



DATE: October 20, 2014

AGENDA ITEM #2

TO: Financial Commission
FROM: Kim Juran-Karageorgiou, Administrative Services Director
SUBJECT: Investment Portfolio Update and Investment Strategy

RECOMMENDATION:

- A) Receive the investment performance as of September 30, 2014
- B) Review City's investment strategy

BACKGROUND

The Financial Commission periodically reviews quarterly updates of the City's investment portfolio performance as a precursor to its delivery to City Council.

DISCUSSION

The attached internal report as of September 30, 2014 brings the Commission up to date on the latest quarter of reporting. This report is also augmented by the attached portfolio presentation provided by the City's investment consultant, Carlos Oblites of PFM as a basis for discussion and questions. Mr. Oblites will be present to discuss the City's investment strategy further with the Commission.

Attachments:

- A) City Wide Holdings and Investment Ladder September 30, 2014
- B) Investment Performance Review September 30, 2014 - PFM

Attachment A

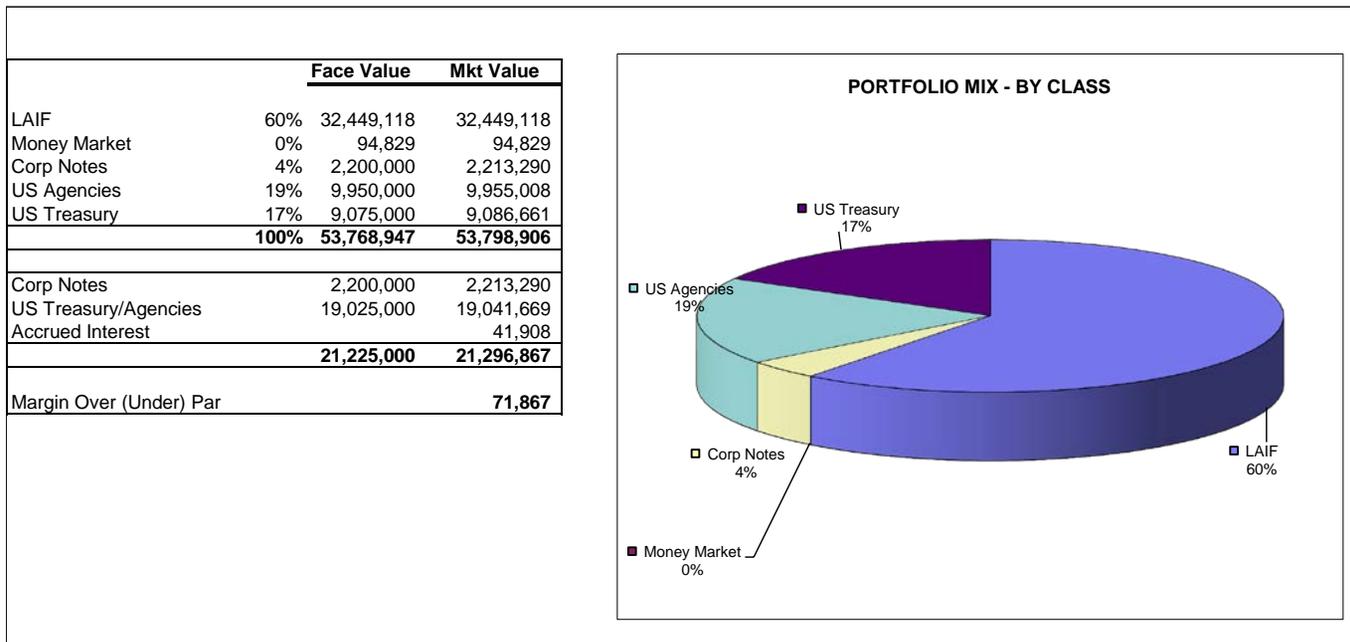
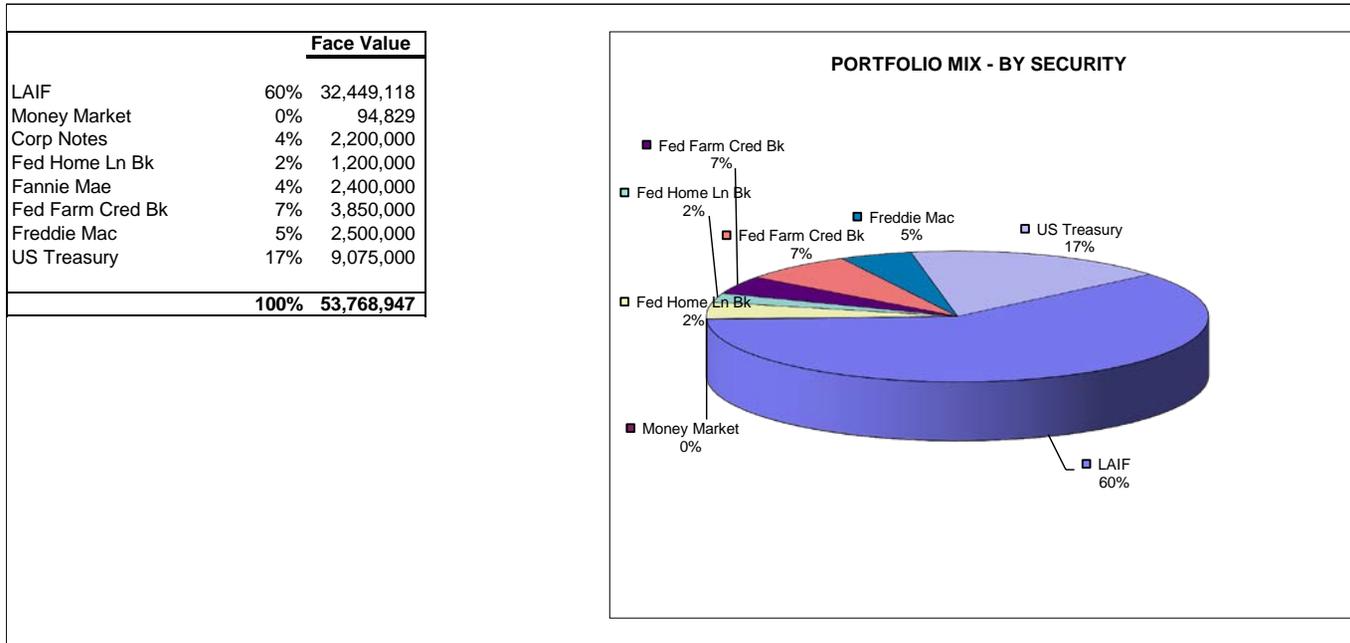
City Wide Holdings and Investment Ladder
September 30, 2014

