City of Boulder

City of Boulder

Finance Department

TO:	The Mayor and Members of City Council Jane S. Brautigam, City Manager
FROM:	Cheryl Pattelli, Director of Finance
SUBJECT:	Investment Performance as of June 30, 2016
DATE:	July 26, 2016

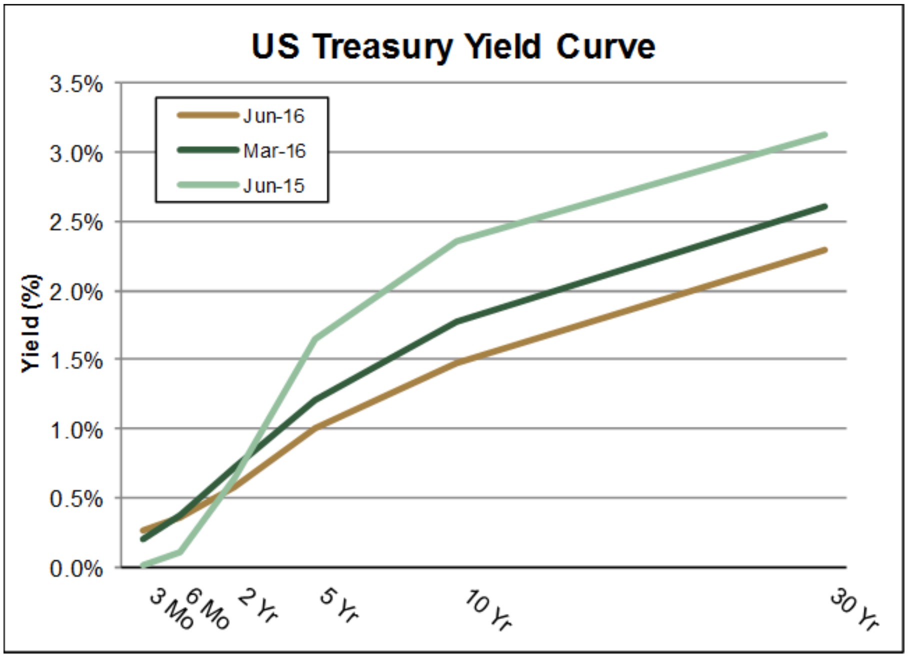
Section 1 – Background

- 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

06/31/2015 vs. 03/31/2016 vs. 06/30/16



Source: Bloomberg

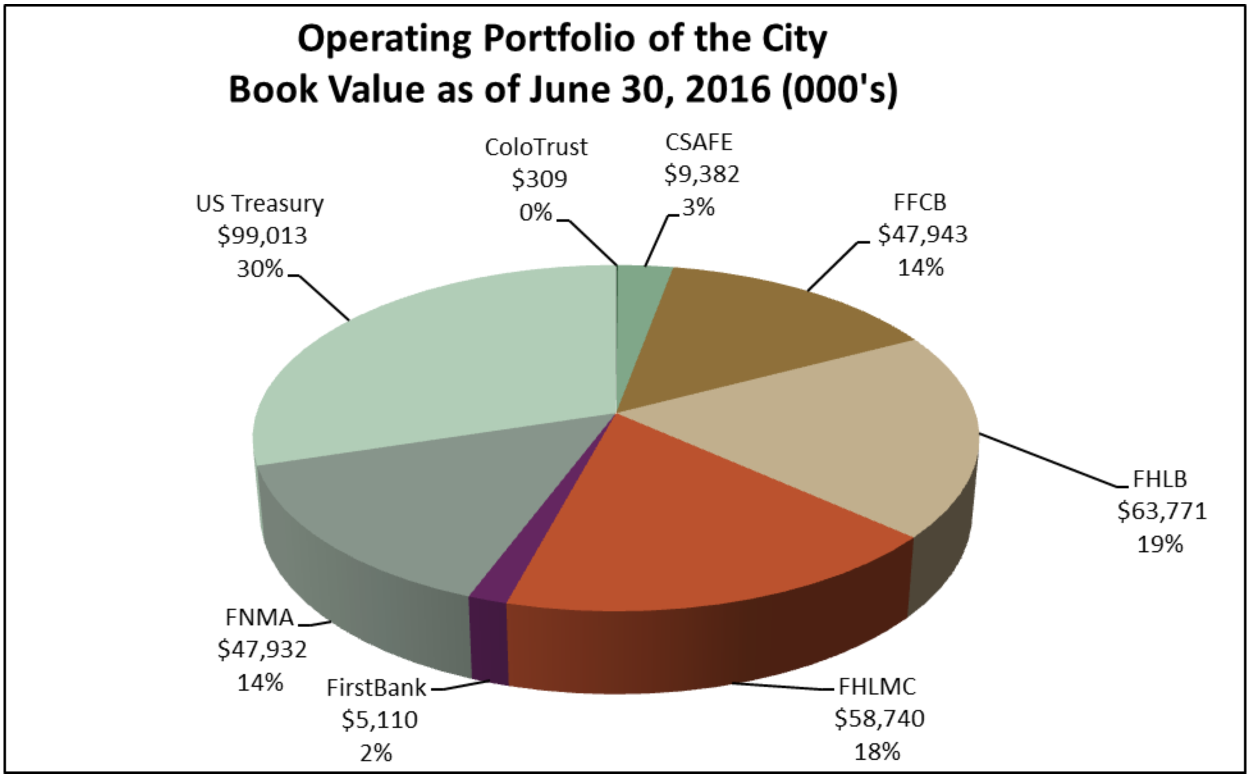
- Over the past three months, the yield curve flattened with the 2-year Treasury yield down 14 basis points and the 10-year Treasury yield down 30 basis points. The flattening is even more pronounced on a year-over-year basis with the 2-year Treasury yield down 6 basis points and the 10-year Treasury yield down nearly 90 basis points. Over the past year, financial market volatility has been elevated due to weak global economic growth, volatile commodity prices, and divergent global central bank monetary policy.
- The Federal Open Market Committee (FOMC) voted to keep the fed funds rate unchanged at the June 14-15 meeting. The FOMC statement was mostly balanced, noting that the pace of labor market gains slowed but economic activity picked up. Brexit fears and the corresponding volatility in sovereign bond yields, along with the disappointing May jobs report, likely prompted the Fed to keep monetary policy on hold. In her press conference, Fed Chair Yellen conceded that the Fed can more effectively respond to an overshoot of inflation than they can to a weakening labor market and/or deflation. In hindsight, the Fed’s cautious stance in June seems to have been prudent. Just a week later, Britain’s unexpected vote to leave the European Union was a shock to the financial markets and prompted a broad selloff of risk assets and spike in the volatility. The long-term implications of the Brexit vote are highly uncertain. Near term, we expect financial market volatility to remain elevated and interest rates to stay lower for longer. WE believe the hurdle rate for future fed funds rate hikes has moved materially higher. Furthermore, we expect the Federal Reserve to remain on hold over the near-term

Section 3 – The City's Portfolios

