

TO: The Mayor and Members of City Council
Jane S. Brautigam, City Manager

FROM: Cheryl Pattelli, CFO

SUBJECT: Investment Performance as of December 31, 2020

Date: January 19, 2021

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 – Market Conditions, the Federal Reserve and the Yield Curve

Markets became significantly more optimistic in Q4: Hope returned to markets in Q4, with announcements from several major pharmaceutical companies that effective vaccines for the coronavirus were available for widespread distribution. Against this backdrop the S&P 500 Index rose to all-time highs, and this supported risk assets generally.

New president means new policies: We expect an additional stimulus package in the \$500bn to \$1 trillion range, a normalization of relations with the EU, and a focus on climate change. Pressure on China should remain, though the approach is likely to be more multilateral.

The yield curve steepened as sentiment improved: The Treasury yield curve steepened over the quarter as shorter maturities remained anchored by Fed policy, but longer maturity yields rose as risk sentiment improved. The 2-year maturity Treasury was unchanged at 0.12%, the 10-year maturity Treasury yield rose by 23bp to 0.92% and the 30-year maturity Treasury yield rose by 19bp to 1.65%.

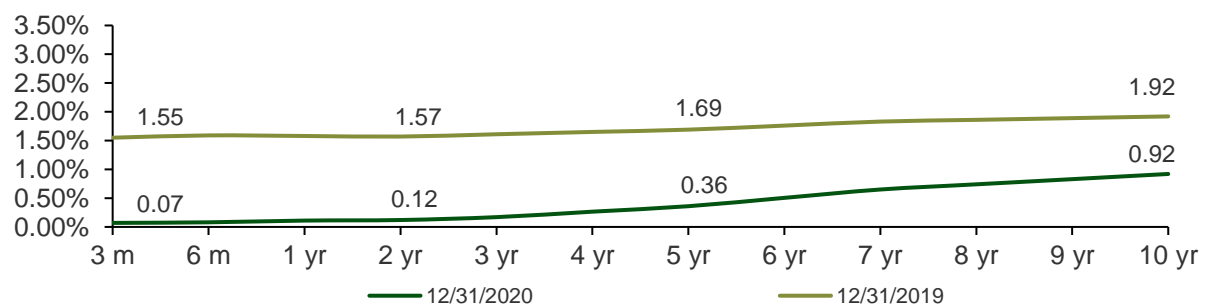
Credit spreads rallied towards pre-crisis levels: Credit spreads tightened in Q4, with aggregate US corporate spreads ending the quarter 40bp tighter. The long area of the credit curve outperformed, tightening by 48bp. BBB-rated issues and high yield generally outperformed given the more positive outlook. Cumulative investment grade credit gross issuance reached \$2.1 trillion over 2020, breaking above the previous annual high of \$1.47 trillion set in 2017.

The S&P 500 Index broke to record highs: US equity markets experienced a strong quarter, driven by a rotation from tech to value as vaccines boosted hopes for a “return to normal.”

Risks include:

- Pressure to increase corporate leverage in a world of ultra low yields could lead to credit downgrades
- Virus mutations that impair vaccine efficacy
- Valuations may have already priced in much of the good news

Treasury Yield Curve: 12/31/2020 and 12/31/2019 (Source: Bloomberg)

