The Public Interest

An objective resource for state, county, & local government investment pools.

June 2007

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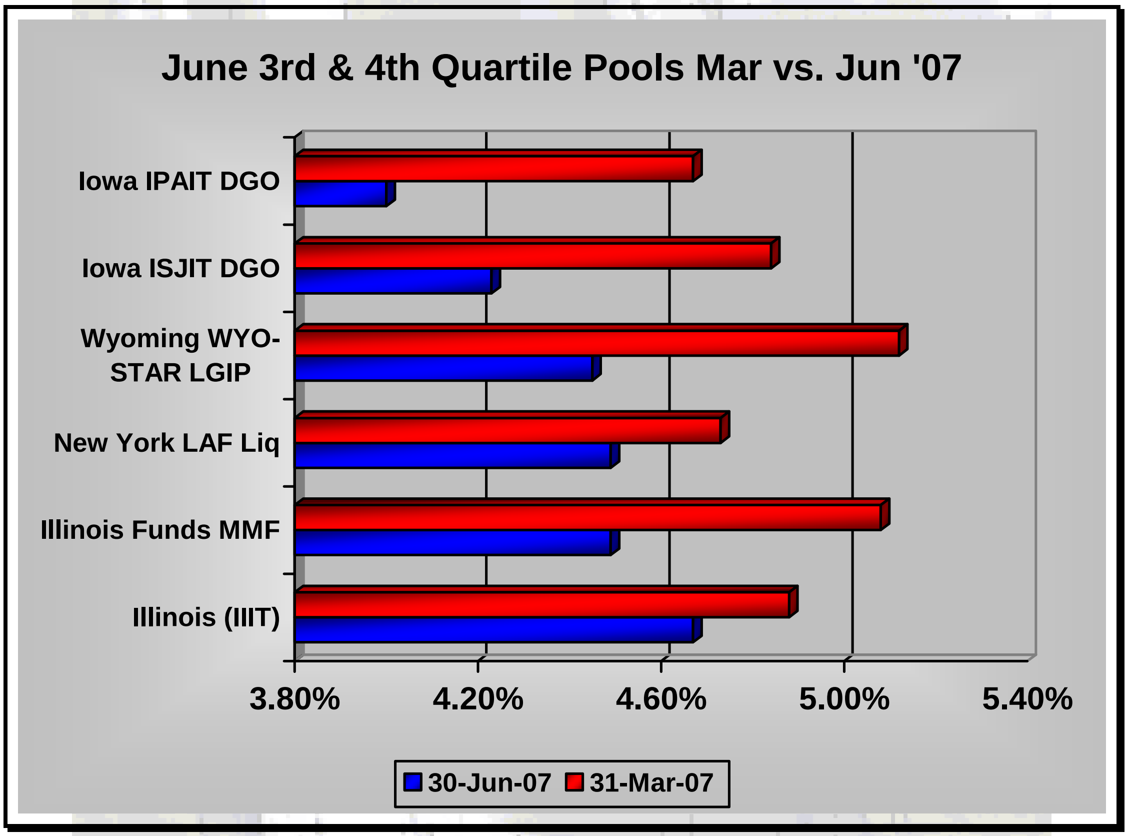
State of Mind

An op-ed by author Jeff Flynn

Many cash managers may not know just what level of risk their state or local government pool has and having a AAA rating or using a $1 NAV may be misleading. Some rated pools manage their money to the true spirit of SEC 2a-7 guidelines but others that market the stability of a $1 NAV whether rated or not may in fact be short term bond funds which carry more interest rate risk and really should use a floating NAV. The fact that all of the pools TRACS monitors are $1 NAV pools, while the variety of maturity risks are all over the map, illustrates just how little uniformity and oversight the local government pool industry has. SEC registered and rated money funds live under a far more scrutinized environment which we believe provides added safeguards but that is a topic for another report.

Pools that are rated AAA and designated as 2a-7s have to live with specific maturity guidelines of 60 days maximum and 397 days maximum stated final; and 90 days can be used as the application of floating and adjustable rate securities are treated. If a pool is not a 2a-7 type instrument, anything goes as far as maturity exposure is concerned. And over the past several years especially in the 2004-2006 period of ever rising Fed fund rates, many longer term pools were constantly underwater and vastly underperformed standard 2a-7s. In our Public Interest article, November 2006, we noted the difference and asked whether the ability to carry longer portfolio WAMs was worth the loss of sleep. The Connecticut state pool is often ranked number 1 in the nation and they are a AAAm 2a-7; we asked the now retired pool manager Hal Johnson in 2004 whether he saw having the maturity cap as a hindrance and he replied, “No!” It gives us a standard operating basis and helps prevent getting too much rope, is how I would paraphrase his comments.