- Portfolio strategies implemented this quarter and all 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, primarily among two major sectors (Treasury and Agency), the Agency issuers and various maturities along the yield curve. Market risk is managed by maintaining a low weighted average maturity (WAM) in the City's portfolio. As of June 30, 2016 the WAM was 1.88 years while the Ordinance allows up to a five year WAM.
    - The City maintains sufficient liquidity. As of June 30, 2016, 3.0% of the portfolio, or $9.4 million remained in overnight accounts.
    - As of June 30, 2016, the yield on the pooled investment portfolio was 1.03%. Our current benchmark is the six month trailing average on the 2-year Treasury, which was 0.75%, as of June 30, 2016. The objective was exceeded by 0.28%.
- There are no investments in the oil and gas industry in the City's portfolio.

- The City's investment adviser purchased approximately $44.8 million of securities during Q2 2016 for the City of Boulder's investment portfolio. The proceeds of $23.6 million of maturities along with existing liquid funds were used to fund the security purchases. The security purchases included Treasury and Agency securities maturing between April 2018 and May 2021. These securities were purchased in this maturity range to maintain the portfolio characteristics in line with the strategy. The Federal Open Market Committee (FOMC) voted to keep the fed funds rate unchanged at the June 14-15 meeting. The FOMC statement was mostly balanced, noting that the pace of labor market gains slowed but economic activity picked up. Brexit fears and the corresponding volatility in sovereign bond yields, along with disappointing May jobs report, likely prompted the Fed to keep monetary policy on hold. The long-term implications of the Brexit vote are highly uncertain. The yield on the two-year Treasury note declined 0.14% during the quarter to 0.58%. Meanwhile, the yield on the ten-year Treasury note decreased 0.30% during the quarter to 1.77%. Near term, we expect financial market volatility to remain elevated and interest rates to stay lower for longer. We believe the hurdle rate for future fed funds rate hikes has moved materially higher. Furthermore, we expect the Federal Reserve to remain on hold over the near-term.

