Agenda Report

February 27, 2017

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending December 31, 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 Investment Report shall include the following information:

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.

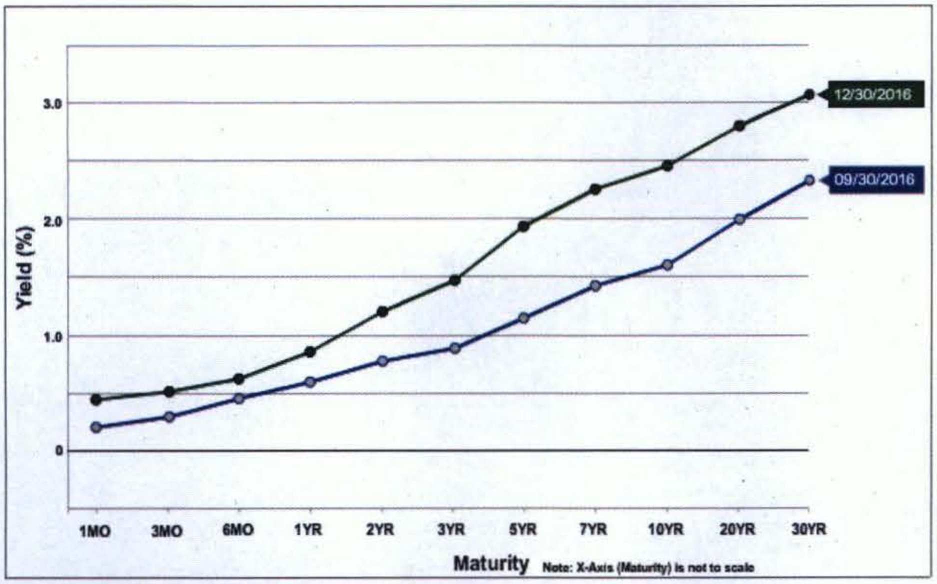
Quarterly Economic Review

Following a 3.5% growth in the economy in the third quarter of 2016, the Gross Domestic Product (GDP) grew by a comparatively slower 1.9% in the fourth quarter of 2016 according to the U.S. Department of Commerce Bureau of Economic Analysis. For the full year 2016, the economy grew by 1.6%, compared to a 2.6% growth in 2015. Consumer spending once again served as the driving force behind the economy's fourth quarter expansion, increasing by 2.5%. Possibly a sign of further expansion in the coming year, business spending also contributed to the economy's growth as the quarter witnessed a $48.7 billion growth in inventories and a 2.4% rise in nonresidential fixed investments. Additionally, business spending on equipment grew 3.1%, the first gain in five quarters. On the housing front, residential investment grew 10.2% year-on-year, after two consecutive quarters of declines. Meanwhile, due to a strengthened dollar, a 4.3% downturn in exports side-by-side with an 8.3% rise in imports worsened the country's trade deficit and provided a drag on GDP.

December 2016 saw nonfarm payroll jobs grow by 156,000 while November and October saw job gains of 178,000 and 161,000 respectively. While these figures are lower than the monthly average of calendar year 2016, it also marks 75 straight months of job creation. This, together with average hourly earnings rising by 2.9% from the prior year, points to a further tightening in the labor market. The unemployment rate held at 4.7% as of the end of December 2016, a figure analysts believe is close to full employment.

The year-over-year unadjusted Consumer Price Index (CPI) rose 2.1% in December 2016, higher than the November reading of 1.7%. The U.S. Bureau of Labor Statistics notes that this figure has been rising steadily since July and that the current rate is the largest 12-month increase since June 2014. This increase was buoyed by a 3.0% increase in the gasoline index and a 0.3% increase in the shelter (rent and owners' equivalent rent) index. Meanwhile, the year-over-year core index, which excludes food and energy components, rose 2.2% for the 12 months ending December 2016.

