GIOA Update

Winter 2017

NEWS from the GOVERNMENT INVESTMENT OFFICERS ASSOCIATION

The Government Investment Officers Association would like to invite you to participate in our 14th Annual Conference at the Luxor Casino Resort March 21-23, 2018 in Las Vegas, Nevada.

Register for the Conference
http://www.gioa.us/2018-registration-form/

All day Pre-Conference Workshops open our event for government members only on Wednesday, March 21st, and a Welcome Reception for all attendees begins Wednesday evening. The main sessions run all day Thursday, March 22nd and conclude Friday, March 23rd at 12pm. Thursday evening will feature a NCAA Basketball Party. NASBA eligible CPE credits will also be offered for assigned sessions.

2018 GIOA Conference Pricing

Government Pricing*	Corporate Pricing
First Time Attendee $25	Early Bird $550 (payment postmarked or received by 2/12/18)
Returning Attendee $150	Regular Price $750 (payment postmarked or received after 2/12/18)

* Government Attendees = Employees of state and local municipal entities

CGIP Update

Nicole Muegge Thurston County

The CGIP program is off to a great start with 16 graduates and 32 additional participants actively working on achieving this designation. I am excited about this newest designation offered in a collaborative effort by the Government Investment Officers Association (GIOA) and Fixed Income Academy (FIA). This educational opportunity provided by both GIOA and FIA are unparalleled to pretty much anything you can find specific to fixed income investing, and especially as it relates to public fund investing.

I am Nicole Muegge, Investment & Banking Officer for Thurston County. I have now been a member of GIOA for 7 years. I have also gladly accepted the role as the online Education Committee Chair to serve as the liaison between FIA and GIOA to be sure that the content offered within the program, along with the continuing education provided, continues to meet the needs of the GIOA members. *Continued on Page 2*

IN THIS ISSUE

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I am excited about this opportunity because I truly have a passion for the ongoing education of public fund investors.

The CGIP program specifically provides more than just foundational knowledge. It provides a student with the information needed to understand ongoing operational knowledge as it relates to public fund investing. I personally have completed both the CFIP program and CGIP program. I can tell you that they are both great programs and I am proud to carry both designations next to my name. The CFIP provides a fantastic foundation, from a broader global perspective, as it relates to Fixed Income Investing in general. This is great to understand both sides of the desk, the impacts of the economy on fixed income markets, etc. The CGIP program provides a more granular perspective from the driver seat of the operations as it relates to public fund investing. It takes into consideration the challenges of working with public funds as a public servant and provides tools and knowledge to understand analyzing securities, managing cash flow, basic accounting principles, and much more.

Don't just take my word for it. Hear from another recent graduate, Kari Sample, Portfolio Administrator for the Washington State Treasurer's Office. When she first told me how happy she was to be part of the program, she said, "I wish I had taken this 10 years ago." Here is what she had to say in a recent review of the program- "This program has given me a greater understanding of the investment manager role. I found the online training modules were easy to access. Each individual module has video class learning and resources linked to each topic which were easy to follow. I really enjoyed the convenience of learning the material on my time with my busy schedule. My goal was to try to complete at least one module a week in my schedule. The Fixed Income Academy provided me with outstanding customer service (student support) and if I had any questions, they answered them quickly. I have recently taken on a new role at work as a Portfolio Administrator. The information that I have learned will really give me the knowledge needed to utilize on a daily basis."

I would love to hear from you as well. If you are currently enrolled, graduated, or considering the program, I want to hear from you. As you consider the CGIP designation, or as you study and work towards the designation, I am here as your advocate. I would love your questions and feedback. Drop me an e-mail me anytime at mueggen@co.thurston.wa.us or give me a call at 360-786-5144.

CGIP

Certified Government Investment Professional

Elevate your knowledge and career by becoming a Certified Government Investment Professional.

Enroll now!

http://www.gioa.us/cgip/

It Doesn't Pay to Wait

The cost of waiting can be high for government investment officers.

