July 2019

OREGON STATE TREASURY

# Inside the Vault

## Local Government Edition

## Credit Market Review

In our last report, the market was still coping with the risks of higher policy rates from the Federal Reserve. Three months later, the market quickly moved to pricing in interest rate cuts, with expectations of a cumulative 75 basis points, or 0.75%, of cuts in the next 12 months. While one can ascribe many reasons to the shift in monetary policy, the main drivers are a weakened outlook for global growth combined with continued tame domestic inflation.

At the moment, the market appears to be priced for perfection. While the interest rate markets are pricing in a handful of interest rate cuts out of the Fed, stocks are at all-time highs and high-yield credit spreads remain well behaved. The market appears to be pricing in the elusive “soft-landing” out of the Fed. Only one such “soft-landing” has occurred in history—the mid-1990’s effort under Chairman Alan Greenspan. Back then, the Fed cut rates by 75bps in response to idiosyncratic risks (Long-Term Capital Management) and offshore financial pressure (Russian and Asian Financial crises). As market followers know, the economy responded well to the action of the Fed which prolonged the economic cycle and bull market.

Overseas developments continue to grab attention. Notably, foreign sovereign debt earning negative yields now totals approximately $18 trillion. For example, the 10-year German bund yields -0.31% while 10-year Japanese government bond yields -0.13%. Continued economic weakness, combined with extraordinary monetary policy, has created an investment environment that is hard to comprehend and one that has no

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## LGIP Investor Meeting

We look forward to connecting with our local government customers at next month’s LGIP Investor Meeting. The event will be held on Thursday, August 29, at The Grand Hotel at Bridgeport. Registration is full but you can still join the waitlist. If you have questions regarding the event, feel free to contact Angela Schaffers, in our investment division, at angela.schaffers@ost.state.or.us.

## Interest Rates

| Average Annualized Yield | |
|---|---|
| June | 2.75% |

| Interest Rates | |
|---|---|
| June 1–30 | 2.75% |

YEAR-END PERFORMANCE 2018

Invested for you

OREGON STATE TREASURY

Helping Oregon keep its promises to our public servants

OREGON STATE TREASURER TOBIAS READ

Every day I come to work, I'm focused on how my team can ensure that Oregon keeps its promise to our valuable public sector workers, by seeking strong and stable investment returns.

As our public servants have committed their careers to making Oregon stronger and safer, Oregon has made a commitment as well: a more secure retirement.

Treasury is working — and excelling — when it comes to investing the Oregon Public Employees Retirement Fund. This is your money — collectively there are about 367,000 beneficiaries, according to the PERS agency — and we are managing it for your sole and exclusive benefit.

At the end of 2018, the pension fund stood at $75 billion. And industry rankings show Oregon consistently beats its peers in terms of long-term investment performance.

The fund is paying benefits that average about $2,800 a month to retired workers who spent their entire careers teaching our children, providing essential social services, protecting our collective quality of life, and keeping our communities safer.

The long-term success of our investment program is paying dividends. An amazing 75 cents of every dollar in pension benefits come from investment performance. That's money that doesn't need to come from any other source.

I have had the privilege to serve as your Treasurer for the past two years, and I am proud of our team's continued efforts to drive the investment program ever more effectively and efficiently.

Last year, we revamped the structure of the Individual Account Program to better align age and risk exposure, which protected late-career workers from losses during the sharp drawdown in equity markets during 2018's fourth quarter. We also expanded our internal investment capacity, which has already resulted in millions in higher net returns. Finally, we recently initiated formal research efforts focused on the identification and management of Environmental, Social and Governance risks, which in turn will allow us to advance our portfolios' sustainability and resiliency.

At the same time, we are always looking to improve, and the Oregon Investment Council — on which I serve — is setting a high bar for principled and thoughtful leadership.

We are building for our future, and for yours. By investing for the long term and making smart decisions, we are protecting your retirement security while also meeting taxpayer expectations for good government.

As always, thanks for everything you do, for Oregon.

Oregon Public Employees Retirement Fund
75.0 billion
Dec. 31, 2018

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INVESTED FOR YOU | SPRING 2019 | 1

## *Invested for You*

Public employees work hard to serve their fellow Oregonians, and Treasury works hard to ensure that Oregon keeps it promise of a secure retirement for our valuable public employees by seeking strong and stable investment returns.

