

Agenda Report

December 10, 2018

TO: Honorable Mayor and City Council
THROUGH: Finance Committee
FROM: Department of Finance
SUBJECT: Quarterly Investment Report – Quarter Ending September 30, 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

According to the advance estimate released by the Bureau of Economic Analysis of the U.S. Department of Commerce, the Gross Domestic Product (GDP) grew by 3.5% during the third quarter of 2018. In comparison, the real GDP growth for the second quarter of 2018 was 4.2%. Increases in personal consumption expenditures, gross private domestic investment, and government spending all contributed to the growth in economic activity. The growth in these sectors was partially offset by a contraction in the net exports of goods and services due to both a decrease in exports and an increase in imports during the quarter.

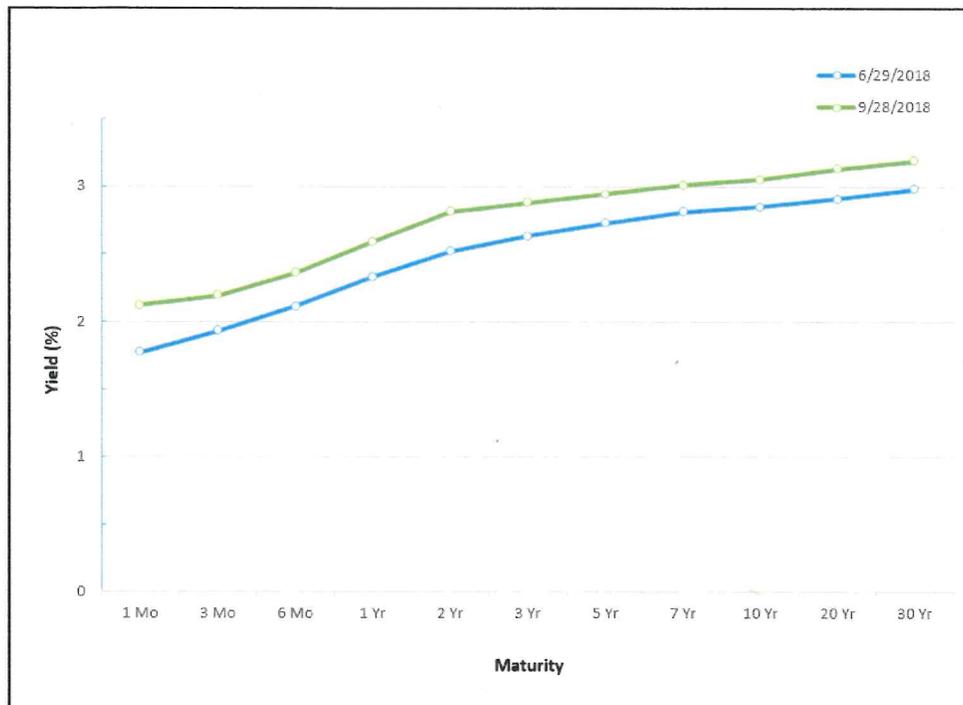
September 2018 saw nonfarm payroll jobs expand by 118,000. With employment gains for July and August coming in at 165,000 and 286,000, respectively, the average monthly jobs created for 2018 stands at about 213,000 per month. Throughout 2017, total nonfarm employment added 2.2 million jobs or an average of 180,000 per month. The unemployment rate declined to 3.7% as of September 2018, the lowest monthly unemployment rate reading since December 1969. The labor market continues to tighten as the average hourly earnings rose by 2.8% on an annualized basis in September.

The year-over-year Consumer Price Index (CPI) rose 2.3% in September 2018. Meanwhile, the year-over-year Core CPI Index, which excludes food and energy components, rose 2.2% for the 12 months ending September 2018. Over the past year, the food index increased 2.3% while the energy index rose 4.8% as buoyed by a 9.6% rise in the energy commodities index.

At its September 25-26, 2018 meeting, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate at 2.0% to 2.25%. The FOMC noted that the labor market has continued to strengthen and that economic activity has been rising at a strong rate. The FOMC specifically highlighted that job gains have been strong in recent months and that the unemployment rate has stayed low. The committee further noted that household spending and that business fixed investment have grown strongly. The FOMC also pointed out that both overall and core inflation remain near 2.0%. The FOMC's September 2018 Summary of Economic Projections slightly changed compared to the June 2018 projections. Real GDP growth for 2018 was revised upwards from 2.8% to 3.1%. The unemployment rate for 2018, previously projected to be at 3.6%, is now seen to be at 3.7% at the end of year. The most recent projections still suggest that the federal funds rate will be between the targeted range of 2.25% to 2.50% by the end of 2018, similar to the yearend targeted range of the June 2018 projections.

