Agenda Report

February 25, 2019

TO: Honorable Mayor and City Council

FROM: Department of Finance

SUBJECT: Quarterly Investment Report – Quarter Ending December 31, 2018

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

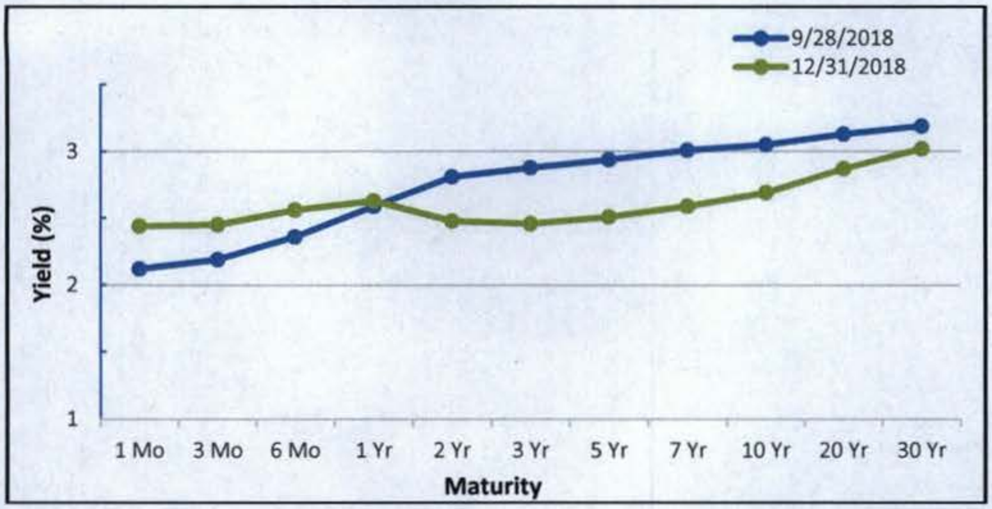
Due to the recent federal government shutdown, the advance estimate of the Gross Domestic Product (GDP) for the fourth quarter of 2018, originally scheduled to be released by the Bureau of Economic Analysis of the U.S. Department of Commerce on January 30, 2019, has been delayed. The Federal Reserve Bank of Atlanta's GDPNow metric, which is recalculated throughout the quarter as new data are released, projects GDP for the fourth quarter of 2018 to come in at 2.7% (as of February 6, 2019). In comparison, the real GDP growth for the third quarter of 2018 was 3.4%.

December 2018 saw nonfarm payroll jobs expand by 222,000. With employment gains for October and November coming in at 274,000 and 196,000, respectively, the average monthly jobs created for 2018 stands at about 214,000 per month. This outpaces 2017 which saw nonfarm employment add an average of 180,000 per month. The unemployment rate rose to 3.9% as of December 2018. The labor market continues to tighten as the average hourly earnings rose by 3.2% on an annualized basis in December.

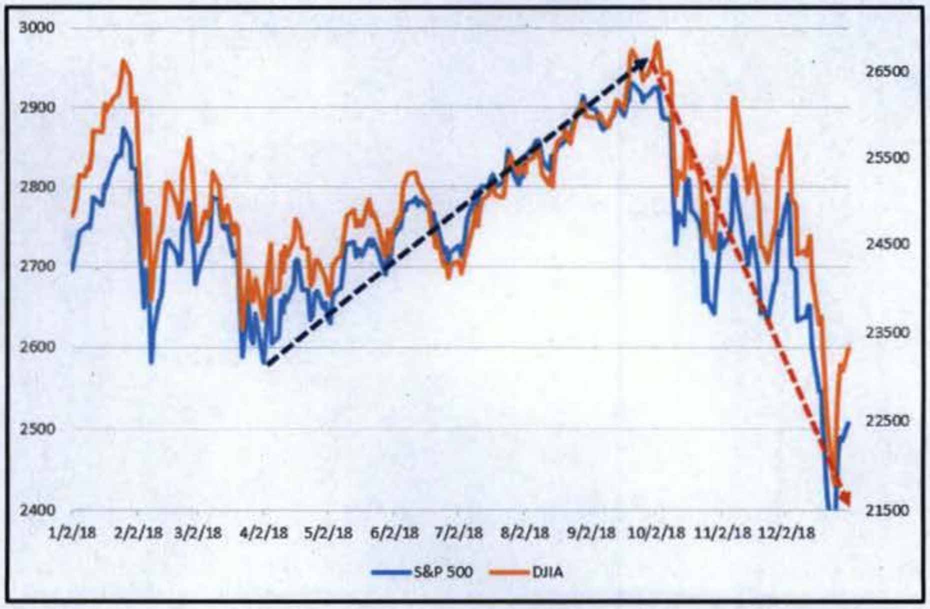
The year-over-year Consumer Price Index (CPI) rose 1.9% in December 2018, which as the Bureau of Labor Statistics notes, is the first time the 12-month change has been under 2.0% since August 2017. Meanwhile, the year-over-year Core CPI Index, which excludes food and energy components, rose 2.2% for the 12 months ending December 2018. Over the past year, the food index increased by a slow 1.6% while the energy index actually contracted by 0.3% with the energy commodities index shrinking by 1.8%.

