



LGIP QUARTERLY MEETING & CONFERENCE CALL

7.26.2012

OFFICE OF THE ARIZONA STATE TREASURER



AGENDA

- **LGIP Performance**
- **Endowment Performance**
- **Endowment Distribution Formula**
- **State Cash Flow**
- **Guest Presentation: Jim Palmer, CFA,
Head of Investments for U.S. Bancorp
Asset Management**
- **Q & A**



INVESTMENT PHILOSOPHY

SAFETY

before

LIQUIDITY

before

YIELD



EARNINGS FOR FY 2012 YTD

\$134,833,364





LGIP PERFORMANCE

Q4 FY2012



POOL 5

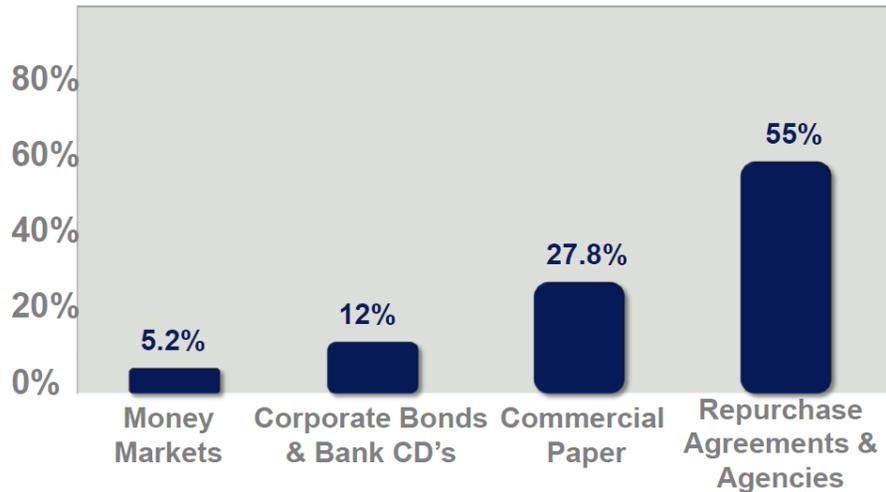
- \$1.22 Billion Assets as of 6/30/2012
- Net Asset Value - \$1.000 6/30/2012
- Diversified investments weighted to highly rated Commercial Paper, Repurchase agreements, and Agency/Treasuries
- Focus is to add to CP names greater than 30 days maturity

Liquidity

Weighted Average Maturity: 26 days on 6/30/2012

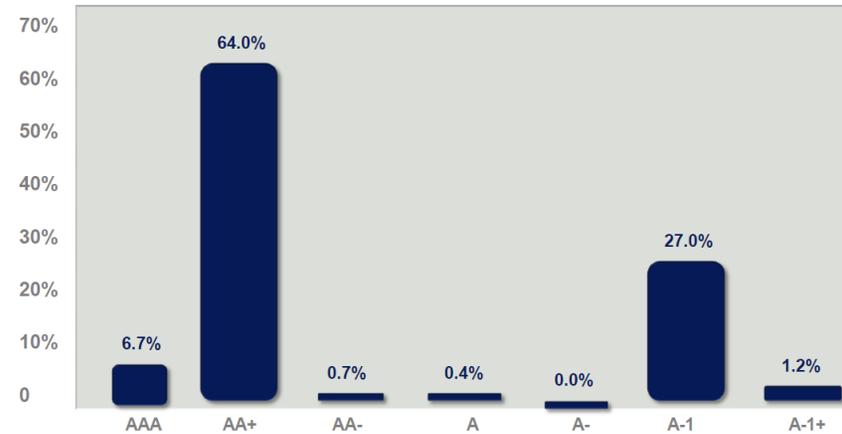
DURATION: 100% from 0-1 yrs

ASSET MIX:



Safety

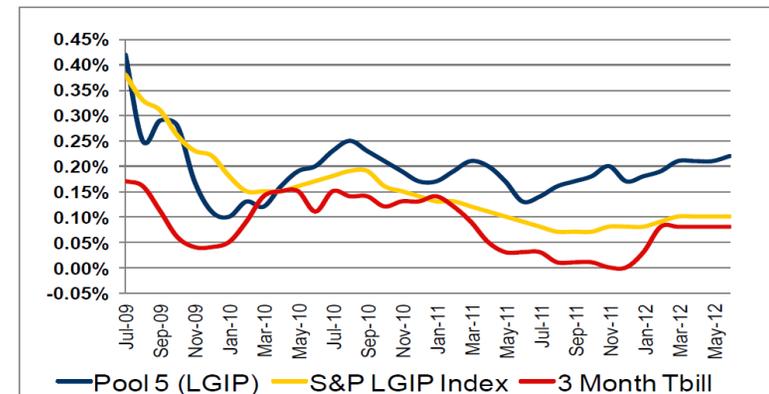
Continues to receive highest rating from Standard & Poor's: AAAf/S1+



Yield

.19% FYTD

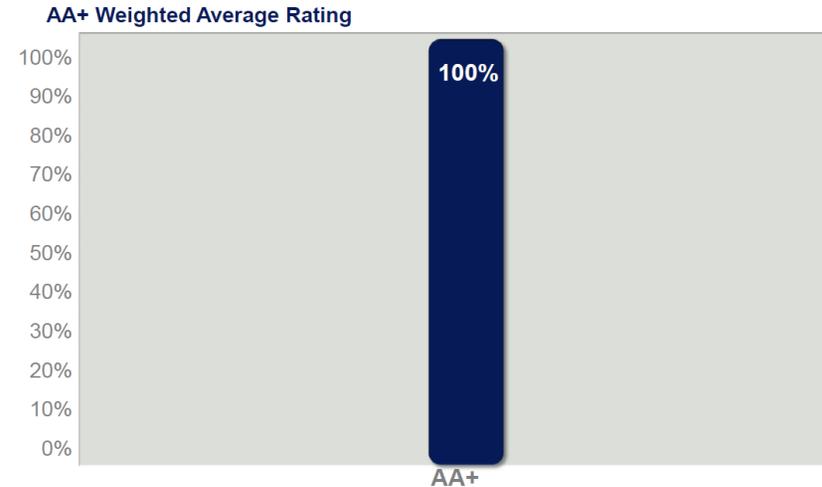
.09% FYTD (S&P LGIP Index)



POOL 7

- \$1.56 Billion Assets as of 6/30/2012
- Net Asset Value - \$ 1.000 6/30/2012
- Repo market eased in the most recent quarter. Watching what Federal Reserve will do on the Discount Rate (IOER) paid to banks on excess reserves held at the federal reserve.
- Looking to ladder treasuries/repo and other full faith and credit products up to 13 month horizon
- WAM will increase but stay under 90 days.