As we gathered our usual numbers for the month of June, several pool yield changes at the end of the month caught our attention and reflect the maturity risks of some pools. In order to maintain the $1 NAV, market yields that were carried on the books had to be cut at month end in order to offset the mark to market paper losses in the principal of the pool. We looked at pools at the bottom of our list and found yields that were quite a bit lower than where they were on March 30 despite no Fed rate changes but amid a massive rate reversal in the markets which probably created some sizable paper losses.



*^Estimate, *Monthly AVG*

In our last issue we noted that the disparity of these pool yields across the nation is appalling and that the smaller municipalities who really struggle with budgets are the most affected by this inequity. States like Iowa, Minnesota, Oklahoma, New York, and Michigan that do not have a formal State Treasurer Pool are often the states with lower than average LGP yields. If you look at the power of competition in a state like Texas, with a AAAm 2a-7 state pool as the base, all of the other 5 LGP yields are usually within a few beeps and always ranked among the top 10 in the nation. The numbers are all public information and there for review; in some cases the data is hard to find as with some California county pools but those with 2a-7 type pools are almost always the first to post.

By the Numbers

If cash managers across the US all had access to the same yields as the top TRACS quartile, the amount of added municipal revenue and in cases where shorter WAM 2a-7s existed, the increased safety of Public Sector funds would be amazing. We noted that TexPool and TexPool Prime pools actually had a month end yield spike well above where their 7 day yields were averaging prior. We would note that each of these pools carry a large amount of repo and repo yields can spike at the end of a quarter if liquidity is tight because repo issuers need the money and are willing to "pay up".

	As of 6/30/2007*		
	Daily	**7 Day**	**Monthly**
1st Quartile	**5.52%**		
Connecticut Short Term Investment Fund	5.52%		
Montana Short Term Investment Pool	5.38%		
Texas TexPool Prime	5.43%	5.37%	
Texas TexStar	5.37%		
Florida SBA LGIP			5.35%
Texas TexPool	5.39%	5.34%	
Prime Money Market Fund Composite	**5.33%**		
Utah Public Treasurers Investment Fund			5.32%
Orange County Investment Pool	5.31%		
Virginia LGIP		5.31%	
Georgia Fund 1			5.30%
Texas CLASS	5.30%		
Texas LOGIC	5.30%		
Virginia State Non-Arb Program SNAP		5.30%	
Orange County Educational Investment Pool	5.29%		
Tennessee LGIP			5.29%
Walla Walla County Investment Pool			5.29%
Louisiana Asset Management Pool		5.28%	
New Mexico LGIP Overnight Pool	5.26%		
California LAIF	5.25%		
Illinois Funds Prime Fund	5.25%		
Illinois Metro Inv Convenience Fund	5.25%		
Kansas Municipal Investment Pool	5.24%		
California PFM Asset Mgmt Program		5.23%	
San Francisco County Investment Pool			5.23%
West Virginia Cash Liquidity Pool			5.23%
Idaho LGIP			5.22%
Virginia PFM Commonwlth Cash Reserve Fund Prime		5.21%	
New Jersey Cash Management Fund			5.20%
Oregon State Pool			5.20%
Washington LGIP			5.20%
Wisconsin CLASS^	5.20%		
Colorado ColoTrust Plus+	5.19%		
Pennsylvania Schl District Investment Pool	5.19%		
Wisconsin LGIP			5.19%
Pennsylvania PFM PLGIT I CLASS		5.18%	