At its December 18-19, 2018 meeting, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate at 2.25% to 2.50%, noting the labor market's continued strength and the economy's strong growth rate. The FOMC also pointed out that both overall and core inflation remain near 2.0%. The FOMC's December 2018 Summary of Economic Projections had notable changes to the September 2018 projections. Real GDP growth for the upcoming year 2019 was revised downwards from 2.5% to 2.3%. The federal funds rate, previously targeted to be in the range of 3.00% to 3.25% by the end of 2019 is now forecasted to be between 2.75% to 3.00%. At its January 29-30 meeting, the FOMC stated that it will be patient as it determines future adjustments to the federal funds rate in light of global economic and financial developments. This pronouncement, together with the lack of references to "further gradual rate increases" which the FOMC previously touted, was taken by the market as a shift in the FOMC's stance. As a result, markets not only priced in the possibility of the federal funds rate being left unchanged by the end of 2019, but also considered the possibility of a rate cut.

Yields rose on treasuries with shorter maturities of one year or less while maturities exceeding one year saw their yields fall (see chart in the following page). The yield on the 2-year Treasury note fell to 2.48% from 2.81% at the end of the previous quarter. Over the same period, the yield on the 5-year Treasury fell to 2.51% from 2.94%. This mixed movement in yields led to a similarly mixed bag of return results among bond sectors. The broad-based Barclays U.S. Aggregate Bond Index posted a 1.64% gain for the quarter, which was just enough for the index to register neither a gain nor a loss for the whole of 2018. The Treasuries sector was the quarter's best performing with a 2.6% total return, while High Yield debt was the worst performing sector of the fourth quarter with a -4.6% loss (Fidelity Investments).



Domestic equities suffered substantial losses during the fourth quarter of 2018. The broad-based S&P 500 composite posted a -13.97% total loss during the fourth quarter of 2018. The Dow Jones Industrial Average similarly posted a dismal performance losing -11.83% for the quarter. The NASDAQ, which is dominated by Information Technology stocks, fared even worse with a -17.54% total loss for the quarter. The chart below shows that the volatile downturn in the stock market during the fourth quarter of 2018 not only erased the gains made during 2018 but has in fact led to losses. The S&P 500 and the Dow Jones Industrial Average indices both ended the year at levels lower than their respective beginning values in 2018.



Total Funds Under Management

The following table represents total City funds under management based on their market values as of December 31, 2018.

	12/31/2018	9/30/2018	$Change
Pooled Investment Portfolio	$579,859,453	$531,303,379	$48,556,075
Capital Endowment	1,969,227	1,958,037	11,190
Stranded Investment Reserve Portfolio	70,977,823	69,598,212	1,379,611
Special Funds	26,033,931	26,480,543	(446,612)
Investments Held with Fiscal Agents	50,135,165	50,543,158	(407,993)
PARS Section 115 Trust	12,281,477	12,786,845	(505,368)
Total Funds Under Management	**$741,257,076**	**$692,670,174**	**$48,586,903**

The Pooled Investment Portfolio value increased by a net $48,556,075 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	$5,558,303
Deposits and Credit Card Receipts	140,681,711
Property Tax Revenues	25,806,151
Sales Tax and Other State Apportionments	12,564,269
HUD Receipts Net of Payments and Loans	1,376,438
Payroll and Payroll-related Expenses	(65,862,641)
Vendor Payments and Accounts Payable Checks	(37,879,986)
Debt Service Payments Net of Reimbursements and Subsidies	(12,754,832)
Water and Power Payments Net of Receipts	(19,541,076)
Net Transfer to Other Funds	(1,392,263)
	$48,556,075

The Capital Endowment Fund increased by a net $11,190 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 a net $1,379,611 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds decreased by $446,612 due to $781,512 Robinson Park construction expenses partially offset by investment earnings for the quarter of $334,900.

