

**REPORT ON THE
STATE POOLED INVESTMENT FUND**
For The Fiscal Year Ended June 30, 2012

PREPARED FOR THE
STATE FUNDING BOARD

December 14, 2012

PREPARED BY
TREASURY DEPARTMENT
CASH MANAGEMENT DIVISION

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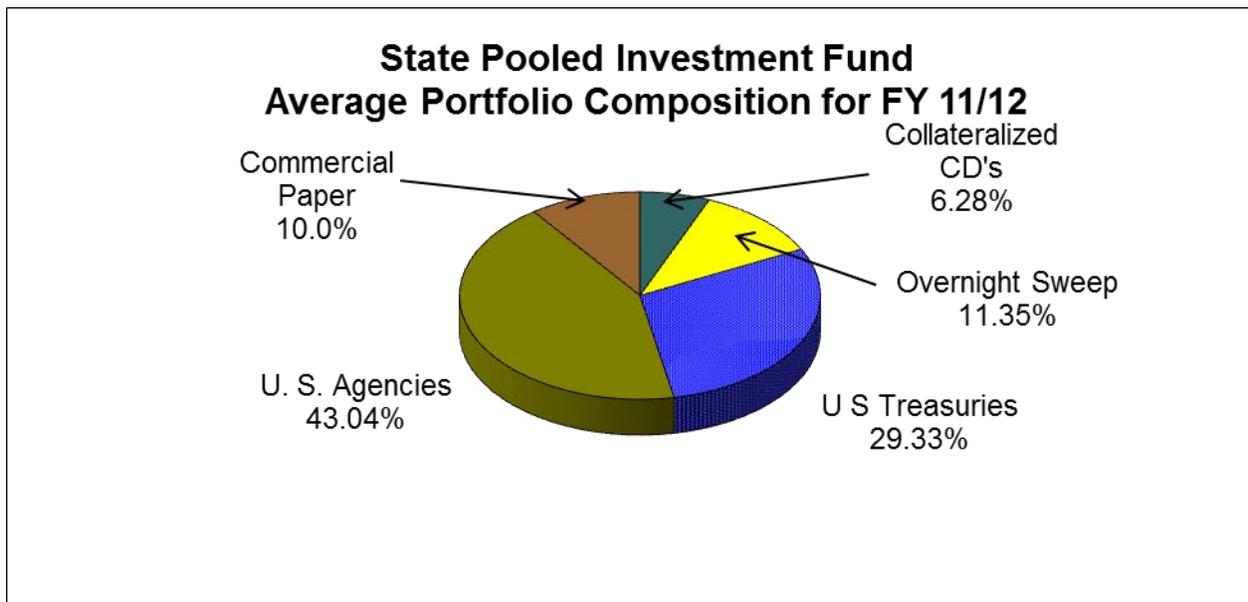
TENNESSEE TREASURY DEPARTMENT
State Pooled Investment Fund Report
For the fiscal year ended June 30, 2012

I. COMPLIANCE WITH INVESTMENT POLICY

The investment policy for the State Pooled Investment Fund 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 state pooled investment fund is to obtain the highest available return on investments consistent with the preservation of principal, while maintaining sufficient liquidity for state expenditures and other withdrawals from the state pooled investment fund.