PERS members can stay informed about Treasury's investment program and fund performance—including Individual Account Program Target Date Funds—through our twice-yearly newsletter called *Invested for You*. The publication is aimed at beneficiaries of the funds we invest, notably the Oregon Public Employees Retirement Fund. If you are a PERS member, this fund is managed for your benefit!

Click here to read the current and past issues, and be sure to subscribe.

## MSRB EMMA Dataport Enhancements Webinar

The Municipal Securities Rulemaking Board (MSRB) will be enhancing the EMMA Dataport user interface. Improvements include seamless navigation between EMMA Dataport and all the features of the Electronic Municipal Market Access (EMMA®) website. The changes build upon the EMMA website usability and design improvements launched in April 2018.

An enhanced design for the EMMA Dataport landing page will continue to provide access to submission interfaces for primary market disclosures, political contribution disclosures, and other data and documents submitted to the MSRB. The continuing disclosure submission interface is being updated and will feature a new questions-and-answer wizard format, and integrated help and resources. There are no changes to the format of the other submission interfaces or to the data required to be submitted.

Register now to join the MSRB for a webinar to explore the enhancements to EMMA Dataport on Thursday, August 8, 2019, at 3:00 p.m. Eastern.

Updated submission manuals and educational resources will be made available on MSRB.org and distributed by e-mail in connection with the changes. If you have any questions, contact MSRB Support at 202.838.1330 or MSRBSupport@msrb.org.

## LGIP: Audit Confirmation Requests

Auditors needing confirmation of Local Government Investment Pool account balances must submit requests in writing to PFM Client Services. Requests must include or be accompanied by a release signed by a participant's authorized contact (the contact must be registered in the records of the pool and have permission to view/access pool account information). Requests/releases can be submitted through EON, faxed to 888.535.0120, or mailed to:

> Oregon LGIP
> PO Box 11760
> Harrisburg, PA 17108-1760

For help with submitting an audit confirmation request, contact PFM Client Services at 855.OST.LGIP.

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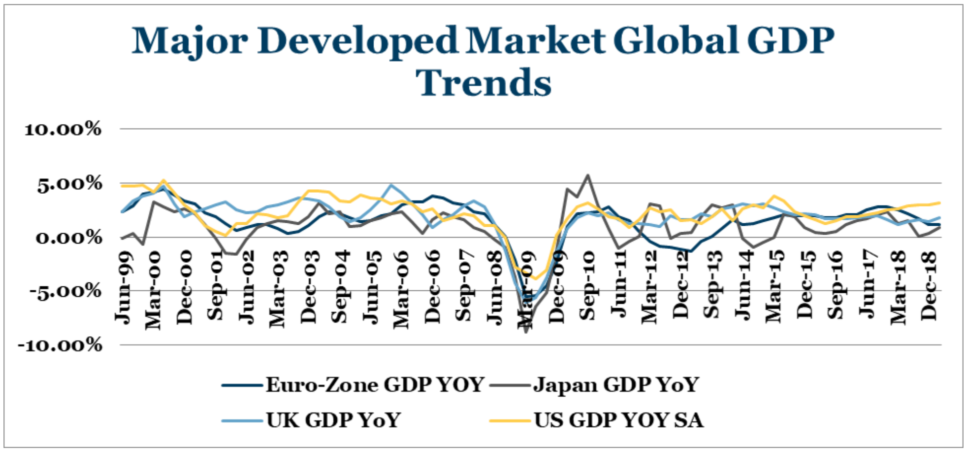
historic precedent. The investment backdrop is also occurring at a time of weakness as Europe continues to struggle with Brexit, Italian politics, and a drop in global trade activity while much of Asia faces slowing growth prospects as the U.S.-China trade conflict exacts its toll on the region.

Turning back to the U.S., economic data has been trending weaker but is still moving along in positive territory. Two weeks ago, the market priced a July Fed rate cut with 100% probability. June's non-farm payroll numbers came in strong with a 225,000 increase versus an expected 160,000 increase. The strong data triggered a re-pricing that shifted the probability of a cut to approximately 80%. All eyes are now on the Fed as we near their decision that is due out on July 31.


U.S. GDP growth continues to trend upward with above expectations numbers stemming from the fiscal spending and tax cuts. The consensus is building for a slowdown in early 2020 as the impacts of the stimulus tapers off and global malaise translates into lower capital spending as business confidence fades. Growth in recent quarters came from boosts in inventories and trade, which are typically reversed as levels rebalance. Moreover, consumer and corporate debt levels continue to pile up. Even with a drop in rates, there are significant questions about the demand for credit.




