes this year. The market fully expects an interest rate increase of 25 basis points to be announced at the next Fed meeting on March 20 which would bring the rate up to 1.50%- 1.75%.



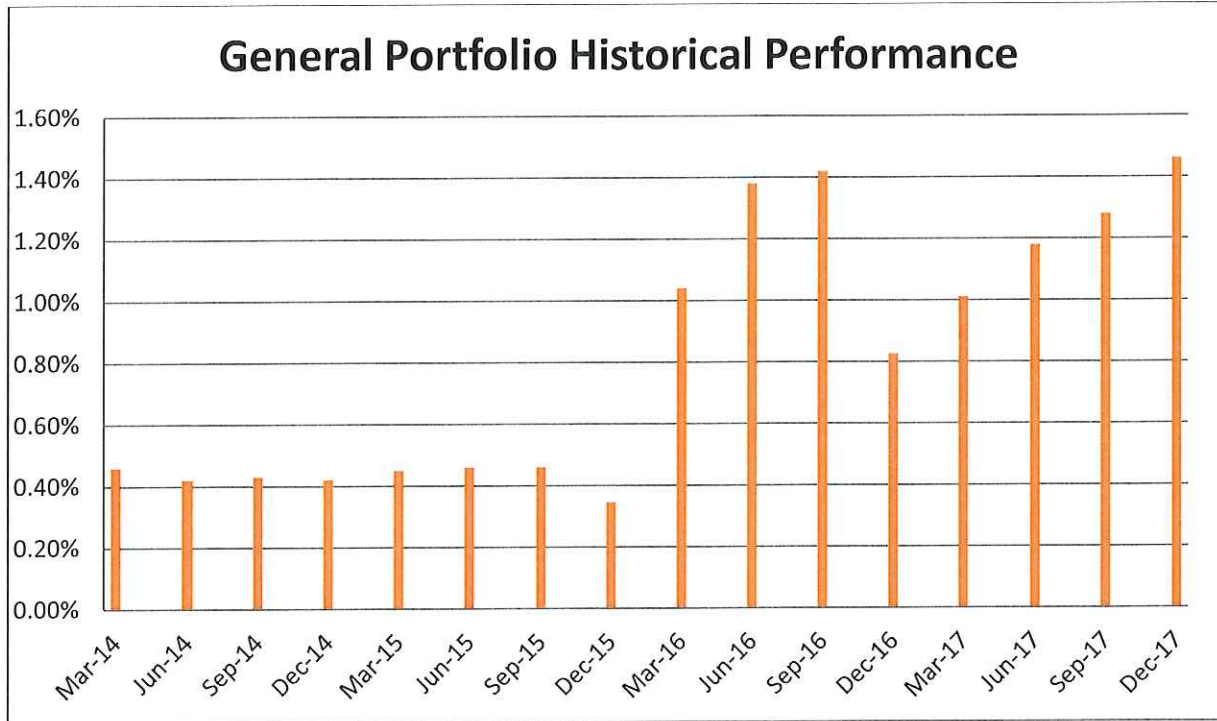
#### Current Performance:

The attached reports indicate performance for the quarter ending December 31, 2017.

- FTN Financial began managing the LGIP portfolio in July 2015. The yield to maturity as of December 31, 2017 for LGIP assets was 1.39% which is 0.11% in excess of the benchmark return of 1.28%.
- The yield to maturity as of December 31, 2017 for total assets in the General Portfolio is 1.35%.
  - The yield to maturity of the internally managed portion of the General Portfolio was 1.461% which is 0.55% in excess of the custom blended benchmark return of 0.91%.
  - Chicago Equity Partners (CEP) began managing \$200 million in General Portfolio assets on August 3, 2015 with an additional \$100 million in 2016 for a total of \$300 million.
    - The year to date time weighted performance is 0.75%. As of December 31, 2017, CEP has distributed \$7.49 million in net interest since inception. The hard dollar fees paid since inception to CEP as of December 31, 2017 were \$799,580.
  - MacKay Shields (MKS) began managing \$200 million in General Portfolio assets on December 1, 2015 with an additional \$100 million for a total of \$300 million.
    - The year to date time weighted performance is 1.06%. As of December 31, 2017, MKS has distributed \$6.31 million in net interest since inception. The hard dollar fees paid since inception to MKS as of December 31, 2017 were \$834,127.

