Minutes of the Cash Management and Policy Board
Buena Vista Conference Center – 11/05/14

Attendance:

Member	Present
J. Flynn Jr, Chair	Yes
M. Morton	Yes
M. Karia	Yes
D. Marvin	Yes
T. Cook	No
J. Bullock	Yes
W. Engle	No
C. Flowers	No
M. Iorii	No

Others Present: E. Black, S. McVay, C. Kurtzman, J. Johnstone, J. Hooper, B. Eamon, J. Gentry, A. Michaliszyn, K. Christian, K. Buterbaugh, D. Scholl, L. Hornsby, W. Dennehy II, B. Stone, M. Dunning

1. Call to Order

Mr. Flynn calls the meeting to order.

2. Approval of June 5, 2014 Minutes

Mr. Flynn asks for comments on the minutes.

Mr. Bullock comments that they are accurate.

Mr. Stephen McVay, Director of Finance and Treasury Services, comments that he has not received the minutes and declines to review them before approval.

Mr. Morton motions to approve and Mr. Karia seconds. The minutes are accepted without objection.

3. Investment Committee Report

Mr. Marvin discusses the process involved in developing the Investment subcommittee's recommendations regarding the Land and Water Endowment Fund. Mr. Marvin states that the recommendation is much simpler than earlier drafts and recommends hiring three managers for the funds who will invest in stocks, bonds, alternative assets, and cash based on broad guidelines requiring adherence to the Prudent Man Rule. Mr. Marvin states that the broad guidelines will allow for creativity in investing and greater variance in results.

Mr. McVay notes that the APA process will slow down the hiring process, but that a draft of the regulation should be made to start the process post haste.

Mr. Bullock asks about the complexity of the particular regulation being drafted.

Mr. Edward Black, Deputy Attorney General, states that this regulation should not be complicated as Cash Management and Policy Board's previous investment guidelines offer a framework.

Mr. Morton asks about the timeline on approval.

Mr. Black states that, if a draft is submitted to the registrar of regulation by November 15th and all the other deadlines in the process were met in a timely fashion, than the regulation would be effective on February 1st.

Mr. Flynn asks what happens if there are no comments.

Mr. Black states that without any comments, the timeline would be the same, but the work involved would be less.

Mr. Marvin states that Requests for Proposals will likely go out in the mid to late first quarter in this case. Mr. Marvin asks about the turn around on the RFPs.

Mr. McVay explains the RFP process, stating that the RFPs may have a deadline of around a month. Mr. McVay states that that the RFP would be evaluated by a committee involving members of the Cash Management and Policy Board. Mr. McVay notes that the timeline depends on the number of applicants and would further involve some interviews by the evaluation committee and then the full Cash Management and Policy Board.

Mr. Marvin states that hiring would likely not be done until the summer.

Mr. McVay states late spring as a best case scenario.

Mr. Flynn states an aim to decide who will allocate the Land and Water Endowment Fund during the June Cash Management and Policy Board meeting.

Mr. Marvin motions the Cash Management and Policy Board accept the Investment Subcommittee's recommendation. Mr. Karia seconds the motion and notes that, despite their absences, Mr. Cook and Mr. Engle both approve of this recommendation fully.

Mr. Flynn seconds Mr. Cook and Mr. Engle's approval of the recommendation. The recommendation is approved unanimously.

4. Input from Attorney General's Office

Mr. Black states that investment guideline changes the Cash Management and Policy Board has previously approved are out for comment in the current edition of the regulation register. Mr. Black notes there have been no comments, and as such the regulations will become final on December 1st.

Mr. Flynn asks that these final guidelines now represent the Cash Management and Policy Board's official position since prior guidelines never went through the APA process.

Mr. Black confirms.

Mr. Bob Eamon, a representative of Delaware State Parks, thanks the Cash Management and Policy Board for their efforts and states an appreciation for the work that will enable future funding through the Land and Water Endowment Fund.

Mr. Flynn asks about the publication process for these official guidelines.

Mr. McVay states that the guidelines will be posted on the Treasurer's official website.

