



LGIP QUARTERLY MEETING & CONFERENCE CALL

5.1.2014

OFFICE OF THE ARIZONA STATE TREASURER



AGENDA

- **LGIP Performance**
- **Endowment Performance**
- **Pooled Collateral Program**
- **State Cash Flow**
- **Guest Presentation: Arizona & U.S. Economic Update – Jim Rounds, Senior V.P. Elliott D. Pollack & Company**
- **Q & A**



INVESTMENT PHILOSOPHY

SAFETY

before

LIQUIDITY

before

YIELD



EARNINGS YTD FY 2014

\$98,352,795





LGIP PERFORMANCE

Q3 FY2014

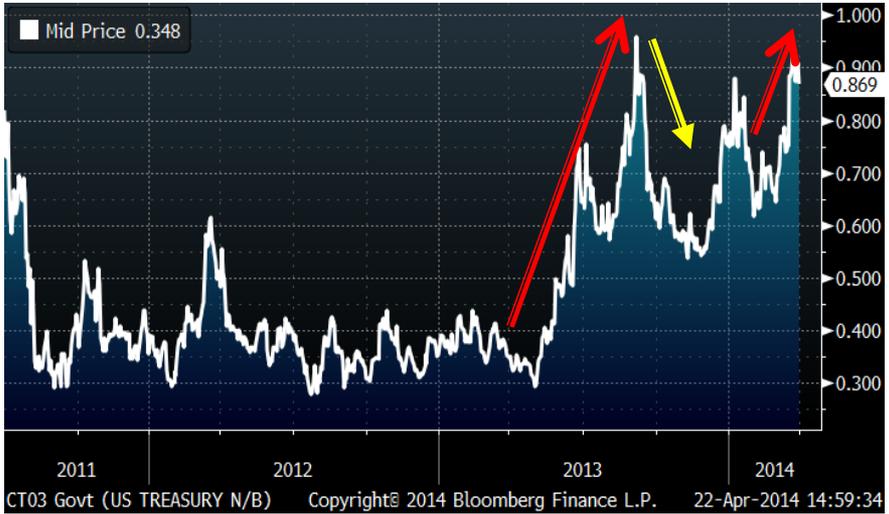


YIELDS: JULY 1, 2011 – MARCH 31, 2014

UST 2-Year Note



UST 3-Year Note



UST 5-Year Note



UST 10-Year Note



POOL 5

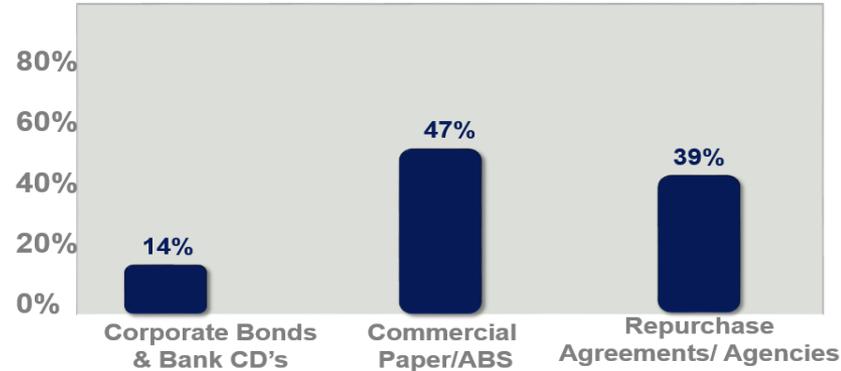
- \$1.25 Billion Assets as of 3/31/2014
- Net Asset Value - \$1.000 3/31/2014
- Diversified investments weighted to highly rated Commercial Paper, Repurchase Agreements, and Agency/Treasuries
- Overnight repo rates continue to be extremely low and as a result allocation to commercial paper has increased. Will continue to add more short corporate bonds and asset-backed securities
- Keep daily liquidity in the 10-30% range
- Maintained the highest rating possible from S&P

Liquidity

Weighted Average Maturity: 47 days on 3/31/2014

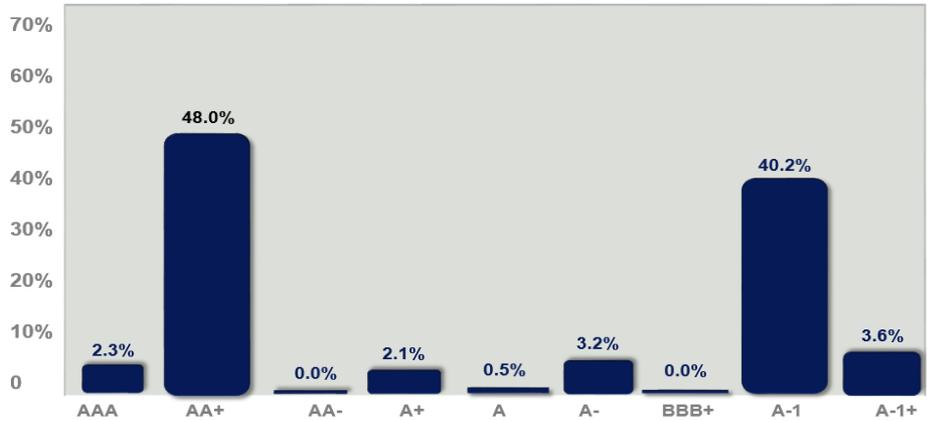
DURATION: 100% from 0-1 yrs

ASSET MIX:



Safety

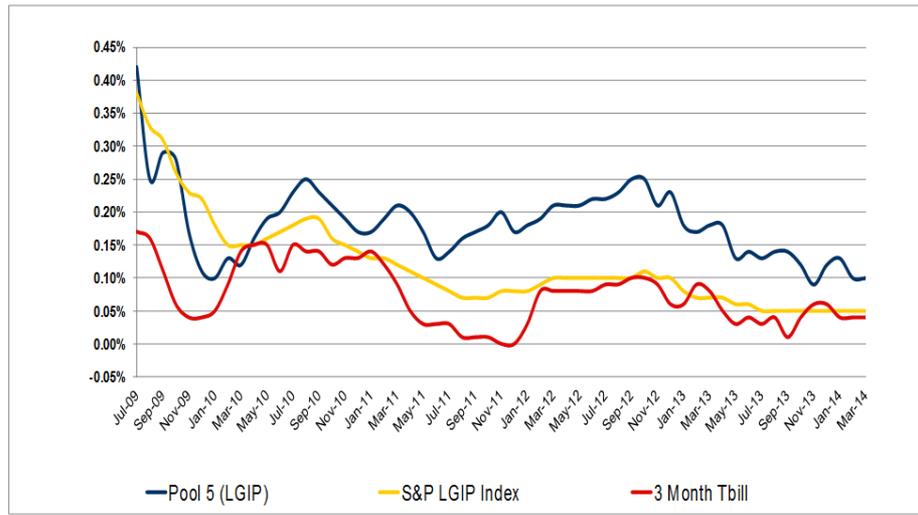
Continues to receive highest rating from Standard & Poor's: AAAf/S1+



Yield

.12% FYTD

.05% FYTD (S&P LGIP Index)



POOL 7

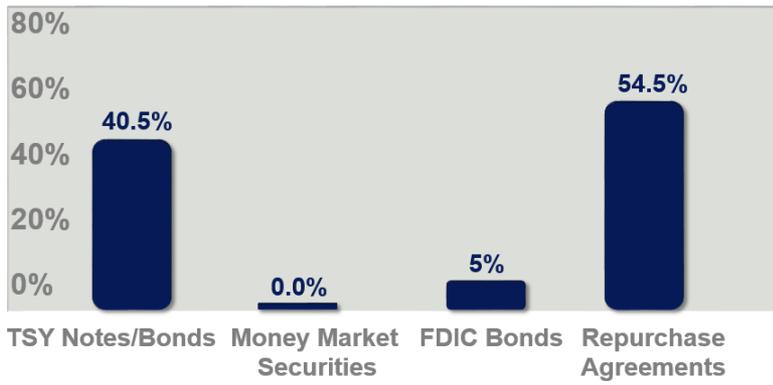
- \$967.5 million Assets as of 3/31/2014
- Net Asset Value - \$ 1.000 3/31/2014
- Overnight repo rates continue to be very low this quarter.
- Looking to ladder treasuries/repo and other full faith and credit products up to 13 month horizon. Planning to purchase new Treasury floaters to add yield.
- WAM will remain short and stay under 90 days to minimize interest rate risk.

Liquidity

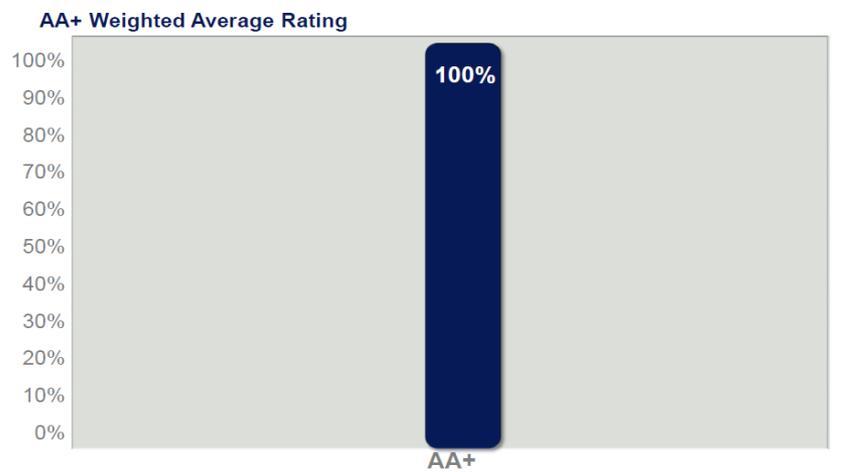
Weighted Average Maturity: 39 days on 3/31/2014

DURATION: 100% from 0-1 yrs

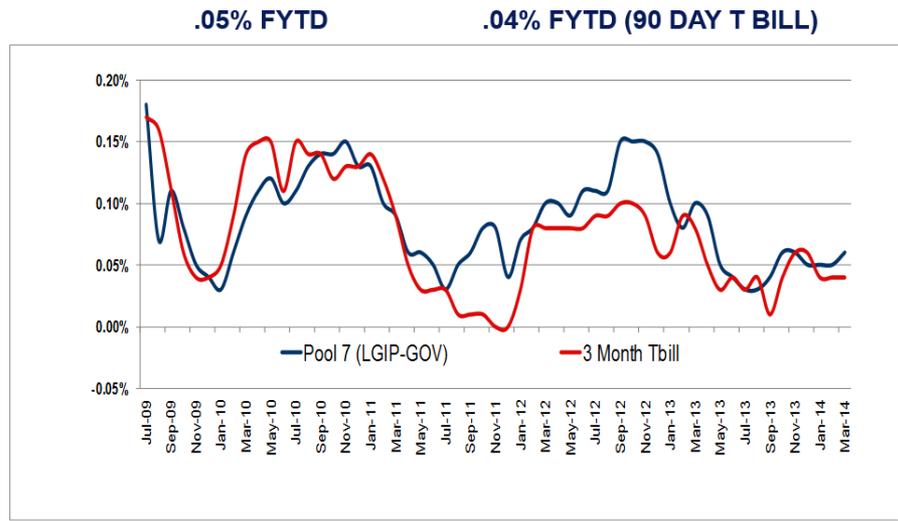
ASSET MIX:



Safety



Yield



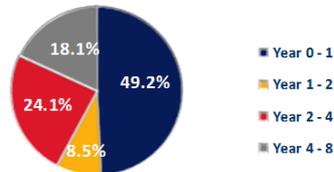
POOL 500

- \$269.5 million in assets as of 3/31/2014
- Floating Net Asset Value - \$1.0289 3/31/2014
- Will continue to invest in assets that provide a prudent diversification that takes advantage of prevailing market opportunities
- Keep maximum exposure to any credit below 2.5%
- Continue to target duration at one year less than the benchmark with 10% to 30% of the fund in liquid short term securities

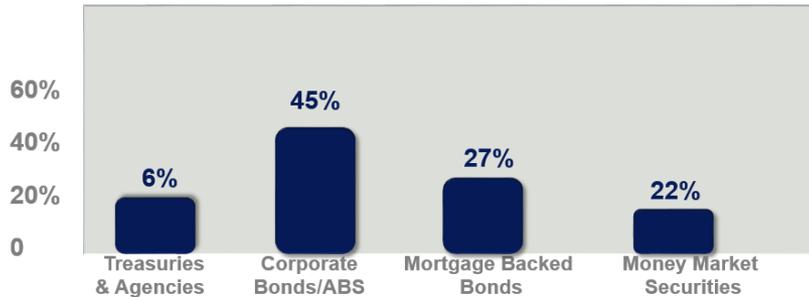
Liquidity

Effective Duration: 1.78 years on 3/31/2014

DURATION:

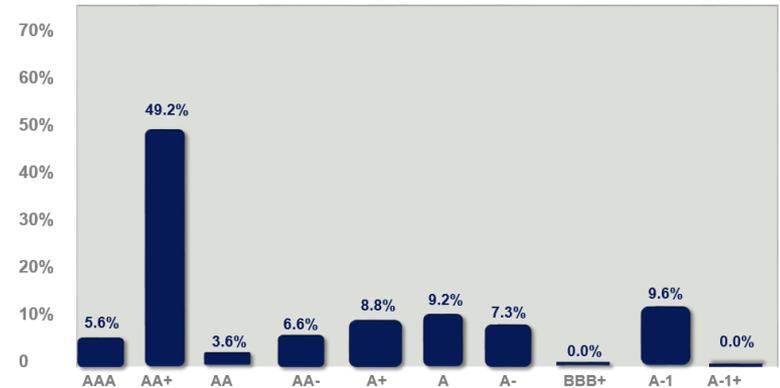


ASSET MIX:



Safety

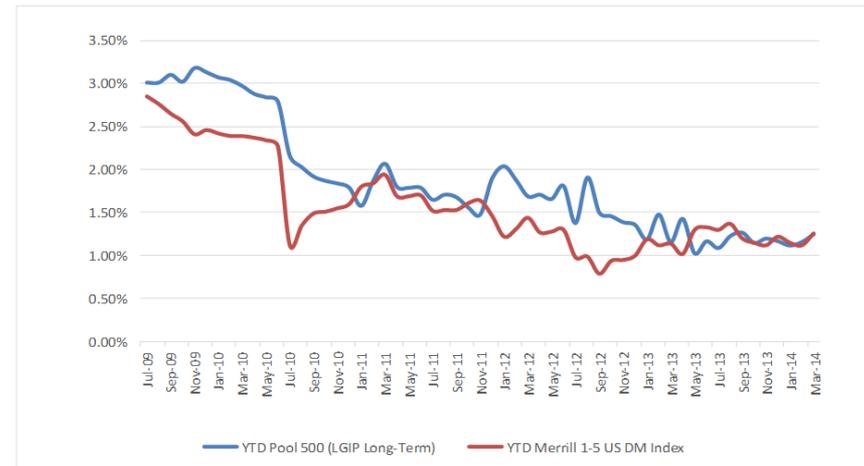
AA Weighted Average Rating



Yield

1.18% FYTD

1.21% FYTD (Index)



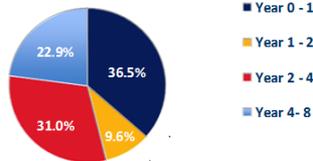
POOL 700

- \$185.9 million in assets as of 3/31/2014
- Floating Net Asset Value - \$.9999 3/31/2014
- Strategy is to invest in a mix of 1-5 year US Treasuries, GNMA Mortgages and FDIC Paper
- All securities backed by US Government
- Continue to target duration at one year less than the benchmark. GNMA mortgage back securities will continue to be overweight the index as there is not a lot of options for full faith and credit bonds and prepayments have slowed with rising rates.

