

Zach Conine
State Treasurer



STATE OF NEVADA
OFFICE OF THE STATE TREASURER

TO: Board of Finance (BoF) Members
FROM: Tara Hagan, Chief Deputy Treasurer
SUBJECT: 3_12_19 BoF Agenda Item 8– State Treasurer Investment Report
DATE: March 5, 2019

Agenda Item #8

Discussion and possible action (a) regarding the State Treasurer's quarterly investment report for the quarter ending December 31, 2018 and (b) to approve or disapprove the Treasurer's investment policies for the General Portfolio and the Local Government Investment Pool (LGIP).

Fixed Income Market Highlights as of December 31, 2018

- As expected, the Federal Open Market Committee (FOMC) raised the federal funds target rate 25 basis points or a quarter of a percent in December to 2.25- 2.50%. This marked the ninth rate hike dating back to December 2015.
- The benchmark 10-year Treasury rate fell nearly 60 basis points from its mid-November high to close the year at 2.65%. Rate declines were slightly more pronounced in longer maturities, resulting in the slope of the yield curve to +20 basis points from the 2-year to 10-year Treasury.
- During the quarter the FOMC accelerated its quantitative tightening approach or balance sheet reduction of US Treasuries and mortgage back securities from \$25 billion per month to \$50 billion.

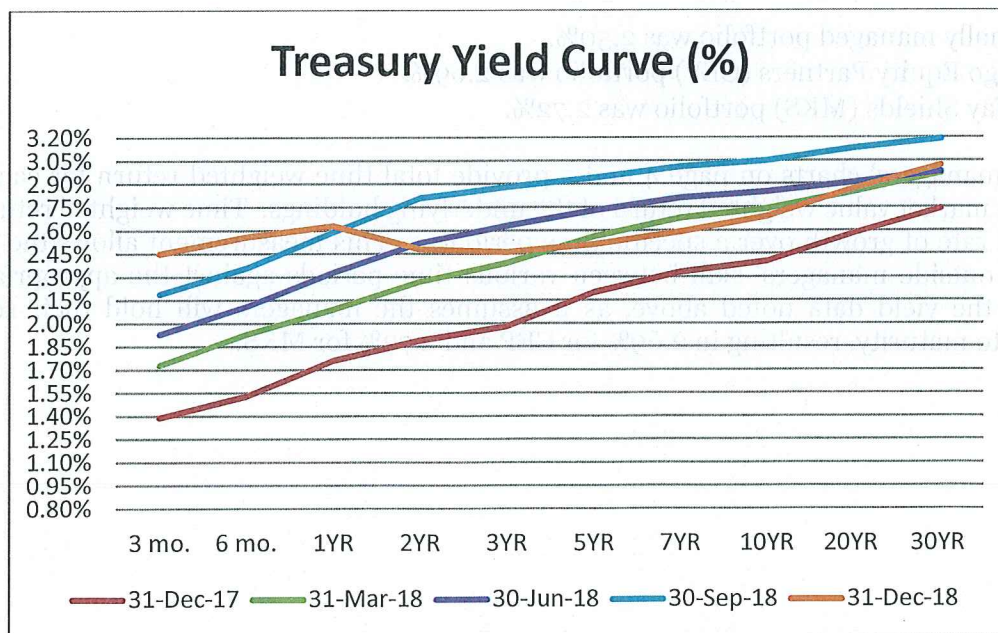


Chart is for illustrative purposes only. Investment Policy prohibits the General Portfolio from investing in Treasuries beyond 10 years.

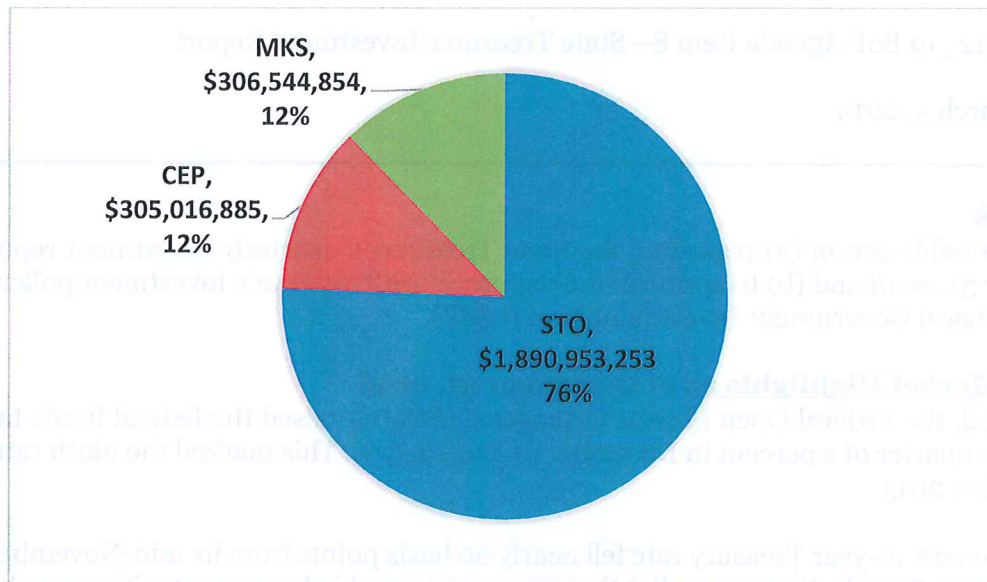
Investment Performance as of December 31, 2018

