Investing 201

ICCCFO Spring 2019 Conference

May 1, 2019
Agenda

- Market Update
- Utilizing Corporate Notes
- Ideas to Expand Investment Statutes
- Investing Foundation Funds
U.S. Economic Conditions

U.S. Real GDP (QoQ, SAAR)

Unemployment Rate

Consumer Confidence

Average Hourly Earnings (YoY)

Source: Bloomberg, latest data available as of 3/31/19. SAAR is seasonally adjusted annualized rate.
Stock Market Climbs to New Record Highs

S&P Price Change

Source: Bloomberg, as of 04/29/2019.
Fed Expects No Rate Hikes in 2019

Fed Participants’ Assessments of ‘Appropriate’ Monetary Policy

Source: Federal Reserve and Bloomberg. Individual dots represent each Fed members’ judgement of the midpoint of the appropriate target range for the Federal Funds rate at each year-end. Fed Funds futures as of 3/20/19.
But, the Market Expects a Rate Cut by Year End

Market Indicators Not Pointing to an Imminent Recession

Source: Bloomberg, as of 3/31/2019.
U.S. Government Yield Curve is Flat / Inverted

<table>
<thead>
<tr>
<th>Maturity</th>
<th>Treasury</th>
<th>Federal Agency</th>
<th>AA Corporate</th>
<th>A Corporate</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-Month</td>
<td>2.41%</td>
<td>2.43%</td>
<td>2.55%</td>
<td>2.67%</td>
</tr>
<tr>
<td>1-Year</td>
<td>2.40%</td>
<td>2.40%</td>
<td>2.60%</td>
<td>2.68%</td>
</tr>
<tr>
<td>2-Year</td>
<td>2.29%</td>
<td>2.33%</td>
<td>2.57%</td>
<td>2.70%</td>
</tr>
<tr>
<td>3-Year</td>
<td>2.27%</td>
<td>2.31%</td>
<td>2.60%</td>
<td>2.76%</td>
</tr>
<tr>
<td>5-Year</td>
<td>2.31%</td>
<td>2.37%</td>
<td>2.75%</td>
<td>2.94%</td>
</tr>
<tr>
<td>10-Year</td>
<td>2.53%</td>
<td>2.76%</td>
<td>3.25%</td>
<td>3.51%</td>
</tr>
</tbody>
</table>

Source: Bloomberg BVAL yield curves for Treasury and Corporate. TradeWeb for Federal Agency yields. 3-month corporate yields from commercial paper; A-1+ for AA and A-1 for A. Yields are for indicative purposes only; actual yields may vary by issue. Yield environment as of April 29, 2019.
Corporate Credit Spreads Return to Close to Historical Averages

Source: Bloomberg, ICE BofAML Indices. OAS is option adjusted spread. As of 03/31/19.
Managing Risks

We have to understand risks before we can manage them…
don’t be a raccoon riding on the back of an alligator

- **Interest Rate Risk**: changing values due to interest rate moves
- **Credit Risk**: risk of default or decline in value, related to issuer
- **Purchasing Power Risk**: loss of purchasing power due to inflation
- **Liquidity Risk**: inability to sell at competitive price
- **Reinvestment Risk**: investing cash flows at lower rates
Pop Quiz!

- Which of the current issuers hold “AAA” long-term ratings by S&P? (as of March 31, 2019)

- Bank of America
- 3M
- Goldman Sachs
- Nestle
- Walt Disney
- Coca-Cola
- Bank of America
- Chevron
- Pepsi
- Exxon Mobil
- Walmart
- Johnson & Johnson
Return Benefits of Diversification

Example 1 – 5 Year Portfolio Sector Allocation

<table>
<thead>
<tr>
<th>Sector Allocation</th>
<th>5-Year Portfolio Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>15% Treasury, 30% Agency, 25% Corp A-AAA, 10% Agency MBS, 10% Supranationals</td>
<td>1.42%</td>
</tr>
<tr>
<td>15% Treasury, 40% Agency, 25% Corp A-AAA, 10% Agency MBS, 10% Supranationals</td>
<td>1.41%</td>
</tr>
<tr>
<td>25% Treasury, 40% Agency, 25% Corp A-AAA, 10% Agency MBS, 10% Supranationals</td>
<td>1.34%</td>
</tr>
<tr>
<td>40% Treasury, 50% Agency, 25% Corp A-AAA, 10% Agency MBS, 10% Supranationals</td>
<td>1.17%</td>
</tr>
<tr>
<td>50% Treasury, 50% Agency, 25% Corp A-AAA, 10% Agency MBS, 10% Supranationals</td>
<td>1.14%</td>
</tr>
<tr>
<td>100% Treasury, 100% Agency</td>
<td>1.09%</td>
</tr>
</tbody>
</table>