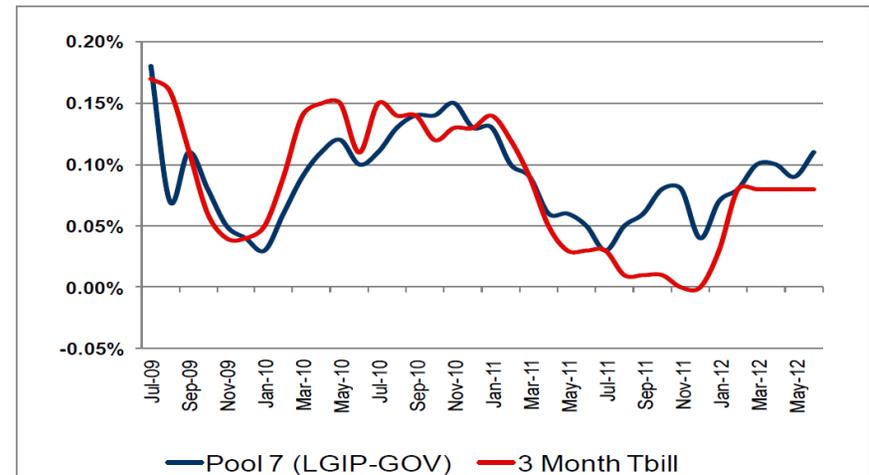
Safety



Yield

.07% FYTD

.04% FYTD (90 DAY T BILL)

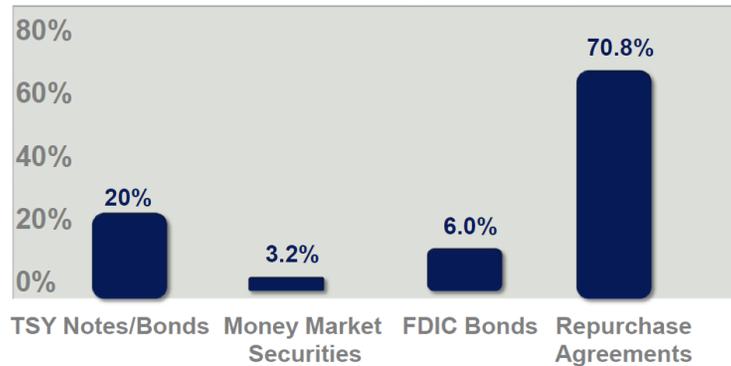


Liquidity

Weighted Average Maturity: 29 days on 6/30/2012

DURATION: 100% from 0-1 yrs

ASSET MIX:



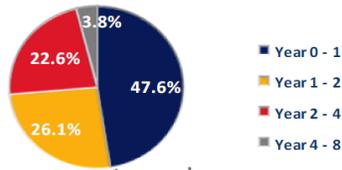
POOL 500

- \$224.6 million in assets as of 6/30/2012
- Floating Net Asset Value - \$1.0429 6/30/2012
- 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%

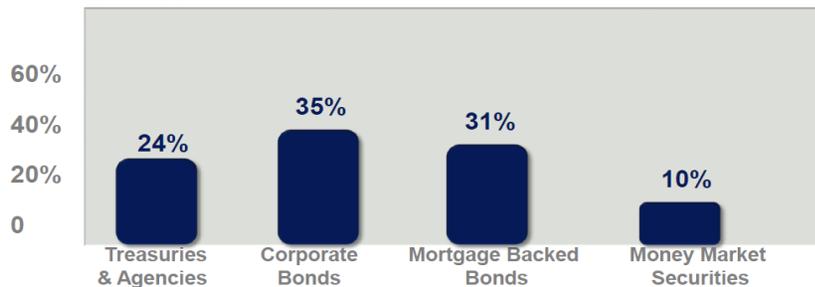
Liquidity

Effective Duration: 1.32 years on 6/30/2012

DURATION:



ASSET MIX:



Safety

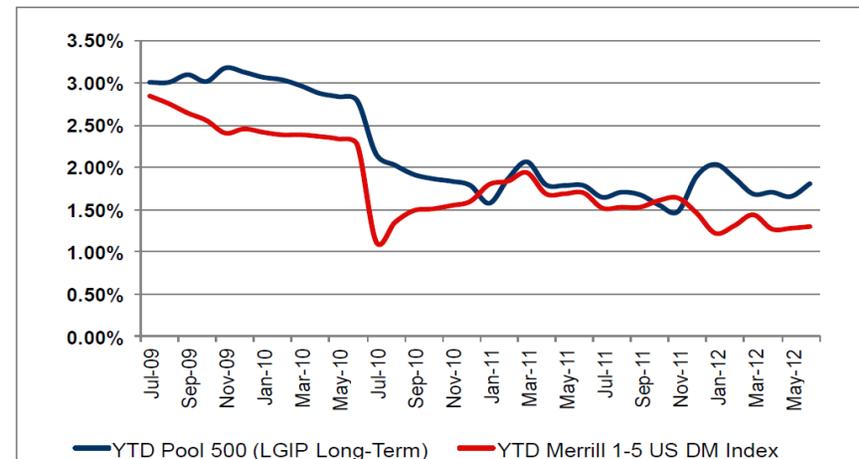
AA Weighted Average Rating



Yield

1.74% FYTD

1.43% FYTD (Index)



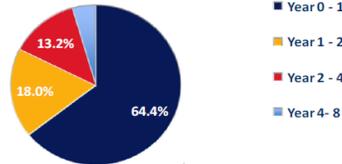
POOL 700

- \$169.3 million in assets as of 6/30/2012
- Floating Net Asset Value - \$ 1.0167 6/30/2012
- Strategy is to invest in a mix of 1-5 year US Treasuries, GNMA Mortgages and FDIC Paper
- All securities backed by US Government

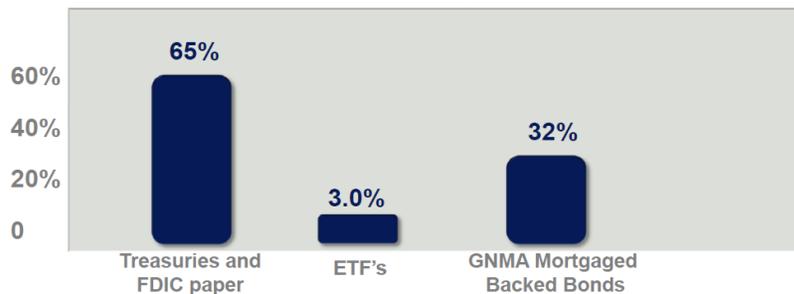
Liquidity

Effective Duration: .93 years on 6/30/2012

DURATION:

