

Agenda Report

June 13, 2016

TO: Honorable Mayor and City Council

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending March 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 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

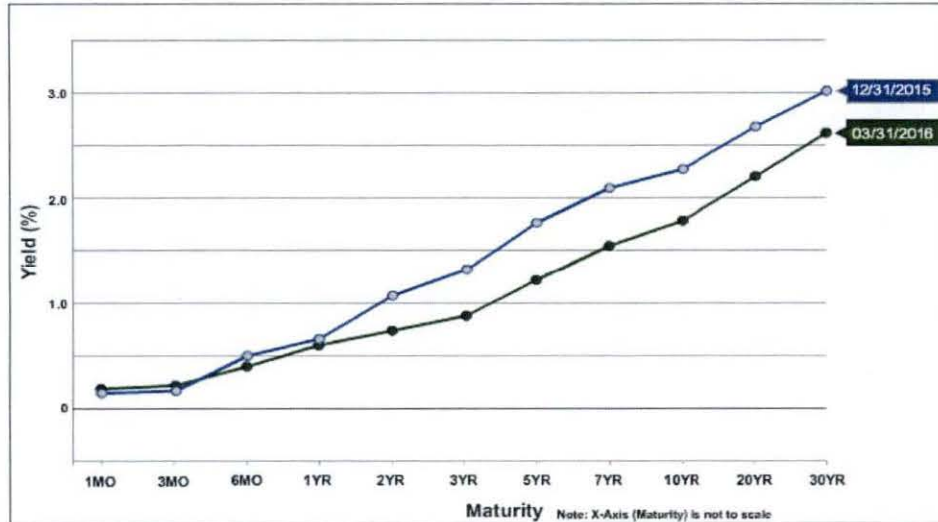
The Gross Domestic Product grew at a lackluster 0.5% annual growth rate for the first quarter of 2016. The previous quarter's growth rate was already deemed tepid at 1.4%. Businesses held back on their investments and liquidated their existing inventory, taking their cue from a weaker global demand. Historic lows in oil and gas prices have also dried out investments, most remarkably in the mining industry. Even consumer spending, accounting for about two-thirds of the economic activity, saw a weak 1.4% growth compared to a 2.4% percent growth in the previous quarter. Traditionally, the first quarter consumer spending has been slowed by seasonality. A harsh winter in the northeast served as a drag to consumer spending. On the other hand, consumer confidence appears to be on the rise as a combination of lower energy costs and job market gains promises improved figures for the next period. One of the few bright spots was the housing sector's performance. Real residential fixed investment, spurred by job growth and relatively low mortgage rates, grew by 14.8%. Total existing home sales rose 5.1% in March at an annualized rate of 5.33 million. Sales rose collectively at 1.5% in all four major regions compared to the prior year's figures.

Even when the economy virtually stood still in the first quarter, job growth remained strong with an average gain of 200,000 jobs per month for the quarter, notably from February's addition of 245,000 new jobs. While the unemployment rate held at 5.0% in March, the same level it was as of the previous quarter, it is worth mentioning that the labor force participation rate rose from 62.6% to 63.0% for the quarter. This rise in optimism is further supported by the fact that this is the 73rd straight month of job growth coinciding with the 14.4 million jobs created by the job sector for the same period per the Bureau of Labor Statistics.

The Federal Open Market Committee softened its rate hike stance and decided during its two meetings during the quarter that overall economic conditions did not warrant a further interest rate hike. Inflation, consistently below the target rate of 2.0% for three years running now, was the reason cited. Despite what appears to be a tightening of labor markets, inflation remains benign. March 2016's year-over-year unadjusted Headline CPI came in at 0.85%, lower than the February register of 1.02%. Meanwhile, the year-over-year Core CPI which excludes food and energy components came in at 2.19%, also down from February's 2.33% reading. On a seasonally adjusted basis, the Core CPI rose by a mere 0.1% from February.

Stock markets began the year with sustained weeks of losses; however, the Dow Jones Industrial Average, the S&P 500 Index, and the Nasdaq all performed briskly in March, garnering gains of 7.22%, 6.78%, and 6.94%, respectively. The March recoveries, attributed to renewed investor confidence and expectations of improving fundamentals, buoyed most indices sufficient enough to net gains and end the quarter in positive territory. The Dow Index ended the quarter at a positive 2.19%, the S&P 500 Index was up 1.34%, and Nasdaq ended the quarter at a -2.39% return. Emerging market stocks, propped by a weakening dollar, outperformed developed market stocks. This is evidenced by a 5.71% gain by the MSCI Emerging Markets Index for the quarter.