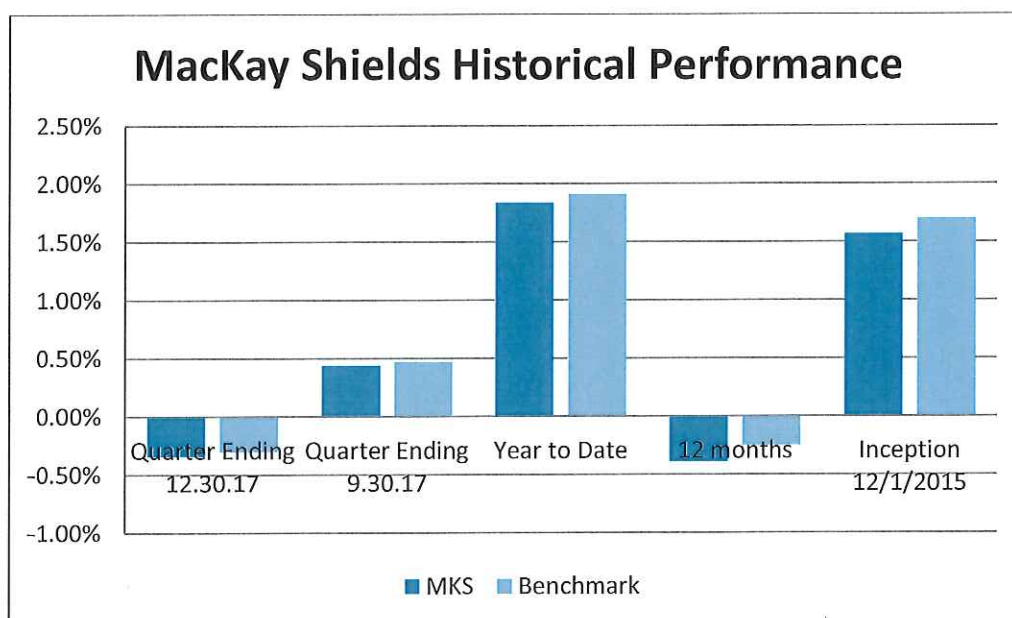
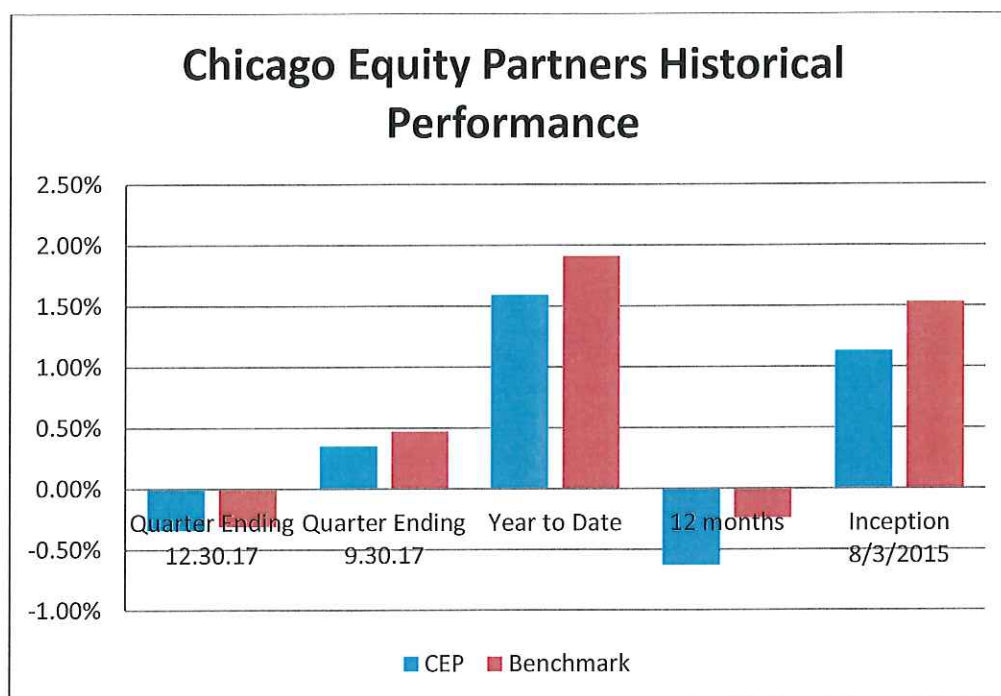
## Historical General Portfolio Performance (includes external and internal management)

