Treasury Investment Board Meeting
May 15, 2023, 1:00 p.m. Village Hall

Members Present:	Mayor Koons, Fiscal Officer Romanowski, Solicitor Matheney, Tom King
Members Absent:	Finance Committee Chair Berger
Visitor:	Eileen Stanic, Meeder Investment Management

The Mayor called the meeting to order. Members introduced themselves, and the Mayor noted that the Finance Committee Chair and Council member Galicki were unavailable.

Eileen Stanic said that in reviewing Council meeting minutes and Finance Committee minutes, it appeared the Village had a lot going on since the previous board discussion in November 2022. She thought this meeting was well timed in terms of what was happening with Council and the Village, and how that should impact the investment decisions from a cashflow standpoint.

Stanic addressed what had been going on in the marketplace. The Federal Reserve drives a lot of what Meeder sees as it relates to short-term interest rates. Longer-term interest rates are driven more so by the market's outlook for inflation and economic growth. When the Federal Reserve meets, as they did in March, they issue an updated forecast of where they believe the overnight rate should be. Referring to a handout she distributed, Stanic said the dot plot compares the December 2022 forecast to the March 2023 forecast and shows the Feds' guidance to the marketplace of the appropriate level of the overnight rate at the end of each year. In looking at the blue dots of 2023, the majority align with an overnight rate in the range of 5 to 5.25% Stanic said that some members of the committee believe rates should be higher. However, in looking out to the Feds' guidance in 2024 and 2025, there is a broader dispersion of those forecasts as expected given the elements of longer-term forecasts. It can be seen clearly that short-term rates will be lower in 2024 and 2025. The Fed has a bias to project rates returning to what is called the "longer run," which is the level of overnight rates that the Fed feels would be supportive of a U.S. economy that is operating with stable prices, i.e., an inflation target of 2% and full employment.

The market has its own opinion and varies on a daily basis. Stanic referred to a graph showing the Fed funds, futures, indications, and at different points in time. To demonstrate the market's volatility, the December Fed's projection was used for the graph, which viewed the U.S. economy as softening more than it has. The market was pricing in a much lower level of the overnight rate. Strong jobs numbers were received. Inflation did not come down as quickly as the market would like to see. As a result, the March 8th portion of the graph showed that the market priced in expectation that the Fed would raise rates above either the levels they were originally projecting three months prior, but that the expectations rates would be lower into 2024. However, then the banking turmoil occurred with the failures. Given that this has been the fastest pace of increasing rates in 40 years, it is not unusual to see stress in the banking industry. The market has begun to price rates being much lower faster. In seeing the reaction in the marketplace, it demonstrates that clearly there is a lot of uncertainty and there always is even when things look like they are on one path. Sometimes all it takes is one event to reverse course.

Overall, in looking at the longer term beyond 2023, the trends are the same. The Fed is setting guidance in 2024 that rates will be lower and the market is expecting the same.

This divergence, known as "great rate debate", has also played out in market volatility. Market volatility means that as the market adjusts its expectations of where rates will be, and considering the increase in uncertainty even with the U.S. economy, the variation can be seen in the price of the two-year U.S. Treasury. Meeder uses the two-year U.S. Treasury because it tends to be a benchmark security and many of their investment portfolios have a weighted average maturity of around two years. As shown on the graph Stanic distributed, there is a glimpse of how volatility had been limited prior to the latter part of 2022 and early 2023 where there are significant swings. From Meeder's perspective, this means that with the price of the securities in which they are investing, the value of those securities has changed rapidly higher and lower based on the uncertainty in the marketplace. It is neither a good nor a bad thing from the Village's perspective and creates opportunities. As it monitors volatility, Meeder considers the timing for purchasing as they reinvest. The market is saying that the Fed must lower rates faster, which is playing out in where Meeder is seeing the two-year U.S. Treasury yield. It has dropped, but looking back over the past seven years, the level of interest rates is higher than what it has been and continues to remain higher than previously seen. This creates uncertainty as well since there is an entire generation of investors who have only known an environment of low interest rates. Likewise, there are businesses that have only experienced low borrowing costs. Now that rates have returned to normal levels, this is creating some stress in the economy, and contributing to the divergence between the Fed and the market where the market is a little ahead of the Fed.

