

# Eastern UP SBO

## Public Act 20: Investment Income

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*PFM Asset Management LLC*

**NOT FDIC INSURED : NO BANK GUARANTEE : MAY LOSE VALUE**

# Where Are We Going Today?

- ◆ Public Act 20 – Breakdown
- ◆ Investment Opportunities



## Investment Program for Public Funds

Governments have a *fiduciary responsibility* in managing their funds, including the ongoing management and monitoring of investment activity. A government's investment program should derive from the entity's Investment Policy.

Developing a public funds investment program is essential to effective financial management, and it sets the foundation for creating protocols and internal controls, constructing and managing the portfolio, navigating changing economic conditions, and communicating information to stakeholders. While different types and sizes of governments require differing levels of complexity in their investment programs, all governments need to recognize their fiduciary responsibility. Having an established public funds investment program provides the structure to effectively set policy, make decisions, and *safeguard* a government's financial assets.

Reference: Government Finance Officer Association Best Practices: [gfoa.org/materials/investment-program-for-public-funds](https://gfoa.org/materials/investment-program-for-public-funds)

# Cash Management & Investment Objectives

## ❖ Safety

Protect principal

High quality investments

## ❖ Liquidity

Provide necessary liquidity to cover both ongoing and unexpected cash needs

Cash flow analysis

## ❖ Return

Provide necessary recognizing need for safety and liquidity, and subject to restrictions specified by the state statutes and the local governing body

## ❖ Compliance with legal restrictions / regulations

## ❖ Accountability and Transparency

## ❖ Stability (Limited Volatility)

## ❖ Simplicity



# Public Act 20 - Breakdown



## ◆ Investment of Surplus Funds of Political Subdivisions (Excerpt) Act 20 of 1943

- Section 129.91: Helps define the box that Treasurers are allowed to invest in
- Section 129.95: Requires the approval of an investment policy and minimum requirements
- Section 129.96: Requires brokers to receive a copy of the investment policy and sign an agreement to comply with the policy     AND
- Requires quarterly reporting to the governing body (*note: does not stipulate what exactly to include in the report*)

# Investment Basics

- ◆ Investment Policy is a reflection of your risk parameters and controls
- ◆ Control Risks – Credit Risk, Interest Rate Risk, Market Risk
- ◆ Understanding your cash flows before investing
  - Historical analysis is helpful, but projections are key
  - Depending on the size of the portfolio, may want to segment into Short / Long Term
- ◆ Historically, yield curve provides higher earnings longer-term
  - Avoid timing market (need to get it right 2x – in and out); consistent investing
  - Long-term investing provides highest likelihood of higher returns
  - The longer you invest, the greater the volatility (unrealized gains / losses)
- ◆ Measure and Report
  - Measure your earnings / total return (considers earnings and market movements)
  - Report results against a market benchmark (i.e., 1 – 3 Year Treasury) on a quarterly basis

# Allowable Bank Accounts and FDIC Coverage

- ◆ P.A. 20 allows for deposits into checking, NOW, savings, money market, CD's, and CDARS



<b>Bank Account Type</b>	<b>In State</b> <i>(bank is located in the same state as the public entity)</i>	<b>Out of State</b> <i>(bank is located outside of the state of the public entity)</i>
<b>Demand Deposit</b> <i>Including NIBTA and Interest Bearing Transaction Account</i>	\$250,000	Not separated
<b>Time &amp; Savings</b> <i>Including Negotiable Order of Withdrawal (NOW) and Money Market accounts</i>	\$250,000	Not separated
<b>Total</b>	\$500,000	\$250,000

*Note: public entities are not allowed to invest in banks that do not have a physical place of deposit in the state of Michigan*



# P.A. 20 Allowable Investments

Sector	Maximum Maturity	Minimum Credit
U.S. Treasuries	No Limit	N/A
Federal Agencies	No Limit	N/A
Obligations of the State of Michigan	No Limit	Rated investment grade by at least one rating service
Commercial Paper	270 days	(A-1, A-2 / P-1, P-2) Rated in the two highest classifications by not less than two standard rating services
Certificates of Deposit (including CDAR's)	No Limit	N/A
Repurchase Agreements*	No Limit	N/A
Bankers' Acceptances	No Limit	N/A
Mutual Funds**	No Limit	N/A
Investment Pools**	No Limit	N/A

\* Agreements must be collateralized with bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.

\*\* Mutual funds and investment pools must be composed entirely of investment vehicles that are legal for direct investment by a public corporation.