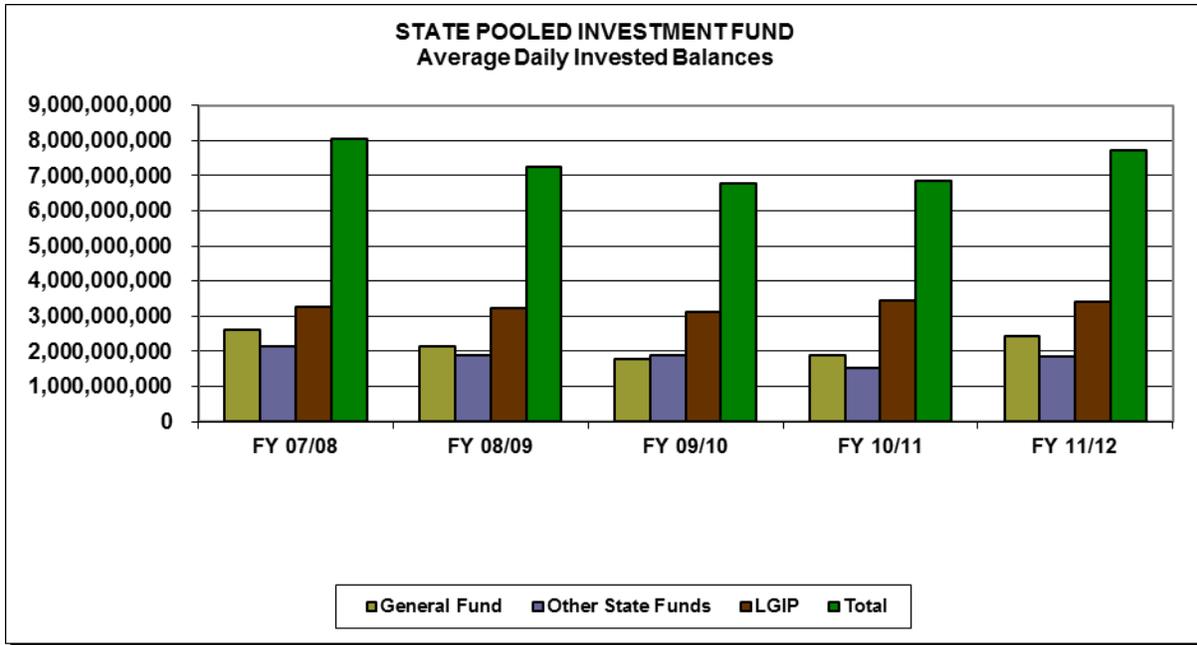
Portfolio Composition

The State Pooled Investment Fund had a monthly average of \$ 7.716 billion invested for the fiscal year ended June 30, 2012. The following chart shows the composition of the average portfolio.



Notice in the graph that the average invested in commercial paper during the year was 10.0% of the SPIF which is within the policy limitation (total of 40% of the SPIF, 35% up to 180 days and 5% overnight). The investment policy provides for investment in collateralized certificates of deposit as a priority over other investments to the extent in-state financial institutions want the CD's at the state's assigned rate. Typically, U. S. Agency securities are acquired instead of Treasuries when the yield spread makes them more attractive to own. This year, limited supply of other approved securities was the reason more Treasuries were acquired.

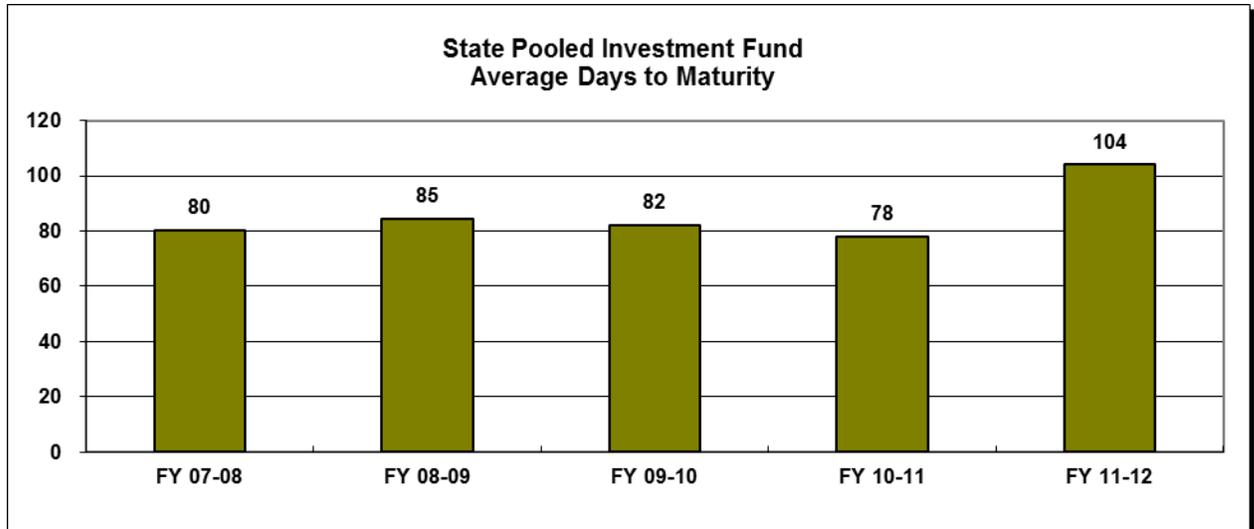
The following chart shows the average monthly balances in the state pooled investment fund for the last five years. At 6/30/12, the LGIP balance comprised 38.02% of the state pooled investment fund. The actual balance of funds available to invest on behalf of the General fund (Unrestricted Accounts) increased \$776.3 million (33%) from \$2.35 billion for 10/11 to \$3.12 billion for 11/12.



