

Agenda Report

August 26, 2019

TO: Honorable Mayor and City Council
THROUGH: Finance Committee
FROM: Department of Finance
SUBJECT: Quarterly Investment Report – Quarter Ending June 30, 2019

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

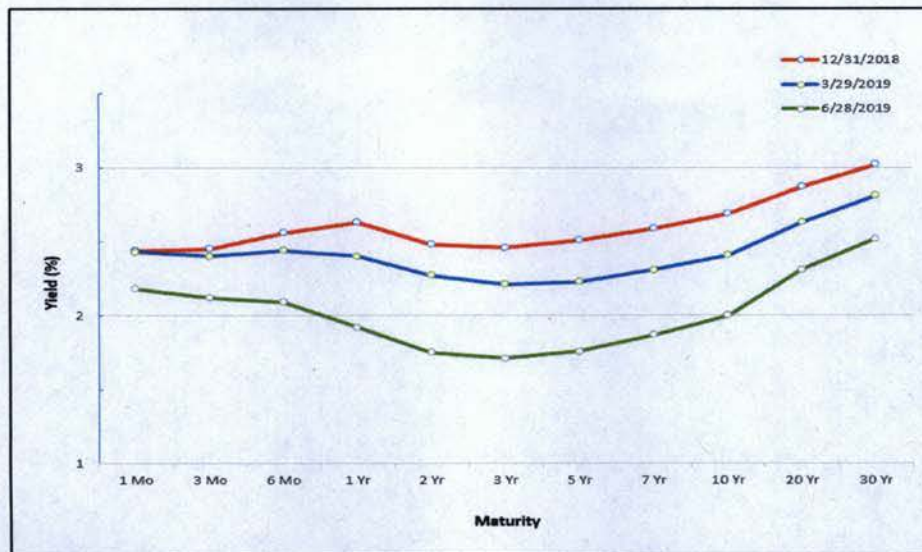
According to the advance estimate released by the Bureau of Economic Analysis of the U.S. Department of Commerce, the Gross Domestic Product (GDP) grew by 2.1% during the second quarter of 2019. In comparison, the real GDP growth for the first quarter of 2019 was 3.1%. Increases in personal consumption expenditures and government spending contributed to the growth in economic activity. This was partially offset by a 5.5% drop in gross private domestic investment and by a deterioration of the net exports of goods and services. The GDP growth recorded in June 2019 also marked the record for the most consecutive months of economic expansion, 121, dating back to 2009.

June 2019 saw nonfarm payroll jobs expand by 193,000. With employment gains for April and May coming in at 216,000 and 62,000, respectively, the average monthly jobs created for 2019 thus far stands at about 165,000 per month. In contrast, 2018 saw nonfarm employment add an average of 214,000 jobs per month. The unemployment rate stood at 3.7% as of June 2019, slightly up from the May 2019 rate of 3.6%. The labor market continued to tighten as the average hourly earnings rose by 3.1% on an annualized basis in June. Mirroring GDP growth, the June 2019 employment growth marked the 105th consecutive month of job gains.

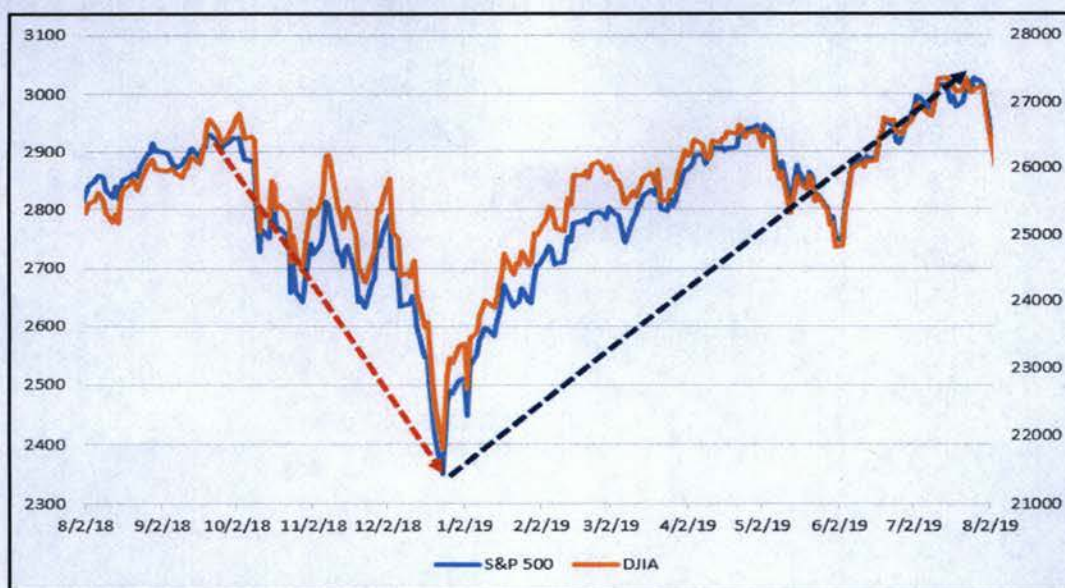
The year-over-year Consumer Price Index (CPI) rose 1.6% in June 2019, which is now the seventh month in a row this figure has been at or below 2.0%. Meanwhile, the year-over-year Core CPI Index, which excludes food and energy components, rose 2.1% for the 12 months ending June 2019. Over the past year, the food index increased by 1.9% while the energy index contracted by 3.4%.

