



To: Cash Management Policy Board
From: Jennifer Appel, Kevin Leonard, Alexandra Sollers
Date: October 10, 2023
Subject: Delaware Budget Stabilization Account Reserve Analysis

Background

NEPC was asked to prepare an analysis for the Delaware Budget Stabilization Reserve Account (the Account) to ensure that an adequate reserve or cushion above the statutorily required amount was maintained. The minimum amount that must be maintained in the Budget Stabilization Reserve Account for Fiscal Year 2024 is \$410,100,000, which is an increase of \$7,500,000 from the Fiscal Year 2023 level of \$402,600,000. The reserve or cushion for Fiscal Year 2023 was \$2,000,000 bringing the total for fiscal Year 2023 to \$404,600,000.

Analysis

Our analysis was conducted on the Liquidity Portfolio in total, a dual manager arrangement, whereby two high quality cash-like portfolios demonstrate a cash plus risk and return profile. The Federal Reserve has indicated that they intend to raise short-term interest rates at least one more time through 2023 and expect fewer rate cuts in 2024 as elevated inflation pressures persist within across the economy. The Fed Funds rate, which peaked in 2Q23 at 5.5%, is expected to follow a similar path as seen by pricing in the interest rate futures market.

This analysis considers two separate measures to develop a recommendation. The first measure utilizes NEPC’s Capital Market Assumptions to determine expected volatility and confidence intervals. The second measure accounts for the impact of interest rate increases of 0.25%, 0.50%, and 1.00%.

The analysis, presented below, indicates that a reserve cushion would not be needed when relying on NEPC’s Capital Market Assumptions given the impact of reinvestment at higher interest rate levels that would offset expected price volatility. That being said, using the interest rate shock analysis, the liquidity portfolio would incur losses of between ~\$451,000 and ~\$1,800,000.

Summary & Recommendation

**State of Delaware
 Budget Stabilization Account
 Data as of August 1, 2023**

Required Balance: \$410,100,000
Duration: 0.45

	<u>Return</u>	<u>Volatility</u>	Decline with a		
			<u>1 SD Event</u>	<u>2 SD Event</u>	<u>3 SD Event</u>
NEPC Capital Market Assumptions	4.22%	0.85%	\$ 13,517,070	\$ 10,107,720	\$ 6,698,370
Interest Rate Shock Results			<u>25 bps increase</u> \$ (451,238)	<u>50 bps increase</u> \$ (902,475)	<u>100 bps increase</u> \$ (1,804,950)

Based on the result of these analyses and expectations of persistent elevated short-term interest rates by the Federal Reserve, NEPC recommends no changes to reserve amount be added to the Delaware Budget Stabilization Account's minimum required level of \$410,100,000.

We look forward to discussing this recommendation with the Board.