Michigan CLASS^	5.17%		
New Jersey PFM Asset & Rebate Mgmt Program		5.17%	
Ohio State Treasury Asset Reserve STAR	5.17%		
Pennsylvania PFM PLGIT ARM		5.17%	
Colorado ColoTrust Prime	5.16%		
Pennsylvania PFM PLGIT PLUS CLASS		5.16%	
Wisconsin Investment Series	5.15%		
2nd Quartile	**5.14%**		
Colorado CSAFE	5.14%		
Pennsylvania INVEST Daily		5.14%	
Pennsylvania INVEST Community Pool		5.13%	
West Virginia Govt Money Market Pool			5.13%
Iowa IPASeducation	5.11%		
Minnesota PFM Schl Dist Liq Asset Fund - Max		5.10%	
Indiana Invest CLASS^	5.09%		
Alaska Municipal League Invest Pool	5.07%		
Michigan PFM Schl Dist Liquid Asset Fund Plus - Max		5.07%	
Minnesota Muni MMF (4M) - Plus	5.05%		
Missouri PFM Securities Invest Program Mon Mkt		5.05%	
Illinois Schl Dist Liquid Asset Fund Plus - Max		5.03%	
Iowa Schl Joint Invest Trust Diversified+	5.03%		
Pennsylvania PFM PLGIT CLASS		5.03%	
Iowa Schl Joint Invest Trust Diversified	5.02%		
New York CLASS^	5.02%		
Connecticut CLASS PLUS^	5.00%		
Pennsylvania Schl District Liquid Asset Fund Max	5.00%		
Maine CLASS^	4.98%		
Virginia PFM Commonwealth Cash Reserve Fund Fed		4.98%	
Nebraska PFM Schl Dist Liquidity Asset Fund Plus		4.96%	
Minnesota Muni MMF (4M)	4.94%		
Minnesota PFM Assc of Govts Inv for Counties		4.93%	
Wyoming Secured Investment Program (WYOSIP)		4.93%	
Rhode Island CLASS^	4.92%		
Wyoming Government Investment Fund		4.91%	
New Jersey CLASS^	4.90%		
Illinois Schl Dist Liquid Asset Fund Plus - Liq		4.89%	
Kentucky Govt Org's Liq Fund (GOLF)	4.89%		
Iowa IPAIT Diversified	4.88%		
Connecticut CLASS^	4.84%		
Illinois PFM Park Dist Liquid Asset Fund Plus		4.83%	
Michigan PFM Schl Dist Liquid Asset Fund Plus - Cash		4.83%	
Minnesota PFM Schl Dist Liq Asset Fund - Liq		4.82%	
Oklahoma Pub Schools Liq Asset Pool	4.82%		
South Dakota Pub Funds Invest Trust Gen Cash	4.82%		
New York Liquid Asset Fund Max	4.80%		
Wisconsin Investment Series Cash Management	4.78%		
Median			
3rd Quartile	**4.76%**		
Nebraska Public Agency Investment Trust			4.71%

New Hampshire Public Dep Invest Pool^	4.69%		
Illinois Institutional Investors Trust (IIIT) b		4.67%	
Pennsylvania Schl District Liquid Asset Fund Liq	4.64%		
Solano County Investment Pool			4.53%
Illinois Funds Money Market Fund	4.49%		
New York Liquid Asset Fund Liq	4.49%		
Wyoming WYO-STAR LGIP	4.45%		
4th Quartile	**4.38%**		
Iowa Schl Joint Invest Trust DGO	4.23%		
Iowa IPAIT DGO	4.00%		

*^Estimate, *Many rates this month were as of 7/2/07 due to the 30th falling on a weekend*

Rated State Pool	**As of 6/30/2007***		
	Daily	**7 Day**	**Monthly**
Connecticut Short Term Investment Fund	5.52%		
Texas TexPool Prime	5.43%	5.37%	
Texas TexPool	5.39%	5.34%	
Virginia LGIP		5.31%	
Georgia Fund 1			5.30%
Louisiana Asset Management Pool		5.28%	
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Idaho LGIP			5.22%
Ohio State Treasury Asset Reserve STAR	5.17%		
Pennsylvania INVEST Daily		5.14%	
Pennsylvania INVEST Community Pool		5.13%	
Illinois Funds Money Market Fund	4.49%		
AVG	**5.22%**		

Non-Rated State Pool	**As of 6/30/2007***		
	Daily	**7 Day**	**Monthly**
Montana Short Term Investment Pool	5.38%		
Florida SBA LGIP			5.35%
Utah Public Treasurers Investment Fund			5.32%
Tennessee LGIP			5.29%
California LAIF	5.25%		
West Virginia Cash Liquidity Pool			5.23%
New Jersey Cash Management Fund			5.20%
Oregon State Pool			5.20%
Washington LGIP			5.20%
Wisconsin LGIP			5.19%
West Virginia Govt Money Market Pool			5.13%
Wyoming WYO-STAR LGIP	4.45%		
AVG	**5.18%**		