Multi-Bank Securities

Many experts are predicting higher rate increases in the future after the Fed raised interest rates twice in 2017, but be wary – basing investment decisions on interest rate projections can be a risky choice for public funds investors.

Variables that drive the market are so complex that even market experts cannot consistently predict rate trends. Many investors have lost out on investment returns over the past 10 years while waiting for rates to increase, which is problematic for investors who are accountable for public funds. Investing in all rate environments allows you to match your investment decisions to your cash flow needs and avoid the cost of waiting.

The **cost of waiting** is the opportunity cost of income lost by keeping your funds in cash instead of investing for term. It is a common misconception that investors forgo higher rates by waiting to invest – the interest rate curve is steep, so the 3- and 5-year rates you see today already reflect the higher rates experts anticipate for the future. These higher rates are already "in the market" for longer-term investments.

Consider the following example: betting on assumptions, an investor decides to keep $500,000 in cash (earning 0.30% interest) instead of investing in a 3-year CD earning 1.90%, based on the assumption that rates will increase by 0.50% in six months.
However, if rates take a year to increase instead of six months, the investor loses **$3,000** by not investing today:

	Principal Invested	Annual %	Months	Income
Invest Now	$500,000	1.90%	36	$28,500
Wait 12 Months	$500,000	0.30%	12	$1,500
	$500,000	2.40%	24	$24,000
	Total			$25,500
	Difference			**-$3,000**

Instead of betting on the market, you can utilize the following strategies to help maximize safety, liquidity and yield in a rising rate environment.

Ladder Your Investments
A laddered maturity strategy evenly distributes bonds in a portfolio between short-term rungs, intermediate rungs and long-term rungs. As short-term bonds mature, the funds are reinvested into long-term bonds; securities are then held to maturity. This is a great strategy for any interest rate environment.

Using this strategy, you would have funds evenly distributed between short, intermediate and long-term maturities. By investing at regular intervals, the portfolio is less affected by both high and low points in the market. This reduces the risk typically associated with buying a single bond of a longer-term maturity and potentially increases your overall portfolio return over time.

Diversify Asset Classes
Different asset classes react differently to economic and interest rate changes. Diversification can help you manage risk and reduce the overall impact that rising rates might have on your investment portfolio.**

Selecting different asset classes for the various rungs on your investment ladder can also help you maximize yield on your portfolio. For example, you may be able to get a 1.70% return on a 3-year Treasury bond but a 1.90% return on a 3-year federally insured certificate of deposit (CD).

*Rates are for illustrative purposes only. Current rates may differ.
**Diversification does not guarantee investment returns, does not eliminate risk of loss in a declining market.
For institutional investors only, not intended for the investing public.

Meet the Replacement to LIBOR: SOFR

Rob Zambarano, CFA, Director Macro Products, Guggenheim Securities

In June 2017, the Alternative Reference Rate Committee (ARRC) selected a broad Treasuries repo financing rate as the optimal replacement for Libor in U.S. dollar denominated financial contracts and derivatives. On November 2, the ARRC hosted a roundtable discussion to provide more details of its recommendation and paced transition plan. The Secured Overnight Financing Rate (SOFR) will be published by the Federal Reserve Bank of New York in coordination with the Office of Financial Research. As an alternative to Libor, the SOFR represents a stronger proxy for a risk-free rate without the credit component in Libor and is entirely transaction-based. The ARRC believes this represents the most robust alternative reference interest rate.

What is the SOFR and how is it Calculated?

The New York Fed will begin publishing three reference rates that are derived from transaction-level data from various segments of the repo market.

