City of Boulder

City of Boulder

Finance Department

TO:	The Mayor and Members of City Council Jane S. Brautigam, City Manager
FROM:	Cheryl Pattelli, CFO
SUBJECT:	Investment Performance as of December 31, 2017
DATE:	January 11, 2017

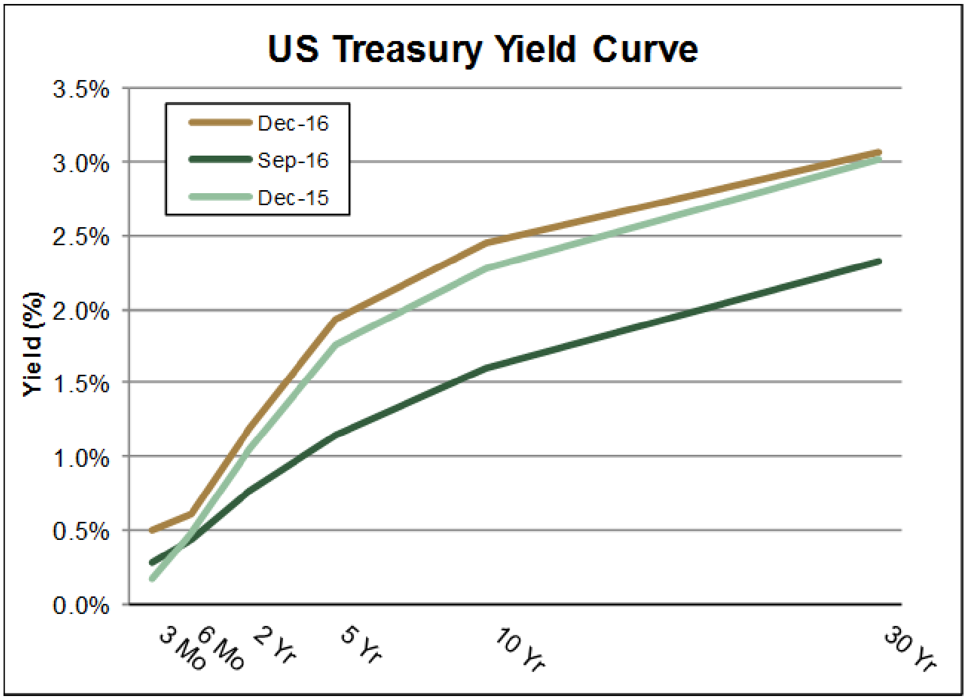
Section 1 – Background

- This report is for City Council information only and requires no action by City Council.
- The investment of City funds is guided by and this report is submitted in compliance with the City's Investment Ordinance. (Chapter 2-10, *Investment of City Funds*, Boulder Revised Code 1981).
- The investment objectives as specified in the Ordinance, are:
    - The primary objective is preservation and protection of capital. This objective reduces the risk to which the portfolio can be subjected. To comply with this objective, investments are diversified by type and maturity horizons.
    - The second objective is to maintain adequate liquidity to meet the daily cash needs of the City. The City's ordinance requires that 5% of the portfolio matures within 30 days.
    - Yield is the third objective. The City strives to maximize return, while minimizing the risks of the market.

Section 2 – The Yield Curve and Federal Open Market Committee ("the Fed")