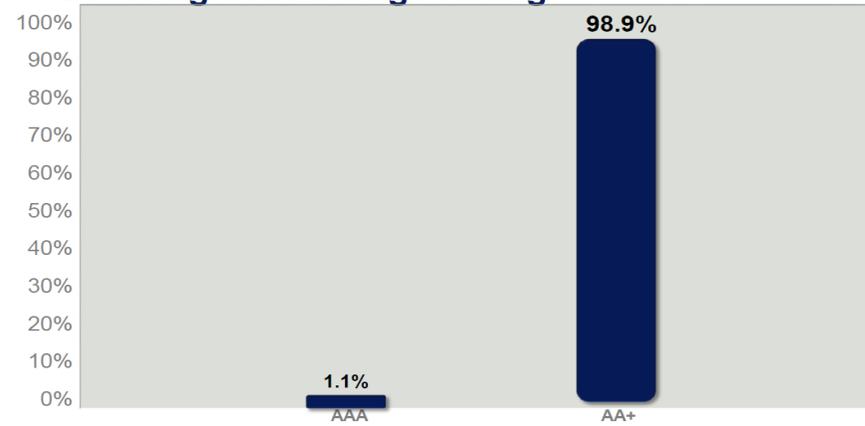


ASSET MIX:



Safety

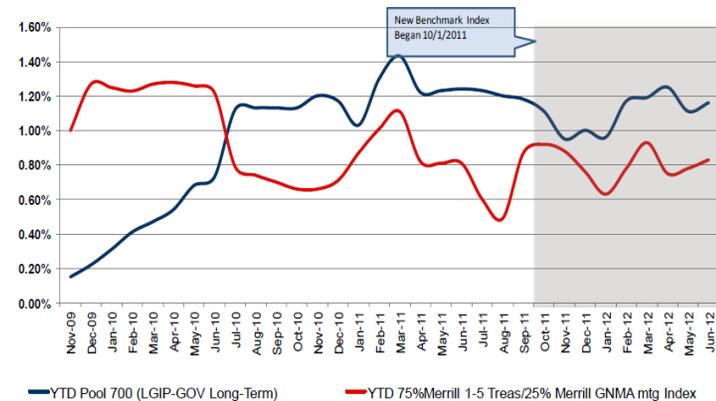
AA+ Weighted Average Rating



Yield

1.12% FYTD

0.85% FYTD (Index)



Separately Managed Accounts (SMAs)

- Designed for those seeking a customized investing solution based on your risk tolerance, liquidity needs and duration target.
- Monthly Liquidity
- Requires \$100 million minimum deposit
- Pre-Meeting with Portfolio Manager to set up Account and determine investing needs.
- Costs: Standard 6 basis points, plus yearly accounting charges of \$20,000 out of earnings (equivalent to 2 basis points.)
- Contact Deputy Treasurer Mark Swenson



OPERATING UPDATES

Starting Monday, July 30, 2012 new key phone numbers:

- Main number **602-542-7800**
- LGIP Line **602-542-7834**
- Mark Swenson **602-542-7877**
- Dale Stomberg **602-542-7833**





