

Agenda Report

March 30, 2020

TO: Honorable Mayor and City Council
FROM: Department of Finance
SUBJECT: Quarterly Investment Report – Quarter Ending December 31, 2019

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:

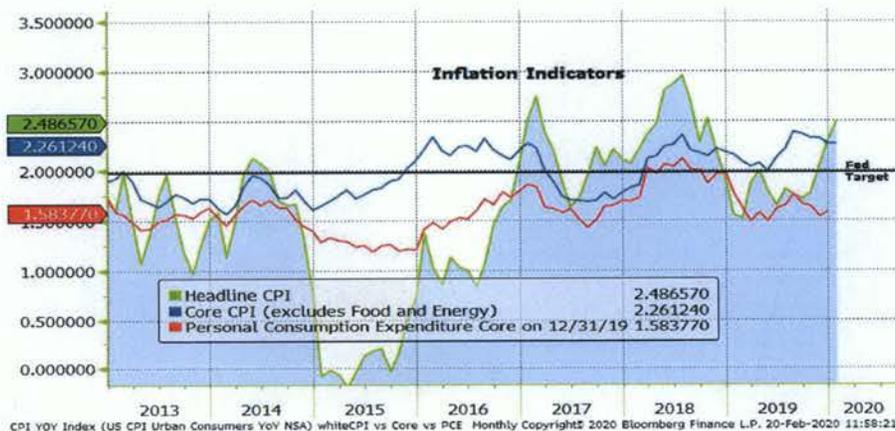
1. The type of investment, name of the issuer, date of maturity, par and dollar amount invested in each security, investment, and money within the treasury;
2. The weighted average maturity of the investments within the treasury;
3. Any funds, investments, or programs, including loans, that are under 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 2.1% annualized rate during the fourth quarter of 2019, the same as the previous quarter. 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.

December 2019 saw nonfarm payroll jobs expand by 147,000. With employment gains for November and October coming in at 261,000 and 185,000, respectively, the average monthly jobs created for the year 2019 stood at 174,000 per month. In contrast, 2018 saw nonfarm employment add an average of 192,000 jobs per month. The unemployment rate stood at 3.5% as of December 2019, unchanged from the prior month. The labor market continues to tighten as the average hourly earnings rose by 3.0% on an annualized basis in December.

The year-over-year Consumer Price Index (CPI) rose 2.3% in December 2019, which is now the third month in a row this figure has increased. Meanwhile, the year-over-year Core CPI Index, which excludes food and energy components, rose 2.3% for the 12 months ending December 2019. Financial market participants, as well as the Fed continue to estimate a low probability of a meaningful increase in inflation in the near term.



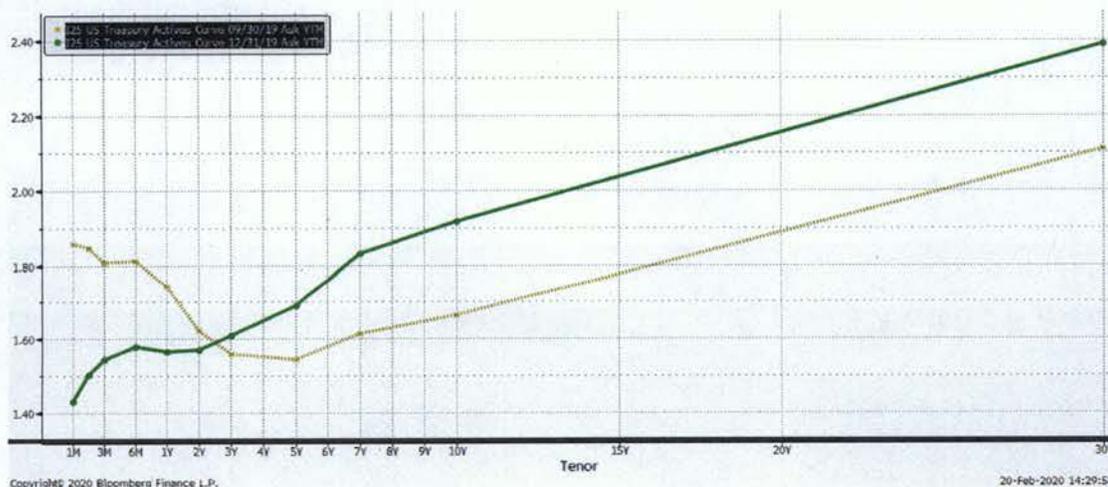
New Housing Units that have started in December measured the highest number at 1,608,000 over the last twelve years and permits were issued for work to begin on 1,420,000 units at an annual rate, up from the original estimates.