LGIP

As of December 31, 2018, the total assets under management (AUM) were \$1,029,145,319. Currently, FTN Financial manages the portfolio and the yield to maturity as of December 31, 2018 was 2.55% which is 8 basis point in excess of the benchmark yield of 2.47%.

General Portfolio

As of December 31, 2018, the AUM for the General Portfolio was \$2.50 billion (market value) with 75% managed internally by State Treasurer Staff and 25% managed by outside managers.



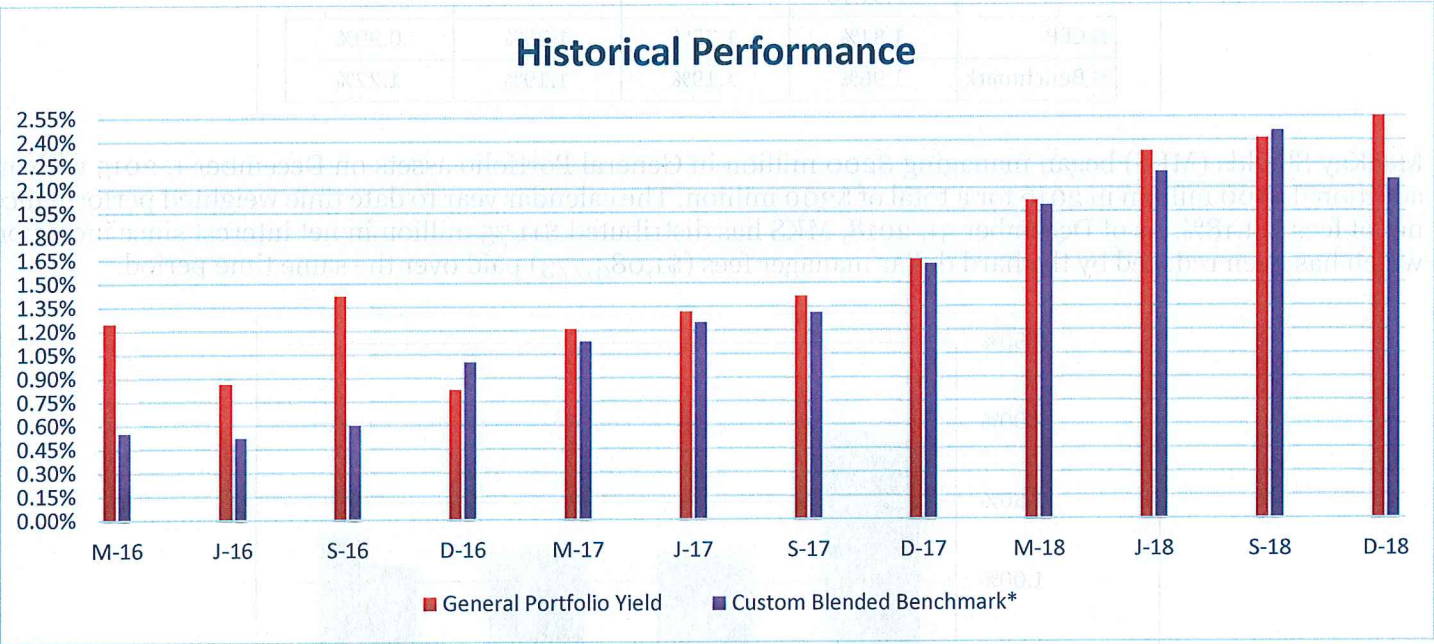
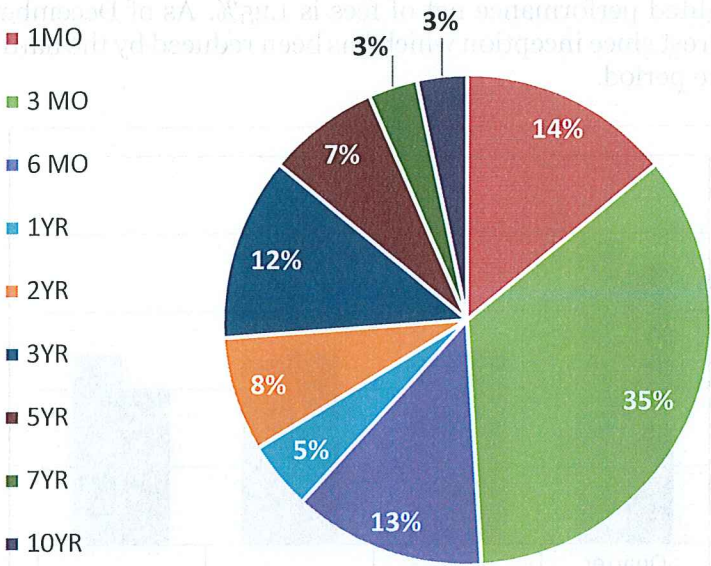
KEY: STO: State Treasurer Staff CEP: Chicago Equity Partner MKS: MacKay Equity Partners