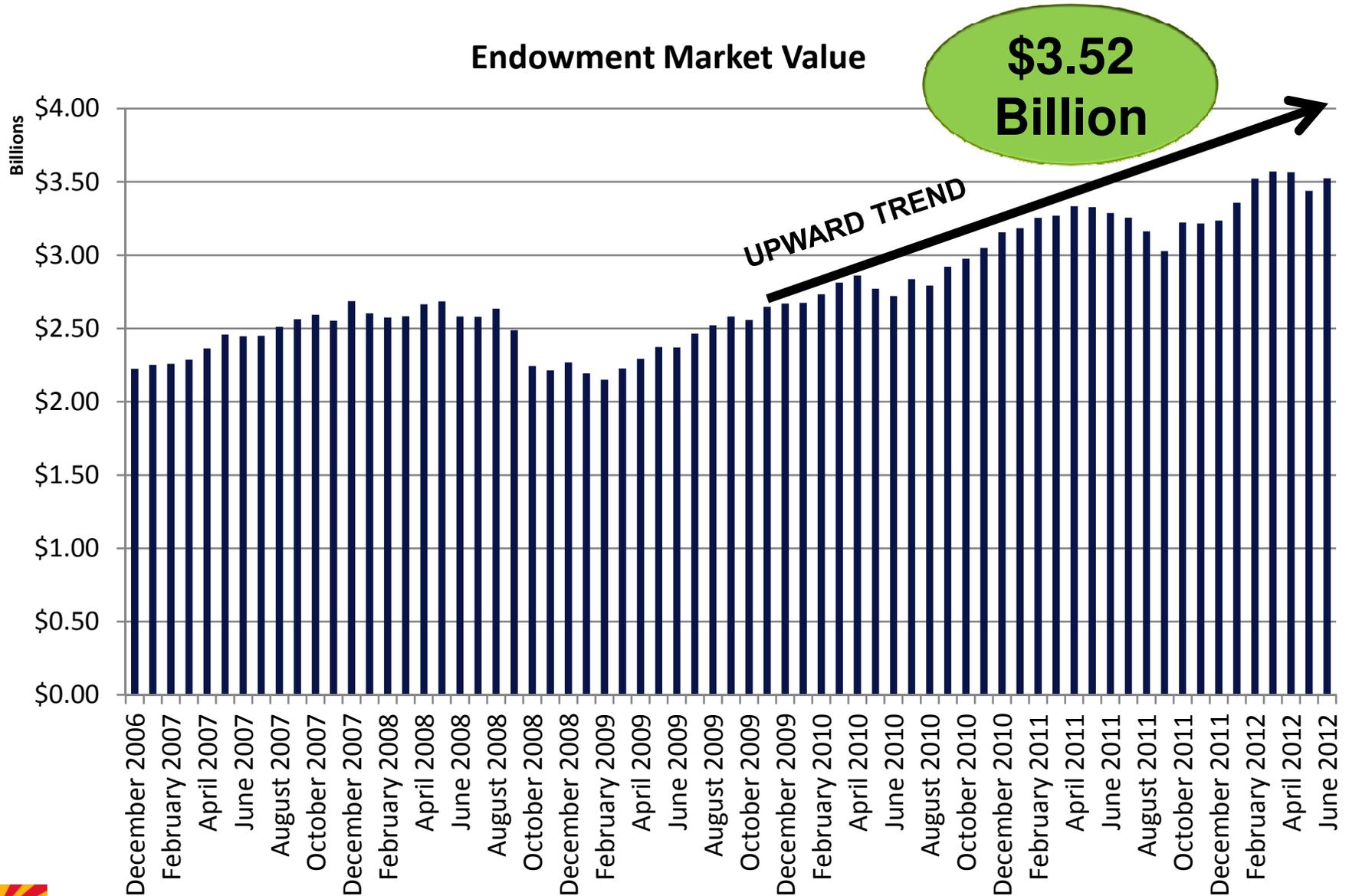
ENDOWMENT PERFORMANCE

Q4 FY2012

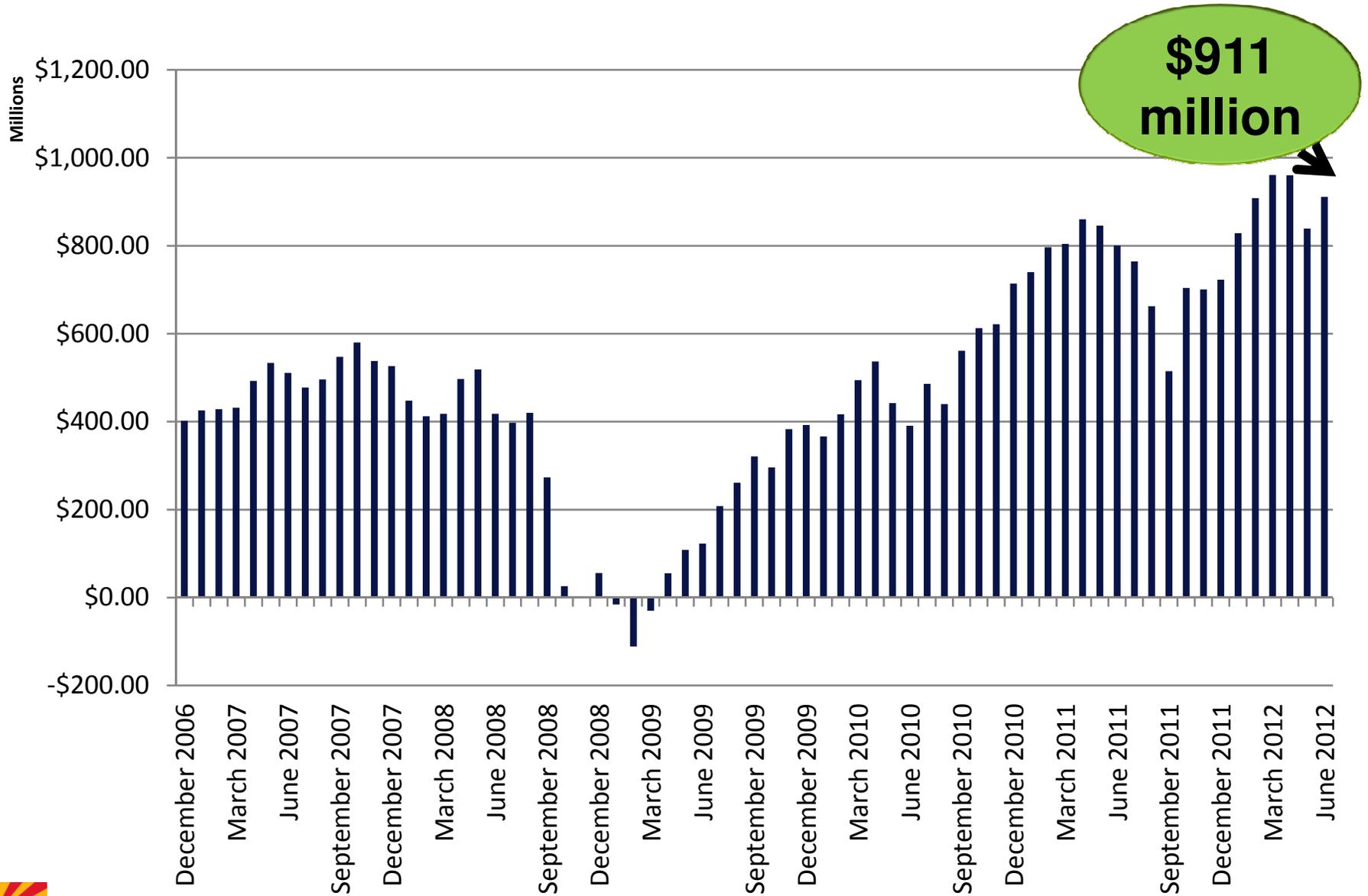
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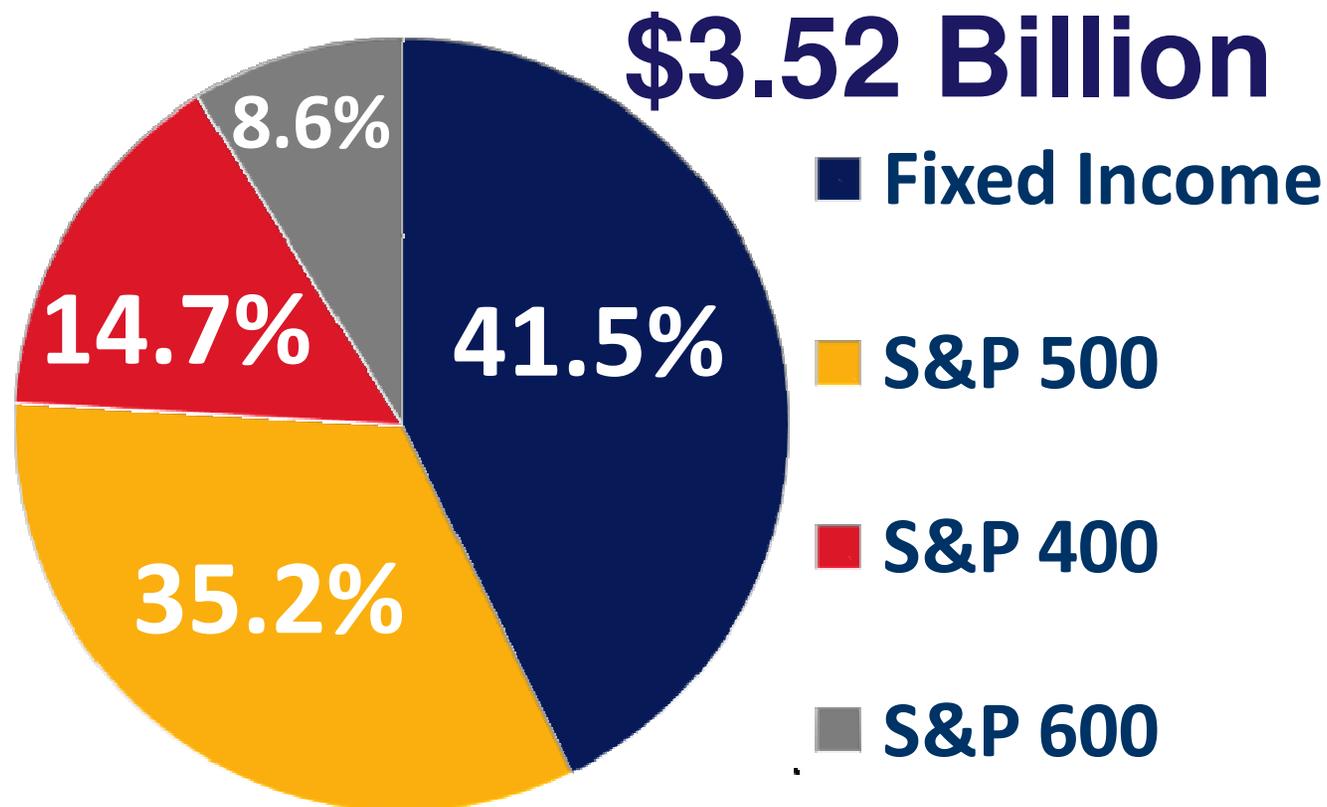
ENDOWMENT MARKET VALUE