Rated LGP	**As of 6/30/2007***		
	Daily	**7 Day**	**Monthly**
Texas TexStar	5.37%		
Texas CLASS	5.30%		
Texas LOGIC	5.30%		
Virginia State Non-Arb Program SNAP		5.30%	
Illinois Metro Inv Convenience Fund	5.25%		
California PFM Asset Mgmt Program		5.23%	
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Michigan PFM Schl Dist Liquid Asset Fund Plus - Cash		4.83%	
Minnesota PFM Schl Dist Liq Asset Fund Liq		4.82%	
New York Liquid Asset Fund Max	4.80%		
Illinois Institutional Investors Trust (IIIT) b		4.67%	
Pennsylvania Schl District Liquid Asset Fund Liq	4.64%		
New York Liquid Asset Fund Liq	4.49%		
Iowa Schl Joint Invest Trust DGO	4.23%		
AVG	**5.01%**		

Non-Rated LGP	As of 6/30/2007*		
	Daily	7 Day	Monthly
Wisconsin CLASS^	5.20%		
Michigan CLASS^	5.17%		
Wisconsin Investment Series	5.15%		
Iowa IPASeducation	5.11%		
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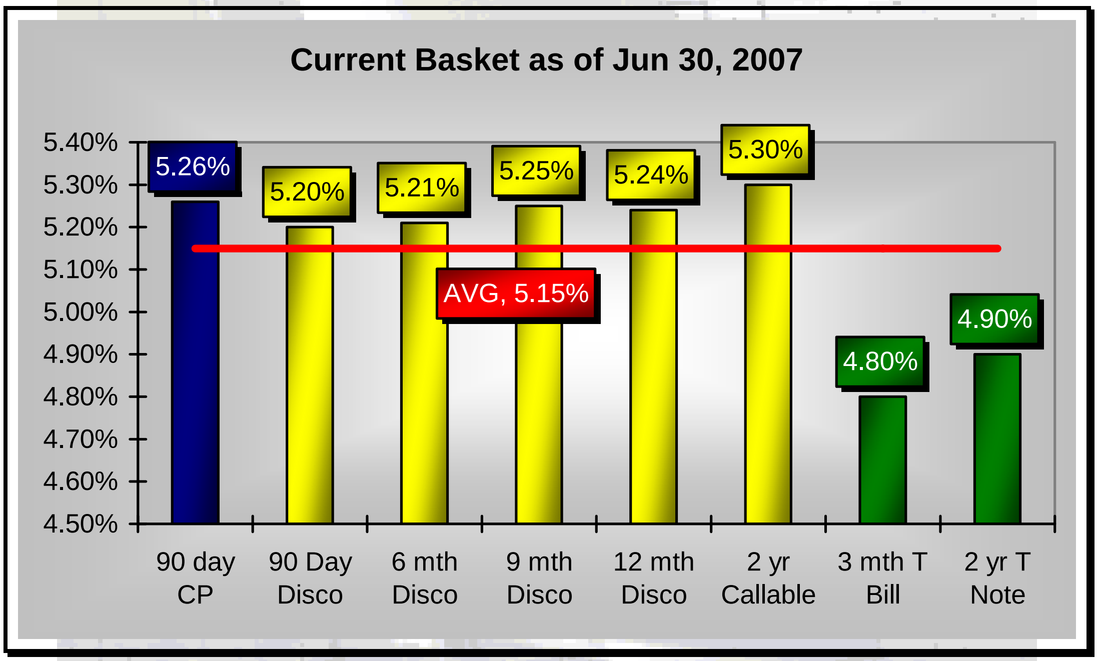
Iowa IPAIT DGO	4.00%		
AVG	**4.91%**		

In summation, pools with the lowest yields are either longer duration pools that had a market impact to total return or they are charging the highest fees generally due to a lack of competition which of course reduces yield. In the book, The Politics of Public Fund Investing, author Ben Finkelstein says about GIPs, "GIPs are not money market funds. They walk like a money market duck (stable $1 NAV), and they talk like one too, (daily access to funds depending on type of pool), but they do not have the same quack". He goes on to say on page 62 that non rated pools like LAIF might carry a lower rating because of their longer portfolio WAMs and durations; further that some pools buy paper that might not qualify under individual investment policies such as CDO backed repo. Finkelstein also focuses heavily on the *"market rate of return"* versus *"total return"* as a significant influence on municipal investing, to which we agree. A mark to market of a pool portfolio which is underwater in certain securities forces a reduction of market based yields; lower stated yields which won't become realized losses unless portions of the portfolio are sold. So a pool which has to reduce yield could argue that if the pool members do not withdraw their funds from the pool in effect makes that lower yield moot; to which we also concur. But the key is that if a pool has that kind of maturity exposure and were the unforeseeable to occur, total return yield could go negative which could trigger an exodus of deposits and force the liquidation of securities with losses. To our knowledge, no AAA rated and registered 2a-7 type money market fund has ever experienced this.

