City of Boulder

City of Boulder
Finance Department

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

FROM: Bob Eichem, Chief Financial Officer

SUBJECT: Investment Performance as of March 31, 2014

DATE: April 25, 2014

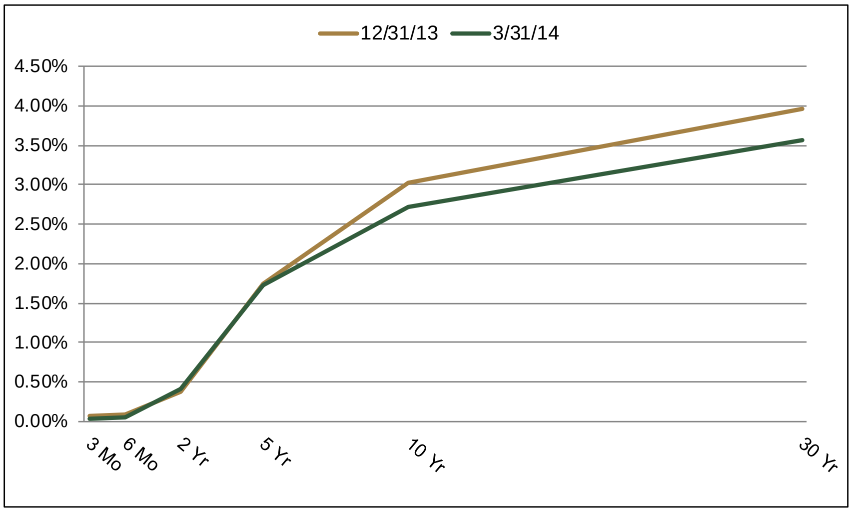
Section 1 – Background

- 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

12/31/13 vs. 3/31/14



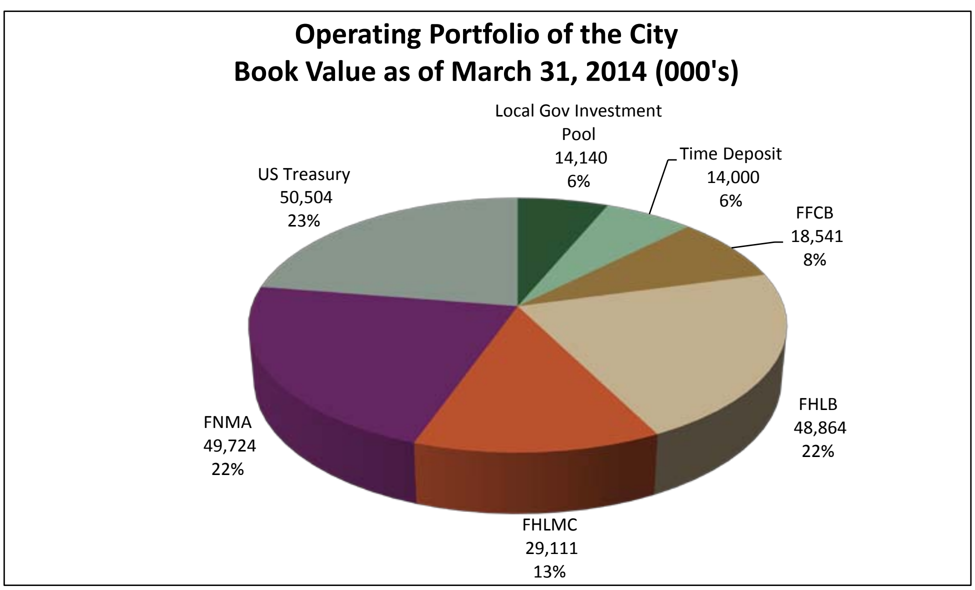
- During the past three months, the yield curve has flattened even as the Fed has been tapering its purchases of long-term Treasury bonds. The shape of the yield curve is changing as market participants anticipate future fed funds rate hikes by the Federal Reserve which has begun to put upward pressure on shorter-term yields. Meanwhile, over the past three months, market participants have reacted to lackluster domestic economic data (largely due to weather), as well as geopolitical tensions and fears about emerging market currencies. These worries have fueled a flight to quality, putting downward pressure on longer yields.

- The Fed left policy rates unchanged at its March 18-19 meeting, and announced another $10 billion reduction in asset purchases beginning in April. The Committee made some changes to its forward guidance on monetary policy. Rather than pointing to 6.5% unemployment as a trigger point for policy change, the Fed is now using more qualitative language and indicated that it will instead be focused on targeting "maximum employment". The Committee will also continue to target a long-run inflation goal of 2%. The Fed slightly lowered its forecasts for GDP growth and unemployment (compared with its forecasts from December), while its inflation outlook was essentially unchanged. In her first post-meeting press conference, Chairwoman Yellen rattled the financial markets when she suggested that the first fed funds rate hike could begin 6 months after the taper is complete (which implies spring of 2015 – a few months earlier than the market had been forecasting). Overall, many market participants viewed Yellen's comments as being more "hawkish" than expected. The next FOMC meeting is scheduled for April 29-30.

