

Memorandum

To: ISO Board of Governors

From: Steve Berberich, Vice President, Technology and Corporate Services
and Chief Financial Officer

Date: March 17, 2010

Re: **2009 Annual Investment Report**

This memorandum does not require Board action.

EXECUTIVE SUMMARY

The investment policy of the California Independent System Operator Corporation requires the Chief Financial Officer to submit an annual investment report to the ISO Board of Governors. This report provides the Board with information about the 2009 investment performance¹ and year-end unrestricted and restricted fund balances related to operations and debt issuance. In general, the funds we invest are ISO corporate funds from bond offerings or general business operations and market related funds associated with generation interconnection deposits, collateral and other funds held for market accounts. Because of the nature of the funds, we pursue a very conservative investment approach focused on principal preservation.

- The ISO achieved an investment return of 1.56% during 2009. The return was 155 basis points better than the benchmark return of US Treasury money market funds of 0.01%.
- A rebalancing of the portfolio began in 2009 to diversify the portfolio away from its heavy concentration in the financial and insurance sectors. The percentage invested in financials and insurance declined from 89% in 2008 to 41% currently.
- The ISO continues to hold the AIG Subsidiary International Lease Finance Corp bond and will continue to closely monitor that position.
- There are still several macroeconomic risks. We continue to experience a low yield investing environment. There is also the risk of interest rates rising which would decrease the market prices of the bonds that the ISO holds.

¹ 2009 Year End Results referenced in this report are unaudited

DISCUSSION AND ANALYSIS

Account Value

The market value of the ISO portfolio as of December 31, 2009 was \$447.5 million, consisting of \$230.1 million (or 51%) in operations-related funds (funds consisting of payables, accrued operating costs, generation interconnection deposits, operating and debt service reserves) and \$217.4 million (or 49%) in restricted bond funds that are for special purposes such as the new building or other capital spending as well as funds held in trust for the market. A portfolio summary can be found in Attachment 1a, and a report of detailed portfolio holdings in Attachments 1b and 1c.

Performance

Despite a difficult investing environment due to the financial crisis, the ISO achieved an investment return of 1.56% in 2009 compared to the benchmark return of 0.01% in treasury money markets, for a spread of 1.55% (Attachment 1d). This return is inclusive of annual interest earnings and changes in market value.

Corporate Portfolio Mix

The ISO has also made significant progress in the diversification of the corporate portfolio away from financials and insurance and into other market segments as illustrated below. The ISO will continue this process over the next few years.

The current portfolio mix is reflected below:

2010 Corporate Portfolio Mix		
	<u>Bonds</u>	<u>% Portfolio</u>
Diversified Financials	6	27%
Utilities	4	18%
Insurance	3	14%
Food & Beverage	2	9%
Banks	2	9%
Retail	1	5%
Consumer Products	1	5%
Media	1	5%
Technology	1	5%
Telecom	1	5%
Total	22	100%