

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

FROM: Kara Skinner, Interim Chief Financial Officer

SUBJECT: Investment Performance as of December 31, 2021

DATE: January 20, 2022

### **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**

The economy is moving from recovery to mid-cycle: Forecasts for growth edged lower over the quarter as the emergence of the Omicron variant proved a reminder that the pandemic was not yet over. The economy is still expected to perform well in 2022 but grow at a more moderate pace than in 2021.

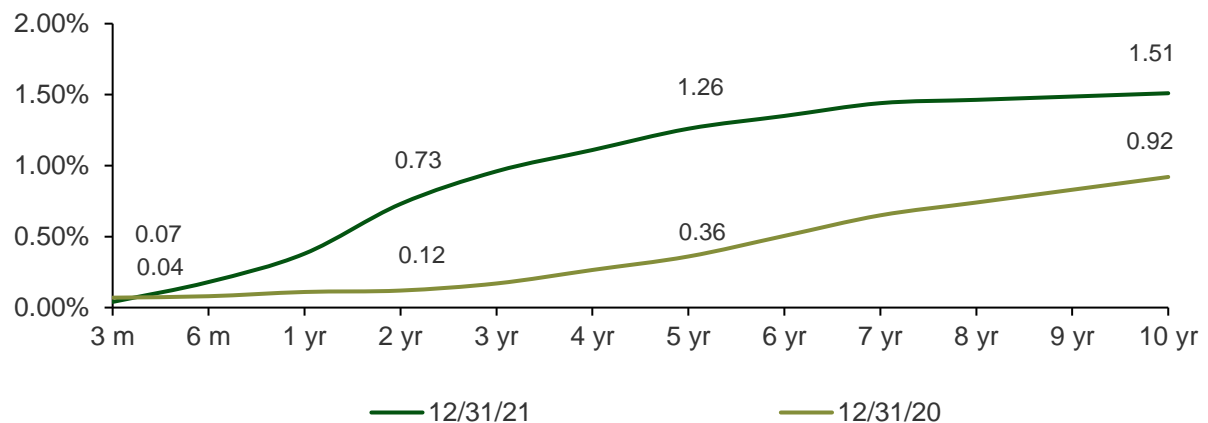
Inflation remained elevated: Headline CPI accelerated to 7.0% in December, the highest level for 40 years. With the level of prices now well above the pre-pandemic trend the Fed has exceeded its average inflation target, and has taken a more hawkish stance, with the 'dot plot' now suggesting multiple rate hikes in 2022. Inflation will likely moderate in mid-2022, taking some pressure off the Fed.

The short end of the curve moved to price in rate hikes: With the prospect of multiple interest rate hikes in 2022, the shorter end of the Treasury yield curve rose sharply, however, at the longer end of the curve yields declined. The 2-year maturity Treasury yield rose by 46bp to 0.73%, the 10-year maturity Treasury yield rose by 2bp to 1.51% and the 30-year maturity Treasury yield declined by 14bp to 1.91%.

Credit spreads widened: Aggregate US corporate spreads ended the quarter 8bp wider. The intermediate and long area of the credit curves also widened by 8bp. High yield outperformed given the still positive economic outlook and less rate sensitivity.

The S&P 500 Index had an extremely strong year: US equity markets moved sharply higher over the quarter, gaining 11% to end the year with a 28% gain.

Treasury Yield Curve: 12/31/21 and 12/31/20 (Source: Bloomberg)

