

# Agenda Report

December 11, 2017

**TO:** Honorable Mayor and City Council  
**THROUGH:** Finance Committee  
**FROM:** Department of Finance  
**SUBJECT:** Quarterly Investment Report  
Quarter Ending September 30, 2017

**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 advance estimate released by the Bureau of Economic Analysis of the U.S. Department of Commerce, the Gross Domestic Product (GDP) grew by 3.0% during the third quarter of 2017. The said growth rate sustains the momentum from the second quarter of 2017, during which the economy grew by 3.1%. Personal consumption expenditure, gross private domestic investment, and net exports contributed to the growth in economic activity. Meanwhile, a contraction in government spending partially offset economic activity growth achieved in the quarter. Looking ahead, a recent Bloomberg News survey of 77 economists projects that the economy will grow by 2.7% in the fourth quarter of 2017.

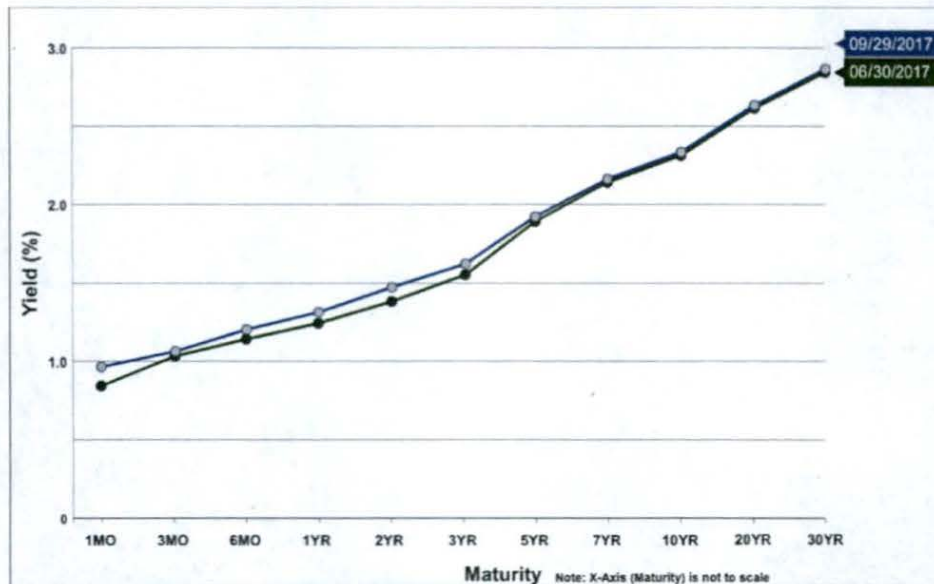
September 2017 actually saw nonfarm payroll jobs shrink by 33,000. Employment gains for July and August were 138,000 and 169,000, respectively. Over the preceding 12 months, total nonfarm employment added an average of 172,000 per month. The U.S. Bureau of Labor Statistics noted that while a number of sectors enjoyed job gains, employment in food services and drinking places lost 105,000 jobs, which the agency attributed to the impact of Hurricanes Irma and Harvey. The unemployment rate declined to 4.2% as of the end of September 2017, and the average hourly earnings rose by 2.9% on an annualized basis, yet again signals of further tightening in the labor market.

The year-over-year Consumer Price Index (CPI) rose 2.2% in September 2017, and has been accelerating since it was 1.6% in June. Meanwhile, the year-over-year Core CPI Index which excludes food and energy components rose 1.7% for the 12 months ending September 2017, its fifth month in a row at that level as noted by the U.S. Bureau of Labor Statistics. The year-over-year energy index, which rose 10.1% in September 2017, was largely buoyed by a steep 19.3% rise in the year-over-year gasoline index.

At its September 19-20, 2017 meeting, the Federal Open Market Committee (FOMC) decided to maintain the target range for the federal funds rate at 1.0% to 1.25%. The FOMC noted that the labor market has continued to strengthen and that economic activity has been rising moderately. The FOMC specifically highlighted that job gains have remained solid, the unemployment rate has remained low, household spending has been expanding moderately, and that business fixed investment has picked up. The FOMC also pointed out that inflation is expected to remain somewhat below the 2.0% in the near term but to stabilize around the 2.0% objective in the medium term. The FOMC's Summary of Economic Projections September 20, 2017 was more optimistic than the June 2017 projections. Real GDP growth for 2017 was revised upwards from 2.2% to 2.4% while the unemployment rate for 2017, is still projected to be at 4.3%. The September 2017 projections still suggest that there will be another 0.25% rate hike in 2017 as the federal funds rate is still targeted to be between 1.25% and 1.5% by the end of 2017.

