

Agenda Report

May 22, 2017

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending March 31, 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.

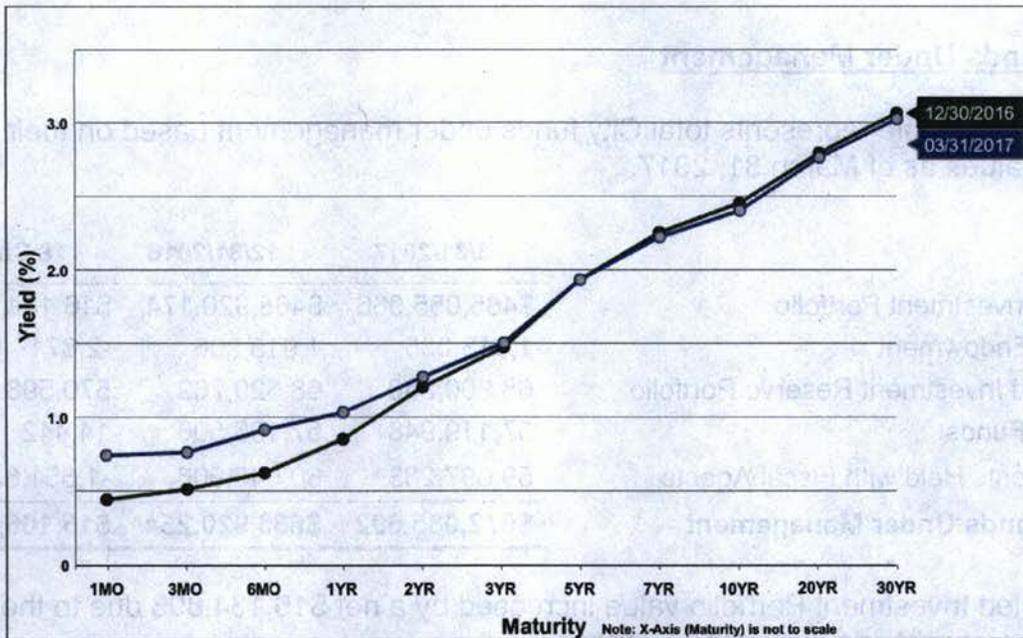
Quarterly Economic Review

Following a 2.1% growth in the economy in the fourth quarter of 2016, the Gross Domestic Product (GDP) grew by a dismally slower 0.7% in the first quarter of 2017 according to the U.S. Department of Commerce, Bureau of Economic Analysis. This is the economy's weakest performance since the first quarter of 2014. Consumer spending once again served as the driving force behind the economy's first-quarter tepid growth, only increasing by a mere 0.3% compared to average growth in personal consumption in 2016 which stood at 3.1% per quarter. The economy was also spurred by a 9.4% growth in business spending, highlighted by 22.1% and 9.1% expansion rates for nonresidential structures and equipment, respectively. Housing also contributed to the economy's growth as residential investments grew by 13.7% for the quarter. Net exports also contributed positively as exports' growth of 5.8% for the quarter was faster than the 4.1% rise in imports. Government spending, which contracted by 1.7%, provided a drag to the quarter's growth in economic activity.

According to the Bureau of Labor Statistics, March 2017 saw nonfarm payroll jobs grow by 98,000. While this figure appears bleak, especially when compared to the job gains in January and February of 216,000 and 219,000 respectively, job gains still averaged 178,000 per month for the quarter which is only slightly lower than the monthly job gains average of 183,000 seen in 2016. The unemployment rate declined to 4.5% as of the end of March 2017, and the average hourly earnings rose by 2.7% on an annualized basis, signaling a further tightening in the labor market.

The year-over-year unadjusted Consumer Price Index (CPI) rose 2.4% in March 2017, lower than the February reading of 2.7%. On a seasonally adjusted basis, the CPI actually decreased 0.3% in March 2017. The U.S. Bureau of Labor Statistics noted that the March decline is the first one-month decrease in the seasonally adjusted index since February 2016 and that it was largely influenced by a 6.2% decline in the gasoline index. Meanwhile, the year-over-year core index which excludes food and energy components rose 2.0% for the 12 months ending March 2017, the smallest 12-month increase since November 2015.