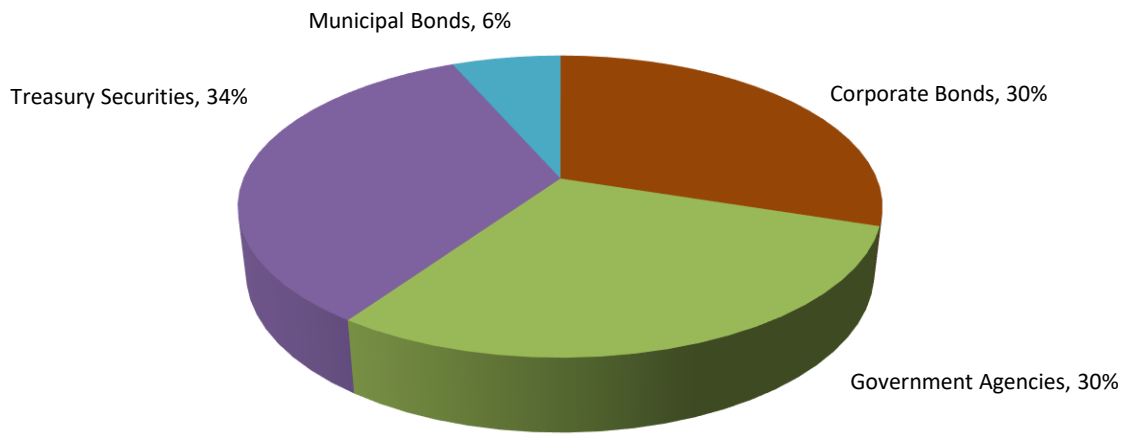


### **Section 3 – The City’s Portfolio**

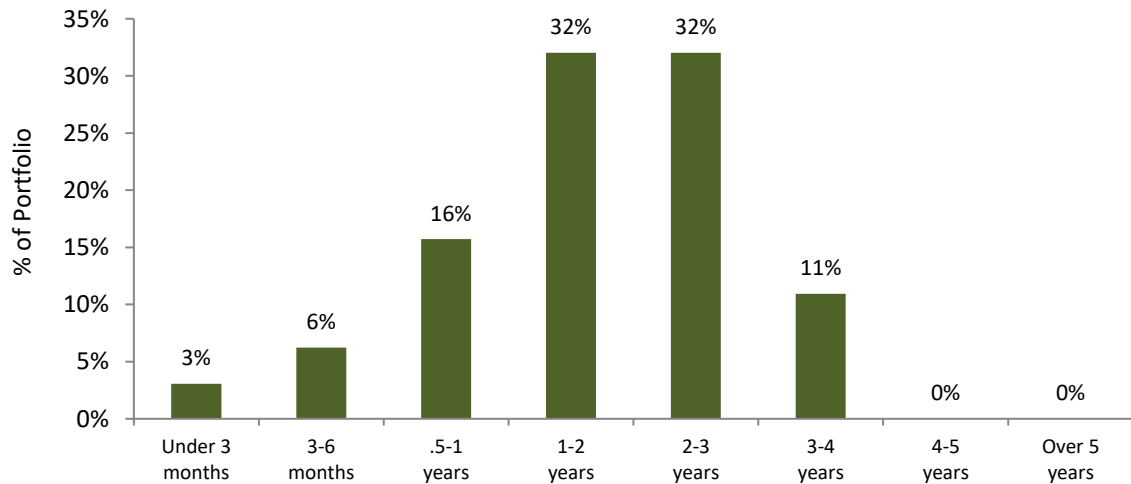
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
  - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury 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 December 31, 2021, the WAM of the operating portfolio is 1.82 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, 1.5% of the term securities held as of December 31 will mature within 30 days.
  - As of December 31, the weighted average purchase yield for the operating portfolio holdings is 1.00%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which is .37% as of December 31. The purchase yield on the operating portfolio as of December 31 exceeds the benchmark yield by .63%.
  - For the fourth quarter 2021, the fair value periodic return on the operating portfolio is negative .52%. The 1-3 Treasury Index return for the period is negative .53%. The periodic return on the operating portfolio for the fourth quarter is .01% 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 fourth quarter 2021, the City’s investment advisor invested approximately \$19 million in securities for the operating portfolio. US Treasury notes, a callable US Agency bond and a corporate security were purchased at a weighted average yield of .61%. The weighted average maturity at the time of purchase for these investments is 2.3 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 December 31, 2021

## Asset Allocation - Historical Cost



## Final Maturity Distribution - Historical Cost



## Summary of Operating Portfolio Characteristics

	December 31, 2021	September 30, 2021
Average Final Maturity (years)	1.82	1.97
Modified Duration (years)	1.73	1.80
Average Purchase Yield	1.00%	1.09%
Average Market Yield	0.68%	0.37%
Average Credit Quality (S&P/Moody's)	AA+/Aa1	AA+/Aa1
Total Market Value (\$)	396,115,637	398,029,931

## Portfolio Holdings as of December 31, 2021

Issuer	Historical Cost	% of Portfolio
US Treasury	135,164,631	33.87%
Federal National Mortgage Association	37,710,463	9.45%
Federal Home Loan Bank	37,546,339	9.41%
Federal Farm Credit Bank	22,066,593	5.53%
Federal Home Loan Mortgage Corp	20,890,868	5.23%
John Deere Capital Corp	14,297,919	3.58%
Microsoft Corp	13,237,312	3.32%
Toyota Motor Credit Corp	12,729,235	3.19%
State Street Corp	12,316,811	3.09%
Caterpillar Financial Services Corp	10,644,296	2.67%
American Honda Finance Corp	10,545,614	2.64%
Apple Inc	9,919,607	2.49%
3M Co	9,366,900	2.35%
City of New York, New York	8,478,013	2.12%
Metro Oregon	7,550,720	1.89%
Wal-Mart Inc	7,029,820	1.76%
Cisco Systems Inc	5,075,200	1.27%
State of Florida	5,001,000	1.25%
State of Maryland	5,000,000	1.25%
International Business Machines Corp	4,871,700	1.22%
Johnson & Johnson	4,401,352	1.10%
Intel Corp	2,624,093	0.66%
PepsiCo Inc	2,594,756	0.65%
Cash	22,867	0.01%
<b>Total Historical Cost</b>	<b>399,086,108</b>	<b>100.00%</b>

## **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 7.0 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: 5.0
- MSCI Governance Pillar Score: 4.6

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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