Agenda Report

May 21, 2018

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: Quarterly Investment Report
Quarter Ending March 31, 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 2.3% during the first quarter of 2018. In comparison, the real GDP growth for the fourth quarter of 2017 was 2.9%. Increases in personal consumption expenditures, gross private domestic investment, net exports of goods and services, and government spending all contributed to the growth in economic activity. For the first time since the second quarter of 2014, gross private domestic investment, which grew by 7.3% during the quarter, had a larger contribution to the economy's growth than did personal consumption expenditures, which only grew by 1.1% for the quarter.

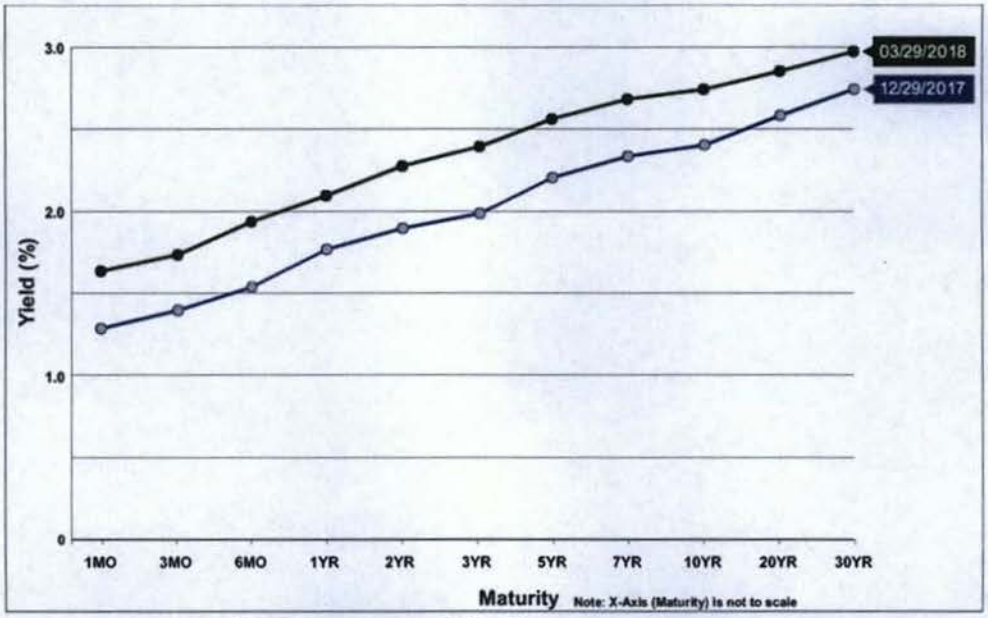
March 2018 saw nonfarm payroll jobs expand by 135,000. With employment gains for January and February coming in at 176,000 and 324,000 respectively, the average monthly jobs created for 2018 stands at 212,000 per month. Throughout 2017, total nonfarm employment added 2.2 million jobs or an average of 180,000 per month. The unemployment rate stood at 4.1% for the sixth consecutive month. The average hourly earnings rose by 2.7% on an annualized basis in March as the labor market continued to tighten.

The year-over-year Consumer Price Index (CPI) rose 2.4% in March 2018. The Bureau of Labor Statistics notes that this was the largest 12-month increase since the period ending March 2017 and that this was higher than the 1.6% average annual rate over the past 10 years. Meanwhile, the year-over-year Core CPI Index which excludes food and energy components rose 2.1% for the 12 months ending March 2018, its largest 12-month increase since the period ending February 2017. Over the past year, the food index increased 1.3% while the energy index rose 7.0%, as buoyed by an 11.3% rise in the energy commodities index.

At its March 20-21, 2018 meeting, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate at 1.5% to 1.75%. The FOMC noted that the labor market has continued to strengthen and that economic activity has been rising at a moderate rate. The FOMC specifically highlighted that job gains have been strong in recent months and that the unemployment rate has stayed low. The committee did note that growth rates of household spending and business fixed investment have moderated from their strong fourth-quarter readings. The FOMC also pointed out that inflation is expected to move up in the coming months and for it to stabilize around the 2.0% objective over the medium term. The FOMC's March 2018 Summary of Economic Projections is slightly more optimistic than the December 2017 projections. Real GDP growth for 2018 was revised upwards from 2.5% to 2.7%. The unemployment rate for 2018, previously projected to be at 3.9%, is now seen to be at 3.8% at the end of year. The most recent projections also still suggest that the federal funds rate will be between the targeted range of 2.0% to 2.25% by the end of 2018.

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 2.27% from

1.89% as of the end of the previous quarter. Over the same period, the yield on the 5-year Treasury rose to 2.56% from 2.20%. The rise in yields led to losses to almost all bond sectors. The broad-based Barclays U.S. Aggregate Bond Index posted a -1.46% loss for the quarter, after managing to generate a 0.39% gain during the fourth quarter of 2017 despite a rise in yields across almost all maturities. The previous quarter's best performing sector, Long Government and Credit, posted a -3.6% loss which made it the worst performing bond sector of the first quarter of 2018 (Fidelity Investments).



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

Domestic equities struggled during the first quarter of 2018, erasing some of the gains made during 2017. The broad-based S&P 500 composite posted a -1.17% contraction during the quarter, its first loss on a quarterly basis since the third quarter of 2015. Similarly, the Dow Jones Industrial Average posted a -2.49% loss for the quarter, a stark contrast from the double-digit total return achieved in the previous quarter. The NASDAQ, which is dominated by Information Technology stocks, fared better than the two aforementioned indices as it managed to post a 2.33% total return for the quarter. Consequently, in terms of sectors, Information Technology performed the best with a 3.5% total return for the quarter. In fact, Consumer Discretionary with a 3.1% gain was the only other sector that managed to not post negative returns. Telecom Services and Consumer Staples were the worst performing sectors for the quarter, posting losses of -7.5% and -7.1% respectively.