The overall yield to maturity (YTM) as of December 31, 2018 for the General Portfolio was 2.55%. Below is the YTM breakdown by portfolio:

- Internally managed portfolio was 2.50%.
- Chicago Equity Partners (CEP) portfolio was 2.69%.
- MacKay Shields (MKS) portfolio was 2.72%.

The outside managers' charts on page 4 and 5 provide total time weighted return for each separate portfolio, including the market value weighted return of the underlying holdings. Time weighted return measures a fund's compounded rate of growth over a specific time period(s). This measurement allows the Treasurer's Office to evaluate the outside managers' skill between various time periods against the appropriate benchmark. This differs from the yield data noted above, as it assumes the managers will hold their respective underlying investments to maturity, resulting in 2.69% for CEP and 2.72% for MKS.

Below is a graphical representation of the asset weighted maturities in the General Portfolio as of December 31, 2018.

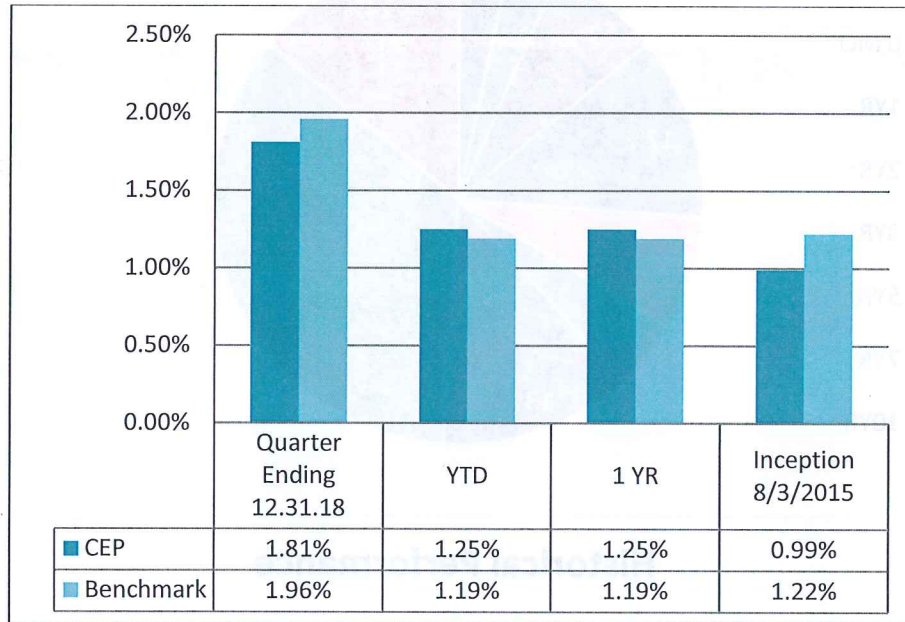


*Custom benchmark yield matches the asset-weighted maturities of the General Portfolio for each quarter to the appropriate Treasury yield.