Bond yields actually rose across all maturities. The rise in yields thinned out as maturities lengthened (see chart in the following page). The yield on the 2-year

Treasury note rose to 1.47% from 1.38% as of the end of the previous quarter. Over the same period, the yield on the 5-year Treasury rose to 1.92% from 1.89%. The rise in yields were minor such that all bond sectors still posted positive returns for the quarter. The broad-based Barclays U.S. Aggregate Bond Index returned 0.85% for the quarter, a weaker performance than the 1.45% registered in the previous quarter. The central bank has also announced that it will begin unwinding its assets which have reached \$4.5 trillion but that it will do so gradually. The expected further rise in yields due to this balance sheet normalization program should therefore also be tempered and gradual.



Source: US Department of the Treasury, [www.treasury.gov](http://www.treasury.gov)

The majority of domestic equities posted solid, positive gains during the third quarter of 2017. On the last trading day of the quarter, the broad-based S&P 500 actually reached an all-time high record. The composite posted a 3.96% total return during the quarter, higher than the 2.57% return achieved in the prior quarter. Similarly, the Dow Jones Industrial Average's return of 4.94% for the quarter was faster than the second quarter return of 3.32%. Market observers even noted that this is the composite's eight straight quarter of gains, the first time in twenty years. The NASDAQ, which is dominated by Information Technology stocks, saw a 5.79% return during the quarter, outpacing by the 3.87% return in the prior quarter. In terms of sectors, Information Technology performed the best with an 8.6% total return for the quarter. Only the Consumer Staples sector lost ground, posting a -1.3% return during the quarter.

### **Total Funds Under Management**

The following table represents total City funds under management based on their market values as of September 30, 2017.

	9/30/2017	6/30/2017	\$ Change
Pooled Investment Portfolio	\$476,281,599	\$500,586,180	(\$24,304,581)
Capital Endowment	1,926,030	1,919,334	6,696
Stranded Investment Reserve Portfolio	69,809,250	69,452,547	356,703
Special Funds	50,457,448	50,347,851	109,597
Investments Held with Fiscal Agents	57,382,407	57,278,760	103,647
<b>Total Funds Under Management</b>	<b>\$655,856,734</b>	<b>\$679,584,671</b>	<b>(\$23,727,938)</b>

The Pooled Investment Portfolio value decreased by a net \$24,304,581 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	\$1,800,518
Deposits and Credit Card Receipts	119,201,786
Property Tax Revenues	3,739,888
Sales Tax and Other State Apportionments	9,847,133
HUD Receipts Net of Payments and Loans	1,178,977
Payroll and Payroll-related Expenses	(63,608,904)
PERS Unfunded Accrued Liability Lump Sum Payment	(27,127,512)
Vendor Payments and Accounts Payable Checks	(42,865,470)
Debt Service Payments Net of Reimbursements	(8,184,029)
Water and Power Payments Net of Receipts	(21,809,876)
Net Transfer from Other Funds	3,522,907
	<b>(\$24,304,581)</b>

The Capital Endowment Fund increased by a net \$6,696 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

The Stranded Investment Reserve portfolio increased by \$356,703 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds increased by \$ 109,597 due to investment earnings for the quarter of \$130,197 partially offset by a \$20,600 Annandale principal payment.

Investments held with fiscal agents increased by a net \$103,647 as a result of a \$527,883 transitional increase for debt service payments made for various bond issues,

\$210,843 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices, and a \$213,392 market value decrease net of interest earnings.