Attachments A
Citywide Holdings and Investment Ladder
September 30, 2014

30-Sep-14 Month	2014				2015				2016				2017			
	YTM	Sec	Call Date	Amount	YTM	Sec	Call Date	Amount	YTM	Sec	Call Date	Amount	YTM	Sec	Call Date	Amount
LAIF	0.25%			32,449,118												
MMKT				94,829												
Jan									1/15/2016	0.360%	USTreas	300,000				
Feb									3/30/2016	0.520%	FNMA	750,000				
Mar					7/2/2015	0.61%	FNMA	900,000					4/30/17	0.860%	USTreas	650,000
Apr									4/11/2016	0.520%	Wmart	800,000				
May									5/13/2016	0.410%	FHLMC	500,000				
Jun									5/13/2016	0.720%	FHLMC	2,000,000				
									6/15/2016	0.500%	USTreas	1,150,000	6/30/17	0.870%	USTreas	1,050,000
									6/24/2016	0.770%	FHLB	1,200,000				
Jul					7/15/2015	0.38%	USTreas	750,000								
					7/15/2015	0.40%	USTreas	1,000,000	7/15/2016	0.590%	USTreas	350,000				
Aug									8/31/2016	0.600%	USTreas	525,000				
Sep									9/29/2016	0.700%	3M	750,000				
Oct	10/15/2014	0.49%	USTreas	1,700,000	10/9/2015	0.78%	CP GE	650,000								
Nov	11/10/2014	0.67%	FFCB	1,000,000	11/16/2015	0.45%	FFCB	1,600,000								
Dec	12/31/2014	0.53%	USTreas	1,600,000	12/21/2015	0.40%	FNMA	750,000								
					12/28/2015	0.41%	FFCB	1,250,000								
Total				\$4,300,000				\$6,900,000				\$8,325,000				\$1,700,000
Count/Percent	3		0	20.26%	7		0	32.51%	10		0	39.22%	2		0	8.01%
Avg YTM/Days	0.56%			49	0.49%			363	0.57%			548	0.87%			974
Total Face Value				\$ 4,300,000				\$ 11,200,000				\$ 19,525,000				\$ 21,225,000

	No of Inv	Ladder Yield	Spread Over LAIF	%	Avg Maturity	# of Callables	Face Value
LAIF	1	0.246%	0.000%	60%	1	0	32,449,118
Money Mkt	0	0.010%	-0.236%	0%	1	0	94,829
2014	3	0.563%	0.317%	8%	49	0	4,300,000
2015	7	0.491%	0.245%	13%	363	0	6,900,000
2016	10	0.569%	0.323%	15%	548	0	8,325,000
2017	2	0.865%	0.619%	3%	974	0	1,700,000
	23	0.28%	0.38%	100%	167	0	\$53,768,947

Portfolio Mix Charts September 30, 2014



Investment Policy Compliance Chart

September 30, 2014

City Investment	% Mix	Par Value	Latest Term	City Policy \$ Limitation	City Policy % Limitation	CAPACITY	% Compliance Yes/No	Term Compliance Yes/No																		
LAIF	60%	32,449,118	09/30/19	50,000,000	100%	17,550,882	Yes	N/A																		
M FUND	0%	94,829	09/30/19		20%	10,658,961	Yes	N/A																		
MTNs	4%	2,200,000	09/30/19		15%	5,865,342	Yes	Yes																		
FHLB	2%	1,200,000	09/30/19		20%	9,553,789	Yes	Yes																		
FNMA	4%	2,400,000	09/30/19		20%	8,353,789	Yes	Yes																		
FFCB	7%	3,850,000	09/30/19		20%	6,903,789	Yes	Yes																		
FHLM	5%	2,500,000	09/30/19		20%	8,253,789	Yes	Yes																		
All Agencies		19%	09/30/19		100%	43,818,947	Yes	Yes																		
TREAS	17%	9,075,000	09/30/19		100%	44,693,947	Yes	Yes																		
	100%	53,768,947																								
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%;">All Agencies</td> <td style="width: 10%; text-align: center;">19%</td> <td style="width: 10%; text-align: right;">9,950,000</td> <td colspan="6"></td> </tr> <tr> <td>Callables</td> <td style="text-align: center;">0%</td> <td style="text-align: center;">-</td> <td colspan="6"></td> </tr> </table>									All Agencies	19%	9,950,000							Callables	0%	-						
All Agencies	19%	9,950,000																								
Callables	0%	-																								

