Missouri Municipal League

Annual Conference 2017

Understanding Key Elements of an Investment Program

Presented by:

Bill Sullivan, Trish Oppeau and Jason Glidden

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William Sullivan

Managing Director

In 2004, William T. Sullivan, Jr. joined PFM as a managing director at the Long Island, New York office. He administers investment pools located in Missouri and Nebraska and is responsible for the national development and implementation of the PFM Procurement Card program.

Bill was previously chairman and CEO of Cadre Financial Services, Inc., and its registered brokerage affiliate, Cadre Securities, Inc. His primary responsibility was the development, marketing and overall administration of liquid asset programs for school districts, municipalities, hospitals, health care providers and Taft Hartley Health & Welfare Benefit Trusts, throughout the United States. These programs represented 3,000 public and private entities in 20 states with assets of over $7 billion under management or administration. For more than 30 years, Bill has been involved in cash flow management and the investment of both operating and surplus funds.

Bill is a nationwide speaker on the U.S. Banking system and cash management technologies. Prior to establishing Cadre in 1982, he was responsible for E.F. Hutton’s banking relations and cash flow management in excess of $2 billion per day. He has served as consultant to the investment committee of the State of West Virginia, the Arizona State Retirement System, the Arkansas Legislative Auditors, Alitalia Airlines North America, and National Securities Clearing Corporation.

Bill holds Series 6, 26, 40 (replaced by 24), and 63 designations from the Financial Industry Regulatory Authority (FINRA).

Trish Oppeau

Director

Trish Oppeau, joins PFM's Asset Management Group with 18 years of investment experience. As a Director overseeing the St. Louis office, Mrs. Oppeau is responsible for managing client relationships throughout Missouri. She assists municipal governments, school districts, colleges and universities, and other political subdivisions with their cash flow analysis and overall investment needs. Her responsibilities also include providing a range of investment advisory and consulting services, developing investment policies, and monitoring guidelines and strategy implementation.

Prior to joining the firm, Mrs. Oppeau was a Vice President at Advisory Research where she was responsible for client services and new business development. Formerly, she served as a senior marketing assistant with Kennedy Capital Management in St. Louis. Mrs. Oppeau’s experience also includes successful roles held at Stifel, Nicolaus & Company, CBIC Oppenheimer and Edward Jones.

Mrs. Oppeau holds a Bachelor of Science in communications management from Missouri State University and a Masters of Business Administration in management from the University of Missouri-St. Louis. She hold FINRA Series 7 and 63 designations.

Jason Glidden

Senior Managing Consultant

Jason Glidden joins PFM's Asset Management Group after spending over 22 years providing liquidity and fixed income expertise to government entities, large corporations, and non-profits. In his current role at PFM, Mr. Glidden manages client relationships for a variety of clients located in Missouri. He assists municipal governments, school districts, colleges and universities, and other public authorities with their cash flow analysis and their overall investment needs. His responsibilities also include providing a range of investment advisory and consulting services, developing investment policies, and monitoring guidelines and strategy implementation

Mr. Glidden began his career with Bank of America Merrill Lynch where he spent 20 years, earning director level in their institutional fixed income division. While there, he was responsible for covering the Midwestern states of Missouri, Kansas, Nebraska and Iowa. Most recently, Mr. Glidden was Vice President at Bank of Oklahoma Financial Securities where he continued to focus on the investment needs of institutional clients throughout the Midwest.

Mr. Glidden earned his Bachelor of Arts degree from the University of Kansas and holds FINRA Series 7 and 63 security designations.

Agenda

ECONOMIC UPDATE

PERMITTED INVESTMENTS

INVESTMENT COLLATERALIZATION

PURCHASING CARDS

MISSOURI SECURITIES INVESTMENT PROGRAM

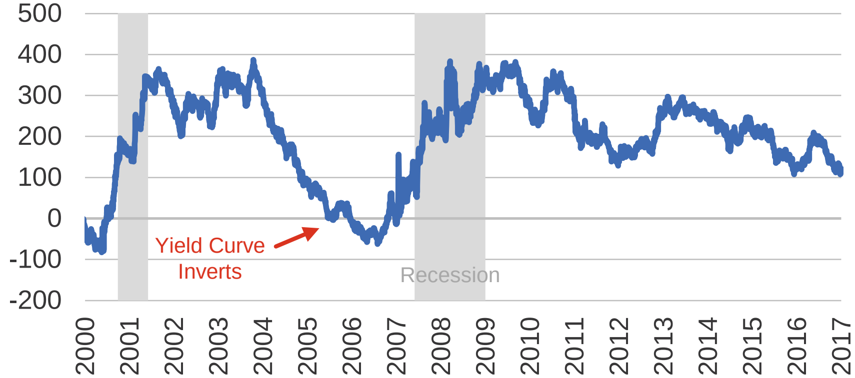
Economic Update

Current Market Themes

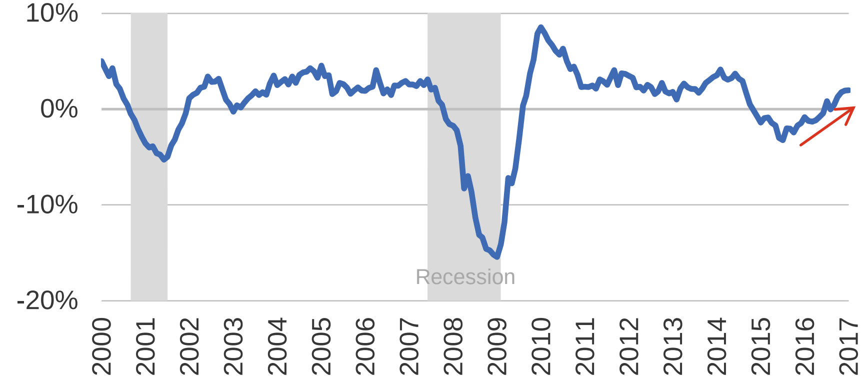
- U.S. economic conditions are characterized by:
  - A pickup in GDP growth in Q2
  - Continuing labor market strength, but with modest wage growth
  - Muted inflation pressures
  - A weaker U.S. dollar
- Short U.S. Treasury yields moved higher following the Federal Reserve’s rate hikes in March and June, but longer-term yields have lagged due to moderating inflation expectations
  - Fed officials still forecast 1 more rate hike in 2017, according to the June “dot plot”
  - The Fed plans to reduce the size of its balance sheet “relatively soon”
- Global stock markets have rallied amid very low volatility as U.S. consumer confidence remains strong and the growth outlook brightens in Europe. Conflicting messages from equity and bond markets are puzzling.
- President Trump’s economic policies were considered pro-business and inflationary, but setbacks to their rollouts have dampened expectations.
- Geopolitical risks continue to loom in the background (North Korea, Middle East, Russia).

