

TO: The Mayor and Members of City Council
Nuria Rivera-Vandermyde, City Manager

FROM: Kara Skinner, Interim Chief Financial Officer

SUBJECT: Investment Performance as of December 31, 2022

DATE: January 17, 2023

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

2022 was a difficult year for most asset classes: In fixed income, the Bloomberg US Aggregate Index recorded its worst return since its inception in 1973 and the S&P 500 Index recorded its worst year since the global financial crisis. For those seeking refuge in overseas assets, the dollar compounded the pain, broadly appreciating and reaching valuations not seen since the Volcker era.

During the fourth quarter the Treasury curve shifted upward and marginally steepened: The FOMC hiked rates to a range of 4.25% to 4.50% but moderated the pace of tightening from 75bp per meeting to 50bp. Two-year yields ended the quarter at 4.43%, 15bp higher. At the longer end of the curve, 30-year yields ended the quarter at 3.96%, 19bp higher.

Credit spreads tightened: Aggregate US corporate spreads ended the quarter 29bp tighter. Spreads in the intermediate area of the curve were 23bp tighter, and at the long end of the credit curves tightened by 40bp. Lower rated credits outperformed, with the spreads of long maturity BBB rated issues tightening by 44bp.

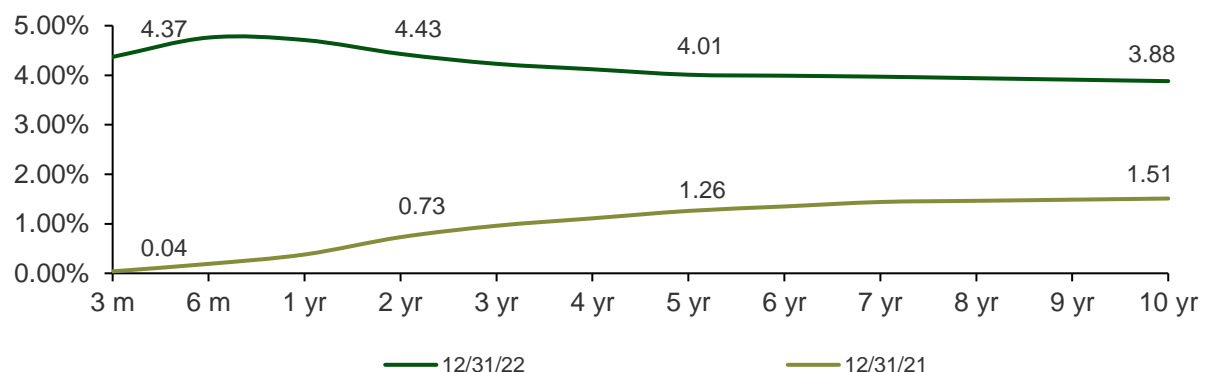
Credit has potentially returned as a way to generate returns: A combination of rising government bond yields and widening credit spreads created a perfect storm for credit investors over 2022, driving absolute yields back to levels similar to those seen before the global financial crisis. Assuming that bond markets stabilize in 2023, yields are sufficiently high to generate meaningful returns from income alone. At some stage in 2023, as investors become more confident about the peak level of interest rates, there is the potential for spreads to rally, further buoying returns.

The S&P 500 Index made a strong gain: US equity markets ended the year very strongly, with the S&P 500 Index rising by over 7%, but down over 18% on the year.

Risks include:

- A policy mistake could raise the risks of domestic recession
- Events in Europe spiral, causing market dislocations around the world
- Elevated food and energy prices could increase geopolitical uncertainty

Treasury Yield Curve: 12/31/22 and 12/31/21 (Source: Bloomberg)

