Lily Osorio:
Good morning. Welcome everyone for being with us today. My name is Lily Osorio and I'm the LAIF administrator. Before we get started, I would like to go over some admin details.

Questions. We will have a separate question and answer period at the end of each presentation. If you have any questions during the webinar, please e-mail LAIF@treasurer.ca.gov and we will answer them during the Q&A period, Nicole Milliron, our LAIF manager, will moderate questions.

Live captioning, access to live captioning is available by clicking on the three dots. This will open a menu on the screen for you to access live captioning

Webinar replay. A replay link and a transcript will be available in the upcoming weeks and will be posted to our website.

In today's agenda, we have California State Treasurer Fiona Ma with our keynote speech followed by Scott Anderson, at Bank of the West.

Discussing economic trends at the end of his presentation, we will have time for Q&A and then our investments division team with presentations regarding the PMIA from our Deputy Director, Jeff Warm, Investment Manager Kim McCorstin, credit manager Tracey Paine and myself with a little bit about LAIF. And finally, a question and answer period.

So with that, let's go ahead and get started.

First up is the treasurer, Treasurer Ma. California is 34th state treasurer. She was elected on November 6th 2018 with more votes than any other candidate for treasurer in the state's history, thank you for being here today, Treasurer Ma.

Treasurer Ma:
Thank you. Thank you, Lily, and thank you, Jeff Wurm and the team for keeping everything going, especially during the pandemic. And I know that all of the participants here today had an equally difficult time weathering the storm pivoting and trying to make sure that we keep our state and our local economies moving forward. And I'm just very proud that at the state treasurer's office we showed up every day. We made sure we were taking in all of the revenues, investing them, issuing bonds, even through the pandemic, and making sure that the 13 boards, commissions and authorities that I chair met consistently every month. We did not miss a deadline, did not miss a regulation change deadline, etcetera. And so I know that all of us here have done a yeoman's job and what we do right to make sure that we keep our fiscal houses in order

Many of you know that I am a real estate tax accountant by training. I started out with one of the Big eight accounting firms and left after five years to start my own practice.

And became president of a small Business Association at the age of 28 years old, and that was really the first time that I got involved in public service, really helping small businesses who are just struggling everyday to make their payroll, yet have a myriad of tax filings and other type of government agency, government agencies that are doing oversight makes it really difficult for small businesses.

So even during this pandemic, I did about 300 zoom webinars, letting small business owners, veterans, seniors, people with disabilities understand the resources that are coming from the federal, state, local

and even the private sectors and the good news is we still have more programs coming. We received about $27 billion from the federal government, some of us, some of that, we did roll out already in different type of programs whether it was to help the restaurants or tenants or our hospitals workers. But there is still more to come.

Uh coming soon is the SSBCI 2.0 program. The state is gonna get a billion dollars, split between the ibank and our office.

That would go to provide loan loss, reserve loan loss guarantees as well as collateral support to our existing programs. This will enable more participating lenders to lend to those underserved communities that did not get the full assistance or any type of assistance during the pandemic. The money will also go to funding a new venture capital program also targeted to certain communities.

I'm trying to bring in more money managers, venture capital folks that have not been able to access some of the large pension funds like CalPERS and Cal Stairs. So this is very exciting. We just received the money last week. We did a rollout and so hopefully we will see more assistance for our small business owners moving forward. We're also very excited to report on our CD AAC.

That site, if you go to our treasurers website www.treasurer.ca.gov and go under the program studio app, there is an education tab. We have completed four modules on demand for elected officials, elected officials focus on public debt financing for the officials and also members of governing bodies. We're hoping that we can do a lot more outreach and perhaps you can also.

Help us introduce these four modules to your elected officials so that they can educate themselves on some of the ways financing tools that are helpful.

Umm ways in which we can plan for either expansion or down downturns. But hopefully this will help you in your job since you don't have to explain as much to them or also you can share what you know what they know with you and and have an informed conversation. Because ultimately these elected officials it is their duty to make these decisions, especially the difficult ones during difficult times.

And if they don't understand the decision, then.

Right. The responsibility falls on you and me as the as the Treasurer, as the tax collector. As you know, the the folks who are making these important decisions. So we're hoping that you can help us spread the word and those modules are elected.

We also have debt ad regarding debt issuance modules and also invest ads for public fund investments. So we're really trying to do more to educate all of us here in this space, so that we all understand what the options are and the ramifications for some of the decisions that we are making financially.

I also chair three savings programs and look to partner with all of you to help us. Let your constituents know that these programs are available first. Scholarshare 529, which is intended to keep our next generation out of high student loan debt. We currently have a bonus program if you open up a scholarshare 529 and feed it with $1000, we will give you an additional $100 and that promotion expires at the end of this month, September 30th. I do post all of these programs.

Loans, glance and and others on my Twitter, so if you follow me at @FionaMa, maybe you can help share these programs with others, but we really want to partner with you to let your employees know that these programs are available. They are very low cost.

Umm, they are chaired by my office and they say with the individual lots of transparency, accountability they can log on, they can change their investment criteria, they can put more money into their account and watch it grow every single day.

New this year as well, the governor and the legislature put over a billion dollars into a new cow kids program.

We are really doubling down and investing in our children.

For every baby born after July 1st.

They will get a seed amount of 25 to $100 in that child's account.

The motive is to watch that about grow for 18 years and when they're ready to go to higher ad or to a certify, the Prentice ship program, they can withdraw the money and use it for those purposes.

We also have a tax credit bill sitting on the I'm sorry, tax deduction, bill sitting on the governor's desk. He has until the end of this week to sign the remaining bills that are on his desk.

Our Dell Fe 1374 would provide a tax deduction for single taxpayers and married taxpayers who deposit money into a solar share 529. So for single taxpayers making up to $100,000 a year.

They potentially could take $1000 in a tax deduction on their tax return for each beneficiary. So if you have three kids, you can potentially take up to $3000 in a tax deduction.

If you are a married couple and make up to $200,000 a year.

That tax deduction increases to $2000 per beneficiary.

We feel this is very important because we are one of five states that does not offer a tax deduction for investing in our next generation and putting money into a scholarship, 529 so cross your fingers if you feel compelled to reach out to the governor's office to support this bill. That bill is SB1374, and in the past four years we've made improvements to this program, namely that now we have added.

Certified Apprenticeship program as an eligible use, not only Community College or higher education, but we know that some young people want to go into the trade and so certified apprenticeship programs are now eligible. Also, if you have extra money in your scholarship 529 and don't use it, you can now apply $10,000 to pay down other student loan debt in a family. So another family member.

And then also these accounts are no longer subject to bankruptcy, so if the parents face bankruptcy, the court cannot take the money that is invested in. In these scholarship 529 because these children should not be penalized for things that happen in their parents lives, and we really want to make sure that they have this money to go toward higher education or apprenticeship program.

The second savings program is Cal able for those people who are diagnosed with a disability before the age of 26 years old.

That person can now save up to $16,000 in that person's name without jeopardizing their other health and safety benefits. The prior amount was only $2000, so it's $2000 doesn't go a long way, but now people with disabilities can save up to $16,000 in their own name, up to $100,000 that could be used for any type of disability expenses. Whether you need a cane.

You need to put in a ramp at your house. You need a new wheelchair or a motorized wheelchair. And even sometimes, if you need to take vacation, you could use that money.

The third program is Cal Savers.

On this started four years ago, when I first got elected to office, championed by my predecessor, Treasurer John Chiang, and it basically requires anyone who employs five or more employees.

That does not offer a retirement savings account at their workplace.

To upload the roster to our Cal Savers program, where we will now help that employee manage their account, it's stays with the employee. It is portable and once that small business owner or business owner complies with uploading to Cal Savers, they no longer have any sort of legal or financial liability moving forward. Like I said, these are portable accounts that stay with the employee.

We just recently got a bill signed that will expand the program to any employer who employs one or more employees and that program or that deadline will start on January 2025 because we saw a lot of confusion with people who had part time employees, seasonal employees that had sometimes three, sometimes 8, sometimes 10, and they kept toggling back and forth.

Between that five Magic 5 number and so now it's gonna go to one or more employees and we had no opposition. So that means that our Cal savers program is working and people are saving. It is easy to use, employers love IT, employees love it, and we're very, very happy that the governor signed that bill.

And another new program that you might hear about that is the California dream for all program.

My treasurer’s office was tasked with putting out the RFP. I'll for the study California forward one the RFP. It is online on our website as well as if you want to just Google California dream for all you will find the report, but essentially starting.

Probably not next year, but probably the year after, California will help with down payment assistance for low wage workers, mid-size workforce taxpayers, because we know that some workers cannot save that 20% for a down payment. And so California will be engaging into call. It's called the silent 2nd.

From program where we will now share the appreciation with the homeowner, so when the homeowner sells their house, we will get back a certain amount of return which will go back into the fund so that it could be used for additional down payment assistance for others who will need it. So we are very, very excited that we are helping people build equity.

I achieved the American dream by buying their first home because we know that that's what really propelled people out of poverty is owning their own home and being able to build that equity. So these are just some of the new programs that are rolling out that are gonna be coming. You may hear about them as always, if you need any assistance or if we could be of assistance or come and provide speakers at your different events.