Mr. Black notes the guidelines will also become part of the Administrative Code. Mr. Black states one other issue is that DELGIP was not part of this round of regulation because there are no funds in DELGIP. Mr. Black recommendation that a regulation for DELGIP funds be proposed so that it can navigate the APA process in the event that someone decides to invest in DELGIP in the future. Mr. Black notes that the Cash Management and Policy Board has already approved these guidelines, but that they were not included in the previous regulatory process because of their insignificance.

Mr. McVay asks if Mr. Black has the final version of the guidelines.

Mr. Black confirms.

Mr. McVay requests an electronic copy of the final regulations that can be posted on the treasury website and passed along to investment managers once the guidelines become official.

5. Banking Committee Report

Mr. Flynn states that Mr. McVay will present for Mr. Engle on banking issues as Mr. Engle is on vacation.

Mr. McVay requests that the Wells Fargo contract for processing direct deposits of payroll and pension checks be given a one year extension taking the terms to June 30th, 2015. Mr. McVay notes that the Treasury defers to agency preferences on this sort of contract and that PHRST and the pension office are very happy with Wells Fargo's service. Mr. McVay notes the contract is relatively inexpensive at $17,000 for the service last year.

Mr. Morton asks how many more extension options exist.

Mr. McVay states that there is one more one year extension left, but that it makes sense to only extend the contract in a manner that allows the new treasurer some input in the process after experiencing the status quo service.

Mr. McVay's request is made a motion by Mr. Morton, seconded by Mr. Marvin and is approved unanimously.

Mr. McVay discusses the upcoming contract expiration of the state's card processor, Electronic Payment Exchange, on March 1st 2015. Mr. McVay requests the use of the first of two one-year extensions. Mr. McVay again notes that this allows the new treasurer a chance to evaluate all the contracts at hand and make his own decisions on these matters.

Mr. Bullock asks if Electronic Payment Exchange are having financial difficulties.

Mr. McVay states that there are no financial difficulties to his knowledge.

Mr. Bullock asks where Electronic Payment Exchange are based.

Mr. McVay states that the company is Wilmington based, but that they were recently acquired.

Mr. Bullock states a memory of lingering problems concerning Electronic Payment Exchange and asks that we return to a potential motion after he checks with some references.

6. Presentation from Intermediate Managers

Mr. Kurtzman discusses the Credit Suisse review of Delaware's investment managers including a Performance by Entity report and a quarterly manager review. Mr. Kurtzman's review includes month to date, year to date, one year, and three year returns for both liquidity and reserve accounts from each manager. Mr. Kurtzman states that there is little dispersion in results among managers, but that there is greater dispersion in the reserve accounts. Mr. Kurtzman states that this dispersion is a result of difference in the duration, the use of a barbell approach, more corporate bond exposure, and full allocation to mortgage and asset backed securities.

Mr. Flynn asks who the top performing manager is.

Mr. Kurtzman states that the top performing reserve account is Chandler at 164 year to date and J.P. Morgan is the lowest at 91 year to date. Mr. Kurtzman notes that some of the mangers with longer legacy positions have done very well this year because they were rebounding from poor prior years related to those legacy positions. Mr. Kurtzman notes that managers with unfavorable legacy positions were those that replied to their hiring slower and thus received the leftover legacy assets.

Ms. Amy Michaliszyn, Senior Vice President at Federate Investment Counseling, introduces senior portfolio manager Mr. John Gentry.

Mr. Gentry discusses the performance of Federated Investment Counseling's portion of Delaware's portfolio. Mr. Gentry states the view that U.S. growth will drive interest rate increases with the yield curve normalizing and the Fed loosening short term rates likely in the middle of next year. Mr. Gentry states an investment outlook overweight in corporates and demand for asset back securities. Mr. Gentry explains a desire to preserve capital in the face of rising interest rates by adding yield to the portfolio to offset the price erosion caused by higher interest rates.

Mr. Marvin asks if adding yield means downgrading the quality of bonds.

Mr. Gentry recommends being able to purchase single A corporate bonds, increasing the amount of Mortgage-backed and Asset-backed securities (MBS/ABS) allowed to 20%, and increasing the allowable term for Asset-backed securities from 2 years to 3 years as means toward increasing yield.

Mr. Marvin asks if single A bonds are already allowed.

Mr. Flynn states that this change is part of the newly approved regulations that go into effect December 1st.

