

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 March 31, 2022

DATE: April 22, 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 invasion of Ukraine by Russian forces sent an inflationary pulse around the world: Although small economically, the two countries have an oversized position in key energy and agricultural markets. Forecasts for global inflation in 2022 increased by 1.2% over the quarter, causing central banks to accelerate their tightening cycles and resulting in a decline in forecasts for global growth for both 2022 and 2023.

The short end of the curve moved to price in a significant number of rate hikes: The Federal Open Market Committee shifted its forecast for the expected future path of interest rates sharply upwards, with seven hikes now expected in 2022. This caused the yield curve to shift upwards and flatten. In the first quarter, the 2-year maturity Treasury yield increased by 161bp to 2.34%, the 10-year maturity Treasury yield increased by 82bp to 2.34% and the 30-year maturity Treasury yield increased by 55bp to 2.46%.

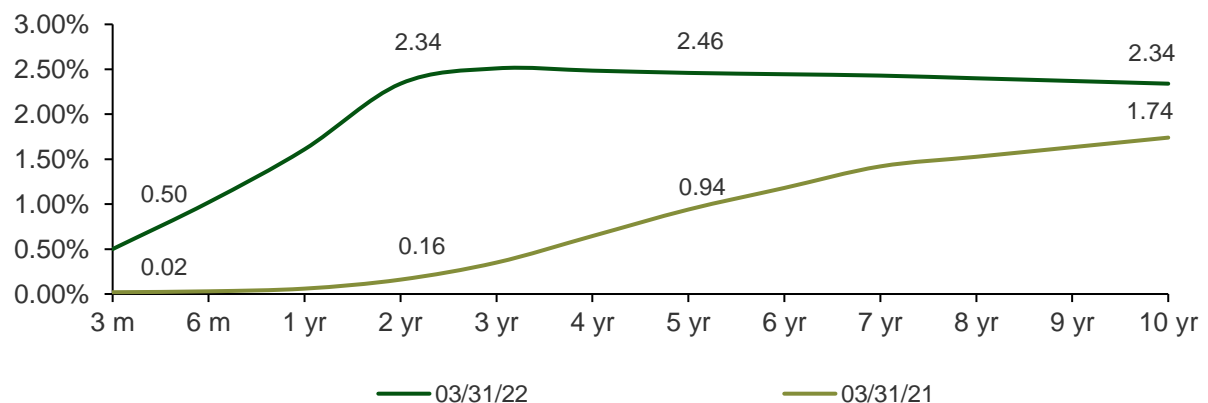
Credit spreads widened: Aggregate US corporate spreads ending the quarter 24bp higher. The intermediate and long area of the credit curves widened by 24bp and 25bp respectively. The generally lower duration of high yield issues meant that the asset class outperformed on a total return basis.

Russia has been removed from a range of equity and fixed income indices: Russian securities were removed from all JP Morgan fixed income indices from March 31, 2022 and MSCI classified Russia as “uninvestable”, reclassifying it from emerging market status to stand-alone market status.

The S&P 500 Index declined: US equity markets moved lower over the quarter, declining by 4.6% following a strong gain in 2021.

Policy tightening is a global phenomenon: The Bank of England and the Bank of Canada raised rates while the ECB guided to rate hikes before year-end. This pushed global yields higher—the 10-year German bund rose 73bp to 0.55%. European credit markets underperformed with investment grade spreads widening 34bp to 129bp given greater downside risks from the Russia-Ukraine war amid sharply higher natural gas prices.

Treasury Yield Curve: 03/31/22 and 03/31/21 (Source: Bloomberg)