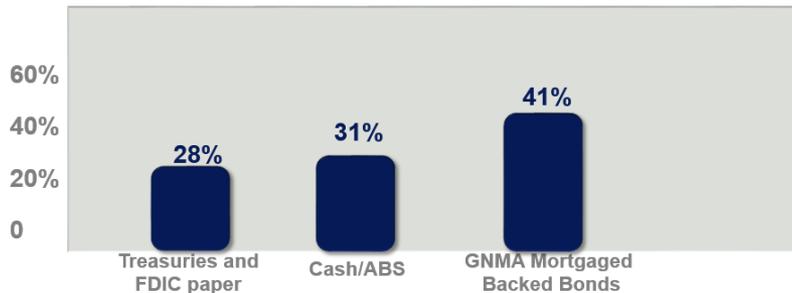
Liquidity

Effective Duration: 2.23 years on 3/31/2014

DURATION:

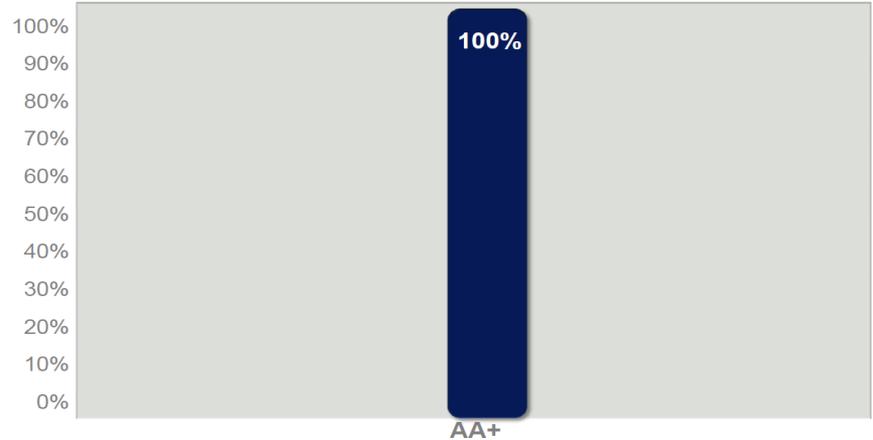


ASSET MIX:



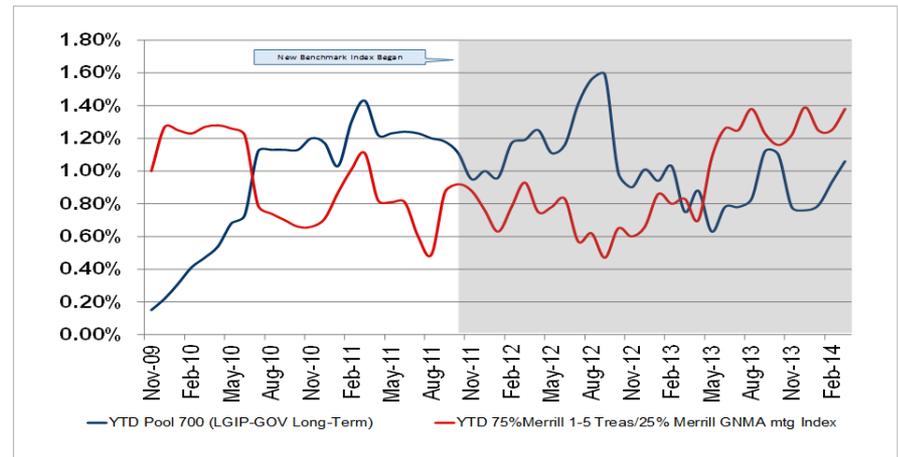
Safety

AA+ Weighted Average Rating



Yield

.90% FYTD 1.28% FYTD (Index)



OFFICE UPDATES

- **April 1, 2014: Conversion to State Street from JPMorgan**
- **Questions/Comments?**
- **Contact: Dale Stomberg**
602-542-7833
DaleS@aztreasury.gov





