City of Boulder

City of Boulder
Finance Department

TO:	The Mayor and Members of City Council Jane S. Brautigam, City Manager
FROM:	Cheryl Pattelli, CFO
SUBJECT:	Investment Performance as of December 31, 2017
DATE:	January 28, 2018

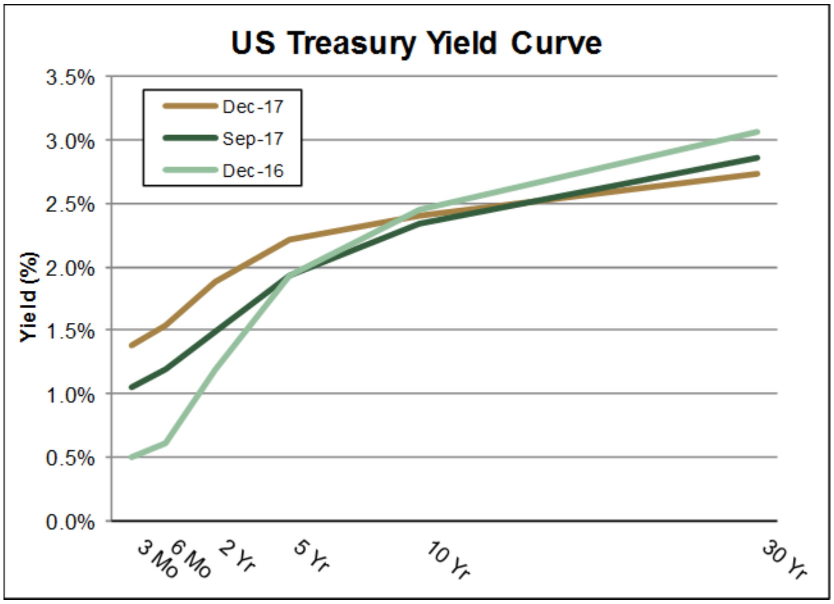
Section 1 – Background

- 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 – The Yield Curve and Federal Open Market Committee ("the Fed")