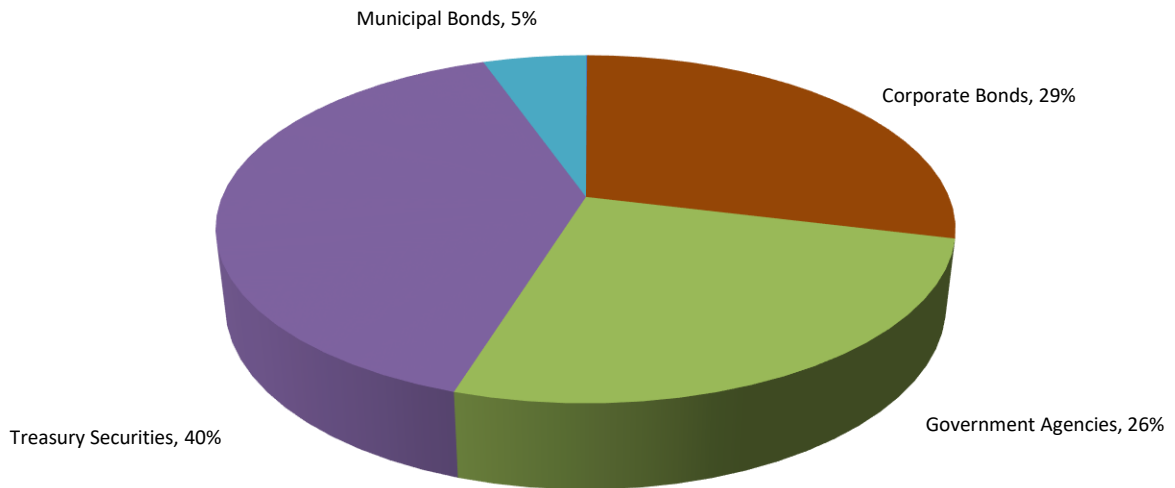


Section 3 – The City’s Portfolio

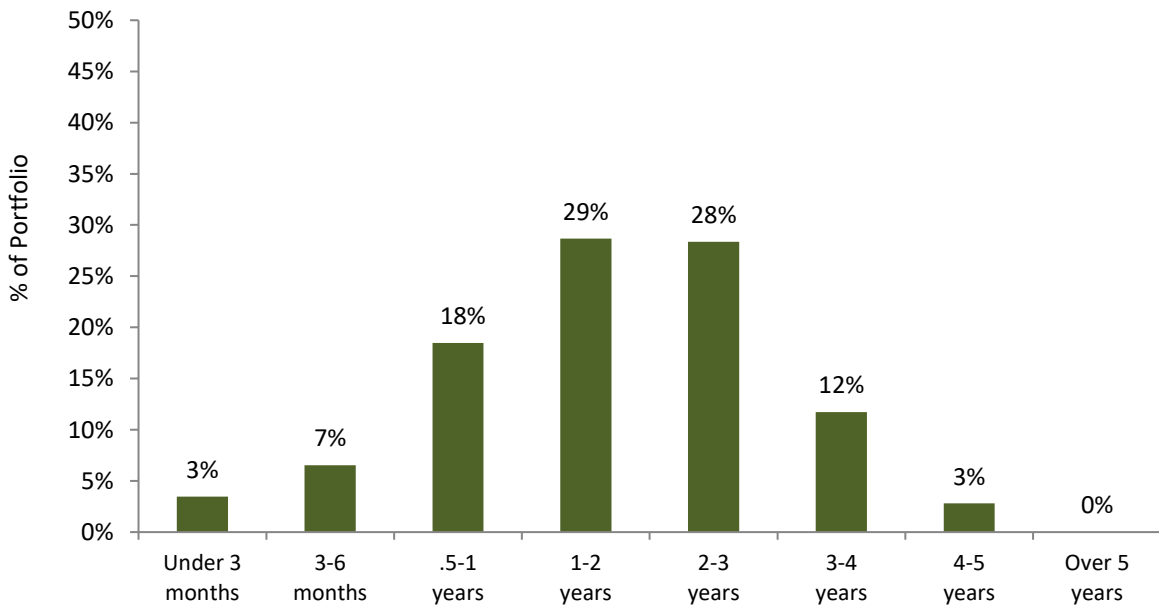
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
 - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury 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 is progressing strategically relative to market conditions. Market risk is managed by maintaining a low weighted average final maturity (WAM) in the City’s portfolios. As of December 31, 2022, the WAM of the operating portfolio is 1.81 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, 1.8% of the term portfolio holdings as of December 31 will mature within 30 days.
 - As of December 31, the weighted average purchase yield for the operating portfolio holdings is 1.82%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which is 3.88% as of December 31. The purchase yield on the operating portfolio as of December 31 trails the benchmark yield by 2.06%.
 - For the fourth quarter 2022, the fair value periodic return on the operating portfolio is positive 0.93%. The 1-3 Treasury Index return for the period is 0.74%. The periodic return on the operating portfolio for the fourth quarter is .19% 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 2022, the City’s investment advisor invested approximately \$35 million in long-term securities for the operating portfolio. US government securities and corporate bonds were purchased at a weighted average purchase yield of 4.32%. The weighted average maturity at the time of purchase for these investments is 3.64 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 over time.

City of Boulder Operating Portfolio Profile As of December 31, 2022

Asset Allocation - Historical Cost



Final Maturity Distribution - Historical Cost



Summary of Operating Portfolio Characteristics

	December 31, 2022	September 30, 2022
Average Final Maturity (years)	1.81	1.81
Modified Duration (years)	1.71	1.71
Average Purchase Yield	1.82%	1.60%
Average Market Yield	4.53%	4.26%
Average Credit Quality (S&P/Moody's)	AA+/Aa1	AA+/Aa1
Total Market Value (\$)	458,376,957	454,402,998

Portfolio Holdings as of December 31, 2022

Issuer	Historical Cost	% Portfolio
US Treasury	189,944,899	39.48%
Federal National Mortgage Association	41,943,926	8.72%
Federal Home Loan Bank	39,909,725	8.30%
Federal Farm Credit Bank	23,078,185	4.80%
Federal Home Loan Mortgage Corp	20,890,868	4.34%
State Street Corp	15,961,324	3.32%
Toyota Motor Credit Corp	14,759,095	3.07%
John Deere Capital Corp	14,297,919	2.97%
Microsoft Corp	13,237,312	2.75%
Caterpillar Financial Services Corp	13,090,171	2.72%
The Home Depot	11,936,240	2.48%
Colgate-Palmolive Co	10,754,910	2.24%
PepsiCo Inc	9,029,637	1.88%
3M Co	9,366,900	1.95%
City of New York, New York	8,478,013	1.76%
Metro Oregon	7,550,720	1.57%
Cisco Systems Inc	5,075,200	1.05%
American Honda Finance Corp	4,998,500	1.04%
State of Florida	5,001,000	1.04%
State of Maryland	5,000,000	1.04%
International Business Machines Corp	4,871,700	1.01%
Apple Inc	4,606,145	0.96%
Johnson & Johnson	4,401,352	0.91%
Intel Corp	2,624,093	0.55%
Cash	289,000	0.06%
Total Historical Cost	481,096,833	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 centers

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 7.7 which maps to a letter rated of "AA" 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: 5.4
- MSCI Governance Pillar Score: 5.4

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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