Investments held with fiscal agents decreased by $407,993 as a result of $839,852 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices partially offset by a $152,787 transitional increase for debt service payments made for various bond issues, $253,284 in investment earnings, and $25,788 representing cost of issuance for the 2018AB Rose Bowl Refunding bonds.

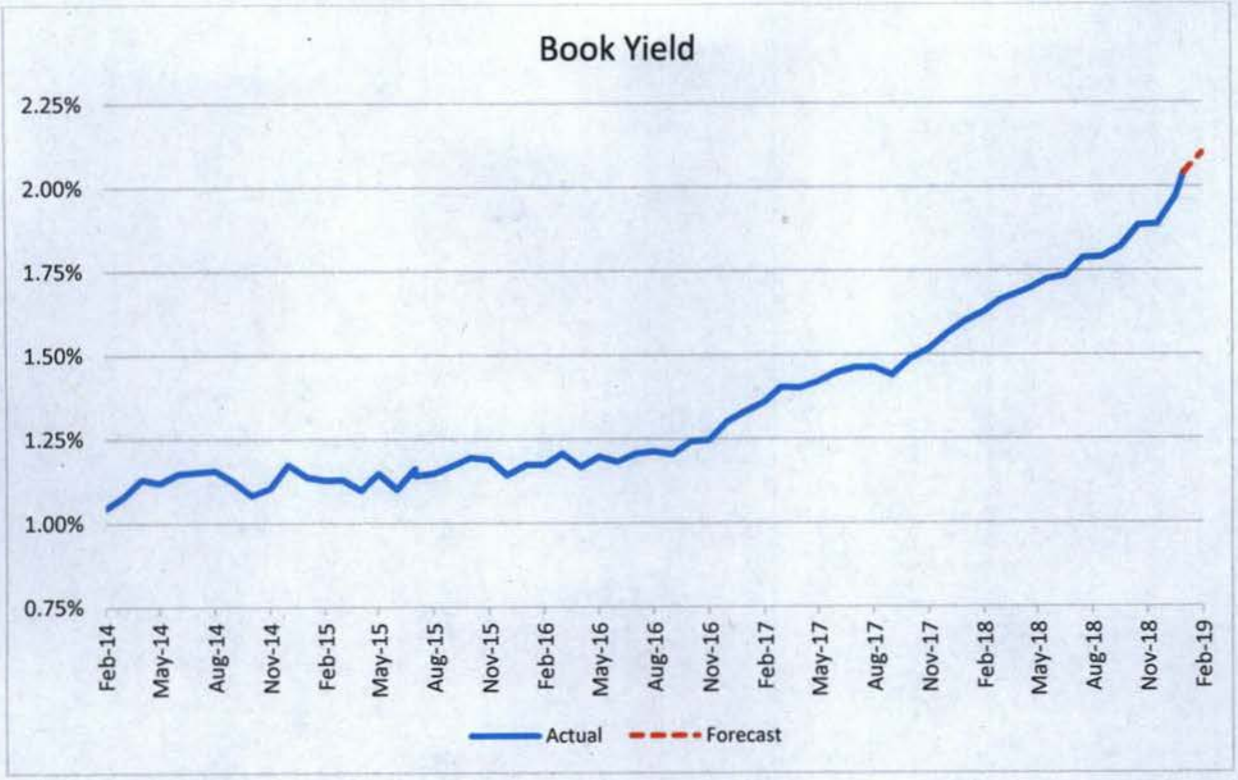
The PARS Section 115 Trust account decreased by $505,368. The change was comprised of $489,758 in market value losses net of earnings, and of $15,610 in investment expenses.

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 December 2018 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately $53 million at the end of December representing 9% 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, 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 December 31, 2018, the portfolio's duration was 1.42 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, 2018. 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 1.04% for the fourth quarter of 2018. This lags the 1.17% return of the assigned benchmark, the Bank of America Merrill Lynch 1-3 Year US Corporate and Government Index, for the same time period. For the whole of 2018, the Pooled Portfolio did manage to outperform its benchmark with a 1.641% annual return as compared to the index's 1.626% return. The Pooled Portfolio's book yield has been rising, reflecting the rise in interest rates since maturing investments are reinvested in securities with higher yields. The graph below represents the historic book yield of the Pooled 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
Department of Finance

Prepared by:

Vic Ergahian
Deputy Director of Finance/City Treasurer

Approved by:

Steve Mermell
City Manager

Attachment: (1)

1) Attachment A – Quarterly Investment Report - Quarter Ending December 31, 2018