Treasury Yield Curve

12/31/2017 vs. 09/30/2017 vs. 12/31/16



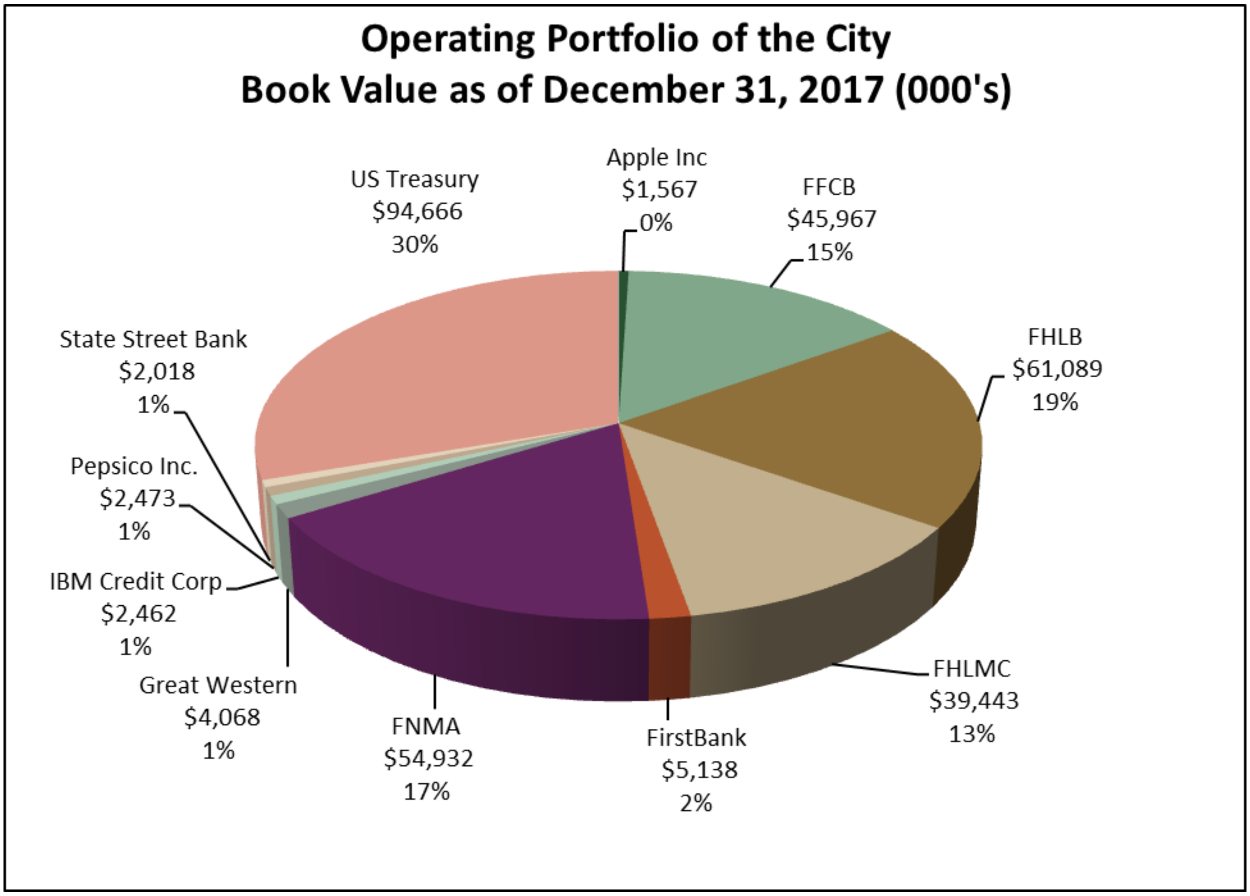
Source: Bloomberg

- The yield curve flattened meaningfully in 2017, with the 2-year/10-year Treasury yield spread narrowing from 126 basis points at the end of 2016 to as low as 52 basis points at the end of December, the tightest spread since October 2007. In December, the 2-year Treasury yield increased about ten basis points to 1.88% and the 10-year Treasury yield was essentially unchanged. During 2017, the Federal Reserve raised the fed funds rate three times by a total of 75 basis points, which largely fueled the increase in shorter rates. However, inflation expectations were muted, which kept a lid on longer-term rates. All else being equal, we believe the Fed's ongoing efforts to normalize the balance sheet should help promote a steeper yield curve, but we don't expect the impact of this to be reflected in the market until later this year. We also believe tax reform is likely to provide a tailwind to economic growth and help drive yields at the long end of the curve higher. Global demand for Treasuries will also continue to influence yields.
- The Federal Open Market Committee (FOMC) raised the fed funds target rate by 25 basis points to a range of 1.25% - 1.50% at the December 13 meeting. The Federal Open Market Committee's (FOMC) economic projections indicate the Fed plans to hike the fed funds rate three times this year to a median level of 2.1%. We believe the rotation of new voting members into the FOMC this year, as well as a new Fed Chairman, may make for a more hawkish FOMC this year. Assuming inflation remains contained below 2.0% and the US dollar does not materially appreciate, we think three rate hikes are likely this year. While we expect the Fed to remain on a path toward monetary policy normalization, we continue to believe that the Fed's terminal rate forecast of 2.8% is too high, and believe the long-run rate is probably closer to 2.5%. As such, we see little room for additional rate hikes beyond this year, unless there is a significant pick-up in economic growth and inflation.

Section 3 – The City's Portfolios

- Portfolio strategies implemented this quarter and all investments held in the portfolios 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, primarily among two major sectors (Treasury and Agency), the Agency issuers and various maturities along the yield curve. On March 7th 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 recently 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 portfolio. As of December 31, 2017 the WAM was 1.69 years while the Ordinance allows up to a five year WAM.
    - The City maintains sufficient liquidity. As of December 31, 2017, 5.7% of the portfolio or $17.8 million will mature over the next 30 days.
    - As of December 31, 2017, the yield on the pooled investment portfolio was 1.32%. Our current yield benchmark is the six month trailing average on the 2-year Treasury, which was 1.52%, as of December 31, 2017. The benchmark yield exceeded the investment portfolio by 0.20%.
- There are no investments in the oil and gas industry in the City's portfolio.
- The City's investment adviser purchased approximately $55.21 million of securities during Q4 2017 for the City of Boulder's investment portfolio. The proceeds of $57.53 million of sales and maturities along with additional cash contributions were used to fund these purchases. Purchases included Treasury, Agency and Corporate securities maturing between November 2017 and April 2021. On a year-over year basis, short-term Treasury yields increased significantly. The 2-year Treasury yield increased 68 basis points to 1.89%. Nevertheless, longer term Treasury yields actually had a modest move lower in calendar year 2017. The 10- year Treasury yield was down 3 basis points, to 2.41%. The Federal Reserve raised the fed funds target rate by 25 basis points three times in 2017 and the possibility exists that an additional three increases will occur in 2018 as well. We continue to position the portfolio to take advantage of higher rates as the Federal Reserve continues to adjust its policy for the current economic environment.