Ms. Michaliszyn asks about the details of the approval process for this change.

Mr. Black states that the change had to go through the APA regulatory process.

Mr. Kurtzman clarifies that changes to the portfolio cannot be made until an official memo from the Treasury has been sent.

Mr. Marvin asks about the risk involved in increasing MBS and ABS holdings.

Mr. Gentry notes that the Fed is leaving this market and as a result the prices should normalize.

Mr. Marvin asks if there is a concern about a quick rise in interest rates.

Mr. Gentry states that rates will rise in a telegraphed manner and will depend on economic fundamentals such as monthly job reports and wage averages.

Mr. Flynn asks if changes two and three are possible under the current guidelines.

Mr. Gentry states that the current maximum for MBS/ABS is 10% and limited to a 2 year asset life for ABS.

Mr. McVay notes that the allowance of heavier ABS/MBS shares had existed prior to the financial crisis and that most managers are at the maximum allowance currently because of yield potential.

Mr. Marvin states the need for further discussion before deciding upon any changes due to the existence of potential danger.

Mr. Kent Christian, Portfolio Manager at J.P. Morgan Asset Management, discusses the performance of J.P. Morgan Asset Management's portion of Delaware's portfolio. Mr. Christian states a preference for spread products over treasuries based on strong corporate balance sheets and economic fundamentals relating to interest rates. Mr. Christian states a preference to overweight in short term assets and corporate bonds. Mr. Christian notes that volatility during the year allowed tactical movement around the durations within Delaware's portfolio. Mr. Christian recommends that ability to go as low as A- in bonds quality and increase the share of ABS allowed to 15%.

Mr. Marvin asks if J.P. Morgan Asset Management thinks the 10-year interest rate could climb to the 3-4% range and short term rates to 1 to 2%.

Mr. Christian states the view that starting in September 2015 the Fed will raise interest rates 25 basis points per meeting until a neutral rate around 2% is achieved. Mr. Christian states the view that the Fed may have to move beyond 2% initially.

Mr. Marvin asks if the dollar will strengthen.

Mr. Christian confirms this view.

Mr. Marvin asks if J.P. Morgan Asset Management believes there will be any action on corporate profits abroad.

Mr. Christian states that there seems to be some momentum towards changes in the corporate tax code and that the United States corporate tax code is inconsistent with foreign counterparts.

Mr. Flynn notes that on December 1st J.P. Morgan Asset Management should receive a notice that enables the inclusion of single A rated corporate bonds.

Mr. Dan Scholl, Co-Head of US Tax-Exempt Fixed Income for Schroeder's Investment Management, states that Schroeder's just had a global fixed-income manager's meeting and that interest rates are at three to four hundred year lows across the globe. Mr. Scholl notes that the portfolio objectives ranks as capital preservation, liquidity, and return in that order, but that risks are magnified currently by the lack of history for comparison.

Ms. Lisa Hornby, Portfolio Manager for Schroeder's Investment Management, notes that the portfolio is conservatively posture in the face of a rising rate environment. Ms. Hornby notes long term structural headwinds such as demographics, high debt levels, and regulatory red tape. Ms. Hornby states the rate normalization will begin in the middle of next year and that the portfolio is set in preparation of this change with short durations and a barbell investing approach. Ms. Hornby states that intermediate bonds are most likely to be sensitive to the Fed's interest rate changes. Ms. Hornby notes that the portfolio is overweigh in financials because the new regulatory structure is good for bank balance sheets with a low risk of releveraging. Ms. Hornby notes the purchase of cheap inflation linked bonds as break even protection in case the Fed is more complacent about rate hikes.

Mr. Flynn notes that on December 1st J Schroeder's Investment Management should receive a notice that enables the inclusion of single A rated corporate bonds.

Mr. Bullock, returning briefly to discussions from the Banking Committee Report, states that Electronic Payment Exchange are in bankruptcy and that the state doesn't have any information about the acquiring entity. Mr. Bullock asks for assurances concerning continued quality and states concerns about international activity around Electronic Payment Exchange.

Mr. McVay states that Electronic Payment Exchange think they will become stronger as a result of the acquisition. Mr. McVay states nothing should change in the current processing and in personnel.