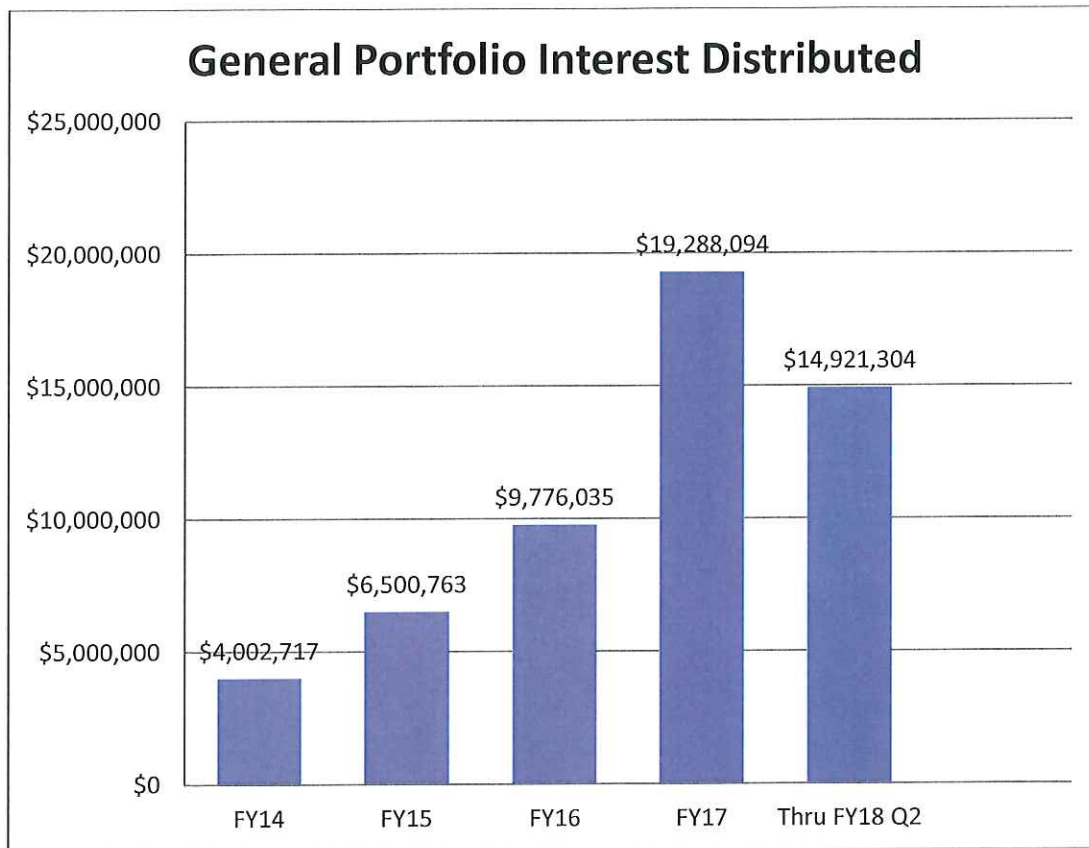
The General Portfolio performance as noted in the graph below began to improve in calendar year 2016 with the longer maturity holdings outperforming the shorter maturity holdings. The managers' performance during mid-2016 was ~2.50% - 3.57%; however, beginning in the 4<sup>th</sup> quarter of 2016, interest rates started to rise and have continued to rise with three rate increases in 2017 coupled with returns on the longer maturity holdings sharply decreased resulting in lower overall returns. The increase in interest rates over the past four quarters has increased the return on the shorter maturities which has helped boost performance in 2017.