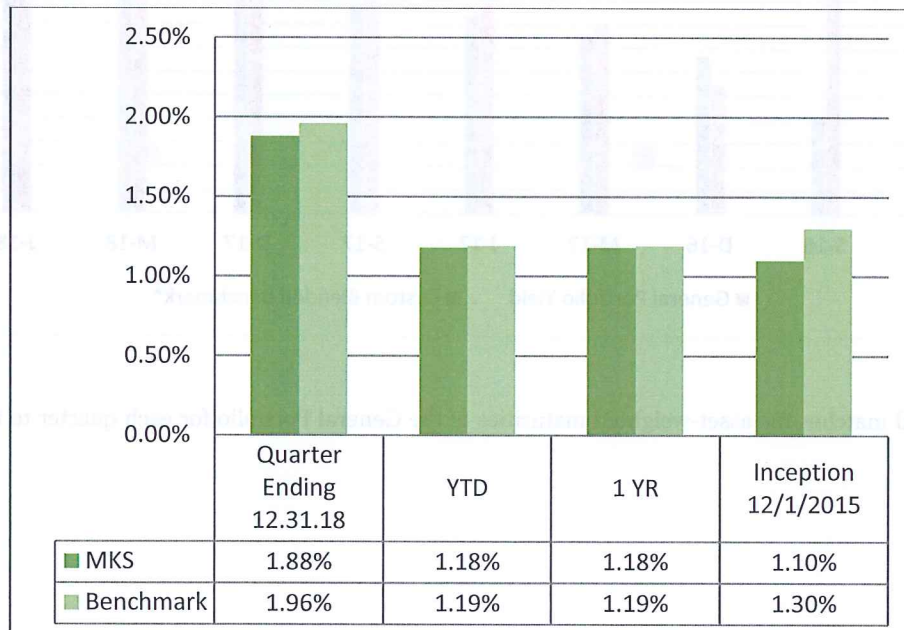
General Portfolio Outside Managers' Performance

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.

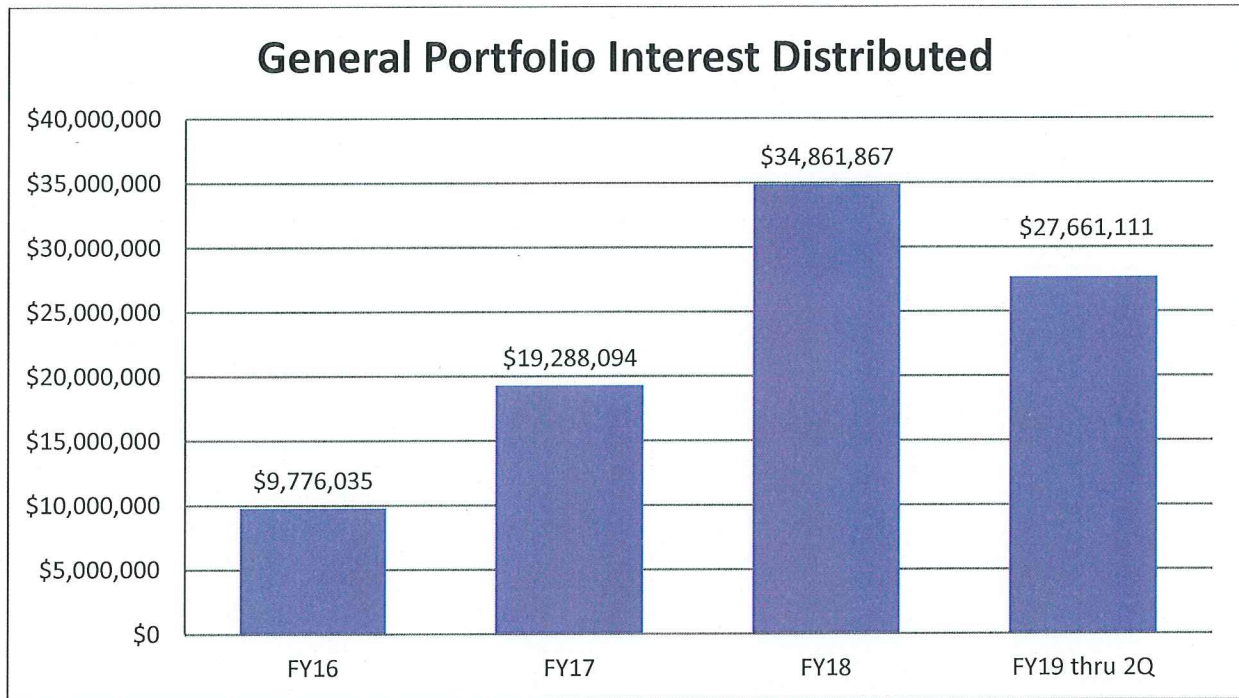
The calendar year to date time weighted performance net of fees is 1.25%. As of December 31, 2018, CEP has distributed \$11.84 million in net interest since inception which has been reduced by the hard dollar manager fees (\$1,073,093) paid over the same time period.