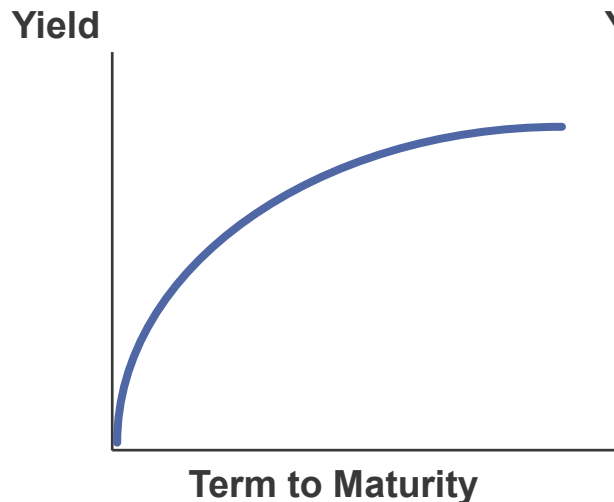
# Investment Opportunities



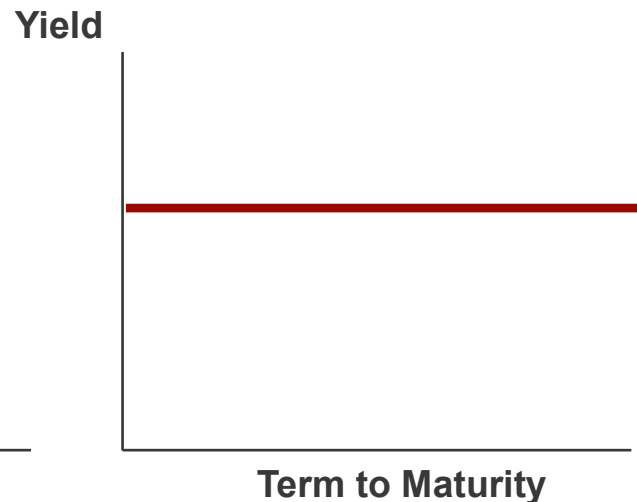
# What Is A Yield Curve?

- ▶ A line that plots interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates
- ▶ Rates at the short end of the curve (under 1 year) are directly correlated to the Fed Funds rate established by the Federal Open Market Committee (“FOMC”); the longer end of the curve typically reflects investor expectations
- ▶ There are three types of curves: normal/positive, inverted, and flat

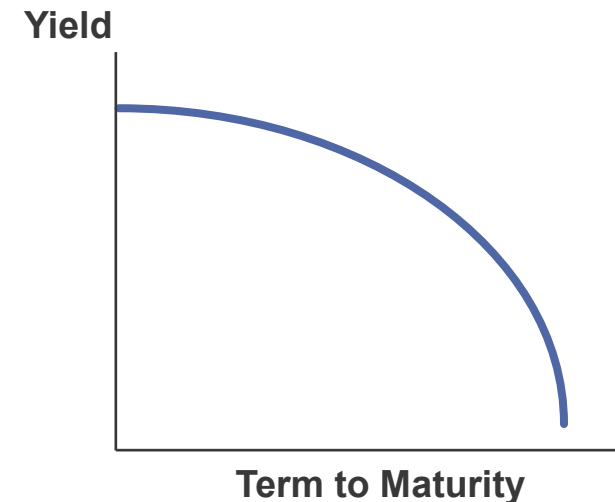
**Upwardly Sloped**  
(Normal)