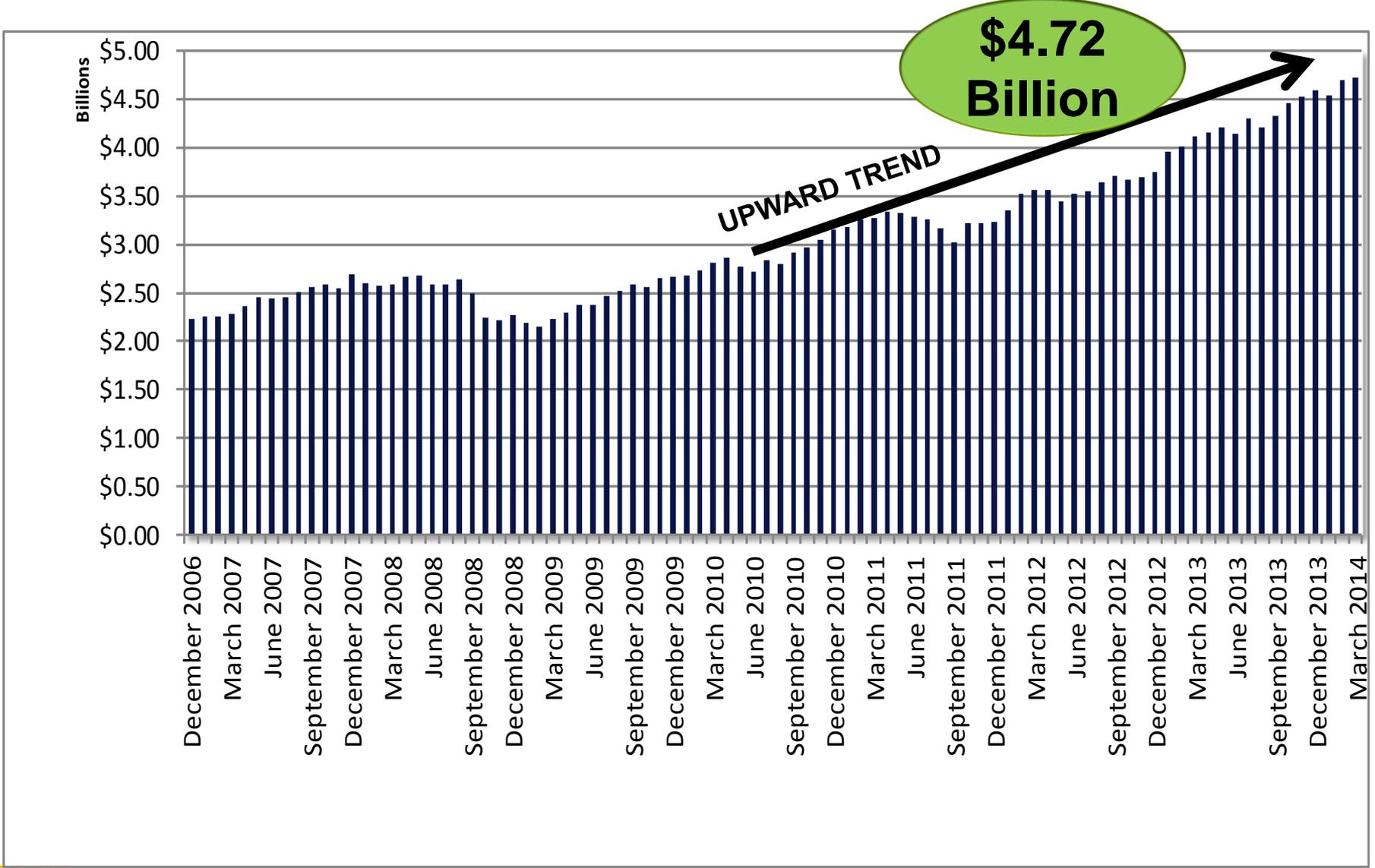
ENDOWMENT PERFORMANCE

Q3 FY2014

OFFICE OF THE ARIZONA STATE TREASURER

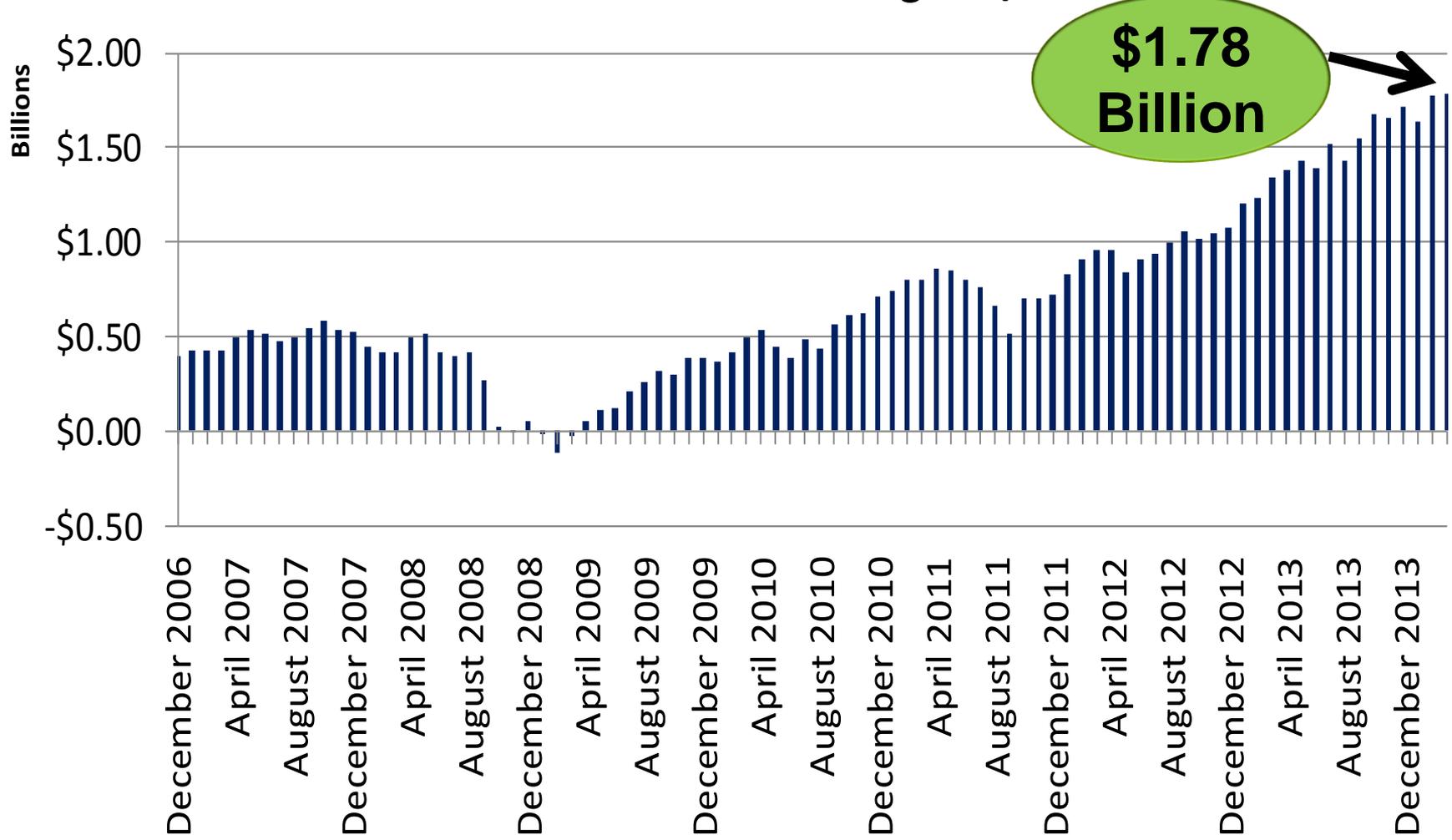


ENDOWMENT MARKET VALUE



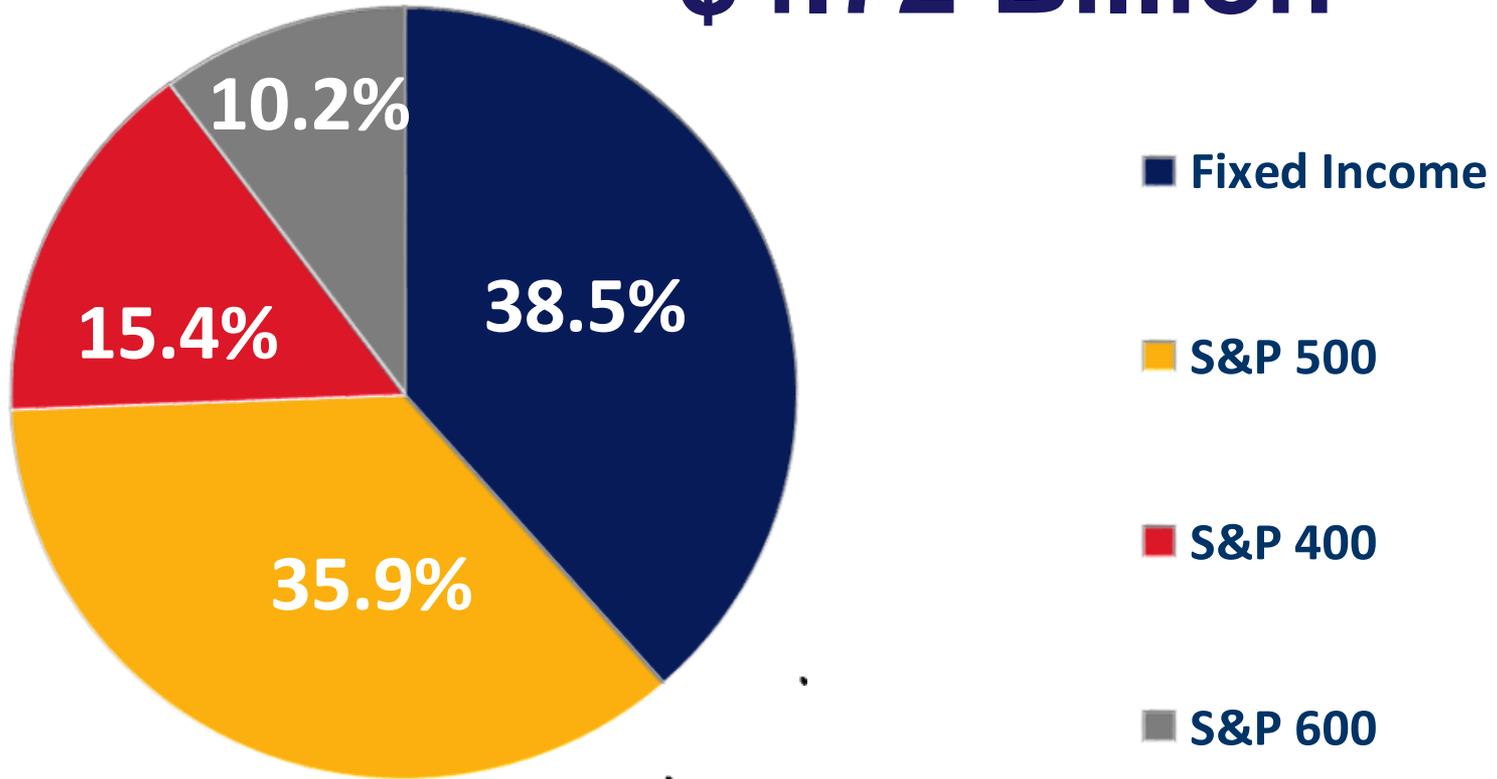
ENDOWMENT UNREALIZED GAINS

Total Endowment Unrealized gains/losses



ENDOWMENT ASSET ALLOCATION

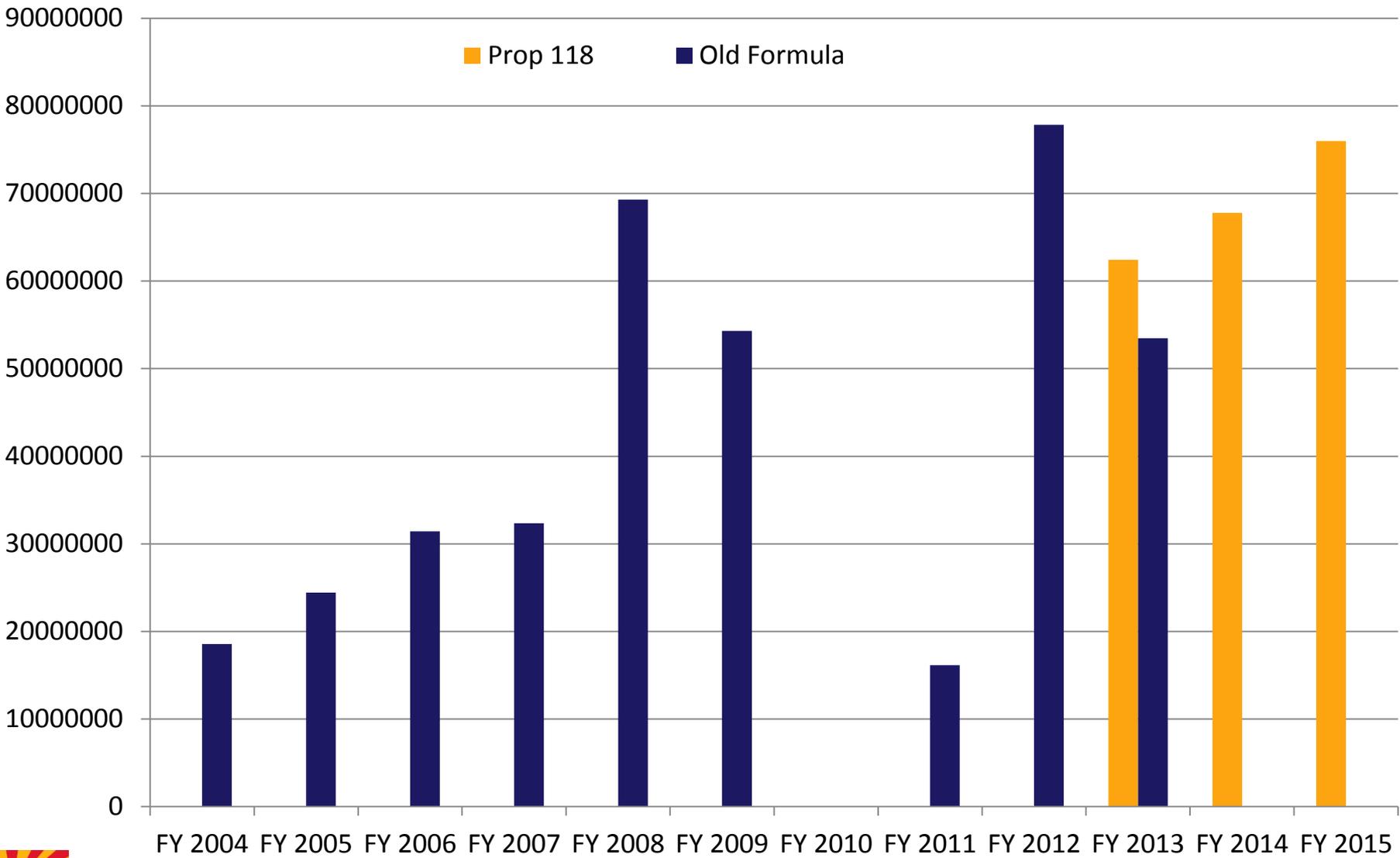
\$4.72 Billion



As of 3/31/2014



K-12 DISTRIBUTIONS





POOLED COLLATERAL PROGRAM

OFFICE OF THE ARIZONA STATE TREASURER



WHAT IS POOLED COLLATERAL?

Current Process

- Each public deposit requires separate collateral to be held
- Every time deposits fluctuate for each individual public entity collateral has to be sold and purchased by the bank
- Each public entity is responsible for monitoring, reporting, and auditing collateral held by their bank

Pooled Collateral

- Banks hold collateral equivalent to all public deposits they have within Arizona
- Deposit fluctuations can be predicted and accounted for as a whole
- Pool administrator is responsible for monitoring and reporting



WHAT IS POOLED COLLATERAL?

Public Entity View

- Public entities continue to bank with their preferred provider
- State pool admin has responsibility for ensuring that banks meet state requirements and providing reporting to public entities
- Collateral management admin costs are shared by the member banks
- Public agencies save time and money due to collateral management and reporting responsibility transferred to the state admin

Bank View

- Banks report public deposits to pool admin
- Banks pledge collateral to a statewide admin to protect all the public fund deposits accepted by the bank from public entities within the state
- Member banks share the costs of collateral management admin
- Banks save time and money due to reduced custodian management expenses and collateral paperwork; cost savings likely to be passed on to public agency



WHAT IS POOLED COLLATERAL?

Implementation Process:

- State Treasurer's Office published draft policies and procedures for comment through May 5th
- Comments and recommendations should include current processes that organizations would like to continue and suggestions to increase efficiency and safety
- All recommendations will be evaluated with final policies and procedures available by May 31st and data testing in June
- Starting July 1st information will be available on the Treasurer's website that will detail the total amount of public deposits per financial institution, the amount of FDIC coverage, and the amount of collateral pledged per institution