Please reach out to me. We also have a dedicated e-mail.

Catherine Asprey is my constituents affairs director. This is all she does is she tries to help people with their issues, doesn't have to be related to the treasurer's office. It could be. I didn't get my franchise tax board refund. I'm still waiting for my unemployment check. We're all supposed to get a refund. The tax refund in October. Some people may throw out the prepaid card and they're gonna want another card. Please reach out to us at ask Fiona@treasurer.ca.gov again. That is ask Fiona@treasurer.ca.gov. Thank you so much for trusting us with your investments.

I always need to say, and I know my team is going to be very happy when I say your money is safe with lace. So thank you all and I hope you have a great conference here today. Thank you, Jeff.

Jeff Wurm:
Thank you, treasurer.

Lily Osorio:
Thank you Treasurer Ma for your time. Next up is the road ahead will Boom turned to bust, presented by Scott Anderson, chief economist and executive vice president at Bank of the West, Mr. Anderson.

Scott Anderson:
Thanks and good. Good morning, everybody. Uh, thanks for joining. Inviting me here today to talk about the economic outlook.

Well, have you been watching Bloomberg or CNBC in the last few days? I'm sure you've been seeing the markets gyrating, interest rates moving up and down 1020 basis points a day in some cases. So a lot of uncertainty going on in the markets. Everyone's trying to figure out where this recovery is headed.

That's my job at Bank of the West. I'm the chief economist and top macro forecaster for our bank. I've been doing this for over 20 years as a professional macro forecaster, as that Wells Fargo for 12 years doing the same thing. So I've seen the Great Recession period I've seen.

You know the financial crisis we went through in 2008.

Ummisawthe.com bubble. But this pandemic is really unprecedented.

Well, you have an impressive impact on our economy. You know, as you know, we've all been on an economic and financial roller coaster since the pandemic began in just two years time. We've gone from Great Depression level unemployment rates to some of the highest inflation we've seen since the early 1980s. We had unprecedented fiscal spending from both the from the federal state and local governments that totaling about six times the amount of spending support we got in the Great Recession period.

And then we had the Federal Reserve that really went all out to stabilize financial markets when this pandemic began, they dropped interest rates to zero and they built the balance sheet up to about $9 trillion. So we've really gone through unprecedented economic shocks as well as policy support in shocks around that.

But now we're in a whole different environment, right? The Fed's not making emergency interest rate hikes. They're no longer supporting employment growth, but trying to bring down this high level of of

price inflation you've got. And it's not just the Fed, but other major central banks as well. Just in the past week, we had the Bank of Sweden raised there policy rate by 100 basis points. We had the ECB the last couple weeks raised there rate by 75 basis points. We had the Bank of England.

Raise their rates by 50 basis points. So we're seeing this almost every central bank in the world is is raising rates now.

I absent China, where we actually seeing them cutting rates a little bit on top of that, I think we've got big global concerns here more than we actually have concerns about the US economy and outlook. There's an energy crisis in Europe right now due to the war in Ukraine. It was just reported this morning they lost.

Ohh, pipeline pressure in the Nord Stream one and two pipelines on it might be sabotaged. But what? What we know is that there's gonna be a huge energy shock. There already has been a huge energy shock in Europe. There's probably gonna be another big one this winter. And I think the chance of a severe recession year up and even other parts of the world, including perhaps China, are very real possibility. China itself is going through a property bubble and mortgage bubble that's in the process of popping as well. So a lot of things on our radar, a lot of risks out there.

Almost all of them right now are to the downside, so that's that's what I think you're saying being priced into into the markets in recent days and and the risk of recession certainly gone up and and now as you'll see in my presentation today, our baseline forecast for the coming years that we will enter at least a mild recession.

For the US economy, probably in the first half and next year, but before I get into those details and talk about what that means for the markets and interest rates, let me start it a little bit and give you a little bit of background on where we've been. If we go to the next slide.

I'd like to show that you just the tremendous amount of shock we saw from this pandemic. We shut down almost all of our a lot of our in person service businesses over two months. Immediately US GDP dropped by about 10%, peak to trough. That's a a shock of almost a magnitude of three times what we had over a year and a half period from the Great Recession. So it was unprecedented shock. 22 million jobs were lost almost overnight.

And then we had this incredible rebound off of the the policy stainless we had from both the Federal Reserve and the federal and state governments. And so we really had an unprecedented recovery. We've already recreated all the jobs that we lost in the pandemic, and we've had actually added another 200,000 on top of that in just a little bit over two years time.

Coming out of the Great Recession, as you know, it took almost 10 years to get back to full employment levels for the US economy. So it's really been an unprecedented recovery, but that boom is is is now in the process of unwinding and could could really end up into more of a bossed situation. The question is how deep and how prolonged does that bus going to be. As you can see here in our forecast, we do think GDP growth is going to fall below the CBOE projection congressional budgets.

Offices, projection of potential GDP. So we've we've really got back to that potential growth over the past years and we do think that with what the feds got in terms of the rate hikes that we've seen already and that they're likely to put into place over the next three to six months, we will see US growth fall well

below potential at least for some time until we see the Fed easing up on the on the brake pedal. If you on the next slide.

Looking at the another way, I showed you GDP. Now I'm gonna show you a payrolls and you can see just the again the almost a three time shock, 300% greater shock coming from this pandemic than what we had during the year and a half and the Great Recession when we lost 8.7 million jobs and the Great Recession here, we've lost 22 million jobs in just about two or three months.

And then, uh, we had 22.2 million jobs of recreated over the past two years. So it's really been, you know, an unprecedented recovery. Unfortunately, they buy ministration is getting isn't getting a lot of credit for the strength of the labor market right now, though it is an important support for consumer spending and consumer confidence.

But yeah, as you know, the attention has fallen squarely on price inflation. I'll talk a little bit about that in a moment. If you go to the next slide.

I I do wanna let everyone know, even though we've recreated all the jobs that were lost in the pandemic.

You know, there's been some sectors that have been clear winners and others that have been are still struggling to recover, including a lot of small businesses. As as Treasurer Ma was was alluding to and talking about.

So we have seen, you know, strong job recreation and actually a lot of sectors. Now the jobs are above pre pandemic levels. You know professional business services trade and transportation jobs are over a million over prepandemic levels also construction, financial services, Information Services, even manufacturing is now jobs are even above prepandemic levels but the the big poster child for the pandemic was leisure and hospitality and that sector is still down about 1.2 million jobs.

You know people that run hotels are very well aware of this. They're still very short of staff cleaning staff and other service jobs on the government side as well. We've we've seen as a considerable loss of about 600,000 jobs from from prepandemic levels.

So not everyone has a benefit equally coming out of this downturn. In fact, the inequality has gotten worse over the past two years. If go to the next slide.

I do because of that inequality that I was talking about, some of the, you know, the major macro indicators we track on the on a monthly basis are really kind of masking some of the the variations we're seeing across the country and in and indeed around income distributions as well. So this chart shows you job growth by state.

And so the darker the color in this chart, this map the, the faster the job growth. So California are our our home state actually is performed quite well over the past year we had a 4% gain in in payrolls over the past 12 months through August and we've California recreated another 677 thousand jobs. So a really good performance not top performance though Texas actually beat California up five point 7% Nevada up 5%.

Even Florida Georgia and New York eat out almost 5% gains in employment over the past year. But we do see a lot of that job growth shifting to the South and western half of the US, where the Midwest and Industrial Midwest states are are tending to delay a bit. If you go to the next slide.

The labor market remains extremely tight. That's why the Fed is doing these emergency rate hikes. We've had 375 basis point rate hikes in a row and it looks like in November the Fed will hike again another 75 basis points and you know there really pointing to the strength of the labor market is one of the reasons why they don't think the US economy is yet intersection and why they think the economy will be able to weather at least a few more rate hikes from here. The problem is there's a still a huge imbalance between labor demand and labor supply.

Some of that is due to the pandemic and the aftermath of that pandemic, but there's no doubt about that. The demand for labor is is some of the hottest we've seen since the 1960s. This chart you see here is is basically the excess of job openings is about 11 million open positions right now in the United States and a little over 5,000,000 people unemployed. So you have excess job openings in about 5 / 5 and a half million.

Uh openings. Umm, you see, compared to any cycle we've seen, even the peak before the pandemic where there's only Nexus number of jobs, about a million. So this is really a problem. And what the Fed's trying to do is rebalance the labor market and rebalance that supply and demand because it is pushing up nominal wages, wage growth and not all terms on average hourly earnings is is growing at over a 5% pace right now, which isn't conducive to bringing inflation back down.

The 2% so you know the message coming from Jerome Paul and the FMC last week was very clear that they're gonna continue to hike rates until they see a noticeable shift in the labor market, which probably means more slack, which means a higher unemployment rate for those of you following at home. If we go to the next slide.

So this is our latest forecast on the unemployment rate. We do think we've hit the low point in terms of US unemployment for this.

This recovery from the pandemic, I do think we'll see the unemployment rate arising at a gradual pace next year.

By the beginning of an end of 2023, we think the US unemployment rate will be closer to 4.8%.