U.S. Recession Indicators: Risks Appear Low in Near Term

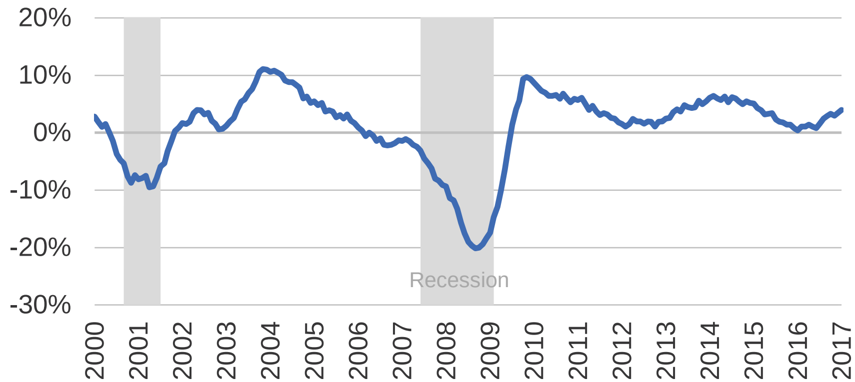
10 Year – 3 Month Treasury Yield Spread
(in bps)



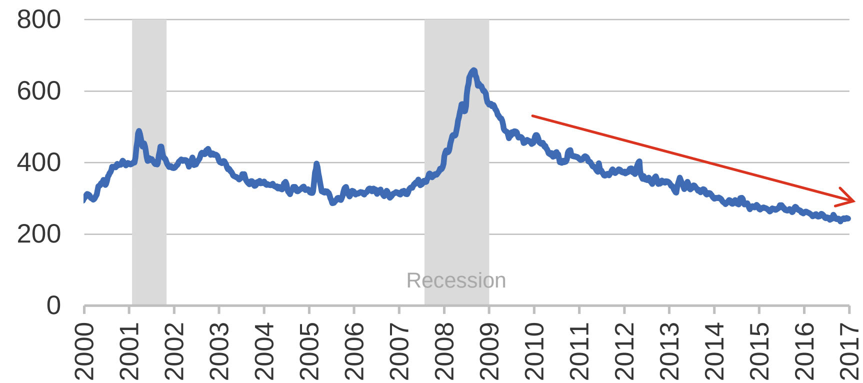
Industrial Production
(YoY)



Conference Board Leading Indicator
(SA, YoY)



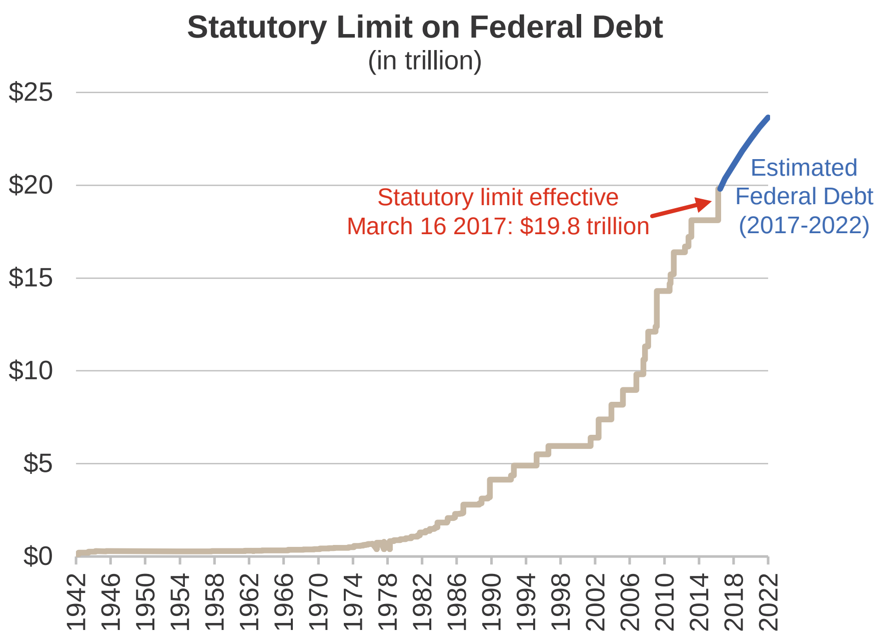
Initial Jobless Claims
(4-week average, in thousand)



Source: Bloomberg, as of 07/31/17. SA is seasonally adjusted.

Federal Debt Limit & Extraordinary Measures

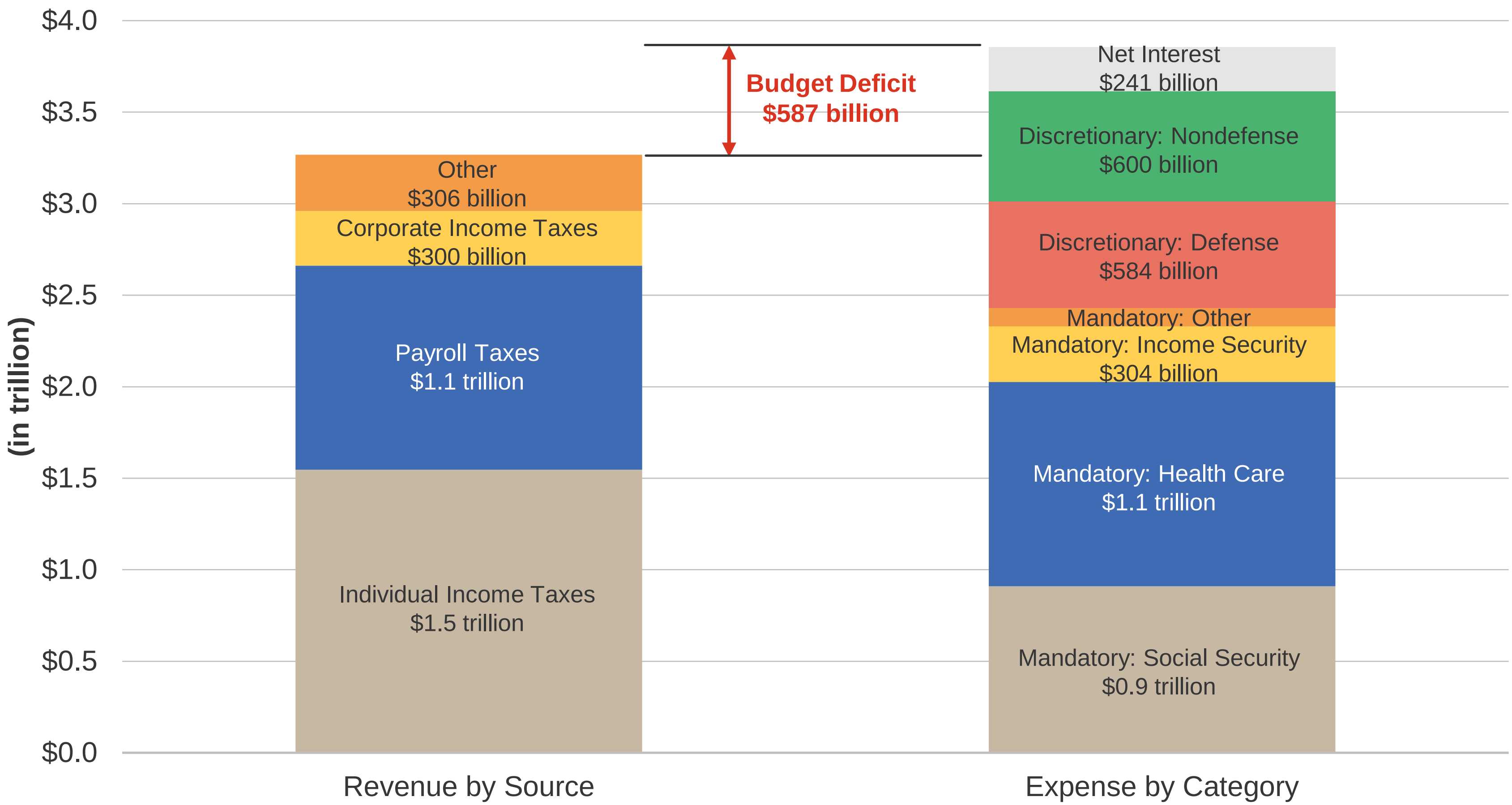
- The debt limit is the total amount of money that the U.S. government is allowed to borrow to meet its existing legal obligations, including Social Security, interest on national debt, tax refunds, etc…
- Congress needs to reach an agreement soon to raise the borrowing limit, or risk the government defaulting on its debt.



