CITY OF PASADENA ☆ INCORPORATED JUNE 1886 ☆

Agenda Report

August 8, 2016

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending June 30, 2016

RECOMMENDATION:

This report is for information only.

BACKGROUND:

Government Code Section 53646 (2)(b)(1) states that in the case of a local agency, the Treasurer or Chief Fiscal Officer (CFO) may render a quarterly report to the legislative body of the local agency containing detailed information on: 1) all securities, investments, and moneys of the local agency; 2) a statement of compliance of the portfolio with the statement of investment policy; and 3) a statement of the local agency's ability to meet its pool's expenditure requirements for the next six months. By making these reports optional, this bill does not impose a state-mandated local program but encourages local agencies to continue to report. The bill also states that the Treasurer or CFO may report whatever additional information or data may be required by the legislative body of the local agency.

The quarterly report shall include the following:

1) The type of investment, name of the issuer, date of maturity, par and dollar amount invested in each security, investment, and money within the treasury;

2) The weighted average maturity of the investments within the treasury;

3) Any funds, investments, or programs, including loans, that are under the management of contracted parties;

4) The market value as of the date of the report, and the source of this valuation for any security within the treasury;

5) A description of the compliance with the Statement of Investment Policy.

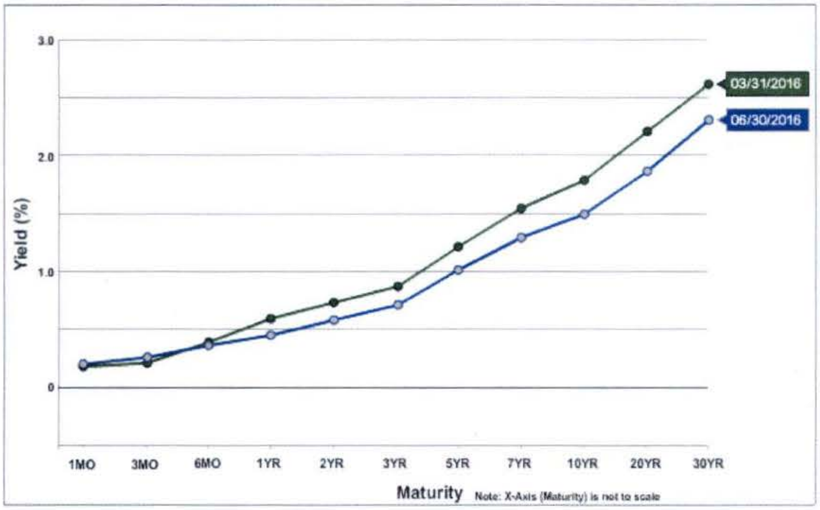
Quarterly Economic Review

According to the US Bureau of Labor Statistics, 287,000 nonfarm payroll jobs were added in June 2016. This bucked the trend of what appeared to be a slowing down of jobs growth. Only 144,000 jobs were added in April, then already the weakest figure in seven months. May provided an even more dismal picture, with only 11,000 jobs being created. Despite the significant rise of jobs created in June, the unemployment rate still deteriorated to 4.9% from the previous month's 4.7%.

Following a guardedly weak jobs report for May, the Federal Open Market Committee decided to hold off on any interest rate hikes for the time being during its June 14-15 meeting. The committee also wanted to wait on the result of the Brexit vote. Financial markets were rocked after the United Kingdom voted to exit the European Union through a referendum held on June 24. Stock markets across Europe suffered losses. Shares of British banks in particular fell victim to heavy selling; trading of Barclays and RBS shares in London was even halted at one point. The UK pound traded below $1.32, its lowest level since 1985. Standard & Poor's even downgraded the United Kingdom by two notches, from a perfect AAA to AA. In the United States, the Dow Jones dropped almost 900 points in 2 days. As swift and sharp the fallout of the Brexit vote was, analysts were stumped by the ensuing rebound. Within a week, UK's FTSE 100 not only recovered all losses following the vote but it also reached an 11-month high, leading the Bank of England to pronounce that there was "no clear evidence" of an economic slowdown. As to its medium to long-term effects on the US economy, bankers and analysts alike assess the impact to be small to none.

June 2016's year-over-year unadjusted Headline CPI came in at 1.0%, similar to the May register. On a seasonally adjusted basis, the Core CPI rose by 0.2% in June. Meanwhile, the year-over-year Core CPI which excludes food and energy components came in at 2.3%, up from May's 2.2% reading. The US Bureau of Labor Statistics has taken exception to this figure, noting that the average annual rate over the past ten years has only been 1.9%. Nonetheless, inflation still appears benign and does not provide a compelling argument for the FOMC to immediately raise rates. Combined with the domestic economy's modest growth pace, cautiousness over potential long-term effects of the Brexit vote on financial markets has led to a perceived softened rate hike stance by the FOMC. The July Bloomberg Survey of Economists saw its forecast for key interest rates hikes revised downward. The consensus projection is now just one hike in the fourth quarter of 2016 and then just two more hikes for the whole of 2017. This is a stark contrast from the beginning of the year when the FOMC appeared to raise interest rates once each quarter.

Yields on US treasuries continue to fall to historic lows as the US Treasury curve shifted downwards (see chart below) and gains were seen in every major bond sector for the second consecutive quarter. The Barclays US Aggregate Bond Index rose 2.21% for the quarter. Long-duration bonds outperformed in particular with the 10-year treasury falling to 1.49%, 29 basis points from the end of the first quarter of 2016. Not since July 2012 has the 10-year treasury rate gone lower than 1.50%. The investment grade and high yield sectors also saw credit spreads tighten during the quarter as Barclays indices for the said sectors returned 6.5% and 5.9% respectively. Analysts have actually pointed to the Brexit vote as contributory to rates being pushed down to historic lows, citing investors' flight to safety.