And that's more than a percentage point above where we were just a month or two ago, so that would qualify as a mild recession. It's probably equivalent to the US economy losing about 1.4 million jobs. It's still a relatively mild recession by historical standards. So there is, I wouldn't call it a soft landing as a possibility, but I do think, you know, some of the more dire forecasts out there is is not our our baseline view. And we will need the some slack and we will need to bring that.

The US unemployment rate well above, I think 4.4% to generate the decline in inflation that the Feds are looking for. If you go to the next slide.

So why, uh? Why not? Or A or a deep recession at this point, given what the feds been doing? We're also coming off of the pandemic relief spending that's actually pushed a real incomes much lower. But as you can see, consumers have been able to build up a huge war chest of savings throughout this pandemic. Part of that was due to the pandemic relief spending that we saw.

Which is really unprecedented amounts of savings.

And now that that error is obviously over, we're now seeing consumers having to dip into their savings to maintain their spending.

So you're seeing, you know, even on the deposit side at the bank, we're starting to see those deposits starting to come down. But even though people are dissaving now and actually pushing down their savings rates, they still have about $2.6 trillion in excess savings to to draw on. So that's still a huge war chest for them and will allow them to continue to spend. And and there is actually a a little bit of an upside here if the fetus successful in bringing inflation down, those people that are able to keep their jobs will actually.

See a boost.

And their real income growth and that will actually be supportive of spending. So there is there are some cross currents here, it's not all doom and gloom for the US economy and the consumer household balance sheets have.

Never been stronger in my my career and I've been doing this for 25 years so that this is a good place to start. Even if we enter a recession over the next three to six months. I I I think the consumer still has quite a bit going for them going to the next slide.

The household wealth effect has been huge. Obviously we've had a huge run up in the stock market. We had two years of 20% plus home price growth. Obviously that era is changing now as well, but there's been a huge explosion. It was almost exponential growth in household wealth. You add that to that. The pandemic relief spending and there's no no surprise that we're we're fighting some of the highest inflation in 40 years.

It was just an awful lot for the economy to take again when supply chains were disrupted when people couldn't come in because of the pandemic and fears about the coronavirus.

So we are seeing stocks dropping. We just fell into a bear market yesterday and the stock market, which means a decline of of over 20% in all the major indicators, we're up a little bit today. But you know, we do think there's further downside in the market. So some of this gain is going to to, to disappear but not not not the bulk of it and that's still going to be a good tailwind for consumers going forward here, go to the next slide.

It also makes the Fed's job harder to bring inflation back down to their 2% goal. The other thing I wanted to show is just the unprecedented nature of the consumer spending we saw throughout throughout the pandemic and and largely due to the the relief payments we got mostly from the federal government.

We've never seen a stronger recovery in real consumer spending.

Coming out of a recession I on average we're coming slowing down quite rapidly now from the peaks we hit early last year, but.

Still, on average, consumer spending has been growing since the recovery started from this pandemic at over 7% pace, you can see that all the expansions going all the way back to 1949.

In in in the especially the last few expansions where we only saw consumer spending in the two to 3% range, it's a whole different animal right now. You know, we have this huge explosion of imports, port backlogs developed as well.

So that was that imbalance where services spending went down, but good spending exploded and including for for automobiles and and we're we're living in the aftermath of that inflation as well. If you go to the next slide.

So this year's been quite different. You know, the Fed really, you know, put the markets on notice in December of last year that they were going to stop supporting employment and shift to their other mandate, which is maintaining stable prices and bring inflation back down to their 2% target. So they started hiking rates in Marge, they started at 25 basis point hike than a 50 basis point hike. And then the last three meetings they've done 75.

And each meeting. So they've been, you know, incrementally pushing up the pressure on on financial conditions and and financial markets. The good news is we're really not in recession at this moment in the US economy. You certainly don't see that in the labor market. There were still over 300,000 jobs created last month in the month of August.

For the US economy. But even in the GDP data, if we look at an average of gross domestic income and in real GDP growth, you know growth did slow to a crawl in the first half of the year, but wasn't actually even though the GDP prints were negative. Technically that's a recession. The two negative GDP prints and consecutive quarters, a lot of people use that rule of thumb to call recession and argue where we're not quite there yet. Growth did slow to a crawl.

But a lot of the decline in GDP in the first half of this year was really due to disruptions from the pandemic. You know movements and the supply chain that whip side trade balances and also a a a shift in inventories, there's a build up of inventory last year and we worked that down in the first half of this year. So overall demand was still growing, expansion continues and and we see that in the PMI measures as well. But as I look into my crystal balls, we look out in the third and fourth quarter of this year and into 2023.

I do think the risk continue to to ratchet up and I do think by probably the first half of 2023, we actually see some more negative prints on GDP, but it it'll start fairly gradually and I think we'll probably continue to grow the economy at least to the end of the year. If you go to the next slide.

I've been talking about how unbalanced this recovery has been between, you know, goods demand and services demand and and job growth and unemployment rates. But we're also seeing a lot of inequality here in terms of incomes as well. And so while I'm saying we're in expansion, we're saying, you know, continued growth and real incomes at the national level.

I wanted to show this data. This data actually comes from news University of California, Berkeley that they're doing. They're doing an excellent job here and they actually are splitting out kind of aggregate real income growth for the US economy into, you know, income, income brackets. And so the take away I see from this chart is in the second quarter of this year, we saw very strong income growth. If you're at the top end of the income bracket, really if you're in that 1%, top 1%.

To top .01% bracket you saw, you know, income growth in the five to 7% annualized pace range, but most of us aren't in that income bracket.

You know you you gotta make at least 1.7 million or more a year to be in those brackets. The other thing we're seeing is the bottom half, bottom 50% of the income bracket. We saw very good income growth and that's because a lot of these low skilled, low wage jobs be they in retail be they in fast food service, be they in hospitality or travel.

We're seeing pretty strong wage gains still in those sectors and that's helped push up that that lower part of the bracket, the middles, if you're in the middle range, which means kind of an average income of about $94,000 a year, really not seeing any real income growth from that, that middle 40% of the bracket. So it really does depend on where you are and and So what you're seeing in terms of this economy and and and how it's.

Playing out if you want the next slide.

So.

Everyone agrees. Inflation's unacceptably high. I do think we probably peaked on consumer inflation in June, when June CPI measure hit nine point 1%, just a tad below 10%. It was the highest inflation we've seen since the early 1980s. But as we as we go forward here, we are seeing some relief, you know, gasoline prices have been down strongly over the past couple of months, even though here in California, we're starting to see those gasoline prices moving back up. So by no means are we completely out of the woods yet though we are seeing more and more evidence of some relief on on a lot of the measures that we track on a daily, monthly and quarterly basis that gives us some confidence in our forecast along with the continued fed rate hikes by the way.

That we'll see this inflation problem slowly dissipating next year and probably picking up some steam as we get into the second-half of next year, though I still think by the end of next year, inflation's gonna remain uncomfortably high, probably well above 3% still in the fourth quarter next year. So the Fed won't be able to declare victory very early next year and they'll probably have to keep interest rates high at least through 2023 and and maybe even start to think about cutting rates maybe at the end of the first quarter 2024.

If you go to the next slide there, I would say though, there's still a lot of uncertainty around these inflation forecasts. So what's going right? Well on inflation, we are seeing the futures prices, commodity prices, the raw materials that we use for production of goods.

Those prices are coming down quite sharply. A lot of that is due to the slowdown we're seeing in China, the strength we're seeing in the dollar, the slowdown. We're now starting to see in Europe and the UK as well. So we are seeing lumber prices kind of backed down. You know, number was one area where we saw huge price increases in gasoline. We're now seeing a broad cross section of commodities now we're seeing prices starting to come down though. You'll see that food inflation.

Remains stubbornly high and you know, we're just starting to see a little bit of relief maybe on cattle prices. But corn and wheat prices remain very high. And so we're not seeing a lot of relief yet on the food and beverage side of the equation, but it's a good start and we expect to see more in the months ahead. We've gone next slide.

The other thing we're seeing is supply chain disruptions, the shipping backlogs, you know looking at the port of LA and Long Beach, we you know we had you know 3040 fifty ships waiting to unload last year around September but before the holidays.

Right now it's more like 10 or 11 ships or even less. And so we've seen those container rates coming back down.

From their nose bleed levels, where they're down about 77%. I feel like a container prices from China to the US West Coast. So we're kind of back down to where we were at the beginning of 2021. So that's a a notable feather in the cap. the Fed can look at and in the environment stration can point to their their help in in leading to some relief there. If you go to the next slide.

The Fed also has this global supply chain pressure index. It takes into consideration a much broader cross section of indicators.

Ohh you can TuneIn including container prices. But and it's more of a global measure and the higher the number here shows that the more pressure on those global supply chains shortages develop as a result of that. The good news here is through August it's been coming down quite rapidly, still not back to normal by any means. The war in in Ukraine and Russia's in Europe has already has aggravated.

These measures, and we did see a little bit of uptick for a month or two, but that's that's the slower demand now is starting to have an effect. So that's good news if go to the next slide.