Attachment B
Investment Performance Review Third Quarter 2014



City of Los Altos



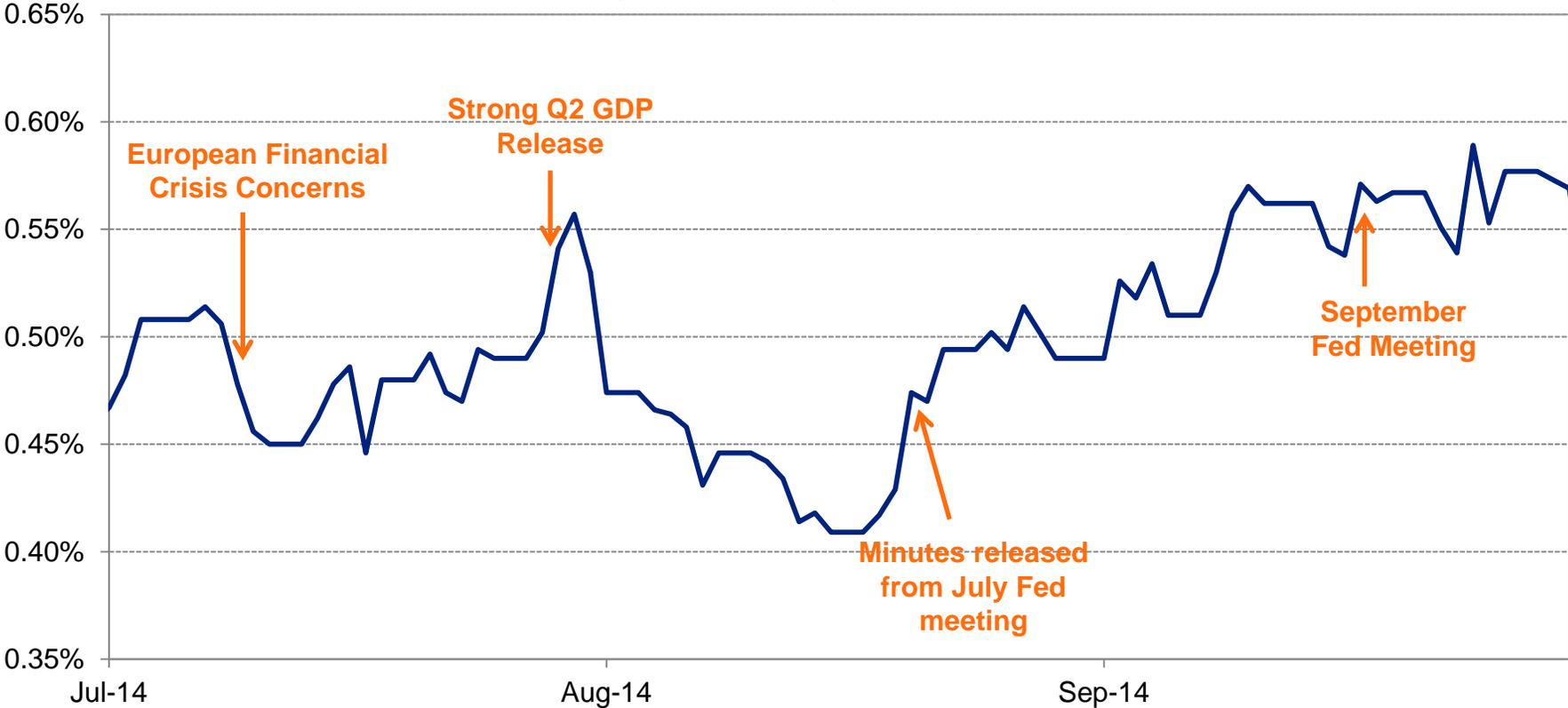
Third Quarter 2014 Review of Portfolio October 20, 2014

PFM Asset Management LLC
50 California Street, Suite 2300
San Francisco, CA 94111
415-982-5544

Rates Rose to Multi-Year Highs

- In the third quarter, interest rates rose and ended the quarter near their highest levels in 3 years.