MacKay Shields (MKS) began managing \$200 million in General Portfolio assets on December 1, 2015 with an additional \$100 million in 2016 for a total of \$300 million. The calendar year to date time weighted performance net of fees is 1.18%. As of December 31, 2018, MKS has distributed \$11.75 million in net interest since inception which has been reduced by the hard dollar manager fees (\$1,084,773) paid over the same time period.



Please note the applicable Nevada statutory restrictions regarding corporate notes, local authorities, foreign sovereigns, supranational and foreign agency can negatively impact each manager's portfolio performance versus the index.



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
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INVESTMENTS

GENERAL PORTFOLIO

FISCAL YEAR 2019

Period Ending
December 31, 2018

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

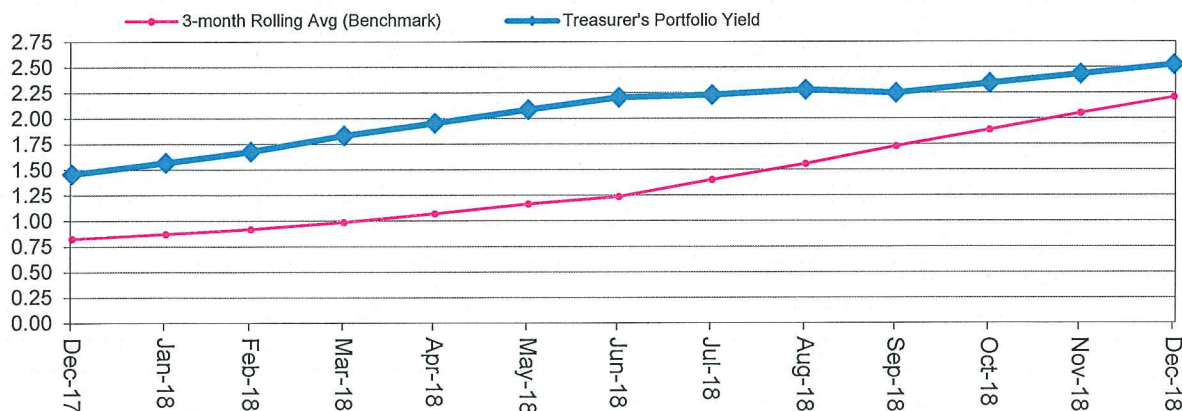
The permissible investments of the General Portfolio include United States Treasury and Agency securities, repurchase agreements, high quality corporate notes and commercial paper, negotiable certificates of deposit, municipal bonds and banker's acceptances. These securities are diversified to prevent 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, 2018, the yield on the portion of the General Portfolio managed in-house was 2.527%. A three month rolling average of this benchmark for this period was 2.21% with the average days to maturity at 218 days. The average days to maturity for the in-house managed portfolio was .53 years or 192 days.

