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

FROM: Cheryl Pattelli, CFO

SUBJECT: Investment Performance as of September 30, 2020

Date: October 21, 2020

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 cautiously optimistic given uncertain outlook: With the economic carnage of the first half of the year moving into the rear-view mirror, investors focused on the recovery, which has proven much sharper than expected as lockdowns reversed. Still, we expect the pace of growth to slow given permanent damage done by COVID. The Federal Reserve modified its inflation target to an average of 2% and signalled they wanted to see inflation overshoot 2% before hiking rates. Improving growth and an accommodative Fed buoyed risk sentiment as investors sought what yield they could find. Perhaps, the sharp rebound in technology stocks was the clearest example of increased risk appetite.

The yield curve steepened marginally as sentiment improved: The Treasury yield curve shifted marginally higher and steeper over the quarter as shorter maturities remained anchored by Fed policy, but longer-maturity yields drifted higher after making strong gains in the previous quarter. Some of this steepening reflects increased inflation risk from the Fed's new framework. The 2-year maturity Treasury yield declined by 2bp, the 10-year maturity Treasury yield rose by 3bp and the 30-year maturity Treasury yield rose by 6bp.

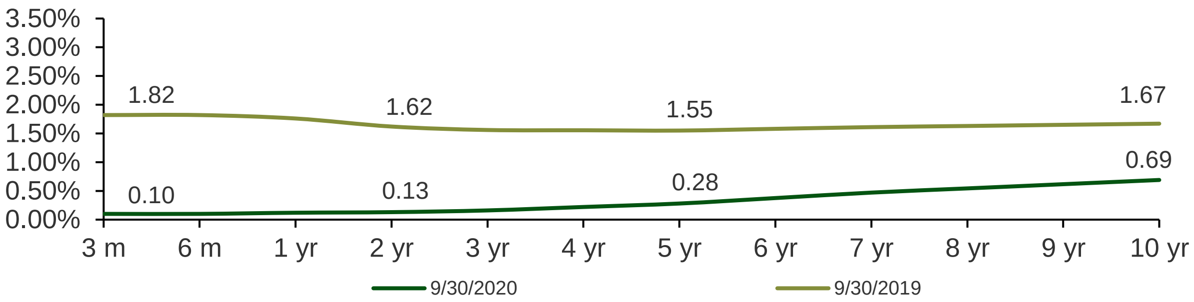
Credit spreads recover: Credit spreads tightened in Q3, with aggregate US corporate spreads ending the quarter 14bp tighter than where they began. The intermediate area of the credit curve outperformed marginally, tightening by 16bp given direct Fed purchases. BBB-rated issues generally outperformed given more positive sentiment in credit markets. Cumulative investment grade credit gross issuance reached $1,835bn at the end of Q3, breaking above the previous annual high of $1,468bn set in 2017.

Equity markets rebound: US equity markets experienced a strong, but volatile, quarter, with technology stocks rallying to record highs before giving back some of these gains at the end of the quarter on valuation concerns.

Risks include:

- A stop-start recovery, where further waves of the virus make it difficult for activity to recover, which would not be good for corporates
- Election uncertainty and the impact of the election result is difficult to estimate
- Brexit could be a flashpoint in Europe at year end

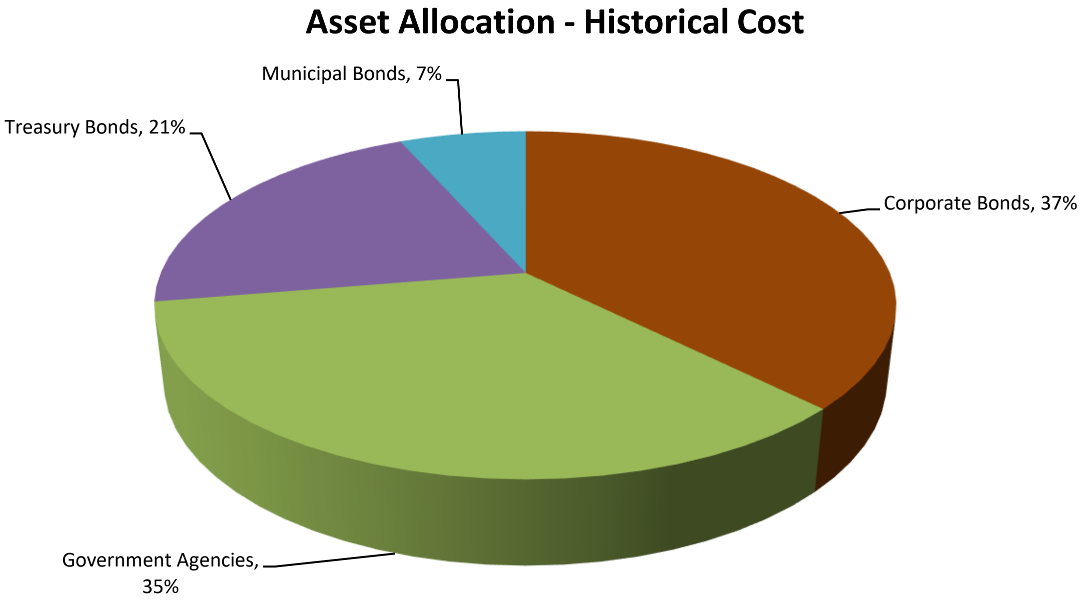
Treasury Yield Curve: 09/30/2020 and 09/30/2019 (Source: Bloomberg)