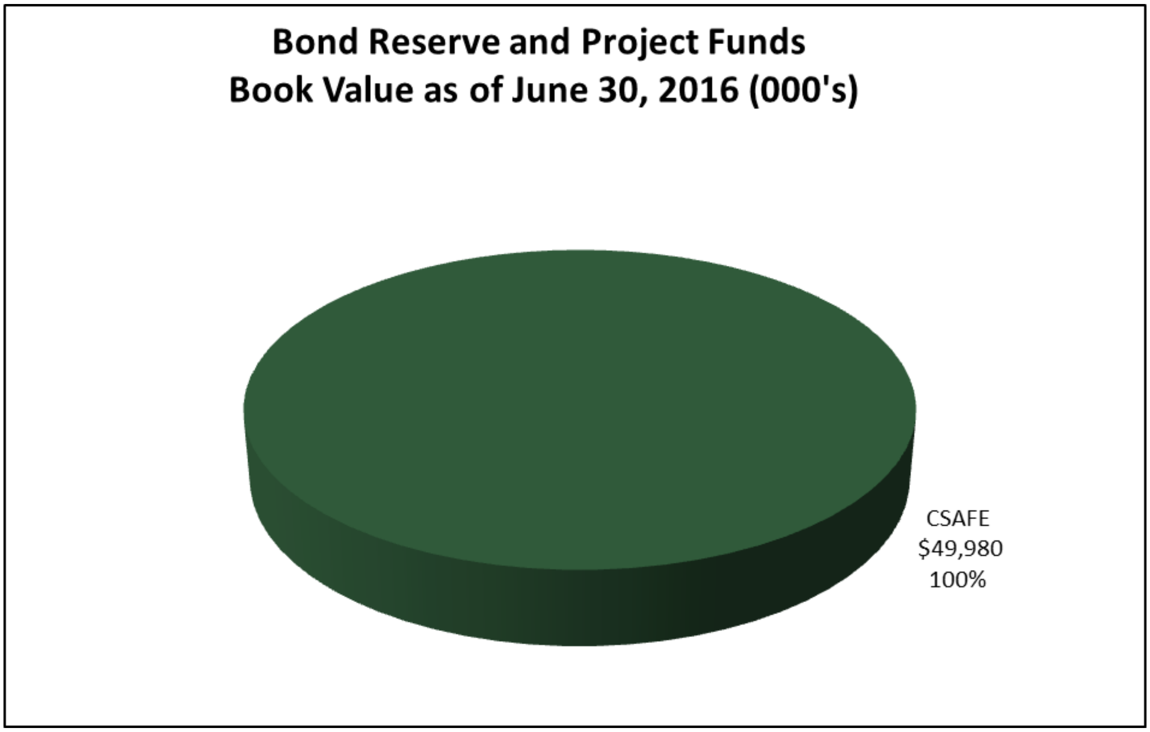
Operating Portfolio of the City



Portfolio Characteristics
City of Boulder Consolidated Non CIP

	06/30/2016	03/31/2016
	Portfolio	**Portfolio**
Average Maturity (yrs)	1.88	1.76
Modified Duration	1.84	1.72
Average Purchase Yield	1.032%	1.054%
Average Market Yield	0.666%	0.746%
Average Quality	AA+/Aaa	AA+/Aaa
Total Market Value	335,428,244	313,301,575

Bond Reserve and Project Funds



Portfolio Characteristics
Bond Reserve and Project Funds

	06/30/2016	03/31/2016
	Portfolio	**Portfolio**
Average Maturity (yrs)	0.00	0.00
Modified Duration	0.00	0.00
Average Purchase Yield	0.55%	0.50%
Average Market Yield	0.55%	0.50%
Average Quality	AAA/NR	AAA/NR
Total Market Value	49,980,496	14,947,836

When the Bond Reserve and Project Funds proceeds of over $54 million were received in March 2012, a separate portfolio was established to facilitate IRS required arbitrage calculations. The balance of $49.9 million as of June 30, 2016 was invested as shown above in the graph and table to assure timely funding for the projected draw down schedule expected to end in January 2015.

- 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 June 30, 2016 the portfolio yield was 0.55%.
- Daily liquidity in the portfolio is currently 100% of the portfolio, or $49.9 million, resulting in a very short weighted average maturity of 0.0 years. The portfolio has virtually no market risk and 100% of the funds are available for immediate draw down as projects need funding. This portfolio structure safely supports the short liability duration of the projects that are expected to end in January 2015.