COMMITTEE ON FINANCE

California State University Annual Investment Report

Presentation By

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Assistant Vice Chancellor
Financing, Treasury and Risk Management

Summary

This item provides the annual investment report for fiscal year 2014-2015 for funds under the California State University Investment Policy.

Background

Most CSU funds are invested through the CSU Systemwide Investment Fund-Trust (SWIFT) investment portfolio, 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, and for investment management purposes the SWIFT portfolio is divided equally between two investment management firms, US Bancorp Asset Management and Wells Fargo Asset Management (formerly 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. Beginning fiscal year 2014-2015, the agreement with the state was lifted, which required the CSU to maintain a minimum balance of approximately $310 million in the SMIF during prior fiscal years to assist in the funding of payroll. The Local Agency Investment Fund (LAIF) is used by the State Treasurer to invest local agency funds. For 2014-2015, the CSU did not invest funds in LAIF. The year-end results for these two funds are reported in Attachment A.

The California State University Investment Policy in effect during fiscal year 2014-2015 is included as Attachment B.
Market Summary

For the fiscal year ending June 30, 2015, U.S. Gross Domestic Product grew by 2.4%, with solid contributions from consumption and housing offset by tepid growth in government and exports. Employment conditions continued to improve as the unemployment rate fell from 6.1% at the end of June 2014 to 5.3% at the end of June 2015. Nonfarm Payrolls added 2.9 million jobs in the fiscal year, an increase of 283,000 over the previous fiscal year. Driven by a strong U.S. dollar and declining oil and commodity prices, inflation stayed well below the Federal Reserve’s (Fed’s) 2% target range.

The basic conduct of monetary policy was relatively unchanged during the fiscal year. The Fed kept the federal funds target range at 0.0% to 0.25%. It also completed the tapering process of its asset purchase program in October 2014 and, as expected, continued to re-invest principal proceeds in order to maintain a stable portfolio size. The year ended with considerable investor disagreement over the timing and pace of any Fed rate tightening. One camp, seemingly favored by Fed Chairman Janet Yellen, favors an “earlier and gradual” timing and pace of rate hikes versus the more traditional accommodative stance of a “later and faster” timing and pace. Other factors complicating the Fed’s decision are the strong dollar and international concerns such as Greece and China, which can impact the stability of financial market conditions.

Credit market conditions were less favorable in the fiscal year ending June 30, 2015 versus the prior period as credit spreads widened meaningfully during the year, particularly for corporate securities. Generally, balance sheet fundamentals remained relatively solid for entities rated A or higher. However, driven by challenging conditions for revenue growth and very low interest rates, some companies conducted more mergers and acquisitions, or re-leveraged their capital structures for the benefit of shareholders, which eroded credit quality around the edges. As a result, rating agency activity was skewed toward the negative during the year, further pressuring credit spreads. In addition, investors demanded higher yields as the markets became more skittish over concerns about Greece, Puerto Rico, China, Ukraine / Russia and the direction of U.S. monetary policy.

Investment Account Performance

As of June 30, 2015, the asset balance in the SWIFT portfolio totaled $3.22 billion. The objective of SWIFT is to maximize current income while preserving and prioritizing asset safety and liquidity. Consistent with the California State University Investment Policy and state law, the portfolio is restricted to high quality, fixed income securities.
As of June 30, 2015, the SWIFT portfolio’s holdings by asset type were as follows:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>0.81%</td>
</tr>
<tr>
<td>US Treasuries</td>
<td>22.50%</td>
</tr>
<tr>
<td>US Government Agencies</td>
<td>35.84%</td>
</tr>
<tr>
<td>Corporate Securities—Long Term</td>
<td>35.95%</td>
</tr>
<tr>
<td>Corporate Securities—Short Term</td>
<td>4.90%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

The SWIFT portfolio provided a return of 0.71% during the 12 months ended June 30, 2015. 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>LAIF²</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Month Return</td>
<td>-0.004%</td>
<td>0.023%</td>
<td>N/A</td>
</tr>
<tr>
<td>3 Months Return</td>
<td>0.112%</td>
<td>0.122%</td>
<td>0.073%</td>
</tr>
<tr>
<td>12 Months Return</td>
<td>0.710%</td>
<td>0.648%</td>
<td>0.268%</td>
</tr>
<tr>
<td>Annualized Return since SWIFT Inception</td>
<td>1.376%</td>
<td>1.849%</td>
<td>1.116%</td>
</tr>
</tbody>
</table>

**Update on the California State University Investment Authority, Policy, and Portfolio Review Initiative**

As presented to the board at its January 2015 meeting, staff has been reviewing the existing legislation governing the CSU’s investments and working with key partners in the legislature, the Department of Finance, and the State Treasurer’s Office to change that legislation in order to provide the CSU with greater investment flexibility and increased earnings on its existing base of funds. Discussions with these key partners are ongoing. The goal is to provide the CSU with the same investment flexibility as the University of California, which has broader latitude in the types of investments it may choose when investing its funds, and which has been able to earn significantly higher returns than the CSU. This potential for additional revenues would have a meaningful impact on the CSU’s ability to address a variety of needs, including its deferred maintenance and critical infrastructure backlog.

Along with possible legislative changes, staff will conduct a review of the CSU’s investment policy and present appropriate amendments to the policy to the board for discussion and approval at a future meeting. Based upon any legislative and policy changes, staff would then work to restructure the CSU’s investment portfolio to meet the CSU’s needs.

¹ Bank of America Merrill Lynch 0-3 Year Treasury Index
² LAIF investment returns are provided for reference only
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, 2015, the amount of CSU funds invested in SMIF was approximately $90 million.

SMIF Performance

<table>
<thead>
<tr>
<th>Apportionment Annualized Return</th>
<th>Quarterly Apportionment Yield Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>FYE 06/30/15 0.25%</td>
<td>Average 1.78%</td>
</tr>
<tr>
<td>FYE 06/30/14 0.24%</td>
<td>High 5.24%</td>
</tr>
<tr>
<td></td>
<td>Low 0.22%</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, 2015, 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 06/30/15 0.27%</td>
<td>Average 1.79%</td>
</tr>
<tr>
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<td>High 5.25%</td>
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<td></td>
<td>Low 0.23%</td>
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</tbody>
</table>
The California State University Investment Policy

The following investment guidelines have been developed for use when investing California State University 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 the Chancellor and his designees with the greatest possible flexibility to maximize investment opportunities. However, as agents of the trustees, the Chancellor and his designees 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 CSU funds, the primary objective of the CSU shall be to safeguard the principal. The secondary objective shall be to meet the liquidity needs of the CSU. The third objective shall be to return an acceptable yield.

**Investment Authority**

The CSU 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 CSU investment portfolios by limiting reverse repurchase agreements used to buy securities to no more than 20 percent of a portfolio.

C. 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 portfolio 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**

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 the CSU, including market values.

(Approved by the CSU Board of Trustees in January 1997; and as amended in September 2011 and November 2013)