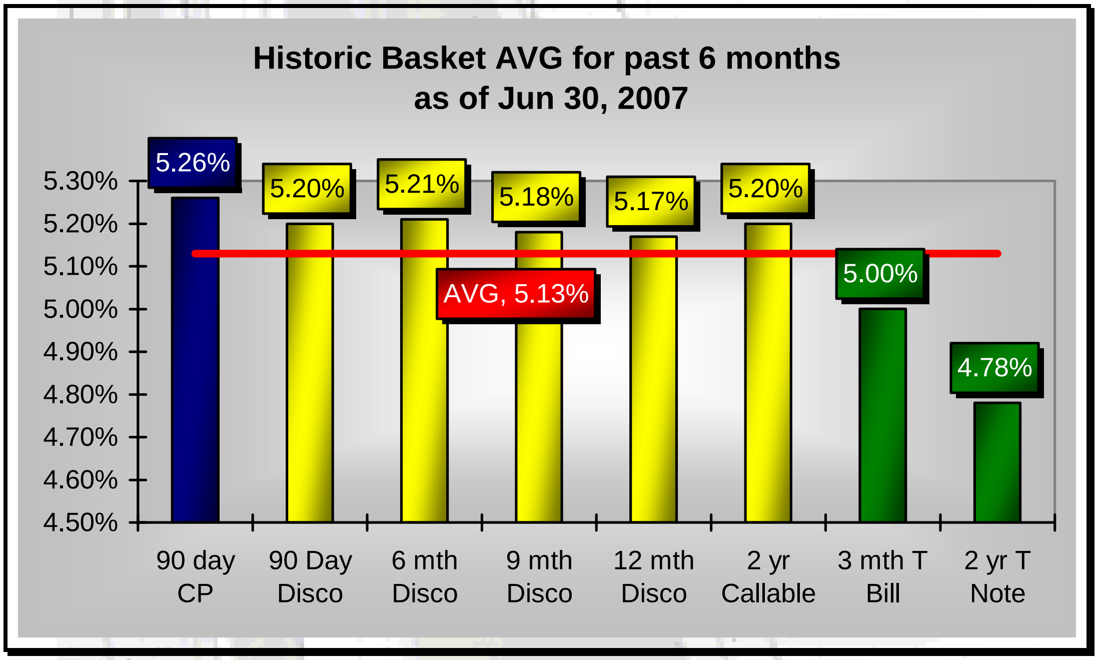
AAA ratings generally refer to the credit quality of a pool rather than the maturity risk. The rating agencies have recently been under fire regarding their high ratings for CDO paper and if a pool that may be AAA rated for quality were to take a market hit that pushed its yield into negative returns, these ratings could be further questioned.

Benchmarks

The most notable benchmark yield for June had to be the *TRACS Longer Duration Index* which came in at a total return of 4.58%. The index comprises 5 various longer duration type funds net of fees. It shows just how much affect the reversal in rates had on total return based yield.

