COMMITTEE ON FINANCE

California State University Annual Investment Report

Presentation By

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Assistant Vice Chancellor
Financial Services

Summary

This item provides the annual investment report for fiscal year 2012-2013 for funds managed under the California State University Investment policy.

Background

The bulk of CSU funds are invested through the CSU Systemwide Investment Fund-Trust (SWIFT), which was established in July 2007 for the purpose of enhancing centralized cash and investment management. On a daily basis, net investable cash, from the Chancellor’s Office and campus-controlled bank depository and disbursement accounts, is pooled and moved into SWIFT for investment. All SWIFT cash and securities are held by US Bank, the custodian bank for SWIFT. For investment management purposes, the SWIFT portfolio is divided equally between two investment management firms, US Bancorp Asset Management and Wells Capital Management.

The state treasurer also provides investment vehicles that may be used for CSU funds. The Surplus Money Investment Fund (SMIF) is used by the state treasurer to invest state funds, or funds held by the state on behalf of state agencies, in a short-term pool. Pursuant to an agreement with the state, CSU maintains a minimum balance of $310 million in the SMIF to assist in the funding of payroll. The Local Agency Investment Fund (LAIF) is used by the state treasurer to invest local agency funds. The year-end results for these two funds are reported in Attachment A.

In July 2011, the state legislature created a new investment vehicle at the state level in which CSU may invest funds. Senate Bill 79 created the State Agency Investment Fund (SAIF), under Government Code section 16330, which allows state agencies to invest a minimum of $500 million and earn a higher rate of return than other investment options at the state level. Pursuant to a memorandum of understanding dated July 20, 2011 between CSU and the Department of Finance, CSU deposited $700 million in the SAIF in late September 2011. The funds were
Finance
Agenda Item 4
November 5-6, 2013
Page 2 of 3

returned in April 2013. The deposit of $700 million earned an annual rate of 2.0 percent. The
year-end results for this fund are also reported in Attachment A.

The California State University Investment Policy in effect during fiscal year 2012-2013 is
included as Attachment B.

Market Summary

In the fiscal year ending June 30, 2013, U.S. Gross Domestic Product grew at a modest 1.4
percent rate. Despite this modest level of expansion, the unemployment rate fell from 8.2 percent
at the end of June 2012 to 7.6 percent at the end of June 2013, with non-farm payrolls adding a
respectable 2.267 million jobs over the year. Inflation remained well within the Federal
Reserve’s (Fed) 2 percent target range with the Personal Consumption Expenditure Core Index
increasing 1.2 percent year-over-year as of June 2013. This measure of inflation fell
meaningfully from the June 2012 year-over-year rate of 1.9 percent. The economy benefitted
from strong growth in the housing sector, as average home prices, existing home sales and
housing starts all improved measurably over the year.

Given the continued sub-standard growth rate of the U.S. economy, the Fed maintained the
federal funds target rate in the 0.0 to 0.25 percent range, the same level targeted since December
2008. The Fed did alter its forward looking interest rate guidance by suggesting the current
“exceptionally low” range would be appropriate as long as the unemployment rate remained
above 6.5 percent and forward-looking inflation is below 2.5 percent. To further ease financial
conditions, the Fed embarked on an $85 billion asset purchase program in January in an effort to
lower interest and mortgage rates, encourage risk-taking and inflate asset prices. Late in the
fiscal year, investors began to focus on a potential “tapering” of these large-scale asset purchases
after comments made by Chairman Bernanke suggested the Fed could begin unwinding their
program should the economy continue to improve. This resulted in a significant jump in interest
rates in May and June, highlighted by ten-year U.S. Treasury yields rising from 1.626 percent on
May 2, 2013, to 2.487 percent at year-end. Foreign central banks continued to battle slow global
economic growth as the European Central Bank maintained its commitment to keeping interest
rates at record low levels and the Bank of Japan began a massive monetary stimulus program.

