COMMONWEALTH OF VIRGINIA
Department of the Treasury
Manju S. Ganeriwala, State Treasurer
P. O. Box 1879
Richmond, Virginia 23218

Toll-Free (800) 643-7800
Phone (804) 786-1156
Fax (804) 225-3478

Participant Newsletter December 31, 2017

LGIP
Investment Guidelines Compliance (12-31-17):

● Diversification:	Actual	Max.
U. S. Treasury/Agency	21%	100%
Repurchase Agreements	15%	50%
Negotiable CDs & BAs	35%	40%
Commercial Paper	29%	35%
Corporate	0%	25%
AAA Sovereign Govt	0%	10%
● Maturity Limitations:		
Average Days to Maturity	51 days	60 days

LGIP Monthly Statistics:

- Avg NAV: 4,751,000,000
- Active Accounts: 791
- Simple Yield: 1.34%
- Effective Yield: 1.34%
- NAV (per Share): $1.00

Quarterly Performance:

● Average Yield:	2nd Qtr FY 18	YTD FY 18
LGIP ($ weighted)	1.27%	1.22%
Institutional Money Funds[1]	0.86%	0.81%
Treasury 3-Mo. Constant Maturity[2]	1.22%	1.14%

[1]Consists of 468 institutional money market funds totaling $1,815 billion as reported by iMoneyNet as of 12-31-17.

[2]Federal Reserve Bank H.15 Release.

LGIP EM
Investment Guidelines Compliance (12-31-17):

.Diversification:	Actual	Max.
U. S. Treasury/Agency	41%	100%
Repurchase Agreements	0%	50%
Negotiable CDs & BAs	31%	45%
Commercial Paper	18%	35%
Corporate	4%	25%
AAA Sovereign Govt	4%	10%
Virginia Treasury LGIP Portfolio	2%	15%
● Duration Limitations:	0.81 years	1 Yr +/-3Mo

LGIP EM Monthly Statistics:

- NAV: 161,684,000
- Active Accounts: 16
- Simple Yield: 1.43%
- Yield as of 12-31-17: 1.48%
- NAV (per Share): $9.97

Quarterly Performance:

	2nd Qtr FY 18	YTD FY 18
● Total Return:		
LGIP EM	0.08%	0.30%
U.S. 1-Year Treasury Bill Index[1]	0.10%	0.31%
● Average Yield:		
LGIP EM ($ weighted)	1.40%	1.34%
U.S. 1-Year Treasury Bill Index[2]	1.57%	1.40%

[1]The annual performance benchmark is BofA Merrill Lynch U.S. 1-year Treasury Bill Index + 15 bps.

[2]The BofA Merrill Lynch US 1-year Treasury Bill Index Yield to Maturity as of 12-31 2017.

Market and Economic News

During the September to December quarter, the US Treasury yield curve flattened as short-term rates increased and long-term rates declined. One- and two-year Treasury yields increased 40 basis points during the final quarter of 2017 and 93 and 70 basis points, respectively, during calendar 2017, driven by the tightening domestic monetary policy environment. US economic growth indicators continue to reflect a gradual, albeit robust, recovery and expectations for a long awaited pickup in inflation are ratcheting higher. The final estimate for third quarter US GDP growth showed the economy grew at a 3.2 percent pace, driven primarily by personal consumption expenditures, inventory investments, exports, federal government spending, and state local government spending. Market participants continue to be focused on tax reform and the changing makeup of the Fed's Open Market Committee (FOMC), where developments have generally bolstered equity and other risk markets, contributing to policy-makers' case for further rates hikes in 2018.

The FOMC raised policy rates 25 basis points, as expected, to the 1.25 percent to 1.50 percent range at their December meeting. Policymakers increased rates three times during calendar 2017, largely in-line with analyst expectations at the beginning of the year. The accompanying meeting statement characterized economic growth as "rising at a solid pace" and noted that employment conditions continue to improve but admitted that inflation readings remain below target levels. The ‘dot plot’ addendum showed that FOMC participants generally expect three more 25 basis point rate hikes during 2018. The Committee raised GDP growth estimates for 2018-2020, somewhat resulting from expected stimulative effects of tax reform according to outgoing Fed Chair Yellen, although not enough to accelerate policy tightening. The unemployment rate forecast was revised lower (from 4.1 percent to 3.9 percent next year), illustrating continued labor market strength. Janet Yellen’s replacement as Fed Chair, Jerome Powell, is not expected to diverge significantly from the Fed’s current gradualist monetary policy stance although there has been some recent speculation over the way policymakers assess inflation (‘price stability’) in their decision-making.

A large focus in financial markets recently has been the dramatic flattening of the US Treasury yield curve during the September to December quarter. The basis point spread between 2-year Treasury Notes and 30-year Treasury Bonds declined almost 50 basis points, which is the tightest spread over the last decade. At the time of this writing, markets are pricing an approximate 75 percent chance that the Fed will increase rates in March 2018 and a 50 percent chance that policy rates will be close to 2.0 percent by mid-summer 2018. Some market analysts are penciling in four policy rate hikes during 2018. This is notable because if the Fed continues raising rates at the current pace, the Treasury yield curve may ‘invert’ in that short rates will be higher than long rates. Conventional wisdom suggests that an inverted yield curve is a predictor of recessionary economic conditions although many market strategists do not necessarily agree. Technical factors including the Fed’s outsized balance sheet and negative rates in foreign markets seem to be among the reasons that historical signaling interpretation of the shape of the Treasury yield curve may not hold in the current environment.

The short average maturity profile of the LGIP (less than 60 days) and the LGIP EM (approximately 1 year) allow the overall yield-to-maturity of these funds to more quickly adjust to higher short-term rates compared to portfolios with longer overall maturity profiles. However, over the short term, the market valuation of the securities in the portfolios will decline as rates rise, resulting in a declining overall share price, particularly for the LGIP EM portfolio as it is marked-to-market on a daily basis. The current expectation is that short-term rates will stabilize and unrealized losses will diminish as securities mature off and are reinvested at higher rates.

Please feel free to contact us at (800) 643-7800 with any questions regarding either of the LGIP program investment options.