2-Year U.S. Treasury Yield
July 1, 2014 – September 30, 2014

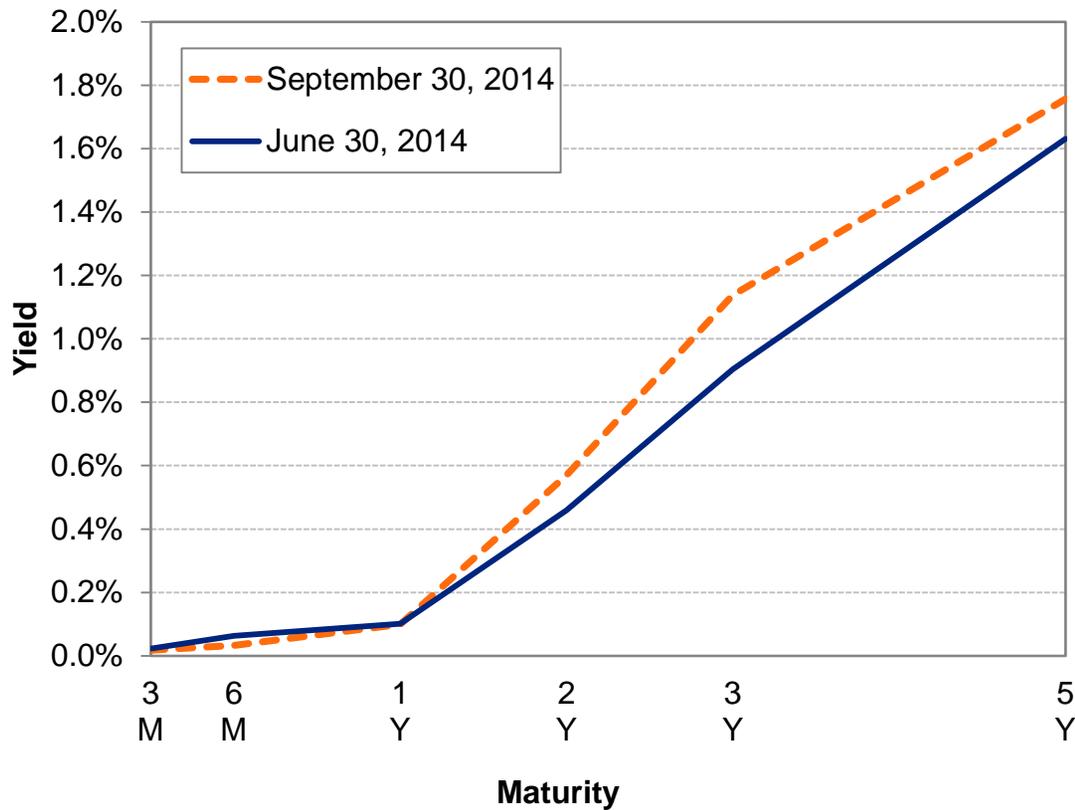


Source: Bloomberg

Yield Curve Steepened

- The yield curve steepened as short-term rates remained mostly unchanged and longer-term rates rose.

U.S. Treasury Yield Curve

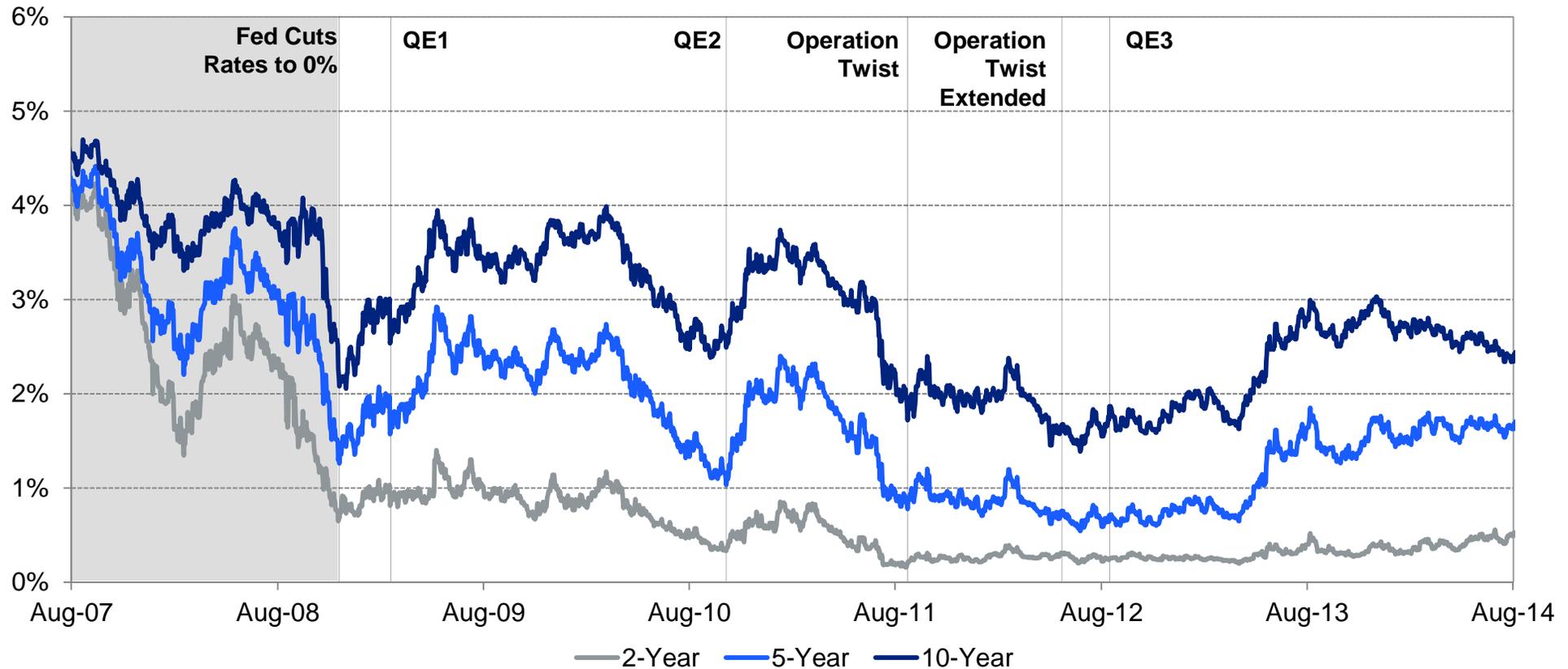


Source: Bloomberg

	6/30/14	9/30/14
3 Month	0.02%	0.02%
6 Month	0.06%	0.03%
1 Year	0.10%	0.10%
2 Year	0.46%	0.57%
3 Year	0.90%	1.14%
5 Year	1.63%	1.76%

A Longer View of Treasury Yields

- The rate normalization process that began in 2013 has tapered off even as the Fed's "Quantitative Easing" bond purchase program winds to a close.
- Short-term rates remain anchored by Fed policy, intermediate-term rates moved modestly higher in August, while long-term rates continued their year-to-date decline.



Source: Bloomberg. As of August 31, 2014

Portfolio Generated Strong Returns

- As rates rose in the third quarter, the market value of the portfolio declined, but the interest earnings were sufficient to cover this decline resulting in a positive total return.