Liquidity

The Governmental Accounting Standards Board (GASB) issued a statement on “Accounting and Financial Reporting for Certain Investments and for External Investment Pools” (GASB Statement 31) which impacted the investment policy for the State Pooled Investment Fund (SPIF). The SPIF is operated in a manner consistent with the Security and Exchange Commission’s Rule 2a7 of the Investment Company Act of 1940. Until 2010, this rule required a dollar weighted average portfolio maturity of 90 days or less and a maximum maturity of any single investment of 397 days or less. In 2010, the SEC made further modifications that allow a dollar weighted average maturity of either 60 days or 120 days, based upon reporting methods used.

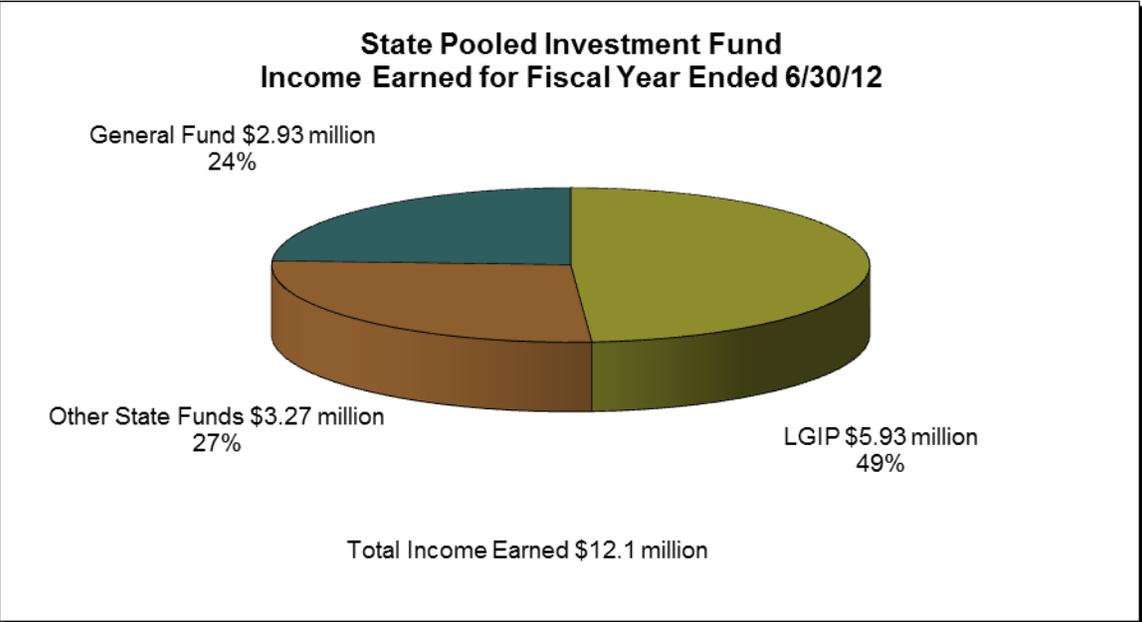
The following chart shows the dollar weighted average maturity of the SPIF over the past five years.