Total Funds Under Management

The following table represents total City funds under management based on their market values as of March 31, 2018.

	3/31/2018	12/31/2017	$ Change
Pooled Investment Portfolio	$515,313,860	$502,992,352	$12,321,507
Capital Endowment	1,933,596	1,932,723	873
Stranded Investment Reserve Portfolio	69,368,825	69,858,422	(489,597)
Special Funds	49,031,119	49,924,177	(893,058)
Investments Held with Fiscal Agents	52,263,062	55,772,940	(3,509,878)
Total Funds Under Management	**$687,910,461**	**$680,480,614**	**$7,429,847**

The Pooled Investment Portfolio value increased by a net $12,321,507 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	($494,389)
Deposits and Credit Card Receipts	104,845,559
Property Tax Revenues	26,361,424
Sales Tax and Other State Apportionments	10,797,729
HUD Receipts Net of Payments and Loans	1,804,721
Payroll and Payroll-related Expenses	(62,827,441)
Vendor Payments and Accounts Payable Checks	(35,355,997)
Debt Service Payments Net of Reimbursements and Subsidies	(14,991,747)
Water and Power Payments Net of Receipts	(19,725,662)
Property Purchase	(2,845,763)
Net Transfer from Other Funds	4,753,073
	$12,321,507

The Capital Endowment Fund increased by a net $873 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

The Stranded Investment Reserve portfolio decreased by $489,597 due to market value losses of $818,882 partially offset by investment earnings for the quarter of $329,285.

Special Funds decreased by $893,058 due to $421,895 Robinson Park construction expenses, $304,732 Painted Hills project completion deposit release, $124,974 Resurfacing and Slurry Seal Project expenditures, and $199,061 market value losses partially offset by investment earnings for the quarter of $157,605.

Investments held with fiscal agents decreased by a net $3,509,878 as a result of $1,033,341 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices, the residual release of $2,540,091 from the 1993 COP Reserve Fund, net excess reserve transfers of $191,272 from various bond issues, a $552,375 transitional increase for debt service payments made for various bond issues, and $297,549 in market value losses net of investment earnings.

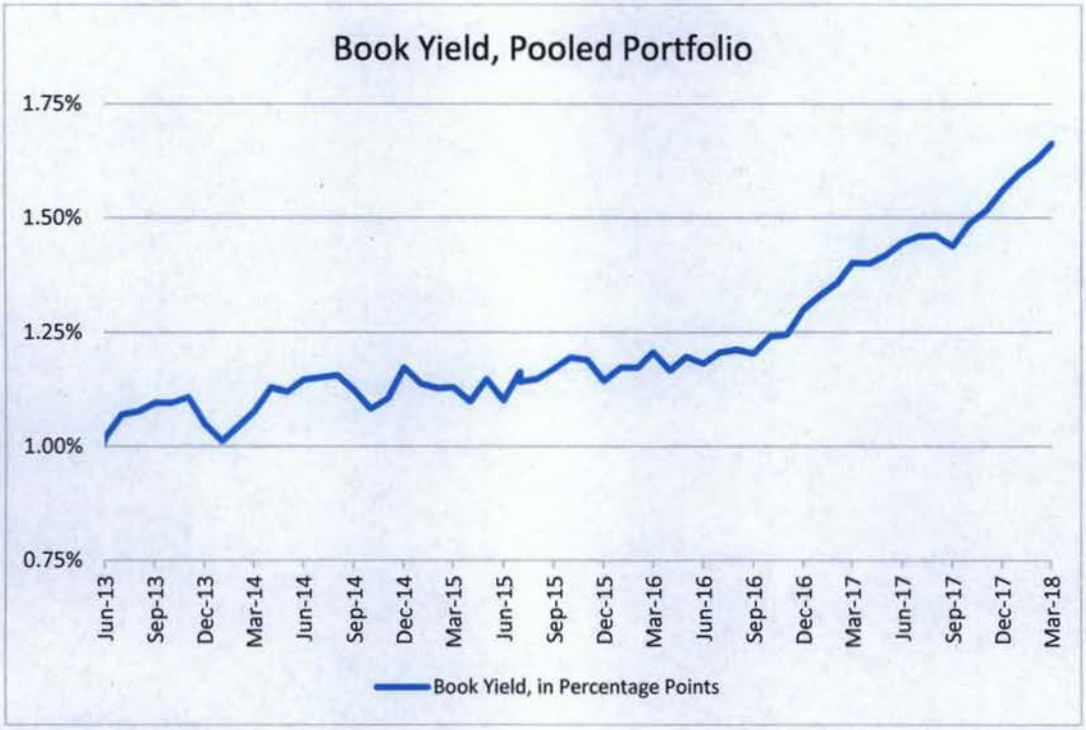
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the March 2018 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately $78 million at the end of March representing 15% 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, 2018, the portfolio's duration was 1.83 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, 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 2018 Investment Policy, which was adopted by the City Council on August 28, 2017 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 $1/12^{th}$ 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 1.52% for the Pooled Portfolio as of March 2018, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 1.26%, the Los Angeles County Treasurer's Pooled portfolio yield of 1.46% (as of February 2018), and the average yield on the two-year U.S. Treasury of 1.72%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.83%.

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 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 Ergadian
Deputy Director of Finance/City Treasurer

Approved by:

STEVE MERMELL
City Manager

Attachment: (1)

Attachment A – Quarterly Investment Report - Quarter Ending March 31, 2018