Source: The U.S. Treasury, Office of Management and Budget, as of 06/16/17.

- While Congress debates to raise the debt ceiling, the Treasury Department began to take several actions in March 2017 (known as extraordinary measures) to keep paying bills without issuing new debt:
  - Suspending the issuance of State and Local Government Series (SLGS) securities
  - Suspending new investments of the Civil Service Retirement and Disability Fund and the Postal Service Retirees Health Benefit Funds over the period 03/16/16 – 07/28/17.
  - Suspending daily investment of the G Fund, in which federal employees can invest a portion of their salaries
  - Suspending daily investments in the Exchange Stabilization Fund
- These extraordinary measures are expected to keep the government funded through September/October 2017, but is dependent on the timing of unexpected bills and tax revenues.

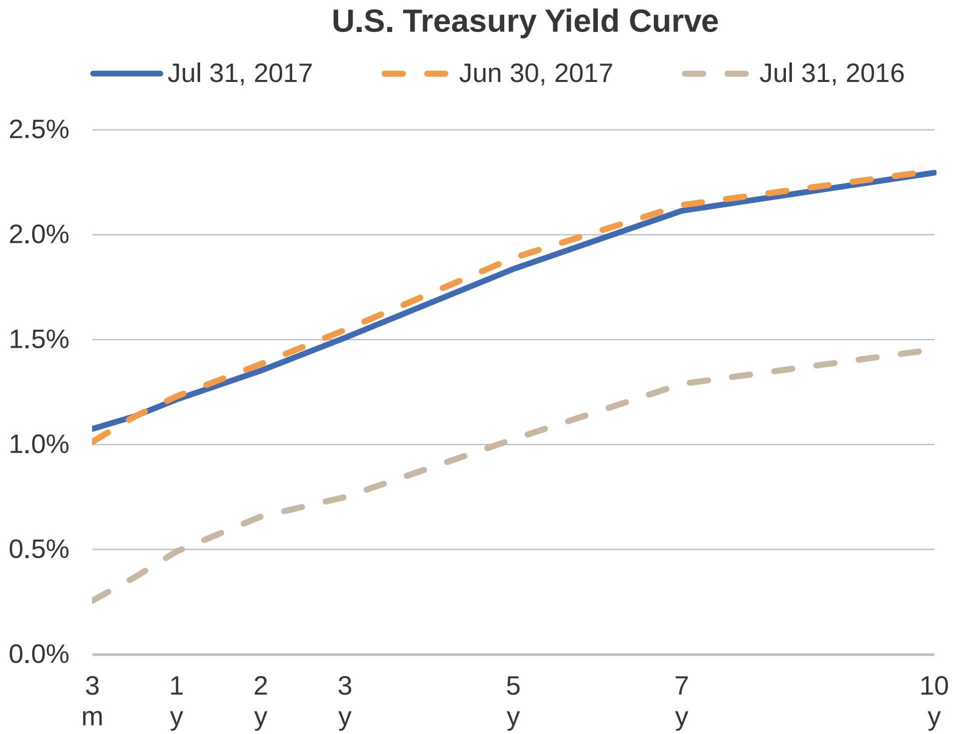
U.S. Federal Budget – Actual FY 2015-2016



Source: Congressional Budget Office, as of January 2017. Other revenue includes federal excise taxes, custom duties and Federal Reserve remittances. U.S. fiscal year is the 12-month period ending September 30.

Short-Term Yields Higher, but Curve Flatter

- Treasury yields are substantially higher compared to a year ago; short-term yields rose as the Fed raised rates several times, while longer yields reflected higher inflation expectations following the U.S. Presidential Election.
- Yields were little changed in July as investors awaited further clarity on both domestic inflation data and Congress.



Yield Curve History

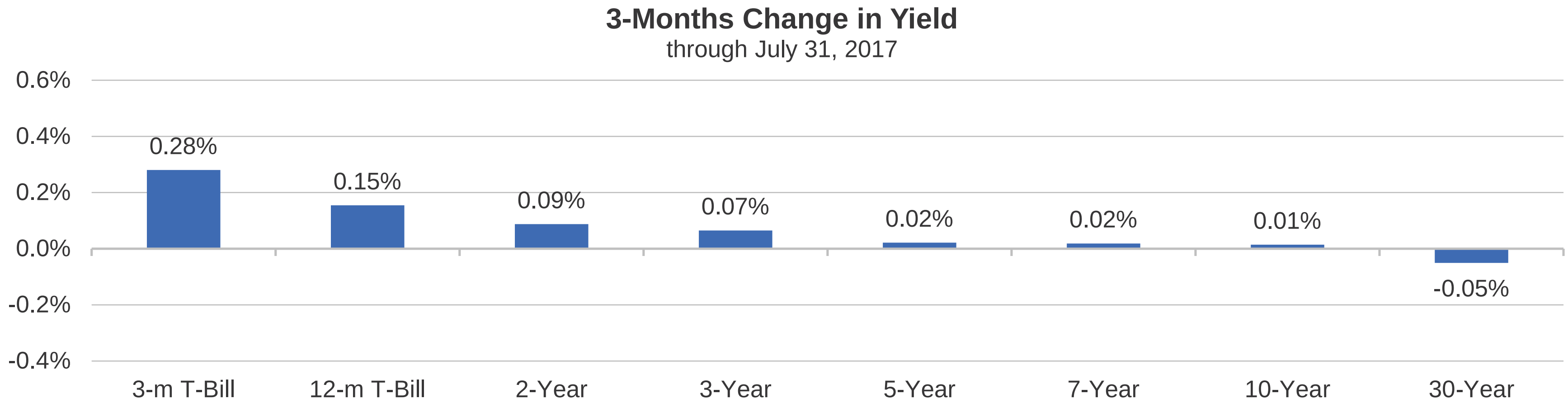
Maturity	07/31/17	06/30/17	07/31/16
1-Mo.	0.98	0.84	0.18
3-Mo.	1.08	1.01	0.26
6-Mo.	1.13	1.13	0.37
1-Yr.	1.22	1.23	0.49
2-Yr.	1.35	1.38	0.66
3-Yr.	1.51	1.55	0.75
5-Yr.	1.84	1.89	1.03
7-Yr.	2.11	2.14	1.29
10-Yr.	2.30	2.31	1.45
30-Yr.	2.90	2.84	2.18