It's all in line with our forecast. There's a couple of things working against the Fed though in terms of bringing inflation down. One of them is the inflation we've seen in the housing market and in the rental markets, as you know here in California and around the country, rent pressures have been a tremendous it. It really was somewhat was really to work from home phenomenon and how migration trends changed when the pandemic began. We, we've seen a lot more increase in rents.

In the suburbs and exurbs, then, we have seen in the city centers and high density housing cities.

But even there we're seeing 1015% rent growth now from from the pandemic from the start of the pandemic. So these are unprecedented, right increases is putting a lot of pressure on households and it's also keeping our inflation rate continued to elevate and we're just starting continuing to see now that rent inflation now feeding through into the shelter and housing component of the CPI index and part of the reason why we haven't seen a lot of relief yet.

And overall headline inflation, if you go to the next slide.

So I do think we'll see some improvement there as well. Yeah, I think, which I see now with the drop in gasoline energy and other commodity prices, we are seeing consumers starting to factor in lower inflation. It peaked, like I said a few months ago and a lot of these inflation expectation measures, they're starting to come down. This data comes from the New York Fed Survey of consumer expectations.

The good news here is it's moving in the right direction. Still too elevated and the Fed will like to see these these moving lower. But again this is again another sign that maybe we'll get a handle on the inflation problem by the end of next year. If you go to the next slide.

The other thing we saw is is with the drop in gasoline, consumer is very rapidly cut their expectations for inflation from gasoline and from food by the way. We saw a nice relief from the last August or a survey around food as well. So those are two categories. We're we're we're, you know consumers are looking to some relief over the coming year, but there's other categories here that haven't really budged at all like rent like medical care.

Well, like college education. So like I said, we're not completely out of the woods yet. And the Fed's gonna have to continue to work on demand here to try to bring down on some of these broader service categories that tend to be more sticky.

If you go to the next slide.

The other thing we're seeing weighing on the consumer is just the fact, you know, we had this explosion, inflation, but also the unwind of the COVID relief payments. So we have had negative real income growth for more than a year now. At one point it was down 21% year over year and that was really due to the unwind of the the early 2020 pandemic payments. But still it's still negative because people's incomes, even though they're picking up wage growth, is picking up, it's still not keeping pace.

Was nearly nine percent inflation, so this is a headwind for consumers and part of the reason why you're seeing more and more consumers having to cut back on discretionary items. We're also expecting to see them cut back on autos and housing purchases and focus more on their necessities like food and rent and medical care. If you go to the next slide.

So while I don't think the US economy is yet in recession, I will say that the housing market is already in recession.

We've had the worst collapse in housing affordability on record, and it's it's combination of the record high home prices that we we got over the past two years the the quick run up in in housing prices that weren't matched by income gains. And then of course the increase now in mortgage rates through your mortgage rate is sitting at 6.5% today.

So housing affordability nationally now on a fixed rate mortgages is actually below where we were at the height of the housing bubble right before the Great Recession in 2008, so.

That's bad news. It means you know, the housing markets gotta go through a correction. As Jerome Powell said, we're we've been slashing our forecast on on home sales and housing starts and and marking down our home price forecast as well. We we don't see a collapse in home prices yet now certainly not in every market around the country because we're coming from a pretty good sub.

On a very tight supply situation.

And you know, just today we got a new home sales and we saw a big jump in home sales, up 28% in the month of August. And that was partly due to the fact that you know, inventories had built up a little bit and in builders cut their home prices and that that led to people try to piling back in and and mortgage rates did dip a little bit as well in August. That's probably not sustainable and we're going to see a further weakening in the housing market going forward, go to the next slide. And I I you know some some big shops like Rudy's.

Politics and others.

Uh, when that look at regional markets, you know, certainly not all the realm of possibility that some markets in the US will see you know like 20 to 25% decline from peak to trough on home prices. It not not what we're predicting nationally. We do think it'll be more single digits for the US as a whole. But one thing I am noting is here in San Francisco, we've seen which was one of the hottest housing markets in the country until very recently is actually seeing some of the biggest pullback right now.

In home prices.

So we're definitely seeing, you know that starting to play out around the country, you're seeing that reflected in the National Association of Home Builders, housing market indexes. And one thing I'd point here too is the fact that, you know, the western half of the US is looking even a little bit weaker than the national numbers. And you certainly seeing that showing up in places like San Francisco, LA and San Diego, that had huge run UPS during the pandemic going next slide.

So can I put it all together here? We do think the economies in for a pretty hard stop. This is going to be a bumpy landing for the Fed to to achieve. If we if we land at all. So our view is that we will enter another reset mild recession. You know second quarter will probably be worse than the first quarter.

On annualized basis, we could see GDP declined by about 1.3% pace, but you can see I know fourth quarter to fourth quarter basis it's it doesn't look quite as severe and it's you know a couple of years of modestly negative GDP growth. So this is a really a stagflation area sort of forecast and it does take us a while to build back up to you know potential growth probably not even not even getting there by the end of 2025 and that's because the Fed's gonna have to keep rates high in restrictive territory.

At least, uh, probably through 2024 before moving them back down to more normal neutral levels. If you go to the next slide.

So just very quickly on the on the right side, we do think we're gonna get to about between 4:25 and 4:50 on the Fed funds rate by the end of the year. That implies a 75 basis point hike in November, another 50 basis point hike hike in December. And then we'll think we'll see another 25 at the February FOC meeting next year. That gets us up in the 4:50 to 475 range by the year end of 2023.

The Fed probably holds rates at that level at least till 2024. Hopefully by that point inflation is at a level where the Fed's gonna be able to ease off the brake pedal a little bit. But as you can see, it's gonna be a slow decline. And I still think you know the Fed funds rate by the end of 2024 still gonna be just shy of 4%.

And and it won't be really until 2025 where the Fed might be able to, you know, push rates back down to something closer to to three or or 325.

If you go to, the next slide was that mean for the overall?

Treasury curve. While you've seen a huge amount of movement in the treasury curve just in the last, I put those chute together on Friday and I can tell you this, this green line, which is the current treasury yield curve, we're already 20 basis points above that this morning. So the the Treasury yield curve has been moving up and it's been almost a parallel shift higher across the curve just in the past since the FOC meeting.

Happened last week, so you can see the huge change in expectations not only around the Fed rate decisions, but also where long term rates are gonna be.

Umm, over the near term. So it's been a little bit of a challenge to keep up with the markets here, but I think we're in, we're in a pretty reasonable range on that right now and where we where we may end up, if you go to the next slide.

We're also seeing a lot of inversion in the Treasury yield curve. You look at the 2:10 spread, it's been inverted by almost, you know, 45 basis points. That's a pretty strong signal from the bond market of of recession. There's other measures of recession of bond markets look at and you can look at three month or 10 year spread as well. But the bottom line here, the bond market is pricing in a pretty noticeable deceleration growth if not outright recession and maybe even more severe recession being priced in than than what we're currently forecasting.

The other thing that's working against lower rates.

As inflation, it comes down as the fact that real interest rates have been going up and that's really a reflection of the tighter monetary policy from the Fed. And that's really what's pushed up the long end of the curve in recent days has been this readjustment in Fed rate rate expectations. If you go to the next slide.

We can see inflation break evens aren't coming down, so the bond market is, you know, certainly not in the inflation camp. I mean the they're expecting.

Even over the coming year, you the bond market, you know very recently on Friday was forecasting a inflation rate of a little over 2%.

Over the coming years. So that's that's a pretty low forecast on on prices lower than what I I presented to you today. So you know definitely the markets think this inflation episode is pretty short term and that a recession will quickly end the inflation that we're we're seeing right now in the US economy go on the next slide.

So kind of putting it all together here, I do think we're going to see an inverted yield curve probably continuing into the end of next year and that's really due to the fact that the fat is gonna overtighten on the short end, inverting that treasury yield curve and probably holding at those levels until they bring inflation down. So I do think the 10 year has more upside from here. We've been trending at around 3.9 on the 10 year just in the past day or two. I think we get up to about 4.3.

On the 10 year still below the Fed funds rate.

And again, that's because we think the federal eventually have to cut rates. They won't be able to keep them above form forever. If you go to the next slide.

So the Fed tightening cycle rarely ends well.

You know, even periods when the Fed hikes rates and there isn't an outright recession, there tends to be a financial crisis tied to it. You can see that in this data going back to 1971, we've identified some of those financial crises. Right now, it seems like the UK could be a poster child, right? We've we've seen the pound collapsing below the dollar. We saw a gilt yields jumping 40 basis points the other day.

You know real panic in the markets around a new fiscal policy that the new Prime Minister and administration put out in the UK. So these sorts of crises are certainly possible and and we're we're looking more closely at the potential instability around currencies in global growth as well. So buckle your seat belts we we think the US is probably in a better shape going into this thing. But sometimes these crises start other places and then migrate to the US you go to the next slide. I'll, I'll end with a a few.

Ohh keynotes here, I think the global economy is looking much weaker than the US economy is right now, and if you look at the G20, the top 20 economies in the world, we actually saw a negative GDP print.

From those top 20 economies, so probably the global economy is already in recession. You can see that they're not even seeing any relief on the inflation side either globally. So we are more pessimistic on the global economy. Do think a severe recession in Europe as possible as we get into next year and in a sharper slowdown in China, certainly in the cards as well. Other emerging markets could be vulnerable here as the dollar continues to strengthen you on the next slide.