The U.S. federal budget deficit improved significantly in the past year with the Congressional
Budget Office forecasting a deficit of $642 billion for the 2013 fiscal year ending September 30,
2013, versus a deficit of $1.087 trillion for 2012. The fiscal improvement is in large part due to
tax increases and mandatory spending cuts that began in January 2013.
Investment Account Performance

As of June 30, 2013, the asset balance in the SWIFT portfolio totaled $2.55 billion. The objective of SWIFT is to maximize current income while preserving and prioritizing asset safety and liquidity. Consistent with the Investment Policy and State law, the portfolio is restricted to high quality, fixed income securities.

As of June 30, 2013, the SWIFT portfolio’s holdings by asset type were as follows:

 Asset Breakdown as of June 30, 2013

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>0.36%</td>
</tr>
<tr>
<td>US Treasuries</td>
<td>20.61%</td>
</tr>
<tr>
<td>US Government Agencies</td>
<td>33.00%</td>
</tr>
<tr>
<td>Corporate Securities—Long Term</td>
<td>33.71%</td>
</tr>
<tr>
<td>Corporate Securities—Short Term</td>
<td>12.32%</td>
</tr>
<tr>
<td></td>
<td>100.00%</td>
</tr>
</tbody>
</table>

The SWIFT portfolio provided a return of 0.41 percent during the 12 months ended June 30, 2013. This return was greater than the benchmark for the portfolio, which is a treasury based index.

<table>
<thead>
<tr>
<th>Period</th>
<th>SWIFT Portfolio</th>
<th>SWIFT Benchmark¹</th>
<th>LAIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Month Return</td>
<td>-0.147%</td>
<td>-0.045%</td>
<td>N/A</td>
</tr>
<tr>
<td>3 Months Return</td>
<td>-0.151%</td>
<td>-0.066%</td>
<td>0.063%</td>
</tr>
<tr>
<td>12 Months Return</td>
<td>0.406%</td>
<td>0.292%</td>
<td>0.308%</td>
</tr>
<tr>
<td>Annualized Return</td>
<td>1.573%</td>
<td>2.267%</td>
<td>1.401%</td>
</tr>
</tbody>
</table>

(1) Bank of America Merrill Lynch 0-3 Year Treasury Index
Surplus Money Investment Fund (SMIF)
The Surplus Money Investment Fund (SMIF) is a vehicle used and managed by the State Treasurer to invest State funds, or funds held by the State on behalf of State agencies, in a short-term pool. Cash in this account is available on a daily basis. The portfolio’s composition includes CD’s and Time Deposits, U.S. Treasuries, Commercial Paper, Corporate Securities, and U.S. Government Agencies. As of June 30, 2013, the amount of CSU funds invested in SMIF was approximately $371 million.

**SMIF Performance**

<table>
<thead>
<tr>
<th>Apportionment Annualized Return</th>
<th>Quarterly Apportionment Yield Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYE 06/30/13 0.30%</td>
<td>Average 2.11%</td>
</tr>
<tr>
<td>FYE 06/30/12 0.37%</td>
<td>High 5.24%</td>
</tr>
<tr>
<td></td>
<td>Low 0.25%</td>
</tr>
</tbody>
</table>

Local Agency Investment Fund (LAIF)
The Local Agency Investment Fund (LAIF) is a vehicle used and managed by the State Treasurer to invest local agency funds. All investments are purchased at market, and market valuation is conducted quarterly. As of June 30, 2013, there were no CSU funds invested in LAIF.

**LAIF Performance**

<table>
<thead>
<tr>
<th>Apportionment Annualized Return</th>
<th>Quarterly Apportionment Yield Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYE 06/30/13 0.31%</td>
<td>Average 2.12%</td>
</tr>
<tr>
<td>FYE 06/30/12 0.38%</td>
<td>High 5.25%</td>
</tr>
<tr>
<td></td>
<td>Low 0.25%</td>
</tr>
</tbody>
</table>

State Agency Investment Fund (SAIF)
The State Agency Investment Fund (SAIF), created in July 2011, is a vehicle used and managed by the State Treasurer which allows state agencies to invest a minimum of $500 million and earn a higher rate of return than other investment options at the state level. CSU funds in SAIF earn an annual rate of 2.0 percent. CSU deposited $700 million in SAIF in late September 2011 which was returned on April 26, 2013.