**Flat**

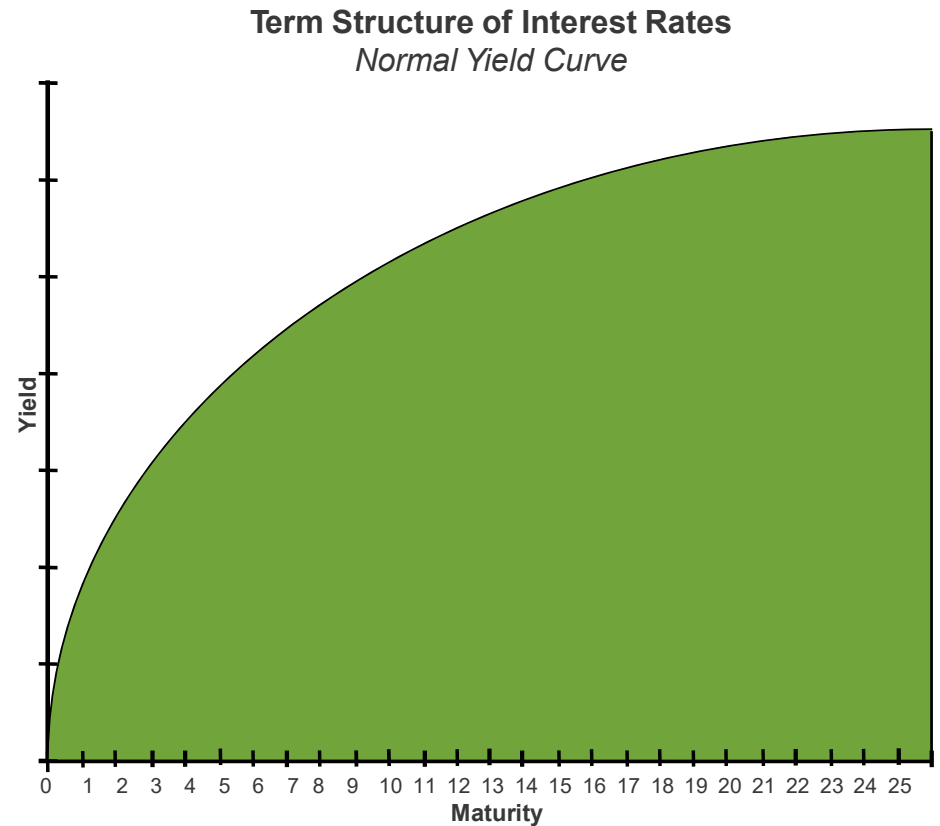


**Inverted**



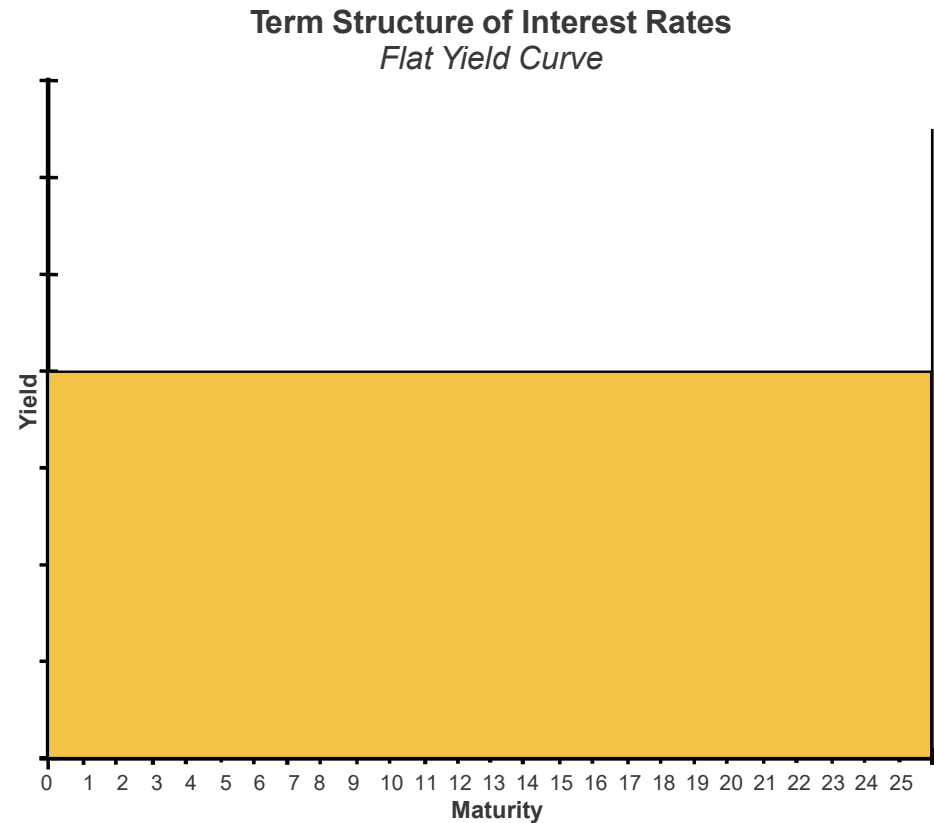
# A Normal Yield Curve

- ▶ Forms during market conditions where investors generally believe that there will be no significant changes to the economy
- ▶ Longer-term instruments offer higher yields than shorter-term instruments