The above-mentioned volatility in equities and other riskier assets pushed investors towards the safer bond markets. The US Treasury curve shifted downwards (see chart below) as gains were seen in every major bond sector. The Barclays US Aggregate Bond Index rose 3.03% for the quarter. Long duration bonds outperformed in particular with the 10-year treasury falling to 1.78%, the lowest end of quarter level since the fourth quarter of 2012 and 49 basis points from the end of 2015. The investment grade and high yield sectors also saw credit spreads tighten during the quarter as indices for the said sectors returned 3.97% and 3.82%, respectively.



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

Commodities markets headlines were dominated by the alarm over the volatility of oil prices as the price of crude oil dipped below \$27 per barrel in late January, even lower than levels during the height of the financial crisis. Prices recovered to \$37.49 as of end of the first quarter of 2016 and, although it appears to have normalized, the path of oil prices and its effect on the domestic economy continue to elicit concern and uncertainty among analysts.

On the international front, China's government continues to wield fiscal policy stimulus, partially allaying concerns about China's subdued economic outlook. While the European Central Bank and the Bank of Japan continue with their respective monetary easing projects with their respective key overnight lending rates both now subzero, results so far have been mixed as inflation remains at historically low levels. Political headwinds also hound the Eurozone with the possibility of Great Britain exiting the European Union and the continuing refugee crisis posing the most political risks.

Total Funds Under Management

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

	03/31/2016	12/31/2015	\$ Change
Pooled Investment Portfolio	\$430,967,622	\$396,289,128	\$34,678,494
Capital Endowment	1,902,673	1,900,474	2,199
Stranded Investment Reserve Portfolio	69,448,429	68,628,879	819,550
Special Funds	24,066,911	28,918,623	-4,851,712
Investments Held with Fiscal Agents	60,799,876	59,872,458	927,418
Total Funds Under Management	\$587,185,511	\$555,609,562	\$31,575,949

The Pooled Investment Portfolio value increased by a net \$34.67 million mainly due to the receipt of \$25.745 million in property tax revenues, a \$20.5 million draw on the Bank of America line of Credit related to the construction of the GT5 repowering project, \$3.22 million receipt from the Redevelopment Property Tax Trust Fund, an increase in cash deposits by \$5.932 million, and an increase in investment earnings of \$2.9 million. These cash inflows were offset by \$18.79 million in debt service payments made on various bond issues, and the payment of \$4.841 million related to the GT5 Electric Repowering Project.

The Capital Endowment Fund increased by \$2,199 representing the net investment earnings for the period.

The Stranded Investment Reserve portfolio increased by \$819,550 representing the investment earnings for the period adjusted by the unrealized gains.

Special Funds decreased by a net \$4.85 million mainly due to the payment of \$4.128 million by the City's Successor Agency to the state as part of the state's Due Diligence Review, the withdrawal of \$1 million from the 2015 Electric Bond proceeds for project costs related to the GT5 project adjusted by the net investment earnings of \$227,811.

Investments held with fiscal agents increased by a \$927,418 representing mainly investment gains in the accounts.

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 2016 fiscal year accounting records have not yet closed, staff estimates that the General Fund's cash balance was approximately \$50 million at the end of March representing 11.6% of the March 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

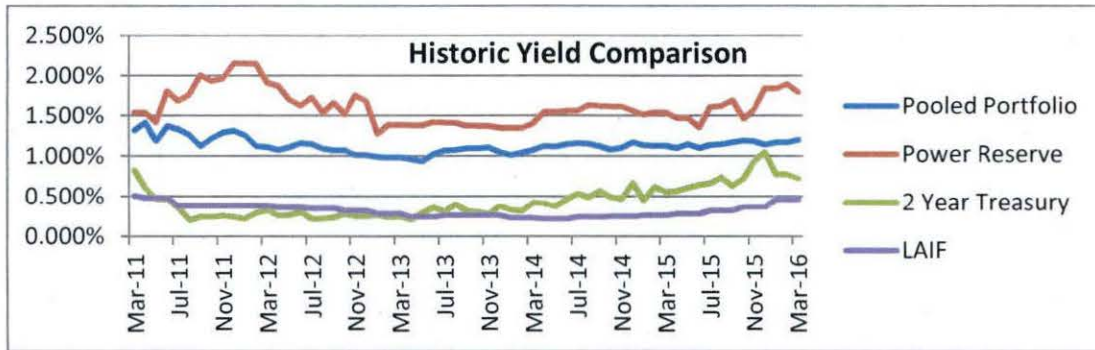
the bond indentures. The City targets a duration average of two years in managing the pooled portfolio based on the portfolio's risk and return evaluation and industry best practices as it pertains to public funds management. As of March 31, 2016, the portfolio's duration was 1.99 years.

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 March 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 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 \$45 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 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 March 2016, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 0.38%, the Los Angeles County Treasurer's Pooled portfolio yield of 0.79%, 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 1.60%.

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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