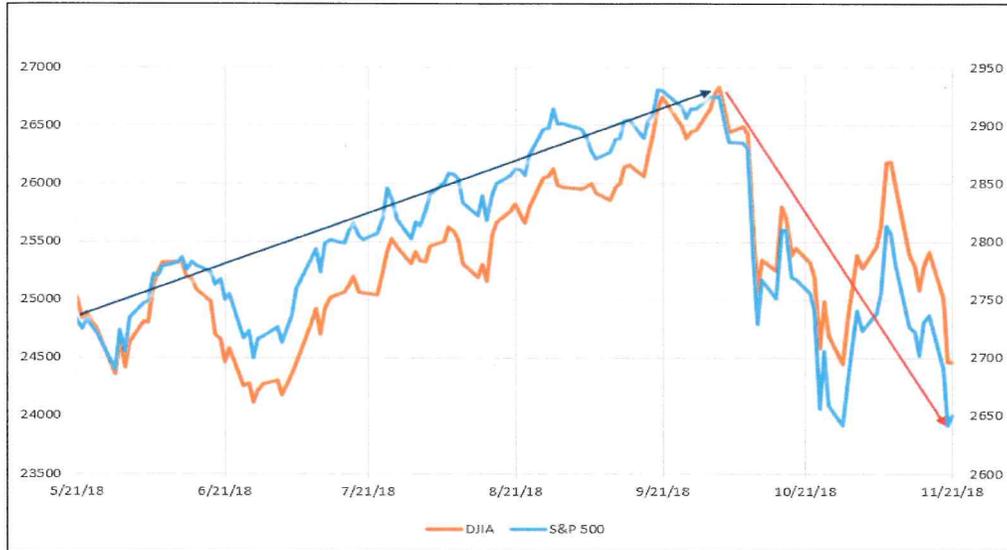
Since the previous quarter, the yield curve shifted upwards across all maturities (see chart in the following page). The yield on the 2-year Treasury note rose to 2.81% from 2.52% at the end of the previous quarter. Over the same period, the yield on the 5-year Treasury rose to 2.94% from 2.73%. This rise in yields led to a mixed bag of return results among bond sectors. The broad-based Barclays U.S. Aggregate Bond Index

posted a 0.02% gain for the quarter, an improvement from the previous quarter's -0.16% loss. High Yield debt was again the quarter's best performing sector with a 2.4% total return, while TIPS and Treasuries were the worst performing sectors of the third quarter with -0.8% and -0.6% losses, respectively (Fidelity Investments).



Domestic equities made solid gains during the third quarter of 2018. The broad-based S&P 500 composite posted a 7.20% total return during the third quarter of 2018, a stark increase from the 2.93% earned during the previous quarter. The Dow Jones Industrial Average similarly posted a strong performance gaining 9.01% for the quarter as compared to a 0.70% return in the previous quarter. The NASDAQ, which is dominated by Information Technology stocks, managed to post a 7.14% total return for the quarter, still faring better than the previous quarter which saw a 6.31% gain. In terms of sectors, Health Care and Industrials performed the best with 14.5% and 10.0% total returns, respectively, for the quarter.

The chart in the following page exhibits the gains made by domestic equities through the period covering the third quarter of 2018. The S&P 500 and the Dow Jones Industrial Average indices show parallel paths of growth beginning with relative lows at the start of the quarter and both indices reaching all-time highs around the end of the quarter. Since October however, the stock market has become much more volatile. Domestic equities saw several periods of extended sell-offs which, as of the date of this report (November 20), have now erased the gains made during the year.



Total Funds Under Management

The following table represents total City funds under management based on their market values as of September 30, 2018.

	9/30/2018	6/30/2018	\$Change
Pooled Investment Portfolio	\$531,303,379	\$528,341,164	\$2,962,214
Capital Endowment	1,958,037	1,945,408	12,629
Stranded Investment Reserve Portfolio	69,598,212	69,565,043	33,170
Special Funds	26,480,543	28,175,002	(1,694,459)
Investments Held with Fiscal Agents	50,543,158	54,176,523	(3,633,365)
PARS Section 115 Trust	12,786,845	12,597,008	189,838
Total Funds Under Management	\$692,670,174	\$694,800,148	(\$2,129,974)

The Pooled Investment Portfolio value increased by a net \$2,962,214 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	\$2,256,112
Deposits and Credit Card Receipts	122,440,280
Property Tax Revenues	5,365,847
Sales Tax and Other State Apportionments	10,167,799
HUD Receipts Net of Payments and Loans	2,011,261
Payroll and Payroll-related Expenses	(70,013,984)
Vendor Payments and Accounts Payable Checks	(40,801,454)
Debt Service Payments Net of Reimbursements and Subsidies	(4,152,617)
Water and Power Payments Net of Receipts	(27,630,840)
Net Transfer from Other Funds	3,319,810
	\$2,962,214

The Capital Endowment Fund increased by a net \$12,629 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 \$33,170 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds decreased by \$1,694,459 due to \$1,743,244 Robinson Park construction expenses, a \$21,850 Annandale principal payment, and \$49,996 market value losses partially offset by investment earnings for the quarter of \$120,630.

