

SAN MATEO COUNTY
INVESTMENT ADVISORY COMMITTEE

MINUTES

April 19, 2010

MEMBERS IN ATTENDANCE

Larry J. Shaw (Vice President UBS/PaineWebber) **Chairman**
Reyna Farrales (Deputy County Manager- Alternate)
Margie Gustafson (Administrator, County Office of Education)
John Marty (Treasurer, City of San Bruno)
Patricia Reavey (Transportation Authority)

MEMBERS ABSENT

Marc J. Friedman (Member, Board of Trustees, Burlingame School District)
Jim Saco (Assistant Budget Director, County Manager's Office)
Linda Serdahl (Finance Manager, Bay Area Air Management District - Alternate)
Anthony J. Zidich (Treasurer, City of Daly City)

OTHERS IN ATTENDANCE

Charles M. Tovstein (Assistant Treasurer)
Joe Demeo (Financial Services Manager)
Sandie Arnott (Deputy Treasurer-Tax Collector/Acting Assistant Tax Collector)
Joe Galligan (Certified Public Accountant)
Peter Struck (Ph.D,CMB)
Lawrence Pon (Certified Public Accountant)
Nilita Meitz (Executive Assistant, Treasurer's Office)

Mr. Shaw opened the meeting at 12:09 p.m. and welcomed both guests and committee members to the meeting. Members and guests were asked to introduce themselves.

MINUTES

Minutes of the January 25, 2010 meeting were approved as submitted.

REPORT BY CHARLES TOVSTEIN

Mr. Tovstein began his report with the pool's gross earnings of 1.01% for the month of March, and 1.01% for the quarter ended March 31, 2010. When compared to LAIF (Local Agency Investment Fund), the County's pool is, in Mr. Tovstein's opinion, more liquid, more transparent, and generally considered higher quality. The pool continues not to have any funds invested in LAIF and the spread between the County pool and LAIF is approximately 40 to 50 basis points for the quarter. **Mr. Tovstein** turned the committee's attention to the cashflow report and mentioned being extremely liquid, and having excess cash available in the coming months. He spoke briefly of State funds and the impending budget crisis. He is being very conservative in cashflow estimation and will continue to exclude State funding to a separate line in the projected cashflow report. **Mr. Demeo** also noted that the cashflow report does not include overnight investments which, as of that day, were approximately 500 million. A short discussion ensued regarding the State's budget position, and whether or not the State will withhold or delay funds due to local municipalities. **Mr. Tovstein** then asked the members to follow along as he reviewed pages in the monthly investment report. He touched upon the Diversification Report indicating corporate securities, which are non-government guaranteed holdings that operate under the 5% maximum rule of the proposed investment policy. He noted TLGP paper is FDIC guaranteed and does not count under the 5% rule. He also noted "AAA" rated paper is extremely hard to find. He

pointed out that both Berkshire Hathaway and General Electric were recently downgraded from “AAA” rating and that the majority of corporate paper in the pool is rated “AA” or better. Morgan Stanley, Oracle and Suntrust Bank are the only “A” rated paper currently in the pool. He turned to the Distribution by Maturity report that showed the pool having extremely high levels of liquidity and ended his review with the Distribution by Moody Rating report, which is in compliance with the investment policy.

As for his outlook, **Mr. Tovstein** predicts moderate inflation at best, and does not believe the economy is currently strong enough for the Feds to immediately raise rates. The economy is slowing grinding forward and he anticipates rates should begin to increase sometime in the 4th Qtr, possibly as early as November. However, he mentioned politics and specifically the November elections will certainly play a part in any decision the Fed makes.

Mr. Tovstein reported receiving numerous solicitations from distressed buyers wanting to purchase the County’s Lehman securities. To date, the value of the Lehman securities is \$34–\$36 million. He went on to mention that Anna Eshoo, Jackie Speier, Mary McMillan and John Beiers will all be in Washington D.C. on Tuesday, April 20th, to attend a hearing before the House Financial Services Committee. **Mr. Tovstein** commended Mary McMillan for her hard work and spoke of the plan to push for a new direction to keep the County’s loss separate from TARP funds and Distressed Assets. He reported firms making an enormous amount of profit, like Citicorp Bank, by being providing TARP money. Hence, the government is actually making money by bailing out these firms. The intent, of the County’s representatives, is to perhaps have the government purchase the County’s bond portion out of their profits and forget the bankruptcy. He noted that although he feels the end is close at hand, did remind the committee that this is strictly a proposal and nothing more at this juncture. Following a short discussion on the House Financial Hearings, several interesting articles regarding Goldman Sachs were distributed. **Mr. Pon** asked where he could find more detailed realized gains and losses report; **Mr. Tovstein** said the report is broken down by security type, included in the monthly investment packet, but encouraged **Mr. Pon** to give him a call for a more detailed reporting.

On a separate issue, **Mr. Tovstein** spoke of his 15 years with the Treasurer’s office when the pool was \$450 million and mentioned how proud he was of the department and staff. With the June election approaching, he is bothered by the amount of negative, inflammatory, and inaccurate statements posted mainly on blogs; and commends the staff for continuing to provide excellent service to the taxpayers in spite of the inaccuracies and low morale. **Mr. Tovstein** does not deny the fact that the Lehman loss occurred, in fact, he takes full responsibility, but stressed that the Lehman securities were highly rated, (Wall Street Journal, February 24, 2010) purchased under the Board of Supervisor’s approved investment policy, and well within the policy guidelines.