## Historical General Portfolio Managers' Performance





**Recommendation:**

I respectfully request consideration and approval of the quarterly investment reports and the Treasurer's investment policies for the General Portfolio and the LGIP.



State Treasurer  
[www.NevadaTreasurer.gov](http://www.NevadaTreasurer.gov)

## INVESTMENTS

### GENERAL PORTFOLIO

FISCAL YEAR 2018  
Period Ending  
December 31, 2017

### Overview

Investment of the State of Nevada General Fund Portfolio is a function performed by the State Treasurer, who, by the provisions of NRS 355, has adopted policies for the prudent and conservative investment of these funds. The General Portfolio encompasses governmental, proprietary, enterprise and fiduciary funds of the State. Investment objectives include safety of principal, portfolio liquidity and market return.

### Investment Guidelines

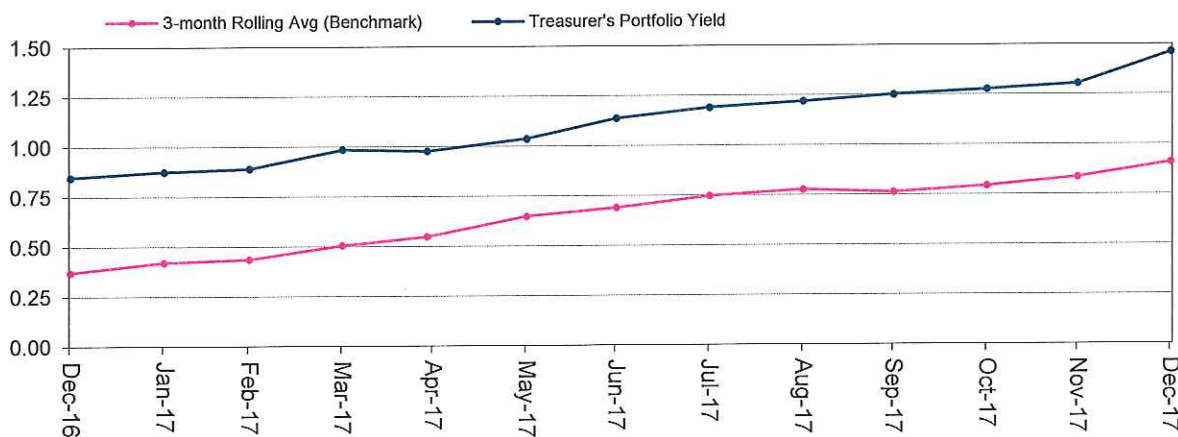
The permissible investments of the General Portfolio include United States Treasury and Agency securities, repurchase agreements, high quality corporate notes and commercial paper, negotiable certificates of deposit, municipal bonds and banker's acceptances. These securities are diversified to prevent over-concentration in a specific maturity, a specific issuer, or a specific class of securities. The targeted duration of the portfolio is one and a half years, with no security extending longer than ten years.

The State Treasurer maintains a conservative, moderately active investment strategy. Cash flow forecasts are prepared to identify operating cash requirements that can be reasonably anticipated. In order to maintain sufficient liquidity, a portion of the portfolio is structured so that securities mature concurrently with cash needs in the short and medium term. Monies deemed to have a longer investment horizon, are invested to take advantage of longer term market opportunities.

