OREGON STATE TREASURY

Local Government

News Report

APRIL 2012

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INSIDE THIS ISSUE

WE'VE CHANGED OUR LOOK

Thank you to everyone who responded to our survey last summer regarding newsletter format, structure, and content. We appreciate the input we received, and you will note that we have started to implement changes with this edition. We will continue to make revisions in the coming months. We hope you find the design and structure of the information to be in a format that is user-friendly, and the content suitable to your needs.

The Local Government News Report is one of our primary methods of communicating with LGIP participants when it comes to local government cash management topics and issues. We ask that you assist us in ensuring that the appropriate staff or oversight bodies for your entity receive the monthly newsletter. If there are members of your organization that you believe should be receiving the monthly newsletter, and are not currently, please have them sign up to receive future newsletters by clicking here.

Finally, please continue to provide us feedback as we make modifications and roll out upcoming changes to the newsletter. Your input is greatly appreciated. Again… THANK YOU!

INTEREST RATES

The average annualized yield for March was:
0.5323 percent.

The rate for March was as follows:
March
1st — 21st
0.50 percent
22nd—31st
0.60 percent

HOLIDAYS AND CLOSURES

No Banking Holidays or OST Closures in April

Coming in May:
Memorial Day
May 28th-
OST and Banks Closed

INTEREST RATE UPDATE

You may have noticed a recent increase in the earnings rate on balances in the Local Government Investment Pool ("LGIP"). Here's a little background about that.

At the height of the credit crisis in 2008, Lehman Brothers Holdings Inc. filed for Chapter 11 bankruptcy protection. At that point, in September 2008, the Oregon Short Term Fund held $191 million (par value) of senior unsecured Lehman bonds scheduled to mature in January and May of 2010. The Oregon State Treasury (Treasury) began building an allowance after the bankruptcy filing to absorb the anticipated loss shortly after this event, using a portion of the portfolio's investment earnings.

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Interest Rate Update

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The allowance continued building until last month when the target balance was achieved. March 21, 2012, Treasury Investment staff sold the Lehman holdings at approximately 28 cents on the dollar. The resultant loss was fully absorbed by the allowance, permitting Treasury to exit this position without impacting participant account balances and, in fact, we realized a gain on the sale since the net proceeds from the sale exceeded the allowance balance.

In light of the Lehman experience, Treasury will continue to accumulate a small allowance for unexpected future market events. The target balance for this allowance is based on historic default rates for similar types of investment pools, and will accumulate slowly over the next two years or so.

With the successful resolution of this event Treasury reassessed investment income levels and on March 22, 2012, adjusted the interest rate for participants to 60 basis points (0.60 percent), an increase of 10 basis points (0.10 percent) over the previous rate in effect since October of 2010.

Treasury took these steps to ensure preservation of principal for all participants, and we believe the LGIP remains a secure option for the investment of local government funds. Fifty percent of the portfolio is invested in US Treasuries, US Agencies, and FDIC-guaranteed corporate notes; and its weighted average credit quality is AA. The LGIP continues to provide same-day liquidity and an attractive, above-market return. And finally, the Pool's expenses are only 0.3 basis points per month (.003 percent), well below what local governments would pay for private management in a money market fund.

Disaster Recovery

Treasury is continually evaluating processes to ensure that critical needs are met in the event of a potential disaster. If a major disaster impacted Treasury, it could take 48 to 72 hours for Treasury to be able to process local government transactions. Please note that as a result of our continual evaluation process, we have updated the maximum time it would take to restore services to pool participants to recognize a variety of additional internal and external requirements.

It is important to remember that the local government pool is intended to be an investment vehicle, not a bank account. Therefore, Treasury recommends local governments have money available from sources other than the pool at all times to fund expenditures for at least 48 to 72 hours. If your organization has not already done so, it may be prudent to discuss short-term liquidity options with your governing body and your financial services providers.

TREASURY RECOMMENDS LOCAL GOVERNMENTS HAVE MONEY AVAILABLE FROM SOURCES OTHER THAN THE POOL AT ALL TIMES TO FUND THEIR EXPENDITURES FOR AT LEAST 48 TO 72 HOURS.

STAFF COMMENTS: IS THE GLASS HALF-FULL OR HALF-EMPTY?

As mentioned in the Interest Rate Update article, staff is pleased to announce, as you may already know, that the OSTF/LGIP rate was increased on March 22, 2012, to 0.60 percent, after about 17 months at a rate of 0.50 percent. Throughout the recent past and as illustrated in the chart on page 4, the OSTF/LGIP has continued to provide a competitive and generally above-market rate plus complete liquidity.