Total Returns for Periods ending September 30, 2014

	Duration (years)	Yield to Maturity	Past Quarter	Past Year	Past 3 Years	Since Inception
City of Los Altos	1.22	0.57%	0.04%	0.54%	0.52%	0.73%
Merrill Lynch 1 Year U.S. Treasury Index	0.91	0.09%	0.10%	0.26%	0.28%	0.38%
Merrill Lynch 1-3 Year U.S. Treasury Index	1.84	0.55%	0.03%	0.50%	0.48%	0.76%

Notes:

- Performance on trade-date basis, gross (i.e., before fees) in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).
- Merrill Lynch Indices provided by Bloomberg Financial Markets.
- Inception date is third quarter 2010.
- Return calculation excludes LAIF

Third Quarter Total Return Detail

Calculating Return in Dollars

Ending Market Value + Accrued Interest		\$21,391,695
- Beginning Market Value + Accrued Interest	-	\$21,383,524
+ Distributions	+	\$0
- Contributions	-	\$0
= Total Return		\$8,171

Components of Dollar Return

Realized Gain/Loss:		\$0	Realized Return
Net Interest Income:	+	\$30,489	
Realized Dollar Return:		\$30,489	→ +0.143%
<hr/>			
Unrealized Gain/Loss:		- \$22,318	
Total Return		\$8,171	

Calculating Average Balance

Beginning Market Value + Accrued Interest		\$21,383,524
- Time-Weighted Distributions	-	\$0
+ Time-Weighted Contributions	+	\$0
= Time Weighted Average Balance		\$21,383,524

$$\text{Total Return} = \frac{\$8,171}{\$21,383,524} = +0.038\%$$

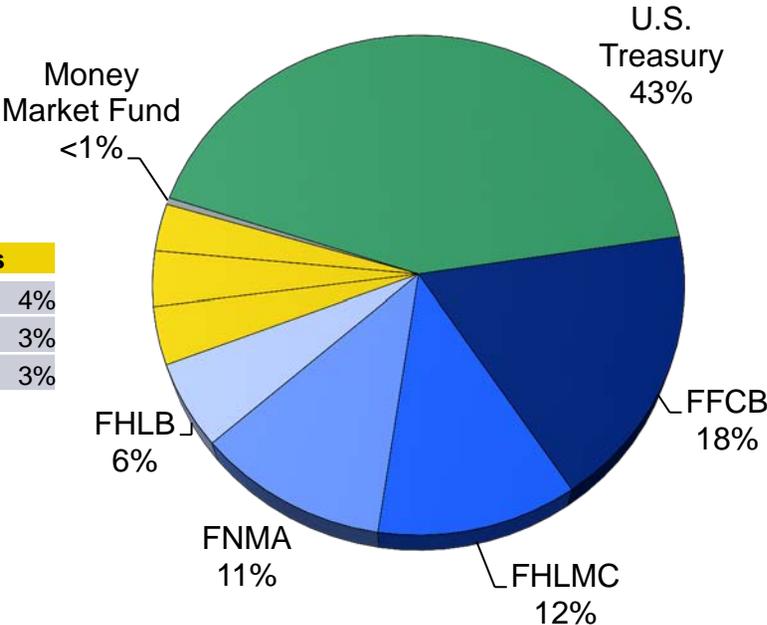
Portfolio Holdings in Compliance with California Code and City's Investment Policy

Security Type	Market Value as of September 30, 2014	Percent of Portfolio	Permitted by Policy	In Compliance
U.S. Treasury	\$9,109,346	43%	100%	✓
Federal Agencies	\$9,969,267	47%	100%	✓
Corporate Notes	\$2,218,253	10%	30%	✓
Money Market Fund	\$94,829	<1%	20%	✓
Total	\$21,391,695			

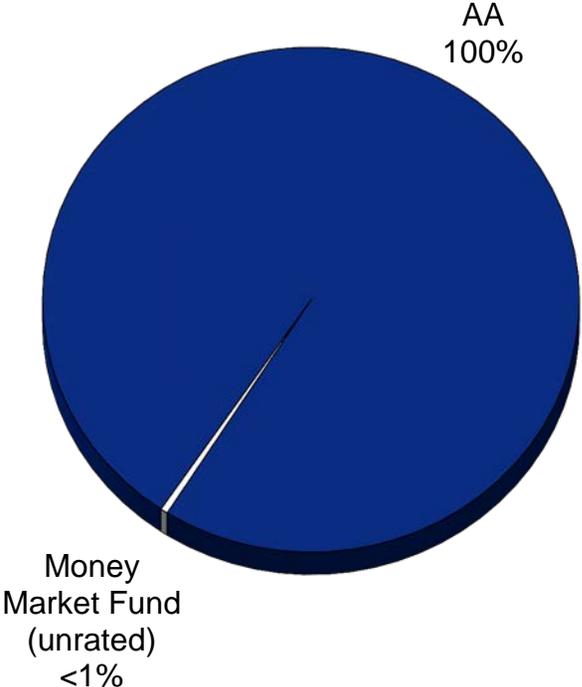
City's Holdings Maintain Highest Credit Quality

- The portfolio has excellent credit quality: 100% of the portfolio is invested in securities rated in S&P's second highest ratings category, AA.
- The City's portfolio continues to be well diversified by both sector and issuer.