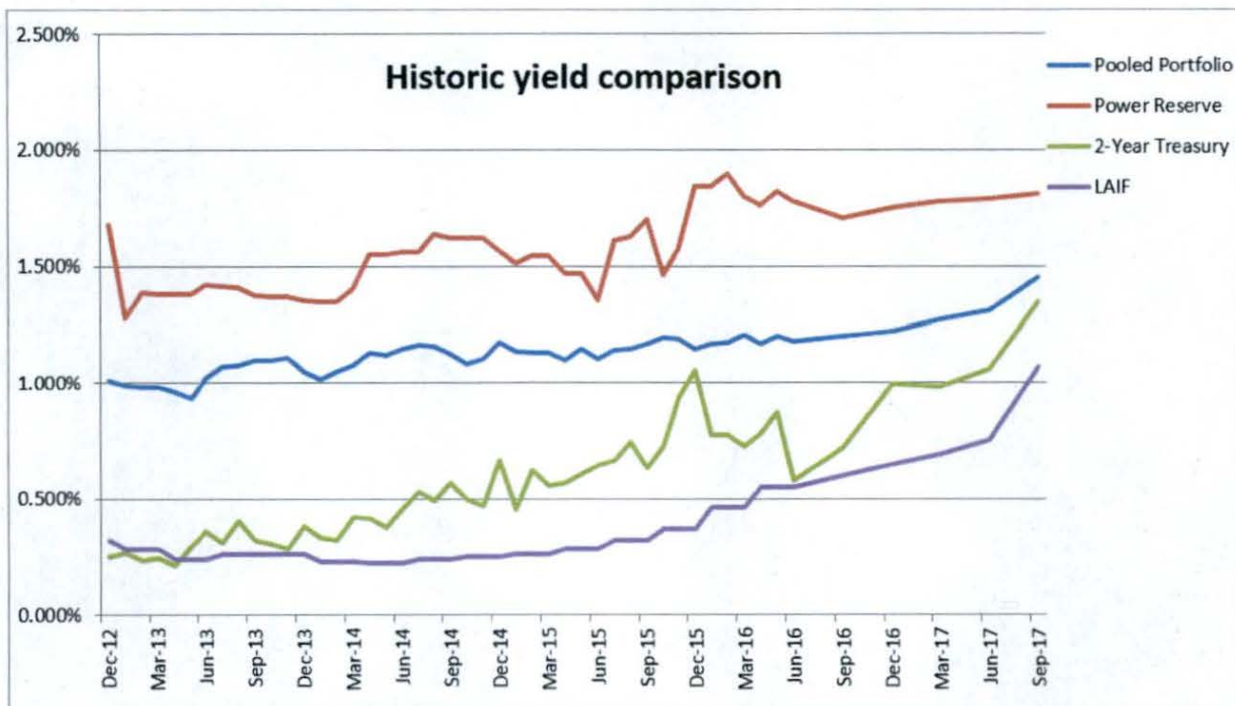
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the September 2017 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately \$53 million at the end of September representing 11% of the September 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 an average duration 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 September 30, 2017, the portfolio's duration was 1.84 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 September 30, 2017. 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 2018 Investment Policy, which was adopted by the City Council on August 28, 2017 and Section 53600 of the State Government Code. The City Treasurer currently maintains over \$50 million short-term liquid investments (1 to 90 day maturities) which represents approximately 1/12<sup>th</sup> 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 fiscal year to date effective yield which represents the portfolio investment earnings rate adjusted by the realized trading gains and losses was 1.45% for the Pooled Portfolio as of September 2017, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 1.07%, the Los Angeles County Treasurer's Pooled portfolio yield of 1.39%, and the average yield on the two-year U.S. Treasury of 1.35%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.81%.

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



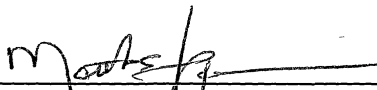
**COUNCIL POLICY CONSIDERATION:**

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

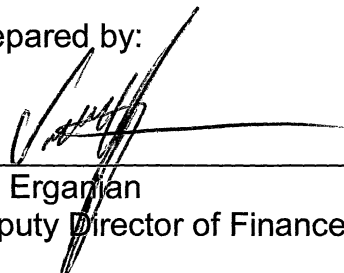
**FISCAL IMPACT:**

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,

  
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MATTHEW E. HAWKESWORTH  
Director of Finance  
Department of Finance

Prepared by:

  
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Vic Erganian  
Deputy Director of Finance/City Treasurer

Approved by:

  
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STEVE MERMELL  
City Manager

Attachment: (1)

Attachment A – Quarterly Investment Report - Quarter Ending September 30, 2017