

Wyoming State Treasurer
Mark Gordon

THE TREASURER'S
INTERNAL INVESTMENT PROGRAM

Report to the
Joint Appropriations Committee and the
Select Committee on
Capital Financing & Investments

December 1, 2017

Wyoming State Treasurer

Mark Gordon

MEMORANDUM

TO: JOINT APPROPRIATIONS COMMITTEE &
SELECT COMMITTEE ON CAPITAL FINANCING & INVESTMENTS

FROM: The Honorable Mark Gordon

DUE: December 1, 2017

SUBJECT: Report on the Treasurer's Internal Investment Program

I. INTRODUCTION

In accordance with 2017 Wyoming Session Laws, Chapter 120, Section 2, Section 004, footnote 3 ("Act") (see Figure 1), I submit this report to the JOINT APPROPRIATIONS COMMITTEE and the SELECT COMMITTEE ON CAPITAL FINANCING & INVESTMENTS.

Under the Act, my office may use one-half of the documented savings from terminating or renegotiating contracts with external investment managers, up to three million dollars, to create an internal investment program for the State of Wyoming.

I am pleased to report that we have certified savings in excess of \$6 million, have expended a total of \$112,868 on our internal investment program, and have begun investing two internal funds. We are satisfied with our accomplishments thus far, and are focused on our potential next steps.

Part II of this report provides the documented savings the State has realized. Part III addresses the expenditures to date by our office on the internal investment program. Last, Part IV shows performance and performance measures.

Figure 1. 2017 Wyoming Session Laws, Chapter 120, Section 2, Section 004

APPROPRIATION FOR	GENERAL FUND	FEDERAL FUNDS	OTHER FUNDS	TOTAL APPROPRIATION
	\$	\$	\$	\$
Section 004. STATE TREASURER				
PROGRAM				
Treasurer's Operations	4,564,127			4,564,127
	4,193,198			4,193,198
Veterans Tax Exemption ¹	10,700,437			10,700,437
Manager Payments ³			64,950,566 SR	64,950,566
Unclaimed Property			1,720,075 SR	1,720,075
Indian Motor Veh. Exemp ²	698,529			698,529
TOTALS	<u>15,963,093</u>	<u>0</u>	<u>66,670,641</u>	<u>82,633,734</u>
	<u>15,592,164</u>			<u>82,262,805</u>
AUTHORIZED EMPLOYEES				
Full Time	<u>26</u>			<u>35</u>
Part Time	<u>0</u>			
TOTAL	<u>26</u>			<u>35</u>
<p>1. Of this general fund appropriation, one hundred twenty-three thousand four hundred sixty-two dollars (\$123,462.00) is effective immediately.</p> <p>2. Of this general fund appropriation, forty-two thousand sixty-five dollars (\$42,065.00) is effective immediately.</p> <p>3. (a) <u>Of this other funds appropriation, the state treasurer may expend one-half (1/2) of any documented savings up to three million dollars (\$3,000,000.00)SR for purposes of compensation and benefits for up to nine (9) full-time employees, rent, one-time and on-going information technology costs, equipment and all other support costs and professional contracts for internal investment management. Savings shall be reported by the state treasurer to the joint appropriations committee and the select committee on capital financing and investments not later than December 1, 2017 and June 30, 2018, respectively. Reported savings shall be limited to foregone expenditures from terminated or renegotiated contracts with external investment managers and funds for which the appropriation in this section have not and shall not be expended for external investment manager contracts. The state treasurer shall also include an explanation and accounting of all expenditures relating to actions taken pursuant to this footnote and a description of the work performed by the new internal investment staff. The report shall outline what the standards, objectives and investment policies are for any and all funds redirected for internal management, and a performance report for all such funds, including benchmark comparisons, overall return on the funds, as well as comparative performance from the externally managed funds for an identical timeframe.</u></p> <p>(b) <u>The state treasurer's office shall include a new division in its 2019-2020 biennial budget request to account for the new internal investment management team. To the extent expenditures are recurring, authorizations for positions and required appropriations shall be included in the state treasurer's 2019-2020 biennial budget request pursuant to W.S. 9-2-1002(a)(ix).</u></p>				

II. SAVINGS

We have certified to the Auditor’s Office that over \$6 million has been cut from managers’ fees, thus allowing \$3 million to be appropriated to the new investment division. These savings are limited to foregone expenditures from terminated or renegotiated contracts with external investment managers as well as appropriated funds which our office has not spent and will not spend on external investment manager contracts. We terminated contracts with six managers, and renegotiated fees with two managers.