# A Flat Yield Curve

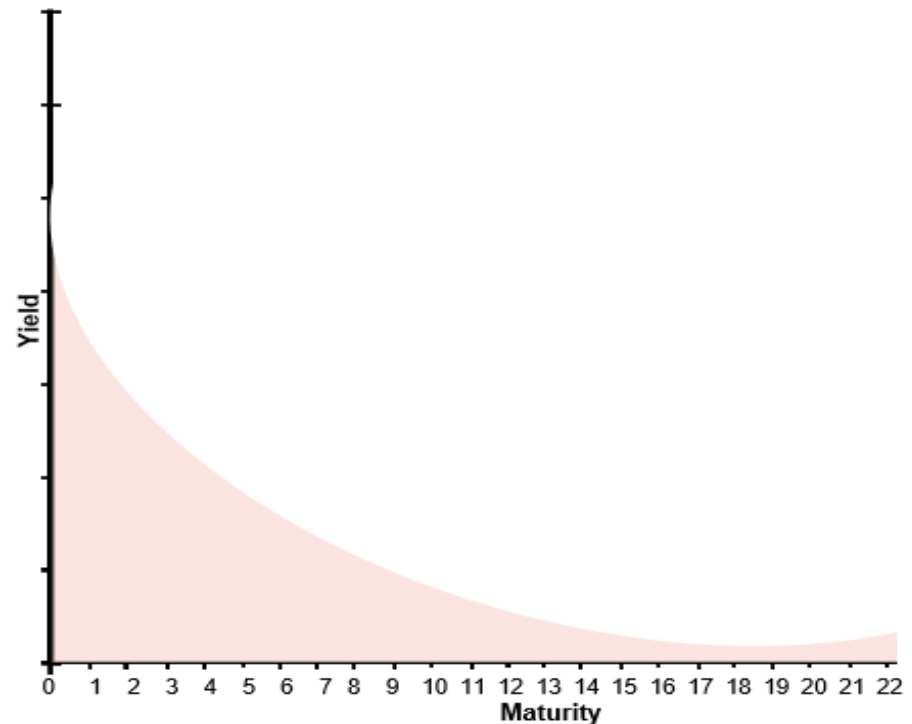
- ▶ Indicates that the market is sending mixed signals to investors
- ▶ There may be **some** signs that short-term interest rates will rise and others that long-term interest rates will fall