Issuer Distribution



Credit Quality

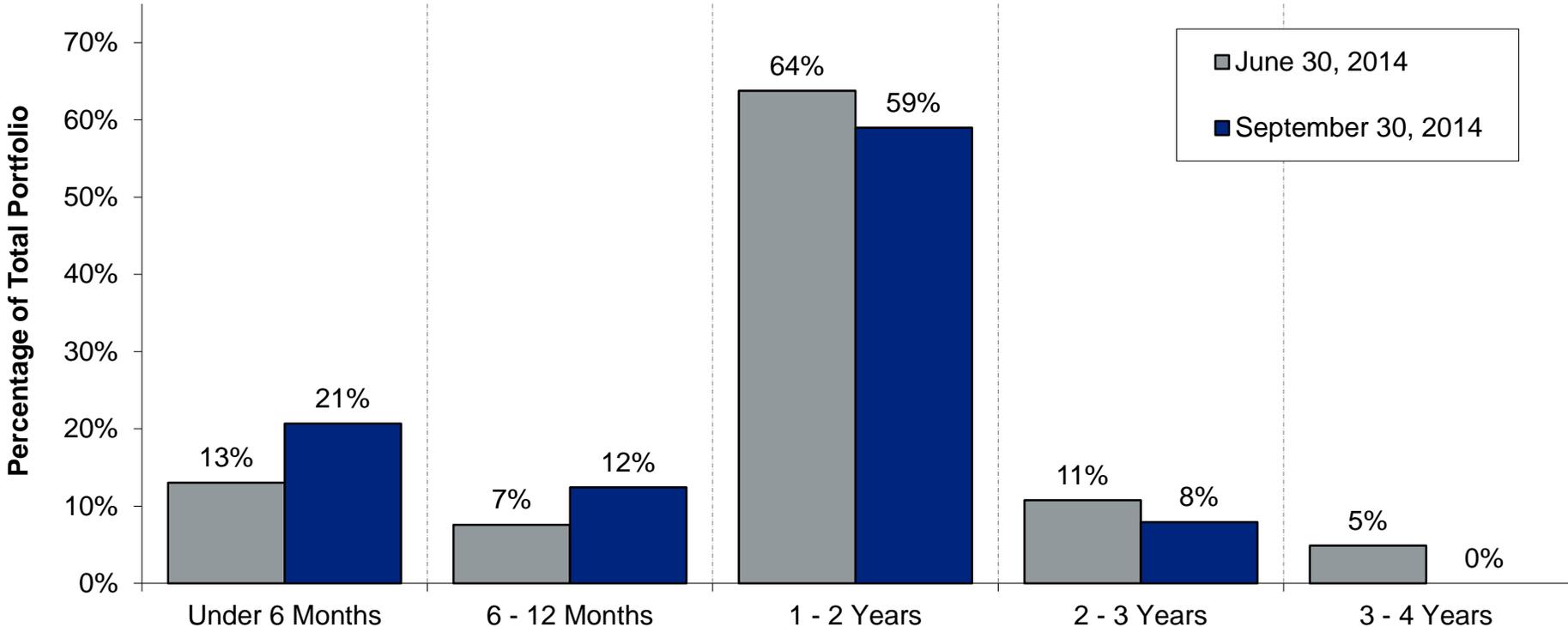


Notes:
 • As of September 30, 2014
 • Standard & Poor's Ratings

Portfolio Holdings Are Diversified by Maturity

- The portfolio has continued to drift shorter due to the City's investment restrictions.

Portfolio Maturity Distribution ¹



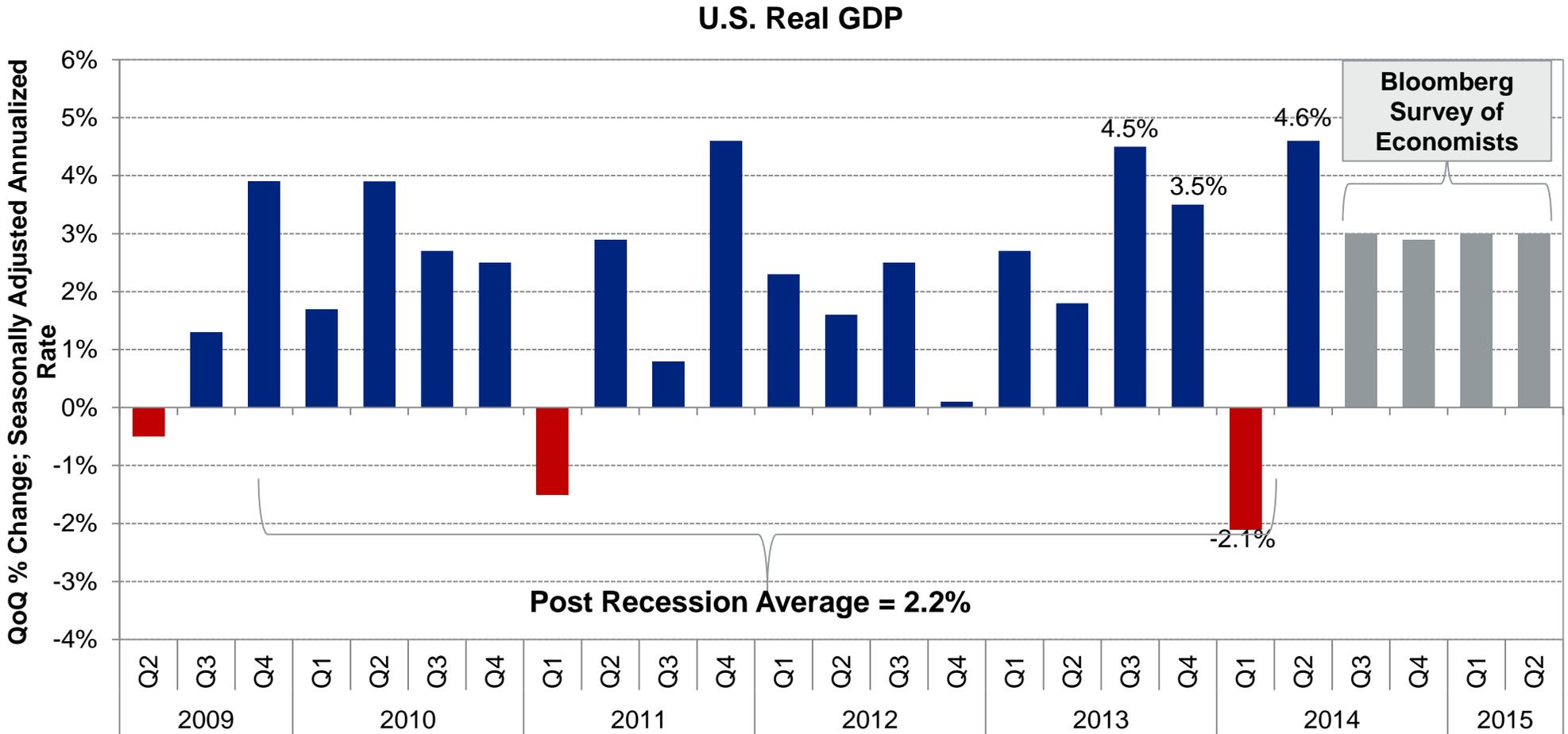
Note: Callable securities in portfolio are included in the maturity distribution analysis to their stated maturity date, although they may be called prior to maturity.