### In-House Performance

As of December 31, 2017, the yield on the portion of the General Portfolio managed in-house was 1.461%. A three month rolling average of this benchmark for this period was .91% with the average days to maturity at 218 days. The average days to maturity for the in-house managed portfolio was .47 years or 173 days.

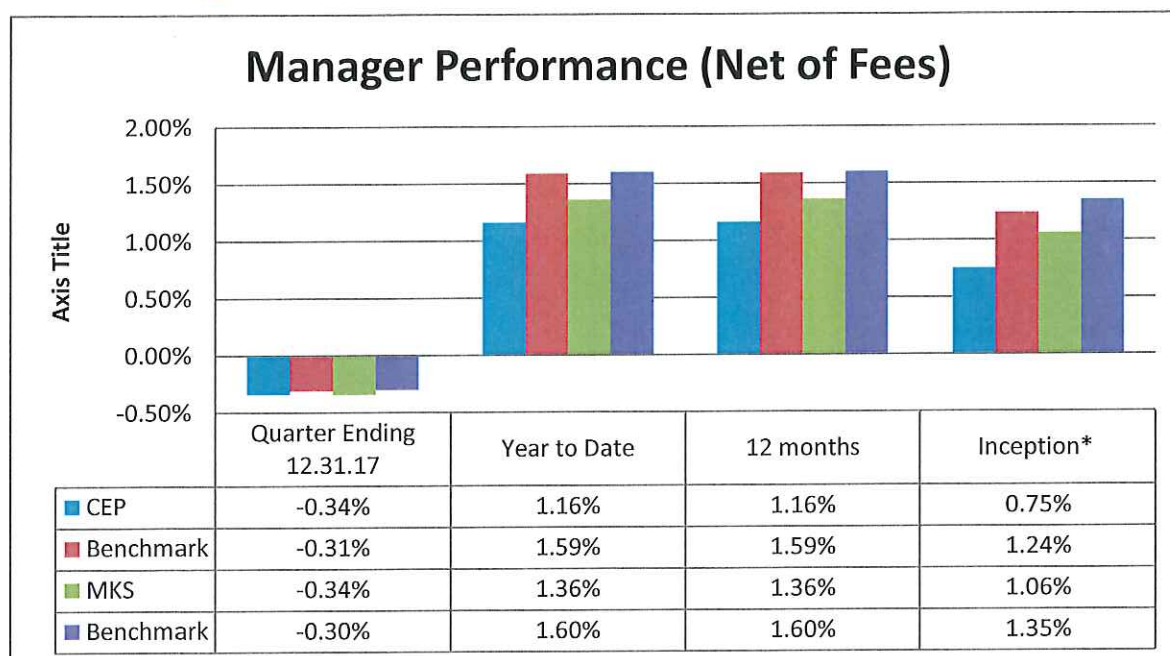
### In-House Performance vs. Benchmark



## Outside Manager Performance

The performance since inception for period ending December 31, 2017 for manager Chicago Equity Partners (CEP) is .75% and for Mackay Shields (MKS) is 1.06%\*. Both of these returns are based on time-weighted rate of return which is defined as the compounded growth rate of \$1 over the period being measured. These funds have been assigned the Bloomberg Barclays Intermediate A or better Government Credit benchmark. The Nevada statutory requirements prevent managers from investing in certain securities (supranationals and foreign sovereigns), fewer corporate notes and governmental securities longer than 10 years which is the cause of the difference in manager performance versus the benchmark. \*CEP inception date is August 2015 and MKS is December 2015.

