

# Agenda Report

October 22, 2018

**TO:** Honorable Mayor and City Council

**THROUGH:** Finance Committee

**FROM:** Department of Finance

**SUBJECT:** Quarterly Investment Report  
Quarter Ending June 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 4.1% during the second quarter of 2018. In comparison, the real GDP growth for the first quarter of 2018 was 2.2%. Increases in personal consumption expenditures, net exports of goods and services, and government spending all contributed to the growth in economic activity. The growth in these sectors were partially offset by a contraction in gross private domestic investment, specifically from decreases in residential fixed investments and nonfarm private inventories.

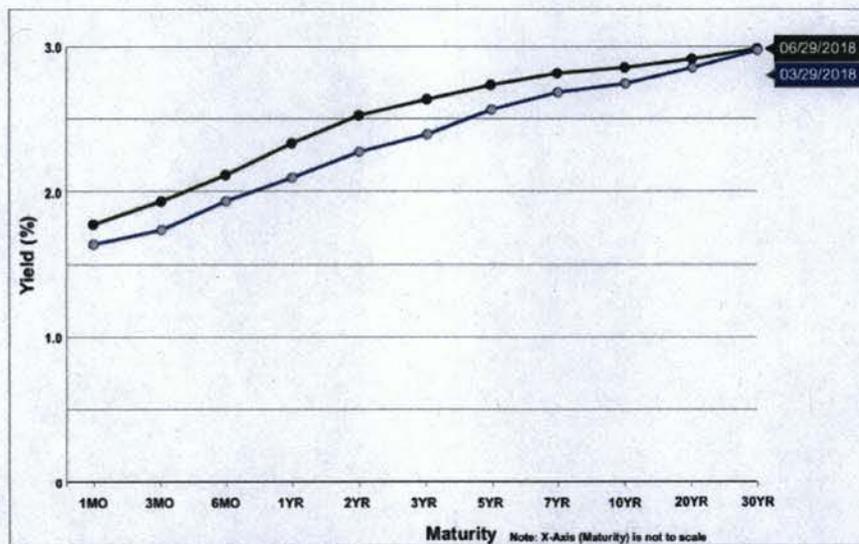
June 2018 saw nonfarm payroll jobs expand by 248,000. With employment gains for April and May coming in at 175,000 and 268,000 respectively, the average monthly jobs created for 2018 stands at 224,000 per month. Throughout 2017, total nonfarm employment added 2.2 million jobs or an average of 180,000 per month. The unemployment rate stood at 4.0% as of June 2018. This was actually a 0.2% point increase from the prior month of May 2018's 3.8% reading, the lowest monthly unemployment rate reading in eighteen years. The labor market continues to tighten as the average hourly earnings rose by 2.7% on an annualized basis in June.

The year-over-year Consumer Price Index (CPI) rose 2.9% in June 2018. The Bureau of Labor Statistics notes that this was the largest 12-month increase since the period ending February 2012. Meanwhile, the year-over-year Core CPI Index which excludes food and energy components rose 2.3% for the 12 months ending June 2018. Over the past year, the food index increased 1.4% while the energy index rose 12.0%, as buoyed by a 24.3% rise in the energy commodities index.

At its June 12-13, 2018 meeting, the Federal Open Market Committee (FOMC) decided to raise the target range for the federal funds rate at 1.75% to 2.0%. The FOMC noted that the labor market has continued to strengthen and that economic activity has been rising at a solid rate. The FOMC specifically highlighted that job gains have been strong in recent months and that the unemployment rate has declined. The committee further noted that growth of household spending has picked up and that business fixed investment has continued to grow strongly. The FOMC also pointed out that both overall and core inflation have now moved close to the medium term objective of 2.0%. The FOMC's June 2018 Summary of Economic Projections is slightly more optimistic than the March 2018 projections. Real GDP growth for 2018 was revised upwards from 2.7% to 2.8%. The unemployment rate for 2018, previously projected to be at 3.8%, is now seen to be at 3.6% at the end of year. The most recent projections now suggest that the federal funds rate will be between the targeted range of 2.25% to 2.50% by the end of 2018, or an additional 0.25% to the yearend targeted range of the March 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 2.52% from 2.27% as of the end of the previous quarter. Over the same period, the yield on the

5-year Treasury rose to 2.73% from 2.56%. 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 -0.16% loss for the quarter, an improvement from the previous quarter's -1.46% loss despite remaining in negative return territory. High Yield debt was the quarter's best performing sector with a 1.0% total return, while Emerging Market Debt was the worst performing sector of the second quarter of 2018 with a -3.5% loss (Fidelity Investments).