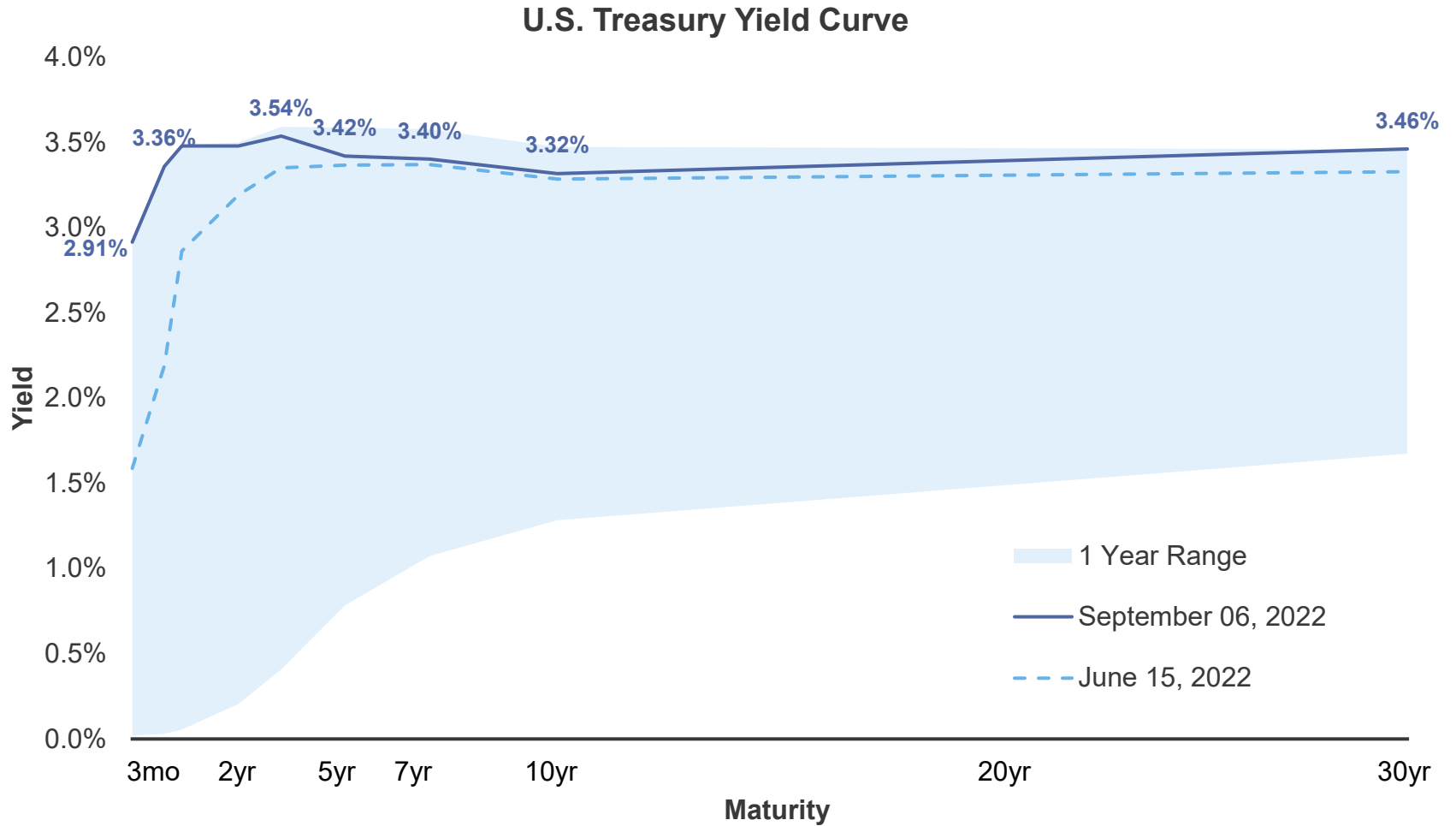
# An Inverted Yield Curve

- ▶ Forms during market conditions where investor expectations are completely inverse to those demonstrated by a normal yield curve
- ▶ Investors assume long-term rates will decline, likely driven by expectations of a slow-down in economic growth
- ▶ Historically, certain types of yield curve inversions have signaled a pending economic slowdown