The U.S. economy continues to exceed other developed markets, albeit the gap is narrowing as Japan and the U.K. show some life. The Eurozone continues to trend downward, as problems persist from poor conditions in the Mediterranean states, Brexit inconclusiveness, and structural issues with major continental banks.

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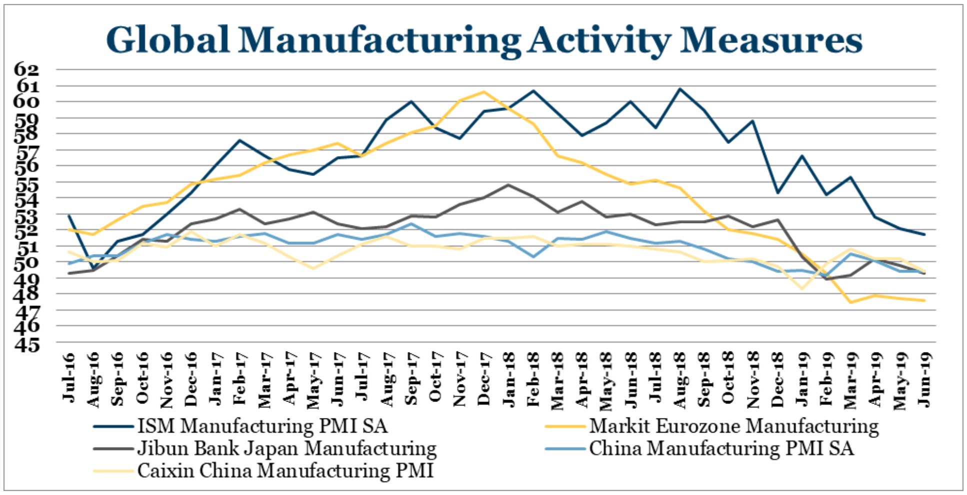
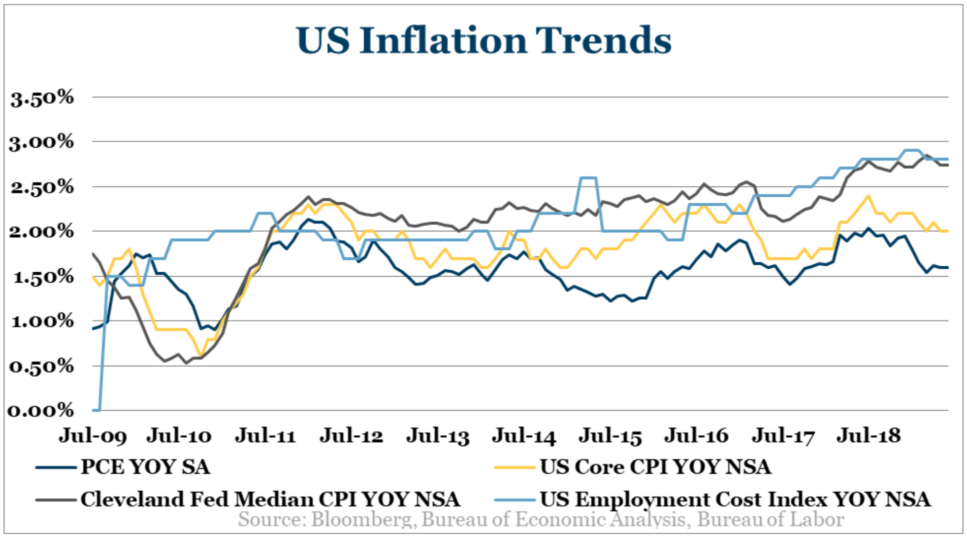
Europe's strong trade ties with China (and greater East Asia) are weighing on industrial production and exports.




The U.S. PMI is the only major index over 50, meaning expansionary, but is trending downward as growth cools. Meanwhile, the Asian and Eurozone indicators are printing under 50, representing a contraction in output. The collapse in the Eurozone highlights the continent's reliance on high-end exports to East Asia, where demand is plummeting. China's slowdown in manufacturing activity since 2015 is particularly bothersome, given the intensity of the stimulus four years ago and current efforts by Beijing to reignite the export growth machine in order to keep growth up at China's lofty 6.5% target.