Treasury Yield Curve

12/31/2015 vs. 09/30/2016 vs. 12/31/16

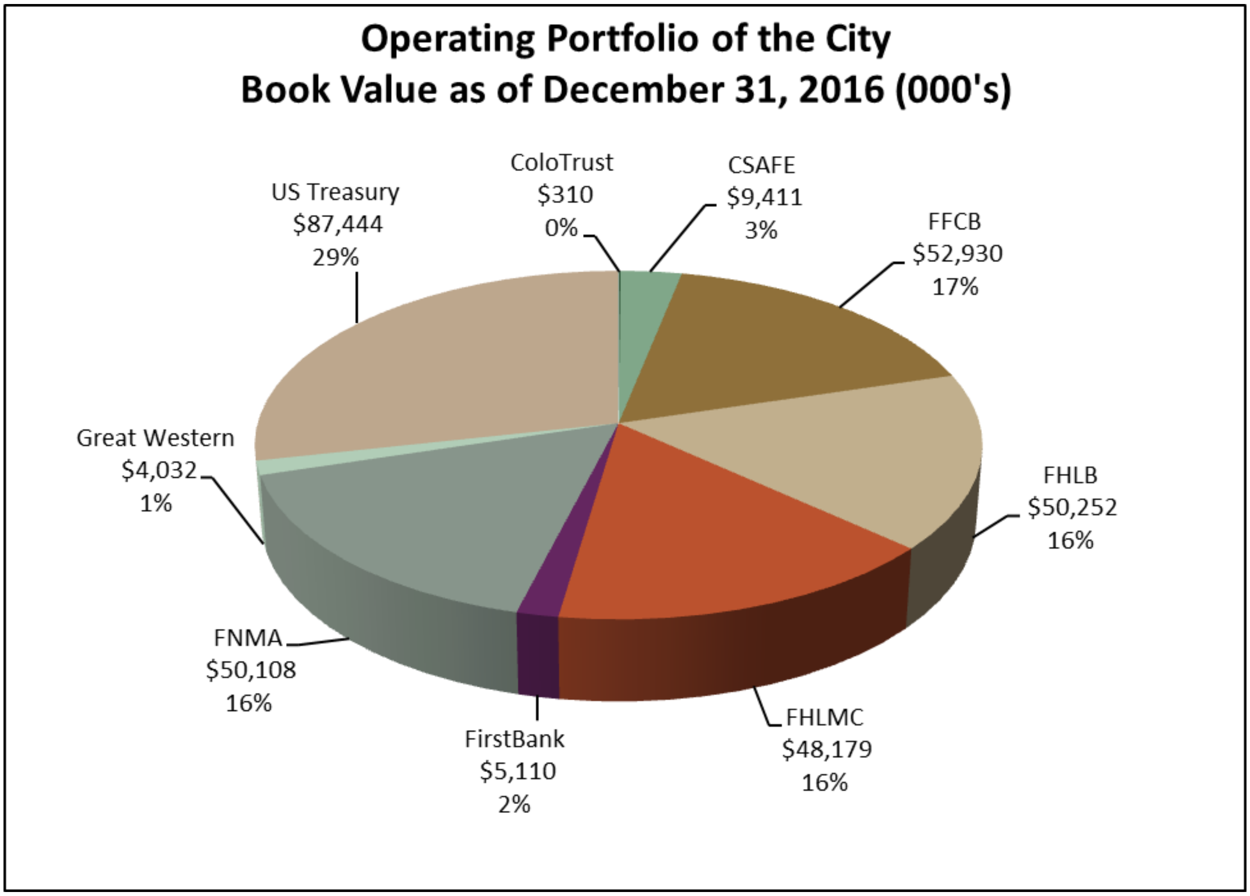


- Over the past three months, the yield curve steepened with the 2-year Treasury yield up nearly 43 basis points and the 10-year Treasury yield up 85 basis points. On a year-over-year basis the 2-year Treasury yield increased 14 basis points and 10-year Treasury yield increased about 18 basis points. Over the past year, financial market volatility has been elevated due to weak global economic growth, volatile commodity prices, political uncertainty, and divergent global central bank monetary policy.
- The Federal Open Market Committee (FOMC) unanimously voted to increase the target fed funds rate by 25 basis points to a range of 0.50% - 0.75%, at the December 14 meeting. The Fed noted that economic activity has expanded at a moderate pace and labor market trends have improved, but inflation remains below target. The Fed's revised "dot plot" was slightly more hawkish, as the projected path of the fed funds rate was revised upward. The Committee's GDP and inflation forecasts were little changed while projections for the unemployment rate were revised won slightly. The FOMC's median projection for the fed funds rate in 2017 was revised up to 1.4% from 1.1%, which would be indicative of three more 25 basis point rate hikes next year. The Fed's longer-run median fed funds target rate was revised up to 3.0% from 2.9%. Fed Chair Yellen downplayed the forecast changes during her press conference, and continued to emphasize that future increases in the fed funds rate are expected to be gradual. She added that it is too early to anticipate how potential changes in fiscal policy will impact the economy and the Fed's outlook. The market is now pricing in more than a 70% chance of another rate hike in June 2017.