ENDOWMENT UNREALIZED GAINS



ENDOWMENT ASSET ALLOCATION



As of 6/30/2012



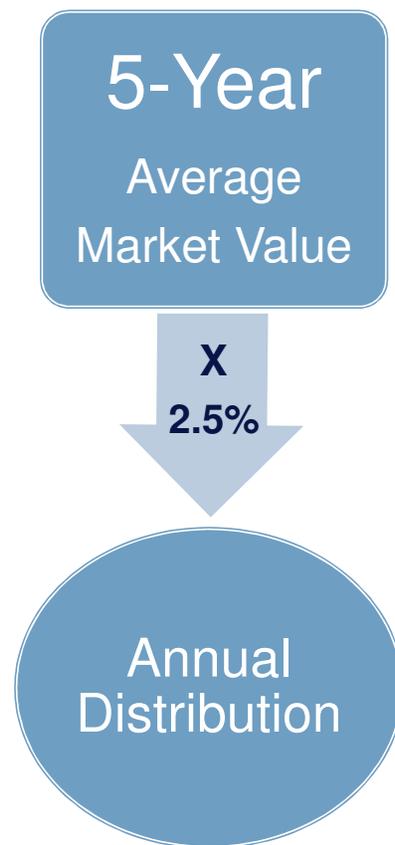


PROPOSED ENDOWMENT DISTRIBUTION FORMULA

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SMOOTHER, CONSISTENT DISTRIBUTIONS



Takes 2.5% of the average monthly market value from each of the previous five years