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 March 31, 2014 the WAM was 1.33 years while the Ordinance allows up to a five year WAM.
  - The City maintains sufficient liquidity. As of March 31, 2014, 6% of the portfolio, or $14.1 million remained in overnight accounts.
  - As of March 31, 2014, the yield on the pooled investment portfolio was 0.59%. Our current benchmark is the six month trailing average on the 2-year Treasury, which was 0.35%, as of March 31, 2014. The objective was exceeded by 0.24%.
- There are no direct investments in the oil and gas industry in the City's portfolio.
- The City's investment adviser purchased approximately $40 million of securities during Q1 2014 for the City of Boulder's investment portfolio. The security purchases included Treasury and Agency securities maturing between September 2015 and July 2017. The securities were purchased in this maturity range to take advantage of the historically steep yield curve. The historically steep yield curve is a result of the Federal Reserve's accommodative monetary policy along with an expanding US economy resulting in very low short-term interest rates and normalizing long-term interest rates. The purchase of these securities moved the portfolio closer to the characteristics of the style and strategy selected by the City. Future securities purchases will rebalance the City's investment portfolio closer to the targeted risk characteristics. This will be accomplished by investing liquidity not needed for other operations and reinvesting funds from maturing bonds.

Operating Portfolio of the City

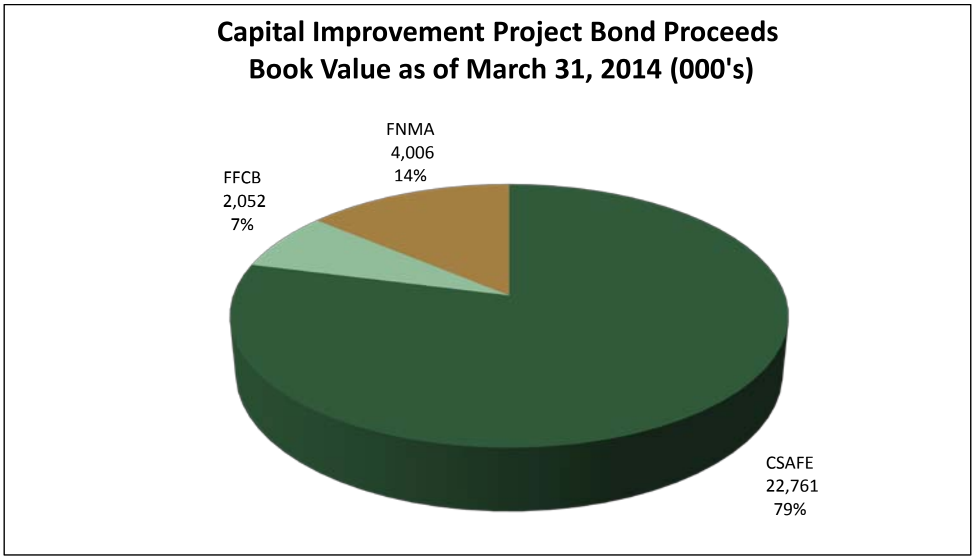


Portfolio Characteristics

Operating Portfolio of the City

	03/31/2014	12/31/2013
	Portfolio	**Portfolio**
Average Maturity (yrs)	1.33	1.25
Modified Duration	1.31	1.24
Average Purchase Yield	0.59%	0.58%
Average Market Yield	0.34%	0.30%
Average Quality	AA+/Aaa	AA+/Aaa
Total Market Value	226,016,829	194,092,133

Capital Improvement Project 2012 Bond Proceeds



Portfolio Characteristics

Capital Improvement Project 2012 Bond Proceeds

	03/31/2014	12/31/2013
	Portfolio	**Portfolio**
Average Maturity (yrs)	0.08	0.14
Modified Duration	0.08	0.14
Average Purchase Yield	0.10%	0.42%
Average Market Yield	0.03%	0.06%
Average Quality	AA+/Aaa	AA+/Aaa
Total Market Value	28,866,739	31,650,694

When the Capital Improvement Bond proceeds of over $54 million were received in March 2012, a separate portfolio was established to facilitate IRS required arbitrage calculations. The balance of $28.9 million as of March 31, 2014 is 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 March 31, 2014, the portfolio yield was 0.10% compared to a yield of 0.12% on the one year Treasury.
- Daily liquidity in the portfolio is currently 79% of the portfolio, or $22.8 million, resulting in a very short weighted average maturity of 0.08 years. The portfolio has virtually no market risk and 79% 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.