The Labor market has allowed the Fed to maintain rates where they are and has supported the Fed in continuing to raise interest rates above and beyond the inflation picture. She referred to a chart she distributed which showed the change in nonfarm payrolls, which is an indication of job growth. There was much stronger job growth in latter 2021 into early 2022 than what has been experienced lately. Job growth has been strong but at a much slower rate. The unemployment rate stands at 3.4%, which has not been seen since the 1960's. What is also being seen is an increase in the number of companies laying off individuals and an increase in those people filing initial claims for unemployment insurance. Additionally, there has been a drop in job openings, and she suspected that companies learned to function with fewer employees through automation or because business is slowing down. Four months ago, the number of job openings was over 10 million, where now it is 9.5 million, which is significant. The concern is that with the turmoil in banking, this will translate into increased costs within the banking industry. When an organization starts to realize increased costs, it looks to what can be reduced to offset the cost; generally, it is people. She summarized that the labor market has been strong but is starting to slow down a bit. Inflation has also started to come down, but not at the pace the Fed would like to see. Wage growth has remained relatively solid but has trended down from the highs seen last year.

All of this is playing out into the level of interest rates. She referred to page 7 of the handout, which showed the U.S. Treasury yield curve. It indicated where interest rates were at the end of April 2022, where rates are today, and the level of Treasury yields on October 20th, which marked the high point as far as term interest rates. What was interesting to note was the shape of the yield curve. Up to this point, the yield curve had not been inverted, but had been upward sloping or relatively flat. It is now inverted, which is when short-term interest rates are higher than longer-term interest rates. This is a reliable indicator of a recession forthcoming in the next six to twelve months. It is not good at revealing when it will happen or if it is already occurring. Nor does it tell the severity or lack of depth of it as well as the amount of time it will take. It is an inflection point within the U.S. economy where there are a lot of moving parts, some of which are starting to point more negatively, while others still continue to show strength. The data will determine how this all pans out.

Stanic referred to a graph showing the average Local Government Investment Pool (LGIP), which is a national index and includes Star Ohio. When the graph gets to where it is no longer rising, it tops out, shifts, and there is a pivot where it can be seen that the overnight rate can drop quickly. In view of the rhetoric from the Fed, expectations are that they will not raise interest rates another 25 basis points but will be at a pause. From a technical standpoint, the short-term overnight rates will flatten out. Based on the data, it may be at this inflection point where the next move of the Fed in the next three to six months will be to start to cut rates. This will translate directly to something like a Star Ohio.

The Mayor asked how volatile it would be after next month's meeting with the Fed. Stanic did not think it would be very volatile for that reason. Volatility would be the result of the market expecting that rates would not be changed, but the Fed going ahead and doing it. As long as there are no surprises, the volatility within the marketplace remains relatively contained. With the June meeting, she expects an updated dot plot and forecast from the Fed. She did not anticipate anything that would be a surprise and that the dots would show cuts or convergence around the current levels versus March. At the end of each meeting, the Fed issues a statement, which is analyzed by the market. The May statement changed a little, which contributed to the market thinking that the Fed felt additional rates hikes were appropriate. It is month by month, looking at the data, and perhaps setting the stage that the appropriate level of overnight rates has been reached. As long as they continue the same message, this would not be a surprise. The Mayor asked if they are confident they have tamed inflation. Stanic explained that they are confident in the trend that inflation will continue to trend down. Monetary policy works with a lag, which historically has been six months. In thinking of the 10 rate hikes that have occurred over the past 14 months, the first 8 months of rate movements have flowed through the economy and the remaining have not completely flowed through. The Fed is feeling that the path of inflation will continue to trend down. The Mayor said that cruise ships are packed, and airports are packed which does not balance together with a recession coming. Stanic agreed and explained that there is data that is very strong and other data that is pointing in the opposite direction. This is what is creating volatility in the marketplace and a high degree of uncertainty.