- TGCR – Tri-party General Collateral Rate : Based on trade-level tri-party data
- BGCR – Broad General Collateral Rate: TGCR + GCF repo
- SOFR – Secured Overnight Financing Rate: BGCR + FICC-cleared bilateral repo

The SOFR is the most comprehensive of the three repo rates and excludes reverse repo transactions conducted with the Federal Reserve. The New York Fed will begin publishing the three rates in the first half of 2018 with expectations for publication to begin in the Q2. In addition to serving as an alternative reference rate, the SOFR (along with the TGCR and the BGCR) is intended to provide market participants with greater transparency into an important segment of the U.S. financial markets . The bottom quartile of transactions will be excluded in order to eliminate the distortions from specials and late day transactions. Daily publication will occur by 8:30 based on the prior day's data. Compared to the current publication of Libor which relies on "expert judgement" by submitting panel banks, the SOFR is entirely transaction based from a large underlying market which produces a more robust reference rate. Current aggregate daily volumes for the SOFR are approximately $800 billion while daily volumes supporting Libor are less than $1 billion, hence the proliferation of "expert judgement" for Libor submissions.

Why Create an Alternative to Libor?

The Financial Conduct Authority (FCA) that oversees the publication of Libor announced in July that the reference rate will be phased out in 2021. Following the aftermath of the 2008 financial crisis when the scandal broke that banks were not accurately reporting their borrowing costs in their panel submissions, inter-bank transaction volumes fell sharply. Banks were reportedly manipulating their panel submissions in order to mask their true funding costs. Even though governance over the submission process improved, underlying transactions remained extremely low and the long-term outlook for Libor became uncertain. Banks face a dilemma since they are less reliant on term funding and therefore have less term transactions for submissions. Panel member banks have committed to maintaining submissions over the next four years, *Continued on Page 5*

though maintaining Libor beyond 2021 to accommodate legacy contracts remains an open question. Most legacy contracts have insufficient contingency arrangements and inadequate contractual fallbacks.

Legacy Contracts Tied to Libor

Currently, there are over $160 trillion of notional contracts referencing Libor with U.S. dollar denominated interest rate swaps representing approximately 90 percent of the gross notional. The path forward transitioning to SOFR appears easier than dealing with the legacy contracts. Fortunately, agency MBS does allow for the issuer to name a successor rate. Prime is currently the preferred alternative for MBS but the rate has extreme basis risk with Libor. The biggest challenge facing legacy contracts is getting issuers and lawyers to agree on language to standardize the method of migrating to the new rate. Libor may exist post 2021 to facilitate these legacy contracts but the form is uncertain at this point. Banks are uneasy maintaining a rate based on "expert judgement" beyond 2021.

The Path Forward

The New York Fed is expected to begin publishing the SOFR in Q2 2018. Overnight transactions represent the bulk of the volume. There are not enough term transactions to calculate a viable rate for longer tenor contracts, such as 1- and 3-month rates. In order to build out a forward curve, market participants need a sufficient data set of the spot SOFR market. In addition, the CME is preparing a SOFR futures contract to build out liquidity in derivatives markets, which takes time. The ARRC will continue to update the transition timeline as traded products begin referencing the new rate.
The public and private sector partnership through the ARRC is an example of balancing the collective interests of market participants in order to confront challenging issues and produce viable solutions. The SOFR will provide market participants with a reference rate that is more robust and with greater transparency than Libor and further strengthen the functioning of financial markets.

Changes Afoot for Fed in 2018

Marvin Loh, Senior Global Markets Strategist, BNY Mellon

While a New Year always brings new faces to the Federal Reserve, 2018 will see a far greater degree of rotation at the US central bank than average.

The Federal Reserve System is comprised of the Board of Governors in Washington and the 12 regional Federal Reserve banks. There are many roles and responsibilities conferred on the Federal Reserve System, including monetary policy, which is mandated to promote maximum employment while maintaining stable prices.

Monetary policy is carried out by the 12 members of the Federal Open Market Committee (FOMC), which is comprised of the seven members of the Board of Governors, the President of the New York Fed and four rotating seats allocated to the presidents of the other 11 regional Federal Reserve banks.

All members of the of the Board of Governors and each regional Fed president participates in the policy process, but only the 12 annual members cast a ballot, with a simple majority carrying the vote.