Source: US Department Of The Treasury, *www.treasury.gov*

Equities earned modest gains during the quarter as the S&P 500 and the Dow Jones posted returns of 2.46% and 2.07% respectively. Buoyed by the continuing recovery of oil prices, energy was the best performing sector, returning 11.6%. Sectors known for high dividend yields, mostly categorized as value stocks, were made attractive by low bond yields and outperformed during the quarter. On the commodities front, the Bloomberg Commodity Index returned 12.8% for the quarter, marking the asset class' rebound. Gold reached a two-year high as investors turned to safer assets following the market volatility brought about by the Brexit vote. Other precious metals also followed suit in posting gains.

Amidst the backdrop of tepid global economic activity, US economic data point to very low odds of a recession in 2016. A group of more than 60 economists surveyed by Bloomberg projects the annual growth rate of the Gross Domestic Product to be at a modest 1.9% in 2016 and 2.2% in 2017. GDP growth for the 1st quarter, initially reported at a tepid 0.5%, was revised upward to 1.1%. Consumer spending which accounts for about two-thirds of the GDP will be the main driving force behind the second quarter growth.

Total Funds Under Management

The following table represents total City funds under management based on their market values as of June 30, 2016.

	06/30/2016	03/31/2016	$ Change
Pooled Investment Portfolio	$447,344,740	$430,967,622	$16,377,118
Capital Endowment	1,905,834	1,902,673	3,161
Stranded Investment Reserve Portfolio	69,833,352	69,448,429	384,924
Special Funds	24,400,825	24,066,911	333,914
Investments Held with Fiscal Agents	60,481,790	60,799,877	-318,087
Total Funds Under Management	**$603,966,541**	**$587,185,512**	**$16,781,029**

The Pooled Investment Portfolio value increased by a net $16.4 million mainly due to the receipt of $30.8 million in property tax revenues, $8.04 million sales tax revenues, $4.75 million receipt from the Redevelopment Property Tax Trust Fund, and an increase in investment earnings of $1.54 million. These cash inflows were offset by $18.64 million in debt service payments made on various bond issues during the quarter and $10.16 million payments made for the purchase of power.

The Capital Endowment Fund increased by $3,161 representing the net investment earnings for the period.

The Stranded Investment Reserve portfolio increased by $384,923 representing the investment earnings for the period adjusted by the market value change of investments.

Special Funds increased by a net $333,914 due to investment earnings during the period and the receipt of a deposit from a contractor.

Investments held with fiscal agents decreased by $318,087 as a result of a drawdown of $178,456 from the 2013 Rose Bowl Bonds Series A&B Construction Fund, the release of $87,894 interest from the 2008A COPs Reserve Fund to pay debt service on the bonds and an adjustment of $51,577 to reflect the fair value change of investments.

The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the 2016 fiscal year accounting records have not yet closed, staff estimates that the General Fund's cash balance was approximately $45 million at the end of June representing 10% of the June Pooled Portfolio value. The General Fund's cash balance fluctuates daily based on the timing of revenues receipts and payment of expenditures. Investments in the Capital Endowment Fund, the Stranded Investment Reserve Fund, the Special Funds, and funds held with fiscal agents are restricted funds or bond proceeds reserved in accordance with the City Charter, City ordinances, and the bond indentures. The City targets a duration average of two years in managing the pooled portfolio based on the portfolio's risk and return evaluation and industry best practices as it pertains to public funds management. As of June 30, 2016, the portfolio's duration was 1.88 years.

Per government code requirements, attached are reports by each fund indicating the type of investments, date of maturity, par and dollar amount invested in each security, as well as investment and moneys within the Treasury with market values as of June 30, 2016. On a monthly basis, the City Treasurer prices the pooled portfolio and all other funds and investments under management. The market values are obtained from Interactive Data Corporation (IDC) and from Bloomberg Financial System. IDC is an independent third party whose sole service is to provide market prices for all types of securities.

The types of securities held in the portfolio and their percentage allocation to the total are in compliance with the City's Fiscal Year 2016 Investment Policy, which was adopted by the City Council on July 27, 2015, and Section 53600 of the State Government Code. The City Treasurer currently maintains over $45 million short-term liquid investments (1 to 90 day maturities) which represents approximately 1/12th of the City's total aggregate annual operating budget. This balance, along with anticipated cash flows into the City's account, represents a strong liquidity position to meet budgeted expenditures for the next six months.

The yield to maturity on the City's Pooled Portfolio began to gradually increase after it stabilized at around 1% due to declining interest rates in the last six years as short-term rates remained between 0.00% and 0.25% until December 16 when the Fed increased the target Fed Funds rate by 0.25%. The fiscal year to date effective yield which represents the portfolio investment earnings rate adjusted by the realized trading gains and losses was 1.22% for the Pooled Portfolio as of June 2016, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 0.43%, the Los Angeles County Treasurer's Pooled portfolio yield of 0.82% (thru May 2016), and the average yield on the two-year U.S. Treasury of 0.77%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.64%.

The graph below represents the historic yields comparison of the Pooled Portfolio and the Power Reserve Portfolio over the last five years.

COUNCIL POLICY CONSIDERATION:

This action supports the City Council's strategic goal to maintain fiscal responsibility and stability.

FISCAL IMPACT:

There is no fiscal impact as a result of this action nor will it have any indirect or support cost requirements. There is no anticipated impact to other operational programs or capital projects as a result of this action.

Respectfully submitted,

MATTHEW E. HAWKESWORTH
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Department of Finance

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Approved by:

STEVE MERMELL
City Manager

Attachments: (1)
Attachment A – Quarterly Investment Report - Quarter Ending June 30, 2016