In closing, **Mr. Tovstein** announced that while reviewing the budget with Lee Buffington and Sandie Arnott, the administrative fees for all pool participants will be lowered by 8%, which equals 11½ basis points for fiscal year 2010-11. This will begin July 1, 2010, and will be reviewed annually. This fee reduction is due to the savings from automation and the elimination of one consultant in the tax office. Finally, he reported that the security lending income has dropped significantly due mainly to the current credit market and the tight or non-existent short term spreads to treasuries. He said spreads are nowhere near where they were prior to the financial crisis, and until the credit market changes or the spreads become larger, treasury repurchase agreements will continue to be the only allowable investment on the security lending side. He further noted that since security lending’s earnings have dropped significantly; the Bank of New York’s custodial banking fees have increased somewhat. He is looking to deposit additional funds in the New York bank to offset the custodial fees and to have available money, in case of a disaster, where the investment staff can easily access funds from their homes via their blackberrys. A short discussion ensued regarding security lending. In response to **Mr. Pon**, **Mr. Tovstein** has always considered purchasing CD’s from local banks as long as they meet certain qualifications such as being FDIC insured, sufficient collateralization and competitive rates.

Mr. Shaw welcomed Dr. Peter Struck and thanked him for coming and addressing the Treasury Oversight Committee.

ECONOMIC REPORT

Dr. Struck began by turning the committee's attention to the handout entitled Whatever It Takes - He touched upon the following:

Demographic Trends

- The population, on balance is aging (thanks to the baby boomers).
- Immigration (legal & illegal) activity may be softening due to fewer economic opportunities and political overtones (e.g., pending state of AZ legislation).

Re-regulation

- In response to the financial meltdown, expected re-regulation (or more regulation) is highly anticipated this year.

De-leveraging

- After 25 years of enjoying the benefits of ever increasing levels of debt, the economy has begun a painful retrenchment.
- Household debt has been lowered – some voluntary (pay off credit card balances) and some has been involuntary (bankruptcy/foreclosure).
- Corporations have also pared down debt as well as raised equity capital, especially the banks.

De-globalization

- Choices by different national economies are producing dramatically different outcomes that are affecting financial market.

What's Ahead?

- There will be a sector rotation as the federal government's massive intervention and stimulus is withdrawn and the private market's tentative momentum grows.
- Following a robust 04-09 GDP reading of 5.6% (however, -2.4% for the full year), the Fed's projection of economic activity for '10 is about 3% and then increasing to about 4% for '11 and '12; "longer run" their assumption is 3%
- Inventory rebuilding helped the Q4 numbers, and is not sustainable unless final demand picks up dramatically

Is The Recession Over?

- Officially, "No", unofficially, "tentatively yes" although to the average citizen it probably doesn't feel like it.

Unemployment Levels Remain Stubbornly High

- 9.7% national unemployment level – has stabilized.
- 16.9% when you include underemployed & discouraged workers.

Is Inflation a Problem?

- CPI running @ 2.3% over past year; core level @ 1.1%.
- Wage growth has slowed sharply in recent months.
- Wal Mart, the largest retailer in the U.S. just announced a new "lower price".
- The Fed continues to project inflation well under 2% for '10, and very gradually increasing over the next two year, but still at or below 2%

What about the Global Economies

- Our largest trading partner, Canada, is doing quite well, due to its commodity-based economy.
- China and the other emerging Asian economies have rebounded quite strongly and have low debt-to-GDP levels, fiscal policy flexibility, and generally unleveraged consumers; the Euro area appears to have more benign growth prospects.
- The U.S. trade deficit has regained 30% from its mid '08 levels, but still remains a much small portion of overall GDP.

Where Are Interest Rates Headed?

- An economic boom is underway that implies greater demand for credit.
- Inflation is expected to be rising over the next several years.
- Uncertainty (or lack of faith in elected officials) is high.

Whatever It Takes!!

The federal government has clearly demonstrated that it will impose its will on the private economy; while there are short-term benefits that circumvented a more severe downturn, there will now be the longer term challenge of extricating that federal government intervention in the markets.

Mr. Shaw again thanked Dr. Struck and called for any other business to be discussed. **Ms. Reavey** asked Mr. Tovstein to clarify the responsibilities of the committee members. **Mr. Tovstein** said the oversight committee is advisory only. He stated that the Treasurer annually prepares the investment policy and it is then reviewed and monitored by the oversight committee. A discussion ensued regarding responsibilities of membership for the oversight committee. **Mr. Pon** asked if the proposed investment policy was available to the public. The question of whether or not the proposed policy should be on the Treasurer's website was posed. **Mr. Tovstein** said the only policy now on the website is the approved 2008 policy, but he will discuss the matter with Mr. Buffington when he returns on the 5th of May. It was noted by **Ms. Farrales** that the Finance and Operations Committee will distribute to the Pool participants and the Oversight committee, the proposed 2010 Investment Policy for their comments.

PUBLIC COMMENT

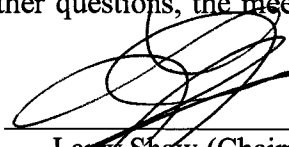
Mr. Lawrence Pon introduced himself as a concerned citizen and expressed his disappointment when he read that the October 19, 2009 meeting was cancelled due to a lack of a quorum. He stated that the committee needs to take their roll seriously and to ask the hard questions. **Ms. Reavey** noted that the committee's role is limited. **Mr. Shaw** ended the meeting by saying that each member serves as a communication device to both the Treasurer and to their individual boards.

DATE OF NEXT MEETING

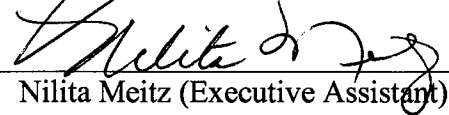
The next meeting of the Treasury Oversight Committee will be held on Monday, October 25, 2010 at 12:00 noon.

ADJOURNMENT

There being no additional business and no further questions, the meeting was adjourned at 1:24 p.m.



Larry Shaw (Chairman)



Nilita Meitz (Executive Assistant)