In-House Performance vs. Benchmark

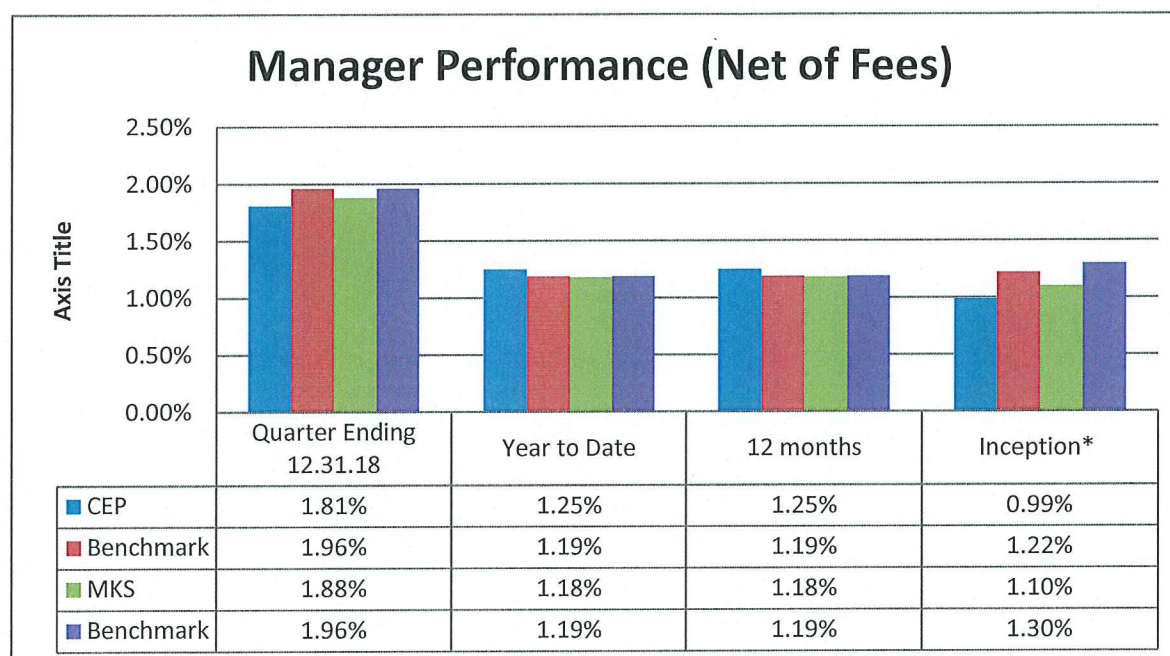


* Benchmark is 3-month rolling weighted average of 80% 3-month Treasuries and 20% 2-year Treasuries

Outside Manager Performance

The annualized performance since inception for period ending December 31, 2018 for manager Chicago Equity Partners (CEP) is 0.99% and for Mackay Shields (MKS) is 1.10%*. 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.

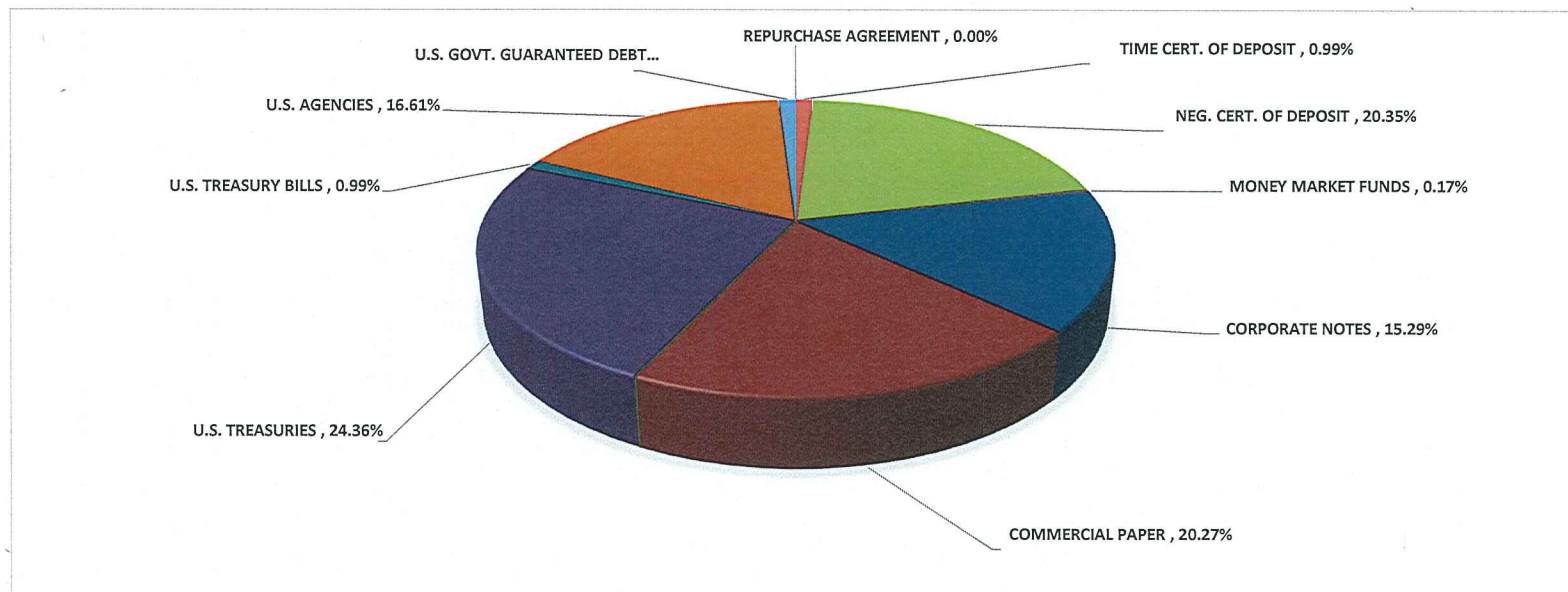
Outside Managers' Performance vs. Benchmark