Bond yields rose on short maturities but were largely unchanged on maturities beyond two years (see chart in the following page). The yield on the 2-year Treasury note rose to 1.27% from 1.20% as of the end of the previous quarter. Over the same period, the yield on the 5-year Treasury was unchanged at 1.93%. The first quarter of 2017 saw all bond sectors earning positive total returns. The Barclays U.S. Aggregate Bond Index returned 0.8% for the quarter. Emerging Market Debt, as represented by the JP Morgan EMBI Global Index, returned 3.9% and was the best performing sector during the quarter. As represented by the Bank of America Merrill Lynch High Yield Bond Index, the High Yield Debt sector continued to benefit from the tightening of credit spreads, posting a total return of 2.7% for the quarter. Treasuries, Asset-Backed Securities, and Mortgage-Backed Securities, lagged the aggregate in terms of performance during the quarter, only posting total returns of 0.7%, 0.5%, and 0.5% respectively.



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

The majority of equity market sectors posted positive gains during the first quarter of 2017. Information Technology stocks, leading all sectors with a 12.6% total return, earned a boost from the administration's planned cuts to corporate taxes. Similarly, the NASDAQ, dominated by IT stocks, posted a return of 9.8% for the quarter, indicative of the outperformance of the technology sector. Meanwhile, the broader S&P 500 and the Dow Jones Industrial Average posted returns of 5.5% and 4.6% returns, respectively. The Russell 2000, a small-cap stock market index, gained 2.1% for the quarter.

The Federal Open Market Committee (FOMC) decided to raise the federal funds rate by another 0.25% at its March 15, 2017 meeting, thereby bringing the target range for the federal funds rate to 0.75% to 1.0%. The FOMC noted that the labor market has continued to strengthen with job gains remaining solid and that economic activity has continued to expand at a moderate pace. The FOMC also pointed out that inflation has moved close to its long-run target of 2.0%. The FOMC's Summary of Economic Projections dated March 15, 2017 validated the December projections of the 2017 real GDP growth of 2.1% and unemployment rate of 4.5%. The March 2017 projections also still suggests that there will be two more 0.25% rate hikes in 2017 as the federal funds rate is still seen to be between 1.25% and 1.5% by the end of 2017. Per Bloomberg Intelligence, the market remains confident in 2017's second rate hike in June but not so much with the third rate hike in December. The market has now assigned the probability of three rate increases within the year at 50% with analysts citing the volatile political landscape as the primary concern.

Total Funds Under Management

The following table represents total City funds under management based on their market values as of March 31, 2017.

| | 3/31/2017 | 12/31/2016 | \$ Change |
|---------------------------------------|----------------------|----------------------|---------------------|
| Pooled Investment Portfolio | \$485,055,066 | \$468,920,174 | \$16,134,893 |
| Capital Endowment | 1,913,035 | 1,915,906 | -2,871 |
| Stranded Investment Reserve Portfolio | 68,900,360 | 68,329,762 | 570,598 |
| Special Funds | 57,119,948 | 57,105,506 | 14,442 |
| Investments Held with Fiscal Agents | 59,097,283 | 60,648,906 | -1,551,623 |
| Total Funds Under Management | \$672,085,692 | \$656,920,254 | \$15,165,439 |

The Pooled Investment Portfolio value increased by a net \$16,134,893 due to the following transactions during the quarter:

| | |
|---|---------------------|
| Net Investment Earnings (Fair Market Value Change plus Interest Income) | \$2,070,749 |
| Deposits and Credit Card Receipts | 103,096,775 |
| Property Tax Revenues (including SB481) | 29,863,845 |
| Sales Tax and Other State Apportionments | 10,999,662 |
| HUD Receipts Net of Payments and Loans | 51,668 |
| Payroll and Payroll-related Expenses | (68,336,501) |
| Vendor Payments and Accounts Payable Checks | (29,618,669) |
| Debt Service Payments | (9,166,466) |
| Water and Power Payments Net of Receipts | (21,857,632) |
| Net Transfer to Other Funds | (968,537) |
| | \$16,134,893 |

The Capital Endowment Fund decreased by a net \$2,871 due to an \$8,500 fund transfer partially offset by net investment earnings for the period of \$5,629.

