

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 June 30, 2022

DATE: July 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 Fed stepped on the brakes in June:** The first 75 basis point rate hike since 1994 combined with ongoing elevated inflation caused forecasts for growth to move sharply lower, compounded by a surprise contraction in Q1 GDP.

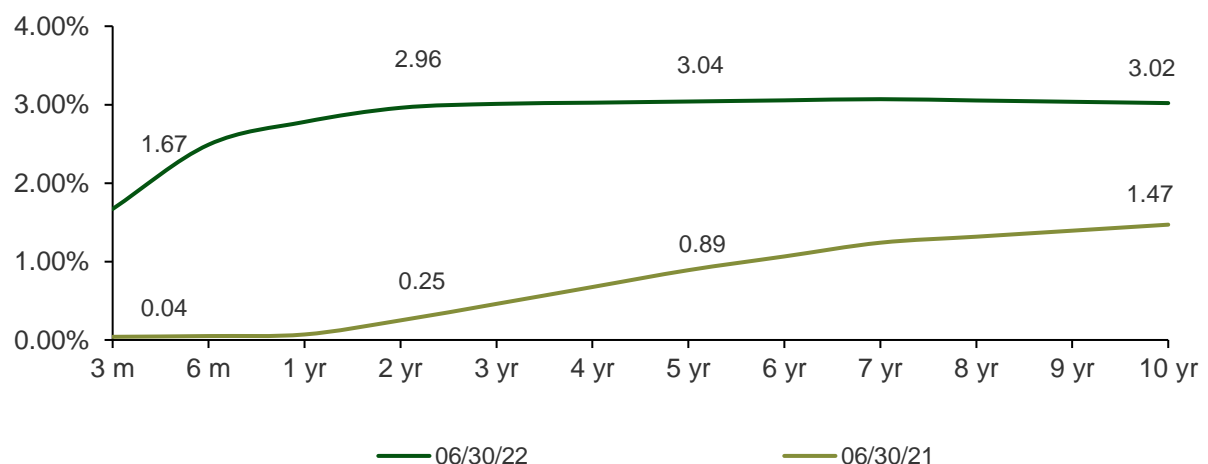
**The Treasury curve moved upwards and steepened:** A hawkish Fed, rising global yields, and concerns about inflation put upward pressure on yields over the quarter. The 2-year maturity Treasury yield increased by 62bp to 2.96%, the 10-year maturity Treasury yield increased by 68bp to 3.02% and the 30-year maturity Treasury yield increased by 73bp to 3.19%.

**Credit spreads widened:** Aggregate US corporate spreads ended the quarter 39bp higher. The intermediate and long area of the credit curves widened by 47bp and 31bp respectively. Lower rated credits underperformed, with the spreads of long maturity BBB rated issues widening by 41bp. High yield credit also experienced notable losses, although this was mitigated to a degree by the asset class's shorter duration. Although spreads have widened there is growing evidence that corporations are successfully passing rising costs onwards to consumers and, with funding locked in at advantageous levels, this may be an opportunity for some corporations to inflate away their debts.

**The Fed may cause a recession, but it would likely be shallow:** The Fed would rather cause a recession than have inflation remain above 5% for a prolonged period of time; however, as inflation does come down, the Fed will become more responsive to growth risks and the employment side of its dual mandate. Given the rapid pace of tightening, there is substantial risk of recession. However, consumer balance sheets are very strong, and the corporate sector is retaining free cash flow, which should limit the severity of a potential downturn.

**The S&P 500 Index declined:** US equity markets moved lower over the quarter, with the S&P 500 Index declining by 16.1%, taking its loss over the first half to -20%, entering a bear market in one of the worst starts to the year since the 1970s.

