

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 March 31, 2023

DATE: April 20, 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**

The end of the hiking cycle is in view: The Federal Reserve has indicated that recent events in the banking sector will result in tighter lending standards, potentially reducing the number of rate hikes needed to bring inflation back to target. Markets have moved quickly to price in not just a May peak for rates, but a series of rate cuts over the rest of the year. This expectation may be misplaced, with the Fed likely to be on hold after a May hike.

The Treasury curve inverted further: The Federal Open Market Committee increased rates to a range of 4.75% to 5% in March, tightening policy by 50bp over the quarter. Problems in the banking sector led to fears of a tightening in lending standards and speculation that this would cause the Fed to terminate the hiking cycle and even shift to cutting rates in the months ahead. Two-year yields ended the quarter at 4.03%, 40 basis points lower compared to the end of December. At the longer end of the curve, 30-year yields ended the quarter at 3.65%, 31 basis points lower.

Credit spreads widened: Credit spreads widened in Q1, with aggregate US corporate spreads ending the quarter 19 basis points higher than where they began. The long section of the credit curve outperformed, with spreads rising by only 10 basis points.

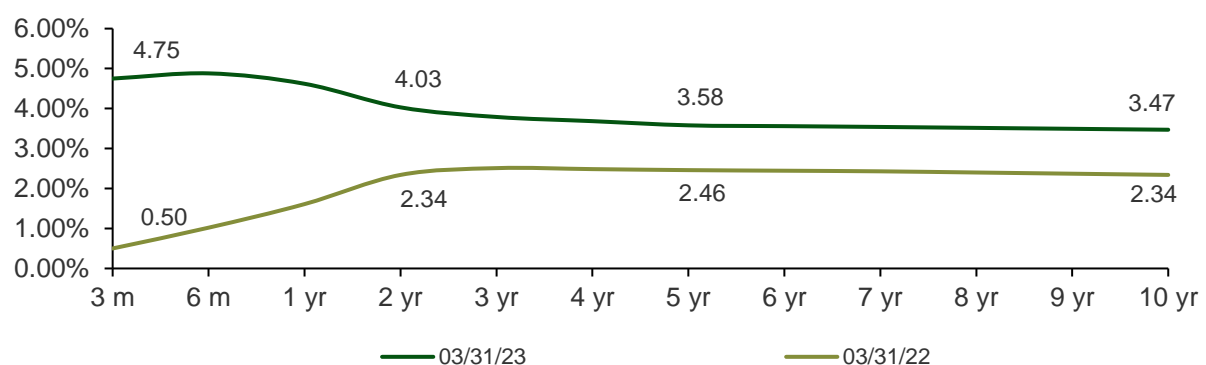
Fixed income markets offer significant opportunity: While 2022 represented a challenge for fixed income investors, the resultant normalization in yields potentially represents the best opportunity for fixed income investors in the preceding fifteen years. Also, there are now more opportunities to use corporate bonds to enhance income generation.

The S&P 500 Index made a strong gain: US equity markets started the year strongly, with the S&P 500 Index rising by over 7.5% in Q1.

Risks include:

- Further dislocations in the financial system as a result of Fed policy
- Events in Europe spiral, causing market dislocations around the world
- Tensions between China and the US spill over into conflict

Treasury Yield Curve: 03/31/2023 and 03/31/2022 (Source: Bloomberg)

