

COMMITTEE ON FINANCE

California State University Annual Investment Report

Presentation By

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Summary

This item provides the annual investment report for fiscal year 2010-11 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 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 (previously known as FAF Advisors) 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. 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 the CSU may invest funds. Senate Bill 79 created the State Agency Investment Fund (SAIF), under new 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 between the CSU and the Department of Finance, the CSU will deposit \$700 million in the SAIF from late September 2011 through April 2013 at an annual rate of 2.0%. Modifications to the board's investment policy that incorporate this new investment option will be presented for action in a separate item.

The California State University Investment Policy in effect during fiscal year 2010-11 is included as Attachment B.

Market Summary

The fiscal year ended June 30, 2011 was marked by an economic recovery hampered by numerous factors, including the ongoing housing slump, stagnant unemployment rates, the continuing European Union bank and sovereign funding crisis, rising oil and gas prices, the earthquake and resulting tsunami in Japan, problems related to the stressed financial condition of state and local governments, and the possibility of a double-dip recession. The economy grew in the fiscal year with GDP increasing by 1.6%. In the last quarter of the fiscal year, the economy grew at an annualized rate of 1.3% with the unemployment rate increasing to 9.2% from 8.8%. Credit spreads widened in June 2011 on concerns over a global economic slowdown and European debt and as a result, corporate debt underperformed Treasury debt for the month. Fiscal policy has been dominated by the recent U.S. debt ceiling negotiations in Congress. Notwithstanding the recent agreement to increase the debt ceiling, future federal government expenditures will be lowered, creating a fiscal policy drag on the economy.

In response to the ongoing difficult environment, the Federal Reserve (Fed) continues to be accommodating, notwithstanding concerns about inflation, and has left the federal funds rate target unchanged at the 0.0% to 0.25% range, indicating that the rate may stay exceptionally low for an extended period. During the last quarter of the fiscal year, the financial markets focus changed from conversations about the potential implications of the pending completion of the Fed's Quantitative Easing program (QE2) ending on June 30 to a debate for the need of an additional round of quantitative easing by the Fed.

Investment Account Performance

As of June 30, 2011, the asset balance in the SWIFT portfolio totaled \$2.3 billion. The objective of SWIFT is to maximize current income while preserving and prioritizing asset safety and liquidity. Consistent with the CSU investment policy and state law, the portfolio is restricted to high quality, fixed income securities.

As of June 30, 2011, the SWIFT portfolio's holdings by asset type were as follows:

California State University Systemwide Investment Fund-Trust
Asset Breakdown as of
June 30, 2011

Cash	0.21%
US Treasuries	13.39%
US Government Agencies	31.68%
FDIC Guaranteed	9.03%
Corporate Securities—Long Term	24.04%
Corporate Securities—Short Term	<u>21.66%</u>
	100.00%

The SWIFT portfolio provided a return of 0.56% during the 12 months ended June 30, 2011. This return was less than the benchmark for the portfolio, which is a treasury based index and benefited from the flight to quality during certain periods of the year. Additionally, because of budget uncertainty at the state level and the possibility that the CSU might need to use its own funds to meet operating requirements during a prolonged budget impasse, the SWIFT portfolio strategy had been defensive throughout a significant portion of the year, emphasizing high liquidity and resulting in a much shorter maturity profile with lower returns.

The SWIFT portfolio's benchmark, the Merrill Lynch 0-3 Year Treasury Index, has been reviewed to determine if a more appropriate benchmark might be used for measuring the SWIFT portfolio's performance. Because of the volatility of the financial markets and the decision to keep the SWIFT portfolio defensive, conditions which are viewed as temporary, the decision has been made to keep the existing benchmark in place, but continue monitoring the appropriateness of the benchmark relative to the SWIFT portfolio's structure and investment strategy.

	<u>SWIFT Portfolio</u>	<u>SWIFT Benchmark⁽¹⁾</u>	<u>LAIF</u>
1 Month Return	0.02%	0.03%	N/A
3 Month Return	0.37%	0.61%	0.12%
12 Month Return	0.56%	1.06%	0.49%
Annualized Return since SWIFT Inception	2.08%	3.19%	1.91%

(1) 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, 2011, the amount of CSU funds invested in SMIF was approximately \$381 million.

SMIF Performance Report		SMIF Past Performance	
Apportionment	Annualized Return	Quarterly Apportionment	Yield Rate
		2002-2011	
FYE 06/30/11	0.49%	Average	2.60%
FYE 06/30/10	0.65%	High	5.73%
		Low	0.46%

Local Agency Investment Fund (LAIF)

The Local Agency Investment Fund (LAIF) is a vehicle used by the State Treasurer to invest local agency funds. LAIF is administered by the State Treasurer's Office. All investments are purchased at market, and market valuation is conducted quarterly. As of June 30, 2011, there were no CSU funds invested in LAIF.

LAIF Performance Report		LAIF Past Performance	
Apportionment	Annualized Return	Quarterly Apportionment	Yield Rate
		2002-2011	
FYE 06/30/11	0.49%	Average	2.59%
FYE 06/30/10	0.66%	High	5.33%
		Low	0.47%

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 Section 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)

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, or bonds with principal and interest guaranteed by the full faith and credit of the State of California;
 - Various debt instruments issued by: (1) federal land banks, (2) Central Bank for Cooperatives, (3) Federal Home Loan Bank Bd., (4) Federal National Mortgage Association, (5) Federal Home Loan Mortgage Corporation, and (6) Tennessee Valley Authority;
 - 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; and
 - 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 reverse repurchase agreements to unencumbered securities already held in the 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)