The process of selecting members of the Board is markedly different from the selection process for regional presidents. Each of the seven members of the Board are selected by the President and confirmed by the Senate. The congressional process includes hearings of the Senate Banking Committee before a full floor vote of the entire chamber.

Once approved, a Governor's term runs for 14 years, and they are only allowed to serve one full term. If a Governor is appointed to complete an existing term, they are permitted to be re-nominated for a full term. The Chairman and Vice-Chairman are also considered members of the Board, but must be confirmed to those roles by the Senate. These positions are held for four years and they may be reappointed as long as their board membership remains active.

Regional Fed presidents are selected by the directors of the regional banks for five-year terms that require the Fed Board's approval. There are no term limits at the regional President level, although various maximum retirement ages exist.

Changes in 2018

2018 will include a number of empty and/or new roles on the Board in addition to the normal rotation at the regional president level. As the attached chart indicates, Chicago, Philadelphia, Dallas and Minneapolis are the 2018 voters that will rotate out of the FOMC. In turn, Cleveland, St. Louis, Richmond and San Francisco will rotate in. We assign a rating based on the dovishness (1) or hawkishness (5) of each voter.

On average, the regional presidents maintained a 2.4 average in 2017 with Chicago and Minneapolis both rated 1 on our scale. Looking into 2018, we rate the regional president votes moving towards a more neutral 3.3 rating, as Cleveland is a 5 on our scale, along with several more neutral voices. The chairmanship of the Richmond Fed is currently vacant. The most recent occupant of the post was a vocal hawk and will likely be replaced with an individual that holds a similar view.

William Dudley, the President of the New York Fed has also announced he will retire in mid-2018, creating yet another vacancy that adds a degree of uncertainty. *Continued on Page 7*

As can be inferred from its permanent seat on the FOMC, the New York president's position has added importance due to its role as the manager of the System Open Market Account, which is responsible for executing open market trading on behalf of the entire system.

Chairman-Elect Powell

At the Board, there will be a rotation in the leadership, and several vacancies that will need to be filled. President Trump has chosen to elevate Jerome Powell, a current Board member, to the role of Chairman. Powell has been confirmed by the Senate. Powell represented the safest choice for those advocating continuity at the central bank.

He joined the Fed Board in May 2012 as an appointee of President Obama, effectively serving out the remainder of Kevin Warsh's term. He was reappointed in 2014 and was confirmed to his current term which ends in 2028.

As a member of the Board, Powell has voted at every monetary policy meeting since May 2014, never once dissenting from the majority position in any of the 44 votes that he cast. Unlike the four preceding chairmen, Powell is not an economist by training, having served as a visiting scholar at the Bipartisan Policy Center prior to joining the Fed and best known for being a partner at the Carlyle Group as well as an undersecretary for finance under George H.W. Bush.

Chairman Yellen has announced that she will leave the Board. She has the option of finishing her term that ends in 2024, but unsurprisingly has chosen to relinquish that role. This will create another vacancy at the Board, which currently has three empty seats. The President will therefore have the ability to drastically reshape the Fed, having appointed two of the four current board members with the possibility of an additional four within the foreseeable future.

This comes as the Fed embarks on the most challenging part of its policy normalization process, having already raised interest rates four times. With another four rate hikes earmarked through 2018 and the end of this tightening cycle on the horizon in 2019, the Fed has a view towards complete normalization.

Investors currently view the economy and inflation in a different vein with limited rate hikes expected over the next few years and a flattening yield curve indicating differing opinions on economic growth -and/or inflation. The new Chairman and to-be-decided board members will need to either continue along the gradual tightening process already underway or possibly implement a drastic departure for monetary policy.