STATE CASH FLOW

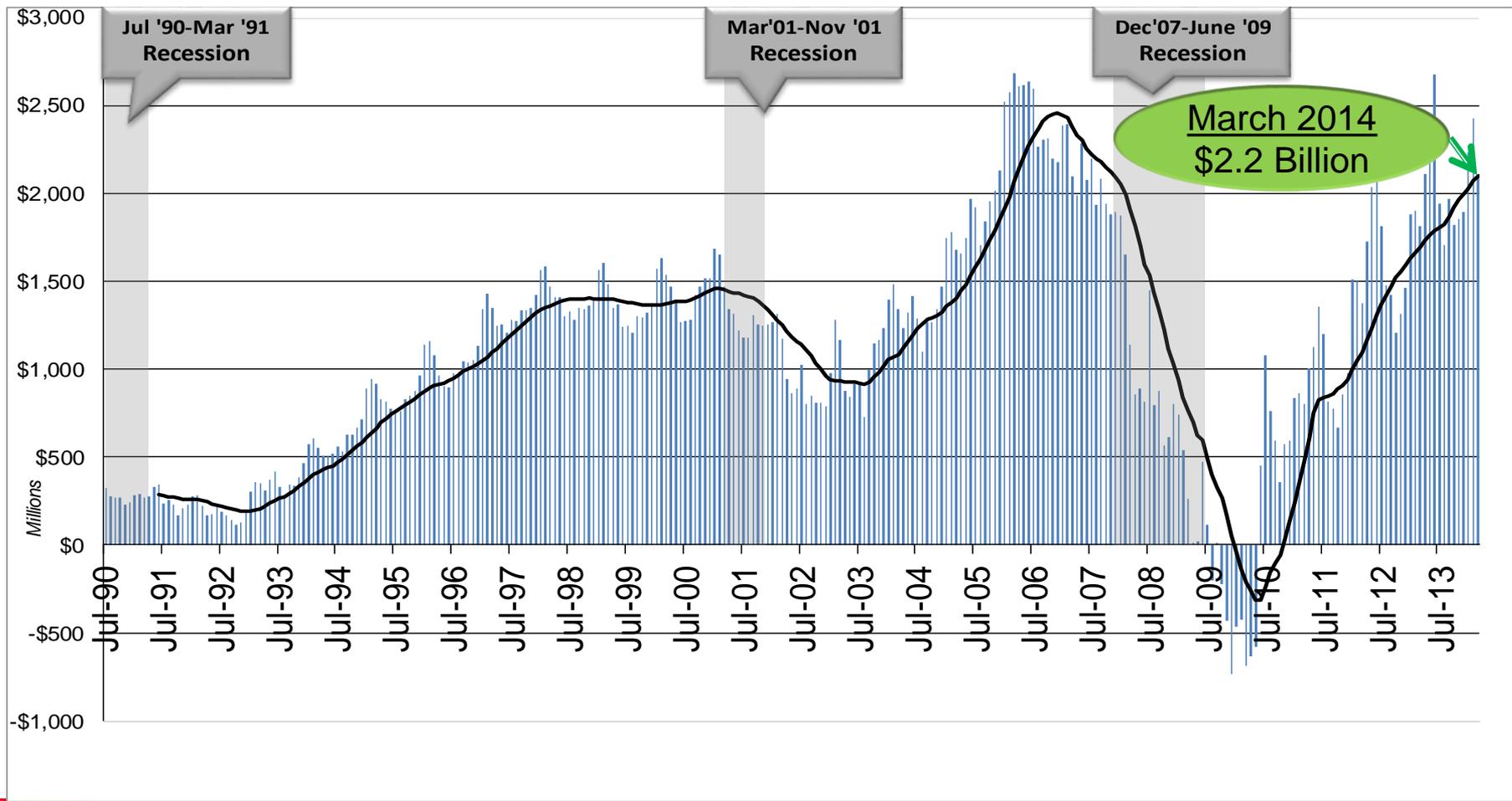
OFFICE OF THE ARIZONA STATE TREASURER



STATE CASH FLOW

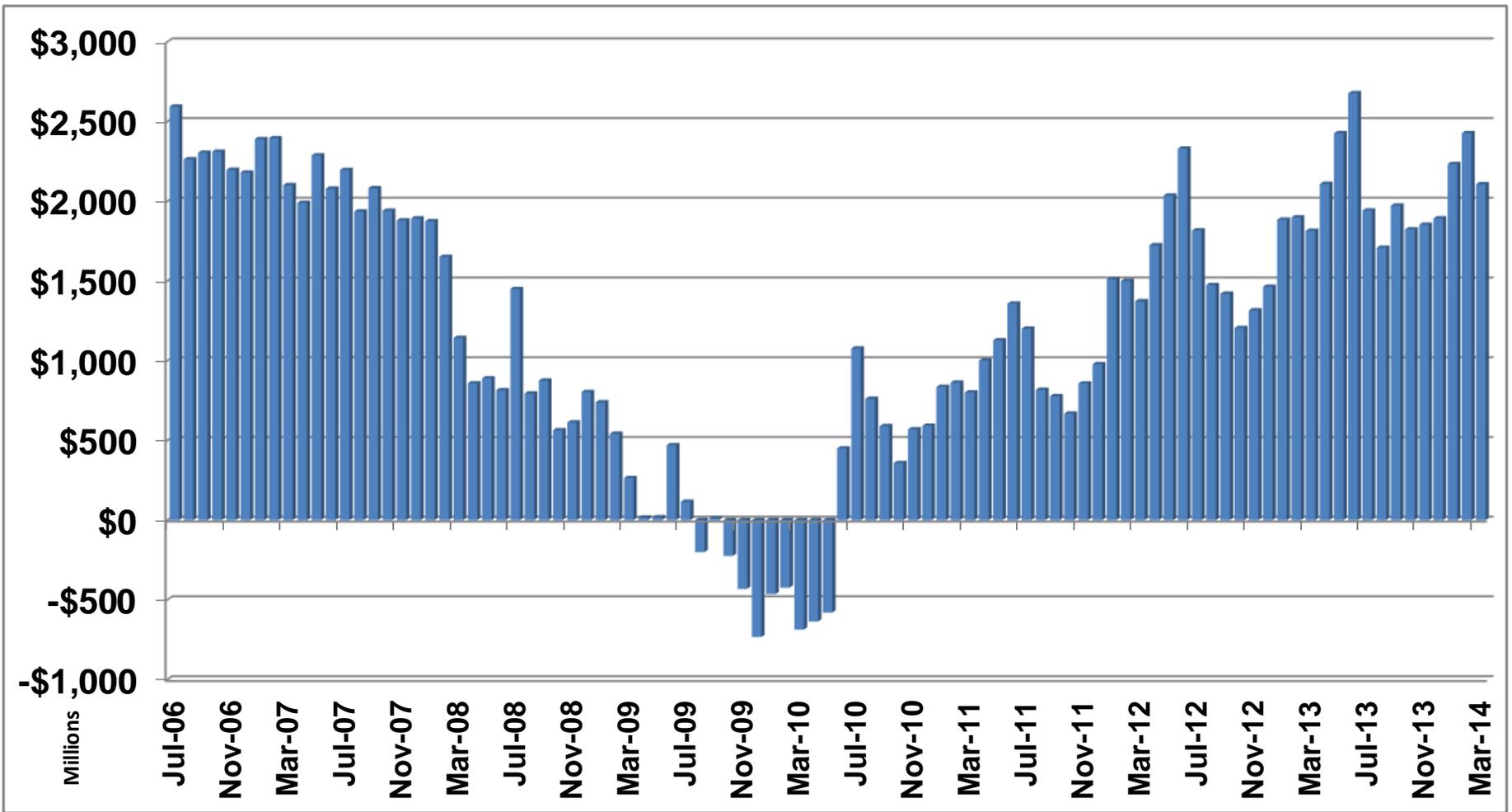
TOTAL OPERATING ACCOUNT AVERAGE MONTHLY BALANCE

Up 25% in First 9 months YOY



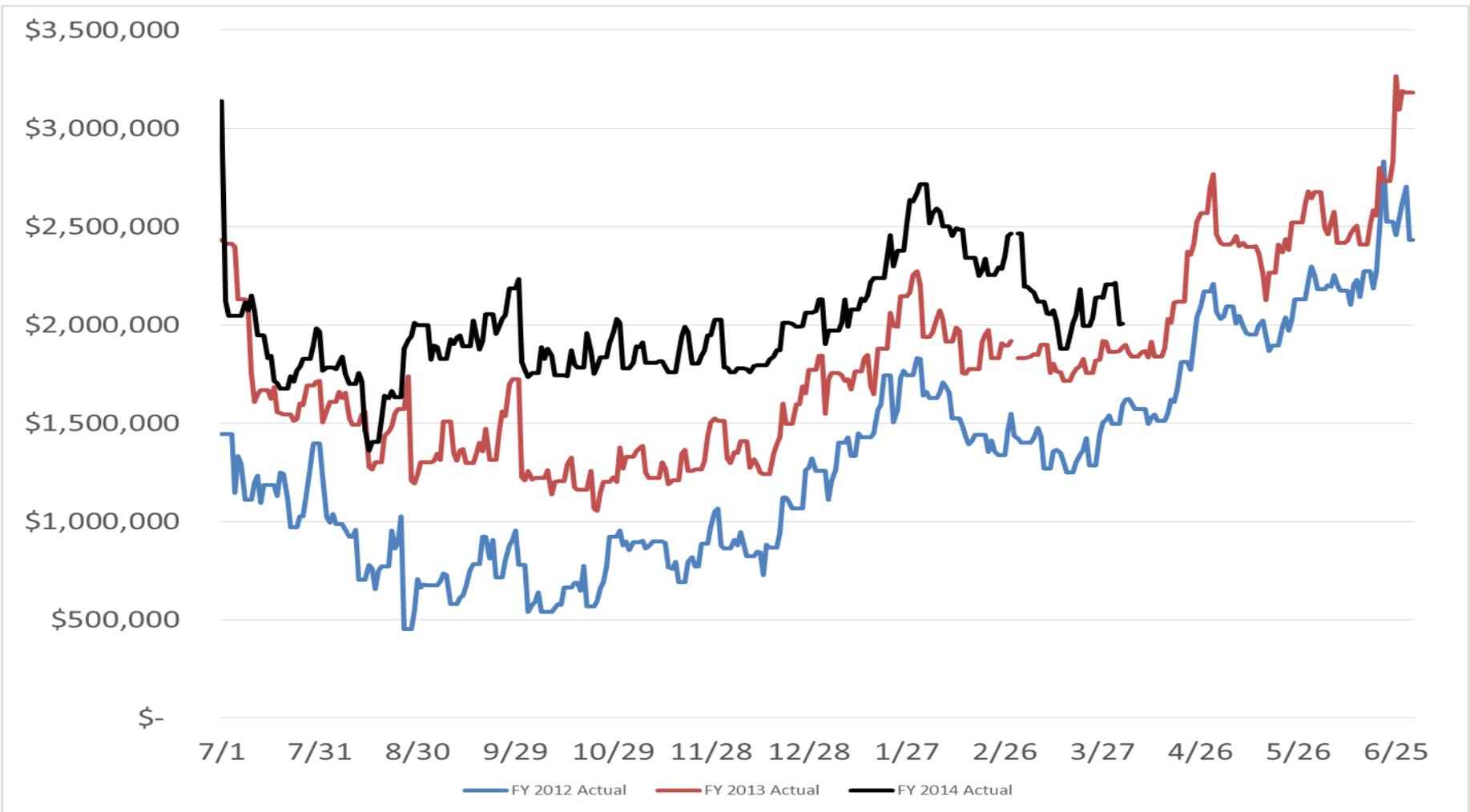
STATE CASH FLOW

State Operating Balance FY 2007 - FY 2014 YTD



STATE CASH FLOW

YTD FY 2014 Cash Flow vs. Last Two Fiscal Years





GUEST PRESENTATION:

JIM ROUNDS

SENIOR VICE PRESIDENT

ELLIOTT D. POLLACK & COMPANY

OFFICE OF THE ARIZONA STATE TREASURER





Arizona Economic Update

Office of the Arizona State Treasurer

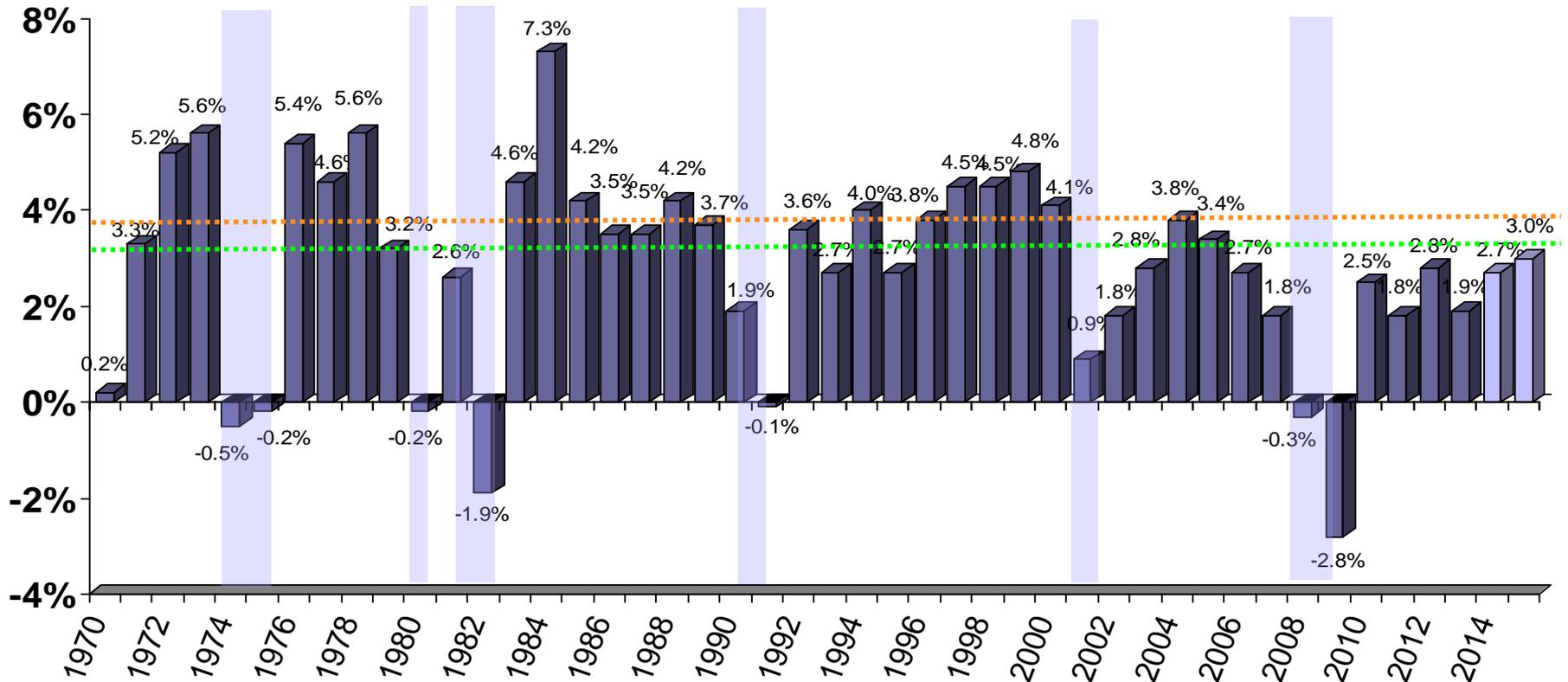
May 1, 2014

**Presented By:
Jim Rounds
Senior Vice President
Elliott D. Pollack & Company**



United States Real Gross Domestic Product* Annual Growth 1970 - 2015**

Source: U.S. Bureau of Economic Analysis & *Blue Chip Economic Indicators*



* Based on chained 2009 dollars.

** 2014 and 2015 are a forecast from the Blue Chip Economic Indicators, April 2014.

----- 3.8% = 40-year avg during expansion

----- 3.2% = 20-year avg during expansion

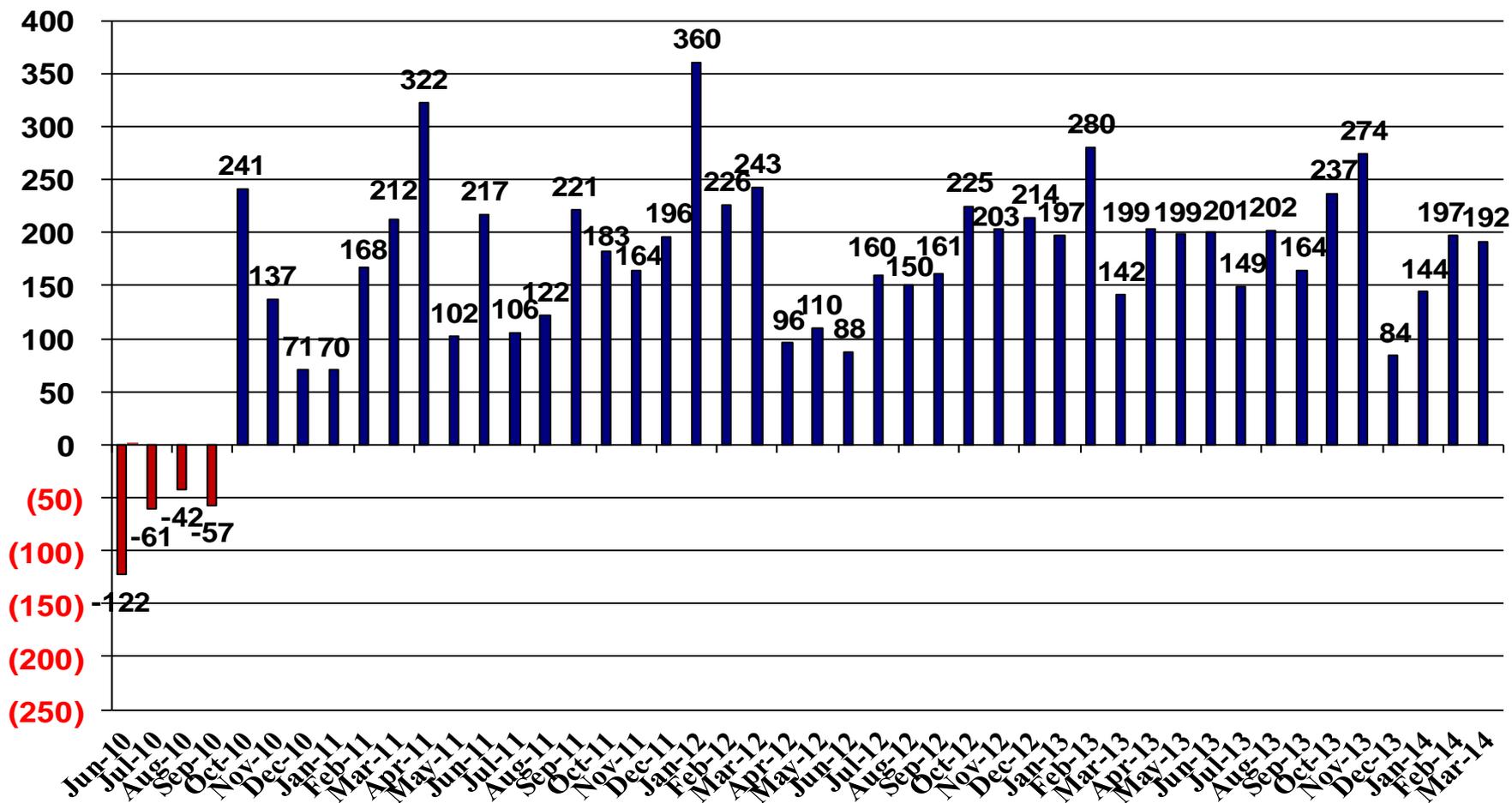
Recession Periods



US Non-Farm Employment Change from Prior Month (S/A)