Bond yields rose across all maturities. (See chart on the following page.) The yield on the two-year Treasury note rose to 1.20% from 0.77% as of the end of the previous quarter. Over the same period, the yield on the five-year Treasury note rose to 1.93% from 1.14%. The rising bond yields lead to lower bond valuations and losses were seen in most bond sectors for the quarter. The Barclays U.S. Aggregate Bond Index lost 3.0% for the quarter but gained 2.6% on a full-year basis. Investment-Grade Bonds, Treasuries, and Municipal Bonds were the worst-performing categories during the quarter losing 7.8%, 3.8% and 3.6% respectively but posted positive though tempered returns for the full year.



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

Equities posted positive gains in the fourth quarter of 2016. Energy stocks led all sectors as they returned 7.3% during the quarter and 27.4% for the full year 2016. The performance of the energy sector can be mostly attributed to the recovery of oil prices as the Organization of Petroleum Exporting Countries (OPEC) promised to cut supply. This development, together with the fiscal expansion expected from the incoming administration, pushed stock prices higher. On November 21, 2016, all four major stock indices (Standard & Poor's 500, Dow Jones Industrial Average, NASDAQ, and the Russell 2000) simultaneously hit record highs, a performance last achieved in December 1999. NASDAQ, dominated by IT stocks, posted a return of 1.3% for the quarter and 7.5% for the year. The S&P 500 gained 3.3% for the quarter and 9.5% for the year. The Dow Jones Industrial Average, composed of blue-chip stocks, gained 7.9% for the quarter and returned 13.4% for the year. The Russell 2000, a small-cap stock market index, gained 8.3% for the quarter and 19.4% for the full year. Fidelity Investments has attributed the outperformance of small-cap stocks relative to large-cap stocks to lower exposure to global economy headwinds such as the rise of the dollar and trade protectionism.

The Federal Open Market Committee (FOMC) decided to raise the federal funds rate by 0.25% at its December 13-14, 2016 meeting. The FOMC noted that the labor market has continued to strengthen and that economic activity has moderately been expanding. The FOMC, which follows the slightly lower Personal Consumption Expenditures price index issued by the Bureau of Economic Analysis rather than the CPI issued by the Bureau of Labor Statistics, also pointed out that while inflation is still below its long-run target of 2.0%, certain market-based measures of inflation compensation have moved up. In particular, the FOMC mentions that as the transitory effects of past price declines in energy and imports dissipate and as the labor market further strengthens, inflation is expected to rise to 2.0% in the medium term. The FOMC's Summary of Economic Projections also suggests that there will be three, 0.25% rate hikes in 2017 as the federal funds rate is seen to be between 1.25% and 1.5% by the end of 2017. The FOMC also revised the 2017 GDP growth forecast to 2.1% from 2.0% in September, with the individual projections falling in the range between 1.7% and 2.4%.

Total Funds Under Management

The following table represents total City funds under management based on their market values as of December 31, 2016.

	12/31/2016	09/30/2016	$ Change
Pooled Investment Portfolio	$468,920,174	$459,942,963	$8,977,211
Capital Endowment	1,915,906	1,910,208	5,698
Stranded Investment Reserve Portfolio	68,329,762	69,965,911	-1,636,149
Special Funds	57,105,506	24,470,382	32,635,124
Investments Held with Fiscal Agents	60,648,906	59,439,998	1,208,908
Total Funds Under Management	**$656,920,254**	**$615,729,462**	**$41,190,792**

The Pooled Investment Portfolio value increased by a net $8,977,211 due to the following transactions during the quarter:

Investment Earnings adjusted by FMV change	(2,414,850)
Deposits and Credit Card Receipts	109,496,627
Property Tax Revenues	22,996,396
Sales Tax and Other State Apportionments	9,961,307
HUD Receipts Net of Payments	2,819,095
Payroll and Payroll-related Expenses	(61,646,683)
Vendor Payments and Accounts Payable Checks	(34,388,387)
Debt Service Payments	(13,320,444)
Water and Power Payments Net of Receipts	(24,273,850)
Net Transfer to Other Funds	(252,000)
	$8,977,211

The Capital Endowment Fund increased by $5,698 representing the net investment earnings for the period.