Section 3 – The City’s Portfolios

- Portfolio strategies implemented this quarter and all investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments:
    - The objective of safety is achieved through a well-diversified portfolio, primarily among two major sectors (Treasury and Agency), the Agency issuers and various maturities along the yield curve. Market risk is managed by maintaining a low weighted average maturity (WAM) in the City’s portfolio. As of December 31, 2016 the WAM was 1.73 years while the Ordinance allows up to a five year WAM.
    - The City maintains sufficient liquidity. As of December 31, 2016, 4.0% of the portfolio, or $9.7 million remained in overnight accounts.
    - As of December 31, 2016, the yield on the pooled investment portfolio was 1.07%. Our current benchmark is the six month trailing average on the 2-year Treasury, which was 0.87%, as of December 31, 2016. The objective was exceeded by 0.20%.
- There are no investments in the oil and gas industry in the City’s portfolio.
- The City’s investment adviser purchased approximately $14.2 million of securities during Q4 2016 for the City of Boulder’s investment portfolio. The proceeds of $15.3 million of maturities were used to fund these purchases. Purchases included Treasury and Agency securities maturing between May 2018 and November 2021. These securities were purchased in this maturity range to maintain the portfolio characteristics in line with the strategy. We continue to position the portfolio to take advantage of higher interest rates in light of continued financial market volatility. Over the past three months, the yield shifted upward as the 2-year Treasury yield increased nearly 43 basis points and the 10-year Treasury yield increased approximately 85 basis points. The move up in interest rates was largely driven by heightened expectations for fiscal stimulus, and a potential increase in inflation, in light of President-elect Trump's victory and the Republican Party congressional sweep in the US. Global factors (including steeper yield curves in Japan and Germany, and an expectation for ongoing stimulus from the European Central Bank) also continue to influence US Treasury yields. The U.S. labor market continues to improve, consumer confidence remains strong, and housing trends remain favorable. Market participants estimate GDP grew 2.2% in the fourth quarter. The Federal Open Market Committee (FOMC) unanimously voted to increase the target fed funds rate by 25 basis points to a range of 0.50%-0.75%, at the December 14 meeting. The Fed noted that economic activity has expanded at a moderate pace and labor market trends have improved, but inflation remains below target. The FOMC’s median projection for the fed funds rate in 2017 was revised up to 1.4% from 1.1%, which would be indicative of three more 25 basis point rate hikes next year. The market is pricing in more than a 70% chance of another rate hike in June 2017. The portfolio will continue to benefit from higher reinvestment rates on maturities as the Fed continues its slow transition to a less accommodative monetary policy.