Fourth Quarter 2014 Investment Outlook and Strategy

- The Fed will conclude its large-scale asset purchase program in October, after which all eyes will turn to the FOMC's main policy tool – the Fed Funds Rate – and the potential timing and magnitude of expected rate hikes in 2015.
- As was experienced in previous periods of monetary policy adjustment, we believe a significant market move will precede a formal FOMC announcement. In such a higher risk period, we will continue to favor a defensive duration position for the portfolio.
- We expect yield spreads will remain narrow; however, we will maintain the flexibility to capitalize on any temporary market movements or specific opportunities.

U.S. Economy Surges in 2nd Quarter of 2014

- In the second quarter, U.S. GDP was revised upward to a 4.6% annualized rate supported by increased business spending on new equipment and buildings, and increased household spending.

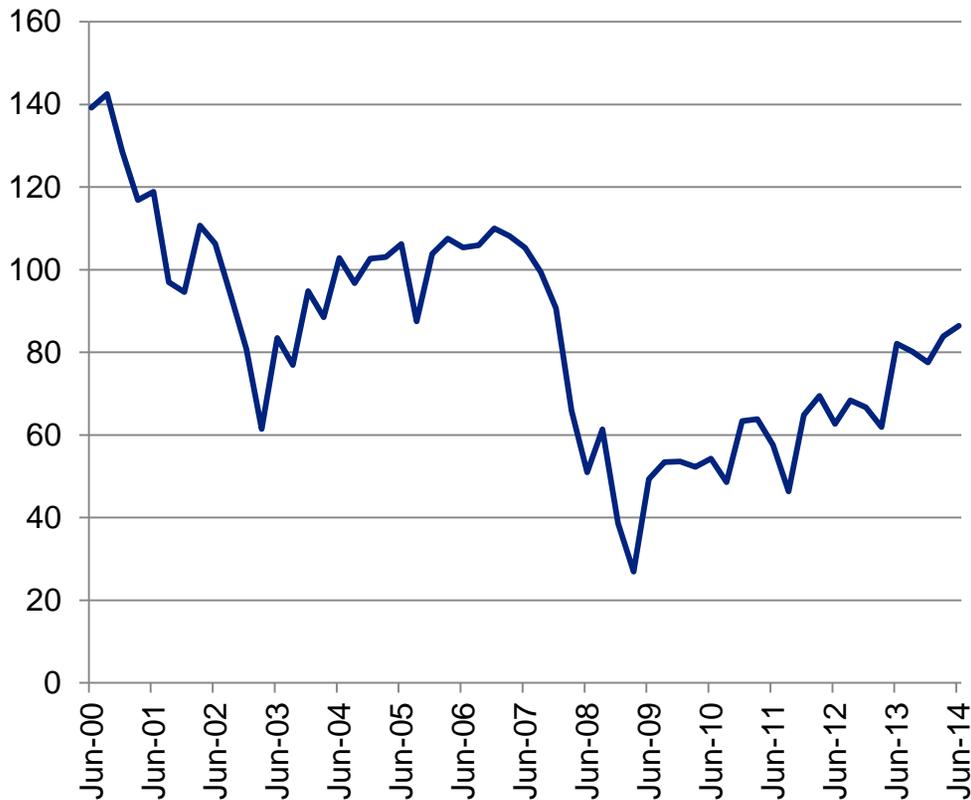