Source: US Department of the Treasury, [www.treasury.gov](http://www.treasury.gov)

While domestic equities struggled during the first quarter of 2018, some gains were made during the second quarter. The broad-based S&P 500 composite posted a 2.88% total return during the second quarter of 2018, a recovery from the -1.17% loss suffered during the previous quarter. The Dow Jones Industrial Average similarly posted a turnaround, gaining 0.70% for the quarter as compared to a -2.49% loss in the previous quarter. The NASDAQ, which is dominated by Information Technology stocks, managed to post a 6.31% total return for the quarter, also faring better than the previous quarter which saw a 2.33% gain. In terms of sectors, Energy performed the best with a 13.5% total return for the quarter. Financials and Industrials were the worst performing sectors for the quarter, both posting losses of -3.2%.

**Total Funds Under Management**

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

	6/30/2018	3/31/2018	\$ Change
Pooled Investment Portfolio	\$528,341,164	\$515,313,860	\$13,027,305
Capital Endowment	1,945,408	1,933,596	11,811
Stranded Investment Reserve Portfolio	69,565,043	69,368,825	196,218
Special Funds	28,175,002	49,031,119	(20,856,116)
Investments Held with Fiscal Agents	54,176,523	52,263,062	1,913,462
PARS Section 115 Trust	12,597,008	-N/A-	12,597,008
<b>Total Funds Under Management</b>	<b>\$694,800,148</b>	<b>\$687,910,461</b>	<b>\$6,889,687</b>

The Pooled Investment Portfolio value increased by a net \$13,027,305 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	\$1,393,101
Deposits and Credit Card Receipts	106,329,032
Property Tax Revenues	34,128,873
Sales Tax and Other State Apportionments	9,207,178
HUD Receipts Net of Payments and Loans	2,435,384
Payroll and Payroll-related Expenses	(56,509,819)
Vendor Payments and Accounts Payable Checks	(38,384,508)
Debt Service Payments Net of Reimbursements and Subsidies	(32,355,247)
Water and Power Payments Net of Receipts	(20,498,934)
PARS Section 115 Trust Contributions	(12,578,864)
2016A Electric Revenue Refunding Project Fund Drawdown	18,904,484
Net Transfer from Other Funds	956,624
	<b>\$13,027,305</b>

The Capital Endowment Fund increased by a net \$11,811 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 \$196,218 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds decreased by \$20,856,116 due to an \$18,904,484 drawdown against the 2016A Electric Revenue Refunding Project Fund, \$2,150,957 Robinson Park construction expenses, and \$55,088 market value losses partially offset by investment earnings for the quarter of \$254,413.

Investments held with fiscal agents increased by a net \$1,913,462 as a result of a \$2,588,375 transitional increase for debt service payments made for various bond issues and \$67,985 in net investment earnings partially offset by \$727,246 in withdrawals made from the Stabilization Fund to pay for Water and Power invoices and the release of the remaining balance of \$15,653 from the 2006 Lease Revenue Bonds.

The PARS Section 115 Trust account was funded with a total of \$12,578,864 in contributions during the quarter. Investment earnings net of expenses amounted to \$18,144.