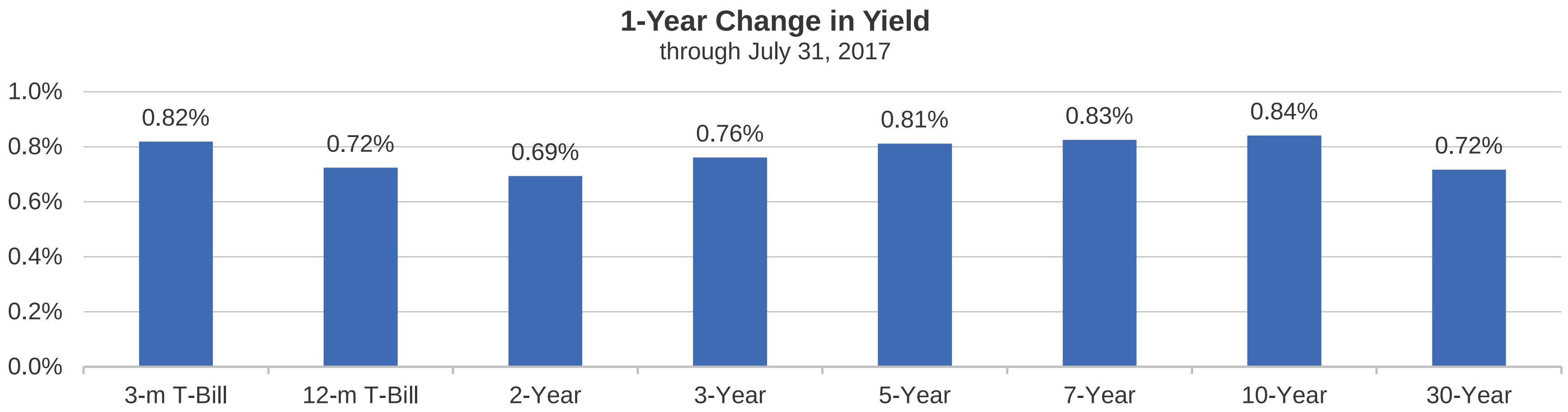
Source: Bloomberg, as of 07/31/17.

U.S. Treasury Yield History over Past 12 Months

Source: Bloomberg, as of 07/31/17.

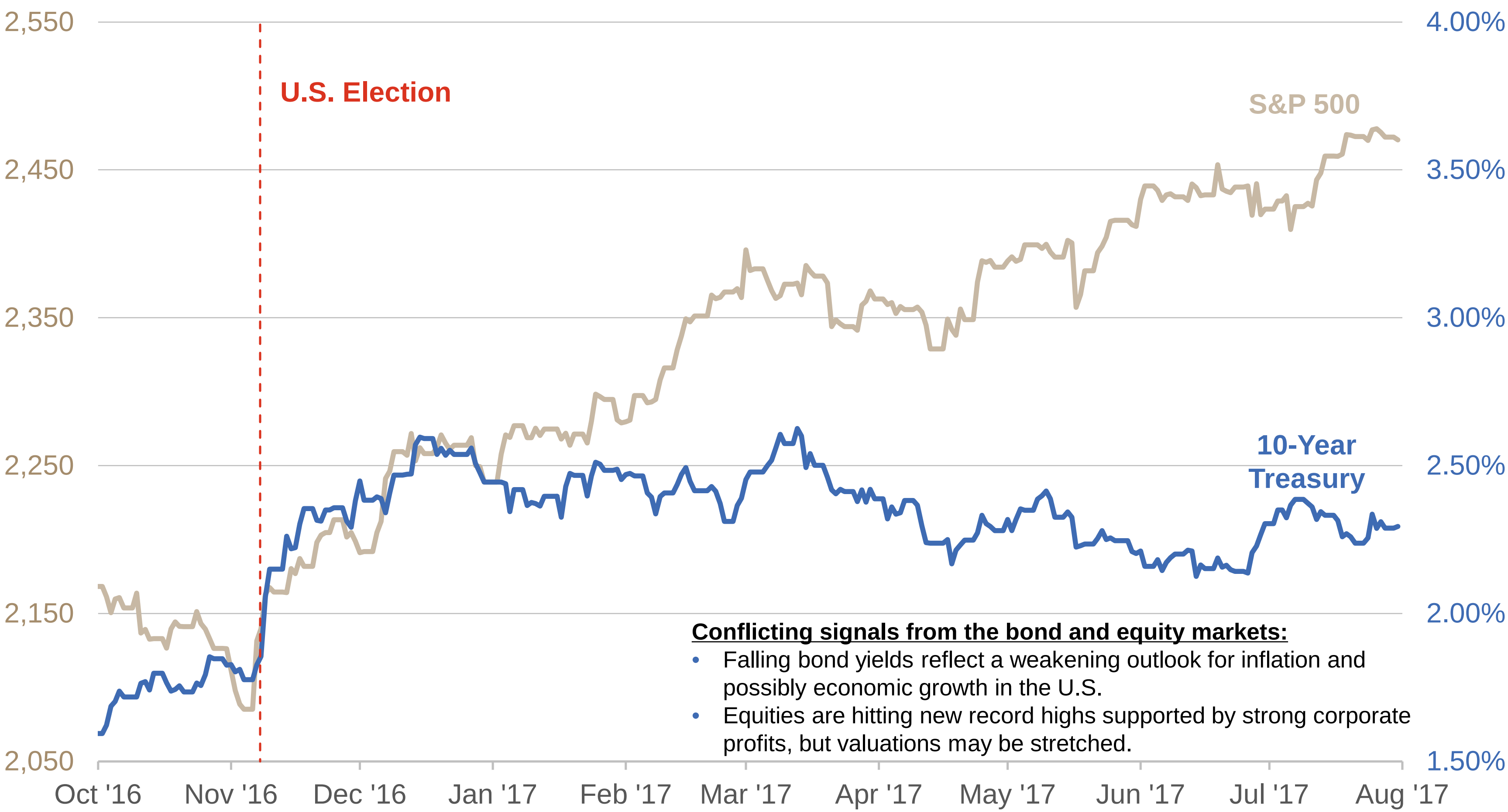
Yield Curve Flatter as Inflation Expectations Have Moderated





Source: Bloomberg, as of 07/31/17.

