To:	**Cash Management Policy Board Investment Committee**
From:	**Jonovan Sackey, Jennifer Appel, Kevin Leonard**
Date:	**July 21, 2025**
Subject:	**2025 Liquidity & Reserve Manager Due Diligence Meetings**

Background

Members of the Delaware Office of the State Treasurer (OST) Staff and NEPC met with the six investment management firms charged with implementing the fixed income portfolio structure for the Delaware OST. The purpose of these meetings was to discuss any significant changes to the investment management organizations, team members, and investment process, along with receiving updates on current portfolio positioning, potential portfolio positioning changes, and current market conditions. Further, the investment management firms relayed potential Investment Guideline enhancements to their mandates managed on behalf of the Delaware OST.

The remainder of this memo summarizes the findings during these meetings. The memo has been structured between the Liquidity and Reserve components of the portfolio.

Liquidity Managers

PFM

PFM noted that there had been no significant changes to the investment organization, the assigned investment team, the investment philosophy, or the approach since the last annual update with Delaware OST staff and NEPC.

PFM highlighted how the fixed income market has evolved, while enduring volatility related to tariffs and other geopolitical concerns. The belief is that the Fed will maintain an easing bias, given that rates are well above where inflation currently sits. Given today's unemployment data, the markets have factored two rate cuts by the Fed this year, which bodes well for the portfolio's current positioning. PFM currently favors longer-dated securities, although it is balancing that by ensuring the portfolio has sufficient front-end roll-down maturities to facilitate any liquidity needs. Regarding allocation, the team cited it has reduced its exposure to commercial paper in favor of negotiable CDs, which presented better floating rate opportunities in the market. Additionally, the allocation to agencies has diminished along with a reduction in supply, as the funding needs of banks have decreased. However, the most significant adjustment PFM has made is with respect to its duration positioning.

As of June 30, 2025, the portfolio had a duration of 0.60 years, compared to 0.39 for the benchmark duration. PFM plans to maintain this overweight duration position instead of rebalancing in the event the Fed cuts rates as it expects. The current portfolio yield reflects 4.39%, exceeding the benchmark yield by 14 basis points.

Guideline Change Recommendation:

- Increase the current 10% allocation limit on ABS products
    - Currently, the investment team aims to maintain a 6-8% allocation to the ABS sector, and it believes an increase to the limit would allow them to pursue more opportunities within the ABS market that would prove additive to the portfolio. Otherwise, the PFM team is able to effectively operate under the State's mandate.

Wilmington Trust

Wilmington Trust noted no changes over the last year within the organization or to the State's specific investment team.

Wilmington discussed current fiscal policy, noting that the Fed is communicating to the market two 25-basis point rate cuts through the end of 2025. This would place the Fed Funds rate at around 3.75% by year-end, with continued declines expected into 2026 before normalizing down to 3% over the longer term. With growth expected to slow, the team anticipates a stagflationary environment in the back half of the year. While Wilmington sometimes approaches the 50% limit to corporate bonds, the portfolio is currently 33% allocated to the sector, with agencies constituting the second largest allocation at 17%.

As of June 30, 2025, the portfolio duration was 0.65 years compared to the benchmark duration of 0.48 years. The portfolio yield also sits slightly above the benchmark (4.29% versus 4.25%). While Wilmington expects the Fed to decrease rates, the timeline continues to be pushed back, which has allowed the portfolio to capture favorable yields on the shorter end as well.

Guideline change recommendation:

- Increase the average life limit on ABS products from two years to 2.5 years
    - This would be in line with the current limit for the State's Reserve accounts.

Reserve Managers

JP Morgan – Tier 1 Reserve Manager (1-3 Years)

JP Morgan noted that there had been no significant changes to the investment organization, the assigned investment team, the investment philosophy, or the approach since the last annual update with Delaware OST staff and NEPC.

JP Morgan iterated that it expects ongoing tariff implementation to have a negative impact on growth throughout the second half of 2025. It then expects the economy to accelerate again in 2026 with the advent of tax cuts and other forms of stimulus. The team highlighted the unemployment rate of 4.2%, which it anticipates will shift slightly higher, presenting a potential opportunity for the Fed to lower rates. In terms of allocation, the portfolio remains underweight treasuries and overweight corporates, specifically within the financials sector. The corporate bond exposure has been the biggest driver of performance within the portfolio.

Up until April, the portfolio was neutral duration relative to the benchmark. When recession probability began to rise, JP Morgan transitioned to a longer duration position. As of the end of Q2, the portfolio duration sat at 1.93 years versus 1.75 years for the benchmark. The portfolio also holds a significant yield advantage over the benchmark with a 4.41% yield versus 3.89% for the benchmark.