*Inception date for CEP is 8.3.15 and 12.1.15 for MKS

GENERAL PORTFOLIO
Amortized Book Value and Purchased Interest

	<u>December 31, 2018</u>			<u>September 30, 2018</u>		
	<u>Amortized Book Value</u>			<u>Amortized Book Value</u>		
	<u>Treasurer In-House</u>	<u>Chicago Equity Partners</u>	<u>Mackay Shields</u>	<u>Treasurer In-House</u>	<u>Chicago Equity Partners</u>	<u>Mackay Shields</u>
WASHINGTON FEDERAL CHECKING ACCT.	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
TIME CERTIFICATES OF DEPOSIT	25,000,000	-	-	25,000,000	-	-
NEGOTIABLE CERTIFICATES OF DEPOSIT	512,002,381	-	-	519,001,166	-	-
MONEY MARKET FUNDS	2,989,217	1,080,952	192,128	5,371,232	3,468,464	82,632
ASSET-BACKED SECURITIES	-	-	-	-	-	-
MORTGAGE-BACKED SECURITIES	-	-	-	-	-	-
CORPORATE NOTES	249,528,718	54,886,370	80,188,122	250,886,185	50,708,518	86,436,332
COMMERCIAL PAPER	509,888,067	-	-	420,993,501	-	-
MUNICIPAL BONDS	-	-	-	-	-	-
U.S. TREASURIES	135,637,849	250,821,882	226,372,294	114,784,264	251,036,555	218,596,933
U.S. TREASURY BILLS	24,859,951	-	-	-	-	-
U.S. AGENCIES	407,719,557	5,196,903	5,006,947	515,009,034	5,598,901	4,999,026
U.S. GOVERNMENT GUARANTEED DEBT	24,548,170	-	-	30,277,489	-	-
REPURCHASE AGREEMENTS	-	-	-	-	-	-
TOTAL	\$ 1,892,173,910	\$ 311,986,107	\$ 311,759,490	\$ 1,881,322,871	\$ 310,812,438	\$ 310,114,923
GRAND TOTAL	\$		\$ 2,515,919,507	\$		\$ 2,502,250,232



YEAR-TO-YEAR BOOK VALUE AND PURCHASED INTEREST COMPARISON

	<u>December 31, 2018</u>	<u>December 31, 2017</u>
TOTAL PORTFOLIO	\$2,515,919,507	\$2,142,750,175

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

	Quarter Ended 09/30/2018	Quarter Ended 12/31/2018	Quarter Ended 03/31/2019	Quarter Ended 06/30/2019	FY 2019 Totals
<u>Average Daily Balances of Funds</u>					
General Fund	806,653,832	836,027,952			821,340,892
All Funds	2,659,186,033	2,656,636,026			2,657,911,029
<u>Annualized Interest Rate</u>					
Cash Basis (see Note 1)	2.0386%	2.07697%			2.0578%
Accrual Basis	1.9953%	2.03360%			2.0145%
<u>Interest Distribution for General Fund (Cash Basis)</u>					
General Fund Interest Collected	4,160,873	4,352,706			8,513,579
General Fund Interest Revenue - Distributed	4,160,873	4,352,706			8,513,579
Undistributed General Fund Interest Revenue	-	-			-
<u>Interest Distribution for All Funds (Cash Basis)</u>					
All Funds Interest Collected	13,716,586	13,947,525			27,664,112
All Funds Interest Revenue - Distributed	13,716,586	13,947,525			27,664,112

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, 2018, 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.