III. EXPENDITURES

In September, we reported that the project was partially underway and we had mostly spent money on electrical work in our building, ordering furniture and computers, and working with A&I personnel to prepare to advertise for staff. We also gave you an update about how much money we had spent or committed, around \$45,000. Now, we have expended a total of \$112,868 on our internal investment program. As required, an explanation and accounting of these expenditures, as well as a description of the work performed by the new internal investment staff follows.

A. Explanation and accounting of all expenditures relating to actions taken pursuant to the Act

To date we have spent \$112,868 on our internal investment program, including for furniture, movers, electrical, phones, information technology lines, and starting now, salary expenditures. The electrical work is complete, the furniture is in, and the computers are in and set up for the positions that we have filled and those joining us soon. (We are not buying nine computers all at once but rather pacing that as we hire or are about to hire.)

We have begun hiring, which is the most important action we will accomplish and which will affect us over the long haul. We have nine new positions and four regular vacancies. Thus far we have filled three of the regular vacancies, leaving one, and have filled two of the nine new positions. We have advertised two accountant positions, have received many applications, and have set interviews over the next two weeks. We are about to release the ads for the third accountant and the information technology position, and we have had leads and inquiries on both of those and anticipate filling them on target by end of December. That leaves the three remaining investment staff, one analyst and two officers. Initially we thought we would want everyone hired by the end of December, but we want to hire as we can best utilize them, in the right sequence. So, we have some legal and much technology work to do before we can expand a lot of our investment work. So we will focus on accountant hiring in November and technology planning in December and January. Then, the Deputy Treasurer and the Chief Investment Officer will start sequencing the last three hires.

We are assessing our technology needs for the internal investment program. Technology improvements are the major key to success for our back office. The Cutter Report from a year or so ago indicated our office was twenty years behind technologically, with hundreds of spreadsheets

in use. There are four components to building out the technology to handle internal investment management, including the JP Morgan feed, the accounting system, the distributions system, and the WOLFS system. We have accomplished much by working with JP Morgan regarding capturing investment data. We have assessed, and continue to assess our spreadsheet use. We need to know exactly what we want a new system to do, and then make decisions regarding whether to buy such system, build a system, or do a combination. We are underway on all these technology steps, and are looking to get our additional staff on to do this project piece well.

B. Description of the work performed by the new internal investment staff

We have hired Investment Analyst Maudi Chahkandi and Attorney Lisa Jerde Spillman. General Counsel Betsy Anderson has investment expertise and will be doing much of the legal work to get the investment program off the ground, and Ms. Spillman is taking Ms. Anderson's position. This will get the investment program up to speed the fastest, but all will be working together. Mr. Chahkandi develops computer programming for investment risk management, quantitative analysis, and performance outlook.

IV. INTERNAL MANAGEMENT PERFORMANCE

Under the Act, my office is to report on the standards, objectives, and investment policies for funds redirected for internal management. I am also to provide a performance report for all such funds, including benchmark comparisons, overall return on the funds, and a comparative performance from the externally managed funds for an identical timeframe.

A. Standards, Objectives and Investment Policies for Funds Redirected for Internal Management

Our office has set up two funds, first, an Internal Fixed Income Portfolio, which is a Bloomberg US Government International Term Bond Index fund, and second, an Internal International Equity Portfolio, which is a FTSE All World ex US Index fund.