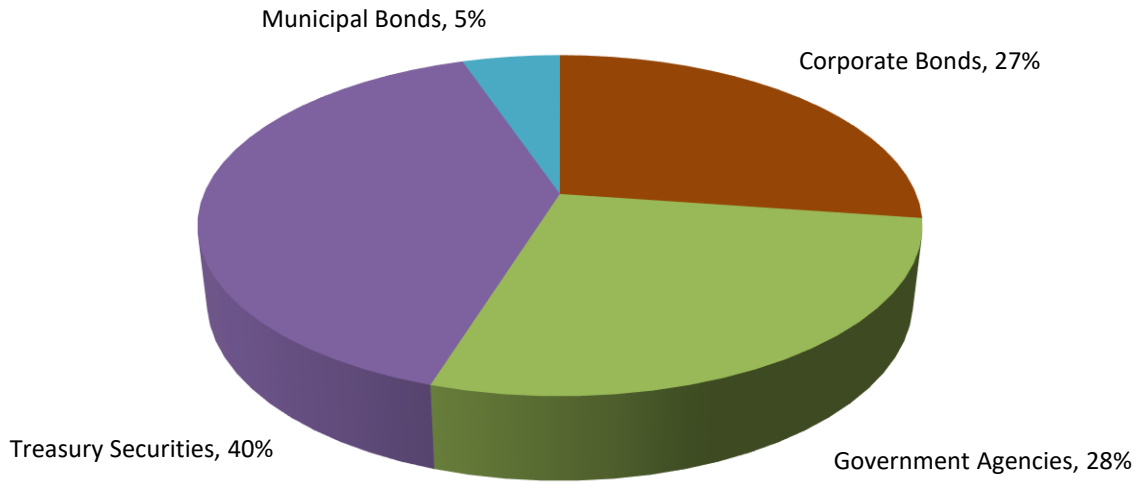


### **Section 3 – The City’s Portfolio**

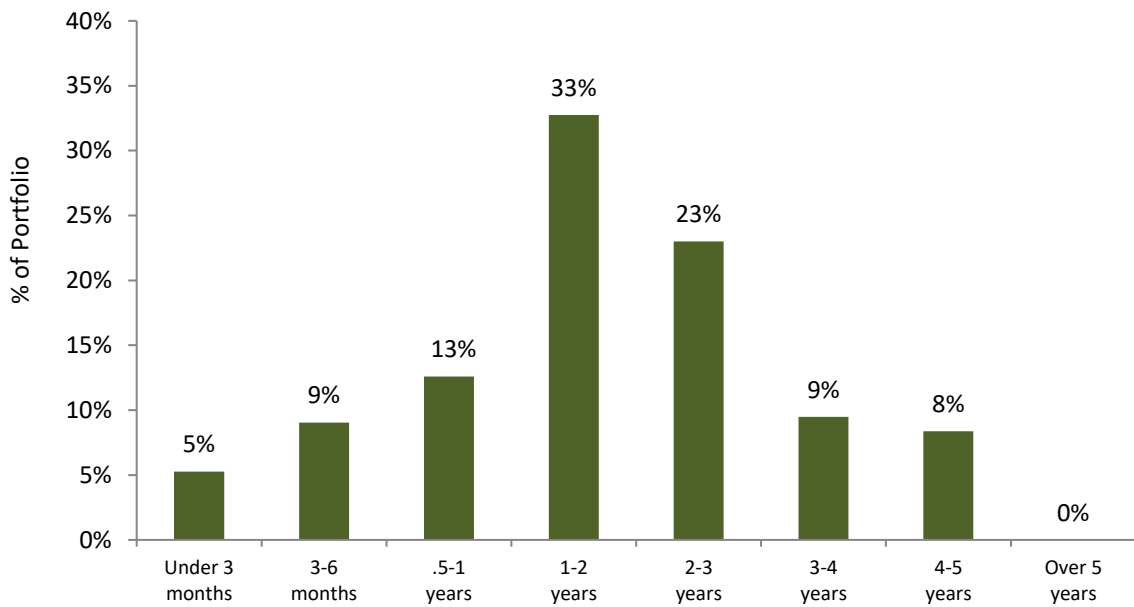
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
  - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury 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 portfolio. 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 March 31, 2023, the WAM of the operating portfolio is 1.86 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, 1.3% of the term portfolio holdings as of March 31 will mature within 30 days.
  - As of March 31, the weighted average purchase yield for the operating portfolio holdings is 2.00%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which is 4.30% as of March 31. The purchase yield on the operating portfolio as of March 31 trails the benchmark yield by 2.30%.
  - For the first quarter 2023, the fair value periodic return on the operating portfolio is positive 1.48%. The 1-3 Treasury Index return for the period is 1.55%. The periodic return on the operating portfolio for the first quarter is .07% lower 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 first quarter 2023, the City’s investment advisor invested approximately \$40 million in long-term securities for the operating portfolio. US Treasury and Agency bonds and a corporate security were purchased at a weighted average purchase yield of 4.00%. The weighted average maturity at the time of purchase for these investments is 4.50 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 March 31, 2023

## Asset Allocation - Historical Cost



## Final Maturity Distribution - Historical Cost



## Summary of Operating Portfolio Characteristics

	March 31, 2023	December 31, 2022
Average Final Maturity (years)	1.86	1.81
Modified Duration (years)	1.74	1.71
Average Purchase Yield	2.00%	1.82%
Average Market Yield	4.37%	4.53%
Average Credit Quality (S&P/Moody's)	AA+/Aa1	AA+/Aa1
Total Market Value (\$)	480,262,635	458,376,957

## Portfolio Holdings as of March 31, 2023

Issuer	Historical Cost	% Portfolio
US Treasury	198,897,063	39.88%
Federal Home Loan Bank	48,268,306	9.68%
Federal National Mortgage Association	38,954,996	7.81%
Federal Home Loan Mortgage Corp	27,320,606	5.48%
Federal Farm Credit Bank	23,078,185	4.63%
State Street Corp	15,961,324	3.20%
Toyota Motor Credit Corp	14,759,095	2.96%
John Deere Capital Corp	14,297,919	2.87%
Microsoft Corp	13,237,312	2.65%
Caterpillar Financial Services Corp	13,090,171	2.62%
The Home Depot	11,936,240	2.39%
Colgate-Palmolive Co	10,754,910	2.16%
Cisco Systems Inc	9,744,250	1.95%
3M Co	9,366,900	1.88%
City of New York, New York	8,478,013	1.70%
Metro Oregon	7,550,720	1.51%
PepsiCo Inc	6,434,881	1.29%
State of Florida	5,001,000	1.00%
State of Maryland	5,000,000	1.00%
International Business Machines Corp	4,871,700	0.98%
Apple Inc	4,606,145	0.92%
Johnson & Johnson	4,401,352	0.88%
Intel Corp	2,624,093	0.53%
Cash	49,444	0.01%
<b>Total Historical Cost</b>	<b>498,684,624</b>	<b>100.00%</b>

## **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 7.6 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: 6.9
- MSCI Social Pillar Score: 5.5
- 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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