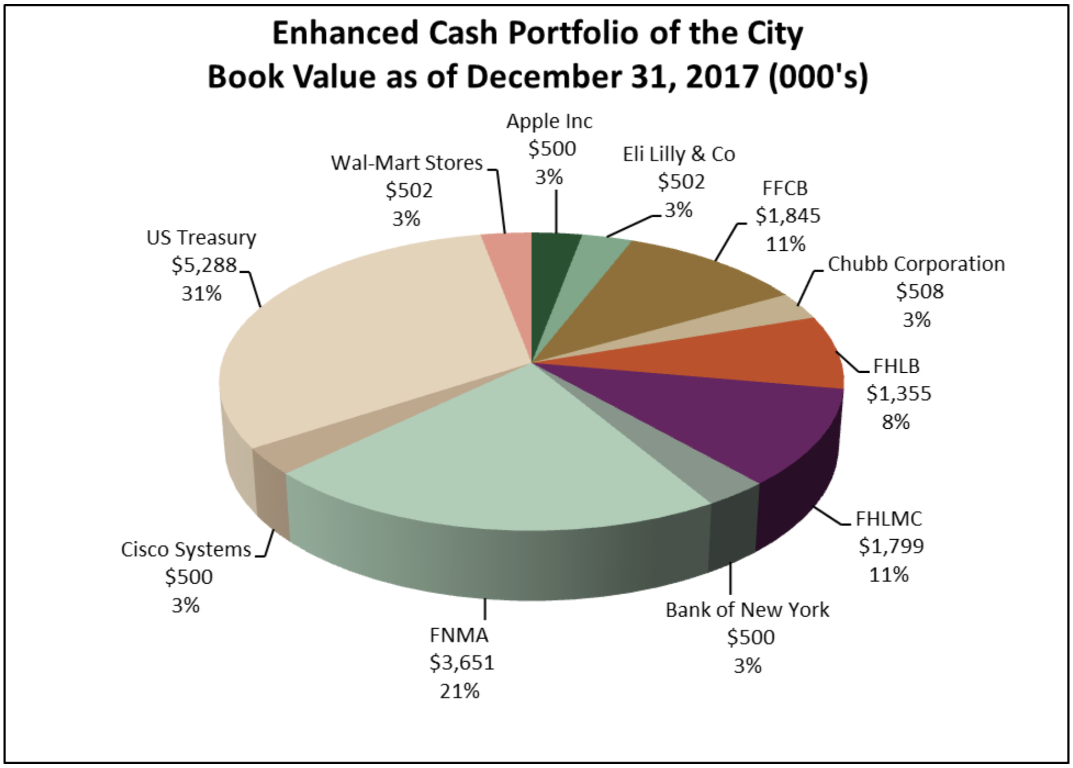
Operating Portfolio of the City



Portfolio Characteristics
City of Boulder Consolidated Non CIP

	12/31/2017 Portfolio	09/30/2017 Portfolio
Average Maturity (yrs)	1.69	1.80
Modified Duration	1.64	1.74
Average Purchase Yield	1.32%	1.26%
Average Market Yield	1.77%	1.43%
Average Quality	AA+/Aaa	AA+/Aaa
Total Market Value	312,607,768	316,669,551

Enhanced Cash Portfolio



Portfolio Characteristics
City of Boulder Enhanced Cash Portfolio

	12/31/2017	09/30/2017
	Portfolio	**Portfolio**
Average Maturity (yrs)	0.96	0.79
Modified Duration	0.95	0.78
Average Purchase Yield	1.37%	1.24%
Average Market Yield	1.80%	1.29%
Average Quality	AA+/Aa1	AA+/Aa1
Total Market Value	16,922,172	34,655,098

In March 2012, a separate portfolio was established to facilitate IRS required arbitrage calculations on Bond Reserve and Project Funds. The balance of $16.9 million as of December 31, 2017 was invested as shown above in the graph and table to assure timely funding for the projected draw down schedule.

- In June 2012, the investment committee selected the one year Treasury as the benchmark for the bond proceeds based upon an average maturity of approximately one year for the portfolio at that time. As of December 31, 2017 the portfolio yield was 1.37%.
- As of December 31, 2017, 2.97% of the portfolio or $500,000 will mature over the next 30 days.
- Approximately 50% of the portfolio matured or was liquidated for cash flow needs during the quarter. The average maturity of the portfolio was 346 days as of December 31, 2017. An objective of this portfolio is to safely support the liabilities of the projected project cash flows.