The Fed's preferred broad inflation index, personal consumption expenditures or PCE, remains well below the unofficial target of 2%. The more traditional core CPI (the consumer price index less food and energy) posted 2% last month but remains on a downward trend. The trend in prices, as with manufacturing, is the major concern for policy rather than the absolute level. Employment costs (light blue line) remain elevated, highlighting the breakdown in the wage-prices relationship an economy usually experiences when operating at a low unemployment rate for a number of years.

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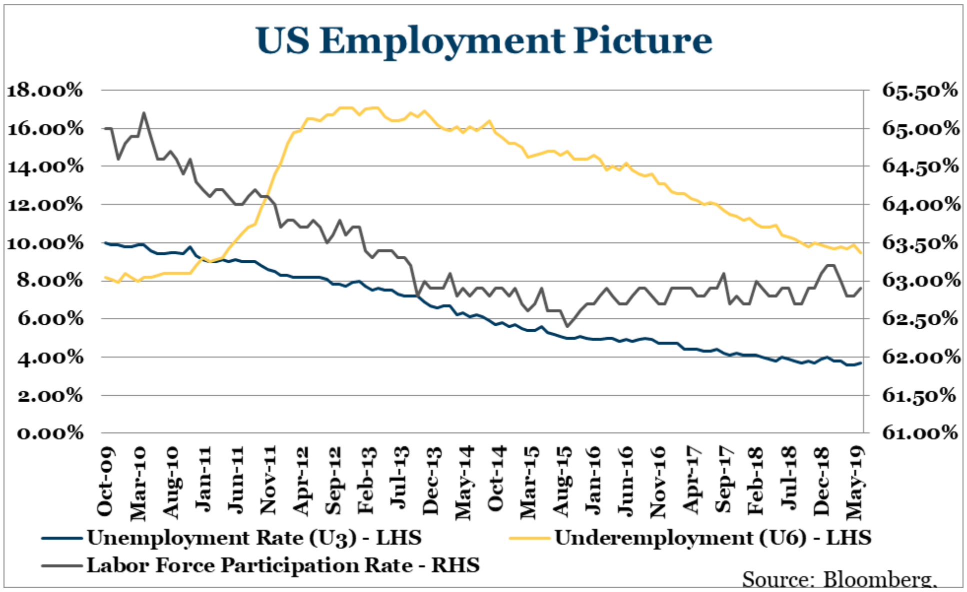
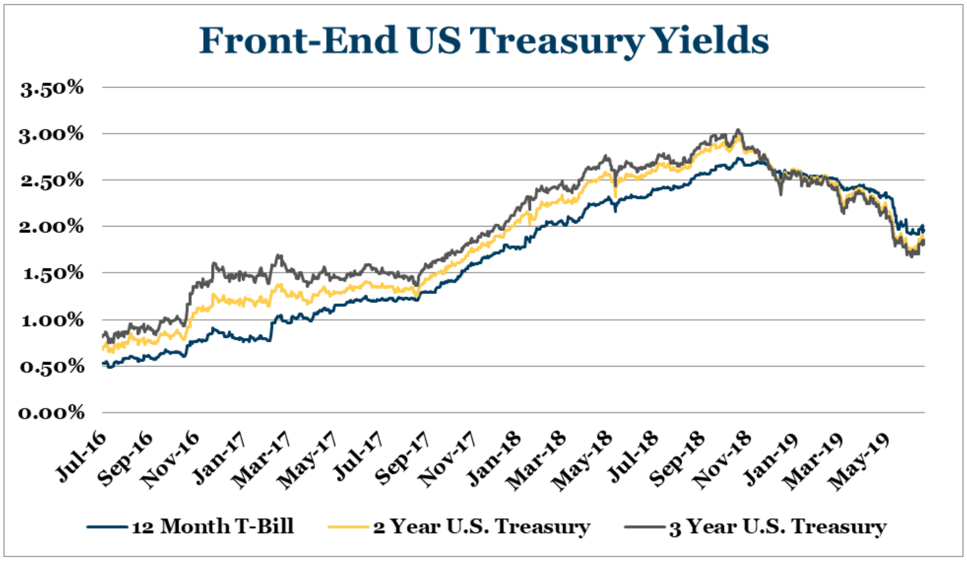



The sharp decline in unemployment to 3.7% alone is a remarkable feat for the U.S. labor force. But far more compelling is the steep drop off in underemployment. However, participation rates at 63% remains a sore spot for the overall picture of the American worker, and a potential cause for the breakdown between wages and prices.