Guideline change recommendation:

- Increase 15% limit on 144A securities
    - With an increasing share of new corporate issuance coming in 144A format, JPM consistently bumps up against the current limit. The yield difference between registered and 144A bonds is roughly 3–5bps, and with144A bonds being a more widely accepted issuance format, it believes this change shouldn't affect risk or liquidity.

- Increase the 10% limit on ABS products
    - The team believes this adjustment will allow for more diversification, an increase in average portfolio rating and potentially additional return. Typically, A-rated corporates within the portfolio would be replaced by AAA-rated ABS or government-backed MBS products.

- Inclusion of collateralized mortgage obligations (CMOs) within the MBS definition
    - Currently the guidelines (section 7.3.9.1) only allow for the inclusion of MBS products issued in the form of pass-throughs; this eliminates collateralized mortgages, which JPM hopes can be included going forward, as they are guaranteed by the US Government but have more predictable cashflow streams and are better suited for the strategy it manages for the State.

- Increase the current 25% industry limit of corporate debt instruments to 30%
    - JPM occasionally approaches the limit in the financials sector and believes having the flexibility to exceed the 25% cap would benefit the portfolio.

BlackRock – Tier 2 Reserve Manager (1-5 Years)

BlackRock relayed that there was one member added to its thought leadership team. Otherwise, there were no significant changes to the investment organization, the assigned investment team, the investment philosophy, or the approach since the last annual update with Delaware OST staff and NEPC.

BlackRock expects to see inflation increase 0.4% month-over-month until the end of 2025. Its belief is that the Fed will view the tariff shock as transitory, and as we move into 2026, runways of inflation will begin to moderate. BlackRock agrees that the Fed will cut rates 1-2 times by the end of the year, even if inflation remains sticky. The team added there was potential for 3-4 rate cuts by the end of 2026.

The portfolio ended the fiscal year right in line with the benchmark duration at 2.58 years. The portfolio yield ended at 4.20% versus 4.06% for the benchmark. BlackRock iterated that it has made a point to maintain a yield advantage to capitalize on that additional income. The team cited its allocation to corporate bonds as a main contributor to strong recent performance. It has been opportunistically adding risk to the portfolio since the "Liberation Day" announcements.

Guideline change recommendation:

- Increase the 10% limit on aggregated MBS and ABS products up to 20%
    - This will allow for the team to take advantage of these high-quality, liquid, and potentially compelling sources of carry.

- Expand the ABS definition to include private student loans
    - While student loans are unsecured consumer loans, they generally cannot be discharged in bankruptcy (unlike other consumer loans).

- Extend the ABS weighted average life (WAL) limit of two years and the floating ABS WAL of three years to five and six years, respectively
    - BR suggests extending these limits to expand the opportunity set.

- Include To-Be-Announced securities (TBAs) and CMOs within MBS definition
    - Current guidelines restrict purchases to pass-through securities. BR recommends including these security types, as these two instruments are most homogenous for investing in the US mortgage market and permit the investment team added flexibility.

- Relax the minimum credit rating for corporate bonds to BBB from A-, potentially up to 10%
    - BBB-rated securities strike a compelling balance between yield and quality and are particularly attractive in a potentially lower-rate environment. With BBBs now comprising over 50% of the IG universe, they also provide broad issuer diversification, helping mitigate concentration risk. Even restricting the BBB cohort to just the highest-rated BBB+ names could be beneficial.

- Allow Foreign Agencies within the portfolio
    - These securities were asked to be excluded from the investment universe, however they are included in the State's guidelines and also make up a small component of the benchmark. Permitting the purchase of Foreign Agencies allows BR to draw upon a more diverse opportunity set.

- Increase the 144A securities limit of 15%

- Allow futures contracts within the portfolio, as a means of hedging against interest rate risk
    - The investment guidelines might even state that US Treasury Futures are to be used for duration hedging purposes only.

Chandler – Tier 3 Reserve Manager (5-10 Years)

Chandler noted that there had been no significant changes to the investment organization, the assigned investment team, the investment philosophy, or the approach since the last annual update with Delaware OST staff and NEPC.

Chandler also highlighted the employment backdrop with a relatively low unemployment rate of 4.2%. The team does anticipate modest deterioration in the payroll backdrop as we move through the year, largely related to the uncertainty around tariffs coupled with factors like a worsening savings rate for the consumer. Chandler expects tariffs to be transitory and really only impact inflation for 2-3 months before getting back to trend. The portfolio has a roughly 41% allocation to corporates and a 56% allocation to treasuries. This substantial treasury allocation is consistent with their view that consumer spending will slow down throughout the remainder of the year, paving the way for spread widening.

