Agenda Report

August 28, 2017

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending June 30, 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.

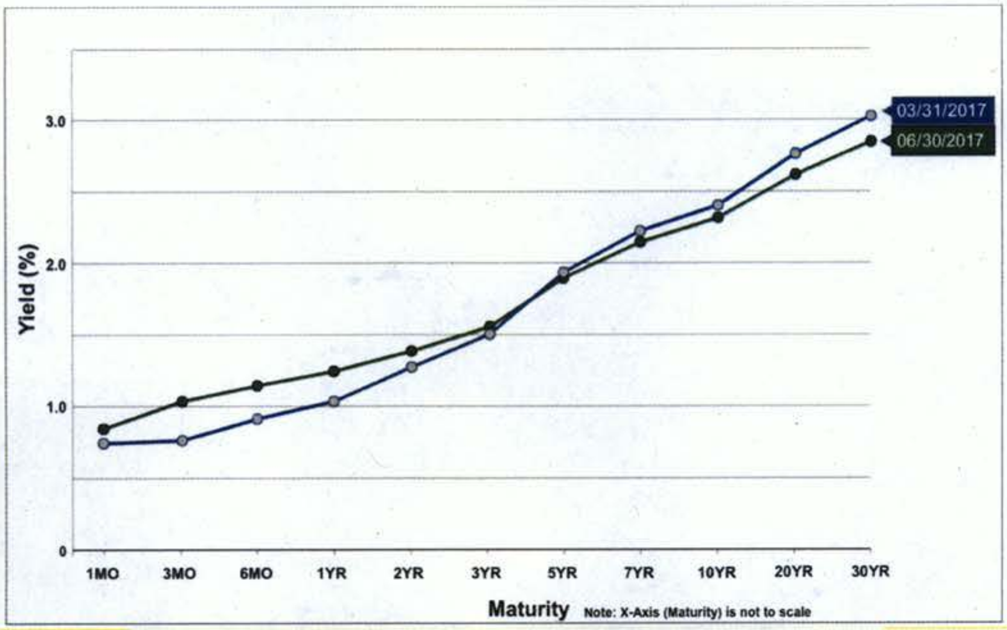
Quarterly Economic Review

Following a 1.2% growth in the economy in the first quarter of 2017, the Gross Domestic Product (GDP) grew by a faster 2.6% in the second quarter of 2017 according to the U.S. Department of Commerce, Bureau of Economic Analysis. Consumer spending, accounting for nearly three-fourths of said second-quarter growth, increased by 2.8%. Housing gains made in the first quarter were not sustained as residential investments shrank by 6.8% in the second quarter. Nonetheless, gains made in non-residential fixed investments were enough to push overall gross private domestic investments' growth to 2.0%. Net exports also contributed positively as exports' growth of 4.1% for the quarter was faster than the 2.1% rise in imports. Government spending, which saw a contraction in the first quarter, grew by 0.7% in the recent quarter and thus also contributed to the growth in economic activity.

According to the Bureau of Labor Statistics, June 2017 saw nonfarm payroll jobs grow by 231,000. Together with job gains in April and May of 207,000 and 145,000 respectively, job gains averaged 194,000 per month for the quarter. This figure is slightly higher than the monthly job gains average of 187,000 seen in 2016. The unemployment rate declined to 4.4% as of the end of June 2017, and the average hourly earnings rose by 2.5% on an annualized basis, yet again signals of further tightening in the labor market.

While the year-over-year Consumer Price Index (CPI) rose 1.6% in June 2017, the U.S. Bureau of Labor Statistics noted that this measure has steadily been declining since February 2017, when it was at 2.7%. Meanwhile, the year-over-year Core CPI Index which excludes food and energy components rose 1.7% for the 12 months ending June 2017, similar to the May 2017 reading. These most recent two months have registered the smallest 12-month increases since November 2015.

Bond yields rose on short maturities but fell on longer maturities; the pivot point appears to be near the 5-year maturity (see chart in the following page). The yield on the 2-year Treasury note rose to 1.38% from 1.27% as of the end of the previous quarter. Over the same period, the yield on the 5-year Treasury fell from 1.93% to 1.89%. The broad-based Barclays U.S. Aggregate Bond Index returned 1.45% for the quarter, a stronger performance than the 0.82% registered in the previous quarter. Except for TIPS (Treasury Inflation-Protected Securities), all bond sectors earned positive total returns in the second quarter of 2017. The best performing sector was Long Government and Investment Grade Credit. The Barclays Long U S. Government Credit Index registered a 4.4% total return during the quarter as it benefited most from a drop in long-term yields. (Source: Fidelity Investments Quarterly Market Update)



Source: US Department Of The Treasury, *www.treasury.gov*

The majority of domestic equities posted positive gains during the second quarter of 2017 but growth was not as rapid as it was in the preceding quarter. The broad-based S&P 500 posted a 2.57% total return during the quarter, slower than the 5.53% return achieved in the prior quarter. Similarly, the Dow Jones Industrial Average's return of 3.32% for the quarter was slower than the first quarter return of 4.56%. The NASDAQ, which is dominated by Information Technology stocks, only saw a 3.87% return during the quarter, far outpaced by the 9.82% return in the prior quarter. In terms of sectors, Healthcare performed the best with a 7.1% total return for the quarter. Energy and Telecom Services lagged all sectors during the quarter, posting -6.4% and -7.0% respectively.