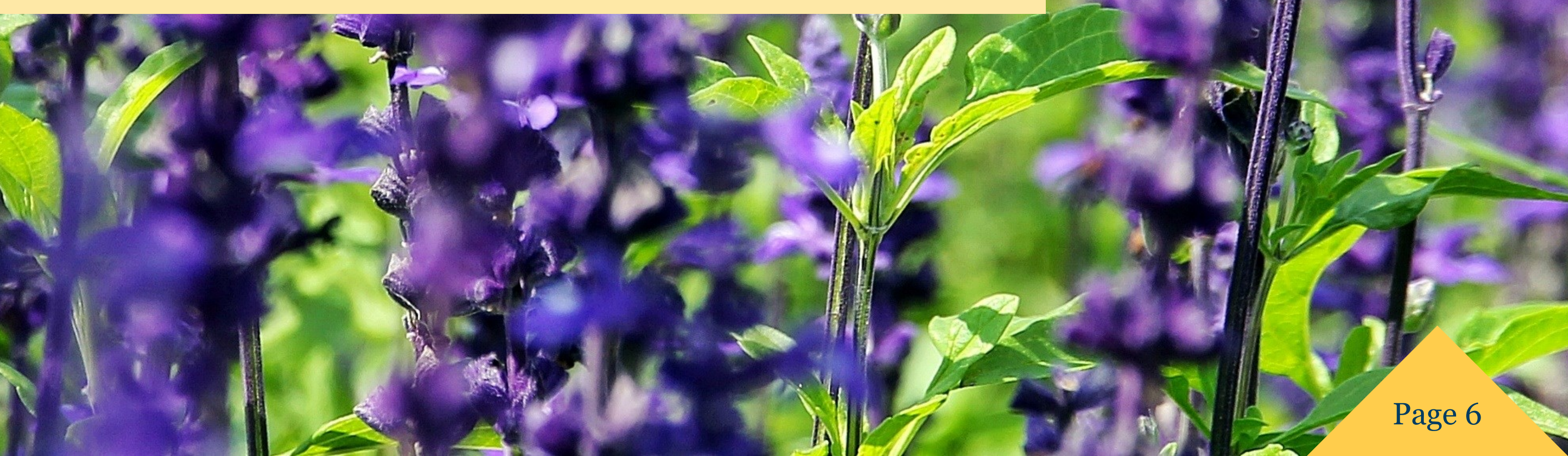

The front-end of the yield curve remains inverted with 12-month bills trading higher in yield than 2-year and 3-year bonds. Focus will be on the July 31 Federal Open Market Committee meeting to see how the Fed guides markets going forward. If the Fed fails to deliver the markets that they want, a re-pricing may be in store.