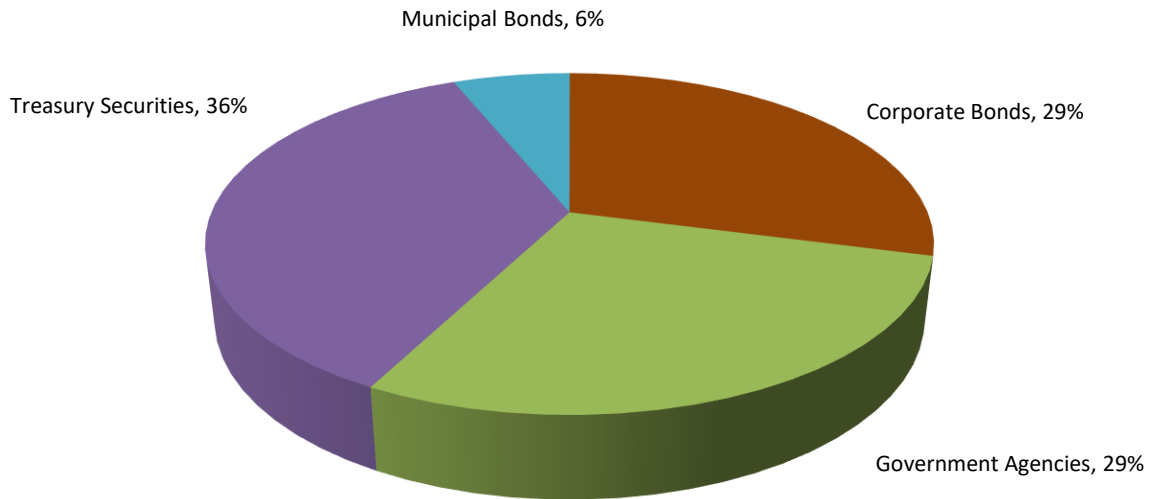


Section 3 – The City’s Portfolio

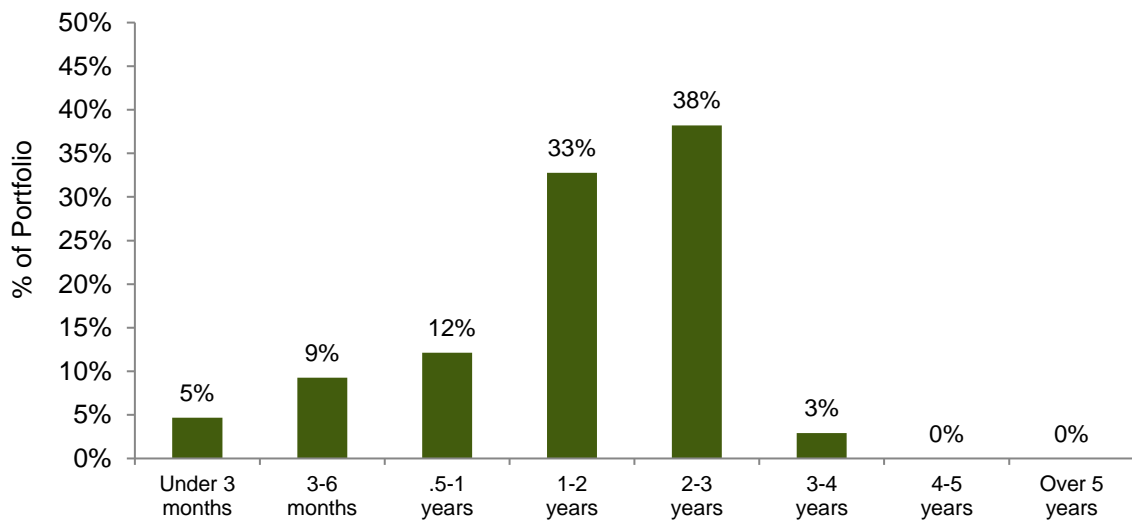
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
 - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury 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 March 31, 2022, the WAM of the operating portfolio is 1.68 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, 1.6% of the term securities held as of March 31 will mature within 30 days.
 - As of March 31, the weighted average purchase yield for the operating portfolio holdings is 1.07%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which is .98% as of March 31. The purchase yield on the operating portfolio as of December 31 exceeds the benchmark yield by .09%.
 - For the first quarter 2022, the fair value periodic return on the operating portfolio is negative 2.03%. The 1-3 Treasury Index return for the period is negative 2.34%. The periodic return on the operating portfolio for the first quarter is .31% 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 first quarter 2022, the City’s investment advisor invested approximately \$45 million in securities for the operating portfolio. US Treasury notes, a US Agency bond and a corporate security were purchased at a weighted average purchase yield of 1.69%. The weighted average maturity at the time of purchase for these investments is 1.8 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 March 31, 2022

Asset Allocation - Historical Cost



Final Maturity Distribution - Historical Cost



Summary of Operating Portfolio Characteristics

	March 31, 2022	December 31, 2021
Average Final Maturity (years)	1.68	1.82
Modified Duration (years)	1.62	1.73
Average Purchase Yield	1.07%	1.00%
Average Market Yield	1.84%	0.68%
Average Credit Quality (S&P/Moody's)	AA+/Aa1	AA+/Aa1
Total Market Value (\$)	407,764,270	396,115,637

Portfolio Holdings as of March 31, 2022

Issuer	Historical Cost	% of Portfolio
US Treasury	151,925,631	36.13%
Federal Home Loan Bank	45,579,059	10.84%
Federal National Mortgage Association	31,838,294	7.57%
Federal Farm Credit Bank	22,066,593	5.25%
Federal Home Loan Mortgage Corp	20,890,868	4.97%
John Deere Capital Corp	14,297,919	3.40%
Microsoft Corp	13,237,312	3.15%
Caterpillar Financial Services Corp	13,090,171	3.11%
Toyota Motor Credit Corp	12,729,235	3.03%
State Street Corp	12,316,811	2.93%
American Honda Finance Corp	10,545,614	2.51%
Apple Inc	9,919,607	2.36%
3M Co	9,366,900	2.23%
City of New York, New York	8,478,013	2.02%
Metro Oregon	7,550,720	1.80%
Wal-Mart Inc	7,029,820	1.67%
Cisco Systems Inc	5,075,200	1.21%
State of Florida	5,001,000	1.19%
State of Maryland	5,000,000	1.19%
International Business Machines Corp	4,871,700	1.16%
Johnson & Johnson	4,401,352	1.05%
Intel Corp	2,624,093	0.62%
PepsiCo Inc	2,594,756	0.62%
Cash	82,716	0.02%
Total Historical Cost	420,513,383	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 7.1 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: 5.2
- MSCI Governance Pillar Score: 4.5

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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