Internal Fixed Income Portfolio

Our Internal Fixed Income Portfolio, which is a Bloomberg US Government International Term Bond Index fund, covers public U.S. government obligations with remaining maturities from one

up to (but not including) ten years. (State of Wyoming State Land and Investment Board, Master Investment Policy Statement and Subpolicies, updated June 1, 2017 [IPS] at p. 30.) The investment policy for our Internal Fixed Income Portfolio reads:

The objectives of the State's intermediate government bond fixed income investments are to provide stable income to the State, safety of principal, diversification of the State's fixed income portfolios, liquidity as needed, flexibility to the overall investment program and consistent returns as measured by the appropriate index. The State Treasurer's Office may implement the strategies described in this section (i) through active management and/or (ii) passively through ETFs, mutual funds and other types of index funds. The guidelines in this section apply to all active intermediate government bond fixed income managers.

- i. Obligations issued or guaranteed by the U.S. government, U.S. agencies or U.S. government-sponsored corporations and agencies are eligible without limit.
- ii. Non-U.S. Government securities are allowed, up to a maximum of 20% of the portfolio.
- iii. Duration should not exceed +2 years of the index.

(IPS at p. 15.)

Internal International Equity Portfolio

Our Internal International Equity Portfolio, as a MSCI ACW (All Country World Index) Ex U.S. Index, "is designed to measure equity market performance in global developed and emerging markets, excluding the US. The 22 underlying developed countries are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The 23 emerging market countries are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and United Arab Emirates." (IPS at p. 30.)

The investment policy for our Internal International Equity Portfolio is:

The objectives of the State's public equity investments are to provide the State with total return, capital appreciation, protection against inflation risk and consistent returns as measured by the appropriate index. The State shall employ diversification by investment style (e.g., value versus growth) and capitalization (small, mid, large). The State Treasurer's Office may implement the strategies described in this section (i) through active management and/or (ii) passively through exchange traded funds ("ETFs"), mutual funds and other types of index funds. The guidelines in this section apply to all active public equity managers, which are diversified across the following strategies: a. All-Cap U.S. Equity b. Small-Cap U.S. Equity c. Global Equity d. International Equity e. Emerging Market Equity

- i. A maximum of 5% or the benchmark weighting + 2%, whichever is greater, of the total stock portfolio of the investment manager be invested in any one company.
- ii. A maximum of 1% of the outstanding float of shares shall be held in companies with market capitalizations of \$5 Billion or greater at the time of purchase. For 14 companies with market capitalizations of less than \$5 Billion, a maximum of 5% shall apply.
- iii. The maximum allowable in any sector, as defined by Global Industry Classification System Level 1, is 2.5 times the respective benchmark weighting.
- iv. A minimum number of 20 securities shall be held.

(IPS at pp. 13-14.)

B. Performance

We are satisfied with the performance thus far. Following is the performance report for all such funds, including benchmark comparisons, the overall return on the funds, and comparative performance from the externally managed funds for an identical timeframe. Our internal funds performance is highlighted in yellow. We show both the bond and equity fund performance over the first year and the most recent 3 months.

Fixed Income Manager Performance

1 year ending 6-30-17

	Account	Allocation FYE 6-30-2017		Performance FYE 2017 (\$ if invested in Index)	
		Market Value (\$)	(Return %)	(Alpha %)	
11.	C.S. McKee	1,265,292,081.00	-0.01		
	Bloomberg US Agg Bond Index			0.30	3,795,876.24
12.	JP Morgan Core	2,158,626,120.00	-0.34		
	Bloomberg US Agg Bond Index			-0.03	-647,587.84
13.	PIMCO Core	2,220,137,910.00	0.32		
	Bloomberg US Agg Bond Index			0.63	13,986,868.83
14.	Neuberger Berman Credit	939,349,147.00	5.79		
	Credit Custom Index			-1.54	-14,465,976.86
15.	Seix	965,016,793.00	7.42		
	Credit Custom Index			0.09	868,515.11
16.	Grosvenor Silvery Lupine Fund	323,650,989.00	11.18		
	CS Western Eur Hi Yld Index			-1.03	-3,333,605.19
17.	Investec	213,007,182.00	7.04		
	JPM GBI-EM Gbl Dvfd Index (USD) (Unhedged)			0.63	1,341,945.25
18.	Stone Harbor	204,548,478.00	6.31		
	JPM GBI-EM Gbl Dvfd Index (USD) (Unhedged)			-0.10	-204,548.48
19.	State Street TIPS	713,634,440.00	-0.84		
	Bloomberg US Trsy: US TIPS Index (Series B)			-0.17	-1,213,178.55
20.	Internal Fixed Income Portfolio	2,573,039,000.00	0.62		
	Bloomberg US Gov't: Int. Term Bond Index			1.87	34,090,829.30
21.	JP Morgan Cash Composite	1,538,608,117.00	0.53		
	JP Morgan Cash Custom Index			0.16	2,461,772.99