Mr. Bullock notes this is not reassuring when Electronic Payment Exchange is in bankruptcy.

Mr. Flynn states two options of extending the contract for a period of time so that the Cash Management and Policy Board can become familiar with the new situation or to not extend the contract and have an emergency meeting if the situation becomes more comfortable.

Mr. Bullock suggests a 6 month extension to allow the new Treasurer to evaluate the situation.

Mr. McVay asks that the Electronic Payment Exchange contract is extended 6 months to September 1st of 2015. Mr. Karia seconds the motion and it is approved unanimously.

Mr. William Dennehy II, portfolio manager at Chandler Asset Management, states that the Chandler firm is focused on giving smaller, less sophisticated entities such as cities and counties the resources to properly manage portfolios and as a result 73% of Chandler's business is governmental accounts similar to Delaware. Mr. Dennehy details a summary of the portfolio based on presented materials. Mr. Dennehy states that the portfolio's duration is continuing to contract towards the benchmark. Mr. Dennehy states a desire to max out securitized allocations at 10% as per current policy and would encourage loosening of investment policy to include single A rated bonds in the portfolio.

Mr. Flynn notes that on December 1st Chandler Asset Management should receive a notice that enables the inclusion of single A rated corporate bonds.

Mr. Dennehy states an expectation that the three to six year portion of the yield curve is most attractive. Mr. Dennehy states an expectation that the Fed will not likely change rates until the second half of 2015, and that the risk is heavier on that start date going further out rather than coming sooner. Mr. Dennehy notes that Chandler's internal models consider the 5 to 10 years part of the yield curve is the least attractive. Mr. Dennehy states the 2 to 5 year portion is the most attractive.

Mr. Flynn notes the interesting dynamic of varied investment strategies.

Mr. Bullock notes someone has to be right and someone will be wrong.

Mr. McVay notes this is the benefit of diversification.

Mr. Marvin states that the market has rushed back to the high yields on ABS, but the cause of the previous crisis is that no one did quality analysis on what was within the asset package. Mr. Marvin states not knowing what is in the asset package creates vulnerability and that is why the Cash Management and Policy Board should be cautious in widening the allowable maximum for ABS.

Mr. Bill Stone, head of US fixed income at Morgan Stanley Investment Management, introduces the portfolio noting that returns are solid and less volatile than the benchmark. Mr. Stone states that this moderate success is being achieved without taking on more risk than the benchmark. Mr. Stone explains Morgan Stanley's performance attribution measures as presented.

Mr. Matt Dunning, portfolio manager at Morgan Stanley Investment Management, states the portfolio has been moved out of treasuries some and into corporate grade bonds and MBS/ABS. Mr. Dunning state the portfolio is particularly overweight in financials and ABS/MBS versus the benchmark.

Mr. Stone states that the return in the market is not sufficient to take on interest rate risk and that the five year portion of the yield curve appears to be the most overpriced.

Mr. Marvin asks what the difference is today versus during the crisis in regards to the risks related to MBS/ABS investments.

Mr. Stone states that there was a lot of volatility in the ABS/MBS market, but that many securities succeeded during the crisis. Mr. Stone states that Morgan Stanley Investment would focus on the fundamentally successful securities; specifically agency backed mortgages. Mr. Stone state that in the case of ABS, only prime securities backed by auto loans and such would be acquired rather than the mortgage securities that were mislabeled as asset backed securities during the crisis.

Mr. Marvin asks about what might have happened if the government had not stepped in to help out Fannie Mae and Freddie Mac.

Mr. Stone states that those securities would not have traded as well, but the fundamentals would have been fine.

Mr. Marvin states that Morgan Stanley was on its way to being Lehmann before the TARP came through and notes the while everything has worked out there was at one point massive risk.

Mr. Flynn notes that on December 1st Morgan Stanley Investment Management should receive a notice that enables the inclusion of single A rated corporate bonds.

Mr. Flynn asks for comments and notes that the variety of approaches is good to see.

Mr. Kurtzman states that the managers all have different approaches, but have all done a reasonably good job.

7. New Business

Mr. Flynn asks if there is any new business. There is none.

8. Public Comment

Mr. Flynn asks if there is any public comment. There is none.

9. Adjournment

The meeting was adjourned.