Corporate bond markets, though, are behaving fairly well. There's been a little sign of distress in the investment grade space, and the corporate bond market, but in in.

But if you look at the high yield space or the market overall, this this comes from the New York Feds brand new measure of corporate bond market distress, their indicator, the the numbers here. I mean the percentile of the distress. So the investment grade, you can see the distress is still around the 75 percentile. So pretty stressful but not as bad as it got.

At the beginning of the pandemic, or what we saw at the height of of the Great Recession, and what really makes people feel a little bit better is, is that the high yield market, which tends to be the higher risk credit. We're actually still not seeing much evidence of all of any stress and it's actually below average in terms of stress at the moment, if you on the next slide.

Another way to look at is the corporate triple BB AA spread between the the corporate bond and the lowest investment grade corporate bonds and the 10 year Treasury. Those spreads have widened out. I just checked it this morning. It's still around 2:14 on that spread. So definitely it's come up from where it's been averaging over the past three years at about 1.5.

But UM, but definitely elevated, but not, you know, catastrophic. See, you know, comparing it to what you saw during the Great Recession, when the spreads widened out to almost 600 basis points and in earlier in the pandemic, when it got closer to 300, we're not quite there yet. So something to to watch. But again, you know companies are coming from pretty good balance sheets as well and corporate profitability remains strong at for at least for the moment they've been able to pass on their higher cost to their customers.

That's not gonna last forever, obviously. And there's gonna be more stress on companies going forward, but they're coming from a pretty strong position. If you go to the next slide.

OK, this is a longer term view and one thing we gotta keep an eye on. And I think the UK situation is a is a cautionary tale here. We can't take our debt for granted and we've been able to throughout a lot of the downturns in the US economy including the latest pandemic were able to throw trillions and trillions

of dollars at the problem in terms of fiscal support stimulus, it's gonna be harder and harder to do that going forward. This these projections over the next.

Or for the federal budget debt over the next 30 years, you can see this chart now. It's very sensitive to interest rate assumptions and productivity assumptions, but we're already starting at some of the highest debt levels for this nation since World War Two.

And we've seen a little bit of relief of the last year or so, but we're gonna see those projections starting to rise quite rapidly and as interest rates rise, those those interest rate expense on the debt, it's going to go up quite quickly. And that's part of the reason why the markets panicked when the UK cut said they were gonna cut taxes to the extent that they're going to because the debt situation in UK is is also quite dire. You're going next slide.

So it's a little hard to read this chart, but if you look at the one above, what's really driving the increase in the debt or the next 30 years, is that wedge called?

The interest rate, expense, interest rate, outlays, that's the the light blue.

Bar there. And that's that's really and that's assuming in this came from the Cbo's projections that they put out over the summer. My guess is those rate expectations were too low. And so you know at at the moment we're probably looking at something even worse than than what you're seeing here in terms of the increase in the deficits from from higher rates.

So yeah, I didn't tell you. I did tell you, you know, economics is the dismal science, so.

Yeah, yeah, I I did want to hit on some of those factors. Well, I think we're done for the next slide. Yep. So I'm conscious. I know. I've, I've, I've gone pretty long here. So I understand. If there's not time for questions. But but happy to answer them if if we do have any questions that people want me to to answer.

Lily Osorio:
Thank you, Mr. Anderson. We will now do a short Q&A. Nicole, do we have any questions for Mr. Anderson at this time?

Nicole Milliron:
Yes, we do have one question from our registration, which is what are some signs in the economy that would signal investors should start extending maturities?

Scott Anderson:
Yeah, that's a good question. Yeah, I don't think we're there yet. I mean, I think what?

Would give me comfort is, you know, when the Fed looks like they're ready to pause. So where they think the inflation rate is come down to a point where they can kind of take a wait and see approach.

Which might not be that long. I think the Fed's gonna stop raising rates in February and so sometime next year might be a good time to start looking at that.

You know that that possibility there, there's gonna be some opportunities with the volatility we're seeing with the the markets moving 1020 basis points a day in some cases to you know for for investors to.

You know, take advantage of that volatility and and take advantage when there's there's a some bargains out there and some high quality debt.

Yeah. One thing we have seen is in the mortgage space, the the spreads of wind up quite, quite rapidly and so on in the mortgage space, mortgage-backed security space, there's some good good bargains. At the moment I think. But but I'd be a little cautious here until we we we get a little bit further along and see how this recession plays out.

Lily Osorio:
Great. Thank you. Mr. Anderson, Next up is the Investment division staff with our PMIA overview and LAIF operations presentations. Now up is our deputy director, Jeff Wurm.

Jeff Wurm:
Well, good morning everybody or almost afternoon. Thank you for joining us. It's an honor to get an opportunity to speak with all of you again.

Uh, before we get digging into what we do here in investments, I just start looking at some headlines from last fall, like right after we met with you from just in California, headlines pulled a few to remind everybody how things as much things change. They kind of stay the same. Same things. We deal with this year fires.

I have a severe drought, you know, low levels and water reservoirs in California. And then I think I've seen some weather forecast saying we're gonna get more of these atmospheric rivers and these atmospheric monsoons, and it's just this rapid back and forth craziness with the weather. So it's a lot like last year again and the year before and it's just kind of reminding everybody this is kind of happening again, right. Next slide please.

Alright, so here I took the Fed release from last November just ten months ago. I'm 11 months ago, almost, and just reminded everywhere we were. It's it's really easy to get caught up in where we are right now and we just heard from Mr. Anderson and where things could be going and things were a lot different. Less than a year ago. So just to highlight a couple things, I highlighted a couple seconds, but in essence the Fed said they're gonna let inflation increase to have an average of 2% over time.

And that they're going to keep the Fed funds rate or the target rate from zero to 25 basis point until inflation has risen to 2% is on track to quote moderately exceed 2% for some time.

Next line please.

So this is a bigger shot of the dot plot at that time, every single four Fed member said. No, we're not raising rates in 21, only half or literally split evenly between one rate hike this entire year, 2022 three thought there might be two rate hikes this year. Next slide, please. OK. Yeah, go ahead. So actually, so I added a couple cartoons on here. One says I see you will be making wildly wrong forecasts and all of us got tired of hearing about this one.

Inflation is transitory.

Next slide please.

Uh, so in December the Fed met again. Here's the new dot plot in December.

OK, so yeah, they all of them agree that rates are gonna go up, one member said. It's only gonna be one rate hike. All of them said at least two and a couple of them out there thought they were. They were the wild and crazy two people there that was gonna be over 1% within 2022 and next slide please.

That's right, the rain is coming. The rate hike is coming sometime when I'm quite sure when, but it's coming there. Next slide.

Well, now we're in March and the Fed is raised their rates one whole quarter of a basis point and now the Fed members are all over the place what their predictions, which is kind of what we're having to invest through. This has been a wild, crazy ride. These people who get to make these decisions already been in agreement on which direction it's going to go. And this is just six months ago, people, this is less than half a year, they were still half the people thought less than 2% by year end, the other half over, we had one person out there.

One wild and crazy guy or woman saying over 3% by year end of this year.

Uh, you can see kind of some forecasts over here on the right side that I added, not a whole lot of aggressive thoughts and what rates we're gonna do even at that time, 1/4 into this calendar year. Next slide please.

Alright, now we're into Junes fed meeting, and now we're all over 3% by the end of this year.

Only 5 / 3 1/2%, which is where we got two last week. So even in short amounts of times, this stuff is changing rapidly.

And and it affects what we do, we pay attention to it just kind of walking everybody through where we were last year. We met to where we are today on the right as you can see when they raised it 75 basis points in June, that was the most aggressive rate hike since 1994. We haven't seen this stuff in almost 30 years. Next slide please.

Alright, so again, just a snapshot to show you how fast the Fed funds rate has increased, but hit again.

That escalated quickly.

Like UM, for those of you who know Ron Burgundy, just thought it would be kind of funny that in there this things are changing really fast. And yes, it hasn't had an impact on on the pool and Lafe and we'll get into more detail later about that. Go ahead, next slide, please. And I'm moving quickly because we are a little short on time. I want to spend a little more time talking you guys, but as things were paying attention to, I'll do these three real quick and then I hand it off to the investment team was very paying very close attention to the China Taiwan conflict that can have an impact.

And a lot of things throughout the world, we're also paying attention to the Russia, Ukraine situation and then but most importantly we containing pay attention to Chair Powell and the Fed and what they are going to do, what they think is gonna happen next. And we're moving quickly. So go ahead and pass this on to Kim. Hey, on.

Kim McCorstin:
Good morning, everyone. Thank you for joining us today. I want to start my presentation with the first page of our monthly report. So this is an overview of what the PMIA looked like on June 30th of this year.

Which is our fiscal year end to start with, we'll go to the bottom of the page and look at that total number, which represents support polio total. So this number is continued to grow the past fiscal year and was approximately 235 billion as of June 30th. This is an increase of over 40 billion from the prior fiscal year when you may recall from last year's webinar, the portfolio took a big jump to 193 billion. So we'll be back up to the top. This portion covers treasuries, treasury bills and notes combined and make up approximately 68% of the portfolio.