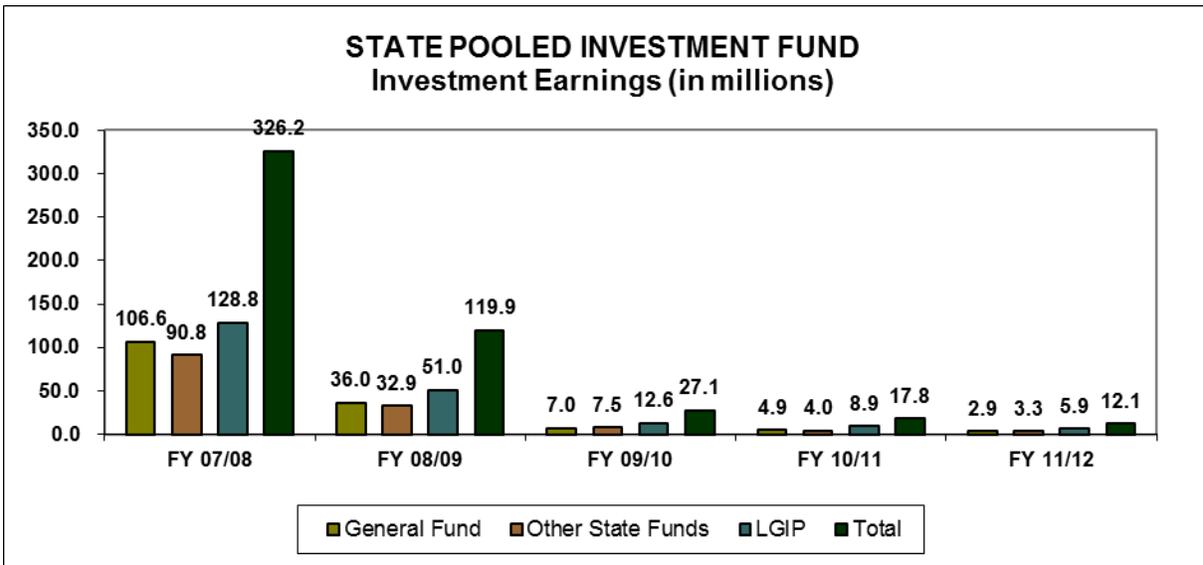
The additional liquidity requirements that were added in 2010 by the SEC also required that no more than 5% of the portfolio can be invested in illiquid securities, at least 10% of the portfolio must be invested in daily liquid assets, and at least 30% of the portfolio must be invested in weekly liquid assets. At June 30, 2012, the SPIF had 0% invested in illiquid securities, 89.4% was invested in daily liquid assets, and 96.6% was invested in weekly liquid assets.

II. PORTFOLIO PERFORMANCE

Income earned on the portfolio during the fiscal year ended June 30, 2012 totaled \$12.1 million. The distribution of earnings as shown on the following pie chart was \$2.93 million to the General fund; \$5.93 million to the LGIP; and, \$3.27 million to Other State funds (accounts specified by statute, court order or regulation to receive interest earnings on their balances). Examples include the funds of TWRA, the Risk Management Fund, and the Group Insurance Fund.



