

**REPORT ON THE  
Intermediate Term INVESTMENT FUND  
For The Fiscal Year Ended June 30, 2016**



PREPARED FOR THE  
**STATE FUNDING BOARD**

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PREPARED BY  
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**TENNESSEE TREASURY DEPARTMENT**  
**Intermediate Term Investment Fund Report**  
For the fiscal year ended June 30, 2016

**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, 2016, there were no additional investments, and the participant had withdrawals a total of \$140 million. 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, 2016, was 97% US agencies and 3% idle cash in the SPIF.

Maturity

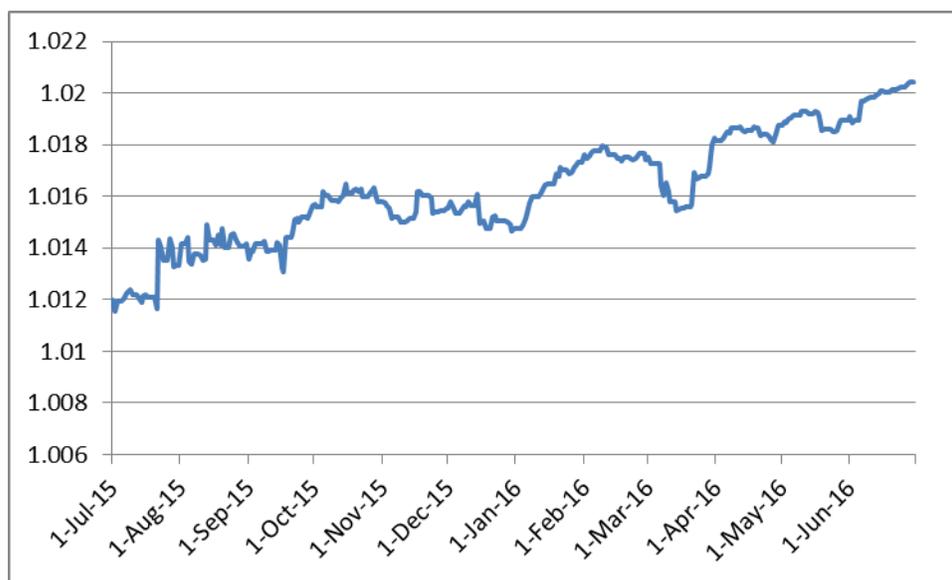
The objective of the ITIF is to take advantage of the expected additional return from investing farther out on the yield curve. The Investment Policy permits investments up to five years with an average maturity of three years. The weighted average maturity of the ITIF began the year at 3 years and rolled down to 2.10 years by June 30. There was an expectation that the Fed might raise rates as many as 3 times during calendar year 2016, but the FOMC decided to stop after the rate hike in December, 2015.

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, 2016, the Intermediate Term Investment Fund has had a market value increase of 2.04%. During fiscal year 2016, the fund increased in value .849% net of expenses, or nearly 85 basis points. During the same period, the SPIF returned 23 basis points, the Vanguard Short Term Federal Fund (VSGBX) had a net return of 185 basis points, and the Barclays Government Bond Fund Index had an average return of 108 basis points. The net asset value (NAV) ranged from 1.011545 on July 2, 2015, to 1.0204339 on June 30, 2016. 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 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. At the time, the Fed was hinting that there may be 3 additional rate hikes during the year. With inflation and unemployment remaining at low levels, the Fed was not able to raise rates which allowed the ITIF to have its best year of performance. 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. There is a strong possibility that the Federal Reserve will raise rates at the December, 2016 meeting of the FOMC, and that would have a negative impact on the ITIF. 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, 2016

DESCRIPTION	ACCRUED INCOME	MARKET VALUE	MATURITY	MKT PRICE	PAR	INC PURCHASED	RATE	CUSIP
FEDERAL FARM CR BKS	4,279.17	7,904,358.17	6/5/2017	100.001	7,900,000.00	8,064.58	0.750	3133ECQS
FEDERAL HOME LOAN BANKS	7,292.08	6,458,066.08	11/24/2017	100.012	6,450,000.00	-	1.100	3130A3GA
FEDERAL HOME LOAN BANKS	165,625.00	15,187,075.00	7/22/2020	100.143	15,000,000.00	-	2.500	3130A5XG
FEDERAL FARM CR BKS	57,200.00	16,560,005.00	7/21/2017	100.017	16,500,000.00	-	0.780	3133EE4J6
FEDERAL HOME LOAN BANKS	49,875.00	15,055,275.00	9/7/2018	100.036	15,000,000.00		1.050	3130A7DW
		61,164,779.25						
	Cash	1,265,260.76						
		62,430,040.01						
	SHARES	61,179,897.79						
	NAV	1.020434						