2018 Fed will Change as Vacancies are Filled

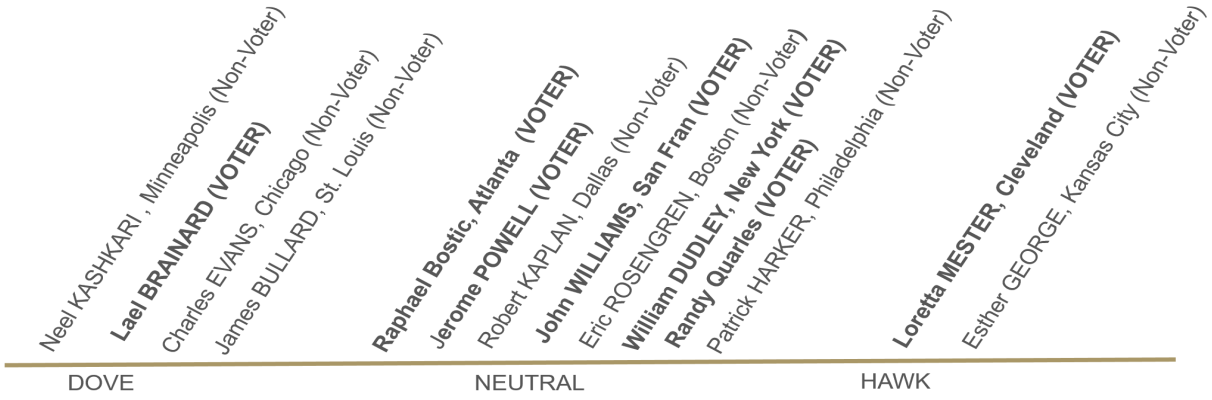
Board Of Governors

Powell, Chairman (Jan '22/Jan '28)	Neutral (3)
Brainard (Jan '26)	Dove (1)
Quarles (Jan '18)*	Neutral (3)
Vacant	??
Vacant	??
Vacant	??
Vacant	??

*Quarles is also Vice Chairman of Supervision

Regional Presidents

Bullard (St. Louis)	Dove (1.5)	2019
Bostic (Atlanta)	Neutral (2.5)	VOTER
Dudley (New York)	Neutral (3)	VOTER
Evans (Chicago)	Dove (1)	2019
George (Kansas City)	Hawk (5)	2019
Harker (Philadephia)	Neutral (3)	2020
Kaplan (Dallas)	Neutral (3)	2020
Kashkari (Minneapolis)	Dove (1)	2020
Mester (Cleveland)	Hawk (4)	VOTER
Rosengren (Boston)	Neutral (3)	2019
Williams (San Francisco)	Neutral (3)	VOTER
VACANT (Richmond)	N/A	VOTER



Source: Federal Reserve System, BNY Mellon

FOMC 2018 - Vacancies Abound, More Hawkish Lean to Regional Presidents

2017		2018	
Board of Governors			
Yellen (Chair)	Centrist (3)	Powell (Chair)	Centrist (3)
Powell	Centrist (3)	Brainard	Dove (1)
Brainard	Dove (1)	Quarles	Centrist (3)
Quarles	Centrist (3)	Vacant	??
Vacant	??	Vacant	??
Vacant	??	Vacant	??
Vacant	??	Vacant	??
Average	2.5	Average	2.3
Regional Presidents			
Dudley (New York)	Centrist (3)	Dudley (New York)*	Centrist (3)
Evans (Chicago)	Dove (1)	Bostic (Atlanta)	Dove Lean (2.5)
Harker (Philadelphia)	Centrist (3)	Mester (Cleveland)	Hawk (5)
Kaplan (Dallas)	Centrist (3)	Williams (San Francisco)	Centrist (3)
Kashkari (Minneapolis)	Dove (1)	xxxx (Richmond)	??
Average	2.2	Average	3.4
Overall Composition	2.3	Overall Composition	2.9

*Yellen will resign once Powell is appointed. Dudley to resign by mid-2018

There will be 4 vacant seats to the Fed Board. Richmond has not yet appointed a new President

Source: Federal Reserve, Thompson Reuters, Business Insider, BNY Mellon