## Outside Managers' Performance vs. Benchmark



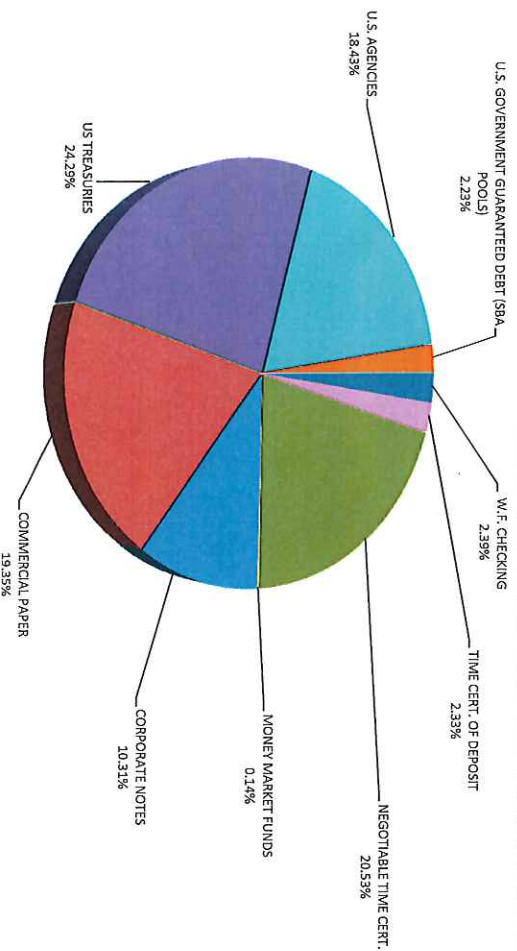
\*Inception date for CEP is 8.3.15 and 12.1.15 for MKS



# GENERAL PORTFOLIO

## Amortized Book Value and Purchased Interest

	December 31, 2017				September 30, 2017			
	Amortized Book Value		Amortized Book Value		Amortized Book Value		Amortized Book Value	
	Treasurer In-House	Chicago Equity Partners	Mackay Shields		Treasurer In-House	Chicago Equity Partners	Mackay Shields	
WASHINGTON FEDERAL CHECKING ACCT.	\$ 51,185,159				\$ 50,905,701			
TIME CERTIFICATES OF DEPOSIT	50,000,000				50,000,000			
NEGOTIABLE CERTIFICATES OF DEPOSIT	440,000,409				325,005,989			
MONEY MARKET FUNDS	2,602,565	312,965	22,345		1,024,428	567,716	23,723	
ASSET-BACKED SECURITIES	0				0			
MORTGAGE-BACKED SECURITIES	0				0			
CORPORATE NOTES	94,568,191	33,131,935	93,164,071		89,756,292	22,899,952	93,440,114	
COMMERCIAL PAPER	414,594,917				410,165,594			
MUNICIPAL BONDS	0				0			
U.S. TREASURIES	45,030,978	267,106,368	208,321,094		47,951,586	266,251,858	206,647,896	
U.S. AGENCIES	382,958,940	7,059,636	4,975,522		509,888,002	16,975,242	4,999,867	
U.S. GOVERNMENT GUARANTEED DEBT REPURCHASE AGREEMENTS	47,715,080				52,212,732			
TOTAL	\$ 1,528,656,239	\$ 307,610,904	\$ 306,483,032		\$ 1,536,910,323	\$ 306,694,766	\$ 305,111,599	
GRAND TOTAL	\$ 2,142,750,175				\$ 2,148,716,689			



## YEAR-TO-YEAR BOOK VALUE AND PURCHASED INTEREST COMPARISON

	December 31, 2017	December 31, 2016
TOTAL PORTFOLIO	\$2,142,750,175	\$2,039,719,234