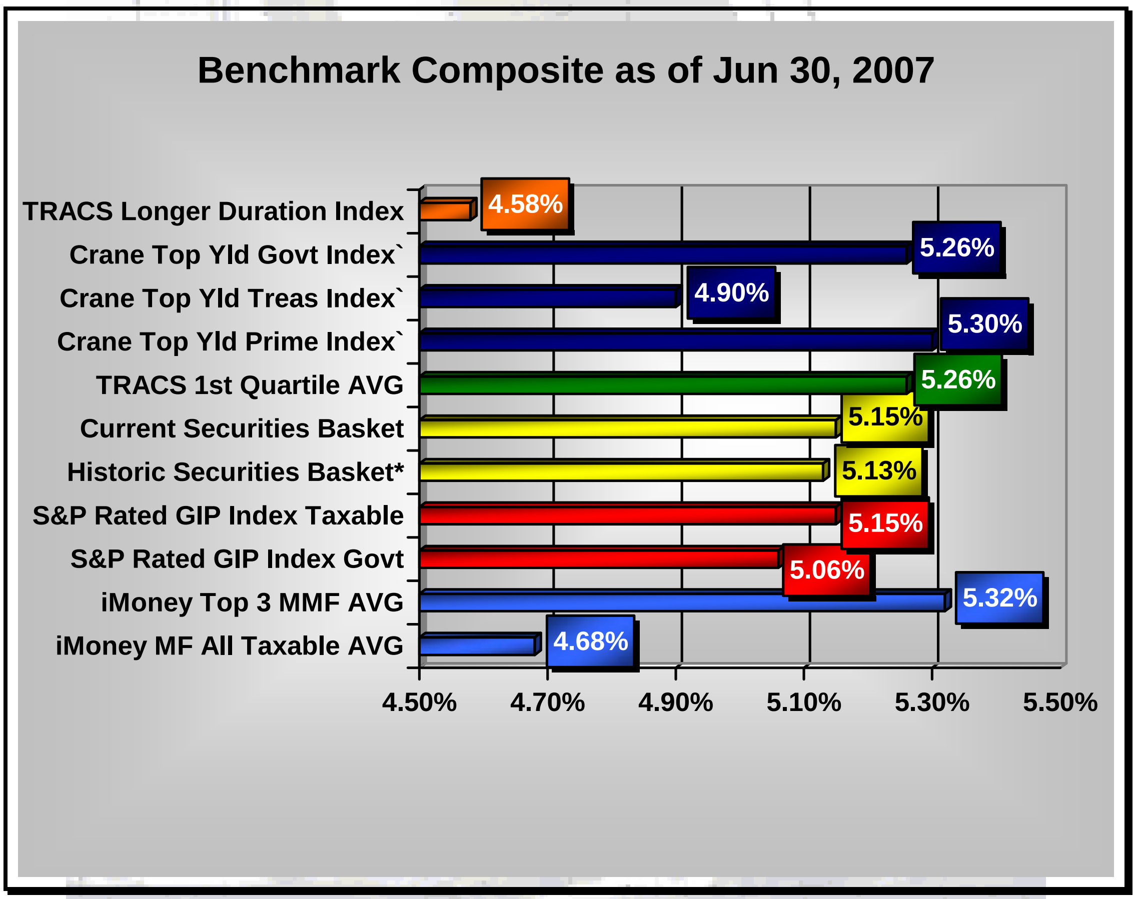


WAY 5.15% **WAM 315 days or 10.5 months**



WAY 5.13% **WAM 315 days or 10.5 months**

**Regular weekly purchase of the security basket over the past 6 months*



**Regular weekly purchase of the security basket over the past 6 months*

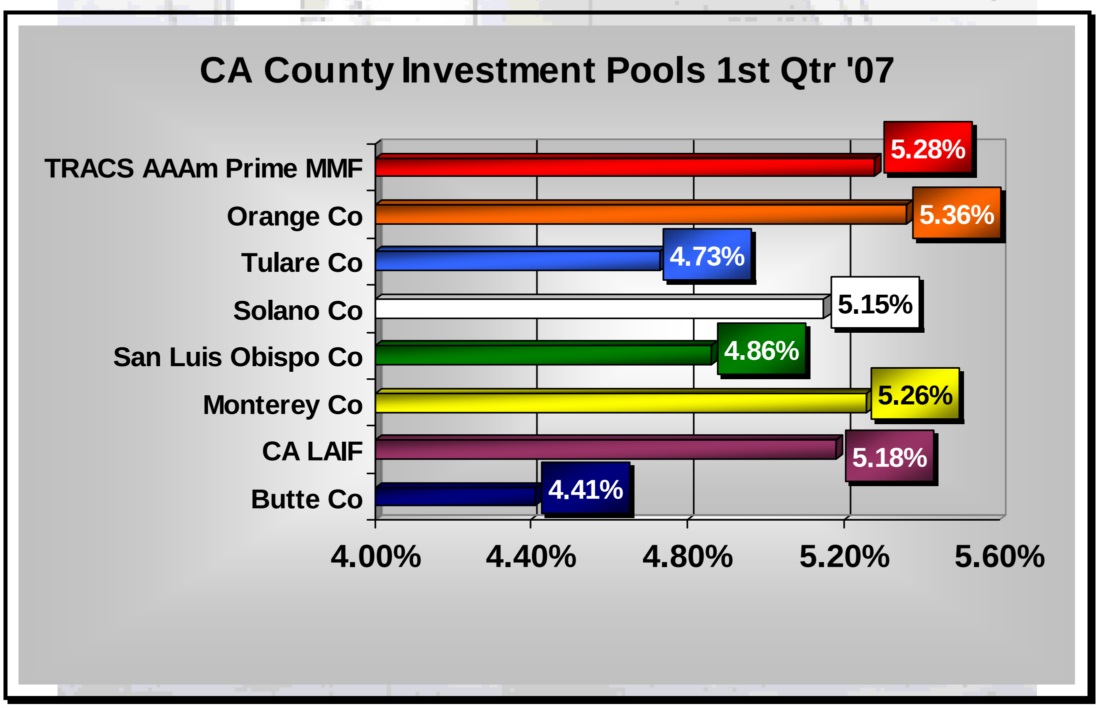
`Crane Data LLC, www.cranedata.us / iMoney information is available at www.imoneynet.com