June 2010 – March 2014

Source: Bureau Labor of Statistics

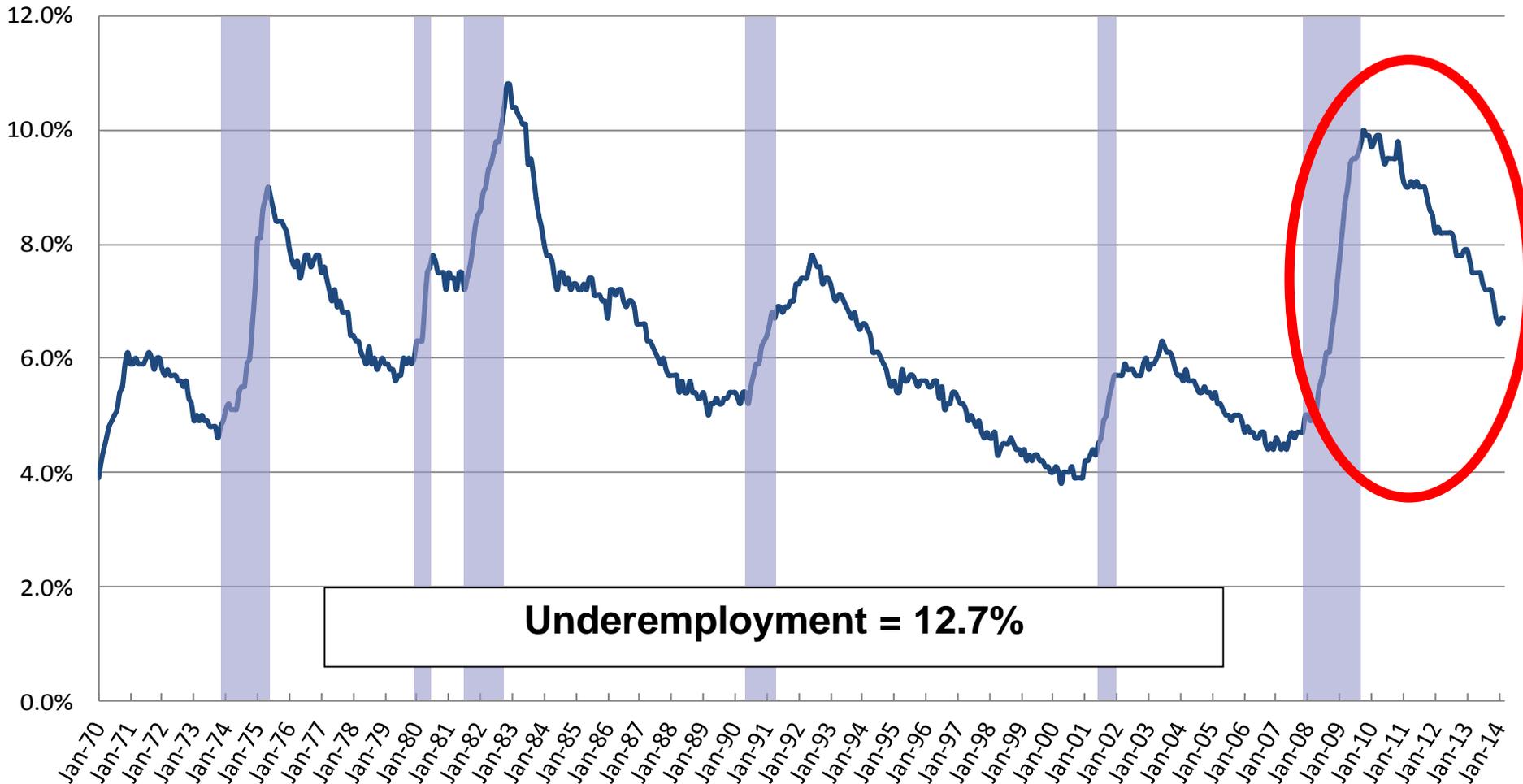


U.S. Unemployment Rate

1970 – 2014*

Source: Bureau of Labor Statistics

Recession Periods



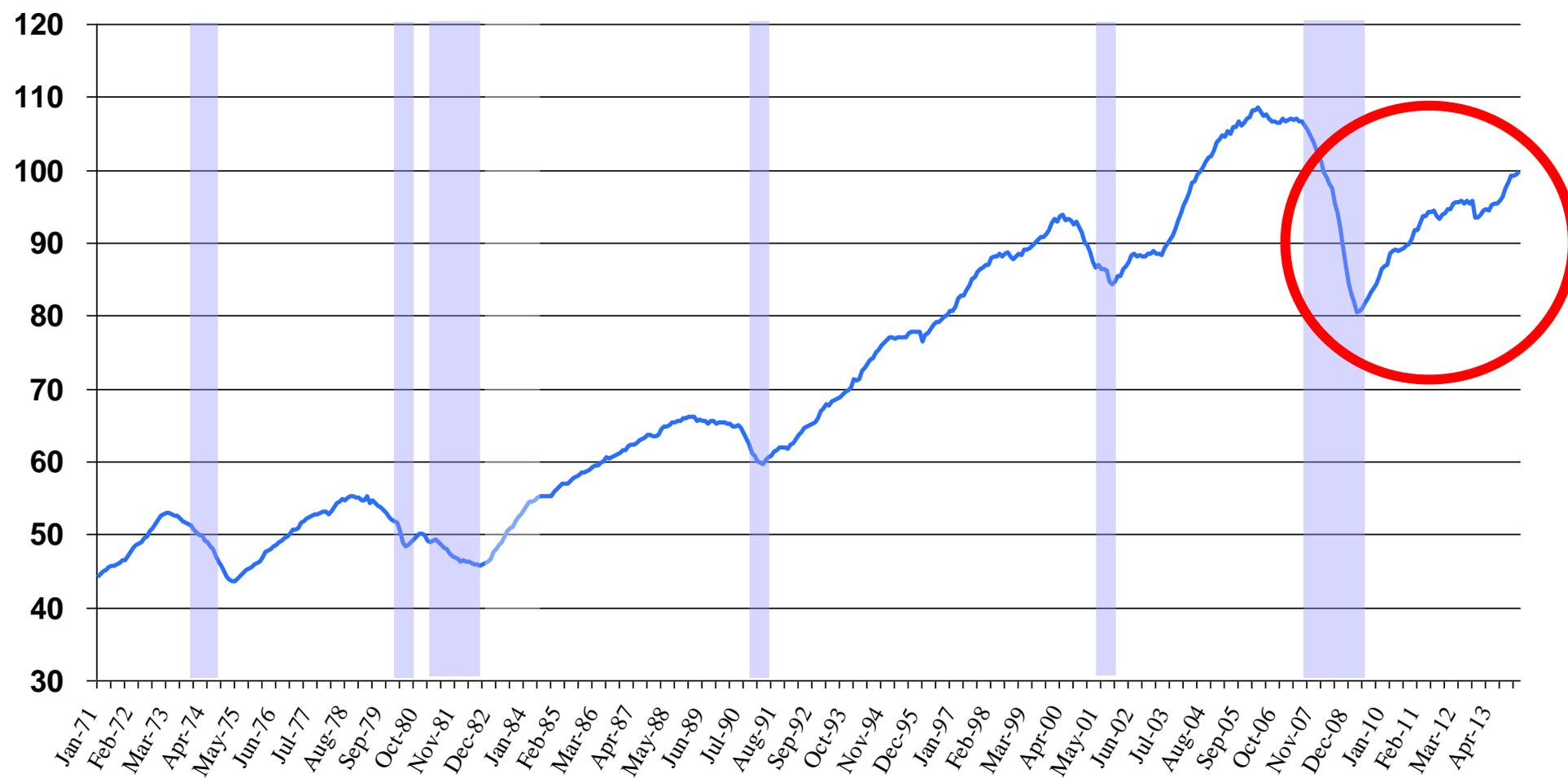
*Seasonally adjusted data through March 2014



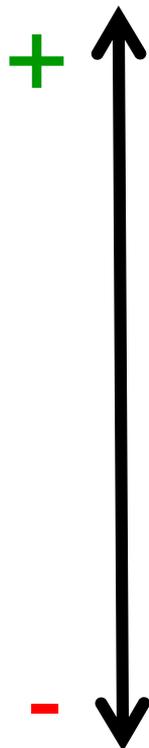
U.S. Leading Indicators 1971 – 2014*

Source: The Conference Board

Recession Periods



10 Components of U.S. Leading Indicators – February 2014

- 
- Interest rate spread
 - Building permits
 - Leading Credit Index (inverted)
 - Manuf. New orders – consumer goods
 - Manuf. new orders – capital goods
 - Stock prices
 - Manuf. new orders index
 - Claims for unemployment (inverted)
 - Consumer expectations
 - Manuf. hours



Risks?



Overall

- **Little irrational exuberance.**

Consumers

- **Debt burden low.**
- **Net worth improved.**
- **Real income growth.**
- **Liquidity improving.**
- **Inflation low.**



Business

- **No excess inventory.**
- **No capacity issues.**
- **Dollar not overly strong.**

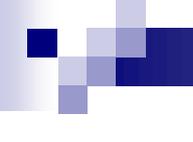
Government

- **Fed policy still expansive (2015).**

Housing

- **Prices up but leveled.**





U.S. Risks

- **Stock market?**

International Risks:

- **China?**
- **Russia?**



What's slowing us down?



- **70s, 80s** – Rapid increase in household formation.



- **90s** – Huge increase in stock market.



- **1996 – 2005** – rapid increase in housing prices/housing based credit.



Now?



Consumers



WEALTH EFFECT



Housing prices are up.

Stock market is up.

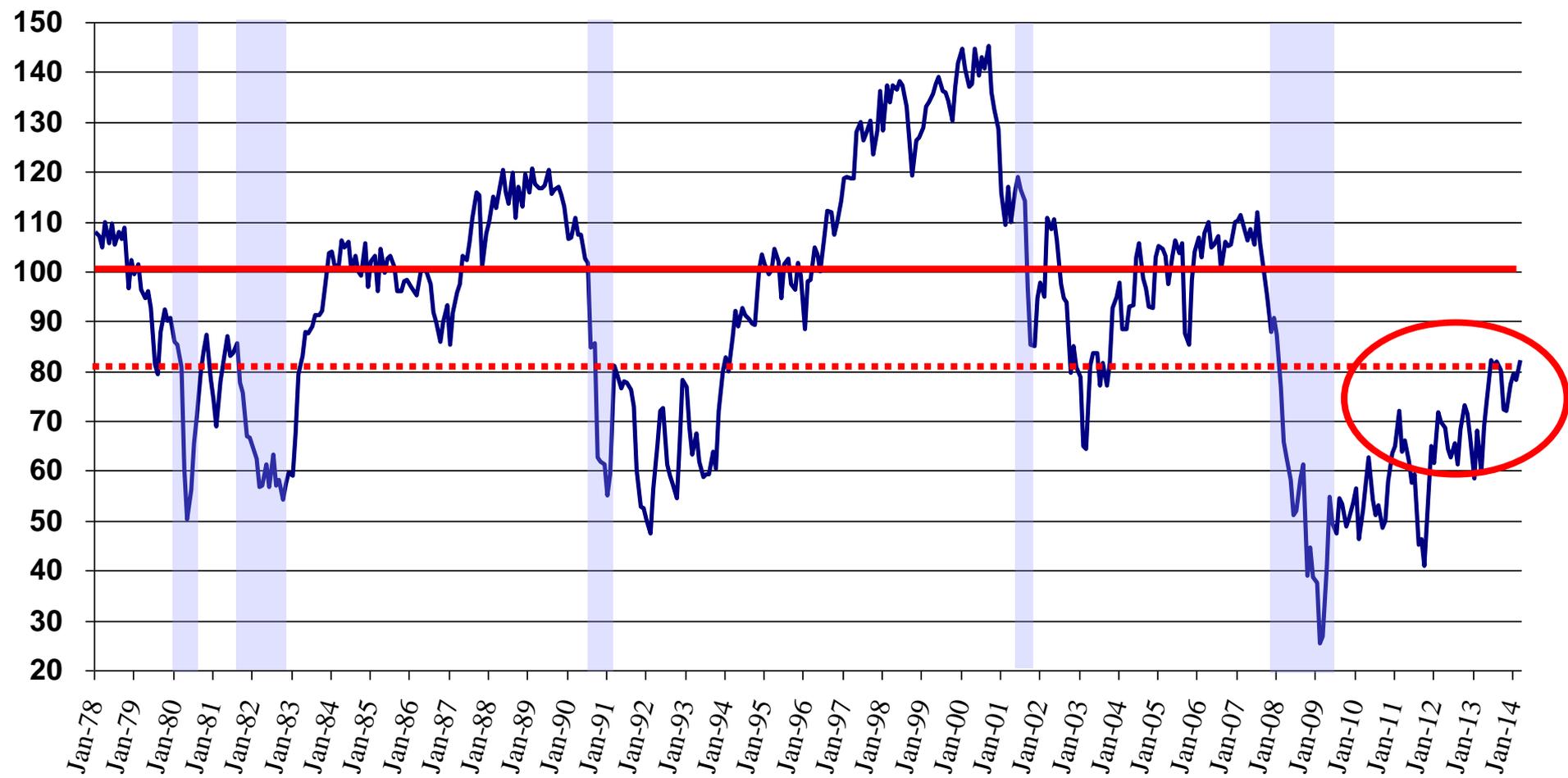


Consumer Confidence

1978 – 2014*

Source: The Dismal Scientist

Recession Periods



*Data through March 2014.



Time to replace the autos...



Average Age of Auto Fleet

(all light vehicles)

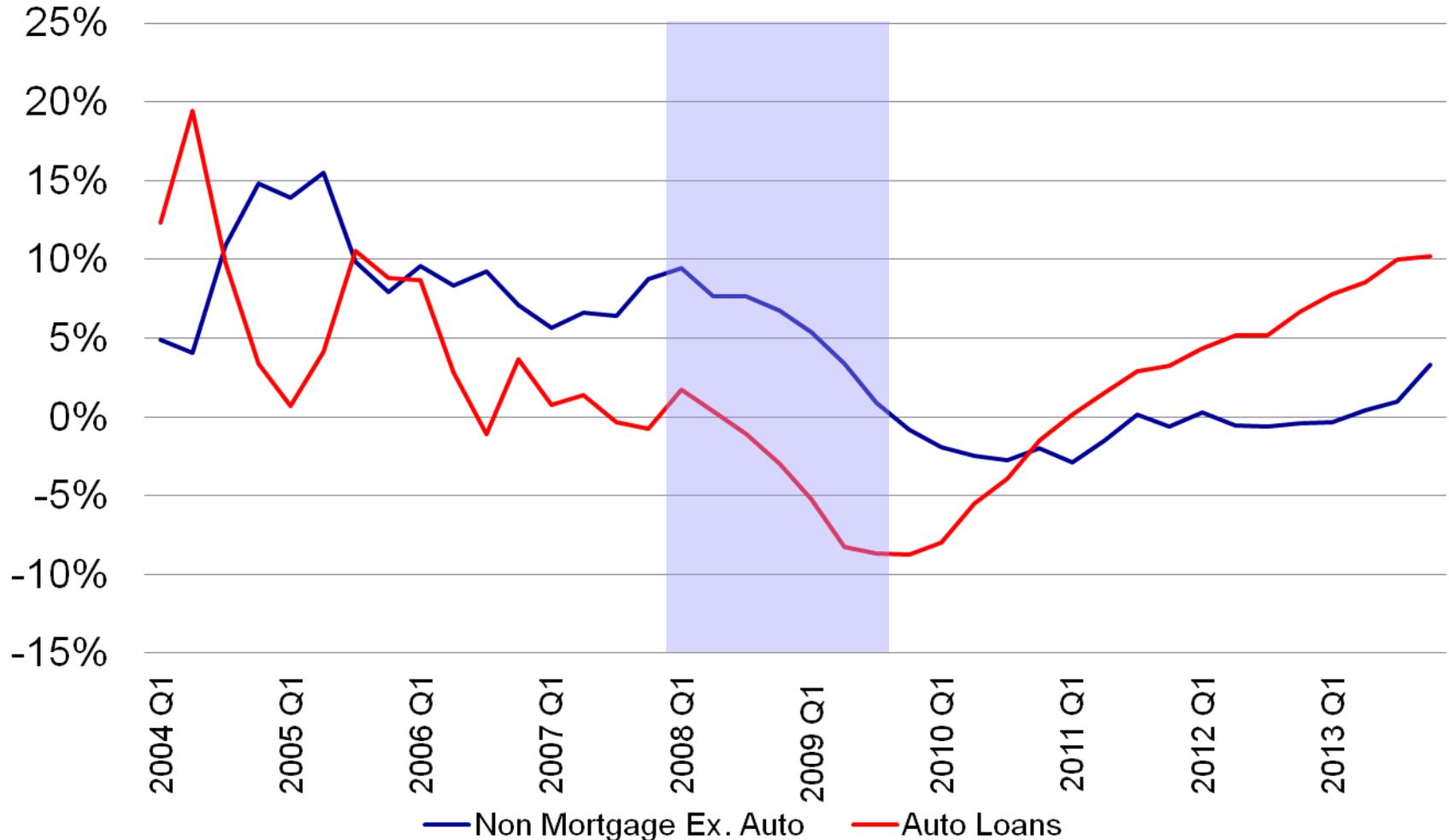
- 2013 – 11.4 years
- 2010 – 10.6 years
- 2005 – 9.5 years
- 2000 – 8.9 years
- 1995 – 8.4 years



Household Debt Composition Percent Change Year Ago 2004 – 2013*

Source: The Federal Reserve Bank of New York

Recession Periods



*Data through fourth quarter 2013.