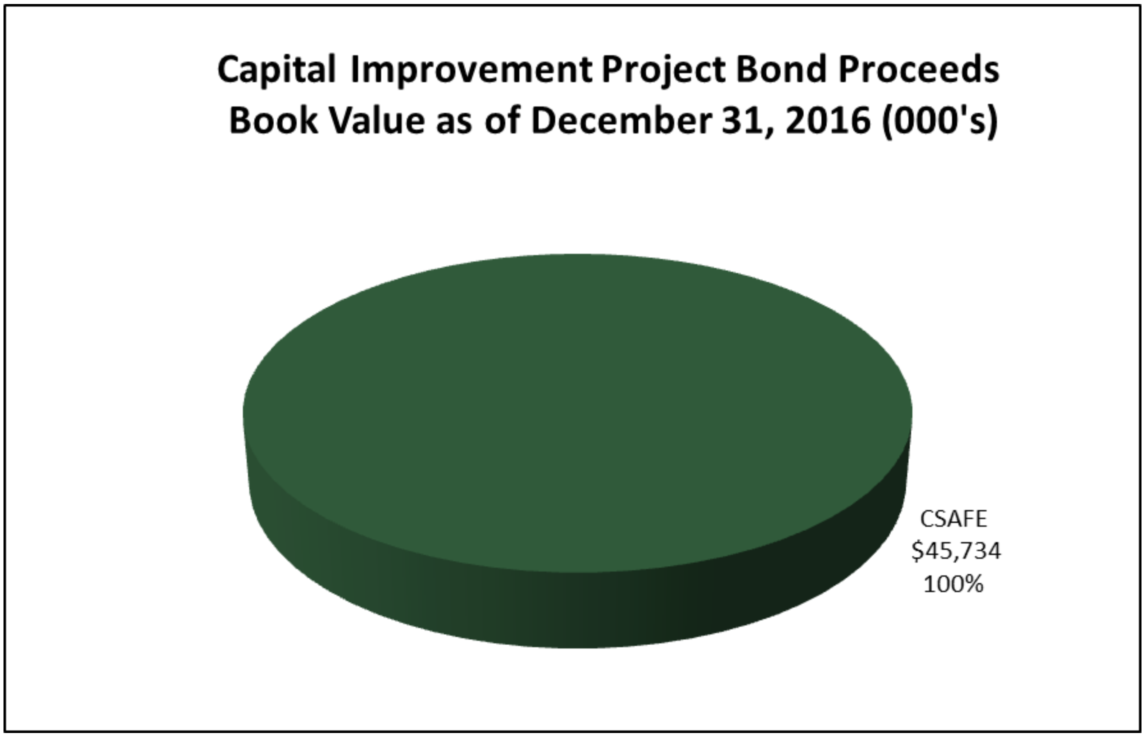
Operating Portfolio of the City



Portfolio Characteristics
City of Boulder Consolidated Non CIP

	12/31/2016	09/30/2016
	Portfolio	Portfolio
Average Maturity (yrs)	1.73	1.80
Modified Duration	1.69	1.77
Average Purchase Yield	1.074%	1.033%
Average Market Yield	1.122%	0.784%
Average Quality	AA+/Aaa	AA+/Aaa
Total Market Value	307,867,680	321,082,072

Bond Reserve and Project Funds



Portfolio Characteristics
Bond Reserve and Project Funds

	12/31/2016	09/30/2016
	Portfolio	**Portfolio**
Average Maturity (yrs)	0.00	0.00
Modified Duration	0.00	0.00
Average Purchase Yield	0.67%	0.59%
Average Market Yield	0.67%	0.59%
Average Quality**	AAA/NR	AAA/NR
Total Market Value	45,734,342	47,596,242

When the Bond Reserve and Project Funds proceeds of over $54 million were received in March 2012, a separate portfolio was established to facilitate IRS required arbitrage calculations. The balance of $45.7 million as of December 31, 2016 was invested as shown above in the graph and table to assure timely funding for the projected draw down schedule expected to end in January 2015.

- In June 2012, the investment committee selected the one year Treasury as the benchmark for the bond proceeds based upon an average maturity of approximately one year for the portfolio at that time. As of December 31, 2016 the portfolio yield was 0.67%.
- Daily liquidity in the portfolio is currently 100% of the portfolio, or $45.7 million, resulting in a very short weighted average maturity of 0.0 years. The portfolio has virtually no market risk and 100% of the funds are available for immediate draw down as projects need funding. This portfolio structure safely supports the short liability duration of the projects that were expected to end in January 2015.