

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

FROM: Kara Skinner, Chief Financial Officer

SUBJECT: Investment Performance as of March 31, 2024

DATE: April 18, 2024

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

- **Inflation and employment:** The decline in US headline and core inflation remained effectively stalled for a second successive quarter at 3.2% and 3.8% respectively for the CPI and CPI excluding food and energy, above the Federal Reserve target of 2%. Meanwhile the labor market remained strong. Over 270,000 jobs were added on average each month during the first quarter and the unemployment rate remained below 4%.
- **Rate cuts are coming, but there's no rush:** The Federal Reserve continued to stand firm in its forecast for three rate cuts by year end, despite increasing its 2024 growth forecast to 2.1% from 1.4% at the March meeting. The resilience of growth means the Federal Reserve will be in no rush to lower rates.
- **Interest rates increased during the first quarter:** Two-year yields ended the quarter at 4.62%, 37bp higher over the quarter. At the longer end of the curve, 30-year yields ended the quarter at 4.34%, 31bp higher.
- **All-in yields appear attractive in corporate sector:** If the economy avoids recession and the Federal Reserve starts to ease in a soft-landing scenario, then the environment should be supportive for corporate securities and yields available in the corporate bond market are attractive despite tighter spreads.
- **The S&P 500 Index made strong gains:** US equity markets had one of the best starts to the year, with the S&P 500 Index gaining 10.4% in Q1.

Risks include:

- Increased volatility as markets accept the end of the era of low rates
- The wars in Europe and the Middle East are of concern, and there is risk that events escalate with unexpected consequences.
- Broader geopolitical tensions are elevated, and tensions between the US and China reflect an increasingly polarized world.

Treasury Yield Curve: 03/31/24 and 03/31/23 (Source: Bloomberg)