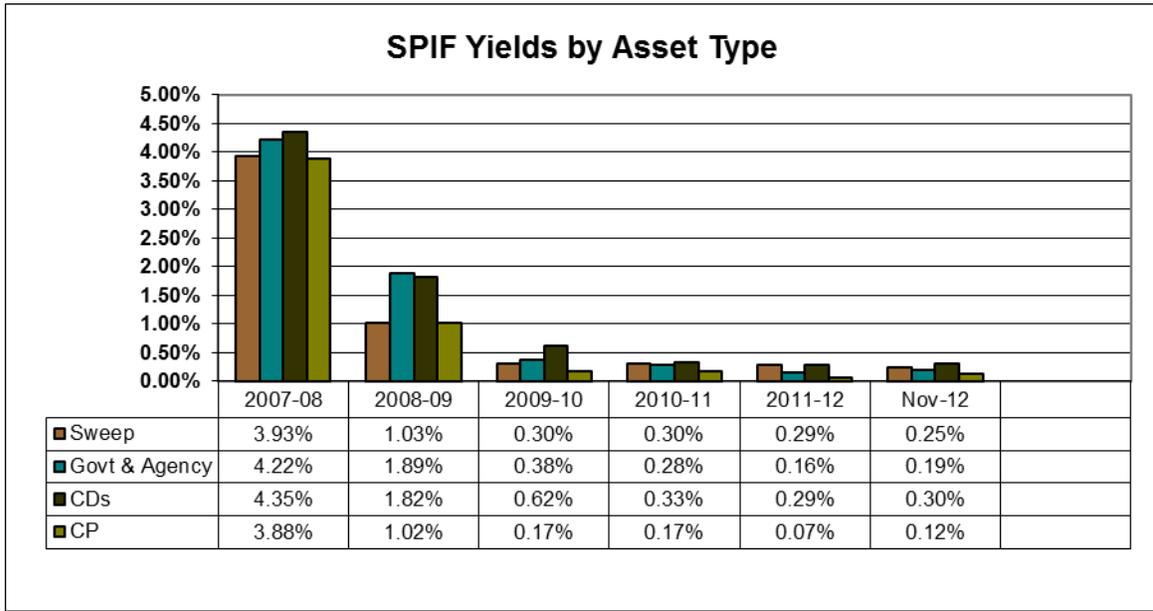
The monies in the SPIF represent the liquid working capital available to the State of Tennessee to cover expenditures until additional revenues are collected. Earnings of the state pooled investment fund for the last five years are shown in the following chart.



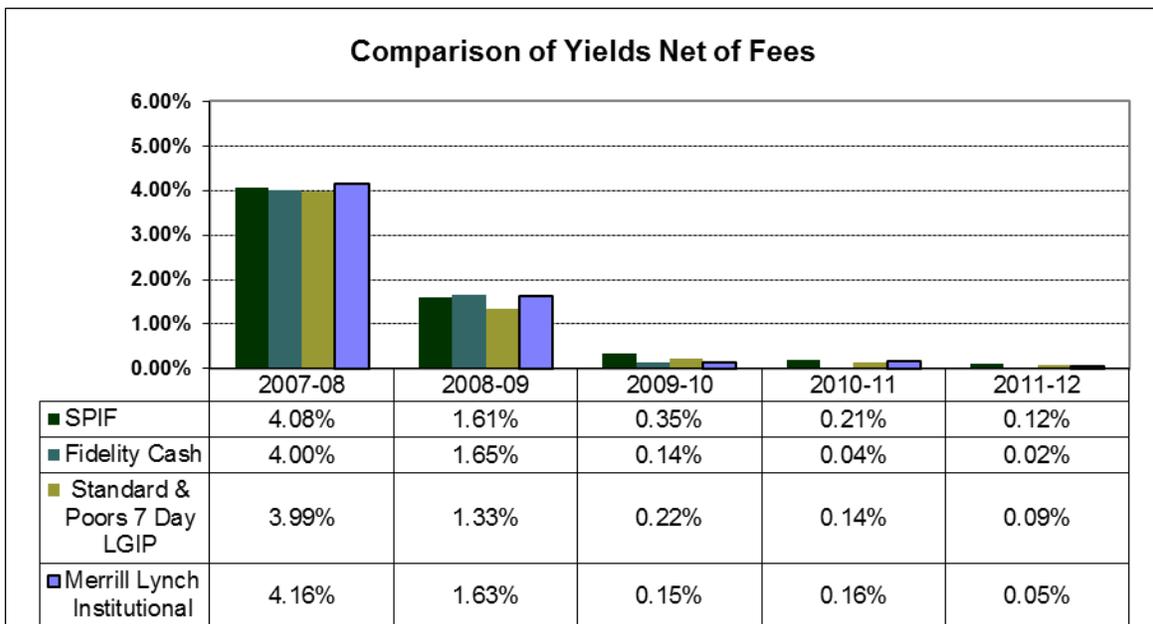
The fed funds target rate was lowered on 12/16/08 to a range of 0% to 0.25% and still remains at that level. The FOMC has given mixed signals recently regarding the timing of the next move in monetary policy, but the futures market anticipates little change over the next 12 months. The chart below shows the actions taken at each of the meetings for the last eighteen months.