**Term Structure of Interest Rates**  
*Inverted Yield Curve*



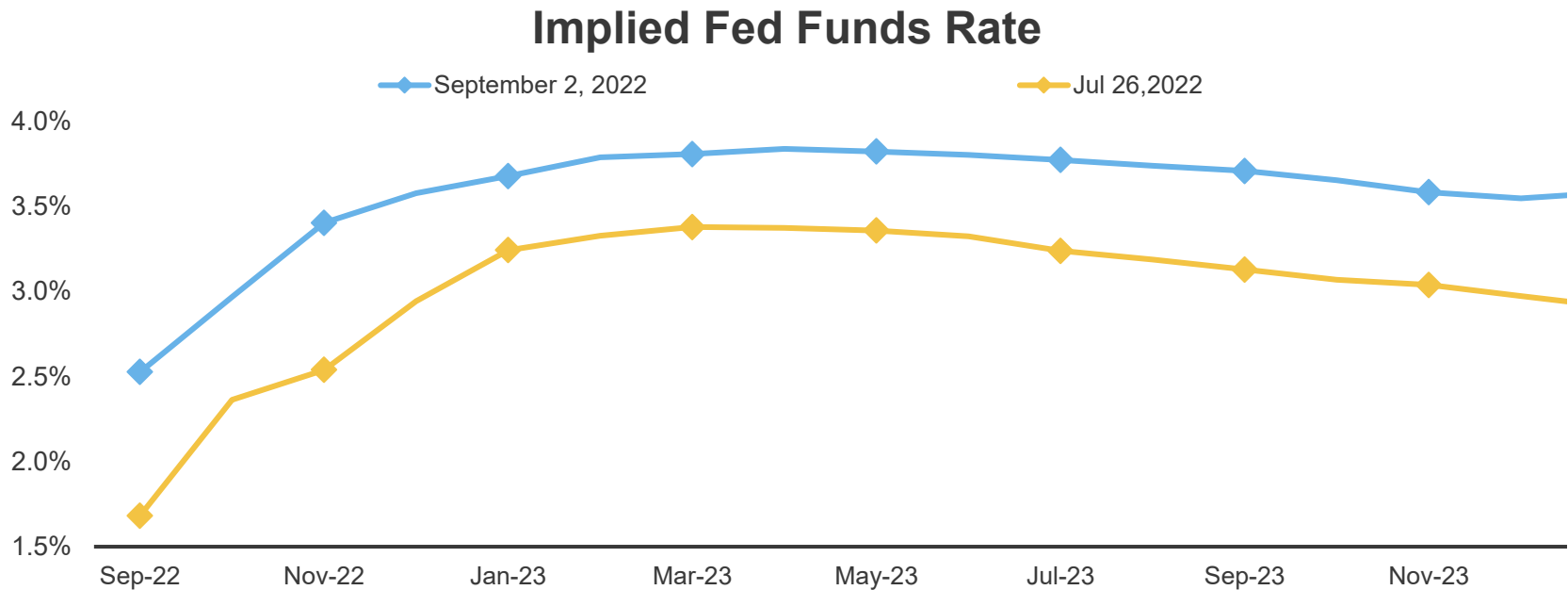
# Treasury Yield Curve Remains Inverted



Source: Bloomberg, as of 09/06/2022.

# Hawkish Fed Drives Yields Higher

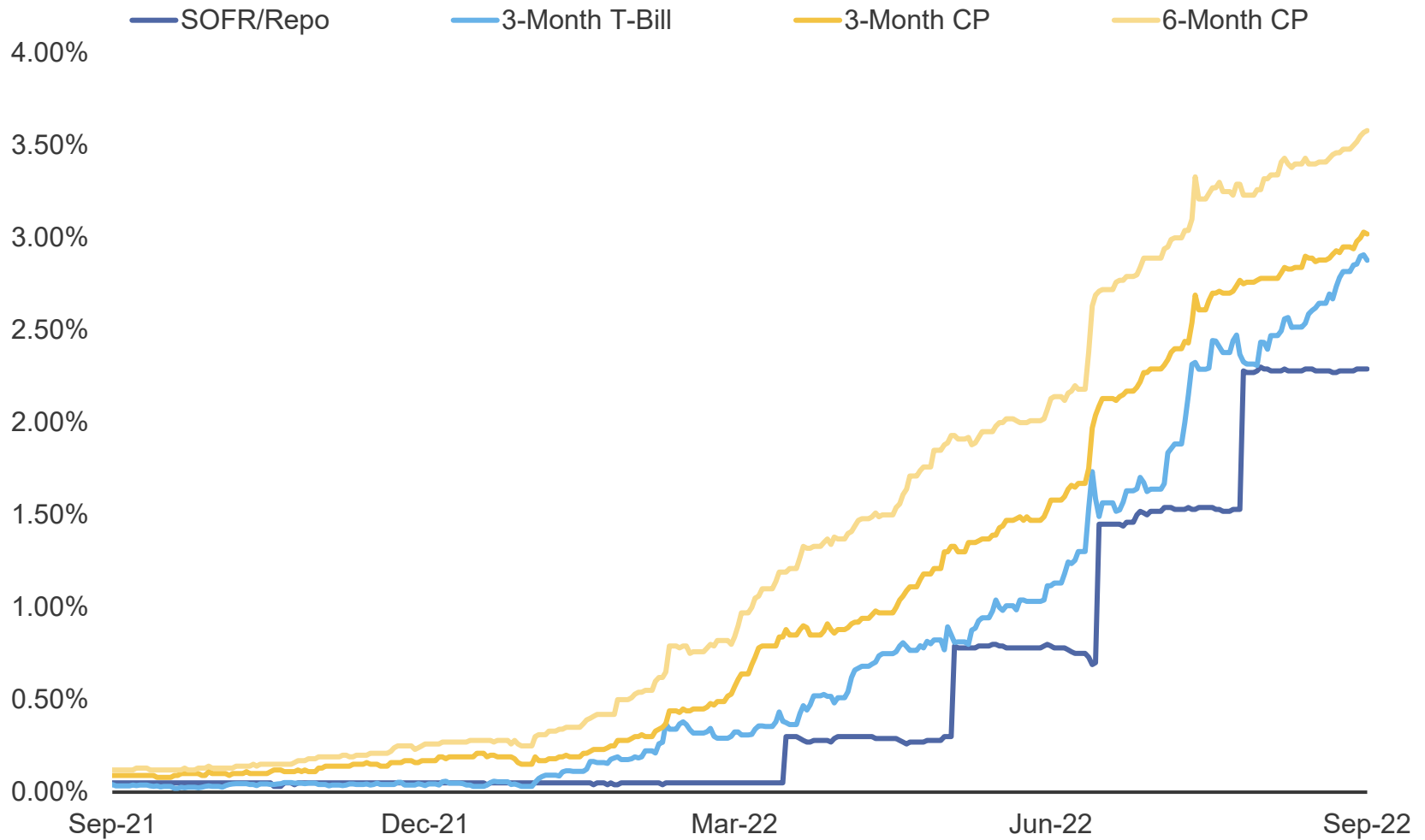
- ▶ The Fed was front and center this past week as the meeting in Jackson Hole led to hawkish headlines of a Fed that is resolved to do what is necessary to bring down inflation; continued rate hikes and an extended timeline for the tightening cycle have translated to rising yields across the curve, and the anticipated increase in the total number of Fed hikes has driven up short-term yields with the expectation of more stubborn inflation figures affecting longer rates
- ▶ A modestly short duration bias cognizant of FOMC meeting dates is recommended, but one should also view maturities 12-months and under favorably given the rapid move in rates across the 3.00% level, especially when maturities are structured in a rolling fashion