The portfolio slightly outperformed over the one-year timeframe. Typically, Chandler would see greater outperformance, but the portfolio's overweight to treasuries served as a headwind to relative performance, as higher quality assets lagged higher risk securities. The team discussed the 50 basis point spread between the 2- and 10-year treasury note. Chandler expects 100 basis points of steepening to be where the curve normalizes, as monetary policy likely shifts front-end rates lower.

Portfolio duration was 5.87 years as of June 30, 2025, compared to 5.97 years for the benchmark. The reason Chandler maintains a shorter duration position is tied to its belief that the curve needs to steepen further. Chandler plans to be well-positioned to add risk to the portfolio when valuations are more compelling. The portfolio yield of 4.26% slightly exceeds that of the benchmark at 4.24%. Portfolio allocation to agencies has really contracted, as it is challenging finding the relative value in the sector; mortgages have not been heavily incorporated into the portfolio.

Guideline change recommendation:

- Allow for the inclusion of split-rated securities
    - The State's current guidelines require securities to have an A rating or better from all three credit rating agencies. The rationale for this adjustment is that the benchmark utilizes a weighted scale, whereby an individual security can have a BBB rating from one of the agencies and still fall within the benchmark.

- Permit the purchase of CMOs
    - Currently the guidelines prohibit the inclusion of these securities, but these issuances maintain an underlying credit quality consistent with the tenets of the State's investment policy and would provide an additional high quality asset class with less optionality around prepayment speeds to enhance the portfolio's total return opportunity.

- Increase the current MBS allocation limit from 10% to 20%

Lazard – Tier 3 Reserve Manager (5-10 Years)

Lazard noted that there had been no significant changes to the investment organization, the assigned investment team, the investment philosophy, or the approach since the last annual update with Delaware OST staff and NEPC.

Starting in December 2024, Lazard began to increase its exposure to the corporate sector. Through the first quarter of 2025, the portfolio remained underweight corporate credit as it ramped up the exposure to be more in line with the index. This shift in allocation now has the portfolio overweight corporates and underweight treasuries, including a 25% drop in treasury allocation over the last six months. In terms of attribution, sector allocation and security section, specifically within corporates has helped performance; an overweight to agency MBS has been additive, as those securities are excluded from the index.

The current portfolio duration sits just below the benchmark (6.07 years versus 6.08 years), and the portfolio yield is 4.28% versus 4.22%. Lazard is currently aiming to remain neutral duration, as it believes two rate cuts from the Fed are plausible, although may come later than expected.

Lazard made no recommendations to the State's current policy.

Potential Guideline Enhancements

The table on the following page summarizes comments that were received related to potential Investment Guideline enhancements. Major themes are captured along with the frequency in which they were cited by the six investment managers.

	PFM	Wilmington Trust	JP Morgan	BlackRock	Chandler	Lazard	NEPC Does not recommend	NEPC/OST recommends	NEPC recommends further discussion
Increase 144a Limits from 15% to 30% in Reserve			X	X				X	
Allow Split Ratings					X		X		
An Increase to Average Life Restrictions on ABS limits from 2 to 2.5		X		X				X	
Expand ABS and/or MBS Definition to include student loans				X					X
Include CMOs and TBAs under MBS definition			X		X		X		
Increase ABS & MBS	X		X	X	X				X

Limits of 10%									
Increase Corporate Debt Limits 25% to 30%			X				X		
Allow Derivatives				X			X		
Allow BBB Securities				X			X		

The first guideline change that NEPC and OST recommend includes increasing the limit on 144A securities from 15% to 30% in the Reserve portfolio. This is a change that has already been implemented in the Liquidity portfolio, and this will enhance portfolio alignment by extending the same flexibility to the portfolio's Reserve managers. NEPC and OST also recommend increasing the average life limit of ABS products from two years to 2.5 years within the Liquidity portfolio. This change will allow the Liquidity managers to take better advantage of the new issuance market in this sector and will align with a change already approved within the Reserve portfolio.

NEPC recommends further discussion with respect to increasing the ABS & MBS aggregated limit of 10%. While several managers requested this increase, responses varied on where the new upper limit would be situated. After discussing with OST, NEPC believes a modest increase to 15% would be appropriate in allowing the State's managers increase their flexibility to diversify, while potential bolstering returns and even credit quality. Additionally, NEPC recommends further discussion around BlackRock's proposed inclusion of private student loans under the broader ABS definition in the State's investment policy. Additional conversations around this would be beneficial, in order to understand how BR would implement the inclusion of these assets, as well as the extent to which they would be additive.

We look forward to discussing this memo with the Investment Committee and Cash Management Policy Board at their upcoming meetings. In the meantime, please reach out with any questions you may have regarding the memo or the individual manager meetings.