FOMC Announcement Date	Fed Funds Target Rate	Direction	Amount of Change	Primary Credit Rate	Economic Assessment
04/27/2011	0 to 0.25%	None	None	3.25%	Growth Risk
06/22/2011	0 to 0.25%	None	None	3.25%	Growth Risk
08/09/2011	0 to 0.25%	None	None	3.25%	Growth Risk
09/21/2011	0 to 0.25%	None	None	3.25%	Growth Risk
11/02/2011	0 to 0.25%	None	None	3.25%	Growth Risk
12/13/2011	0 to 0.25%	None	None	3.25%	Growth Risk
01/25/2012	0 to 0.25%	None	None	3.25%	Growth Risk
02/18/2011	0 to 0.25%	None	None	3.25%	Growth Risk
03/13/2012	0 to 0.25%	None	None	3.25%	Growth Risk
04/25/2012	0 to 0.25%	None	None	3.25%	Growth Risk
06/20/2012	0 to 0.25%	None	None	3.25%	Growth Risk
08/01/2012	0 to 0.25%	None	None	3.25%	Growth Risk
09/13/2012	0 to 0.25%	None	None	3.25%	Growth Risk
10/24/2012	0 to 0.25%	None	None	3.25%	Growth Risk

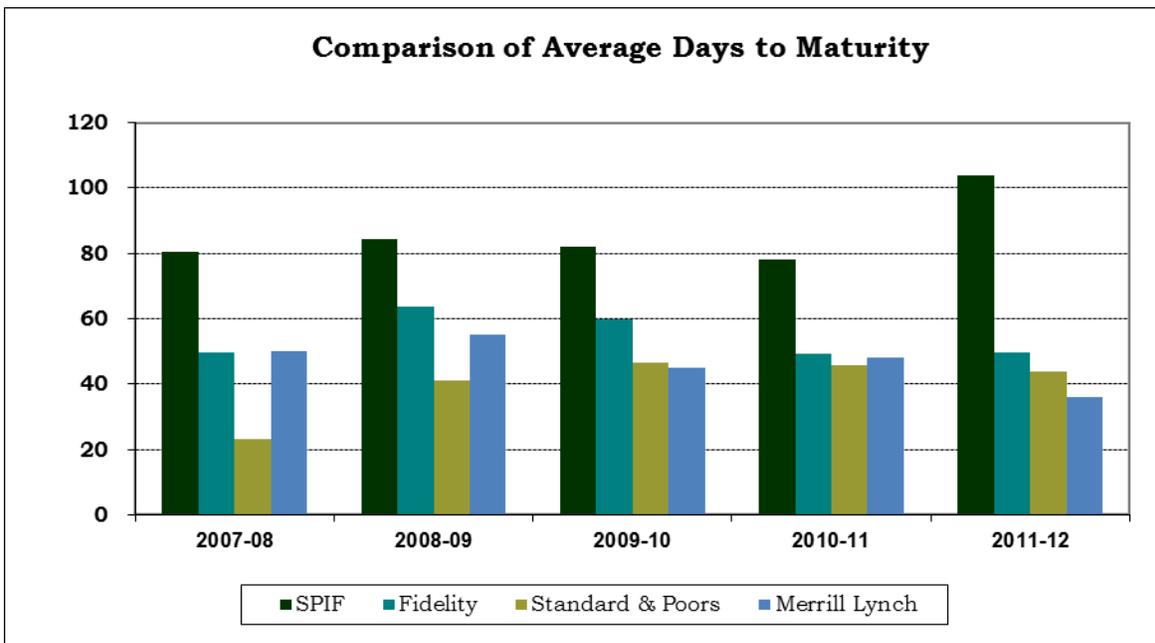
The following chart contains the average yields earned by asset type within the SPIF for the last five years and for the month of November, 2012.