In terms of the market environment, the glass remains "half-empty" as the extremely low interest rate environment will likely persist for at least the remainder of the year, presenting continued challenges for short-term fixed income investors in need of yield, risk-averse investors, and anyone simply trying to save for the future.

This period is one in which the Federal Reserve Bank has maintained a federal funds rate target range of 0 – 0.25 percent as well as having implemented two rounds of quantitative easing, or QE1 and QE2, and, lastly (at least as of April 5th), conducting the ongoing "Operation Twist" program, where the Fed is selling $400 billion of their < 3 year Treasury holdings and purchasing $400 billion Treasury securities with maturities between 6 – 30 years. As of March 28, the total face value of the Fed's balance sheet is approximately $2.8 trillion! For reference, it stood at less than $900 billion in August 2008.

At the January 25, 2012, FOMC meeting, the Fed announced that rates would remain near zero "at least through late 2014" (compared to mid-2013 guidance as announced at the August 2011 FOMC meeting) while the odds of QE3 were increasing though remained data dependent. *If this becomes reality, that would imply six uninterrupted years of a near zero federal funds rate target* and, using past levels as a ballpark guide, somewhere between $1.5 and $2+ trillion (QE1 + QE2 = ~$1.2 trillion) of additional stimulus via QE3.

On April 3rd, the FOMC minutes of the March 13, 2012, meeting were released and read more optimistic about growth, less convinced that the unemployment rate drop is a fluke, and more willing to consider changing forward guidance about late 2014. All in all, the minutes implied a step away from the recent tilt toward QE3, and a small step toward potentially altering the late 2014 guidance. The rise in the stock market, the string of stronger employment reports, and the fading of immediate euro-zone strains seem to have helped.

On April 4th, a press release announced that four Federal Reserve regional bank presidents who vote on monetary policy this year see less of a need for the Fed to spur the economy with new accommodation.

> THE RISE IN THE STOCK MARKET, THE STRING OF STRONGER EMPLOYMENT REPORTS, AND THE FADING OF IMMEDIATE EURO-ZONE STRAINS SEEM TO HAVE HELPED.

The probability of needing to do additional stimulus is lower," San Francisco Fed President John Williams told reporters yesterday. Cleveland's Sandra Pianalto, Atlanta's Dennis Lockhart and Richmond's Jeffrey Lacker also spoke against additional accommodation this week, with Lacker saying yesterday he "was surprised a couple months ago at the probability market participants seemed to ascribe to further easing."

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STAFF COMMENTS: IS THE GLASS HALF-FULL OR HALF-EMPTY?

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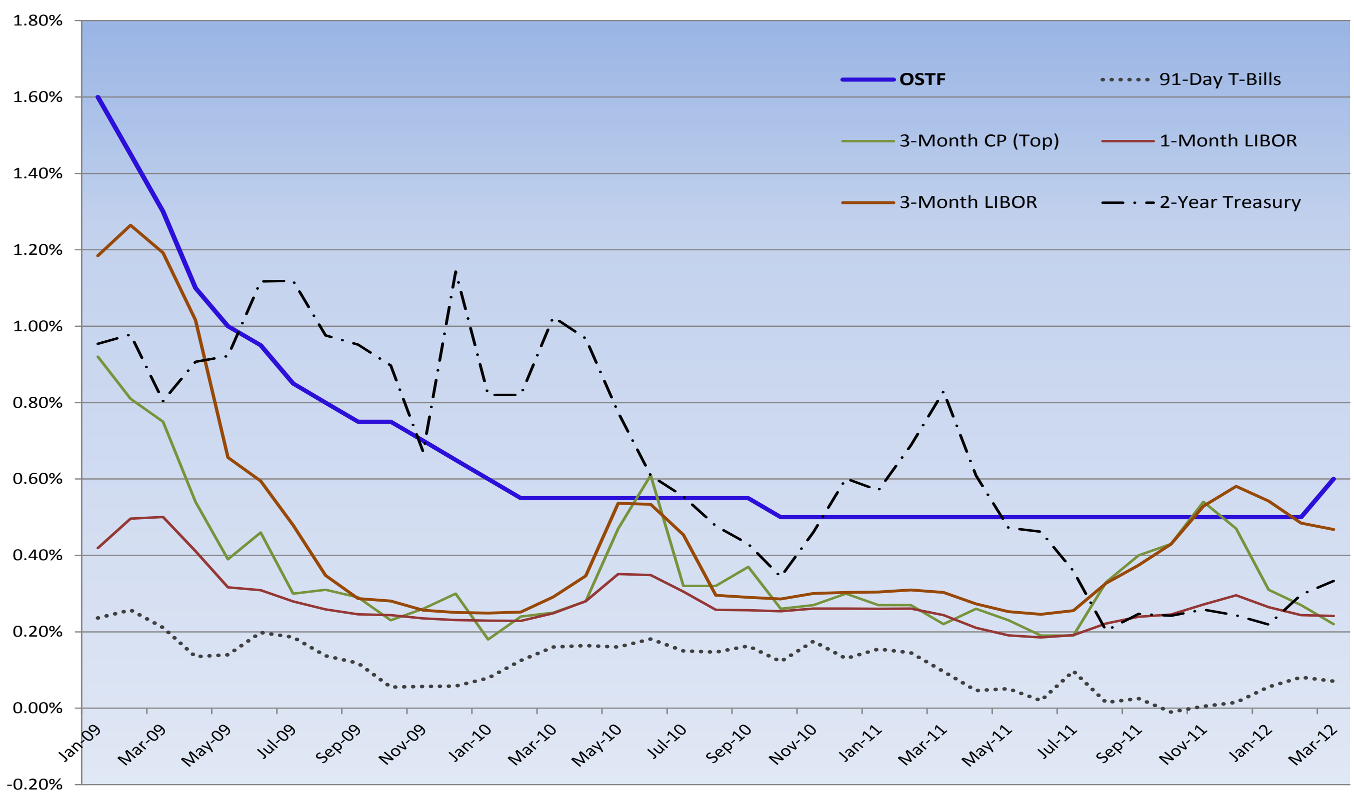
The presidents' comments echo the minutes of the March 13 meeting, in which a "couple of" participants called for easing only "if the economy lost momentum" or if inflation fell below its 2 percent target.