At its October Fed meeting, the Federal Open Market Committee (FOMC) cut the target Federal Funds rate by 0.25% to a range of 1.50% - 1.75% noting the labor market's continued strength, but that growth of economic activity has slowed. The Fed maintained the Fed Funds rate unchanged at its December meeting stating that its monetary policy was likely to remain appropriate "for a time" even though international

trade and weakness in global economic growth posed some risk to the Fed's outlook. In January 2020, the Fed signaled that its policy would be on hold through 2020 given the U.S. presidential election year, and the January survey of 28 economists indicated that economists expected the Fed to be on hold as well through year 2021. On February 11, 2020, Fed Chairman, Jerome Powell stated to Congress in his semi-annual testimony that "it's too uncertain to even speculate" on how the Coronavirus outbreak will impact the U.S. economy even though it will have a material impact on the Chinese economy. Wall Street was increasingly betting for the Fed to cut rates as concerns have significantly increased for a global slowdown due to the spread of the Coronavirus and the futures market had already priced in a couple of Fed cuts for 2020. Real GDP growth rate for the year 2020 was revised downwards to 2.0% and to 1.9% for year 2021. The unemployment rate for the year 2020 is projected at 3.5% and 3.6% for year 2021.

On March 3, 2020, the Fed surprised investors by lowering the Fed Funds rate by 0.50% amplifying fears about the magnitude of the Coronavirus impact on the U.S. economy.

The one-month to two-year treasury yields dropped during the quarter while yields on the three to thirty-year treasuries increased eliminating the inverse yield curve that existed in the prior quarter (see chart below). The yield on the one-year treasury note fell by 0.18% from 1.745% to 1.56%, while over the same period, the yield on the five-year treasury increased by 0.14% from 1.54% to 1.69%, and the thirty-year yield increased from 2.11% to 2.39%.



Domestic equities rallied during the fourth quarter of 2019. The broad-based S&P 500 composite posted a 9.06% return gain during the quarter ending the year with a 31.49% return. The Dow Jones Industrial Average (DJIA) similarly jumped 6.67% and ended the year with an impressive 25.34% return. The NASDAQ, which is dominated by Information Technology stocks, followed a similar arc with a 12.17% gain during the fourth quarter of 2019, ending the year with a 35.23% return.

Total Funds Under Management

The following table represents total City funds under management based on their market values as of December 31, 2019.

	12/31/2019	09/30/2019	\$Change
Pooled Investment Portfolio	\$629,791,190	\$608,598,225	\$21,192,965
Capital Endowment	2,010,867	1,996,358	14,509
Stranded Investment Reserve Portfolio	64,086,916	63,794,231	292,685
Special Funds	21,720,360	21,617,650	102,710
Investments Held with Fiscal Agents	56,521,525	54,223,381	2,298,144
PARS Section 115 Trust	13,856,107	13,498,317	357,790
Total Funds Under Management	\$787,986,965	\$763,728,162	\$24,258,803

The Pooled Investment Portfolio value increased by a net \$21,192,965 due to the following transactions during the quarter:

Net Investment Earnings (Fair Market Value Change plus Interest Income)	\$4,948,516
Deposits and Credit Card Receipts	130,300,691
Property Tax Revenues	27,352,694
Sales Tax and Other State Apportionments	16,213,419
HUD Receipts Net of Payments and Loans	1,757,124
Payroll and Payroll-related Expenses	(72,100,213)
Vendor Payments and Accounts Payable Checks	(45,983,892)
Debt Service Payments Net of Reimbursements and Subsidies	(12,729,862)
Water and Power Payments Net of Receipts	(25,445,953)
Net Transfer to Other Funds	(3,119,559)
	\$ 21,192,965

The Capital Endowment Fund increased by a net \$14,509 representing the investment earnings for the period which includes the market value change of investments.

The Stranded Investment Reserve portfolio increased by a net \$292,685 representing the investment earnings for the period which includes the market value change of investments and the interest earned.

Special Funds increased by \$102,710 representing investment earnings for the quarter.

Investments held with fiscal agents increased by \$2,298,144 as a result of \$3,172,967 contribution from SCAPPA adjusted by a withdrawal of \$589,341.70 to pay costs associated with SCCAPA projects, \$546,513.60 withdrawal to cover debt service payment on the 2016A Rose Bowl Bonds, and the addition of \$261,032.30 for investment earnings in the accounts.

The PARS Section 115 Trust account increased by a net \$357,790. The change was comprised of market value change of investments and the interest earned after adjusting for investment expenses.