Source: Bloomberg, as of 9/2/2022.



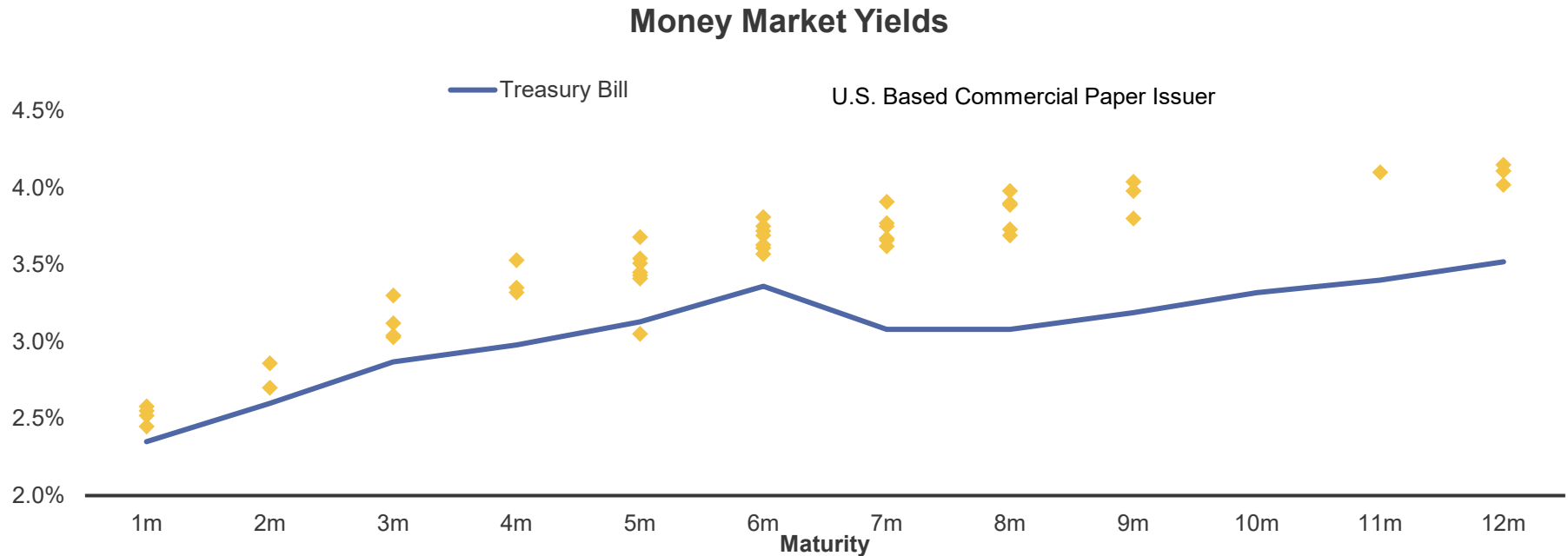
# Short-Term Rates Price in Further Fed Rate Hikes



Source: Bloomberg, as of 9/2/2022.