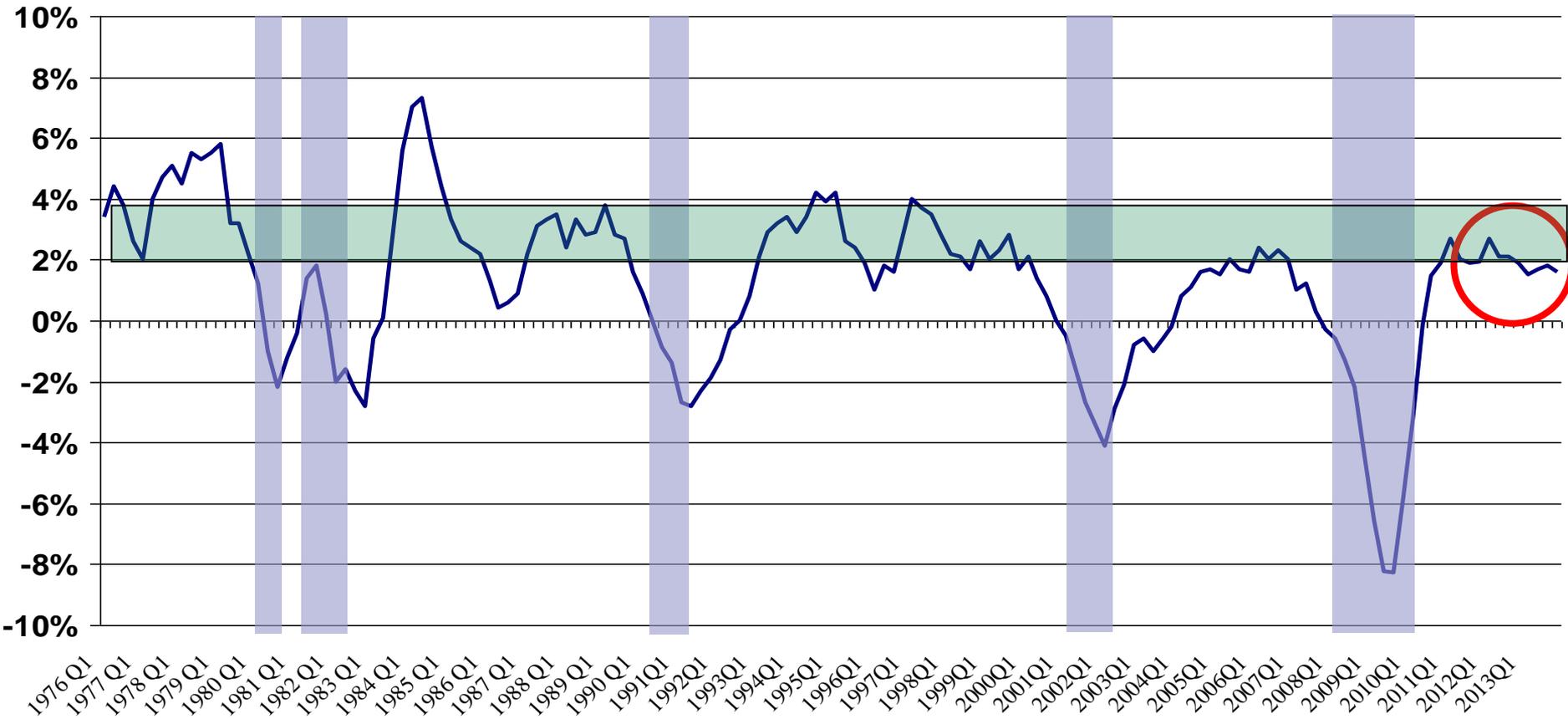
Business



Hours Worked Percent Change from Year Ago 1976 – 2013*

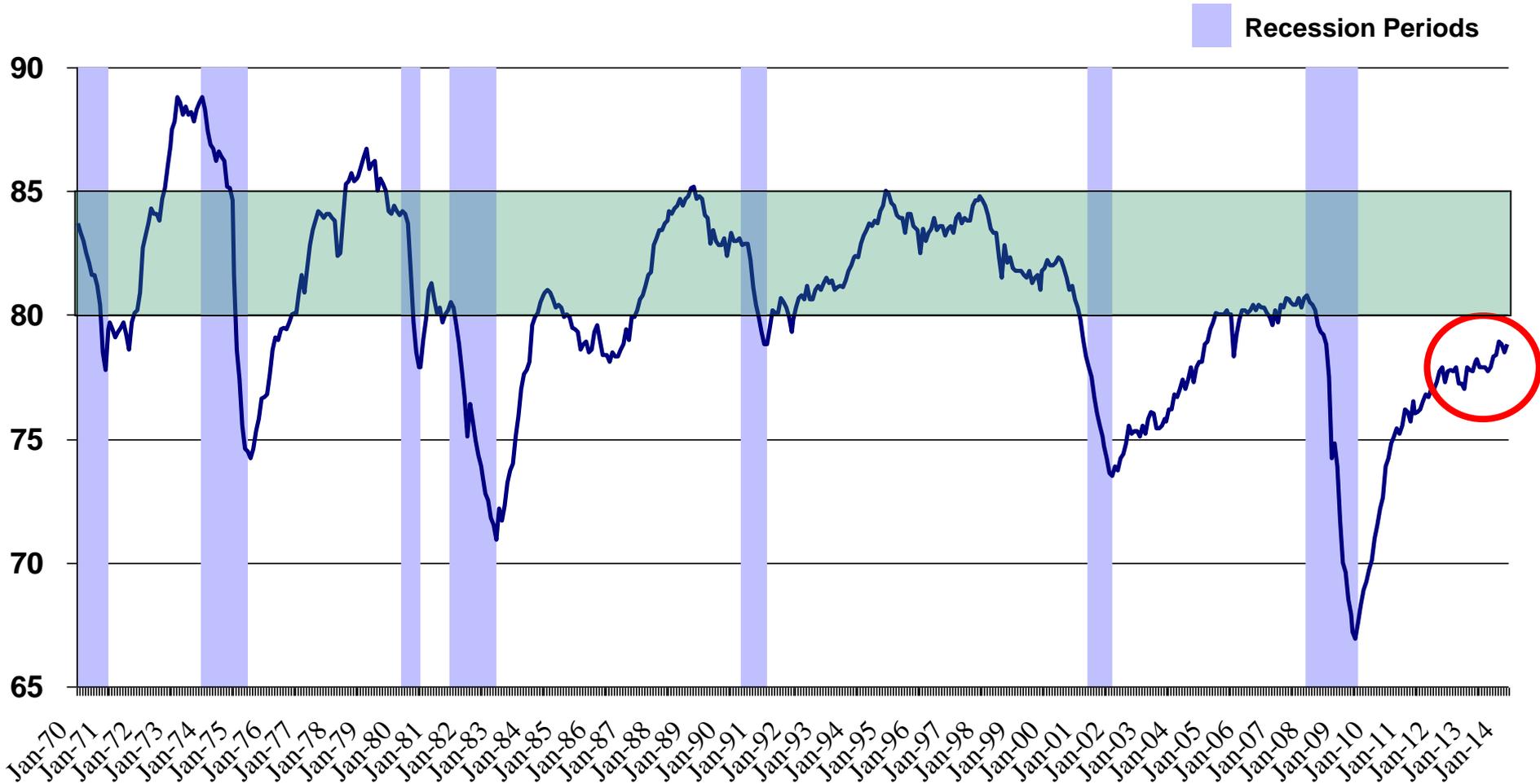
Source: Bureau of Labor Statistics

Recession Periods



Capacity Utilization Rate 1970 – 2014*

Source: The Federal Reserve Bank of St. Louis



*Data through February 2014.





Bottom Line

Mediocrity crept up on us.

**Slower long term growth
with some risk.**

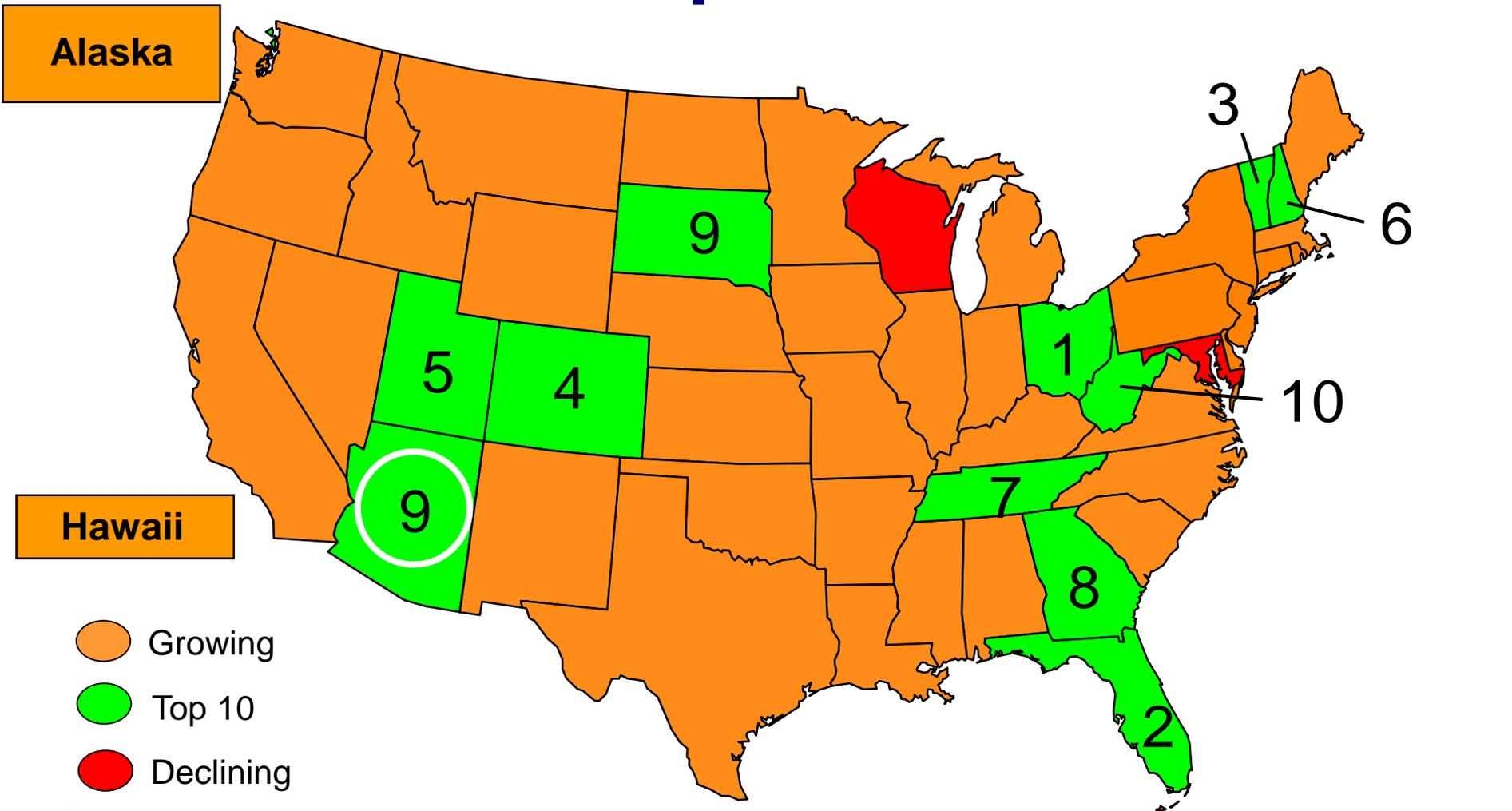


Different this time?