## SB 1049: New Pension Obligation Bond Reporting Requirements

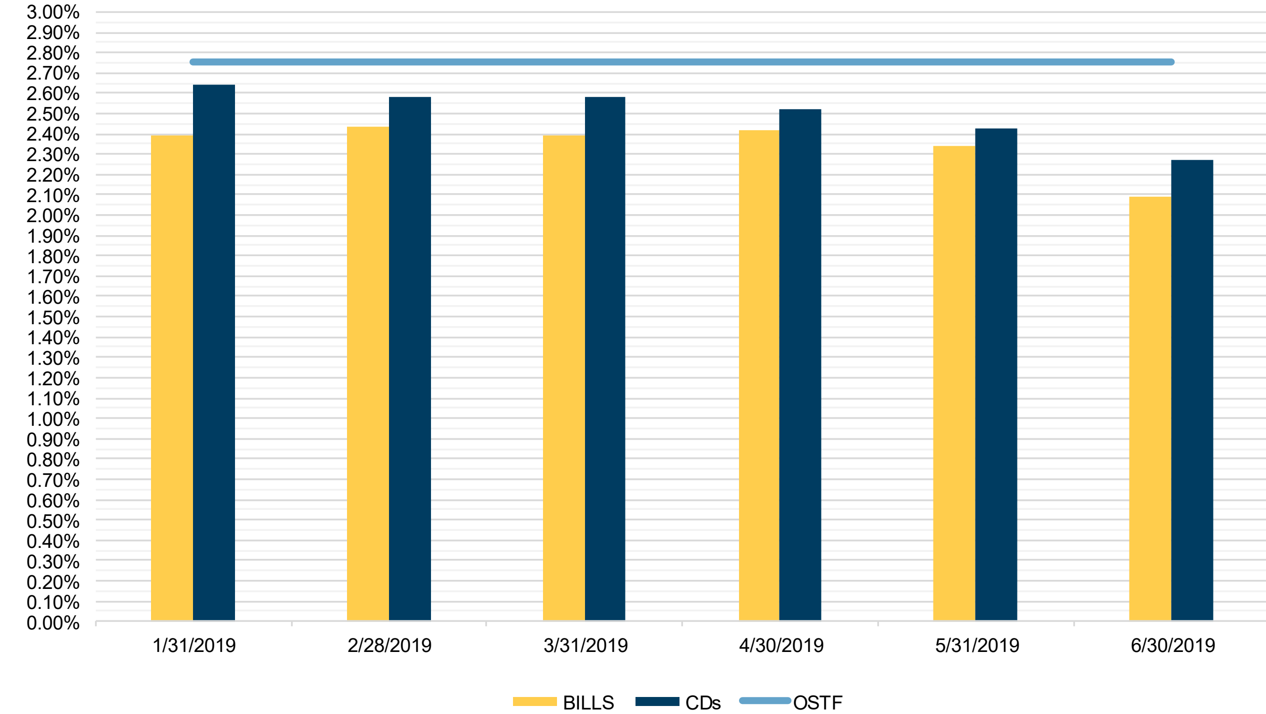
The Governor has signed Senate Bill 1049 (2019), effective immediately under emergency declaration. The bill amends multiple provisions relating to public employee retirement. Public employers should review the bill and consider its impacts. Treasury's Debt Management Division, as staff to the Municipal Debt Advisory Commission, is making process changes and administrative rule amendments in conformance with section 23 (2) and (3).

The legislative summary recaps the bill's amendments regarding pension obligation bonds (sections 22 through 26) as: "The measure requires a public body or intergovernmental entity, prior to issuing pension obligation bonds, to obtain a statistically based assessment from an independent economic or financial consulting firm. The assessment would need to determine the likelihood that investment returns on bond proceeds would exceed the interest cost of the bonds under various market conditions. Upon receipt of the assessment, the public body or intergovernmental entity would need to make the results available to the public and disclose whether it is retained the services of an independent SEC-registered advisor. The public body or intergovernmental agency would be required to submit the assessment to the State Treasurer at least 30 days before issuing the bonds. The State Treasurer would need to provide an annual report on local entities' pension obligation bonds issued to the State Debt Policy Advisory Commission. The measure also limits diversion agreements to no more than 100% of an entity's State School Fund distribution."

In the near future, Treasury will initiate temporary—and subsequent permanent—rulemaking amending OAR 170-061-0000 to incorporate Treasury's oversight responsibilities for the new pension obligation bond requirements. To be added to the list of interested parties for this rulemaking, contact Debt Management at 503.378.4930 or DMD@ost.state.or.us.



# Oregon Short Term Fund Analysis




| | 1/31/2019 | 2/28/2019 | 3/31/2019 | 4/30/2019 | 5/31/2019 | 6/30/2019 |
|---|---|---|---|---|---|---|
| LGIP AV DOLLARS INVESTED (MM) | 9,236 | 9,016 | 8,969 | 8,902 | 9,001 | 7,828 |
| STATE AGENCY AV DOLLARS INVESTED (MM) | 10,844 | 10,922 | 10,833 | 12,229 | 12,782 | 13,024 |
| TOTAL OSTF AV DOLLARS INVESTED (MM) | 20,080 | 19,938 | 19,802 | 21,131 | 21,783 | 20,852 |
| OST ANNUAL YIELD (ACT/ACT) | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 | 2.75 |
| 3-MO UST BILLS (BOND EQ YLD) | 2.39 | 2.44 | 2.39 | 2.42 | 2.34 | 2.09 |
| 3-MO US CD (ACT/360)* | 2.64 | 2.58 | 2.58 | 2.52 | 2.43 | 2.27 |

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to account holders during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from month end. 3-MO US CD rates are obtained from Bloomberg and represent a composite of broker dealer quotes on highly rated (A1+/P1/F1+ from Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings respectivley) bank certificates of deposit and are quoted on a CD equivalent yield basis.