The State Pooled Investment Fund is actively managed within the Treasury Department. Standard and Poor's provides a rating service for LGIP funds and calculates an index return for the rated funds. The following chart compares the average yield of the SPIF (net of administrative fee) to that index and also to the net yield of two well recognized money market funds governed by SEC Rule 2a7, Fidelity Cash Reserves Fund and the Merrill Lynch Institutional Fund.



The following chart indicates how the average days to maturity of the State Pooled Investment Fund compares to the average maturity of the Standard and Poor's rated funds index, Fidelity Cash Reserves Fund, and the Merrill Lynch Institutional Fund.



III. INVESTMENT POLICY REVIEW

There is a possibility that changes will need to be made to the SPiF Investment Policy during the next year. There are changes being proposed to the rules for SEC 2a-7 funds, and the SPiF is considered a 2a-7 like fund in order to comply with GASB 31 rules. Also, with the many challenges facing the economy, any changes that will add to the safety or liquidity of the SPiF will need to be considered as well.

IV. INVESTMENT PLAN

Four years ago, the FOMC lowered the Fed Funds rate to a range of zero to 0.25%. The rate has remained unchanged since that time. Based upon Fed Funds Futures, the overnight rate shows very little change during the next 12 to 24 months. This means that the earnings generated by the SPiF will be immaterial. Staff will continue to seek ways to generate as much revenue as possible and remain in compliance with the Investment Policy. Staff will continue to maintain a diversified portfolio of CDs, bank deposits, US Government obligations, and commercial paper. The yield curve, actions taken by the Federal Reserve Bank, regulatory changes, and other market conditions will be considered when managing the asset mix and average maturity of the portfolio. At the time this is being written, the Transaction Account Guarantee program that insures all bank deposits in non-interest bearing accounts with unlimited FDIC coverage is scheduled to expire on December 31, 2012. If this program is not extended, analysts believe that a majority of these funds will flow into the money market sector. Inventory is already limited, and any event that drives more cash into the money market sector will force rates lower. Even with these challenges, the SPiF remains a safe investment for state funds and monies invested by local government officials. There has been no loss of funds due to credit exposure and no liquidity concerns.

V. COST OF ADMINISTRATION

The cost to operate the SPIF was \$2.995 million for the year ended June 30, 2012. The costs of operations are funded from a 5 basis point charge for assets invested. Most money market 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
- Maintenance of collateral
- Collateral pool administration
- Cash concentration
- Bank reconciliations and resolution of reconciling items
- LGIP program
- Warrant reconciliation
- Accounting and recordkeeping
- Support cost such as internal audit, payroll, personnel, etc.

VI. LARGEST HOLDINGS AT JUNE 30, 2012 BY CATEGORY

Treasuries and Agencies

1. FHLB	\$2,016,839,000
2. FHLMC	782,757,000
3. FFCB	364,882,000
4. FNMA	289,168,000

Commercial Paper

1. BNP Paribas	\$350,000,000
2. Toyota Motor Credit	150,000,000
3. General Electric	100,000,000
4. Pepsi	100,000,000

Bank CD's

1. B B & T	\$275,000,000
2. First Tennessee	100,000,000
3. Pinnacle	70,000,000
4. CapitalMark Bank	27,000,000

Principal Stability Fund Rating Sensitivity Matrix

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WAM (R)	124
WAM (F)	124
Shares Outstanding:	8,322,731,789.00
Total Fund Assets:	8,313,925,340.04
Market Value (NAV):	0.998942
Credit Spread Movement (bps):	5
% Total Credit (Non Gov't) Securities (of portfolio)	28%
% Corporate Floaters (of portfolio)	0%
Total \$ Loss:	(\$8,806,449)
Total \$ Gain:	\$0