**State of Nevada**  
**Office of the State Treasurer**  
**Schedule of General Fund Interest Revenue**

	Quarter Ended 09/30/2017	Quarter Ended 12/31/2017	Quarter Ended 03/31/2018	Quarter Ended 06/30/2018	FY 2018 Totals
<b><u>Average Daily Balances of Funds</u></b>					
General Fund	600,557,399	685,632,066			643,094,733
All Funds	2,422,777,800	2,405,866,498			2,414,322,149
<b><u>Annualized Interest Rate</u></b>					
Cash Basis (see Note 1)	1.1599%	1.3385%			1.2492%
Accrual Basis	1.1272%	1.2717%			1.1994%
<b><u>Interest Distribution for General Fund (Cash Basis)</u></b>					
General Fund Interest Collected	1,709,131	2,287,330			3,996,461
General Fund Interest Revenue - Distributed	1,709,131	2,287,330			3,996,461
Undistributed General Fund Interest Revenue	-				-
<b><u>Interest Distribution for All Funds (Cash Basis)</u></b>					
All Funds Interest Collected	6,895,117	8,026,187			14,921,304
All Funds Interest Revenue - Distributed	6,895,117	8,026,187			14,921,304

**Note 1** Interest is distributed to statutorily approved funds and budget accounts based on the cash basis of accounting. Under the cash basis of accounting, earnings are distributed in the quarter received but not necessarily in the quarter they were earned. Therefore, some of the receipts included in the Actual General Fund interest collected line were actually earned in the prior period and some of the earnings included in the General Fund interest revenue - accrual basis line will not be collected until a subsequent period.



## Overview

The State of Nevada Local Government Investment Pool (LGIP) was established as an alternative investment program to be utilized by local governments for their public funds. This program's operation is the responsibility of the State Treasurer who, by the provisions of state statute, has adopted guidelines for the prudent investment of these pooled funds. Any local government, as defined by NRS 354.474, may deposit its public monies into this fund for purposes of investment. As of December 31, 2017, there were 88 members of the LGIP, which includes cities, counties, school districts, and various special districts. The LGIP's foremost investment objectives include safety of principal, portfolio liquidity, and market return, which are consistent with a conservative, short duration portfolio.

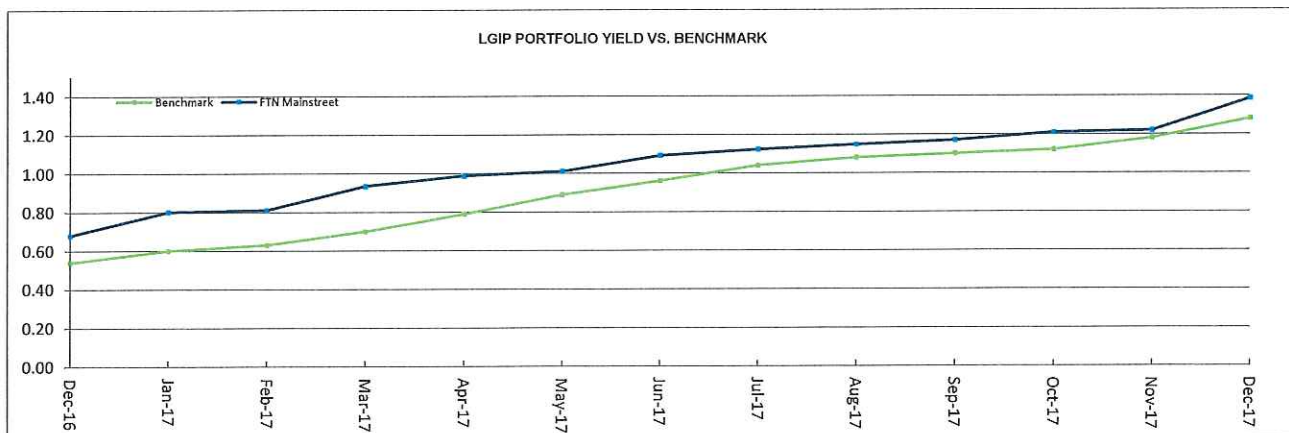
## Investment Guidelines

The permissible investments of the LGIP include United States Treasury and Agency securities, repurchase agreements, high quality commercial paper, negotiable certificates of deposit, municipal bonds and banker's acceptances. These securities are diversified to prevent over-concentration in a specific maturity, a specific issuer, or a specific class of securities. The average maturity of the portfolio must not exceed 150 days, and no single security may be longer than two years.