**This material is available in alternative format and media upon request.**

# Market Data Table

| | 7/12/2019 | 1 Month | 3 Months | 12 Months | | 7/12/2019 | 1 Month | 3 Months | 12 Months |
|---|---|---|---|---|---|---|---|---|---|
| 7-Day Agency Discount Note** | 2.12 | 2.21 | 2.31 | 1.79 | Bloomberg Barclays 1-3 Year Corporate YTW* | 2.39 | 2.49 | 2.82 | 3.13 |
| 30-Day Agy Nt Disc** | 2.13 | 2.20 | 2.35 | 1.84 | Bloomberg Barclays 1-3 Year Corporate OAS* | 0.57 | 0.65 | 0.53 | 0.63 |
| 90-Day Agy Nt Disc** | 2.08 | 2.18 | 2.38 | 1.92 | Bloomberg Barclays 1-3 Year Corporate Modified Duration* | 1.90 | 1.91 | 1.92 | 1.96 |
| 180-Day Agy Nt Disc** | 1.94 | 2.07 | 2.37 | 2.00 | | | | | |
| 360-Day Agy Nt Disc** | 1.92 | 1.99 | 2.31 | 2.17 | 7-Day Muni VRDN Yield** | 1.18 | 1.71 | 1.54 | 1.01 |
| | | | | | O/N GGC Repo Yield** | 2.53 | 2.43 | 2.48 | 1.88 |
| 30-Day Treasury Bill** | 1.98 | 2.06 | 2.32 | 1.84 | | | | | |
| 60-Day Treasury Bill** | 2.08 | 2.14 | 2.35 | 1.87 | US 1 Year Inflation Break-Even** | 0.64 | 0.80 | 4.53 | 1.27 |
| 90-Day Treasury Bill** | 2.07 | 2.15 | 2.37 | 1.92 | US 2 Year Inflation Break-Even** | 1.24 | 1.22 | 1.85 | 1.79 |
| 6-Month Treasury Yield** | 2.07 | 2.20 | 2.45 | 2.14 | US 3 Year Inflation Break-Even** | 1.43 | 1.37 | 1.82 | 1.93 |
| 1-Year Treasury Yield** | 1.96 | 2.02 | 2.41 | 2.33 | | | | | |
| 2-Year Treasury Yield** | 1.84 | 1.88 | 2.36 | 2.58 | 1-Day CP (A1/P1)** | 2.35 | 2.34 | 2.40 | 1.89 |
| 3-Year Treasury Yield** | 1.82 | 1.82 | 2.31 | 2.68 | 7-Day CP (A1/P1)** | 2.35 | 2.35 | 2.41 | 1.92 |
| | | | | | 30-Day CP (A1/P1)** | 2.35 | 2.39 | 2.47 | 2.02 |
| 1-Month LIBOR** | 2.33 | 2.40 | 2.47 | 2.07 | | | | | |
| 3-Month LIBOR** | 2.30 | 2.43 | 2.60 | 2.34 | 30-Day CD (A1/P1)** | 2.35 | 2.42 | 2.47 | 2.05 |
| 6-Month LIBOR** | 2.21 | 2.34 | 2.63 | 2.51 | 90-Day CD (A1/P1)** | 2.29 | 2.42 | 2.57 | 2.24 |
| 12-Month LIBOR** | 2.19 | 2.33 | 2.73 | 2.78 | 6-Month CD (A1/P1)** | 2.21 | 2.34 | 2.60 | 2.43 |
| Sources: *Bloomberg Index Services, **Bloomberg | | | | | 1-Year CD (A1/P1)** | 2.22 | 2.38 | 2.82 | 2.66 |

**Director of Finance**
Cora Parker
503.378.4633

**Local Government Investment Pool**
oregon.gov/lgip

**Deputy Director of Finance**
Mike Auman
503.378.2752

**PFM Client Services**
855.OST.LGIP
cswestregion@pfm.com

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**Treasury**
800.452.0345
lgip@ost.state.or.us

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**Newsletter Questions**
Kari McCaw
503.378.4633

Bryan Cruz González
503.378.3496

**Local-Gov-News Mailing List**
listsmart.osl.state.or.us/mailman/listinfo/local-gov-news

**Oregon Short Term Fund Staff**
503.431.7900

**OREGON STATE TREASURY**
350 Winter Street NE, Suite 100 ▸▸ Salem, OR 97301-3896
oregon.gov/treasury