FILL IN/ADJUST AREAS SHADED GREEN TO RUN SCENARIOS

Basis Point Shift	Selected Shareholders	Largest Redemption over 5 consecutive business days								Gain (Loss)
300	0.986002	0.987448	0.985879	0.987448	0.988108	0.988703	0.989241	0.990586	(94,021,693)	
250	0.988107	0.989335	0.988002	0.989335	0.989896	0.990402	0.990859	0.992001	(79,884,450)	
200	0.990212	0.991223	0.990125	0.991223	0.991685	0.992100	0.992476	0.993417	(65,747,207)	
175	0.991264	0.992166	0.991187	0.992166	0.992579	0.992950	0.993285	0.994125	(58,678,585)	
150	0.992316	0.993110	0.992249	0.993110	0.993473	0.993799	0.994094	0.994832	(51,609,963)	
125	0.993369	0.994054	0.993310	0.994054	0.994367	0.994648	0.994903	0.995540	(44,541,342)	
100	0.994421	0.994997	0.994372	0.994997	0.995261	0.995498	0.995712	0.996248	(37,472,720)	
75	0.995473	0.995941	0.995434	0.995941	0.996155	0.996347	0.996521	0.996956	(30,404,099)	
50	0.996526	0.996885	0.996495	0.996885	0.997049	0.997196	0.997330	0.997663	(23,335,477)	
25	0.997578	0.997828	0.997557	0.997828	0.997943	0.998045	0.998139	0.998371	(16,266,856)	
0	0.998631	0.998772	0.998619	0.998772	0.998837	0.998895	0.998947	0.999079	(9,198,234)	
-25	0.999683	0.999716	0.999680	0.999716	0.999731	0.999744	0.999756	0.999787	(2,129,613)	
-50	1.000735	1.000659	1.000742	1.000659	1.000625	1.000593	1.000565	1.000495	4,939,009	
-75	1.001788	1.001603	1.001803	1.001603	1.001519	1.001443	1.001374	1.001202	12,007,630	
-100	1.002840	1.002547	1.002865	1.002547	1.002413	1.002292	1.002183	1.001910	19,076,252	
-125	1.003892	1.003490	1.003927	1.003490	1.003307	1.003141	1.002992	1.002618	26,144,873	
-150	1.004945	1.004434	1.004988	1.004434	1.004201	1.003991	1.003801	1.003326	33,213,495	
-175	1.005997	1.005378	1.006050	1.005378	1.005095	1.004840	1.004610	1.004033	40,282,116	
-200	1.007049	1.006321	1.007112	1.006321	1.005989	1.005689	1.005418	1.004741	47,350,738	
-250	1.009154	1.008209	1.009235	1.008209	1.007777	1.007388	1.007036	1.006157	61,487,981	
-300	1.011259	1.010096	1.011358	1.010096	1.009565	1.009087	1.008654	1.007572	75,625,224	
<i>Redemptions/Subscriptions</i>	-19%	-10%	-20%	-10%	-5%	0%	5%	20%		
<i>Shares Outstanding</i>	6,716,907,305	7,490,458,610	6,658,185,431	7,490,458,610	7,906,595,200	8,322,731,789	8,738,868,378	9,987,278,147		

Shift Upon NAV = NAV - (WAM/365) * (Bp/10,000)

Dilution Upon NAV= (NAV + Change) / (1+ Change)

Top 10 Shareholders		% of Fund	Stress Redemption
Metro Nashville	570,929,718.69	6.87%	Yes
City of Knoxville	213,754,435.93	2.57%	Yes
Memphis City Schools	156,121,740.67	1.88%	Yes
Shelby County	127,183,061.47	1.53%	Yes
Rutherford County	115,455,123.78	1.39%	Yes
Univeristy of Memphis	104,024,206.08	1.25%	Yes
Tennessee Tech	93,919,983.74	1.13%	Yes
Middle State University	84,303,397.55	1.01%	Yes
ETSU	73,530,578.46	0.88%	Yes
Southwest TN Community College	64,903,082.42	0.78%	Yes
Stress Top 10	\$ 1,604,125,328.79	19.29%	Yes
Total Fund Assets	\$ 8,313,925,340.04	100%	1,604,125,328.79

Largest Five Day Redemption (%)	10%
	6/29-7/03/08

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