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LGIP
LOCAL GOVERNMENT INVESTMENT POOL

# Participant Newsletter September 30, 2016

## Investment Guidelines Compliance (09-30-16):

| • Diversification: | Actual | Max. |
|---|---|---|
| U. S. Treasury/Agency | 24% | 100% |
| Repurchase Agreements | 11% | 50% |
| Negotiable CDs & BAs | 37% | 40% |
| Commercial Paper | 28% | 35% |
| Corporate | 0% | 25% |
| AAA Sovereign Govt | 0% | 10% |
| • Maturity Limitations: | 29 days | 60 days |

## Monthly Statistics:

- Avg NAV: 3,269,989,000
- Active Accounts: 783
- Simple Yield: 0.59%
- Effective Yield: 0.59%

## Quarterly Performance:

| • Average Yield: | 1st Qtr FY 17 | FY 16 |
|---|---|---|
| LGIP | 0.54% | 0.32% |
| Institutional Money Funds[1] | 0.16% | 0.09% |
| Treasury 3-Mo. Constant Maturity[2] | 0.30% | 0.18% |

[1]Consists of 502 institutional money market funds totaling $1,700.0 billion as reported by iMoneyNet as of 09-30-16

[2]Federal Reserve Bank H.15 Release.

## GASB and the LGIP

The following is provided regarding financial statement disclosures and reporting relative to investments in the LGIP:

The LGIP is in compliance with the requirements of GASB Statement 79 and elects to measure its investments at amortized cost for financial reporting. Therefore, participants in the LGIP should also measure their investments in the LGIP at amortized cost for financial reporting. The LGIP does not have any limitation or restrictions on participant withdrawals.

According to GASB 72 investments in the LGIP should be excluded from measurement at Fair Value and thus exempt from the Fair Value Hierarchy Classifications.

## Money Market Reform has Bolstered the LGIP Yield

The yield on the LGIP Investment portfolio has benefited from money market reform. The LGIP is exempt from the floating NAV and gates and fees requirements of registered money market funds. Therefore, as institutional prime funds have exited their normal investment behavior due to a loss of assets, it has created a supply/demand imbalance in short-term markets forcing yields higher on non-government securities. This has benefited the LGIP in several ways. First the absolute yield on short-term securities has significantly increased, plus both LIBOR and the spread to LIBOR on floating rate securities has increased. A large percentage of the LGIP portfolio is comprised of LIBOR based floating rate securities and thus benefited from the increase in LIBOR rates without adding additional duration risk. The impact of the increase in yields could be equated to what would have been expected relative to a Fed rate increase. Most market observers expect this structural premium to remain after the October 14 money market reform deadline.

Another aspect of money market reform not necessarily anticipated is the increased cost to muni issuers of VRDN securities. The decreased demand for VRDN securities has pushed the SIFMA Index significantly higher, recently setting at 87 basis points, the highest level in eight years.

**<u>Market and Economic News</u>**

While the FOMC left rates unchanged at their September 20-21 meeting, as expected, there were increasing signs of division among voting members. Three voters dissented, only the fourth time in the last 25 years that three or more voters dissented, voicing their preference to raise policy rates and noting increasing risk of economic overheating. In the accompanying statement, the FOMC admitted 'that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives.' In the Summary of Economic Projections (SEP) addendum, the FOMC pared down expectations for economic growth and flattened the path of policy rates over the next several years. Participants slightly increased expectations for the rate of unemployment, lowered the inflation forecast, and changed the long-run growth rate forecast for the US economy to 1.8 percent from 2.0 percent. Accordingly, the projected path of monetary policy rates was lowered 25 basis points in 2016, 50 basis points in 2017 and 2018. Most market analysts interpreted the actions by voting members of the FOMC as an acknowledgement that a rate hike is needed soon but that the pace of tightening should be more gradual than previously thought and the long run rate objective should be adjusted down to compensate for lower long term economic growth rate expectations.

Most market observers acknowledge the high likelihood of at least one 25 basis point hike to policy rates during the remaining three months of 2016 (the first hike since December 2015), there is a general consensus that the uncertainty around the November elections will keep the Fed on hold until the December 13-14 meeting. Current implied probabilities calculated from Fed Funds futures contracts indicate approximately 20 percent chance of a Fed rate hike during the November FOMC meeting and 65 percent chance of a hike at the December meeting. Market participants have also directed their focus toward significant moves higher in bank funding rates, particularly in 3- and 6-month LIBOR tenors, since late June. While the initial move higher in LIBOR rates was attributed to market uncertainty following the UK's unexpected decision to split from the EU ('Brexit'), upward pressure since mid-July has been driven by accelerating redemptions out of prime money market funds ahead of the October 14 US money market fund reform compliance deadline. As a result, increased exposure to corporate credit and LIBOR-indexed floating rate securities has bolstered the LGIP fund yield during the quarter and will likely continue to be additive going forward.