Agenda Report

March 12, 2018

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending December 31, 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

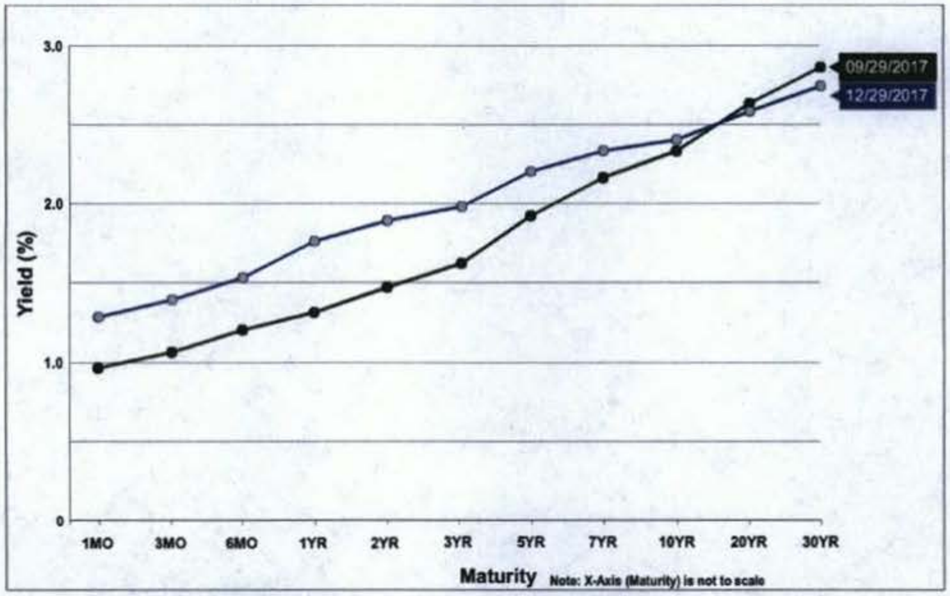
According to the advance estimate released by the Bureau of Economic Analysis of the U.S. Department of Commerce, the Gross Domestic Product (GDP) grew by 2.6% during the fourth quarter of 2017. Increases in personal consumption expenditure, gross private domestic investment, and government spending contributed to the growth in economic activity. Meanwhile, a faster growth in imports led to a contraction in the net exports of goods and services and partially offset economic activity growth achieved in the quarter. Similar trends were observed for these GDP components over the whole year 2017, during which the economy grew by 2.3%.

December 2017 saw nonfarm payroll jobs expand by 160,000. Employment gains for October and November were 271,000 and 216,000, respectively. Over the preceding 12 months, total nonfarm employment added 2.2 million jobs or an average of 180,000 per month. The unemployment rate stood at 4.1% as of the end of December 2017, a 0.6% decrease from the end of 2016. The average hourly earnings rose by 2.5% on an annualized basis in December as the labor market continued to tighten.

The year-over-year Consumer Price Index (CPI) rose 2.1% in December 2017, the same increase as in December 2016. Meanwhile, the year-over-year Core CPI Index which excludes food and energy components rose 1.8% for the 12 months ending December 2017, its eighth month in a row at the 1.7%-1.8% level as noted by the U.S. Bureau of Labor Statistics. The food index increased 1.6% in 2017 after a 0.2% decline in 2016. The energy index rose 6.9% in 2017 after a 5.4% increase in 2016.

At its December 12-13, 2017 meeting, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate at 1.25% to 1.5%. The FOMC noted that the labor market has continued to strengthen and that economic activity has been rising at a solid rate. The FOMC specifically highlighted that job gains have been solid, the unemployment rate has declined further, 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 December 2017 Summary of Economic Projections was more optimistic than the September 2017 projections. Real GDP growth for 2018 was revised upwards from 2.1% to 2.5%. The unemployment rate for 2018, previously projected to be at 4.1%, is now seen to be at 3.9% at the end of year. The most recent projections also suggest that the federal funds rate will be between the targeted range of 2.0% to 2.25% by the end of 2018.

Bond yields actually rose across most maturities; the pivot point appearing to be near the 20-year maturity (see chart in the following page). The yield on the 2-year Treasury note rose to 1.89% from 1.47% as of the end of the previous quarter. Over the same period, the yield on the 5-year Treasury rose to 2.20% from 1.92%. The rise in yields did not prevent all bond sectors from still posting positive albeit lackluster returns for the quarter. The broad-based Barclays U.S. Aggregate Bond Index returned 0.39% for the quarter, a weaker performance than the 0.85% registered in the previous quarter but enough to push the return for the whole of 2017 to 3.5%. Long Government and Credit was the best performing sector, earning 2.8% in the fourth quarter and 10.7% on a full-year basis.



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

Domestic equities continued to enjoy stellar gains during the fourth quarter of 2017. The broad-based S&P 500 composite posted a 6.12% total return during the quarter, higher than the 3.96% return achieved in the prior quarter. Similarly, the Dow Jones Industrial Average achieved a return of 10.33% for the quarter, higher than the third quarter return of 4.94%. The NASDAQ, which is dominated by Information Technology stocks, saw a 6.27% return during the quarter, outpacing by the 5.79% return in the prior quarter. In terms of sectors, Information Technology performed the best with a 9.0% total return for the quarter, bringing its full-year earnings to a remarkable 38.8%. While they earned positive returns during the fourth quarter, Energy and Telecom Services still posted negative returns on a full-year basis.