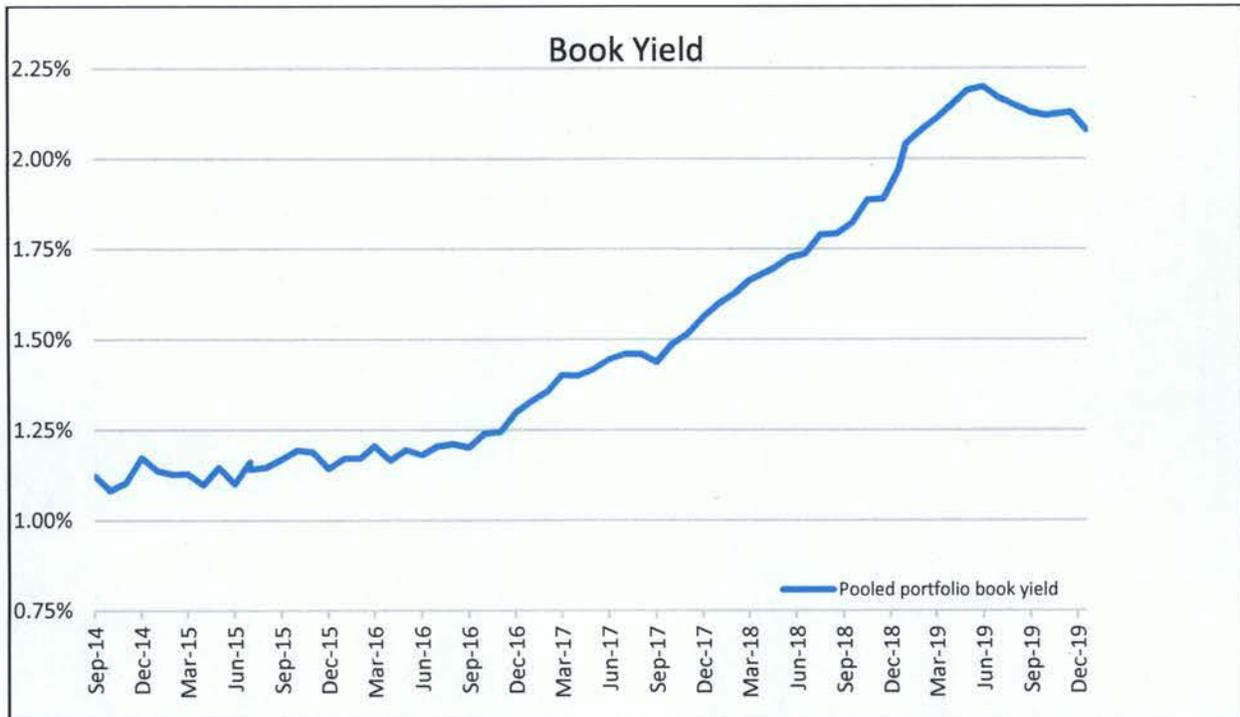
The City pools all internal funds to gain economies of scale and to simplify the investment function. There are over 100 funds in the Pooled Investment Portfolio. As of December 31, 2019 accounting records, General Fund's investment balance was \$72.34 million representing 11% of the December 2019 Pooled 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 December 31, 2019, the portfolio's effective duration was 2.09 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 December 31, 2019. 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 2020 Investment Policy which was adopted by the City Council on July 22, 2019 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.

On a total return basis, the components of which include interest, amortization, and market value changes, the Pooled Portfolio posted a gain of 0.59% for the fourth quarter of 2019 as compared to the 0.60% return of the assigned benchmark, the Bank of America Merrill Lynch 1-3 Year U.S. Corporate and Government Index, for the same period. The Pooled Portfolio's book yield which was consistently increasing over the last fourteen quarters, plateaued and slightly decreased due to the significant drop of overall interest rates in the financial markets. If current rates remain the same and/or continue to decrease, the yield on the City's pooled portfolio will gradually decline, reflecting the drop in interest rates.

The graph below represents the historic book yield of the Pooled Portfolio over the last five years, through December 2019.



COUNCIL POLICY CONSIDERATION:

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

FISCAL IMPACT:

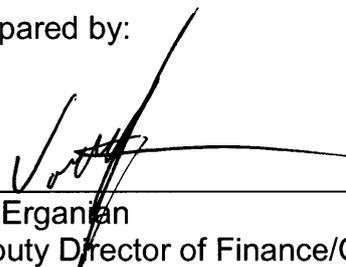
There is no fiscal impact as a result of this action report nor will it have any indirect or support cost requirements. There is no anticipated impact to other operational programs or capital projects.

Respectfully submitted,



MATTHEW E. HAWKESWORTH
Department of Finance

Prepared by:



Vic Erganian
Deputy Director of Finance/City Treasurer

Approved by:



STEVE MERMELL
City Manager

Attachment: (1)

1) Attachment A – Quarterly Investment Report - Quarter Ending December 31, 2019