

STATE TREASURER

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What follows are impressions of a public funds investor who does not want, nor has, a PhD in hedge fund investing. So that you and I get as much value from our chat as possible, I am going to avoid buzz words and inside fallacies in each of our worlds such as Alpha, Beta and I'm an elected official whose IQ and capabilities dramatically increased following my election. An investment relationship with a public fund manager is likely to be more personal. In Wyoming and many other states, expectations are often oral but remembered, more personal than legal. Are representatives of hedge funds capable of communicating, or for that matter desire to communicate, with managers of public funds in terms that each understands and can relate to?

1. Brief history of Wyoming's economy and investment policies over the past ten years:
 - a. Basically mineral driven economy. Economic booms and busts occur fairly periodically. Counter cyclical to most other states. Well off mid 70's to mid 80's. Down late 80's to late 90's. Booming FY 2000 to current. Institutional and citizen residual memories of past busts and the consequences to our citizens. Most similar to New Mexico and Alaska in this regard.
 - b. Very conservative financially. No borrowing to meet current expenses and little to finance maintenance of infrastructure. Over the past five years has financed rebuilding local school buildings from cash surpluses which are continuing. Long residual memories of past busts and leery of financial risks. Until 1999, state funds were invested only in fixed income instruments. Starting in 1999, Wyoming commenced a slow restructuring of the state portfolio into diversified investments in various equity types and fixed income which was permitted for state permanent trust funds and a few statutory funds such as Worker's Compensation fund which alone is approaching \$1 billion. The transformation of the investment portfolio took 8 years and was greatly aided by financial overviews and advice from RV Kuhns, the financial advisor to Wyoming's five elected state officials. The transformation was completed last year and is reexamined annually with targets of 55% maximum in equity types and 45% in fixed income types.
 - c. Wyoming has had a permanent trust fund for local schools since statehood, 1890, and in 1974 the voters approved a constitutional permanent trust fund consisting of special mineral taxes with part of the investment income placed in the state general fund and part placed in corpus to supplement the annual mineral taxes placed in corpus. The market value for total permanent trust funds approaches six billion dollars. Corpus of the funds is growing by over \$500 million per year.

2. What's a hedge fund within the realm of "equities"? Short answer is an active investment strategy which varies from hedge fund to hedge fund. Since the term "hedge fund" seems to be in some disrepute presently, it can also be referred to as an "alternative investment strategy" or perhaps "fund of funds" which is really only an intermediary which will screen large numbers of individual hedge funds and strategies on behalf of an investor. The legal form of the investment can be a limited partnership, a limited liability company, or contract under which investments will be made.
3. Why did Wyoming, one of the most financially conservative states, invest in alternative investments such as hedge funds, private equity, venture capital and commercial real estate in addition to other types of "equities"? Primarily because portfolio simulations and reviews by RV Kuhns and my office predicted that a broadly diversified portfolio, both by class of investments and within each class of investments, would have a lower risk profile comfortable for the investor, i.e. the state of Wyoming, and produce higher returns than solely by fixed income investments or less diversified classes. Specifically, if the Wyoming investment portfolio also had target percentages allocated to hedge funds, private equity and real estate, in addition to other "equity" types, the overall risk profile would decrease and the return would increase. At the same time and with the same simulations, the Wyoming Retirement System, approximately \$6 Billion, was not convinced and does not invest in private equity and hedge funds.
4. My sense of the hedge fund industry is that it historically has been primarily funded by rich folks and foundations and not much by retirement funds and public funds of states and local governments. If true, why so? Because rich folks and many foundations don't have the same fiduciary duties nor are their actions so subject to public scrutiny. Because if rich folks and foundations suffer the loss of large amounts of capital, consequences are generally not as serious as for public officials. But there appears to be a large, untapped source of funding for hedge fund strategies under the right circumstances, which could benefit both investor and manager.
5. Case examples of the commitment of state funds to PAAMCO, Harris and Access Venture Capital. Ten firms were interviewed, four made the cut, and one of the four was not funded because it was not willing to accommodate Wyoming needs as an investor. What did each get and give up:
 - a. The firms agreed to assume some of the fiduciary duties of the state elected officials especially in screening hedge funds on behalf of Wyoming;
 - b. Agreeing to more transparency in operations necessary for public accounting;
 - c. Agreeing to consult with Wyoming if a hedge fund investment was recommended IF leverage in excess of a minimum were also part of the strategy;
 - d. Agreeing that no conflicts of interest would be allowed by managers of the firms;
 - e. Authorizing more latitude as to withdrawals of profits.
 - f. Wyoming gave them public funds to invest;
 - g. Wyoming agreed to annual investment fees and profit sharing;
 - h. Wyoming understands the long term nature of such funds.