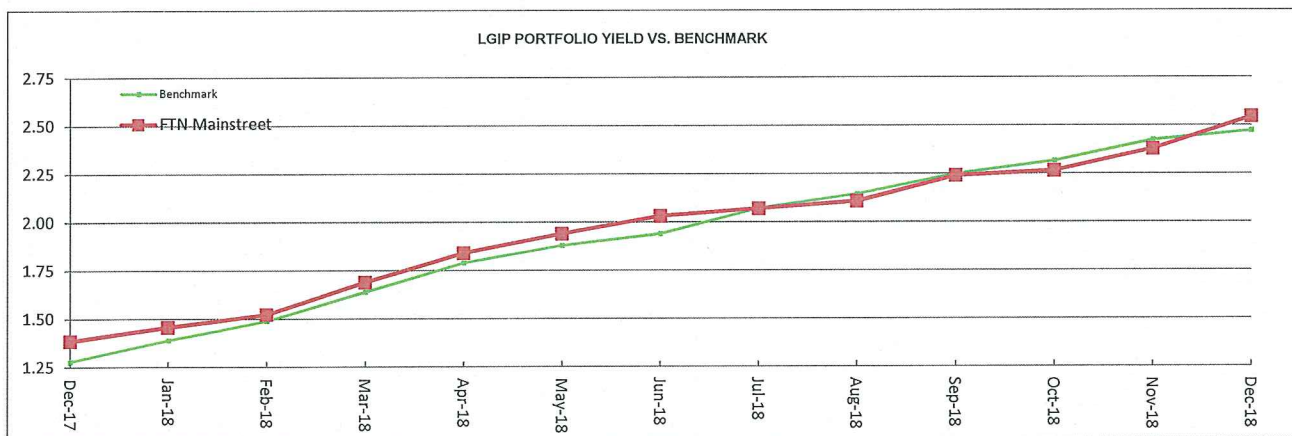
Investment Guidelines

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 10% 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, 2018, the LGIP's portfolio yield was 2.545%, and the blended benchmark was 2.47%. The average days to maturity of the LGIP portfolio was 137 days.

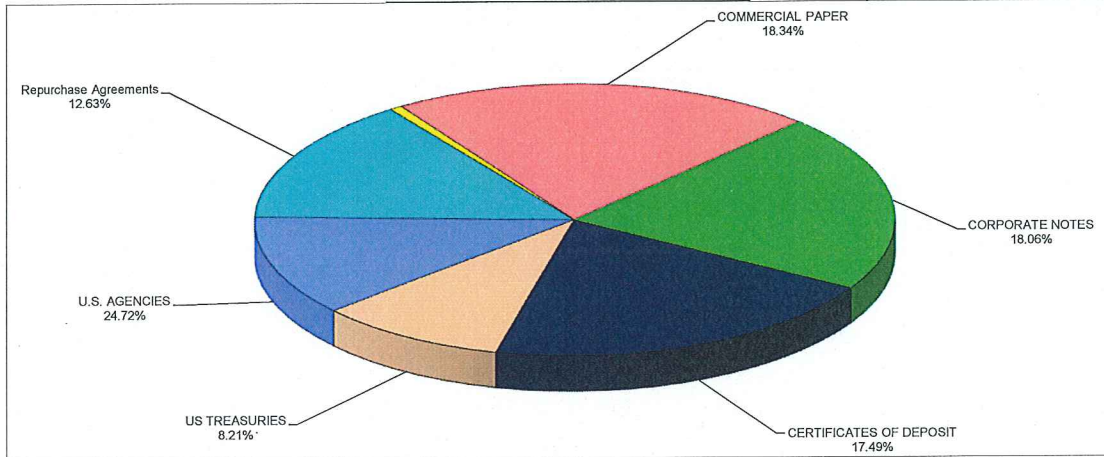


* Benchmark is 3-month rolling weighted average of 20% Dealer Commercial Paper 90-Day Index, 60% Agency Discount Note 6-Month Index, and 20% Morgan Stanley Institutional Liquidity Government Portfolio Fund.

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>December 31, 2018</u>		<u>September 30, 2018</u>	
	<u>Amortized Book</u>	<u>Purchased Interest</u>	<u>Amortized Book</u>	<u>Purchased Interest</u>
MONEY MARKET FUNDS	\$ 5,521,886	\$ -	\$ 36,797,560	\$ -
COMMERCIAL PAPER	188,773,853	-	199,150,364	-
CORPORATE NOTES	185,908,212	-	190,720,086	70,574
CERTIFICATES OF DEPOSIT	179,999,990	1,757	194,992,959	148,157
MUNICIPAL BONDS	-	-	-	-
U.S. TREASURIES		151,835		
NOTES	84,533,641	-	69,829,605	60,122
BILLS	-	-	49,914,394	-
U.S. AGENCIES	104,982,598	94,024	179,716,551	10,461
ASSET-BACKED SECURITIES	-	-	-	-
REPURCHASE AGREEMENTS	130,000,000	-	160,000,000	-
TOTAL	\$ 879,720,180	\$ 247,616	\$ 1,081,121,519	\$ 289,315
GRAND TOTAL	\$ 879,967,796	\$ 879,967,796	\$ 1,081,410,833	\$ 1,081,410,833



YEAR-TO-YEAR BOOK VALUE AND PURCHASED INTEREST COMPARISON

	<u>December 31, 2018</u>	<u>December 31, 2017</u>
TOTAL PORTFOLIO	\$879,967,796	\$1,029,052,369