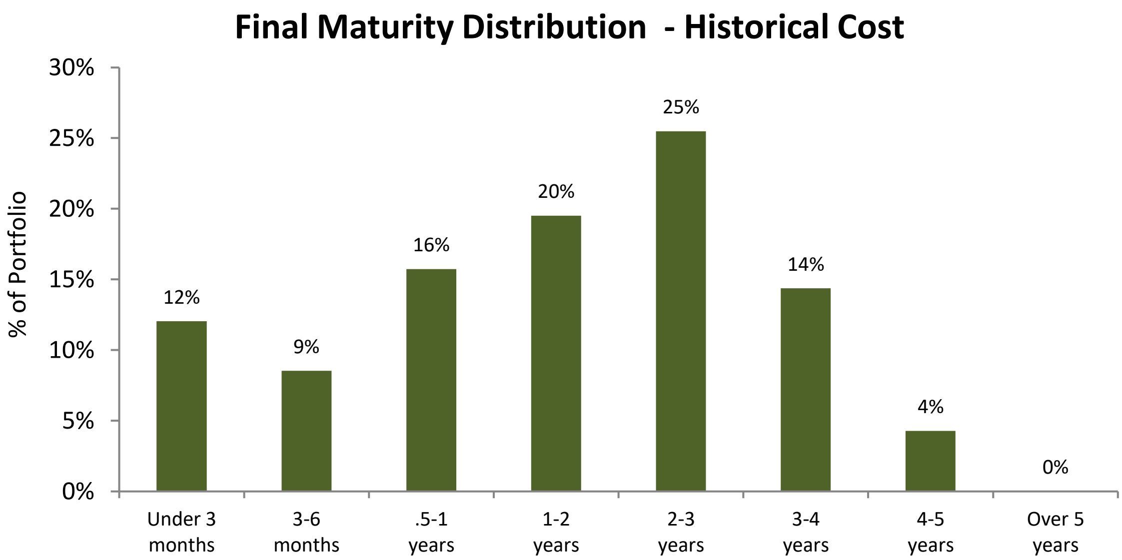


Section 3 – The City's Portfolio

- 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 September 30, 2020, the WAM of the operating portfolio was 1.82 years while the Ordinance allows for up to a 5-year WAM.
    - The City maintains sufficient liquidity. A minimum of 5% of the City's total portfolio is held in liquidity accounts. In addition, approximately 3% of the term securities held as of September 30 will mature within 30 days.
    - As of September 30, the yield on the operating portfolio was 1.99%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which was .17% as of September 30. The yield on the operating portfolio as of September 30 exceeded the benchmark yield by 1.82%.
    - For the third quarter 2020, the fair value periodic return on the operating portfolio was .21%. The 1-3 Treasury Index return for the period was .10%. The return on the operating portfolio for the third quarter was .11% 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 third quarter 2020 the City's investment advisor invested approximately 17 million in longer-term securities for the operating portfolio. US Agency securities, a corporate bond and a taxable municipal issue were purchased at a weighted average yield of .44%. The weighted average maturity at the time of purchase for these investments was 4.2 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.
- No investments were executed for the bond proceeds portfolio during the third quarter. To manage costs and improve efficiency, the bond proceeds portfolio was closed in August.

City of Boulder Operating Portfolio Profile
As of September 30, 2020





Summary of Operating Portfolio Characteristics

	September 30, 2020	June 30, 2020
Average Final Maturity (years)	1.82	1.90
Modified Duration (years)	1.74	1.82
Average Purchase Yield	1.99%	2.10%
Average Market Yield	0.32%	0.35%
Average Credit Quality (S&P/Moody's)	AA/Aa2	AA/Aa2
Total Market Value ($)	327,242,889	321,752,818

Portfolio Holdings as of September 30, 2020

Issuer	Historical Cost	% of Portfolio
US Treasury	67,163,938	21.05%
Federal Home Loan Bank	40,520,231	12.70%
Federal National Mortgage Association	40,497,583	12.69%
Federal Farm Credit Bank	23,582,003	7.39%
Microsoft Corp	11,736,902	3.68%
American Honda Finance Corp	10,545,614	3.30%
Apple Inc	10,457,935	3.28%
Toyota Motor Credit Corp	10,317,940	3.23%
Wal-Mart Inc	10,033,900	3.14%
State Street Corp	8,991,401	2.82%
City of New York, New York	8,478,013	2.66%
Cisco Systems Inc	7,971,070	2.50%
Caterpillar Financial Services Corp	7,714,253	2.42%
Metro Oregon	7,550,720	2.37%
Coca-Cola Company	7,007,940	2.20%
Federal Home Loan Mortgage Corp	6,871,595	2.15%
TWDC Enterprises (Disney)	5,722,720	1.79%
PepsiCo Inc	5,067,281	1.59%
State of Maryland	5,000,000	1.57%
Johnson & Johnson	4,401,352	1.38%
Intel Corp	3,771,120	1.18%
Bank of New York Mellon Corp	2,912,725	0.91%
Oracle Corp	2,895,060	0.91%
United Parcel Service Inc	2,519,450	0.79%
Chubb INA Holdings Inc	2,462,300	0.77%
IBM Credit LLC	2,461,975	0.77%
Praxair Inc	2,456,740	0.77%
Cash	21,794	0.01%
Total Historical Cost	**319,133,556**	**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 6.8 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: 6.8
- MSCI Social Pillar Score: 4.9
- 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.