A Tale of Two Markets



Conflicting signals from the bond and equity markets:

- Falling bond yields reflect a weakening outlook for inflation and possibly economic growth in the U.S.
- Equities are hitting new record highs supported by strong corporate profits, but valuations may be stretched.

Source: The WSJ Daily Shot, Bloomberg, as of 07/31/17.

FOMC Statement Highlights

July

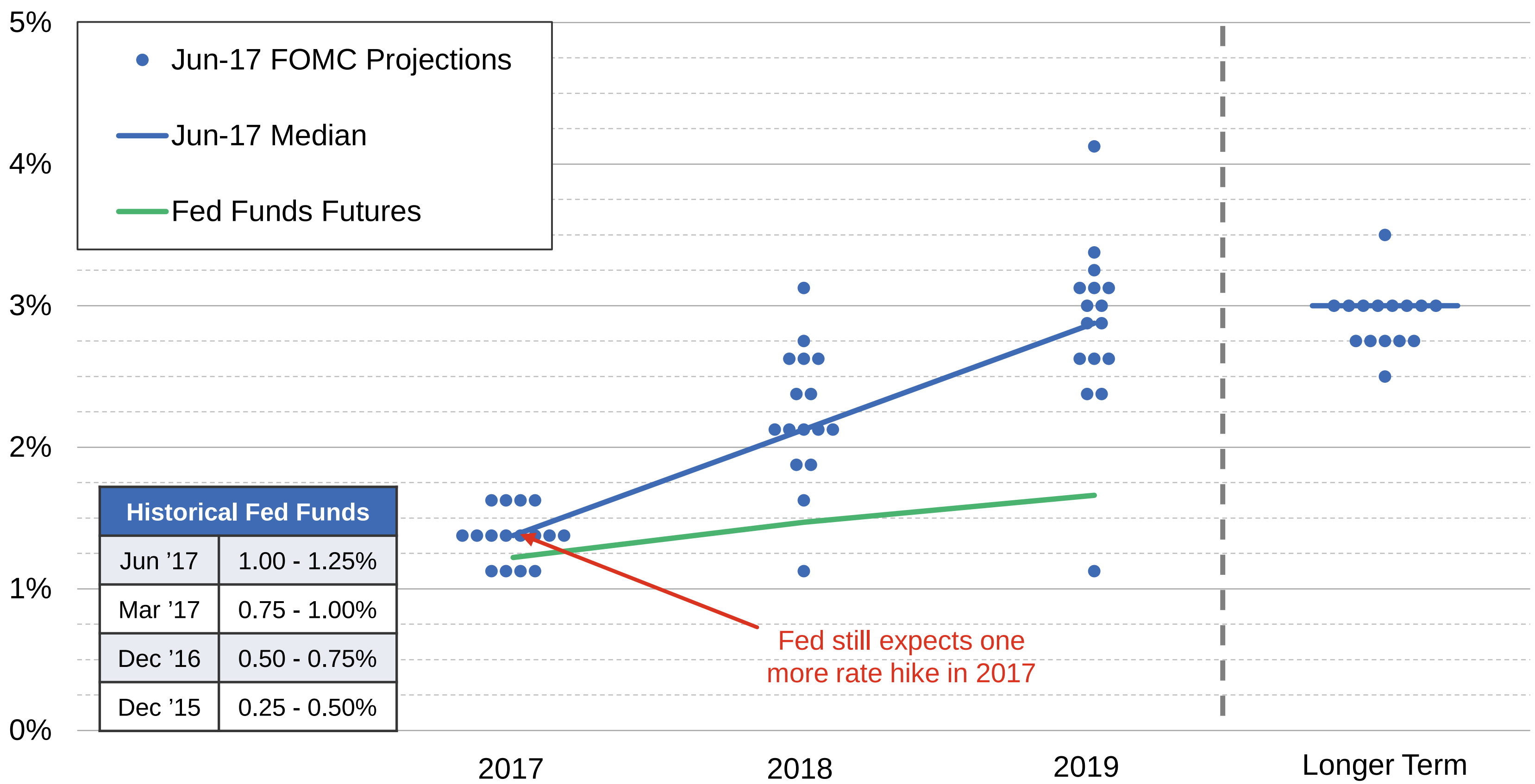
16

- Information received since the FOMC met in June indicates that the **labor market has continued to strengthen** and that economic activity has been rising moderately so far this year. **Job gains have been solid**, on average, since the beginning of the year, and the **unemployment rate has declined**.
- Inflation on a 12-month basis **is expected to remain somewhat below 2 percent in the near term** but to stabilize around the Committee's 2 percent objective over the medium term.
- The Committee decided to **maintain the target range for the federal funds rate at 1 to 1-¼ percent.** The committee expects that economic conditions will evolve in a manner that will warrant **gradual increases in the federal funds rate.**
- The Committee **expects to begin implementing its balance sheet normalization program relatively soon**, provided that the economy evolves broadly as anticipated. This program would gradually reduce the Federal Reserve's securities holdings by **decreasing reinvestment of principal payments** from those securities.
- All nine voting members of the FOMC supported the monetary policy action.

Source: Federal Reserve.

FOMC “Dot Plot” – June 2017

Fed Participants’ Assessments of ‘Appropriate’ Monetary Policy



Historical Fed Funds	
Jun ’17	1.00 - 1.25%
Mar ’17	0.75 - 1.00%
Dec ’16	0.50 - 0.75%
Dec ’15	0.25 - 0.50%

Source: Federal Reserve and Bloomberg. Individual dots represent each Fed members’ judgement of the midpoint of the appropriate target range for the federal funds rate at each year-end. Fed funds futures as of 07/31/17.