At its July 30-31 meeting, the Federal Open Market Committee (FOMC) decided to lower the target range for the federal funds rate to 2.00% to 2.25%. The first interest rate cut in over a decade is seen to support the sustained expansion of economic activity, strong labor market conditions, and inflation near the 2.0% objective. The Fed does have uncertainties about its economic outlook. In particular, Fed chair Jerome Powell mentioned the risks from weak global growth and trade tensions.

Yields fell across all maturities for the second consecutive quarter (see chart in the following page). The yield on the 2-year Treasury note fell to 1.75% from 2.27% at the end of the previous quarter. Over the same period, the yield on the 5-year Treasury fell to 1.76% from 2.23%. This downward movement in yields again led to gains among all bond sectors. The broad-based Barclays U.S. Aggregate Bond Index posted a 3.08% gain for the second quarter of 2019 after returning 2.94% in the previous quarter.



Domestic equities continued their expansion through the second quarter of 2019, after staging a turnaround in the first quarter of 2019. The broad-based S&P 500 composite posted a 3.79% gain during the second quarter of 2019 after posting a 13.07% gain during the prior period. The Dow Jones Industrial Average (DJIA) posted a 2.59% gain after returning 11.15% in the prior quarter. The NASDAQ, which is dominated by Information Technology stocks, followed a similar arc with a 3.58% gain during the quarter following a 16.49% gain in the prior quarter. The recovery of equities in the first quarter of 2019 and their continued expansion in the second quarter of 2019 is graphically displayed in the chart below. On August 5 however, all three indices suffered their respective worst single-day percentage drops in 2019. While most of these single-day losses have been recovered by August 8, the stock market continues to display volatility, largely due to investor concerns over trade relations with China.



Total Funds Under Management

The following table represents total City funds under management based on their market values as of June 30, 2019.

	6/30/2019	3/31/2019	\$Change
Pooled Investment Portfolio	\$605,619,888	\$586,346,085	\$19,273,803
Capital Endowment	1,985,949	1,971,226	14,723
Stranded Investment Reserve Portfolio	66,228,804	72,067,332	(5,838,529)
Special Funds	21,705,766	25,993,551	(4,287,785)
Investments Held with Fiscal Agents	52,886,674	50,067,550	2,819,124
PARS Section 115 Trust	13,356,628	12,970,624	386,004
Total Funds Under Management	\$761,783,707	\$749,416,367	\$12,367,340

The Pooled Investment Portfolio value increased by a net \$19,273,803 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	\$6,307,298
Deposits and Credit Card Receipts	99,640,824
Property Tax Revenues	40,137,532
Sales Tax and Other State Apportionments	12,278,581
HUD Receipts Net of Payments and Loans	1,624,352
Payroll and Payroll-related Expenses	(67,124,611)
Vendor Payments and Accounts Payable Checks	(43,082,170)
Debt Service Payments Net of Reimbursements and Subsidies	(23,758,973)
Water and Power Payments Net of Receipts	(18,594,423)
Net Transfer from Other Funds	11,845,393
	\$19,273,803

The Capital Endowment Fund increased by a net \$14,723 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

The Stranded Investment Reserve portfolio decreased by a net \$5,838,529 due to a \$7,000,000 drawdown from the Contingent Mitigation Fund partially offset by investment earnings for the quarter of \$1,161,471.

Special Funds decreased by \$4,287,785 due to a \$4,572,595 drawdown from the 2016A Electric Revenue Refunding Project fund for project-to-date expenses and a \$27,648 withdrawal from the 2016A Electric Revenue Refunding Cost of Issuance fund used towards debt service, partially offset by investment earnings for the quarter of \$312,458.

Investments held with fiscal agents increased by \$2,819,124 due to \$3,092,129 of new funds for the PARCS Equipment Lease Escrow and investment earnings of \$784,140,

partially offset by \$488,516 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices and a \$568,629 transitional decrease for debt service payments made for various bond issues.

The PARS Section 115 Trust account increased by \$386,004. The change was comprised of market value change of investments and the interest earned totaling \$402,549, less \$16,545 in investment expenses.

