

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

FROM: Cheryl Pattelli, CFO

SUBJECT: Investment Performance as of September 30, 2021

DATE: October 19, 2021

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

Economic momentum softened in Q3 but should recover as the delta wave subsides: A resurgence of the pandemic in the form of the more virulent delta variant reduced momentum in sectors such as leisure and hospitality. However, supply chains are the biggest issue with delta forcing temporary shutdowns in Vietnam, China, and elsewhere. Lean inventories and supply chain delays have pushed prices up and reduced real consumption with the auto sector particularly hard hit. Inventory rebuilding should boost 2022 growth.

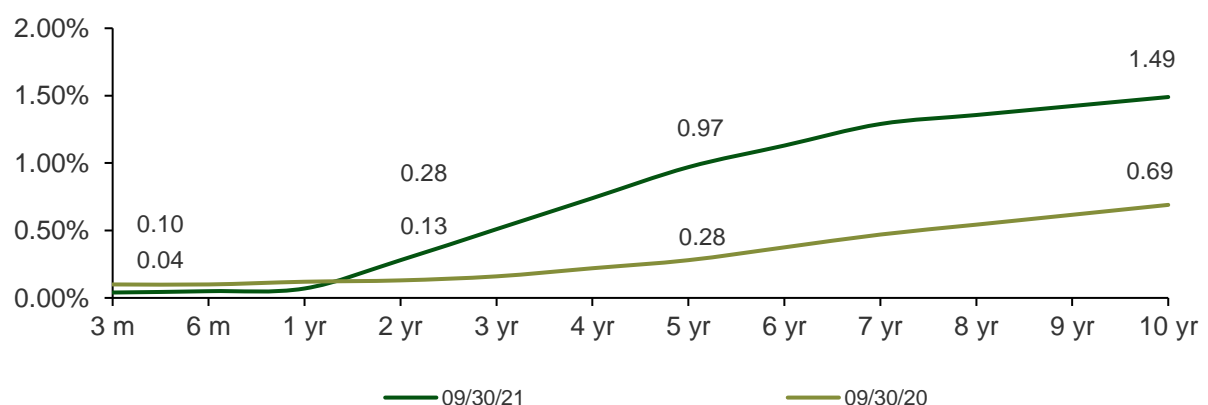
Inflation remains elevated: Headline CPI ticked down from its recent high but remained at an elevated 5.3% year-on-year in August. With the level of prices now above their pre-pandemic trend the Fed has arguably achieved its average inflation target, and markets are anticipating that tapering of bond purchases will be announced in November. This uptick in inflation may prove transitory and slowly dissipate in 2022, though inflation will likely stay above 3% through Q2 2022.

The yield curve flattened despite inflation data: Treasury yields out to twelve years in maturity rose over the quarter, but beyond twelve years they declined, leading to a flatter curve. The 2-year maturity Treasury yield rose by 2bp to 0.27%, the 10-year maturity Treasury yield rose by 3bp to 1.49% and the 30-year maturity Treasury yield declined by 6bp to 2.05%.

Credit spreads widened marginally: Credit spreads drifted wider in Q3, with aggregate US corporate spreads ending the quarter 4bp higher. The intermediate area of the credit curve outperformed, widening by only 2bp. BBB-rated issues and high yield outperformed given the still positive economic outlook.

The S&P 500 Index edged higher: US equity markets drifted lower into the end of the quarter, eroding earlier gains but with the S&P 500 Index managing to record a marginally positive return for the quarter as a whole.

Treasury Yield Curve: 09/30/21 and 09/30/20 (Source: Bloomberg)

