Agenda Report

December 12, 2016

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending September 30, 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 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

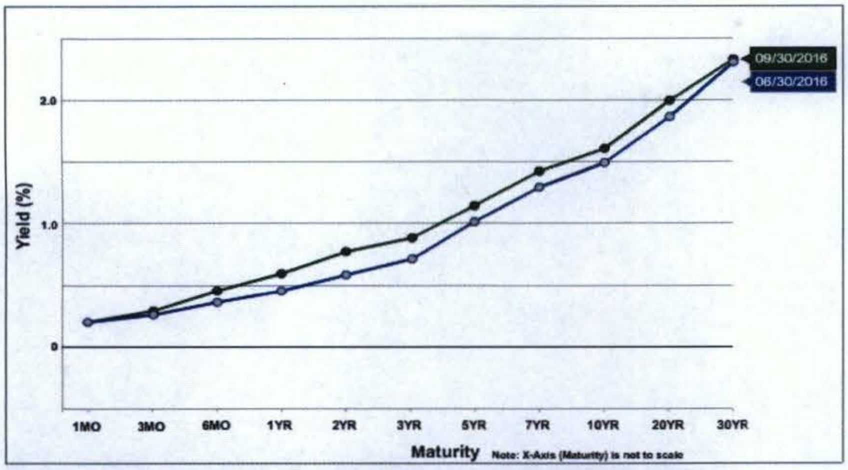
Following a 1 4% growth in the economy in the second quarter of 2016, the Gross Domestic Product grew by a comparatively solid 2 9% in the third quarter of 2016 according to the US Department of Commerce Bureau of Economic Analysis Consumer spending, particularly on services and durable goods, served as the driving force behind the third-quarter growth Strong consumer fundamentals have been attributed to considerable job growth and income gains during earlier months and even lower energy prices The business association Conference Board even released data showing that U S consumer confidence hit a 9-year high in September The GDP growth was also boosted by a pickup in exports Consumption and net exports growth quelled a 6 2% decline in home construction spending

While the economy continues to add jobs, the growth in nonfarm payroll employment has been a bit uneven While July saw nonfarm payroll jobs grow by 255,000, August and September saw only a combined 323,000 job gains, possibly reflecting a tightening in the labor market The average job growth through September 2016 stands at 178,000 per month, persuasively lower than the monthly average of 229,000 in 2015 The unemployment rate held at 5 0% as of September 2016

September 2016's year-over-year CPI (Consumer Price Index for All Urban Consumers) came in 1 5%, higher than the August reading of 1 1% The US Bureau of Labor Statistics notes that this is the largest 12-month increase since October 2014 On a seasonally adjusted basis, the CPI rose by 0 3% in September Meanwhile, the year-over-year Core CPI Index which excludes food and energy components came in at 2 2%

The Federal Open Market Committee (FOMC) decided not to raise the federal funds rate at the September 21' 2016 meeting The FOMC noted that while the economy strengthened, it was so far not enough to raise rates While it acknowledged labor market gains and economic activity growth, the FOMC not only highlighted that inflation is still below the central bank's 2% target, but it also revised its economic projections for the full year downwards Nonetheless, market participants expect that a December move is very likely In a press release dated November 2nd, the FOMC reaffirmed most of its September statements but added that "inflation is expected to rise to 2 percent over the medium term" as "the labor market strengthens" and that "near-term risks to the economic outlook appear roughly balanced "

Except at the very shortest maturities and while they remain near historic lows, yields on U.S. treasuries rose (see chart below).



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

The yield on the 2-year Treasury note rose to 0.77% from 0.58% as of the end of the previous quarter. Over the same period, the yield on the 5-year Treasury note rose to 1.14% from 1.01%. And while rising yields generally lead to lower valuations, gains were still seen in most bond sectors for the third consecutive quarter. The Barclays U.S. Aggregate Bond Index managed to stay in positive territory with 0.46% return for the quarter. The high yield and emerging market debt sectors benefitted from the tightening of credit spreads during the quarter. High yield bonds as measured by the Bank of America Merrill Lynch High Yield Bond Index and the emerging market bonds as measured by the JP Morgan EMBI Global Index, the two outperforming sectors in the fixed income market returned 5.5% and 3.7% for the quarter respectively. On the other hand, municipal debt was weighed down by heavy new supply during the quarter and posted a loss.

Equities were also affected by rising bond yields. While the S&P 500 returned 3.9% for the quarter, high-dividend paying sectors posted losses during the quarter. Most sensitive to interest rate changes and considered as bond proxies, telecom and utilities in particular lost 5.6% and 5.9% during the quarter. Meanwhile, cyclical sectors led by information technology which posted a 12.9% return during the quarter, enjoyed decent gains. NASDAQ, dominated by IT stocks, posted a double-digit return of 10.0% for the quarter. The Dow Jones Industrial Average, composed of blue-chip stocks, gained 2.8% for the quarter. U.S. equity valuations remained high as the S&P 500's forward 12-month price-to-earnings ratio of 16.60 remained well above the 10-year average of 14.3. Consequently, all three major U.S. stock indices reached all-time highs during the third quarter of 2016.