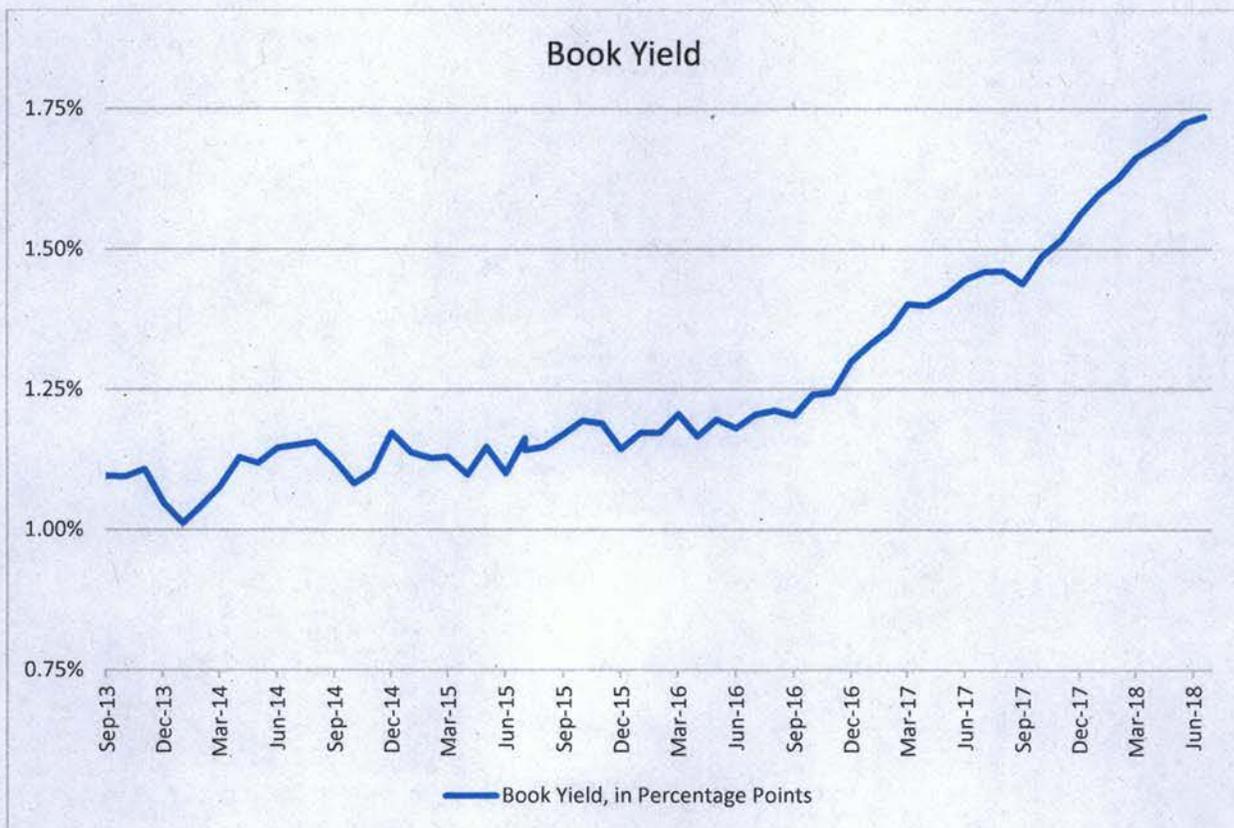
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. Because the June 2018 accounting records have not yet closed, staff estimates the General Fund's cash balance at approximately \$67 million at the end of June representing 13% 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, 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 Agreement. 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, 2018, the portfolio's duration was 1.65 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, 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<sup>th</sup> 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 1.58% for the Pooled Portfolio as of June 2018, compared to the State Treasurer's Local Agency Investment Fund (LAIF) of 1.36%, the Los Angeles County Treasurer's Pooled portfolio yield of 1.58%, and the average yield on the two-year U.S. Treasury of 1.92%. The fiscal year-to-date effective yield for the Power Reserve portfolio was 1.85%.

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.

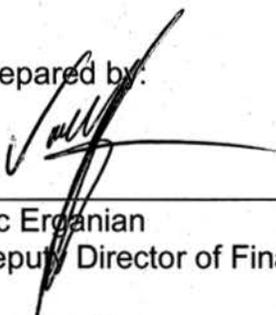
**FISCAL IMPACT:**

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:

  
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Deputy Director of Finance/City Treasurer

Approved by:

  
STEVE MERMELL  
City Manager

Attachment: (1)

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