What does this mean for the OSTF/LGIP? At the end of the day, it does not change our strategy for the structure of the fund. That is, given the historic low level of interest rates over the past 3+ years, staff has been mostly cautious – there is more downside than upside, more risk than reward – that rates may rise. The fund continues to emphasize floating rate securities (about a 33 percent allocation) with an average discount margin (or spread) to 3-month LIBOR of 80 basis points. There are allocations of about 11 percent in fixed rate 1-2 year securities and about 5 percent in fixed rate 2-3 year securities. With money markets so painful to hold, the fund maintains allocations only to meet liquidity needs and is at about 27 percent.

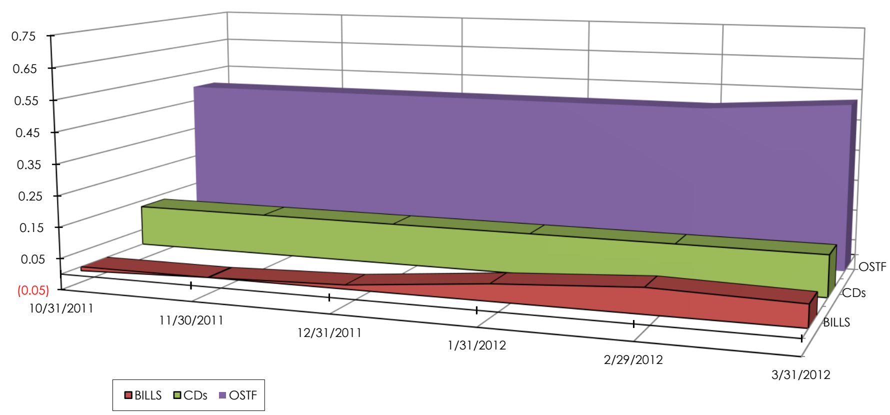
We hope you are pleased with the performance of the OSTF/LGIP and please do not hesitate to contact us with any questions.

So the glass is "half-full" in terms of the OSTF/LGIP.

OSTF/LGIP RATE COMPARISON



OREGON SHORT-TERM FUND ANALYSIS AS OF 3-31-12



	10/31/11	11/30/11	12/31/11	01/31/12	02/29/12	03/31/12
LGIP AV DOLLARS INVESTED (MM)	4,356	5,957	6,305	5,972	5,864	5,643
STATE AGENCY AV DOLLARS INVESTED (MM)	5,456	5,436	5,372	5,515	5,764	5,438
TOTAL OSTF AV DOLLARS INVESTED (MM)	9,812	11,394	11,677	11,487	11,629	11,081
OST ANNUAL YIELD (ACT/ACT)	0.50	0.50	0.50	0.50	0.50	0.53
3-MO UST BILLS (BOND EQ YLD)	(0.01)	-	0.01	0.05	0.08	0.07
3-MO JUMBO CDS (ACT/360)	0.13	0.13	0.13	0.13	0.13	0.13

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to accountholders 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 JUMBO CDS is the highest posted rate received by the Treasury from Oregon banks as of monthend. Consequently, whereas the yield on UST Bills should normally be lower than CD rates, the fact that the quotes are up to a week different in time may result in an apparent reversal of this situation.

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

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