



# Wyoming State Treasurer

## Mark Gordon

### MEMORANDUM

Patricia O'Brien Arp  
Deputy State Treasurer

**TO:** Select Committee on Capital Financing & Investments

**FROM:** Mark Gordon, State Treasurer

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**Mailing Address**  
Capitol Building  
200 West 24<sup>th</sup> Street  
Cheyenne, WY 82002

**Office Location**  
2020 Carey Avenue – 4th Floor  
Unclaimed Property – 3<sup>rd</sup> Floor  
Cheyenne, WY 82002

**Administration**  
307-777-7408  
treasurer@wyo.gov

**Financial Division**  
307-777-6309  
stodeposits@wyo.gov

**Investment Division**  
307-777-6704  
sto-investment-team@wyo.gov

**Unclaimed Property Division**  
307-777-5590  
wyomingup@wyo.gov

Over the past few years Wyoming has benefitted greatly from a series of strong revenue flows, not the least of which has been the returns derived from a diversified and growing portfolio of investments deployed in several “pools.” Some of these are “permanent” implying an “inviolable” nature to their corpuses. Others are carried in the “State Agency Pool.” Some of these pools require greater liquidity because their corpuses are intended for certain projects or agency budget requirements. These two broad types of pools, permanent and non-permanent, are invested differently according to constitutional authority: The permanent funds may invest in statutorily constricted equity whereas non-permanent funds cannot.

Typically the Treasurer’s Office has anticipated (“profiled”) returns for inclusion in the Consensus Revenue Estimating Group (CREG) estimates from interest payments and dividends. These along with rent represent relatively predictable income streams. Also Wyoming has benefitted during the past 20 years from increasing market valuations of some of her securities; and the difference between what the State bought a security for and what it sells it for when it is positive is called a capital gain. Wyoming counts all interest payments, dividends, and gains as income, but counting gains can be somewhat problematic in that they are entirely dependent on the market. The market has been kind for some time up until last year.

When gains fail to materialize or the market value ascribed to the securities falls below what they were purchased for, gains become losses. Gains and losses are related to market dynamics where interest payments and dividends have a greater degree of certainty.

Market unpredictability relative to gains and losses is a well understood phenomenon at this point and is something Wyoming strove to address when it implemented “Spending Policy Reserve Accounts” to smooth returns between years. Nevertheless, the past two years’ experience demonstrates how volatile returns can be. As of June 30, 2015, Wyoming’s portfolio had returned over 1 billion dollars of total income; over 600 million or so was in gains alone. This

year, while interest and dividend income remains on track, we will finish the year nearly flat, probably experiencing some losses. This change in the market is hard to anticipate especially when one has come to expect “routine” gains of hundreds of millions of dollars. It is time to revisit our spending policies.

Adding to these concerns is a look out over a horizon where equity markets are at best extremely volatile. Fixed income assets, which make up the greatest portion of Wyoming’s portfolio cannot be expected to return more than a few percent for the foreseeable future. The fact that if interest rates rise, the inherent value of the assets currently held will fall, makes it quite apparent why the sort of extensive review the Select Committee on Capital Financing and Investments is undertaking absolutely appropriate.

Attached to this memorandum are materials intended to aid in the Committee’s deliberations:

- A memorandum on portfolio performance through Q1
- A memorandum from RVK, Wyoming’s general investment consultant, outlining the difference between a “clip the coupon” approach and “Total Return” strategies and a bit of State history on this topic.
- Excerpts from the 2015 National Association of College and University Business Officers-Common Fund (NACUBO) study which sets a nice context for this year’s discussion. (The Yale Model)
- An article by Bill Gross with a good discussion about the future investment landscape.
- The recently passed Master Investment Policy and Sub-Policies.

Additionally, at the meeting we will provide copies of the 2009 edition *Pioneering Portfolio Management*, by David Swensen’s latest edition of his groundbreaking work which is sometimes referred to as the “Yale Model”. That book formed some of the original thinking for Wyoming’s spending policies and approach to investing. The book is an invaluable resource for any institutional investor.