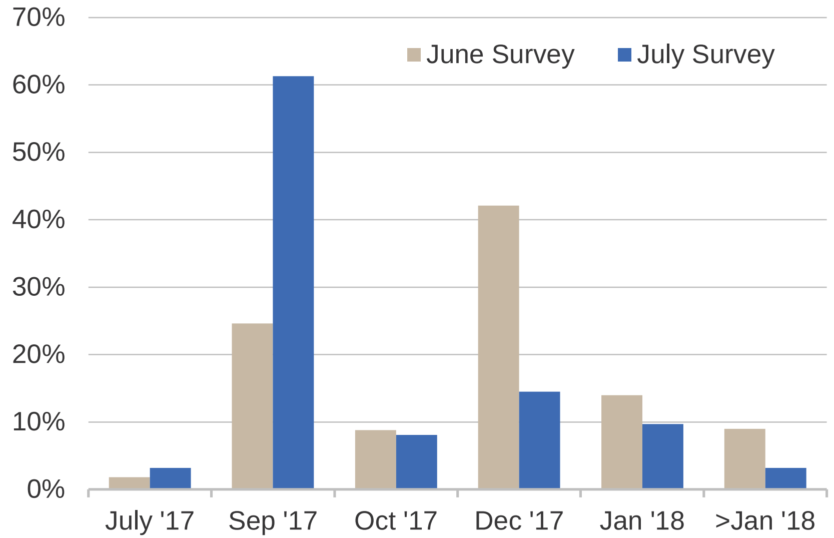
Fed's Next Step for Monetary Policy

- Based on the June dot plot, Fed officials still expected one more rate hike in 2017. With the recent weakness in inflation data, however, the prospect for a near-term rate move has diminished. Fed Funds futures suggest less than a 50% probability for this year.
- Given the Fed's recent communications, market participants are becoming increasingly convinced that in September, the Fed will announce a start in their balance sheet reduction program.

Probability of Next Rate Hike

Meeting	06/30/17	07/31/17
09/20/17	16%	6%
11/01/17	17%	10%
12/13/17	52%	42%
01/31/18	53%	43%

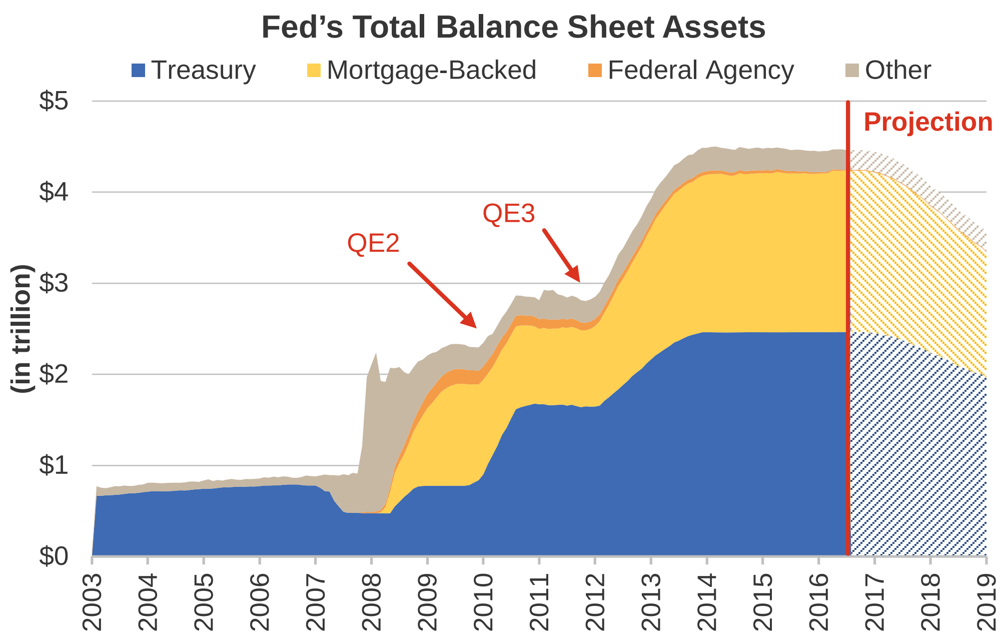
Timing of Fed Balance Sheet Announcement



Source: Probability of rate hike from Bloomberg, as of 07/31/17. Timing of balance sheet announcement from WSJ Economic Forecasting Surveys, as of July 2017. The survey was taken in early July, before the Fed's July meeting.

Fed's Balance Sheet Normalization Plan

- The Federal Reserve laid out its plan at the June FOMC meeting to reduce the size of its balance sheet, which grew to $4.5 trillion after multiple rounds of quantitative easing following the 2008 financial crisis. Fed officials currently expect to begin implementing the program this year, provided the economy evolves broadly as anticipated.
- The Fed plans to gradually reduce its holdings by decreasing reinvestments of principal payments on its U.S. Treasury and agency mortgage-backed securities. The pace of this decline will start at a cap of $10 billion per month, increasing by $10 billion per month every three months, until it reaches $50 billion per month.



(in billion)	Treasury Holdings	MBS Holdings	Total Fed Assets
Sep 2017	$2,465	$1,770	$4,460
Dec 2019 (Projected)	$1,965	$1,350*	$3,540
Difference:	**$(500)**	**$(420)***	**$(920)**

*MBS projection assumes that principal payments will always exceed the cap over the horizon period (i.e. the monthly run off amount is equal to the cap).

Source: PFM, Bloomberg, The Federal Reserve, FRB of St. Louis, as of 06/15/17. Projection is based on maturity schedule of Fed's Treasury holdings and caps on reinvestments as described in FOMC's June 2017 addendum to the Policy Normalization Principles and Plans, assuming normalization begins in October 2017.

Permitted Investments

For additional information on permitted investments please refer to the Missouri Constitution Article IV Section 15.

Investment Guidelines

- Cities in Missouri are permitted to invest in accordance with the Missouri Constitution Article IV Section 15

U.S Treasuries	Recommended
Sector Allocation	100%
Issuer Limit	None
Maximum Maturity	5 years
Bulleted Federal Agencies	
Sector Allocation	100%
Issuer Limit	None
Maximum Maturity	5 years
Collateralized Certificates of Deposit	
Sector Allocation	100%
Issuer Limit	None
Maximum Maturity	1 year
Collateralized Repurchase Agreements (Repo)	
Sector Allocation	50%
Issuer Limit	25%
Maximum Maturity	90 days
Commercial Paper/Bankers' Acceptances (CP/BA)	
Sector Allocation	75%
Issuer Limit	5%
Maximum Maturity	180 days

Tip: All investments shall mature and become payable not more than five years from the date of purchase except Repo and CP/BA which have earlier maturities.