- **Significant declines in population flows.**
- **Steeper housing decline.**



Arizona Population Growth – Still Top 10 in 2013

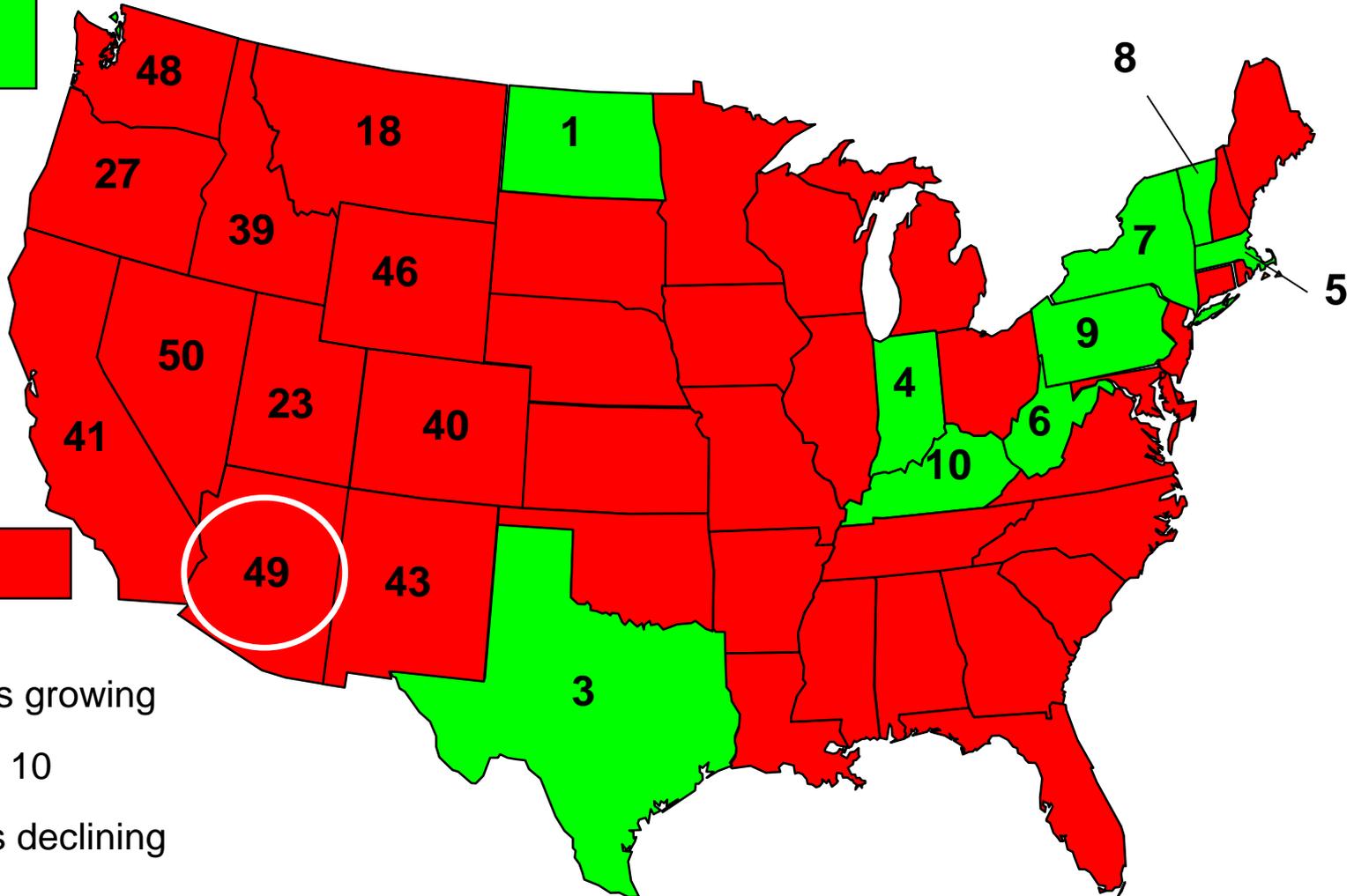


Job Growth 2010

Source: US BLS

Alaska

2



Hawaii

49

Jobs growing

Top 10

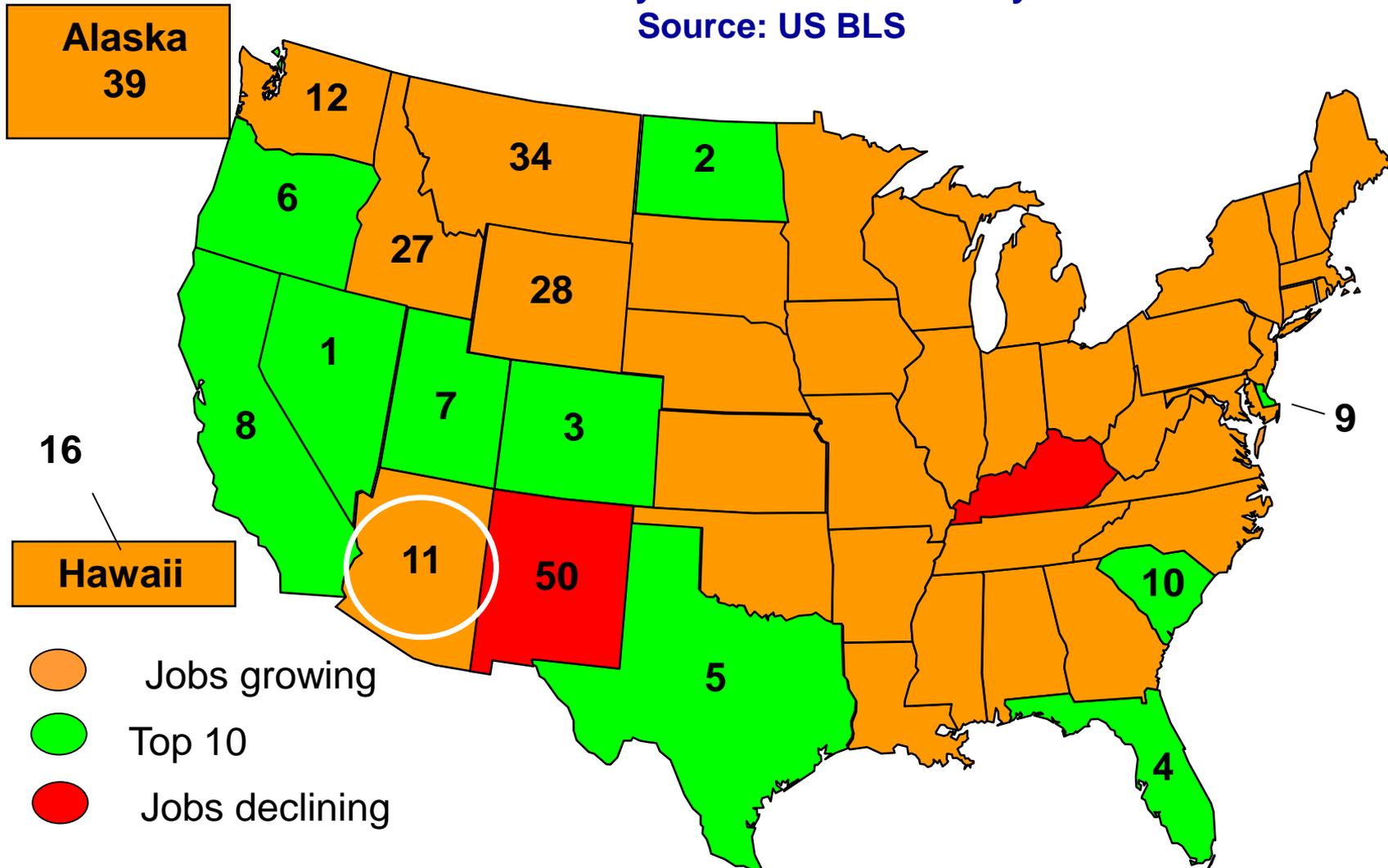
Jobs declining



Job Growth 2014

YTD February 2014 vs YTD February 2013

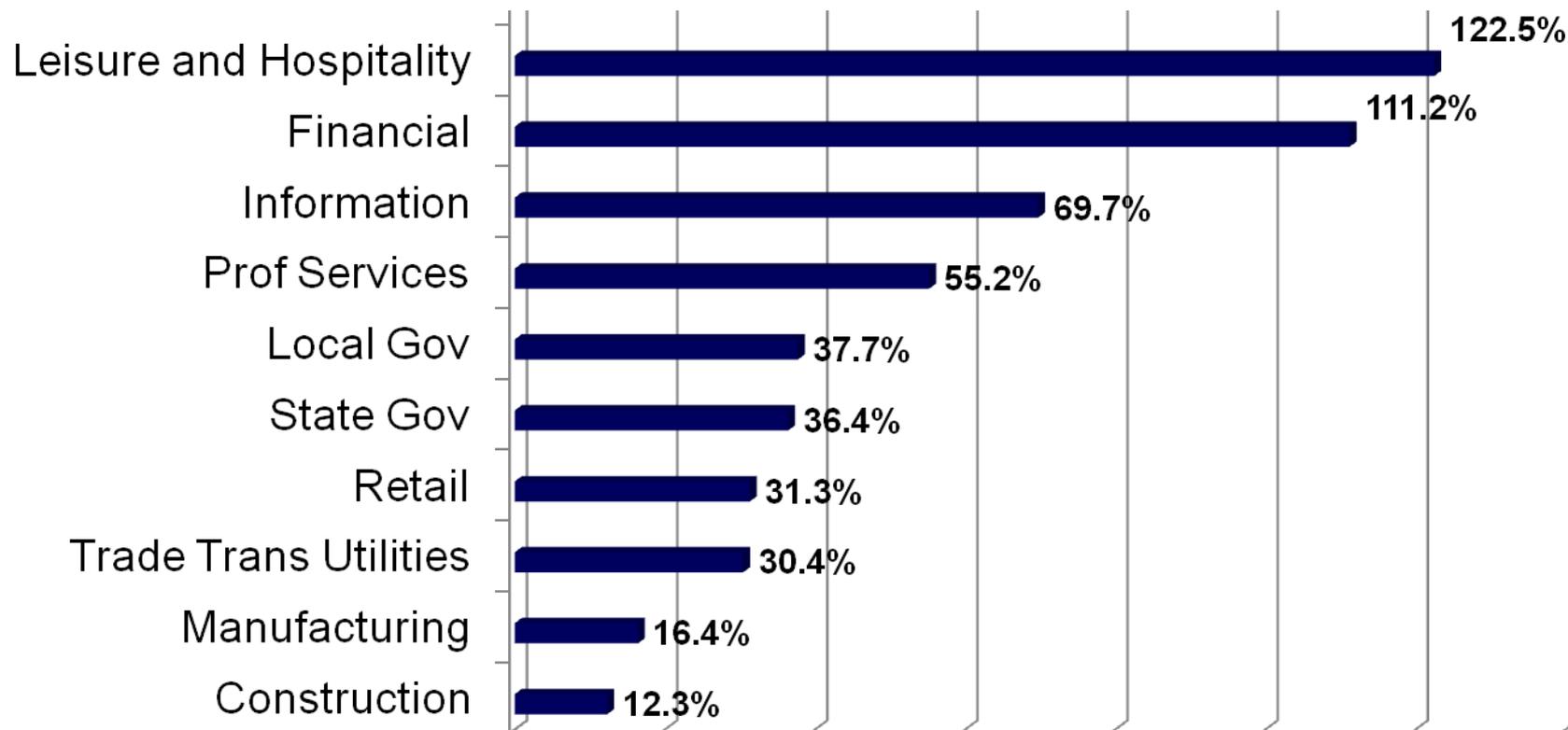
Source: US BLS



Quality?



Arizona Jobs Regained Since Bottom of Cycle Most Industries Yet To Regain Lost Jobs

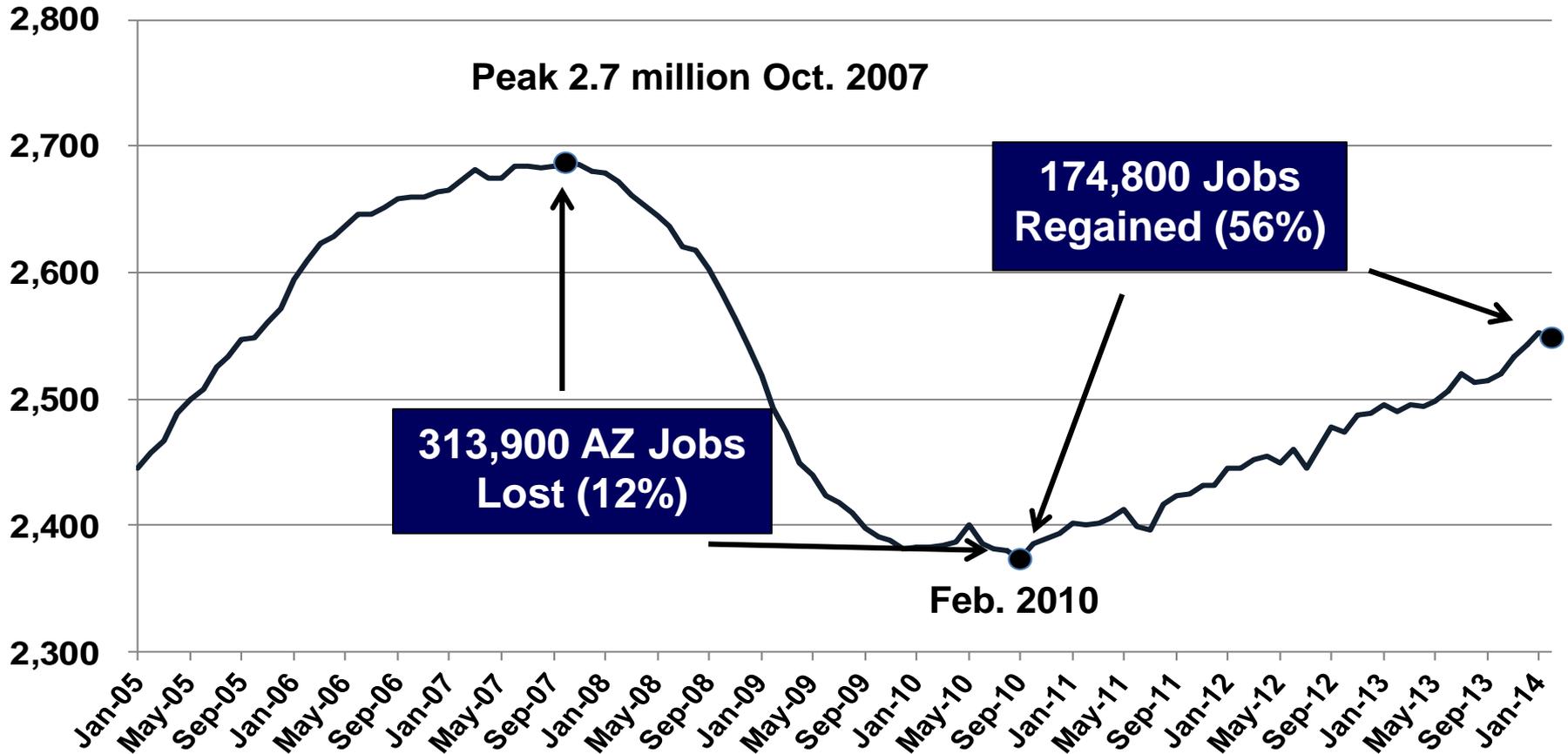


Source: U.S. Bureau of Labor Statistics, Thousands of Jobs, Seasonally Adjusted, As of February 2014



AZ Has Regained 56% of Lost Jobs

139,100 Jobs (44%) Still to Recover



Source: U.S. Bureau of Labor Statistics, Thousands of Jobs, Seasonally Adjusted Data through February 2014.