TRACS Longer Duration Index

	Maturity	Duration
Total Return Bond	6.2 Yrs	4.3 Yrs
US Govt 1-3 Yrs	1.9 Yrs	1.6 Yrs
Ultrashort	0.9 Yrs	0.8 Yrs
Govt Ultrashort	**4.0 Yrs**	0.68 Yrs
Enhanced Cash	0.175 Yrs	**N/A**
AVG	**2.635 Yrs**	**1.845 Yrs**

NOTE$ with Interest

Both pool managers with longer duration $1NAV pools and cash managers that carry some significant maturity exposure in operating portfolios often argue that these funds can extend because a higher level of liquidity will not be needed. The market correction that we saw from March-June where the yield curve righted itself from inverted to ascending in the 5%+ area had a serious impact to yields of longer term pools as the data reveals. We went to a sample of California county pools (the ones we could find) for some Q1 data and found that the Orange County AAAm 2a-7 outperformed the group, but that the non rated Monterey County Pool yield which could extend was managed in a way that outperformed most other non rated county pools and was in line with the AAAm 2a-7 Top TRACS composite in red. We still have not seen the beleaguered San Diego County pool yields and will be watching. They are AAA rated as to issuers but have carried longer portfolio WAMs that has also caused their yields to be less competitive.



In our experience, we find the ease of access to actual pool data to be commensurate with the maturity and risk exposure of the pool itself.

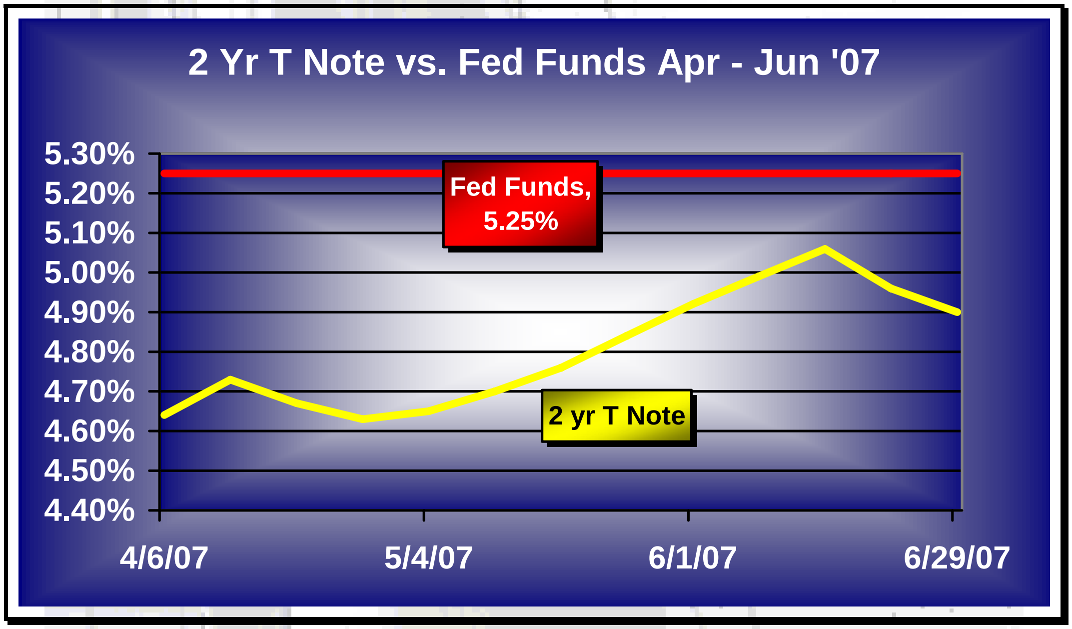
Economic Review, Forecast, & Strategy

This past month saw the first stages of what we see as a serious sub prime crisis ahead, especially in the securitized instruments comprised of sub primes called CDOs, collateralized debt obligations. We have long warned about the issue, especially since our February 5th report, Keeping TRAC of Texas, where we noted changes from S&P in the allowable collateral for repo which basically allows investors to look more to the counterparty agreement of the borrower than to the credit quality of the collateral which the lender would ultimately have to look to. As a Bear Stearns hedge fund which was borrowing money from investment banks was close to going under, many of the lenders who were holding the sub prime based CDOs actually went out to the markets to get bids for the toxic waste. *They found that prices were far below the "par value" they had been carrying on their books which means that they would want to look to the counterparty agreement instead for repayment of their entire loan, "putting back" the junk collateral to the borrower. If the borrower is illiquid and cannot pay back the loan, the CDOs would flood the market and create "actual losses" for the banks. We are likely seeing the tip of this nasty iceberg.*