U.S. Treasuries

- Securities issued directly by the U.S. Government and secured by the full faith and credit of the United States
  - Bills - Discount securities with original maturities of 4 weeks to 1 year
  - Notes - Semi-annual coupon-bearing securities with original maturities between 2-10 years
  - Bonds - Identical to Treasury notes except have original maturities longer than 10 years
  - STRIPS - Discounted securities created by separating principal and interest payments on eligible Treasury issues. Maturities range from 1 month to 30 years
- Typically offer lower yields compared to other fixed income securities because of highest credit quality

U.S. Federal Agencies

- A Federal Agency security is a term used to describe two types of bonds: Bonds guaranteed by U.S. Federal Government Agencies and bonds issued by Government Sponsored Enterprises (GSEs) – corporations created by Congress to foster a public purpose, such as affordable housing
- Federal Agency security types:
  - Discount notes - Similar to T-bills, discount securities that mature from 1 day to 1 year
  - Notes/Debentures - Uncollateralized coupon-bearing securities with a stated maturity and coupon rate
  - Callable notes - Identical to notes/debentures except for specified call provision which grants option to issuer to redeem prior to maturity
- U.S. Federal Government Agency securities are backed by the full faith and credit of the United States Government while GSE securities are considered to be implicitly backed by the government
- Frequent issuers include Fannie Mae, Ginnie Mae, Federal Home Loan Bank, Federal Home Loan Mortgage Corp and Federal Farm Credit Bank

Certificates of Deposit

- A time deposit issued by banks and thrifts that bears a specified dollar amount of the deposit, a maturity date and an interest rate
- Yields vary depending on credit rating of issuing bank, final maturity and money supply.
- There are two types of CDs:
  - Collateralized
  - FDIC Insured — The Federal Deposit Insurance Corporation, or FDIC, permanently raised insurance coverage on CDs to $250,000 on July 21, 2010. They are not traded in the secondary market

Tip: Only invest if you do not need your funds until maturity.

Repurchase Agreements

- An agreement in which an investor buys securities from a counterparty who agrees to buy them back at a later date at an agreed upon price
- Repurchase agreements for public funds in Missouri must be collateralized by:
  - U.S. Treasuries
  - Federal Agency Securities
- Frequently overnight or “term repo” up to 1 year. (Missouri State Statute only allows a term of 90 days or less)
- Investor should require over-collateralization or “haircut” of at least 102%
- Most repurchase agreements are now done on a “tri-party” basis, using a 3rd party custodian as intermediary

Commercial Paper

- Unsecured promissory note, issued by corporations and financial institutions to raise funds on a short-term basis
- Backed by corporate guarantee or bank letters of credit
- Typically offer higher yield than short-term Treasuries or Federal Agency securities because of additional credit risk
- Credit quality varies with issuer by national securities rating services such as Moody’s (P-1, P-2, P-3) & Standard & Poor’s (A-1+, A-1, A-2, A-3)
- Sold at a discount with maturities ranging from 1-270 days (State statute in Missouri limits maturities to 180 days or less)

Tip: Watch out for maturity limit of 180 days.

Bankers' Acceptances

- A bank obligation issued by a domestic or international bank created to facilitate commercial trades
- Credit strength of accepting bank, drawer endorsing bank, pledge of documents representing ownership of trade goods, and insurance on the goods
- Not FDIC insured
- Traded on a discount basis with maturities usually of 6 months or less
- Offered at yields higher than Treasuries and Federal Agency securities
- Maturity limited to 180 days

Investment Collateralization

See section R.S.Mo 30.270 for more specifics on collateralization

Collateral Provisions

- All securities that serve as collateral against the deposits of a depository institution mush be safe kept at a non-affiliated custodial facility. Depository institutions pledging collateral against deposits must, in conjunction with the custodial agent, furnish the necessary custodial receipts within five business days from the settlement date.

- Federal law provides that a depositor's security agreement that tends to diminish or defeat the interest of the FDIC in an asset acquired by it as receiver of an insured depository shall not be valid against the FDIC unless the agreement:
  - Is in writing
  - Was approved by the Board of Directors of the depository or its loan committee, and
  - Has been continuously, from the time of its execution, an official record of the depository institution.

Acceptable Collateral in Missouri

- Treasuries (recommended)
- U.S. Government Agencies (recommended)
- State of Missouri Bonds
- State Agency Bonds including revenue bonds
- FHLB Letters of Credit* (recommended)
- Surety Bonds*
- Tax Anticipation Notes*
- AAA rated out of state municipal bonds*
- Bonds issued by:
  - Missouri Cities with population >2,000
  - Missouri Counties
  - School Districts
  - Special Road Districts
  - Other States

- Each agency should have a depository contract and pledge agreement with each pledging bank

Tip: 1. These are not permitted investment and may only be used as collateral
2. Ensure your collateral is perfected

**See section 30.270 for more specifics on restrictions*

Collateralization

- Collateralization must comply with the requirements of **Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).**
- Collateralization will be required on two types of investments:
  - Certificates of Deposit
  - Repurchase Agreements

Tip: Deposit accounts are not an investment but anything over $250,000 (FDIC Deposit Insurance Assessment must also be collateralized.

To Collateralize CDs and Deposits

- To be properly collateralized
  - Must have a perfected interest in collateral securities
  - Must be able to sell collateral in the secondary market to recoup your investment (does not apply to Federal Home Loan Bank Letter of Credit “ FHLB LOC”)
  - Must have a depository contract and pledge agreement with each pledging bank
  - Must be in writing and approved by the Board of Directors of depository or its loan committee
  - Has been continuously an official record of the depository institution
- In order to anticipate market changes and provide a level of security for all funds, the market value (including accrued interest) of the collateral shall be at least 102% (except for a Federal Home Loan Bank Letter of Credit, which shall be at 100%) or the greater of the amount of certificates of deposit, less the amount, if any, that is insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Unions Share Insurance Fund. Market value shall be calculated using industry convention (collateral substitution may be granted.

To Collateralize Repurchase Agreements

- Limited to Treasury, agency and instrumentality securities that are eligible to be delivered via the Federal Reserve Book-entry system.

- In addition to the collateral requirements (slide 19), must also have in place;
  - A Master Repurchase Agreement
  - Custodian Bank Agreement to hold the securities

Collateralization – Third Party Custodian

- All securities that serve as collateral against the deposits of a depository institution mush be safe kept at a non-affiliated custodial facility. Depository institutions pledging collateral against deposits must, in conjunction with the custodial agent, furnish the necessary custodial receipts within five business days from the settlement date.

Purchasing Cards

What are Purchasing Cards (P-Cards)

- A Purchasing Card (P-Card) is a type of Commercial Card that allows organizations to take advantage of the existing credit card infrastructure to make electronic payments for a variety of business expenses (e.g., goods and services).
- In the simplest terms, a P-Card is a charge card, similar to a consumer credit card. However, the organization must pay the Bank in full each month, and the organization has the ability to set a wide variety of card controls where necessary. P-Cards are also known as Procurement Cards (ProCards), Payment Cards, Purchase Cards or similar terms.
- Organizations that use P-Cards come from the Education, Government and Corporate sectors and are often called "end-users." The individual employees who are issued a P-Card to initiate transactions/payments on behalf of their employer (organization) are known as "cardholders."
- P-Cards are not limited to plastic cards; they can also take the form of non-plastic account numbers. The term "card" is typically used within the industry when describing any type of Commercial Card product, regardless of whether or not a plastic card is issued.

Typical Purchasing Card Account Options

Traditional Card Accounts

Plastic Commercial Cards are issued to specific employees who use the card with multiple suppliers.

Ghost / Cardless Accounts

An account number is issued to individual employees, departments, or specific suppliers or supplier types, who initiate purchases that are processed to a single virtual account.