STATE CASH FLOW

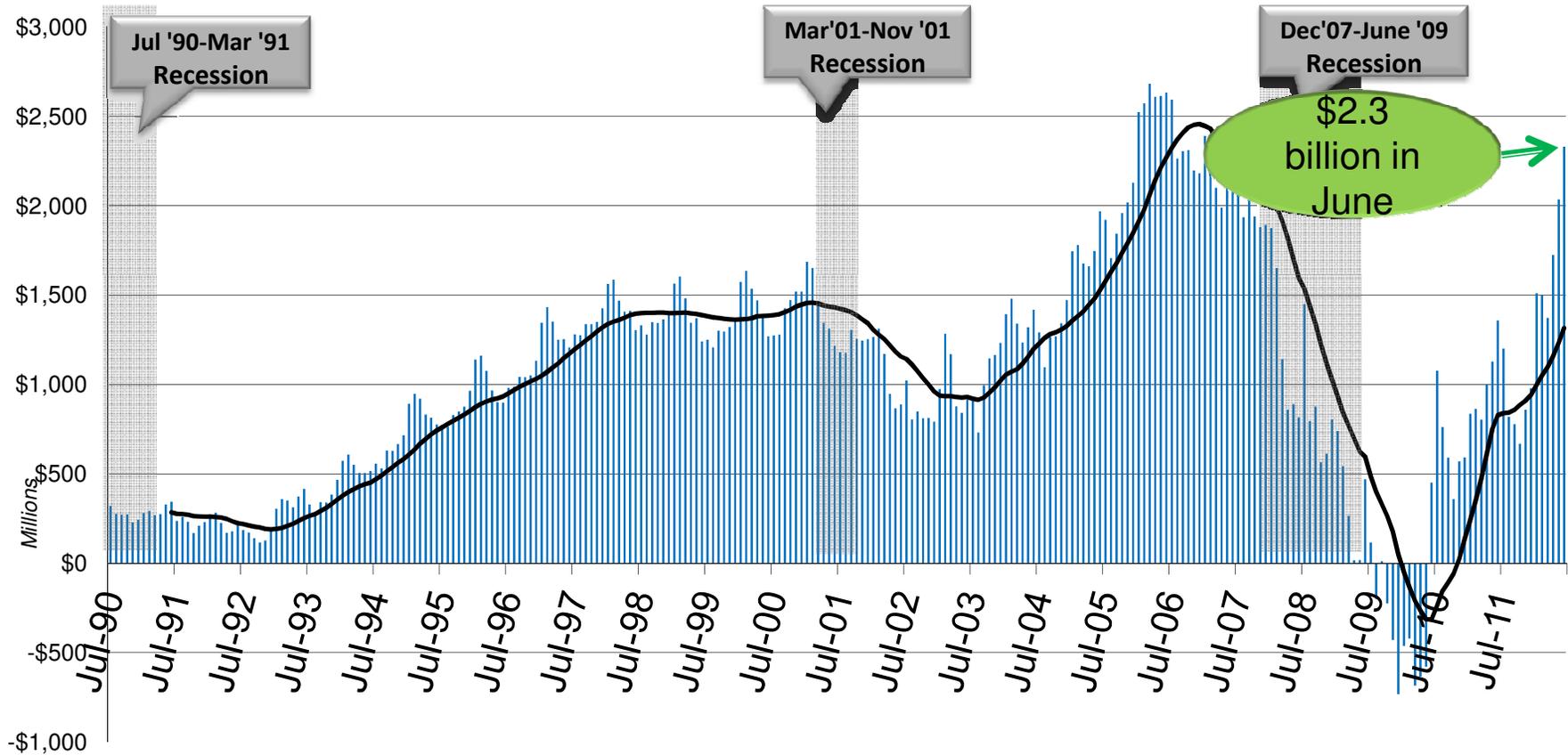
OFFICE OF THE ARIZONA STATE TREASURER



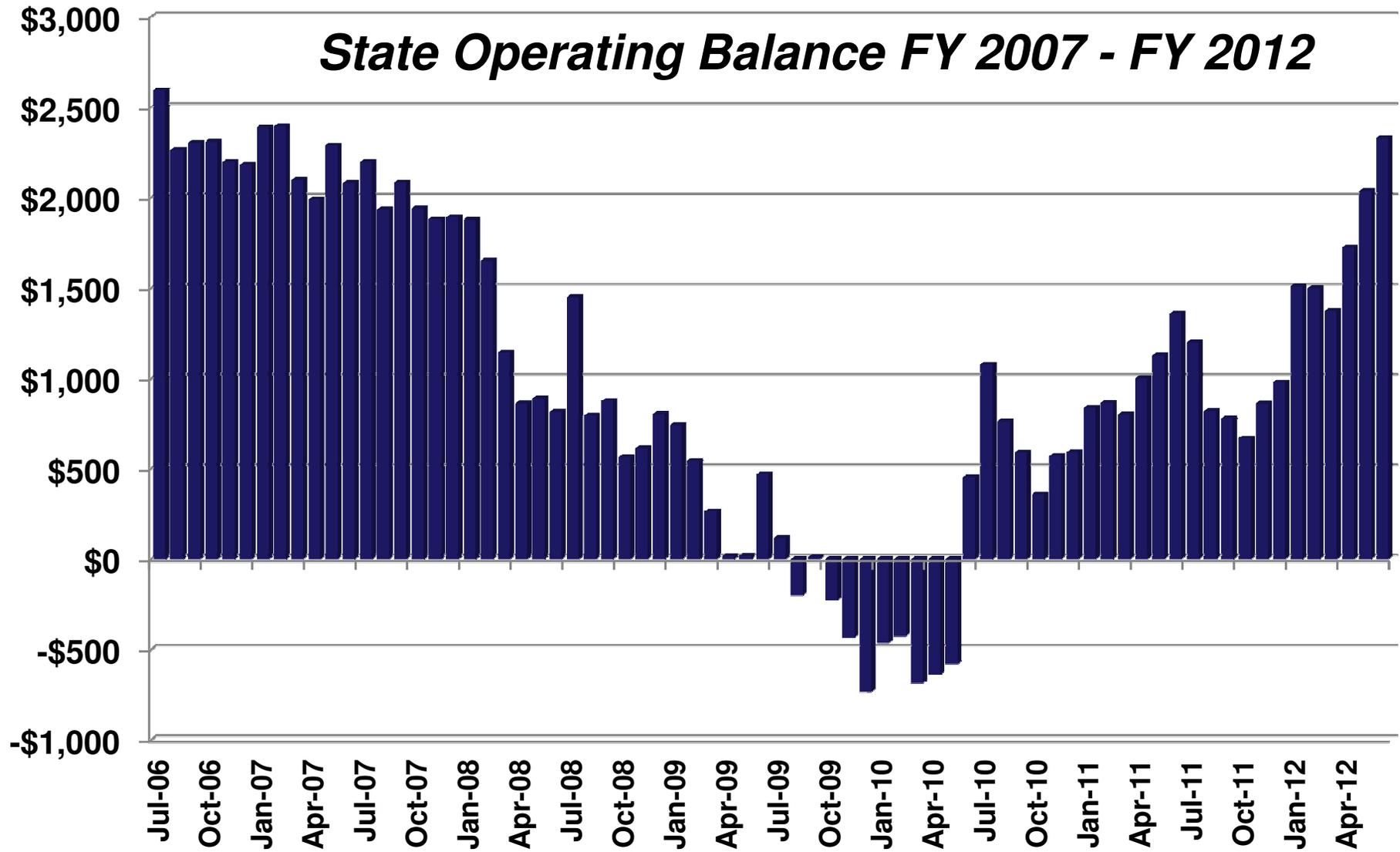
STATE CASH FLOW

TOTAL OPERATING ACCOUNT AVERAGE MONTHLY BALANCE