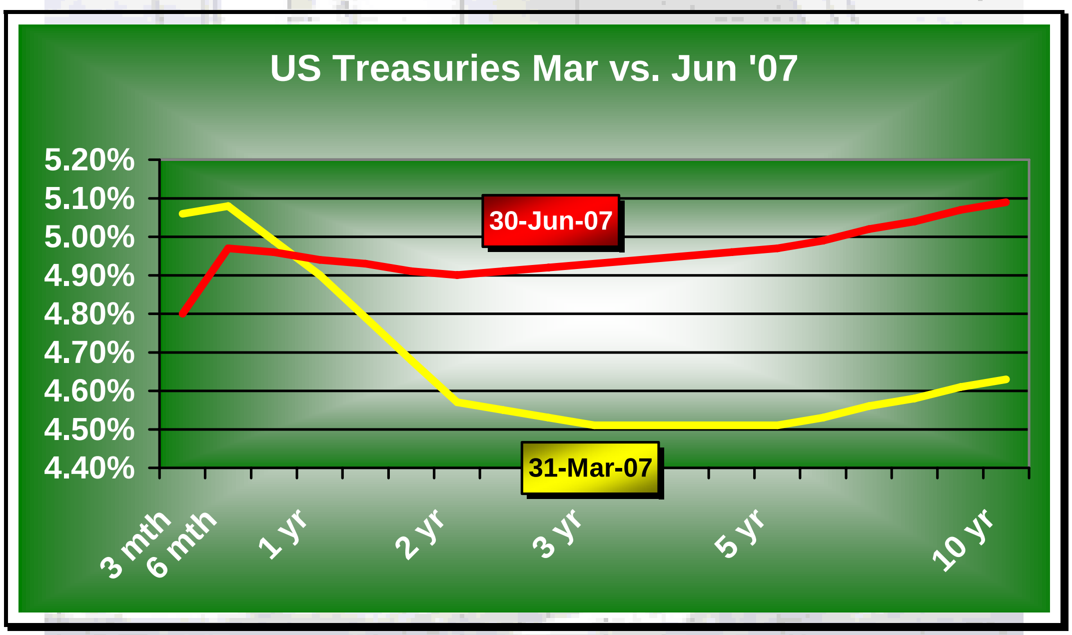
We asked several pools about their repo collateral in February and were rebuked in certain cases; the pools stating that they had no "direct" exposure to sub primes. But it now appears that while that statement could be considered factual IF you have credibility in the strength of the counter party agreement, it may not be factual if the counterparty goes belly up. **We believe that whether it is some financial or political influence that China could flex given their $1 trillion US dollar reserves, or an unraveling of the sub prime fiasco, that $1 NAV pools that are there for real liquidity should consider staying closer to the 2a-7 side of the equation than the riskier longer duration side.** We take a lesson from the Connecticut state treasurer's office which shows that you can have top yields without the maturity risks. ***We do believe that some day we will have a market crisis that will break the bucks of many pools.*** The story is just developing and we will monitor.

The Markets Hit Long Maturities

The reversal in market yields over the past few months reveals just why some pool yields had to be reduced to help offset portfolio paper losses. Brokers love to sell 2-3 year agency new issue paper and many pool and portfolio managers buy them. The 2 year went from 4.62%-5.06% in just 3 months.



The recent market correction may have come from higher foreign yields, sales of Treasuries related to rebalancing mortgage portfolios, or a decline in outright foreign buying amid a falling dollar. Whatever the reasons, market volatility is greater than ever which argues for keeping maturity risk exposure lower than in the past.



Your Municipalities

We believe that being a AAA rated true 2a-7 type pool is in of itself an excellent marketing tool. Or a non-rated pool that acts like a 2a-7 that can show a trend of consistent monthly yields is as well. It is the volatility of monthly yields that could ultimately cause problems. We know that many cash managers have had portfolios underwater over the past several years, and especially of late with the dramatic upward shift in market yields. Brokers only sell 2-3 year new issue agency callables and step ups and they have been underwater.

You might consider pointing out your stability of yield as it connotes a reduced impact of rate risk which only comes from excessive maturity exposure.

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