If we then add in the Agency to venture and discount note lines below, we have almost 87% of the portfolio invested in treasuries and agencies, which actually is in line with our investment policy. That sets the goals and objectives of the portfolio and with that safety is a number one goal followed by the liquidity and then yield, you'll hear us say that a lot and we'll get back to the other types of securities coming in next slide.

OK, so this is a snapshot view of where we were ten years ago where we are today and what the 10 year average was in between. Again, you see the treasuries are a big part of the portfolio. This goes back to the financial crisis. When we started to focus more on safety driven products in addition to necessity because of how large our portfolio has grown. We have had the opportunity to invest in more agencies this year. So you'll see that percentage has grown some and you'll see the CD's and banknotes 10 year average is 16%. However, as of June 30th, the percentage was only 6% and that again is due to the large size of the portfolio.

Like OK, so this slide been around for a while. This bar chart is a visual of the portfolio composition. The past ten years at the top of each bar is the portfolio balance. At June 30th of that year, so June 30th, 2013 portfolio was almost 60 billion and now it's grown to almost 235 billion. You can see last year we had a slightly higher percentage of treasuries unless agencies agencies last year were a little harder to find. But thankfully recently this year we've had more options.

In the in the agency land, so just as a PMIA has been growing LAIF, has also grown in the past few years. Many of much of my time here for many years later seemed to hover between 20 and 22 billion, and it always seemed to be 1/3 of the portfolio. That was pretty standard. However, at June 30th of this year, Lapis at 36 billion but only made-up 15% of the PM IA, which again is doing the large size of the portfolio.

OK, it's already mentioned treasuries make up about 68% of the portfolio or approximately 160 billion you utilizing the treasury markets, an important cash management tool for U.S. Treasuries are always in the market. They're safe, they're liquid. This gives us confidence that we can handle large cash flow swings that may come our way and do come our way. So this chart shows our maturity schedule as of June 30th. As you can see the ladder out, the maturities, it's become a little more congested at past couple of years as we started taking advantage of the four month cash management bills.

Maybe came available so those issues on Tuesdays each week and we've added some of those when they hit dates we need. We also continue to invest in the six month and one year Treasury bills that issue on Thursdays the two year Treasury note that issues on the last business day of the month and the three-year notes that issue on the 15th of the month.

Excellent.

OK, another part of our portfolio consists of agencies. We invest in both federal agencies and supernational agencies, which is also referred to as multilateral development banks.

As a June 30th, agencies made-up about 19% of the portfolio or approximately 44 billion. This slide shows a breakdown of agency, but debentures and agency discount notes, discount notes are very helpful to us. In recent years, Fannie Mae and Freddie Mac have become harder and harder to find, but recently we started picking up some short Freddie Mac discount notes and submit some divisions in both names. Since January, we've become much more active in Federal Farm Credit Bank.

Discount mills and once we cleaned up government code, I'll talk about it a little bit later. Federal Home Loan Bank and World Bank or IBIRD or in the market often. And from time to time we'll see IFC or International Finance Corporation and IMDb, which is international American Development Bank. We've also added more to venture callables to our holdings. So we're pretty well diversified in the agency arena and now I will pass it over to Tracy.

Tracey Paine:
OK, I'm going to talk about our certificates of deposit commercial paper and our corporate bonds.

Those are highlighted on that tie Char and combined. They currently make up just over 10% of the portfolio and totaled about 25 billion on June 30th.

On the next slide.

And you'll see a couple of colorful graphs.

These are the breakdown of the CD and CP Holdings by issuer on June 31 of our goals is to maintain a diverse mix of issuers and programs to ensure that we're minimizing our risk and credit exposure to any single firm or institution. So each issuer is represented by a different color on these graphs. On June 30, the portfolio consisted of 34 different financial institutions CD programs.

And 31 different commercial paper programs.

The next slide.

And this is the breakdown of the 31 different commercial paper programs. 27% of those holdings were incorporate names, which was about 3 billion, 15% were in asset back commercial paper programs, almost 2 billion and 58% were in financial institutions. Just under 7 billion.

The next slide, this explains the diversity of our corporate bonds. We started buying corporate bonds again about a year and a half for a year and a half ago after several years of not buying them. They've slowly built up our holdings and had 492,000,000 as of June 30, which was .21% of the portfolio. We typically buy smaller amounts in corporate bonds compared to what we normally purchase and other security types. So we are not too focused on maturity dates.

Being one of our target dates, but we do diversify by maturity. Overall, about half of the corporate bonds currently on the portfolio have a cool feature. However, we calculate our average life based on final maturity. So this graph on the left shows the diversity of the holdings by the final maturity maturity date, even if it's callable the longest is 5 years, which is the Max per the investment policy.

The other graph shows the corporate bond diversity by market segment. 26% of those holdings were in corporate names and the remaining 74% were in financial institutions.

So now I will explain a little bit about our credit management process and monitoring the approved investments. In total, there are about 100 issuers that are approved for investment in commercial paper certificates of deposit and corporate bonds. Since our number one goal is safety, it is critical that we ensure that PMIA is protected. So we monitor the credit strength of each approved issuer on an ongoing basis.

We collect data and information from the primary rating agencies S&P Moody's and Fitch, as well as from other reliable news sources. This information can include their credit ratings, their credit analysis such as the reasoning behind the rating changes, they're financial results, overall performance reports, also their industry outlooks, and any other important news that could have an impact on the issuer and would be critical for us to consider as part of our evaluation.

We then use the collected information from these sources to, at minimum, ensure the investments are in compliance with government code and the investment policy, and from there we analyze how the ratings that financials are changing because we need to ensure that the stability and the financial and the financial strength of each issuer and then we evaluate their performance and any news events and determine what kind of impact.

Those might have for us and how we're going to proceed with that information and at least we believe that critical information we've collected is consolidated and documented and discussed amongst the team and whether the information is positive or negative, we determine if that will generate a change in our investment strategy and sometimes a change in strategy can be subtle, such as how much we are investing or the length of time of an investment and other times.

It can be more straightforward, such as if we stop investing in that name completely until the deficiency is resolved.

The next slide talks about our process to add new authorized investments. We continually look for new programs to add as approved investments in order to continue to enhance the PMI, a safety liquidity and heal when looking for new programs, they first must be in compliance with government code and investment policy including the rating criteria of ensuring that they are prime quality and rated by at least two national.

Recognized rating organizations then, just like the information we collect to monitor our existing approved investments, we collect and evaluate information on perspective programs such as their financials performance and their ratings. And we look at how all of that.

Has changed over time and how they compare to their peers. We look for fairly large programs and we also look for any news or current events and evaluate what impact those have. And this information is used to complete a comprehensive credit analysis to help determine if the program should be added as an approved investment.

And from there, if we determine it's a program that would benefit the PMIA, they go through the final approval process for new CD issuers, those are approved by the authorized traders. New CP issuers are presented to the Pool Money Investment Board for approval.

And corporate bonds are a hybrid process where they're approved by the authorized traders, but also presented to the board as an information item only.

So that brings me to my next slide, which is about the Pooled Money Investment Board. This board provides oversight to the pool money investment account and includes the state treasurer who serves as chair, the state controller and the Director of Finance. The board meets once a month in order to designate the amount of money available for investment to approve the centralized treasury systems target bank balances to improve state department requests to participate.

And the surplus money investment funds Smith, which allows department funds to be invested in the PMIA. And as I mentioned, they approved new commercial paper names as authorized investments and are also notified of any new corporate bond issuers. So those are the highlights of the processes that we use to ensure our investments are safe. And I'm gonna turn it back over to Kim.

Kim McCorstin:
OK. Thank you, Tracey.

And OK, so again, the portfolio has increased significantly the past few years as hopefully you're aware by now and with the market for eligible securities has been shrinking for us. So in addition, state cash flows have grown larger and more volatile. So as Tracy mentioned, we're always on the lookout for new investment options that need the parameters of both government code and the PMI investment policy. So let's talk a little bit about government code. You may be familiar with the government.

No, section 16430. The statute governs the type of eligible securities the state can invest in for the pull money investment account. The past couple of years of treasurer has sponsored bills to clean up and clarify existing language to make it more consistent and also to broaden eligible security options. So I'll be reviewing some of the changes that became effective January 1st of this year and then I'll highlight an additional change that will take effect next January.

Alright, SP 239 was signed by the governor last year and became effective January 1st of 2022. There were a few amendments to government code section 6 to 16430 from this bill that I wanted to bring your attention to 1st the clarifying language which is highlighted here was added to subsection B and E2. The changes to B clarify that federal agencies backed by the full faith and credit of the US government and U.S. government sponsored enterprises.

They're both eligible securities for purposes of investment.

Next, other obligations was added to subsection E2, which clarifies that Federal Born Credit Bank discount notes can be legally purchased. As I mentioned earlier, we started purchasing the Federal Farm credit discount notes as soon as this became effective. Other discount notes are specified in in code, but the language surrounding this was previously vague.