Donald Trump's presidential election win initially appeared to have startled the markets In a span of a day, the S&P 500 lost 5% while Asian and European stock markets also lost ground But US equities have since rallied, boosted by the prospects of tax cuts and increased infrastructure spending These same prospects triggered massive selloffs in the bond markets, bringing the 10-year Treasury rate to 2 3%, its highest since 2015 Infrastructure spending is seen to worsen the deficit and the tax cuts to reduce revenue, thereby placing pressure on federal debt and pushing inflation As the Fed meets on December 13-14, 2016, the financial market has already priced in a 95% probability of a 0 25% rate hike

Total Funds Under Management

The following table represents total City funds under management based on their market values as of September 30, 2016

	09/30/2016	06/30/2016	$ Change
Pooled Investment Portfolio	$459,942,963	$447,344,740	$12,598,223
Capital Endowment	1,910,208	1,905,834	4,374
Stranded Investment Reserve Portfolio	69,965,911	69,833,352	132,559
Special Funds	24,470,382	24,400,825	69,557
Investments Held with Fiscal Agents	59,439,998	60,481,790	-1,041,792
Total Funds Under Management	**$615,729,462**	**$603,966,541**	**$11,762,921**

The Pooled Investment Portfolio value increased by a net $12,598,223 due to the following transactions during the quarter

Investment Earnings adjusted by FMV change	733,715
Deposits and Credit Card Receipts	117,492,487
Property Tax Revenues	6,920,447
Sales and Other Tax Revenues	9,910,255
HUD Receipts Net of Payments	1,885,516
Payroll and Payroll-related Expenses	(66,540,896)
Vendor Payments and Accounts Payable Checks	(39,254,765)
Debt Service Payments	(7,547,563)
Water and Power Payments Net of LOC Drawdowns	(10,218,437)
Net Transfer to Other Funds	(782,536)
	12,598,223

The Capital Endowment Fund increased by $4,374 representing the net investment earnings for the period

The Stranded Investment Reserve portfolio increased by $132,559 representing the investment earnings for the period adjusted by the market value change of investments

Special Funds increased by a net $69,557 mainly due to investment earnings of $89,057, less $19,500 principal payment on the Annandale Assessment District Bond

Investments held with fiscal agents decreased by $1,041,792 as a result of $636,000 debt service payments made from the various debt service funds held with the trustees, the release of $254,000 excess reserve balance in the various reserve funds, and an adjustment of $151,000 to reflect the fair market value loss on the total investments held in the funds

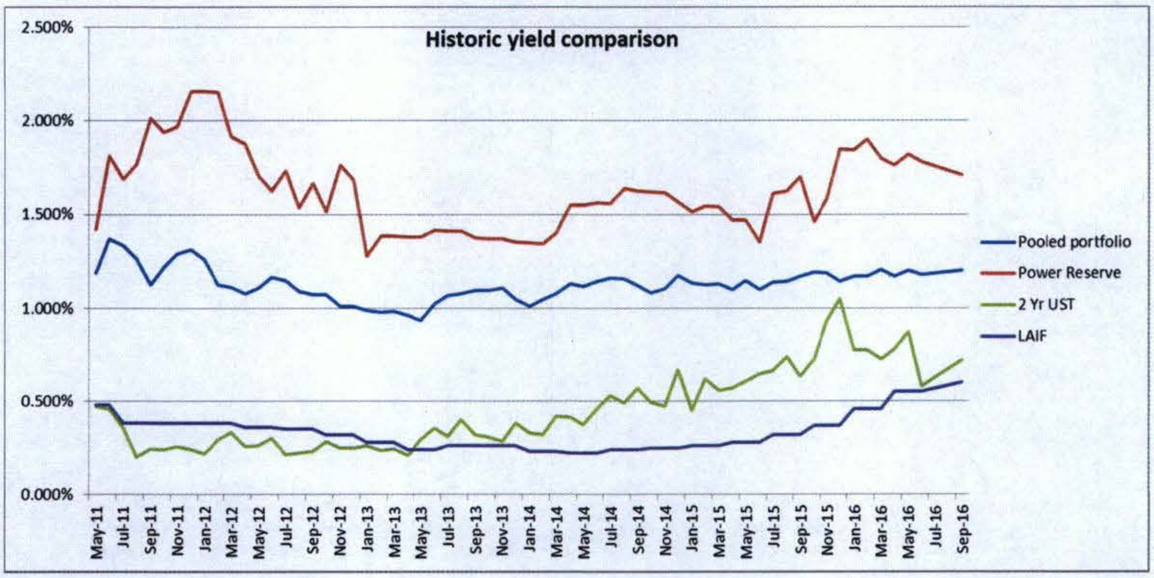
The City pools all internal funds to gain economies of scale and to simplify the investment function There are over 100 funds in the Pooled Investment Portfolio Because the September 2017 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately $45 million at the end of September representing 10% 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, 2016, the portfolio's duration was 2 04 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, 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 2016 Investment Policy, which was adopted by the City Council on July 27, 2015, 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 yield to maturity on the City's Pooled Portfolio began to gradually increase after it stabilized at around 1% due to declining interest rates in the last six years as short-term rates remained between 0.00% and 0.25% until December 16, 2015 when the Fed increased the target Fed Funds rate by 0.25%. The fiscal year to date effective yield which represents the portfolio investment earnings rate adjusted by the realized trading gains and losses was 1.20% for the Pooled Portfolio as of September 2016, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 0.60%, the Los Angeles County Treasurer's Pooled portfolio yield of 0.97%, and the average yield on the two-year U.S. Treasury of 0.77%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.71%.

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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