The Stranded Investment Reserve portfolio increased by \$570,598 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds increased by a net \$14,442 due to investment earnings of \$209,442, and a reduction of \$195,000 for 2016A Electric Revenue Refunding cost of issuance invoices paid during the quarter.

Investments held with fiscal agents decreased by a net \$1,551,623 as a result of \$1,904,782 in debt service payments for various bond issues made, the release of

\$61,353 excess reserve balance in various reserve funds, a \$4,032 cost of issuance invoice paid during the quarter, and net investment earnings of \$418,544.

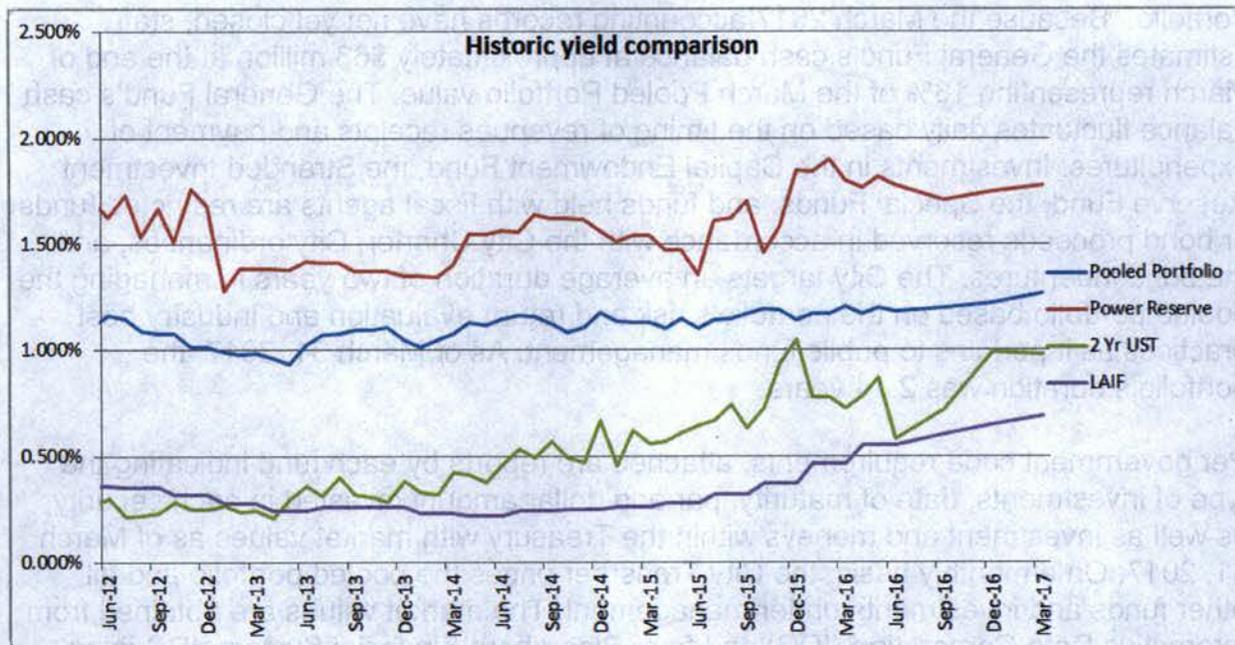
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the March 2017 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately \$63 million at the end of March representing 13% 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 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 March 31, 2017, the portfolio's duration was 2.14 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, 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 1.27% for the Pooled Portfolio as of March 2017, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 0.69%, the Los Angeles County Treasurer's Pooled portfolio yield of 1.06%, and the average yield on the two-year U.S. Treasury of 0.98%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.78%.

The graph below represents the historic yields comparison of the Pooled Portfolio and the Power Reserve Portfolio over the last five years.



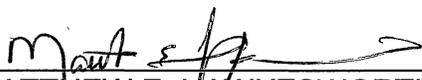
COUNCIL POLICY CONSIDERATION:

This action supports the City Council's strategic goal to maintain fiscal responsibility and stability.

FISCAL IMPACT:

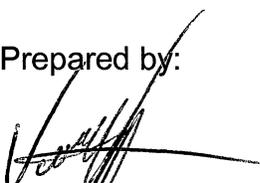
There is no fiscal impact as a result of this action nor will it have any indirect or support cost requirements. There is no anticipated impact to other operational programs or capital projects as a result of this action.

Respectfully submitted,



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