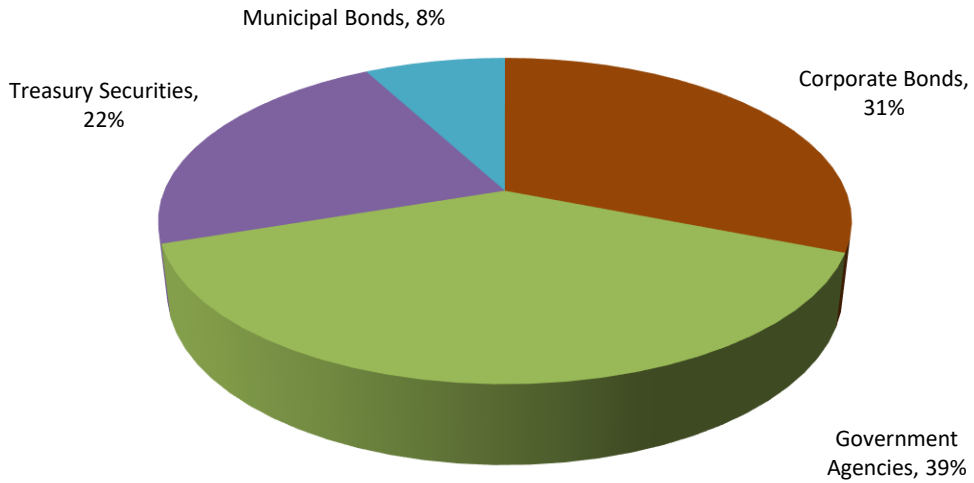


Section 3 – The City’s Portfolio

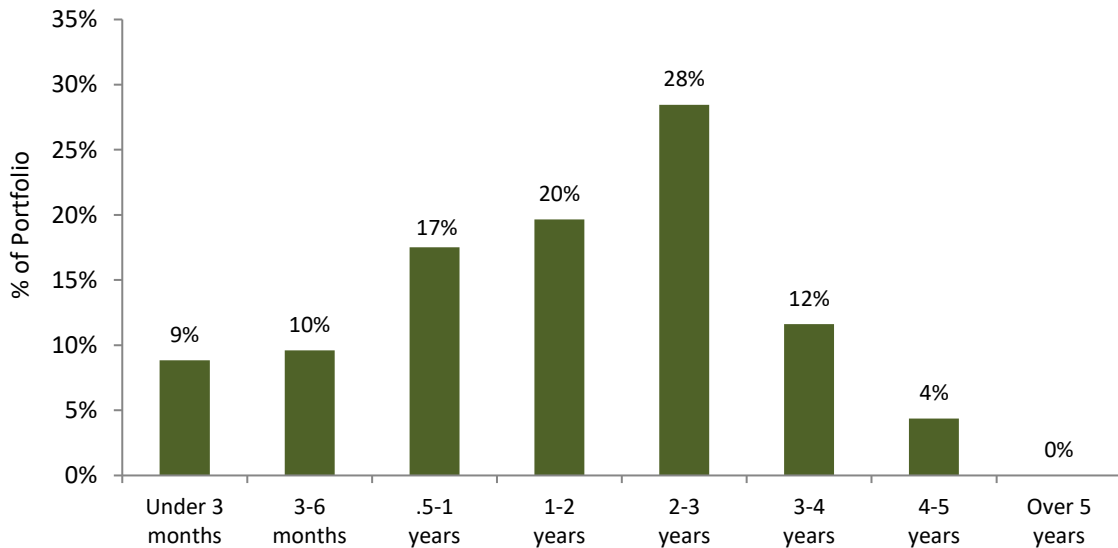
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
 - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury and Agency securities of various maturities. In March 2017 the City Council approved amendments to the Investment Policy proposed by finance staff expanding opportunities to further diversify the portfolios. Pursuit of further diversification through the revised policies will progress strategically relative to market conditions. Market risk is managed by maintaining a low weighted average maturity (WAM) in the City’s portfolios. As of December 31, 2020, the WAM of the operating portfolio was 2.02 years while the Ordinance allows for a WAM of up to 5 years.
 - The City maintains sufficient liquidity. A minimum of 5% of the City’s total portfolio is held in liquidity accounts. In addition, 1.5% of the term securities held as of December 31 will mature within 30 days.
 - As of December 31, the weighted average purchase yield for the operating portfolio holdings was 1.69%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which was .14% as of December 31. The purchase yield on the operating portfolio as of December 31 exceeded the benchmark yield by 1.55%.
 - For the fourth quarter 2020, the fair value periodic return on the operating portfolio was .22%. The 1-3 Treasury Index return for the period was .05%. The return on the operating portfolio for the third quarter was .17% higher than the 1-3 Treasury Index return.
- The City’s portfolio does not hold any investments in the following: fossil fuels inclusive of pipeline construction and extraction; firearms or weapons not used in national defense; tobacco companies; and firms related to mass incarceration/private prisons/detention centers.
- In the fourth quarter 2020, the City’s investment advisor invested approximately \$56 million in longer-term securities for the operating portfolio. US Treasury securities, US Agency notes and a taxable municipal issue were purchased at a weighted average yield of .33%. The weighted average maturity at the time of purchase for these investments was 3.25 years.
- The portfolio duration maintains exposure to longer-term interest rates and the portfolio is well diversified to various market sectors which may enhance the portfolio’s return.