The Stranded Investment Reserve portfolio decreased by $1,636,149 representing the investment earnings for the period adjusted by the market value change of investments.

Special Funds increased by a net $32,635,124 due to the 2016A Electric Revenue Refunding Bond net proceeds of $32,886,018, the Falls Creek collateral deposit of $94,530, and a reduction of $345,424 representing net investment earnings adjusted by the fair market value losses for the period.

Investments held with fiscal agents increased by a net $1,208,908 as a result of a $2,150,941 transfer made to bond trustees to fund the January 1, 2017 debt service payments for various bond issues, an increase of $12,403 representing cost of issuance for the 2016A Rose Bowl Refunding bonds and a fair market value change, net of investment earnings, of $954,436.

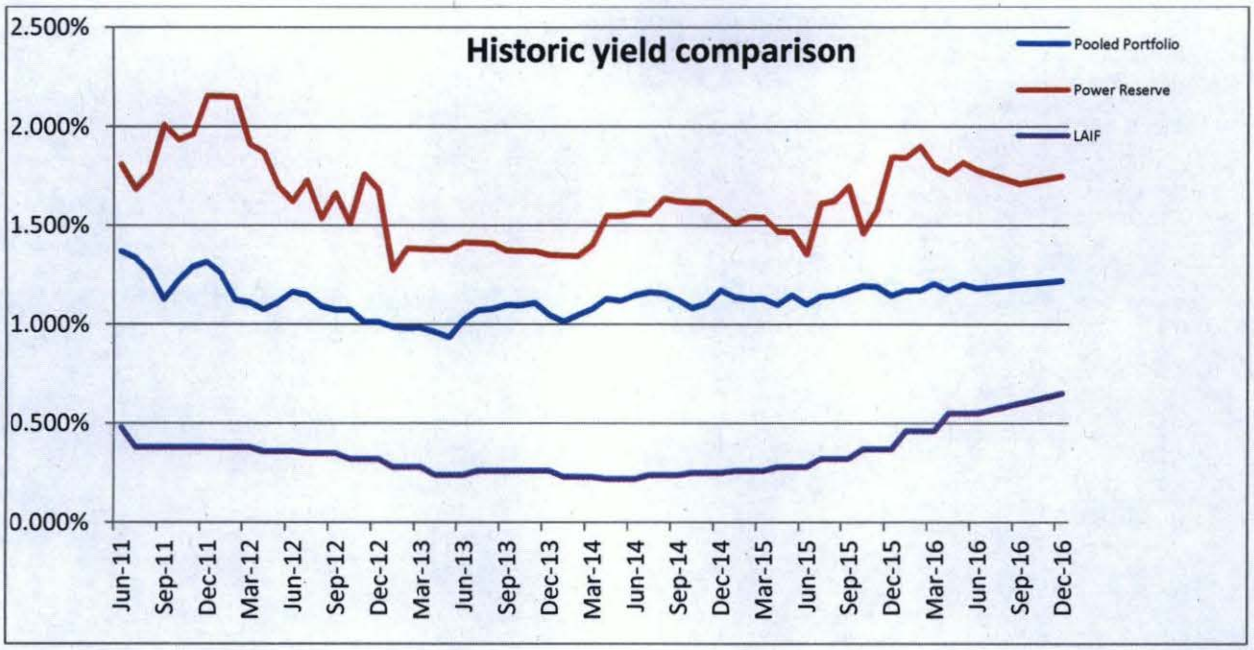
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the December 2016 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately $63 million at the end of December representing 13% of the December 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 December 31, 2016, the portfolio's duration was 2.16 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 December 31, 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 2017 Investment Policy, which was adopted by the City Council on August 8, 2016 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 1/12th 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 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 December 2016, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 0.65%, the Los Angeles County Treasurer's Pooled portfolio yield of 1.00%, and the average yield on the two-year U.S. Treasury of 0.99%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.75%.

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 planning 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
Director of Finance
Department of Finance

Prepared by:

Vic Erganian
Deputy Director of Finance/City Treasurer

Approved by:

STEVE MERMELL
City Manager