

**REPORT ON THE
Intermediate Term INVESTMENT FUND**
For The Fiscal Year Ended June 30, 2017



PREPARED FOR THE
STATE FUNDING BOARD

November 27, 2017

PREPARED BY
TREASURY DEPARTMENT
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TENNESSEE TREASURY DEPARTMENT
Intermediate Term Investment Fund Report
For the fiscal year ended June 30, 2017

I. COMPLIANCE WITH INVESTMENT POLICY

The investment policy for the Intermediate Term Investment Fund (ITIF) is set by the State Funding Board. The board is composed of the Governor, Commissioner of Finance and Administration, Comptroller, Secretary of State, and Treasurer. The investment objective for the ITIF is to offer a longer term investment option for the State and any entity that is eligible to invest in the LGIP. Returns of a fund with a longer term investment horizon are expected to outperform liquidity funds such as the SPIF, but there are risks associated with longer term investments. If interest rates increase, the value of investments will decline. Investors should consider the risks involved, including the lack of liquidity provided from a fund such as the ITIF, before making a decision to participate.

Portfolio Composition

The ITIF was launched on July 22, 2013, when the first participant invested \$200 million. As of June 30, 2017, there were no additional investments, and the participant has made withdrawals of \$140 million since inception. Investment policy permits investments in US Government and Agency securities, repurchase agreements, prime commercial paper, prime banker's acceptances, and the State Pooled Investment Fund (as a source of liquidity or uninvested idle cash, if necessary). During the fiscal year, investments were only made in government agency securities with idle cash invested in the SPIF only until investments in longer term maturities could be purchased. The average composition during the year ended June 30, 2017, was 85.2% US agencies and 14.8% idle cash in the SPIF. The cash component was higher this fiscal year than previous years due to securities being called before maturity and the cash remaining in the SPIF until more opportune times to re-invest.

Maturity

The objective of the ITIF is to take advantage of the expected additional return from investing farther out on the yield curve. The Investment Policy permits investments up to five years with an average maturity of three years. The weighted average maturity (WAM) of the ITIF began the year at 2.10 years and ended the year at 2.61 years. During the year, the WAM ranged from 1.43 years to 2.71 years (within policy limits). There was an expectation that the Fed might raise rates as many as 4 times during calendar year 2017. Rates have been adjusted 3 times to the current level of 1.00% to 1.25% during calendar year 2017.

Liquidity

This fund is not designed to provide liquidity. As a result, the fund will not maintain a significant position in cash equivalent securities for the sole purpose of providing liquidity. Investors are encouraged to only invest funds that are not going to be needed for short term liquidity purposes. Withdrawals are limited to the first working day of each quarter, as long as notice is provided at least 30 days prior to the withdrawal date.

II. PORTFOLIO PERFORMANCE

For the period July 22, 2013 thru June 30, 2017, the Intermediate Term Investment Fund has had a market value increase of 2.47%. During fiscal year 2017, the fund increased in value .33% net of expenses, or 33 basis points. During the same period, the SPIF returned 52 basis points, the Vanguard Short Term Federal Fund (VSGBX) had a net loss of 20 basis points, and the Barclays US Treasury Bond Fund Index had a loss of 386 basis points. The net asset value (NAV) ranged from a low of 1.0150275 on December 15, 2016, to 1.0253193 on June 27, 2017. The graph below demonstrates the daily change in net asset value during the year.



III. INVESTMENT POLICY REVIEW

No Investment Policy changes are anticipated during the current fiscal year. The fund has operated as planned and there have been no concerns that have arisen. Also, there are no market regulations that impact funds of this nature being discussed at this time.

IV. INVESTMENT PLAN

On December 18, 2015, the Federal Reserve raised the Fed Funds rate for the first time since since December, 2008. The rate was raised from a range of zero to 25 basis points to a range of 25 to 50 basis points, with a target of 37 basis points. Since that time, the Fed Funds rate has been raised 3 more times to the current level of a range of 1.00% to 1.25%. While the safety and liquidity offered from money market funds outweighs the risks of investing in funds with longer maturities for many investors, those that have funds not needed for short term liquidity can benefit from a fund similar to the Intermediate Term Investment Fund (ITIF). There are risks associated with investing in the ITIF. The investment policy of the fund attempts to minimize the risks by limiting investments to securities that possess little credit risk and by limiting deposits and withdrawals to the first business

day of each quarter and requiring a 30 day notice before a withdrawal can be made. Rising interest rates can have a negative impact on performance, as was the case this year when the ITIF had the lowest performance since inception. However, the rising rates have resulted in an increase in the total portfolio yield. Staff will continue to monitor the movement in interest rates as well as other market conditions that could impact the fund and make changes as needed to maintain a competitive investment option for public entities across the State.

V. COST OF ADMINISTRATION

The cost to operate the ITIF are minimal due to the efficiencies gained by utilizing many of the same resources as are used to manage other funds within Treasury. The costs of operations are funded from a 5 basis point charge for assets invested. Most commercial funds charge substantially more than 5 basis points. Also, the costs of operations include more than investment management. The 5 basis points finances:

- Investment of portfolio
- Software and hardware support and maintenance
- Accounting and recordkeeping
- Support cost such as internal audit, payroll, personnel, etc.

VI. PORTFOLIO AT JUNE 30, 2017

DESCRIPTION	ACCRUED INCOME	MARKET VALUE	MATURITY	MKT PRICE	PAR	INC PURCHASED	RATE	CUSIP
FHLMC	21,466.67	15,946,106.67	6/8/2022	99.529	16,000,000.00		2.100	3134GBRM6
FEDERAL HOME LOAN BANKS	7,292.08	6,449,229.58	11/24/2017	99.875	6,450,000.00	-	1.100	3130A3GA
FNMA	10,400.00	7,905,360.00	11/22/2019	98.687	8,000,000.00	-	1.200	3136G3Z40
FEDERAL HOME LOAN BANKS	49,875.00	14,999,625.00	9/7/2018	99.665	15,000,000.00		1.050	3130A7DW
FHLMC *			1/11/2021		17,000,000.00		1.800	3134GBXE7

* Trade settles 7/11/17

	45,300,321.25
Cash	17,336,892.64
	62,637,213.89
SHARES	61,148,983.98
NAV	1.024338