City of Boulder Operating Portfolio Profile As of December 31, 2020

Asset Allocation - Historical Cost



Final Maturity Distribution - Historical Cost



Summary of Operating Portfolio Characteristics

	December 31, 2020	September 30, 2020
Average Final Maturity (years)	2.02	1.82
Modified Duration (years)	1.80	1.74
Average Purchase Yield	1.69%	1.99%
Average Market Yield	0.25%	0.32%
Average Credit Quality (S&P/Moody's)	AA+/Aa1	AA/Aa2
Total Market Value (\$)	338,155,500	327,242,889

Portfolio Holdings as of December 31, 2020

Issuer	Historical Cost	% of Portfolio
US Treasury	73,835,421	22.28%
Federal National Mortgage Association	45,689,343	13.79%
Federal Home Loan Bank	30,971,266	9.35%
Federal Home Loan Mortgage Corp	28,590,868	8.63%
Federal Farm Credit Bank	23,582,003	7.12%
Microsoft Corp	11,736,902	3.54%
American Honda Finance Corp	10,545,614	3.18%
Toyota Motor Credit Corp	10,317,940	3.11%
Wal-Mart Inc	10,033,900	3.03%
State Street Corp	8,991,401	2.71%
Apple Inc	8,891,597	2.68%
City of New York, New York	8,478,013	2.56%
Cisco Systems Inc	7,971,070	2.41%
Caterpillar Financial Services Corp	7,714,253	2.33%
Metro Oregon	7,550,720	2.28%
PepsiCo Inc	5,067,281	1.53%
State of Florida	5,001,000	1.51%
State of Maryland	5,000,000	1.51%
Johnson & Johnson	4,401,352	1.33%
Intel Corp	3,771,120	1.14%
Bank of New York Mellon Corp	2,912,725	0.88%
Oracle Corp	2,895,060	0.87%
United Parcel Service Inc	2,519,450	0.76%
IBM Credit LLC	2,461,975	0.74%
Praxair Inc	2,456,740	0.74%
Cash	28,656	0.01%
Total Historical Cost	331,415,670	100.00%

Section 4 - The City's Socially Responsible Investment (SRI) Initiative

The City's investment framework includes considering socially responsible investment factors. The City's SRI program intends to allow the City to better achieve its sustainability and resilience goals, remain financially strong and better align community values. The program incorporates the strategies described below.

Exclusionary Screening. Exclusionary screening, or negative screening, is the process of excluding from investment certain sectors or companies involved in activities which are unacceptable or controversial. Investments for the City's portfolio exclude the following sectors:

- Fossil fuels inclusive of pipeline construction and extraction
- Firearms or weapons not used in national defense
- Tobacco companies
- Firms related to mass incarceration/private prisons/detention center

Included in these negative screens is the prohibition of financial firms associated with pipeline construction. The City has further applied this limitation on financial firms to the group of broker/dealers through which investments may be transacted and the City has taken steps to remove any money market funds or cash pools that invest in the above sectors.

Positive Screening and Impact Investing. Positive screening and impact investing consider the impact that an investment is making. Implementation of this strategy is illustrated by the investment in a municipal bond issued for the construction and management of affordable housing. Other potential impact investing opportunities include investing in securities issued by the World Bank, which is an approved asset class per the City's investment policy.

Environmental, Social and Governance (ESG) Integration. The City's goal is to bring ESG integration to the heart of the investment decision process. The City monitors the ESG ratings provided by MSCI for the corporate bonds in the portfolio. The MSCI ratings are provided on a scale of 1 to 10 with ten being the highest. At this time, the weighted average Industry-Adjusted Score from MSCI for the corporate bond holdings is 6.5 which maps to a letter rated of "A" on a scale of triple-C to triple-A.

The City also monitors the unadjusted Pillar Scores from MSCI for the corporate holdings. At this time, the weighted average Pillar Scores for the corporate bond holdings are as follows:

- MSCI Environmental Pillar Score: 7.1
- MSCI Social Pillar Score: 4.8
- MSCI Governance Pillar Score: 3.9

The City's ESG model can be refined to reflect the issues that matter most to the citizens of Boulder by applying customized weights to the MSCI Pillar Scores, thus creating ESG scores that better reflect the City's values, goals and policies.

Active Ownership/Corporate Engagement. Corporate engagement involves discussions with issuers about ESG risks and opportunities. The City is partnering with Insight Investment to seek the benefits of this goal. Insight requests and participates in meetings with management to understand key risks and potentially influence outcomes. Company engagement is critical to Insight's credit process and their analysts meet with issuers to address ESG factors as well as other credit-related concerns or questions.

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