**Treasury Yield Curve: 06/30/22 and 06/30/21 (Source: Bloomberg)**

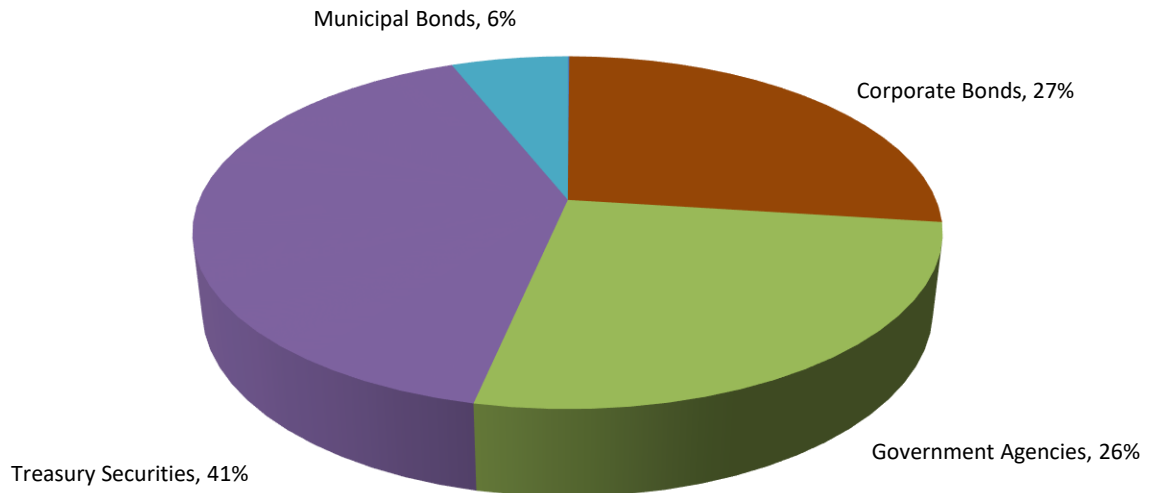


### **Section 3 – The City’s Portfolio**

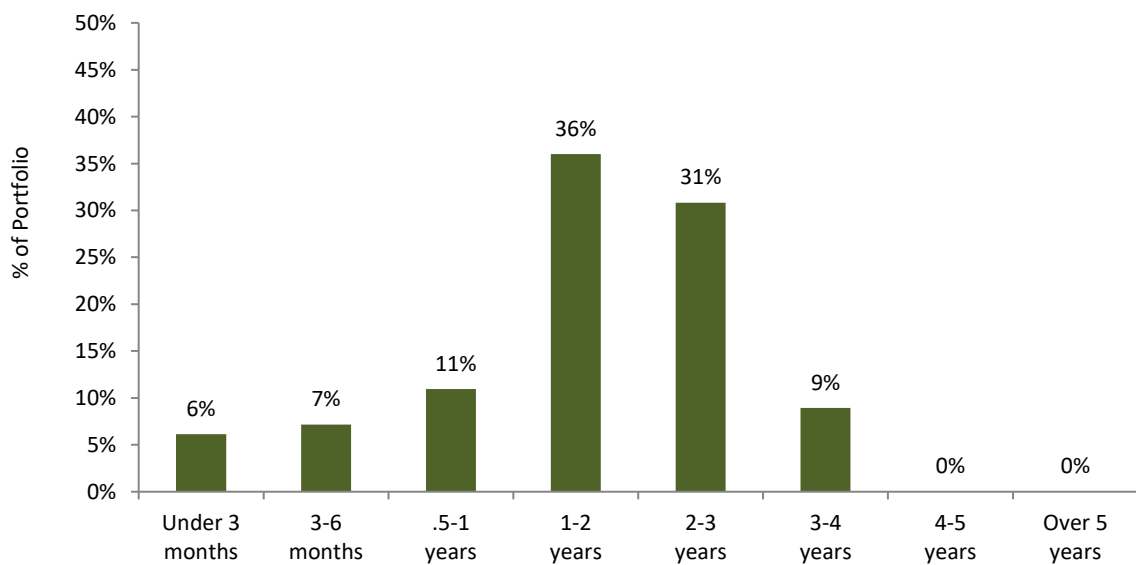
- Portfolio strategies implemented this quarter and the investments held in the portfolio comply with the City’s investment objectives and the Ordinance that specifies allowable investments.
  - The objective of safety is achieved through a well-diversified portfolio invested primarily in US Treasury 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 June 30, 2022, the WAM of the operating portfolio is 1.71 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, 1.7% of the term portfolio holdings as of June 30 will mature within 30 days.
  - As of June 30, the weighted average purchase yield for the operating portfolio holdings is 1.24%. The yield benchmark is the six-month trailing average of the yield on the 2-year Treasury note, which is 2.09% as of June 30. The purchase yield on the operating portfolio as of June 30 trails the benchmark yield by .85%.
  - For the second quarter 2022, the fair value periodic return on the operating portfolio is negative .46%. The 1-3 Treasury Index return for the period is negative .50%. The periodic return on the operating portfolio for the second quarter is .04% 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 second quarter 2022, the City’s investment advisor invested approximately \$44 million in long-term securities for the operating portfolio. US Treasury notes were purchased at a weighted average purchase yield of 2.86%. The weighted average maturity at the time of purchase for these investments is 3.3 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 June 30, 2022

## Asset Allocation - Historical Cost



## Final Maturity Distribution - Historical Cost



## Summary of Operating Portfolio Characteristics

	June 30, 2022	March 31, 2022
Average Final Maturity (years)	1.71	1.68
Modified Duration (years)	1.64	1.62
Average Purchase Yield	1.24%	1.07%
Average Market Yield	2.57%	1.84%
Average Credit Quality (S&P/Moody's)	AA+/Aa1	AA+/Aa1
Total Market Value (\$)	415,983,355	407,764,270

## Portfolio Holdings as of June 30, 2022

Issuer	Historical Cost	% of Portfolio
US Treasury	175,698,335	40.63%
Federal Home Loan Bank	45,579,059	10.54%
Federal National Mortgage Association	25,336,604	5.86%
Federal Farm Credit Bank	22,066,593	5.10%
Federal Home Loan Mortgage Corp	20,890,868	4.83%
John Deere Capital Corp	14,297,919	3.31%
Microsoft Corp	13,237,312	3.06%
Caterpillar Financial Services Corp	13,090,171	3.03%
Toyota Motor Credit Corp	12,729,235	2.94%
State Street Corp	12,316,811	2.85%
Apple Inc	9,919,607	2.29%
3M Co	9,366,900	2.17%
City of New York, New York	8,478,013	1.96%
Metro Oregon	7,550,720	1.75%
Wal-Mart Inc	7,029,820	1.63%
Cisco Systems Inc	5,075,200	1.17%
State of Florida	5,001,000	1.16%
State of Maryland	5,000,000	1.16%
American Honda Finance Corp	4,998,500	1.16%
International Business Machines Corp	4,871,700	1.13%
Johnson & Johnson	4,401,352	1.02%
Intel Corp	2,624,093	0.61%
PepsiCo Inc	2,594,756	0.60%
Cash	318,533	0.07%
<b>Total Historical Cost</b>	<b>432,473,100</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 7.1 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: 5.6
- MSCI Governance Pillar Score: 5.3

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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