# Repricing of Front-End Curve Has Created Some Opportunities

- ▶ CP / CD spreads have slightly compressed as the front-end of the U.S. Treasury curve reprices from expectations that the Fed will continue to be aggressive, and the market catches up to the increased probability of a 75-basis point hike at the next FOMC meeting in September; shorter maturities offer attractive value, while longer maturities should be evaluated on a break-even basis to lock in wider spreads
- ▶ Increased volatility in rates has led to a repricing of the Treasury curve, as demand continues to remain strong and any back-up in yields has been fairly limited as a result; sourcing opportunities in the T-Bill Auction and When Issued market is recommended



Sources: PFMAM Trading Desk, as of 9/2/2022. Yields are for indicative purposes only; actual yields may vary by issue.

# Local Government Investment Pools

## Definition

- ◆ Local Government Investment Pools (LGIPs) are cooperative investment products for the investment of short-term funds.
- ◆ LGIPs are managed like money market mutual funds with a goal of a stable net asset value (NAV) of \$1 per share.

## Goals

- ◆ Safety of principal
- ◆ Liquidity to provide for upcoming needs
- ◆ A Competitive Yield

**Should comply with Government Accounting Standards Board (GASB) Rules  
and  
Recommendations from the Government Finance Officers Association (GFOA)**

## **GASB-79 Benefits**

During times of economic or financial crisis, citizens depend on the efficient functioning of their respective government services. For government finance officials, one of the last things they want to worry about is the safety and liquidity of public funds invested in a local government investment pool (LGIP). In particular, they expect funds invested in a stable value LGIP to be safe and liquid. The good news is that Governmental Accounting Standards Board (GASB) Statement 79<sup>1</sup> became effective in 2015. GASB 79 incorporates robust guidance and accounting standards for an LGIP. An LGIP that follows GASB 79 may elect to use amortized cost in financial reporting if it follows all of the criteria listed below (note that this is a summary, and that each of these criteria has a large amount of detail):

# GASB-79 Requirements – for LGIPs

All securities in the portfolio must have a maturity of 397 days or less. The weighted average maturity must be 60 days or less and the weighted average life must be 120 days or less. This is designed to protect a portfolio against market volatility that could move the underlying value of portfolio securities away from their amortized cost.

The portfolio must hold at least 10% of its assets in daily liquid assets and 30% in weekly liquid assets. This follows Securities and Exchange Commission requirements for registered money market mutual funds and is aimed at providing minimum daily and weekly liquidity under adverse market conditions.

The portfolio would hold no more than 5% of its total assets from a single issuer. U.S. government securities are exempt from this requirement.

Securities must be rated in the highest category of short-term ratings.

The investments in the portfolio should be priced using the fair value method on a monthly basis. The shadow price should not deviate by more than one half of 1 percent from the net asset value per share compared to the value of investments at amortized cost.

# Investment Management Program

## Overnight Liquidity

**GOAL:** meet daily operating expenses

**Key Components:**

- Safety and 100% liquidity
- Low cost banking relationship
- Online banking
- Transaction functionality
- ACH/Wire capability
- Daily fund balances and monthly statements

**Proposed Investment Strategy:**

- Bank deposits
- LGIP
- Money market funds

## Liquidity Surplus

**GOAL:** match assets to future liabilities

**Key Components:**

- Safety and liquidity
- Understanding of known cash flow dates
- Ladder investments with maturities aligned to known future payment dates
- Enhance earnings potential

**Typical Investment Types:**

- LGIP TERM
- Treasury Bills/Notes
- Federal Agency Securities
- Certificates of Deposit

## Core Reserves

**GOAL:** actively manage reserve fund to provide long-term growth

**Key Components:**

- Safety, liquidity, and return
- Prudent reserve balance should not be anticipated to withdrawn on for at least 1-5 years
- Total return strategy
- Understanding of historical cash needs and month-end balances

**Typical Investment Types:**

- Treasury Notes
- GNMA MBS
- Agency Notes
- Corporate Securities

## Liquid Seven Day Yields As of Oct 11, 2022 Current Seven-Day Yield

MILAF+Cash Management Class 2.91%

MILAF+MAX Class 3.07%



## MILAF Term Yields As of Oct 12, 2022

### Yield

60 Days Dec 11, 2022 3.42%

90 Days Jan 10, 2023 3.97%

120 Days Feb 09, 2023 4.12%

150 Days Mar 11, 2023 4.27%

180 Days Apr 10, 2023 4.37%

210 Days May 10, 2023 4.42%

240 Days Jun 09, 2023 4.57%

270 Days Jul 09, 2023 4.62%

300 Days Aug 08, 2023 4.15%

330 Days Sep 07, 2023 4.34%

365 Days Oct 12, 2023 4.37%



# Questions?

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