The Internal Fixed Income fund was our best performing bond fund with an alpha production of 1.87%. This resulted in additional profit of approximately \$34 million dollars more than if the fund had been invested in an index product. The tables below show the percentage of managers that underperformed the benchmark. Eighty-three percent of managers do not beat the Barclay US Government Intermediate index over 10 years. This is the index that the internal fund uses as a benchmark. Over the last year, 58% of managers did not beat the index. Last fiscal year, the average return of the index was -1.25% vs. our return of .62%. This put our performance in the top decile of managers in the S&P Index vs. Active (SPIVA) Scorecard.

FUND CATEGORY	COMPARISON INDEX	1-YEAR	3-YEAR	5-YEAR	10-YEAR	15-YEAR
Government Intermediate Funds	Barclays US Government Intermediate	57.89	76.19	88.89	83.72	87.69

Source: SPIVA – S&P Index vs. Active

Fixed Income Manager Performance

3 months ending 9-30-17

	Account	Allocation Q1 9-30-2017		Performance FY 2017	
		Market Value (\$)	(Return %)	(Alpha %)	(\$ if invested in Index)
11.	C.S. McKee	1,267,363,126.00	0.90		
	Bloomberg US Agg Bond Index			0.05	633,681.56
12.	JP Morgan Core	2,163,314,621.00	0.78		
	Bloomberg US Agg Bond Index			-0.07	-1,514,320.23
13.	PIMCO Core	2,226,827,307.00	1.16		
	Bloomberg US Agg Bond Index			0.31	6,903,164.65
14.	Neuberger Berman Credit	940,865,910.00	1.23		
	Credit Custom Index			-0.07	-658,606.14
15.	Seix	964,901,247.00	1.43		
	Credit Custom Index			0.13	1,254,371.62
16.	Grosvenor Silvery Lupine Fund	314,317,294.00	2.13		
	CS Western Eur Hi Yld Index			-0.18	-565,771.13
17.	Investec	218,902,113.00	4.04		
	JPM GBI-EM Gbl Dvf'd Index (USD) (Unhedged)			0.49	1,072,620.35
18.	Stone Harbor	209,368,012.00	3.88		
	JPM GBI-EM Gbl Dvf'd Index (USD) (Unhedged)			0.33	690,914.44
19.	State Street TIPS	718,517,225.00	0.96		
	Bloomberg US Trsy: US TIPS Index (Series B)			0.06	431,110.34
20.	Internal Fixed Income Portfolio	2,568,390,640.00	0.38		
	Bloomberg US Gov't: Int. Term Bond Index			0.04	1,027,356.26
21.	JP Morgan Cash Composite	1,459,592,735.00	0.27		
	JP Morgan Cash Custom Index			0	0.00

Over the last quarter ending 9-30-17, the Internal Fixed Income Portfolio outperformed by 4 basis points (0.04%) resulting in a \$1.03 million outperformance over the benchmark.