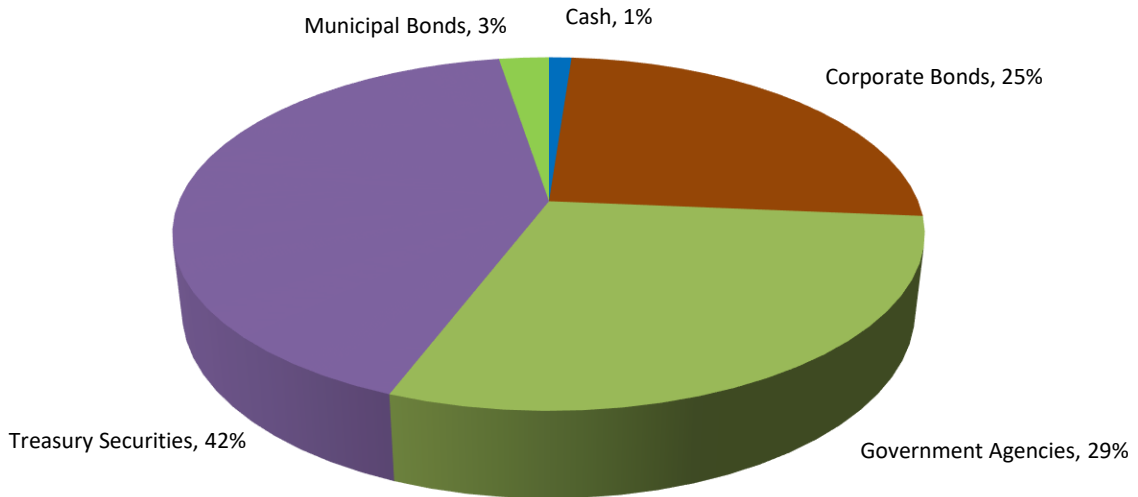


Section 3 – The City’s Portfolio

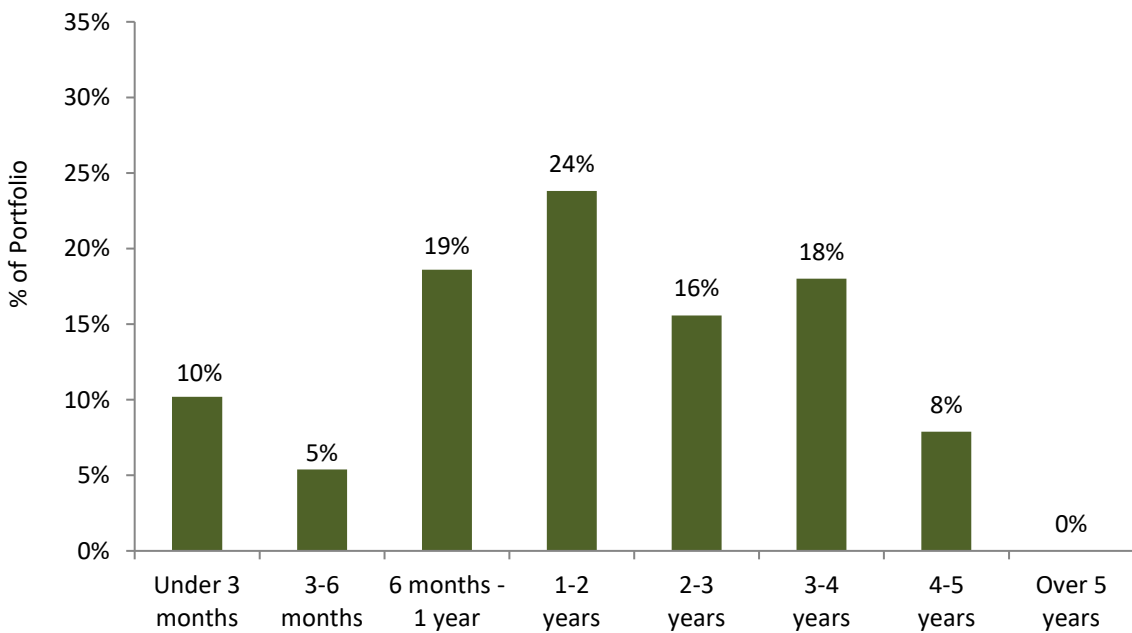
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
 - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury 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 moderate weighted average final maturity (WAM) in the City’s portfolio. As of March 31, 2024, the WAM of the operating portfolio is 1.91 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.
 - As of March 31, the weighted average purchase yield for the operating portfolio holdings is 2.79%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which is 4.65% as of March 31. The purchase yield on the operating portfolio as of March 31 trails the benchmark yield by 1.86%.
 - For the first quarter 2024, the fair value periodic return on the operating portfolio is 0.44%. The 1-3 Treasury Index return for the period is 0.30%. The periodic return on the operating portfolio for the first quarter is .14% 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 first quarter 2024, the City’s investment advisor invested approximately \$17 million in long-term securities for the operating portfolio. US Treasury securities and Agency notes were purchased at a weighted average purchase yield of 4.33%. The weighted average maturity at the time of purchase for these investments is 4.24 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, 2024

Asset Allocation - Historical Cost



Final Maturity Distribution - Historical Cost



Summary of Operating Portfolio Characteristics

| | March 31, 2024 | December 31, 2023 |
|--------------------------------------|----------------|-------------------|
| Average Final Maturity (years) | 1.91 | 2.02 |
| Effective Duration (years) | 1.76 | 1.82 |
| Average Purchase Yield | 2.79% | 2.72% |
| Average Market Yield | 4.79% | 4.54% |
| Average Credit Quality (S&P/Moody's) | AA+/Aa1 | AA+/Aa1 |
| Total Market Value (\$) | 471,768,727 | 483,984,263 |

Portfolio Holdings as of March 31, 2024

| Issuer | Historical Cost | % Portfolio |
|---------------------------------------|--------------------|----------------|
| US Treasury | 200,583,003 | 41.64% |
| Federal Home Loan Bank | 59,189,975 | 12.29% |
| Federal National Mortgage Association | 38,954,996 | 8.09% |
| Federal Farm Credit Banks | 29,861,668 | 6.20% |
| State Street Corp | 14,891,564 | 3.09% |
| Home Depot Inc/The | 14,704,250 | 3.05% |
| Federal Home Loan Mortgage Corp | 13,850,661 | 2.88% |
| Toyota Motor Credit Corp | 13,669,540 | 2.84% |
| John Deere Capital Corp | 13,318,552 | 2.76% |
| PepsiCo Inc | 12,648,873 | 2.63% |
| Colgate-Palmolive Co | 10,754,910 | 2.23% |
| 3M Co | 9,366,900 | 1.94% |
| Caterpillar Financial Services Corp | 8,594,881 | 1.78% |
| Microsoft Corp | 6,508,430 | 1.35% |
| Cash | 5,577,436 | 1.16% |
| 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% |
| Cisco Systems Inc | 4,669,050 | 0.97% |
| Intel Corp | 2,624,093 | 0.54% |
| Apple Inc | 2,527,125 | 0.52% |
| Metro Oregon | 2,349,820 | 0.49% |
| Johnson & Johnson | 2,217,912 | 0.46% |
| Total Historical Cost | 481,736,338 | 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 7.4 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: 6.5
- 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.

© 2015 MSCI ESG Research Inc. Reproduced by permission.

Although Insight Investment's information providers, including without limitation, MSCI ESG Research Inc. and its affiliates (the "ESG Parties"), obtain information from sources they consider reliable, none of the ESG parties warrants or guarantees the originality, accuracy and/or completeness of any data herein. None of the ESG Parties makes any express or implied warranties of any kind, and the ESG Parties hereby expressly disclaim all warranties of merchantability and fitness for a particular purpose, with respect to any data herein. None of the ESG Parties shall have any liability for any errors or omissions in connection with any data herein. Further, without limiting any of the foregoing, in no event shall any of the ESG Parties have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.