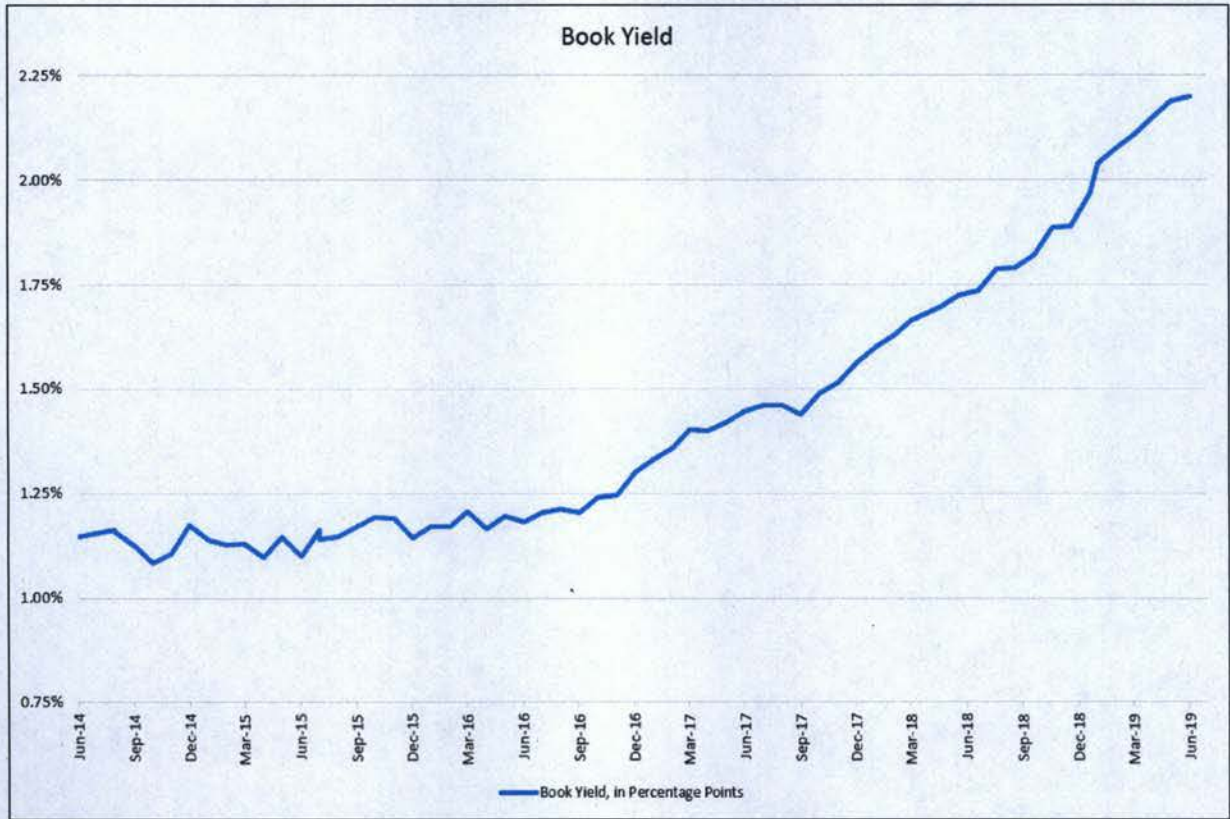
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the June 2019 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately \$80 million at the end of June representing 13% 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, the PARS Section 115 Trust account, and funds held with fiscal agents are restricted funds or bond proceeds reserved in accordance with the City Charter, City ordinances, bond indentures, and Trust Agreements. 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 June 30, 2019, the portfolio's duration was 1.54 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, 2019. 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 2019 Investment Policy which was adopted by the City Council on June 11, 2018 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.

On a total return basis, the components of which include interest, amortization, and market value changes, the Pooled Portfolio posted a gain of 1.05% for the second quarter of 2019. This underperforms against the 1.48% return of the assigned benchmark, the Bank of America Merrill Lynch 1-3 Year US Corporate and Government Index, for the same time period. The Pooled Portfolio's book yield has been rising, reflecting the rise in interest rates thru the end of 2018, since maturing investments

were reinvested in securities with higher yields. The graph below represents the historic book yield of the Pooled Portfolio over the last five years, thru June 2019. The Pooled Portfolio's book yield is expected to drop in the coming months though; this time reflecting the drastic drop in interest rates in 2019 and the most recent interest rate cut by the Fed.



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,



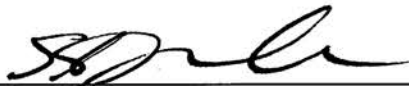
MATTHEW E. HAWKESWORTH
Department of Finance

Prepared by:



Vic Erganian
Deputy Director of Finance/City Treasurer

Approved by:



Steve Mermell
City Manager

Attachment: (1)

1) Attachment A – Quarterly Investment Report - Quarter Ending June 30, 2019