The State Treasurer maintains a conservative investment strategy, which incorporates the matching of maturing securities to the cash needs of the participants. Approximately 20% of the fund matures on a daily basis, ensuring sufficient liquidity to meet both anticipated and unanticipated withdrawals. Additionally, at approximately 60% of the fund matures within 90 days, compared to the policy requirement of 50%. This requirement minimizes the risk that the market value of portfolio holdings will fall significantly due to adverse changes in general interest rates.

## Performance

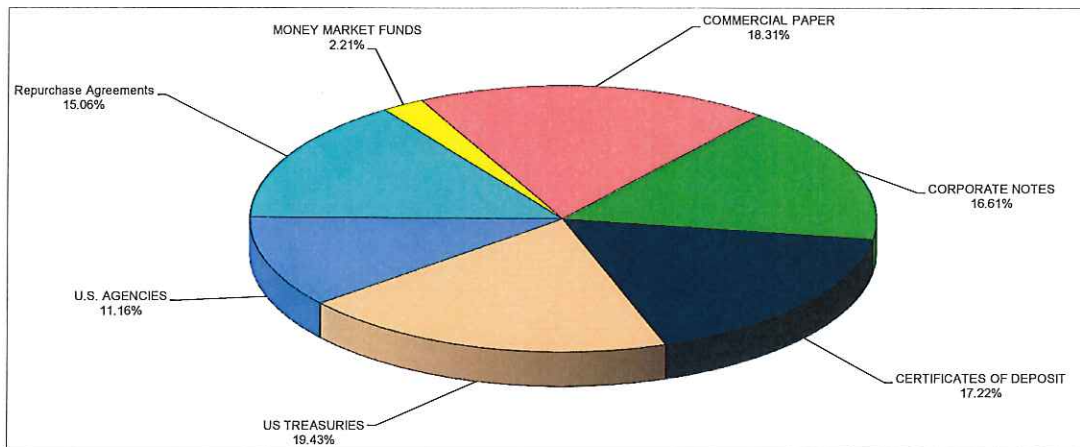
FTN Financial began managing the LGIP portfolio in July 2015. As of December 31, 2017, the LGIP's portfolio yield was 1.386%, and the blended benchmark was 1.28%. The average days to maturity of the LGIP portfolio was 117 days.



### Administration

The State Treasurer has adopted an Investment Policy relating specifically to the LGIP. The State Board of Finance shall review and approve or disapprove the policies established by the State Treasurer for investment of money of the LGIP at least every four months. The State Treasurer hereby confirms all LGIP investments are in compliance with the Terror-Free Investment Policy and the Divestiture Policy. The State Treasurer may contract with an independent auditor to review LGIP transactions for accuracy and fairness in reporting.

	<u>Amortized Book</u>	<u>Purchased Interest</u>	<u>Amortized Book</u>	<u>Purchased Interest</u>
MONEY MARKET FUNDS	\$ 22,728,725		\$ 45,381,810	
COMMERCIAL PAPER	188,417,335		192,342,772	
CORPORATE NOTES	170,399,606	525,233	160,145,087	359,396
CERTIFICATES OF DEPOSIT	177,203,058		170,016,961	
MUNICIPAL BONDS				
U.S. TREASURIES				
NOTES	199,552,122	396,095	114,873,229	54,295
BILLS				
U.S. AGENCIES	114,805,855	24,340	145,687,642	
ASSET-BACKED SECURITIES	-		-	
REPURCHASE AGREEMENTS	155,000,000		170,000,000	
TOTAL	\$ 1,028,106,701	\$ 945,669	\$ 998,447,501	\$ 413,692
GRAND TOTAL	\$ 1,029,052,369		\$ 998,861,192	



### YEAR-TO-YEAR BOOK VALUE AND PURCHASED INTEREST COMPARISON

	<u>September 30, 2017</u>	<u>September 30, 2016</u>
<b>TOTAL PORTFOLIO</b>	\$1,029,052,369	\$844,595,465