Stanic addressed the Village's portfolio at the end of April. The Star Ohio balance was $620,000. Securities are a little over $1,000,000 for a total of $1.6 million. The weighted average maturity of the securities is at 2.18% and the effective duration is at 2.05%. The weighted average yield is just under 4% which is an uptick. Asset allocation for the holdings is very heavily weighted in

Treasury securities. These offer the highest safety in the uncertain economic cycle. Regarding maturity distributions, they are more heavily weighted towards the shortened side of the three-year period. The Village works on what the cashflow needs will be, and whether there is a need to continue to shorten that up. Since funds were invested in the portfolio, rates are lower, so if there is a decision to sell, it can be done without taking a principal loss. The market value of the securities is more than what the cost basis was. King asked how municipal accounting worked for the valuation of bonds/fixed income securities. Stanic stated it is included in the disclosure and footnotes at the year-end, so it is not booked. King clarified the changes in market value are not adjusted. Stanic concurred. The Village's books reflect cost, which goes back to municipalities keeping their books on a cash basis and then doing a gap conversion for their financial statements, which brings in market values for footnote disclosures and accrued income is booked at this point. Income is not booked on a month-to-month basis based on accruals. It is just cash. She further explained that this is because it aligns things from a budgetary standpoint because the budgets are based on cash.

Stanic said that the Village has $230,000 or 23% of the portfolio maturing within the next 12 months and almost 25% maturing in the next year thereafter. The Village is clearly positioned to meet any cashflow needs.

The Mayor commented that the Village is going to ride this out for the next two years. Stanic agreed, but added that unless the Village starts spending down, then the portfolio will get smaller. King said that what Stanic was saying was that these values were what the Village paid for these securities. The Village will get hurt if two things happen; interest rates shoot up and there is a need for money fast. It would be necessary to sell securities to create cash and it would be selling at a loss. The duration number is a rule of thumb to illustrate if the Village had an instantaneous 1%-point jump or drop-in interest rates, this is the value change in opposite direction for the portfolio. There is a duration of two years and if interest rates shot up 1% in a day, which is unlikely, the Village would lose 2% of the value of the portfolio. So, the shorter the duration, the less interest rate risk there is. In his opinion, the Village has a very low risk portfolio.

The Fiscal Officer advised that the Village is working on its five-year forecast. By June or July, she hoped that Council would review and approve it. It could then be shared with the county and public to show the plan looking forward five years. This would be a huge change for the Village, which has always operated on a one-year basis. With it, the Village would have a better idea of its financial needs. The Village is currently in the middle of a bunch of projects. The plan is to shift the attention to look forward five years to determine plans so that they would know how to invest its money. Stanic addressed the anticipated maturities and thought it would be prudent to keep the investment short-term inside of a year. The Fiscal Officer concurred.

King clarified that the Village has $1.6 million invested with Meeder and there is $3.4 million in total cash. The Fiscal Officer stated the total includes that. King concluded that the difference was in the bank.

The Fiscal Officer explained that the Finance Committee wants to create a Reserve Policy (which is the cash reserve on hand) and asked how this number is determined. Stanic said one method is to take the year-end cash balance and say that they would always want to have 20-25% as a reserve. In the Village's case of $3.5 million, this would be somewhere between $600,000 and $750,000. If balances reached this point, the Finance Committee would need to discuss what would have to give. An alternative is to establish a Reserve Policy based on so many months' worth of budgeted expenditures, especially the operating expenditures and keeping track of projected project expenditures. Whether this is for three or six months comes down to the level of comfort. Her recommendation is to start with a little larger number to see how it goes. With time it can be fine-tuned. The Mayor asked if keeping $1 million is too cautious. Stanic did not think so considering that the Village potentially has a lot going on. Secondly, the Village has not had a Reserve Policy in the past. She advised setting the bar a little high and then within the reserve policy stating that it will be reassessed on an annual basis. This provides the setting of an amount, but then the option in a year to adjust it according to what is going on in the Village.

King suggested determining the amount of the annual non-discretionary expenditures for running the Village but not including the projects. This would be the amount to either have in the bank or with Meeder at the very shortest maturity. This would allow the Village to keep the lights on for a year while figuring out what to do in the event things became terrible. He summarized that the plan would allow the Village to pay its operating bills for a year. He tells his students to have six months cash in the bank, so that if they were to lose their jobs, they would have six months to figure things out. It takes the government longer to get things done, so he thought a year was more appropriate. This would be a simple number to explain to the taxpayers. Stanic offered that this would be for things like payroll, utilities, property taxes, etc.

The date for the next meeting was discussed. The Mayor proposed Tuesday, September 5, 2023, at 9:00 p.m. The Mayor adjourned the meeting at 1:39 p.m.

King reminded the group that the difference between the investment market is seeing and what the Village is receiving in interest from the bank for cash deposited is a potential loss.

King asked the Fiscal Officer if she could provide him with the Village's annual income tax collection amounts. She will forward that information to him.