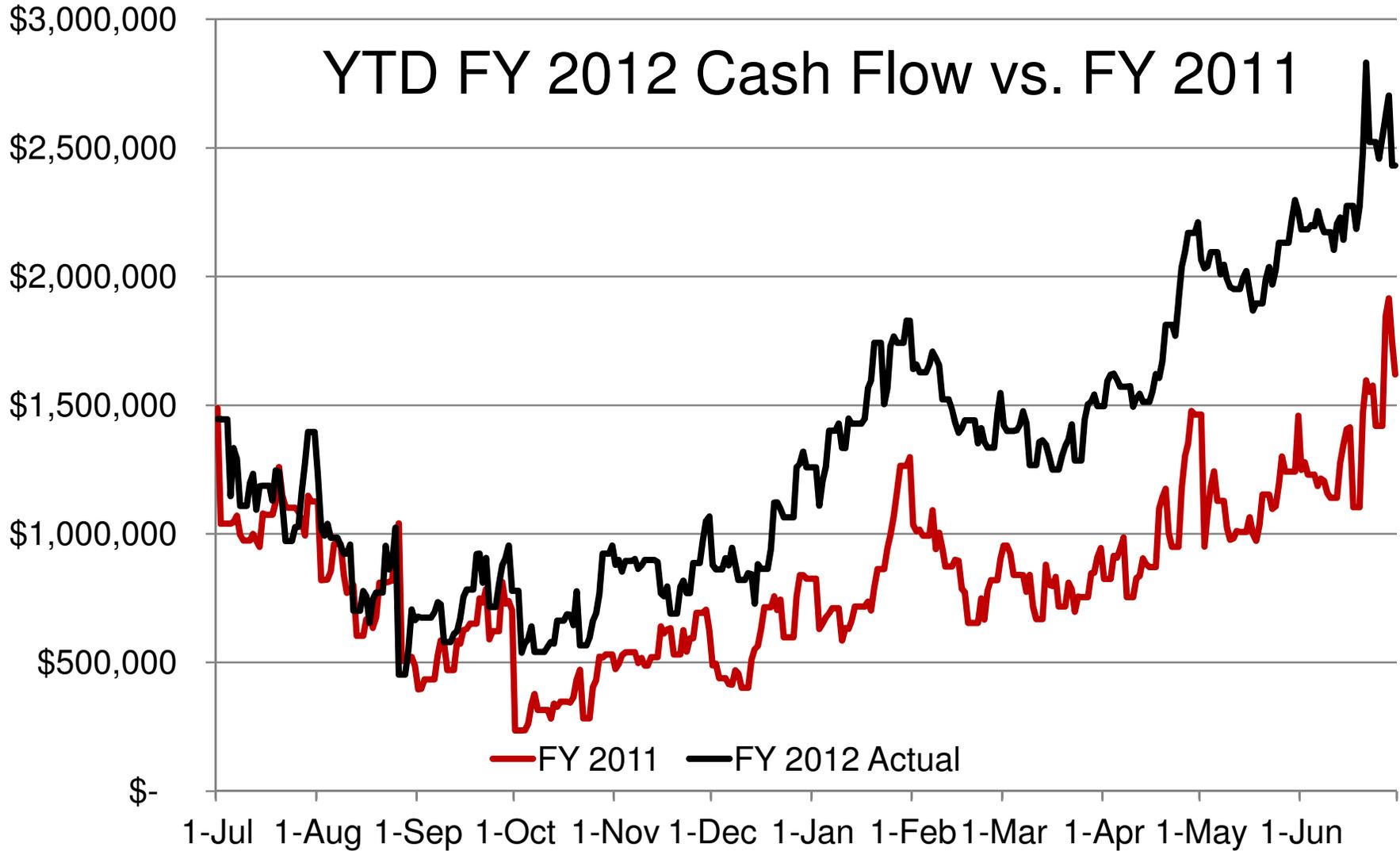
Up 58% YOY in FY 2012



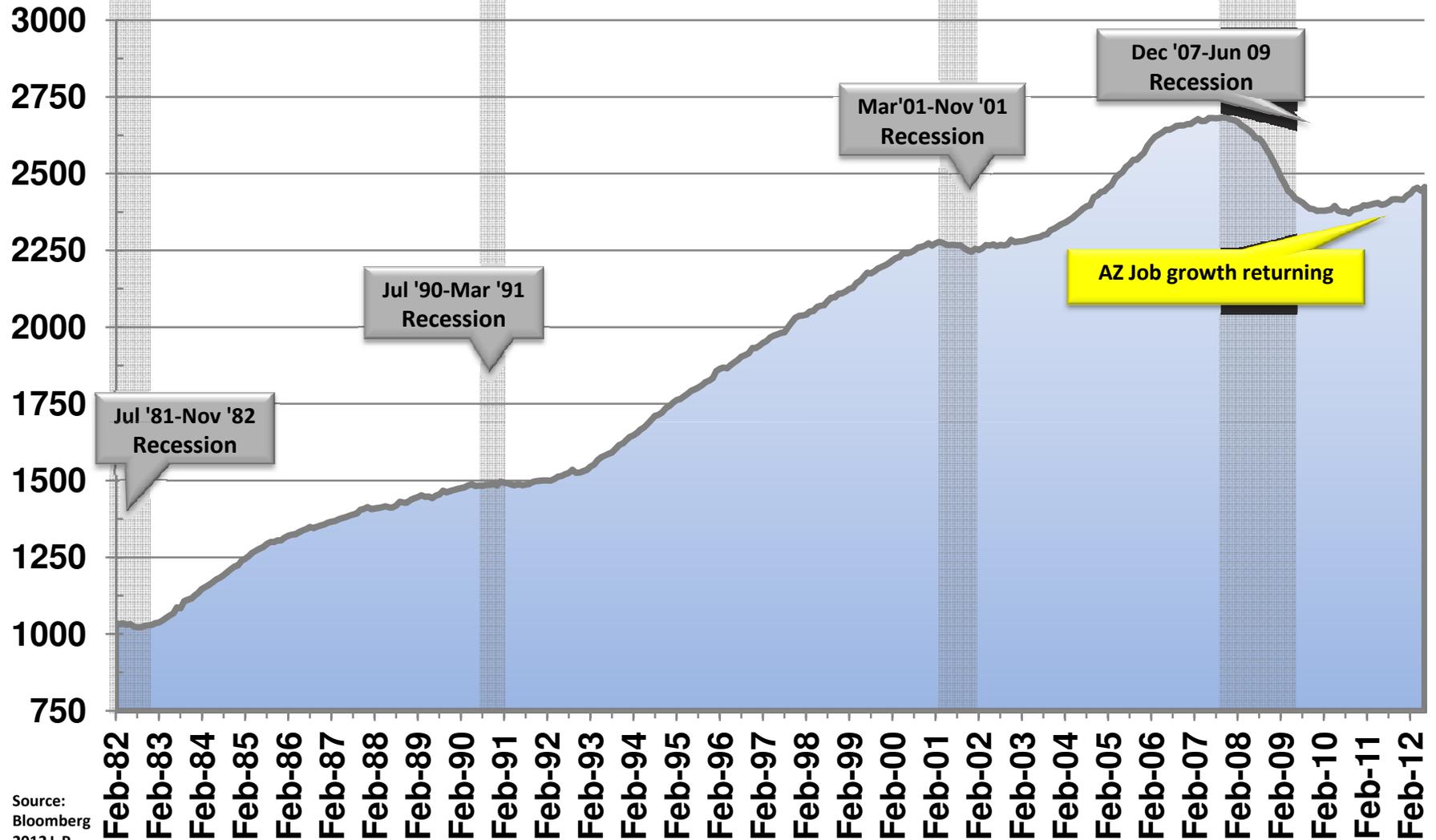
STATE CASH FLOW



STATE CASH FLOW



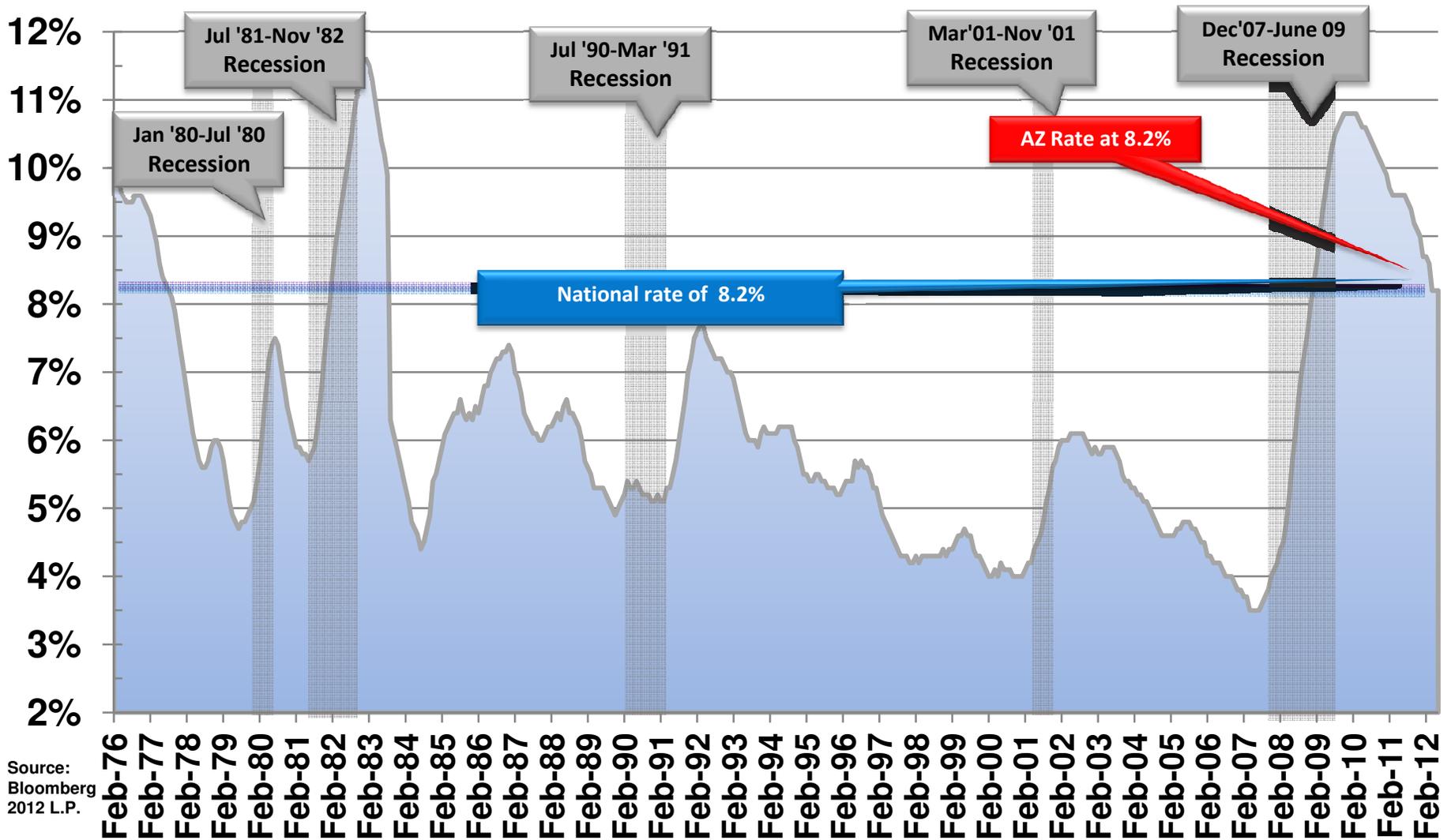
AZ NON-FARM EMPLOYMENT



Source:
Bloomberg
2012 L.P.