The Federal Open Market Committee (FOMC) decided to raise the federal funds rate by another 0.25% at its June 14, 2017 meeting, thereby bringing the target range for the federal funds rate to 1.0% to 1.25%. The FOMC noted that the labor market has continued to strengthen and that economic activity has been rising moderately. The FOMC specifically highlighted that job gains have been solid, the unemployment rate has declined, household spending has picked up, and that business fixed investment has continued to expand. 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 Summary of Economic Projections dated June 14, 2017 was guardedly more optimistic than the March 2017 projections. Real GDP growth for 2017 was revised upwards from 2.1% to 2.2%. The unemployment rate, previously projected to be 4.5% for 2017, is now projected to be 4.3%. The June 2017 projections still suggest that there will be another 0.25% rate hike in 2017 as the federal funds rate is still targeted to be between 1.25% and 1.5% by the end of 2017.

Total Funds Under Management

The following table represents total City funds under management based on their market values as of June 30, 2017.

	6/30/2017	3/31/2017	$ Change
Pooled Investment Portfolio	$500,586,180	$485,055,066	$15,531,113
Capital Endowment	1,919,334	1,913,035	6,299
Stranded Investment Reserve Portfolio	69,452,547	68,900,360	552,187
Special Funds	50,347,851	57,119,948	-6,772,097
Investments Held with Fiscal Agents	57,278,760	59,097,283	-1,818,523
Total Funds Under Management	**$679,584,671**	**$672,085,692**	**$7,498,979**

The Pooled Investment Portfolio value increased by a net $15,531,113 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	$2,036,451
Deposits and Credit Card Receipts	103,841,320
Property Tax Revenues	35,998,058
Sales Tax and Other State Apportionments	9,633,011
HUD Receipts Net of Payments and Loans	3,351,454
Payroll and Payroll-related Expenses	(58,374,052)
Vendor Payments and Accounts Payable Checks	(39,887,453)
Debt Service Payments Net of Reimbursements	(23,114,974)
Water and Power Payments	(23,918,494)
Net Transfer from Other Funds	5,965,793
	$15,531,113

The Capital Endowment Fund increased by a net $6,299 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 $552,187 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds decreased by $6,772,097 due to capital expenditure drawdowns of $6,983,673 partially offset by investment earnings for the quarter of $211,576.

Investments held with fiscal agents decreased by a net $1,818,523 as a result of $2,104,866 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices, $506,331 in debt service payments made for various bond issues, a $108,224 net decrease in reserve requirements due to a bond issue refunding, $57,124 Cost of Issuance funds set up for the previously mentioned refunding net of funds transferred to the Insurance and Condemnation fund, and net investment earnings of $843,774.

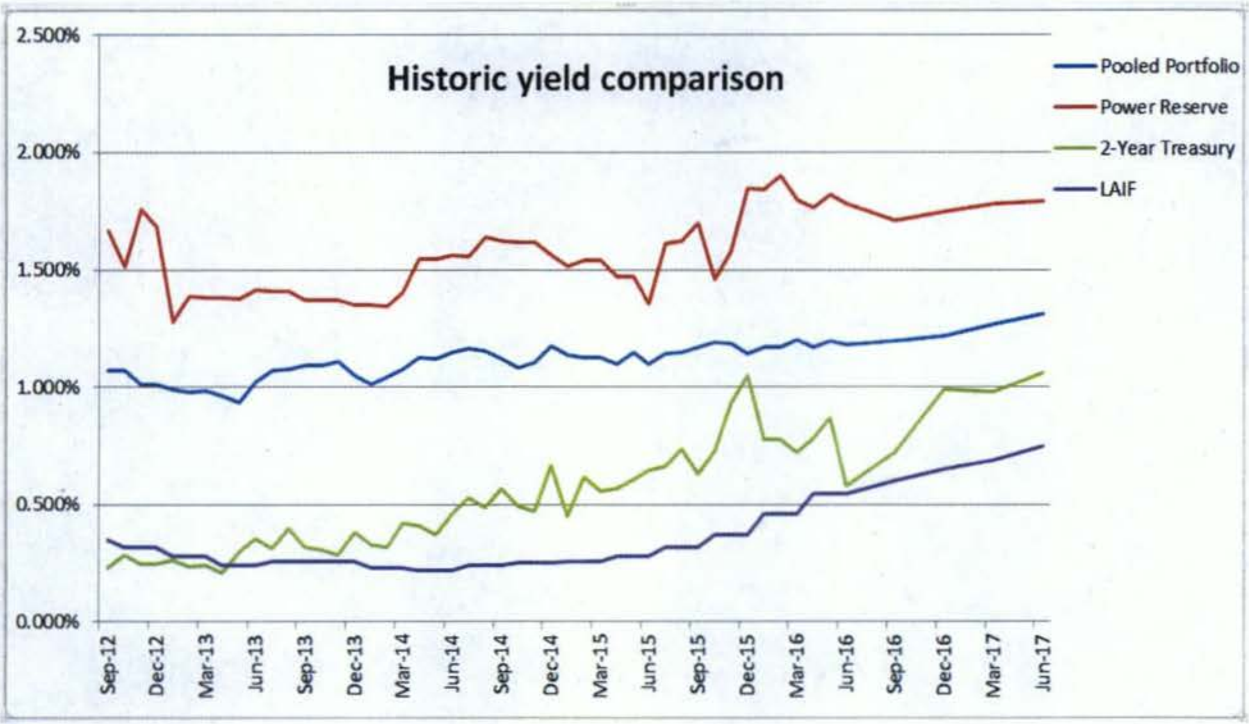
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the June 2017 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately $79 million at the end of June representing 16% 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, 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 June 30, 2017, the portfolio's duration was 2.03 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, 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 2017 Investment Policy, which was adopted by the City Council on August 8, 2016 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 1.31% for the Pooled Portfolio as of June 2017, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 0.75%, the Los Angeles County Treasurer's Pooled portfolio yield of 1.13%, and the average yield on the two-year U.S. Treasury of 1.06%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.79%.

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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