Source: SPIVA – S&P Index vs. Active

Equity Manager Performance

1 year ending 6-30-17

	Account	Allocation FYE 6-30-2017		Performance FY 2017	
		Market Value (\$)	(Return %)	(Alpha %)	(\$ if invested in Index)
	State Street All Cap	1,468,388,420.00	17.28		
1.	State Street All Cap Custom Index			-0.13	-1,908,904.95
	Russell 3000 Index			-1.23	-18,061,177.57
	Epoch	263,860,478.00	22.82		
2.	Russell 3000 Index			4.31	11,372,386.60
	Lazard	319,270,163.00	12.98		
3.	Russell 3000 Index			-5.53	-17,655,640.01
	UW Portfolio Mgmt Program	1,410,522.00	17.51		
4.	S&P 500 Index (Cap Wtd)			-0.39	-5,501.04
	RBC	201,620,672.00	20.82		
5.	Russell 2000 Index			-3.78	-7,621,261.40
	Arrowstreet	426,401,778.00	21.47		
6.	MSCI ACW Index (USD) (Net)			2.69	11,470,207.83
7.	Internal International Equity Portfolio	160,143,255.00	20.18		
	FTSE All Wrld Ex US Index (US Invstr) (USD) (Net)			-0.13	-208,186.23
	Northern Trust	839,582,600.00	20.09		
8.	MSCI ACW Ex US Index (USD) (Net)			-0.36	-3,022,497.36
	Fisher Investments	427,481,219.00	25.62		
9.	MSCI ACW Ex US Index (USD) (Net)			5.17	22,100,779.02
	Allianz Global Investors	517,843,821.00	15.29		
10.	BofA ML All Cnvrts Index (All Qual)			-1.51	-7,819,441.70

The Internal International Equity Portfolio was 13 basis points (0.13%) below the FTSE All World ex-US Index. This fund is a Vanguard mutual fund and never has been traded. The difference between the benchmark and the index is the fee that Vanguard charges and the difference in timing between the closing price in the underlying stocks and the index (fair value pricing).

The tables below show the number of managers that outperform the benchmark. At least 85% of domestic funds do not beat the benchmark over a 10 year period.

FUND CATEGORY	COMPARISON INDEX	1-YEAR (%)	3-YEAR (%)	5-YEAR (%)	10-YEAR (%)	15-YEAR (%)
All Domestic Funds	S&P Composite 1500	47.51	85.61	84.41	85.42	84.57
All Large-Cap Funds	S&P 500	56.56	81.85	82.38	85.08	93.18

Source: SPIVA- S&P Index vs. Active

Equity Manager Performance

3 months ending 9-30-17

	Account	Allocation Q1 9-30-2017		Performance FY 2017	
		Market Value (\$)	(Return %)	(Alpha %)	(\$ if invested in Index)
	State Street All Cap	1,520,242,716.00	4.39		
1.	State Street All Cap Custom Index			-0.05	-760,121.36
	Russell 3000 Index			-0.18	-2,736,436.89
2.	Epoch	271,082,884.00	4.92		
	Russell 3000 Index			0.35	948,790.09
3.	Lazard	318,101,450.00	2.54		
	Russell 3000 Index			-2.03	-6,457,459.44
4.	UW Portfolio Mgmt Program	1,462,574.00	4.16		
	S&P 500 Index (Cap Wtd)			-0.32	-4,680.24
5.	RBC	213,059,945.00	6.94		
	Russell 2000 Index			1.27	2,705,861.30
6.	Arrowstreet	431,678,224.00	5.15		
	MSCI ACW Index (USD) (Net)			-0.03	-129,503.47
7.	Internal International Equity Portfolio	167,831,573.00	5.93		
	FTSE All Wrld Ex US Index (US Invstr) (USD) (Net)			-0.02	-33,566.31
8.	Northern Trust	1,110,718,540.00	6.40		
	MSCI ACW Ex US Index (USD) (Net)			0.24	2,665,724.50
9.	Fisher Investments	453,878,776.00	6.91		
	MSCI ACW Ex US Index (USD) (Net)			0.75	3,404,090.82
10.	Allianz Global Investors	490,285,383.00	3.82		
	BofA ML All Cnvrts Index (All Qual)			0.05	245,142.69

The Internal International Equity Portfolio was 2 basis points (0.02%) below the FTSE All World ex-US Index. Eighty percent of international equity funds do not beat their benchmark over a 10-year period.

FUND CATEGORY	COMPARISON INDEX	1-YEAR	3-YEAR	5-YEAR	10-YEAR	15-YEAR
Global Funds	S&P Global 1200	56.25	75.14	79.90	79.80	84.85
International Funds	S&P International 700	77.81	57.36	71.85	79.92	91.47

Source: SPIVA- S&P Index vs. Active