Next slide. In addition, subsection O is added to government code to allow investment in money market mutual funds. We set parameters around this type of investment to ensure a high level of security ambiguity. For instance, eligible money market funds are limited to U.S. Treasuries, agencies, and repo. The funds must be rated AAA. Financial institution must have five years experience and over 10 billion in assets under management and money market funds.

They won't Pay Commission and there's also limits on the amount we can purchase. So we do plan on investing in these funds and then your future, there'll be a good resource during times of market volatility and they'll provide additional flexibility and diversity and equity to the portfolio. Exciting.

So 8869, this was a separate bill and it added subsection E 9 to government code. This allows for the purchase of foreign government bonds listed by the IMF or the International Monetary Fund as an advanced economy, and it's backed by the full faith and credit of that country that there is additional criteria and limitations that must be met in order to invest in this type of security. And those are spelled out in this subsection.

Alright, so that brings us to current legislation and Assembly Bill 2332. This bill has been signed by the governor and the changes will take effect January of next year. Again, there was some remembering and some cleanup, but we also added to the supranational language. Excellent.

OK, so subsection M which lists the supernationals we're allowed to invest in, was expanded to include the European Bank for Reconstruction and Development, or eBird. And the European Investment Bank or EIB. Supernationals, also called multilateral development banks, or set it by sovereign states, which are shareholders. The IB is sometimes described as a largest multilateral Development Bank.

Next slide.

So I wanted to give you an idea of how these two stack up against the supernationals that we actively invest in. SNP publishes a yearly report on supernationals which includes comparative data. As you can see, the IB and eBird array to AAA and the rating factors arranged from strong to very strong. Both of these products are in the market often and in large US denominations, so this makes them the viable option for our portfolio. We always take a conservative approach when we start investing in a new product.

So those are the recent legislative changes in a nutshell. I do wanna point out that just because a security is allowed by statute does not mean we will invest in it, strictly adhere to our investment policy, which is a little more limiting than government code and an addition. As Tracy spoke to, were consistently monitoring credit, watching the market, you know, listening to the news and the street, formulating strategies to prudently invest state and locals, local governments idle cash while we're effectively managing the state cash flows. And with that, that will turn it back over to Jeff.

OK, before I do that, I want to pick up one one so they can just sit right there. It is important to remember anything you see on the website that we're authorized to purchase doesn't mean we are purchasing. If you have any questions, please call us to clarify.

Jeff Wurm:
Umm, just to we'll answer any questions you have on the and stuff like that. These are just little snippets from the website. If you have any questions about what leaf is, what pulled money investment account is this is more of a reminder. We do stick to the investment policy that states that it and first and foremost were invest safely and then we focus on liquidity. And lastly we focus on yield next slide and I'm gonna move quickly into I know every plan on being done at noon. We're gonna do it. Can't get done really quick. And if you have any questions let you know Kim touched on it but I wanna show you a line graph that the PMIA has grown.

Quite a bit in a very short amount of time. The first time the PMIA exceeded 100 billion in assets was early 2019 and a few short, 2 1/2 years later we broke 200 billion. Now we're at 230 billion and we've been kind of hovering there late. Intern also grew exponentially during that same amount of time frame. So a lot of that could be related to stimulus money and added tax revenues for everybody around here. So next slide.

OK, so I'm going to go back a year and a half, just not that long ago, just running already. So March 3121, the lake deposits were at 34.4 billion. The average life of the PMI was stood at 220 days hit for me one more time.

So we've always focused on having the ability to stay liquid, not just for the state of California's cash flow, but for a local agency investment fund participants. It is important for us to make sure that we have your cache available to you. You have the ability to call every day before 10:00 AM and make a withdrawal. And you know, it's not a leading factor. But since you are our audience, wanna make sure that you guys know that we've always kind of done this. It's always been part of our investment process. First and foremost, we think safety secondary, we think of liquidity which includes the lake deposits, so.

At that time, with $120 billion portfolio, we had enough maturities and securities alone to cover lake deposits within 90 days or three months or less. Next slide.

OK, here's where things got crazy. In a three month span. But we'll we'll stay consistent here for a second. So June 20, June 3021, Lake spots of grew to 37 million, but the average life in the PMI agree to 291 days. It for me one more time.

Because the pull grew during the time we were able to shorten a lot of the securities and we had enough maturities over two months to cover $37 billion worth, the leave deposits and it will probably more time. But look at this, the PMI group, $66 billion in one quarter to 193, just over $193 billion. Now of that 66 billion, I kind of broke it down for you to see what we did. We've always kind of stuck to the prudent person rule as it come to investing. We're not gonna take all 66 billion of added money.

And keep it as short as possible one. It's really hard to find that many securities, those of you who do we do, you get it? We're all fighting for the same product. It would have just absolutely torn the market apart in the, you know, on the front end. If we could just focus there. So we spread it out. We took 11 billion in just over a year to two years and then 12 and two to three years and six, explaining three to four. Well, great. And hindsight, knowing where we are today with rates, that doesn't look super smart. So let's take a look real quick. One more slide. This is where the Fed funds rate.

Start a dot plot was last year at this time. This is the June.

Uh, of FOC comments. They ended by announcing no change of policy. They firmly believed that inflation was transitory and they were gonna stay accommodative as long as they could.

It it just using that and thinking it's gonna be a long time before they raise rates, that's another reason it made it easier for us to spread this money out and limit the pain to kind of stockpiling it just right in front of us. It would. It really would have been problematic to not do this and have the things stay like this. It would have looked silly to not taken some out the curve too. So we just kind of split the difference and we still took more than half of that money and kept it in front of us. In June of 21, there

was a 10 day stretch we invested $46 billion in securities over 10 days. It was an absolute crazy time in the investment. Next slide.

Alright, so here's the Treasury curve as of June 1521, as the gold line on the bottom, the green line is where it was yesterday.

Uh, things are changing a lot. It would have been nice to have that when we got all the money. Slow down. I'm going too fast. I'm sorry. I know we're running out of time.

But this is all just kind of overviews anyway. Next slide.

OK, so here's the portfolio. I I went ahead and skipped it to calendar year in December 31 lake deposits are still 36 billion, but the average life has now grown to 340 days, a lot longer than it has in my lifetime here. Majority of that is due to the size of the portfolio. If you look at my note on the bottom, we didn't take any investments beyond three years during the entire quarter, yet the average life grew.

Uh by 30 days, roughly, I think for or no 50 days from the previous time frame I gave you and hit one more time. We still kept enough money within two months and and maturities to cover all of length deposits.

This is just a lot of this was we were already taking investments very, very short and have no place to take more short money. And if you look at this time frame, that first month is January, we have a ton of money that comes into January. We don't wanna take investments there. The 4th month is April same situation, the six month is June same situation. So we were pushing money out seven months and longer to avoid stockpiling cash and we already had a bunch of money coming in or forecast to come in. So it just kind of started pushing that out.

Check out next slide, please. Alright, now we're at June 30 of this year, just this fiscal year and LAIF is still right around $36 billion. We've been been able to bring the average life down to 311 days. It's under 300 days as of this week.

It is a focus of for us to stay short.

You just kind of get the feeling that the income to the state is gonna slow down locally, agency investment fund participants, you guys are gonna be using your money. It's early in the fiscal year, everybody start spending money. So we had a we are consciously focusing on the short end in front of us. Go ahead and hit one more time. We're still covering LAIF deposits within maturities of the next two months, well over $100 billion in securities maturing in five to six months. It's it's a lot that's turning over the size of the portfolio is.

Is very large, which is kind of again, just doing what we've always done, spreading the money out the curve as it comes in has added some average life to the pool, which is kind of go ahead and the next slide please. I'm sorry. We'll go to the next slide and this is just kind of showing you where we were a year ago.

So to now, a year and a half ago, June of 21, we got all that money is that bottom line just three months ago is the kind of gold line in the middle and then?

The the Green Line is what happened when the Fed raised rate last week. It's just everything's moving up in terms of rates and we're looking at to buy. So clearly as all of these securities that we're talking

about, we have the portfolio maturing, they're being replaced by series of much higher yields. Next slide.

So what does that mean with an average life of about 300 days, we trail the Fed funds or any changes in the market by 10 months. It's just kind of the way it's always been because going back when I first started in investments, the director at the time who was one of my biggest mentors and taught me everything I need to know about this place.

Kind of use the analogy that the PMIA was so big at that time in the mid 40s to $50 million range securities. We were like an aircraft carrier trying to turn around when when rates would change. So we've always been slow to react. We always lag the market on the way up as you can see the top the top chart there, the blue dotted line is PMI. The the red line is the SMP GIF index and the green dotted line is the Fed funds rate. So we've trailed it on the way up at beginning of that.

Yeah. Go on time for me. And as you can see, we trailed it when the Fed had a low, lower rates rapidly going into COVID and prior to COVID.

Umm. And it's just kind of because of the size of the pool and our average life, we lag the market. The inverse is gonna be true as rates are going up rapidly. We're gonna lag by that same kind of timeframe. It's just a product of the environment, a product, the size of the pool and our investment philosophies next week please.

Again, I'm showing you kind of visuals here. We got the aircraft carrier being surrounded by speed boats that can just change directions a lot faster than we can.