Investments held with fiscal agents decreased by \$3,633,365 as a result of a \$2,391,708 transitional decrease for debt service payments made for various bond issues, \$1,027,479 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices, and \$214,178 in market value losses net of investment earnings.

The PARS Section 115 Trust account increased by \$189,838 representing \$204,575 in investment earnings for the period which includes the market value change of investments and the interest earned, offset by \$14,738 in investment expenses.

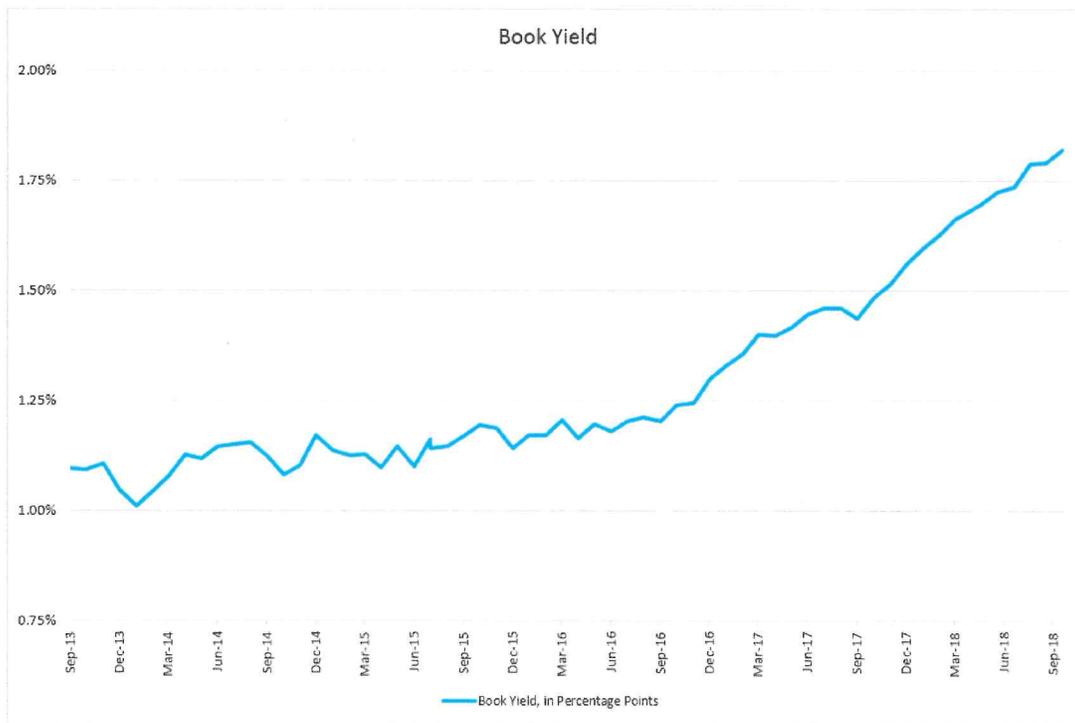
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the September 2018 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately \$53 million 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, 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 September 30, 2018, the portfolio's duration was 1.53 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, 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.

The fiscal year to date effective yield which represents the portfolio investment earnings rate adjusted by the realized trading gains and losses was 1.78% for the Pooled Portfolio as of September 2018, compared to the State Treasurer’s Local Agency Investment Fund (LAIF) of 2.00%, the Los Angeles County Treasurer’s Pooled portfolio yield of 1.91%, and the average yield on the two-year U.S. Treasury of 2.66%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.90%.

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:

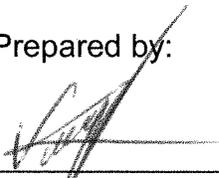
There is no fiscal impact as a result of this action nor will it have any indirect or support cost requirements. There is no anticipated impact to other operational programs or capital projects as a result of this action.

Respectfully submitted,



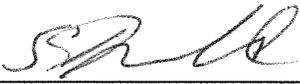
MATTHEW E. HAWKESWORTH
Director of Finance
Department of Finance

Prepared by:



Vic Erganian
Deputy Director of Finance/City Treasurer

Approved by:



STEVE MERMELL
City Manager

Attachment: (1)

Attachment A – Quarterly Investment Report - Quarter Ending September 30, 2018