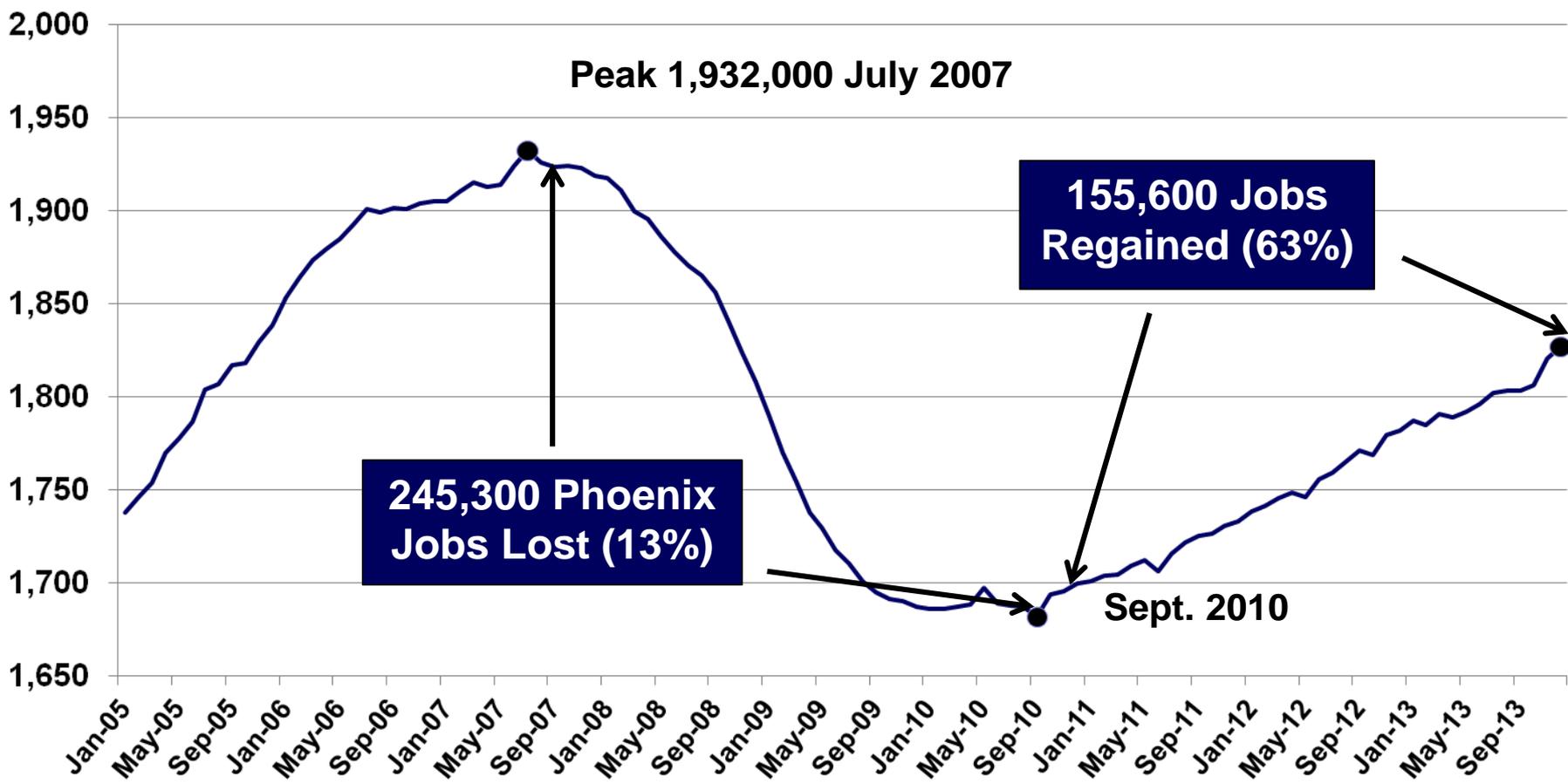


Greater Phoenix



Greater Phoenix Has Gained 63% of Lost Jobs

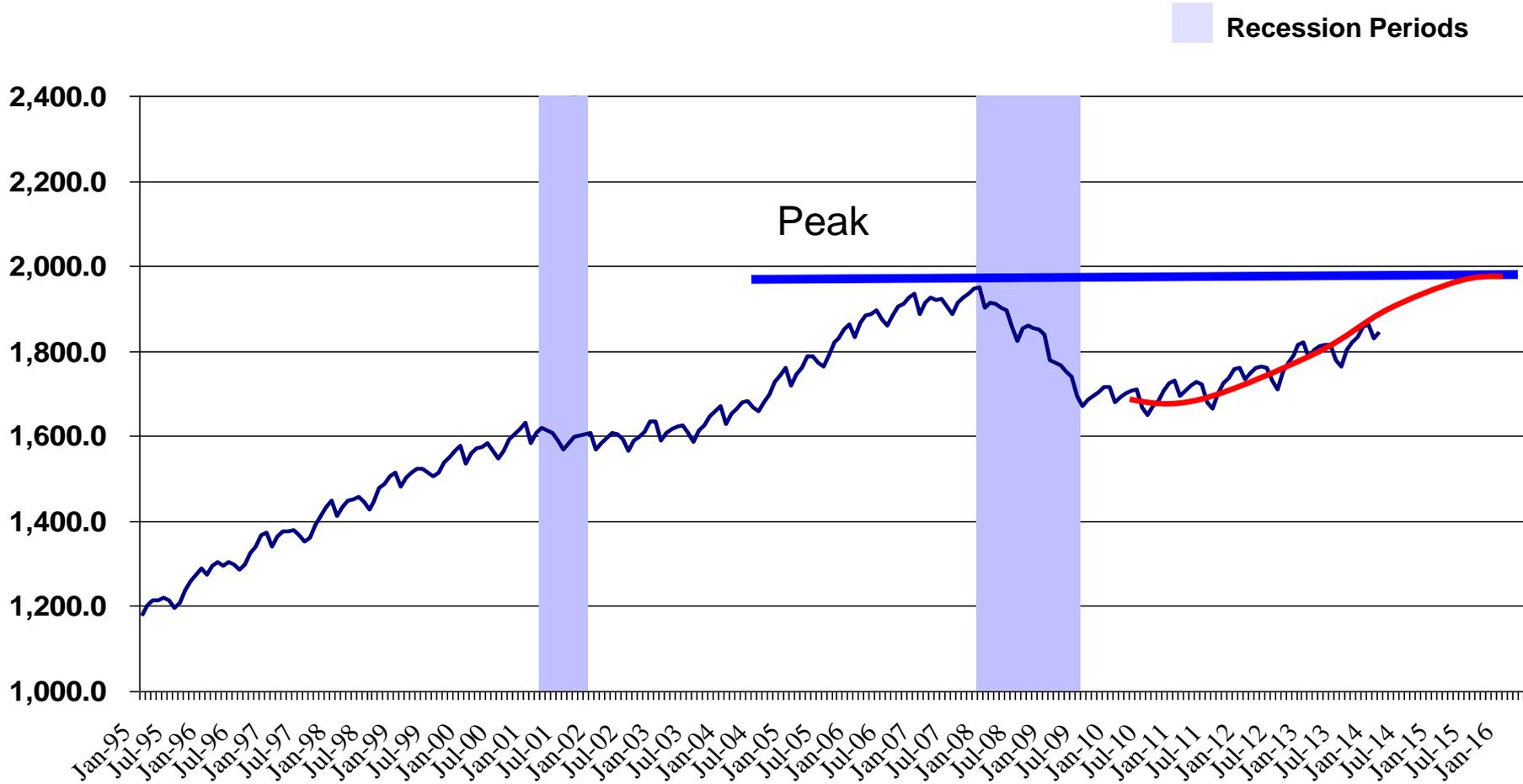
89,700 Jobs (37%) Still to Recover



Source: U.S. Bureau of Labor Statistics, Thousands of Jobs, Seasonally Adjusted Data through February 2014.

Employment Levels: Greater Phoenix back to Peak in 2016?

Source: ADOA



*Based on seasonally unadjusted monthly data



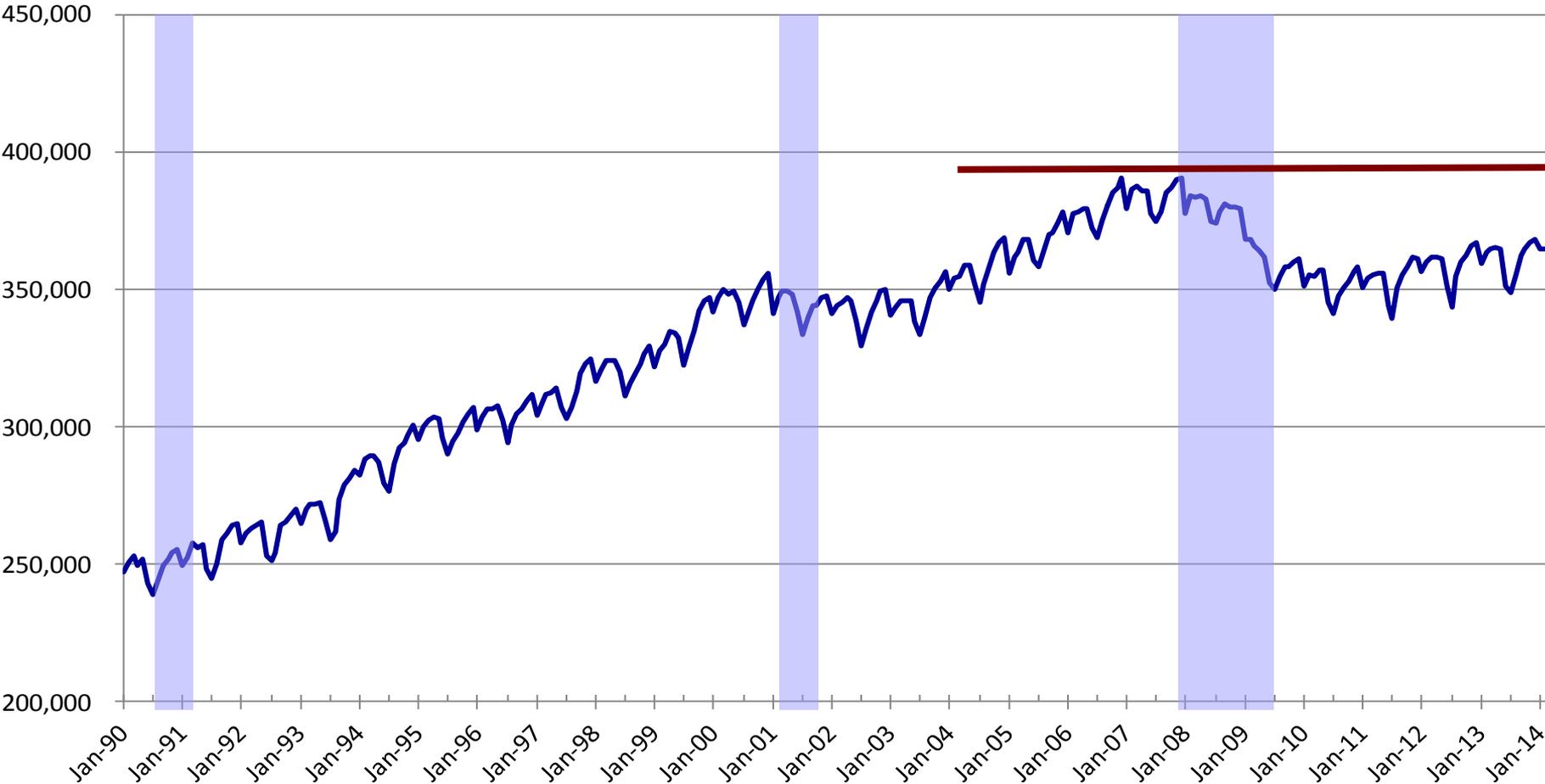
Greater Tucson



Tucson Total Nonfarm Employment NSA 1990 – 2014*

Source: Bureau of Labor Statistics

Recession Periods

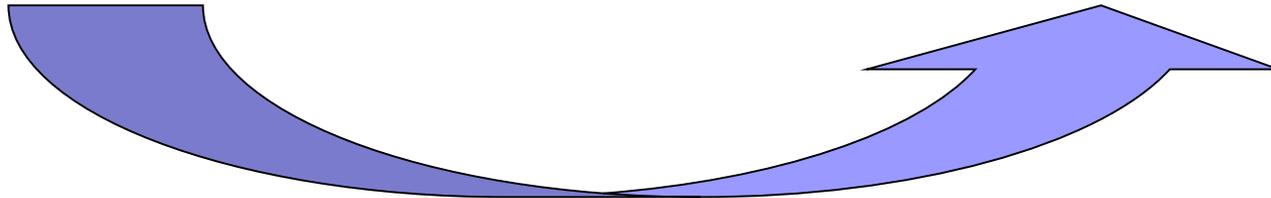


*Data through February 2014.

Tucson Employment*

Source: ADOA

<u>Sectors in Decline</u>	<u>Net Change</u>	<u>% Change</u>	<u>Sectors Improving</u>	<u>Net Change</u>	<u>% Change</u>
Government	-800	-1.0%	Education & Health Services	1,300	2.1%
Manufacturing	-200	-0.9%	Trade, Transp. & Utilities	1,100	1.9%
Professional & Business Services	-200	-0.4%	Natural Resources & Mining	100	4.5%
Information	-100	-2.3%	Financial Activities	100	1.2%
Other Services	-100	-0.8%	Construction	0	0.0%
			Leisure and Hospitality	0	0.0%



Remainder of State



Balance of State Employment*

Source: ADOA

<u>Sectors in Decline</u>	<u>Net Change</u>	<u>Sectors Improving</u>	<u>Net Change</u>
Professional & Business Services	-1,700	Education & Health Services	1,800
Information	-800	Construction	1,800
Other Services	-600	Leisure & Hospitality	1,200
Government	-300	Trade, Transp. & Utilities	1,000
		Financial Activities	700
		Manufacturing	400
		Natural Resources & Mining	0



ARIZONA–

**Slow but mildly accelerating
recovery. (Tuc. vs. Phx?)**

2014 will be better than 2013.

2015 should be a okay year.



Basic Roles of Govt?



Forecasting & Budgeting

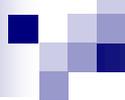
- **Things to keep in mind:**
 - **Avg. expansion is just under 5 years,**
 - **The current expansion will hit 5 years this summer,**
 - **But, its not the age, it's the mileage,**
 - **How many more years of growth?**



Forecasting & Budgeting

- Things to keep in mind:
 - Less time to plan for next downturn,
 - Less time to build infrastructure.
 - What are you doing now in terms of longer term planning?



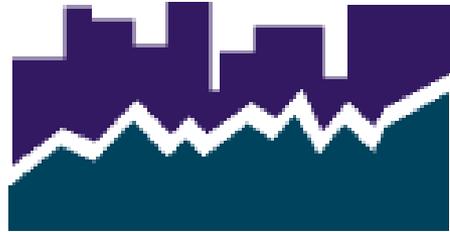


**The long term outlook for
Arizona remains strong.**

We are ready for a boom.

**But, what if there is no boom
this time?**





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QUESTIONS?

OFFICE OF THE ARIZONA STATE TREASURER