Got the tortoise and the hare the the tortoises, the PMIA we're we're just gonna be a little bit slower, but we'll get there. We're gonna get caught up going back to something. Mr. Anderson said during his presentation about looking out further when the Fed slows down and stops hitting the break. And kind of and relaxes a little bit. Give it 9 to 10 months and that's about the time you'll get caught up to everybody. That's kind of the product environment. But as I stole the quote here in the more things change, the more they stay the same, it's again, you go back even further.

The chart in the bottom rights from June of 2010. It covers June of 05 through 10. We lagged on the way up at the beginning of that chart and we lagged on the way down. This is just the way things have always been. We just haven't seen the Fed raised rates this fast and this much at any point in my 21 years here in the Treasurer's office. Next slide please.

Umm, we've always kind of focused on the fact that we do barbell investing, which means most of it is a short term cash flow investing and then at times we'll take things out the curve two or three years, things that I've kind of let slip in these presentations is we also we ladder invest Kim mentioned we buy two and three-year notes. We tend to do that pretty regularly when they issue and again those we consider items that can help us as cash we can solve treasuries can be sold at any day in the market.

As we get closer to maturity, sometimes in the past when, as like, say the planets align, we can sell them to bring down a very large investment date to cover days on the short end or then flip it into stuff that is earning a higher yield. So if you look on here on the left side, when it comes to laddering and say well, this Thursday or Friday on the 30th when the two year notes mature, anything we have extra over what.

We don't use if we have leftover, we will buy the new two year and just kind of flip it back onto the portfolio next slide.

And then this is I'm finishing I'll pass it over Lily. But just to remind you guys, uh, previous treasurers and current Treasurer, it's always been that with LAIF, it's your money. The the legislature can't borrow, it can't touch it. It's yours. It's it's protected by a government code. As the Treasurer mentioned this morning, your money is safe and LAIF. That truly is our focus. You can place your money with us and take it out every day. If you call before or hit LAIF online before 10:00 AM and we continue to follow the investment policies. 123 is the safety liquidity and yield.

The old and it's half joking, but half true. I always tell people that first and foremost is safety. Secondarily, it's safety, so then it's liquid and then actually it's safety again and then we'll consider yield. But any time you guys have questions on GASB, I won't say I'm super happy to talk about it, but I will do everything I can to help you answer the questions. I know we did get one about GASB 79 with the PMIA leave not being a net asset value fund and your dollars being guaranteed you can.

Report it either way.

If you use the market valuation, just recommend putting a footnote that you know you're just doing that, and that's not truly what your investment is because you will get your investment dollars back. ESG has been a popular topic over the last six months to a year. I can tell you the treasuries we invest on behalf of each treasurer, the current treasurer is fully in support of ESG. We don't intend to put anything written in investment policy because each treasurer is gonna have their own.

Fingerprints they'd like to put on the portfolio, that doesn't mean that the legislature isn't discussing us, which I'm sure they are. I have heard rumors that and there may be some things that come through on our government code that that kind of fits the ESG question that people are asking for. But at this time we have discussed and and have chosen not to add ESG to the investment policy. And I think that's all I have for investments and I can pass it over to Lily.

Lily Osorio:
Thanks, Jeff. So I wanted to start by briefly introducing current members of our local agency Advisory Board. Some of you may have had the opportunity to meet them at our last in person conference in 2019. But for those of you who have not, we have Walter Hall, Sun Hyun, Amy Lee and Rafi Manoukian.

Our Advisory Board is comprised of two members who are qualified by training and experience in the field of investment or finance, and two members who are treasurers, finance or fiscal officers employed by any county, city or local district or Municipal Corporation in California. All members are appointed by the Treasurer and the board's primary purpose shall be to advise and assist the state Treasurer in formulating the investment and reinvestment of monies in LAIF and the acquisition retention management and disposition of investments of the fund.

Here is our participation pie with the breakdown as of June 30th. You will see a majority of our accounts are from special districts, which really highlights one of the reasons Lake was created to be an investment alternative for California and local agencies and offer them the opportunity to participate in a major portfolio.

I wanted to briefly go over operations. We call it a refresher for some of you. Our office hours are from 7:30 AM to 4:00 PM and we have staff available during that time to take your calls. Whether you want to schedule a transaction, open a new account or for any other general questions you may have are LAIF online hours vary a little since you can schedule a transaction anytime from 7:00 AM to 7:00 PM. If you would like more information about LAIF online.

Please feel free to give us a call or visit our website, a reminder that same day transactions must be scheduled via phone or online before 10:00 AM, preferably not at 9:59 AM. Transactions received after 10:00 AM will be scheduled for the next business day or can be scheduled up to 10 calendar days in advance.

Our regular accounts have a $75 million cap and you are allowed 15 transactions per month with a minimum transaction amount of $5,000.

I also have some reminders that I wanted to go over. Just please provide us with at least 24 hour notice for withdrawals or deposits of 10 million or more. This not only allows us to make the most effective investment decisions, but helps our cash management division who we work closely with. Do not schedule your wired or transfer before scheduling a deposit. When only this will result with our office calling you for additional information.

And potentially affecting your earnings at the end of the quarter, similarly deposit transfers from your bank should be received on the effective date of the transaction early late and cancelled deposits disrupt the States cash flow investment forecasting and compensating balances. Lastly, make sure you know your agencies bank wire limit can accommodate the deposit amount we have recently encountered this with some agencies which brings us to my next slide.

Keep us in the loop. Please keep us in the loop of any changes that may have occurred in your office. Have you switched banks closed a bank account or two? Has your bank merged with another or changed its name? Possibly updated their ABA number. Please let us know.

As soon as possible and that would be when the bank account authorization form that you'll see on the left.

For the next point is staffing changes. Have there been recent staffing changes? People retire, promote new hires to your office, use our authorization form.

To let us know, this allows us to best serve you when we are kept in the loop with any of these types of changes. These and other forms can be easily found on our website, which is laif.treasurer.ca.gov and like I've mentioned before, if you have any questions about these forms while you're filling them out or anything else, we have a staff available to take your calls.

Here is our contact information along with my e-mail address. If you have any questions or comments.

So now we will take some time to answer your questions, starting with those that were submitted during the registration, then we will.

End hopefully on time. So Nicole, can you give us our first question?

Nicole Milliron:
Yes. So our first question is, will you raise the investment limit?

Jeff Wurm:
I'll leave that to Lily.

Lily Osorio:
So we constantly reviewing it because we do get asked this often. But at the time, we have no plan to, given the size of our portfolio like you know, my fellow peers here have mentioned, our portfolio has grown significantly.

So we take that into consideration, but we do, you know we do hear you and we're constantly having talks about it, but no, at this time we do not have a plan to raise it.

Jeff Wurm:
But that doesn't mean it's a no forever. It's just a no right now.

Nicole Milliron:
Thank you. So our next question is why is there a low return?

Jeff Wurm:
Yeah, I kind of covered it, but I'll briefly give it again. So the average life of the securities within our portfolios right around 10 months, hour, 300 days or just under. And so we're gonna lag the market by that amount of time it takes us that long to get the majority of the securities within the portfolio to mature and come up and be replaced. So it's just a lag of where the market is in terms of the short term rates.

We started the year in the like 20 basis point. The 30 basis point range and earnings and we're over 1 1/2% this time and I know that's way behind where everybody is on the short end, but it's it's moving, it's about as fast as a $230 million portfolio can move. We're we're doing our best without focusing on you.

Nicole Milliron:
I thank you. Our next question is do you have any investment options other than LAIF?

Jeff Wurm:
And so I I'm gonna interpret this question is does the state offer another investment vehicle like LAIF and no, it's a great question though it is something that we have reviewed in the last 10 years on two separate occasions. I actually had the owner of creating a white paper doing all the research on what it would be to create at that time. Both times we considered a longer term investment portfolio.

But no, there are no plans. There's no discussions about that. We have thought about it because of the size of the PMIA.

But there's nothing structural that really makes sense at this time on how we would do that, so.

From a state perspective, no, we just have the just the LAIF and the PMIA.

Nicole Milliron:
OK. Thank you. And then our last question we have is please discuss participant reporting on ACFR using amortized cost versus market value under GASB 79 general rule found in paragraph 4, it states transacts with its participants at a stable net asset value of $1.00.

Jeff Wurm:
Right, So what many participants do? And then other states who have a stable net asset value, their participants do when they report their holdings is they go ahead and use market valuation, which right now is gonna be lower than what you're investment amount is and you footnote it, just stating that it is a. If not, it's a stable value. Fund your investment dollars or what the actual amount you'll get back the amount of securities in the pool or what is below value. So the no GASB 79 allows you to choose. Most people are choosing to go ahead and use the market valuation version and footnoting that information stating that it your investment is protected, you get your full dollars back.

And if that doesn't answer the question, please feel free to call me and we can talk more about it.

Nicole Milliron:
OK. Thanks. That's all the questions that I have.

Lily Osorio:
So at this time, we'd like to thank our keynote speaker treasurer Fiona Ma and our guest speaker Scott Anderson from Bank of the West.

From all of us in LAIF and the investment division, we thank you for attending our 2022 LAIF webinar. Thank you and good afternoon.