Example portfolio returns are based on the ICE BofAML 1 – 5 Year indices for all sectors except for mortgage-backed which use the 0 – 5 Year indices. 5-year returns are for 2013 – 2018.
Permitted Investments – Operating Funds

- Define general universe
- Bound by the Illinois Public Funds Investment Act (30 ILCS 235)
- Set diversification limits
  - Term
  - Sector
  - Credit Quality
- Restrictive clauses

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Allowed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Treasuries</td>
<td>✓</td>
</tr>
<tr>
<td>Federal Agencies</td>
<td>✓</td>
</tr>
<tr>
<td>Agency Mortgage-Backed Securities</td>
<td>✓</td>
</tr>
<tr>
<td>Government Money Market Funds</td>
<td>✓</td>
</tr>
<tr>
<td>Repurchase Agreements</td>
<td>✓</td>
</tr>
<tr>
<td>FDIC-Insured Certificates of Deposit</td>
<td>✓</td>
</tr>
<tr>
<td>Negotiable Certificates of Deposit</td>
<td>✓</td>
</tr>
<tr>
<td>Municipal Bonds</td>
<td>✓</td>
</tr>
<tr>
<td>Commercial Paper</td>
<td>✓</td>
</tr>
<tr>
<td>Local Government Investment Pools</td>
<td>✓</td>
</tr>
<tr>
<td>Corporate Notes</td>
<td>✓</td>
</tr>
<tr>
<td>Short-Term Corporate Bond Funds</td>
<td>✓</td>
</tr>
<tr>
<td>Mutual Funds (Equity)</td>
<td>NO</td>
</tr>
</tbody>
</table>
Option A:
(k-new) A community college district may invest non-public funds, including tuition and fee revenue, in any publicly traded mutual fund, so long as the mutual fund has assets of at least $100 million at the time of purchase. The investments shall be subject to approval by the local community college board of trustees. Each community college board of trustees shall develop a policy regarding the investment of non-public funds.

OR

Option B:
(j-revised) ...Additionally, a community college district may re-invest the interest earned on public funds, including interest earned on working cash funds, in any publicly traded mutual fund, so long as the mutual fund has assets of at least $100 million at the time of purchase. The investments shall be subject to approval by the local community college board of trustees. Each community college board of trustees shall develop a policy regarding the investment of public funds and the re-investment of interest earned on public funds.
Key Considerations

- The language “in any publicly traded mutual fund” would allow for investing in the stock (equity) market

- Investing in the stock market carries a high level of risk in that prices can fluctuate widely

- Prudent investment principles recommend that only funds which can be held for the long term (5 – 10 years) should be invested in the stock market

- Most community colleges plan to spend the majority of their revenues, including tuition, fees and interest income throughout the year

- Even if some reserve balances build up, they are often planned in to future capital spending or educational program enhancement

- Stakeholders, taxpayers, and other revenue sources (state and federal) might question endowment-styled investments
### Other Possible Changes to State Statutes (Avoiding Unnecessary Policy Constraints)

<table>
<thead>
<tr>
<th>Policy Constraint</th>
<th>Suggested Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Max Maturity</td>
<td>Extend the corporate note maximum maturity limit from 3 to 5 years</td>
</tr>
<tr>
<td>Corporate Note Limit</td>
<td>Remove 1/3 limit on corporate note obligations</td>
</tr>
<tr>
<td>Inability to purchase asset backed securities</td>
<td>Permit the purchase of high-quality (&quot;AAA&quot;-rated) asset-backed securities</td>
</tr>
<tr>
<td>No exposure to foreign issuers</td>
<td>Allow for the investment in CDs and corporates of foreign issuers</td>
</tr>
</tbody>
</table>
Permitted Investments – Foundation Funds

- Not bound by the Illinois Public Funds Investment Act (30 ILCS 235)
Focus on Asset Allocation to Help Achieve Your Long-Term Return Goals

Determinants of Portfolio Performance Variation

- Strategic & Tactical Asset Allocation: 92%
- Security Selection: 5%
- Market Timing: 2%
- Other Factors: 2%

Keep Costs in Check

- Passive index strategies may help reduce costs over the long-term

Source: Morningstar Inc. U.S Fund Fee Study, published 2018
What Does it Mean to be a Fiduciary?

- Oversee the investments as a prudent person acting in the best interests of the fund and its beneficiaries
- Exercising duty of care
- Monitoring expenses
- Portfolio diversification
- Consider the risk of loss versus the opportunity for gain
Questions???
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Thank You!

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