Department Card Accounts

Plastic Commercial Cards are issued with a department name to be utilized by different employees within that specific department.

(Card not covered by MasterCoverage; it is not issued to an individual)

Budget Card Accounts

With a fixed credit line that is depleted as transactions are made, the Banks Corporate Budget Card is a secure and convenient solution for managing business expenses with fixed budgets

(Credit line does not automatically replenish once amount is exhausted)

Purchasing Card Transaction Addendum Details

LEVEL 1 → Date, Supplier, Dollar Amount

LEVEL 2 → LEVEL 1 + sales tax and a variable data field to assist with reconciliation

LEVEL 3 → LEVEL 2 + item product code, description, quantity, unit of measure, price and tax

Purchasing Card Opportunity & Statistics

Purchasing Card Third Party Research

Based upon 2014 research conducted by RPMG, organizations can realize cost-savings as follows:

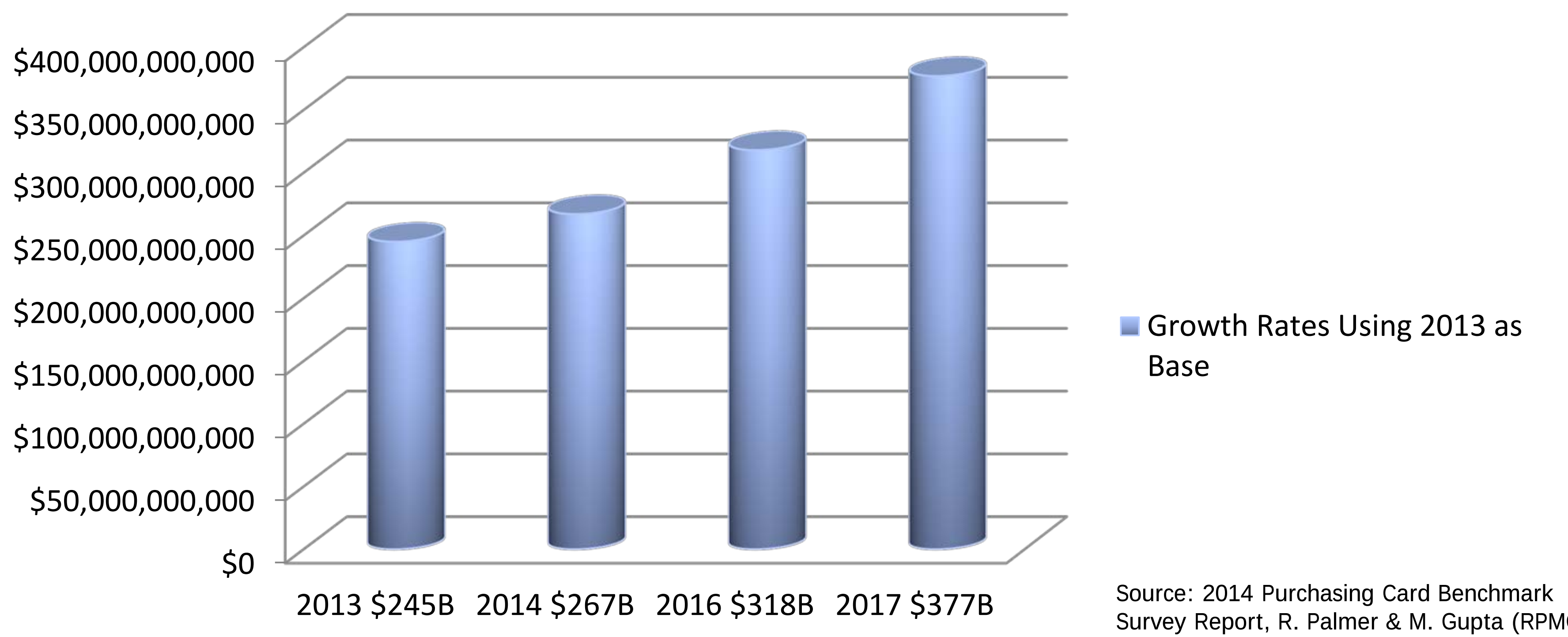
- Respondents reported administrative cost savings of $74 per transaction when compared to the traditional purchase order driven acquisition process
- Use of P-Cards for “higher ticket” goods and services is growing steadily. In 2011, 9% of transactions between $10,000 and $100,000 were paid by PCard
- 27% of respondents report that their organization uses P-Card spend data to obtain higher discounts for goods and services from their vendors.

Based upon an IRS ruling Public Sector organizations can eliminate 1099 reporting as of January 1, 2011 when transactions are paid for with a PCard

Trends in Purchasing Card Spend

Estimated P-Card Growth – Overall North America

Overall, P-Card spending has continued to grow in a time of long-term economic challenges. Between 2011 and 2013, purchasing card spending in North America grew from $196 billion to $245 billion.



Source: 2014 Purchasing Card Benchmark Survey Report, R. Palmer & M. Gupta (RPMG)

Payment Solutions - Benefits

FOR CARDHOLDERS:

- ☑ An alternative and less expensive method to make purchase payments
- ☑ No purchase order or requisition process is necessary or keep existing process in place
- ☑ Ability to receive discounts from “net” payment terms
- ☑ Opportunity to earn annual cash rebates on total annual spend volume
- ☑ More information on purchase history and enhanced reporting capabilities
- ☑ Limit the need for petty cash
- ☑ Ability to set internal controls (merchant category codes, dollar & transaction limits, etc.)

FOR SUPPLIERS:

- ☑ Receive payment within 24 - 48 hours of submitting the transaction to the bank. The result is improved cash flow – two days vs. the typical 30 – 60 days.
- ☑ Streamline administrative functions via the elimination of invoices and the consolidation of receivables.
- ☑ Meet the requests of customers, differentiate themselves from their competitors, and build better partnerships with customers. The result is additional sales revenue.

Purchasing Card Spending Controls

Entities use Card Account Limits, Merchant Category Codes, and Vendors to direct or block spending

- How much your cardholders can spend on their cards
- How often they can make purchases
- Who they buy from
- What they buy

All controls are implemented and deployed only by authorized personnel which the entity appoints to managing the program

Missouri Securities Investment Program (MOSIP)

About MOSIP

- Established in 1991
- Statewide local government investment program owned 100% by its Investors
- Seeks to preserve safety, provide adequate liquidity, and maximize yield while minimizing expenses
- Investments meet applicable Missouri Investment Statutes
- Governed by MOSIP Board of Directors (elected by the investors)
- Over 300 members with current assets totaling over $1.5 billion as of May 31, 2017
- Sponsored by the Missouri Municipal League (“MML”), the Missouri School Board Association (“MSBA”), the Missouri Association of School Administrators (“MASA”), the Missouri Association of School Business Officials (“MoASBO”) and the Missouri Association of Counties (“MAC”)

For additional information go to: www.mosip.org

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