**SAIF Performance**

<table>
<thead>
<tr>
<th>Annualized Return</th>
<th>Quarterly Yield Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYE 06/30/13 2.00%</td>
<td>FYE 06/30/13 0.50%</td>
</tr>
</tbody>
</table>
The California State University Investment Policy

The following investment guidelines have been developed for CSU campuses to use when investing funds.

Investment Policy Statement
The objective of the investment policy of the California State University (CSU) is to obtain the best possible return commensurate with the degree of risk that the CSU is willing to assume in obtaining such return. The Board of Trustees desires to provide to each campus president the greatest possible flexibility to maximize investment opportunities. However, as agents of the trustees, campus presidents must recognize the fiduciary responsibility of the trustees to conserve and protect the assets of the portfolios, and by prudent management prevent exposure to undue and unnecessary risk.

When investing campus funds, the primary objective of the campus shall be to safeguard the principal. The secondary objective shall be to meet the liquidity needs of the campus. The third objective shall be to return an acceptable yield.

Investment Authority
The California State University may invest monies held in local trust accounts under Education Code Sections 89721 and 89724 in any of the securities authorized by Government Code Sections 16330 and 16430 and Education Code Section 89724 listed in Section A, subject to limitations described in Section B.

A. State Treasury investment options include:
   • Surplus Money Investment Fund (SMIF)
   • Local Agency Investment Fund (LAIF)
   • State Agency Investment Fund (SAIF)

Eligible securities for investment outside the State Treasury, as authorized by Government Code Section 16430 and Education Code Section 89724, include:

   • Bonds, notes or obligations with principal and interest secured by the full faith and credit of the United States;
   • Bonds, notes or obligations with principal and interest guaranteed by a federal agency of the United States;
• Bonds or warrants of any county, city, water district, utility district or school district;

• California State bonds, notes, or warrants, or bonds, notes, or warrants, with principal and interest guaranteed by the full faith and credit of the State of California;


• Commercial paper exhibiting the following qualities: (1) “prime” rated, (2) less than 180 days maturity, (3) issued by a U.S. corporation with assets exceeding $500,000,000, (4) approved by the PMIB. Investments must not exceed 10 percent of corporation’s outstanding paper, and total investments in commercial paper cannot exceed 30 percent of an investment pool;

• Bankers’ acceptances eligible for purchase by the Federal Reserve System;

• Certificates of deposit (insured by FDIC, FSLIC or appropriately collateralized);

• Investment certificates or withdrawal shares in federal or state credit unions that are doing business in California and that have their accounts insured by the National Credit Union Administration;

• Loans and obligations guaranteed by the United States Small Business Administration or the United States Farmers Home Administration;

• Student loan notes insured by the Guaranteed Student Loan Program;

• Debt issued, assumed, or guaranteed by the Inter-American Development Bank, Asian Development Bank or Puerto Rican Development Bank;

• Bonds, notes or debentures issued by U.S. corporations rated within the top three ratings of a nationally recognized rating service;

B. In addition to the restrictions established in Government Code Section 16430, the CSU restricts the use of leverage in campus investment portfolios by limiting reverse repurchase agreements used to buy securities to no more than 20 percent of a portfolio.
Furthermore, the CSU:

- Prohibits securities purchased with the proceeds of a reverse repurchase from being used as collateral for another reverse repurchase while the original reverse repurchase is outstanding;

- Limits the maturity of each repurchase agreement to the maturity of any securities purchased with the proceeds of the repurchase (but in any event not more than one year) and;

- Limits reverse repurchase agreements to unencumbered securities already held in the portfolio.

**Investment Reporting Requirements**

A. Annually, the chancellor will provide to the Board of Trustees a written statement of investment policy in addition to a report containing a detailed description of the investment securities held by all CSU campuses and the Chancellor’s Office, including market values.

B. Each campus will provide no less than quarterly to the chancellor a report containing a detailed description of the campus’s investment securities, including market values. A written statement of investment policy will also be provided if it was modified since the prior submission. These quarterly reports are required:

- to be submitted to the chancellor within 30 days of the quarter’s end

- to contain a statement with respect to compliance with the written statement of investment policy; and

- to be made available to taxpayers upon request for a nominal charge.

(Approved by the CSU Board of Trustees in January 1997 and as amended in September 2011)