AZ UNEMPLOYMENT AT 8.2%



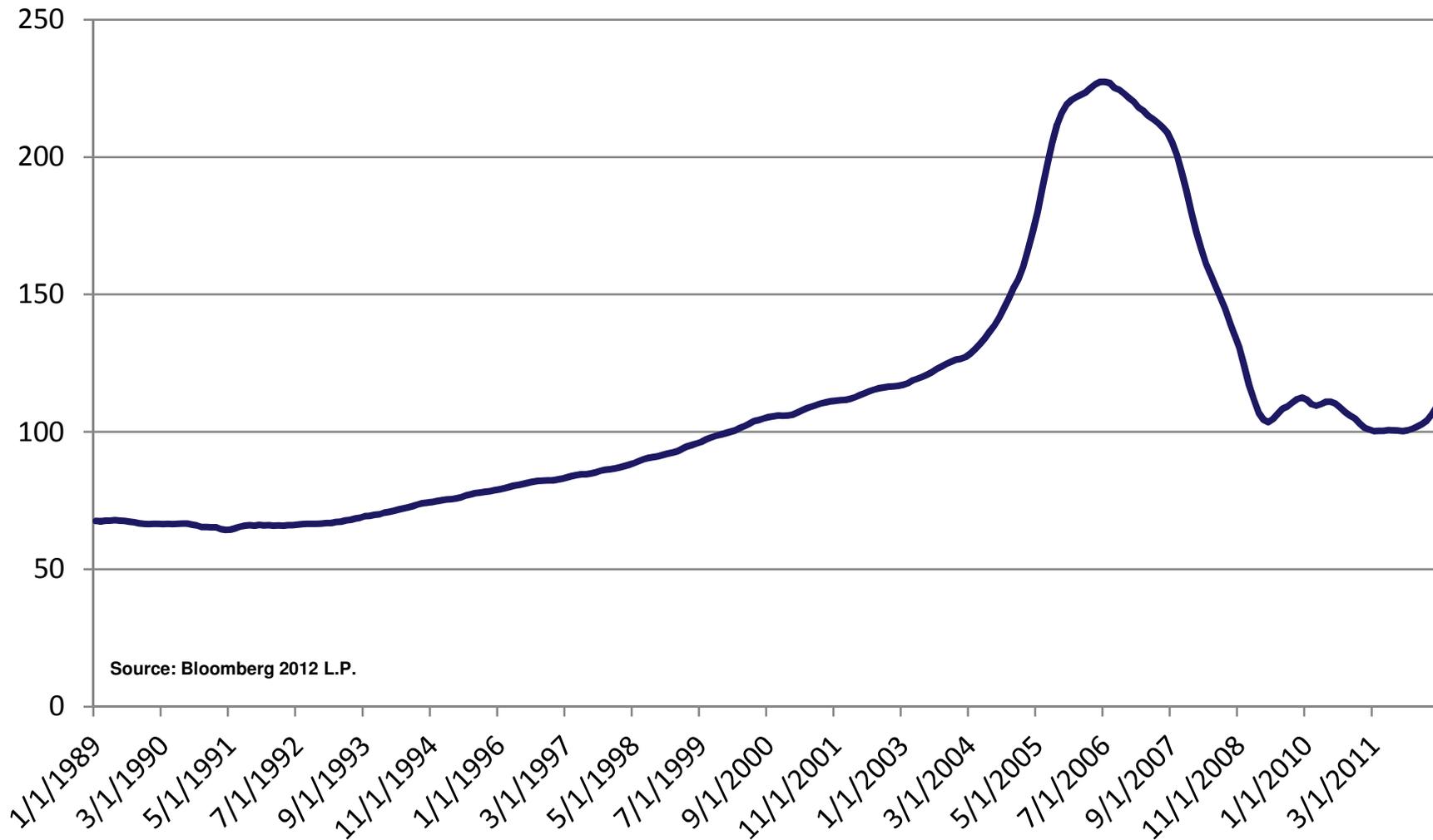
Source:
Bloomberg
2012 L.P.



ARIZONA STATE TREASURER DOUG DUCEY

AZ HOUSING PRICES

S & P/Case Schiller Housing Price Index for Phoenix



Source: Bloomberg 2012 L.P.





Guest Presentation:
James Palmer, CFA: Head of Investments for
U.S. Bancorp Asset Management

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Asset Management, Inc.

Arizona State Treasurer's Office LGIP Quarterly Meeting and Q4 2012 Conference Call

Presentation By:

Jim Palmer, CFA
Head of Investments
612.303.3434

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Market Conditions

Fed/Central Bank Policy

- Current policy indication is to keep the federal funds rate “exceptionally low” at least through late 2014
- Operation Twist – supportive of short-term yields
- Risk is skewed toward implementing additional monetary stimulus. All would be negative for short-term yields
 - Additional Asset Purchases, aka: Quantitative Easing 3
 - Extending language to keep Federal Funds Rate “exceptionally low”
 - Reducing the “Interest on Excess Reserves” rate
- ECB has taken aggressive actions
 - 3-year LTROs
 - Reduced key refinancing rate to 0.75%
 - Reduced interest rate on overnight deposits to 0.00%

Market Conditions

Economic Growth

- Recent U.S. economic data has been disappointing
 - Employment, manufacturing, retail sales
- Global growth is slowing
- Policymakers view inflation as relatively contained

Market Conditions

Credit Market Challenges

- European sovereign and bank debt crisis continues and represents the largest tail risk to the financial markets
- Rating agency risk remains, but has diminished after Moody's completed its reviews of global financial institutions in the second quarter
- U.S. has significant policy making uncertainties
 - “Fiscal Cliff”
 - U.S. fiscal debt ceiling

Strategies

Yield Curve

- Fed policy supports 2- to-3-year and under bond prices
- Risk is skewed toward steeper yield curve, favoring a bullet strategy
- LIBOR remains attractive in the mid-40 bps range

Duration Management

- Fed policy argues for extending portfolio duration to maximize yield for shorter portfolios
- Long-run view suggests risks are skewed toward higher interest rates

Strategies

Sectors

- Treasuries – current yield curve relatively low
- Agencies
 - Spreads have tightened
 - Callable spreads have tightened but select securities can still offer value
- Corporates
 - Industrial companies have built strong balance sheets and cash positions
 - U.S. banks have built strong capital and liquidity positions
 - Spreads have tightened in past six months
- Asset-Backed Securities (ABS)
 - At current spreads, ABS offer more value as a portfolio diversifier than as a yield enhancement strategy
- Agency MBS
 - Favor CMOs with tighter pre-pay speed bands over pass-throughs
 - Recent bump in pre-pay speeds has limited opportunities
 - Additional Fed policy actions could increase risk of faster pre-payments



QUESTIONS?

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