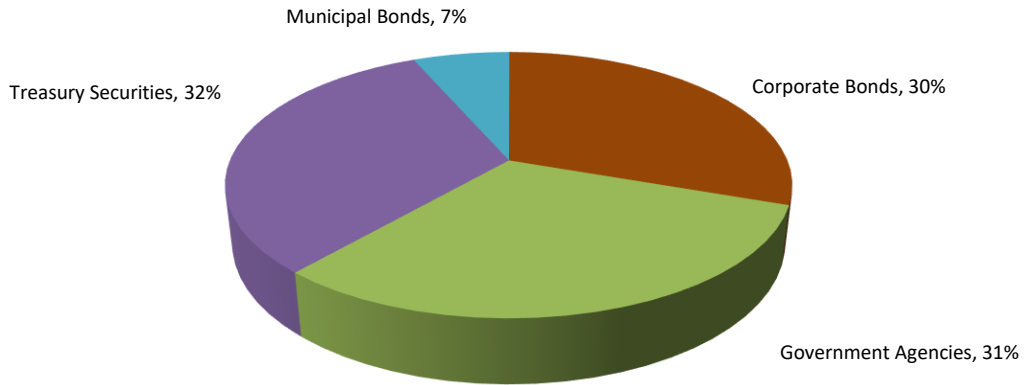


Section 3 – The City’s Portfolio

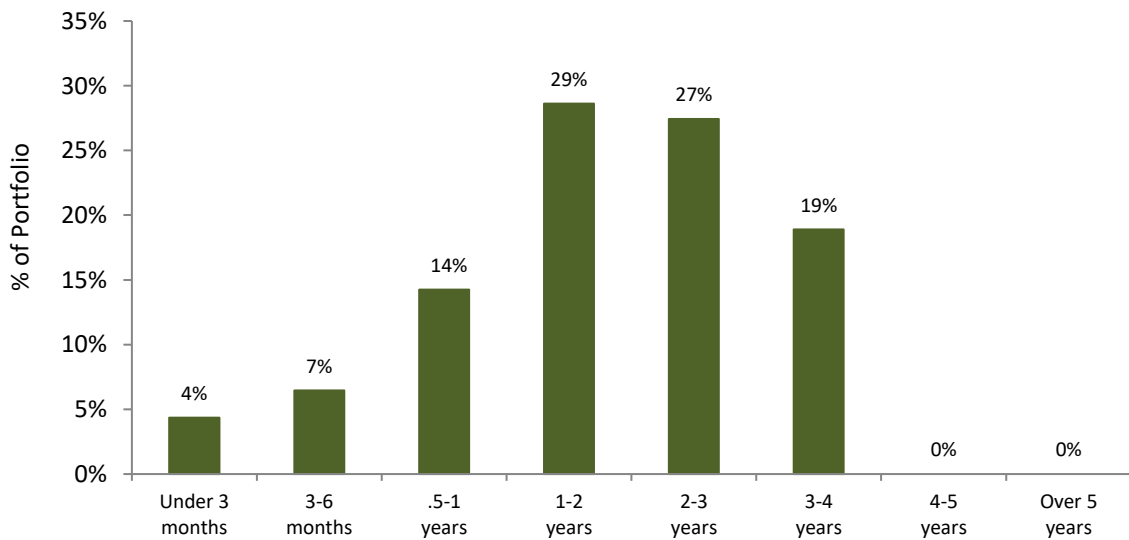
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
 - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury 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 final maturity (WAM) in the City’s portfolios. As of September 30, 2021, the WAM of the operating portfolio was 1.97 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. In addition, 1.3% of the term securities held as of September 30 will mature within 30 days.
 - As of September 30, the weighted average purchase yield for the operating portfolio holdings was 1.09%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which was .20% as of September 30. The purchase yield on the operating portfolio as of September 30 exceeded the benchmark yield by .89%.
 - For the third quarter 2021, the fair value periodic return on the operating portfolio was positive .09%. The 1-3 Treasury Index return for the period was positive .06%. The periodic return on the operating portfolio for the third quarter was .03% 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 2021, the City’s investment advisor invested approximately \$78 million in longer-term securities for the operating portfolio. US Treasury notes, US Agency bonds and corporate securities were purchased at a weighted average yield of .43%. The weighted average maturity at the time of purchase for these investments was 2.6 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.

City of Boulder Operating Portfolio Profile As of September 30, 2021

Asset Allocation - Historical Cost



Final Maturity Distribution - Historical Cost



Summary of Operating Portfolio Characteristics

	September 30, 2021	June 30, 2021
Average Final Maturity (years)	1.97	1.95
Modified Duration (years)	1.80	1.78
Average Purchase Yield	1.09%	1.34%
Average Market Yield	0.37%	0.34%
Average Credit Quality (S&P/Moody's)	AA+/Aa1	AA+/Aa1
Total Market Value (\$)	398,029,931	352,905,904

Portfolio Holdings as of September 30, 2021

Issuer	Historical Cost	% of Portfolio
US Treasury	126,982,213	31.98%
Federal Home Loan Bank	38,543,739	9.71%
Federal National Mortgage Association	37,710,463	9.50%
Federal Farm Credit Bank	26,580,663	6.69%
Federal Home Loan Mortgage Corp	20,890,868	5.26%
John Deere Capital Corp	14,297,919	3.60%
Microsoft Corp	13,237,312	3.33%
Toyota Motor Credit Corp	12,729,235	3.21%
State Street Corp	12,316,811	3.10%
Caterpillar Financial Services Corp	10,644,296	2.68%
American Honda Finance Corp	10,545,614	2.66%
Apple Inc	9,919,607	2.50%
City of New York, New York	8,478,013	2.14%
Metro Oregon	7,550,720	1.90%
Wal-Mart Inc	7,029,820	1.77%
3M Co	6,274,560	1.58%
Cisco Systems Inc	5,075,200	1.28%
State of Florida	5,001,000	1.26%
State of Maryland	5,000,000	1.26%
International Business Machines Corp	4,871,700	1.23%
Johnson & Johnson	4,401,352	1.11%
Intel Corp	3,771,120	0.95%
PepsiCo Inc	2,594,756	0.65%
Linde Inc	2,456,740	0.62%
Cash	184,028	0.05%
Total Historical Cost	397,087,750	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 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: 6.9
- MSCI Social Pillar Score: 5.1
- MSCI Governance Pillar Score: 4.4

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.

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