Total Funds Under Management

The following table represents total City funds under management based on their market values as of December 31, 2017.

	12/31/2017	9/30/2017	$ Change
Pooled Investment Portfolio	$502,992,352	$476,281,599	$26,710,754
Capital Endowment	1,932,723	1,926,030	6,693
Stranded Investment Reserve Portfolio	69,858,422	69,809,250	49,172
Special Funds	49,924,177	50,457,448	(533,271)
Investments Held with Fiscal Agents	55,772,940	57,382,407	(1,609,468)
Total Funds Under Management	**$680,480,614**	**$655,856,734**	**$24,623,880**

The Pooled Investment Portfolio value increased by a net $26,710,754 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	($284,492)
Deposits and Credit Card Receipts	117,639,348
Property Tax Revenues	23,927,007
Sales Tax and Other State Apportionments	10,394,652
HUD Receipts Net of Payments and Loans	2,759,723
Payroll and Payroll-related Expenses	(56,895,591)
Vendor Payments and Accounts Payable Checks	(37,608,140)
Debt Service Payments Net of Reimbursements	(12,470,329)
Water and Power Payments Net of Receipts	(20,700,748)
Net Transfer to Other Funds	(50,675)
	$26,710,754

The Capital Endowment Fund increased by a net $6,693 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 $49,172 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds decreased by $533,271 due to $599,585 Robinson Park construction expenses partially offset by investment earnings for the quarter of $66,314.

Investments held with fiscal agents decreased by a net $1,609,468 as a result of $1,028,695 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices, a $605,755 transitional decrease for debt service payments made for various bond issues, and $24,982 in investment earnings.

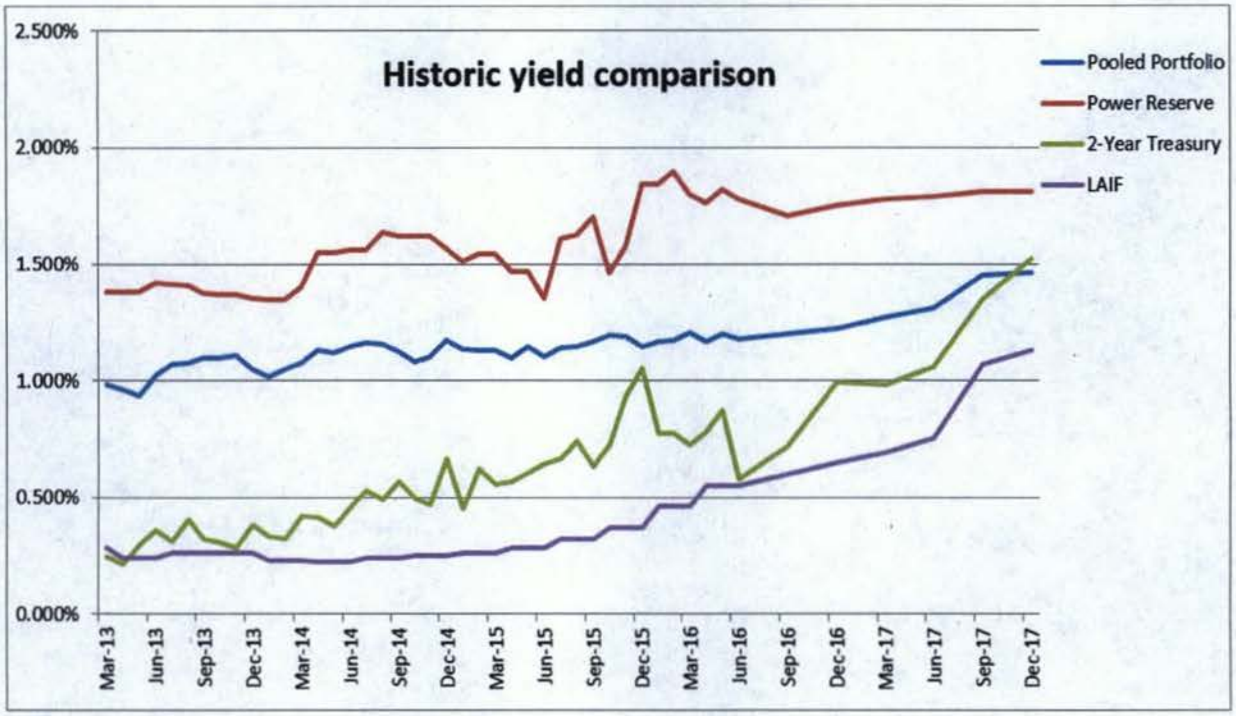
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the December 2017 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately $65 million 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, 2017, the portfolio's duration was 1.93 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, 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 1/12th 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 1.46% for the Pooled Portfolio as of December 2017, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 1.13%, the Los Angeles County Treasurer's Pooled portfolio yield of 1.41%, and the average yield on the two-year U.S. Treasury of 1.52%. 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,

MATTHEW E. HAWKESWORTH
Director of Finance
Department of Finance

Prepared by:

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Deputy Director of Finance/City Treasurer

Approved by:

STEVE MERMELL
City Manager

Attachment: (1)

Attachment A – Quarterly Investment Report - Quarter Ending December 31, 2017