Source: Bureau Of Economic Analysis

Consumers Continue to Support Growth

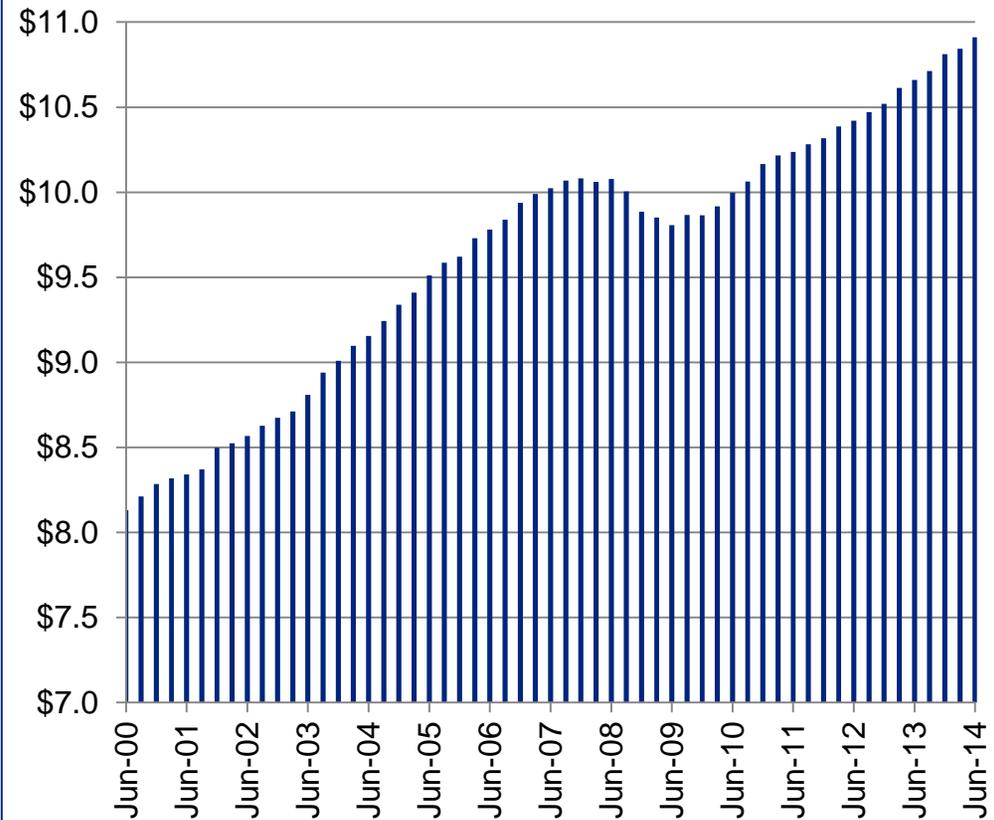
- Recent GDP readings have portrayed a significant contribution from the consumer sector. As Consumer Confidence has rebounded from its depths during the recession, so has spending.
- Consumer behavior offers a vital indication on the general direction of economic growth as Consumer Spending accounts for approximately 70% of overall GDP growth.

University of Michigan Consumer Confidence



Source: Bloomberg

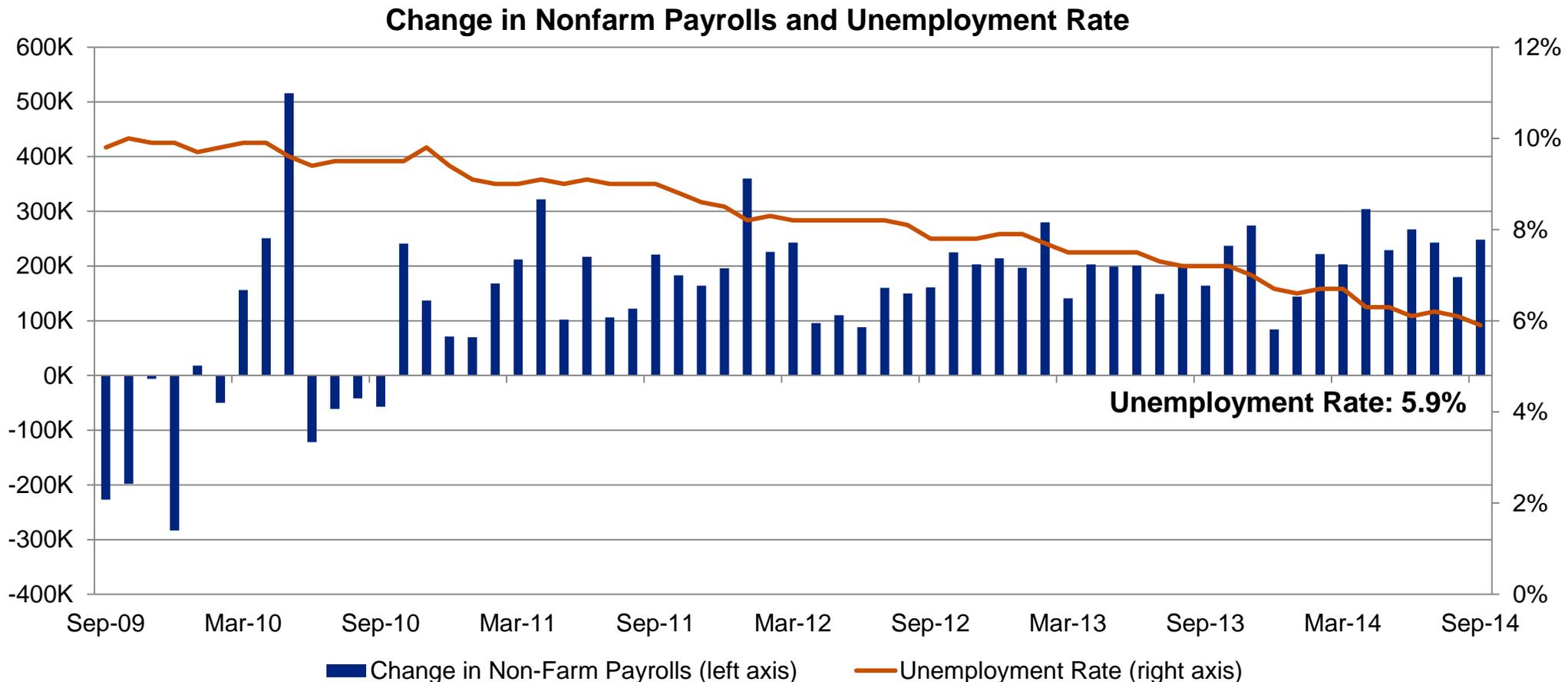
Consumer Spending: Contribution to GDP (trillions)



Source: Bloomberg

Labor Market Continues Improving

- U.S. job creation exceeded market expectations, adding 248,000 net new jobs in September. The disappointing initial estimate of 140,000 for August was also revised upwards to 180,000.
- The unemployment rate fell slightly to 5.9%, its first time below 6.0% since 2008.

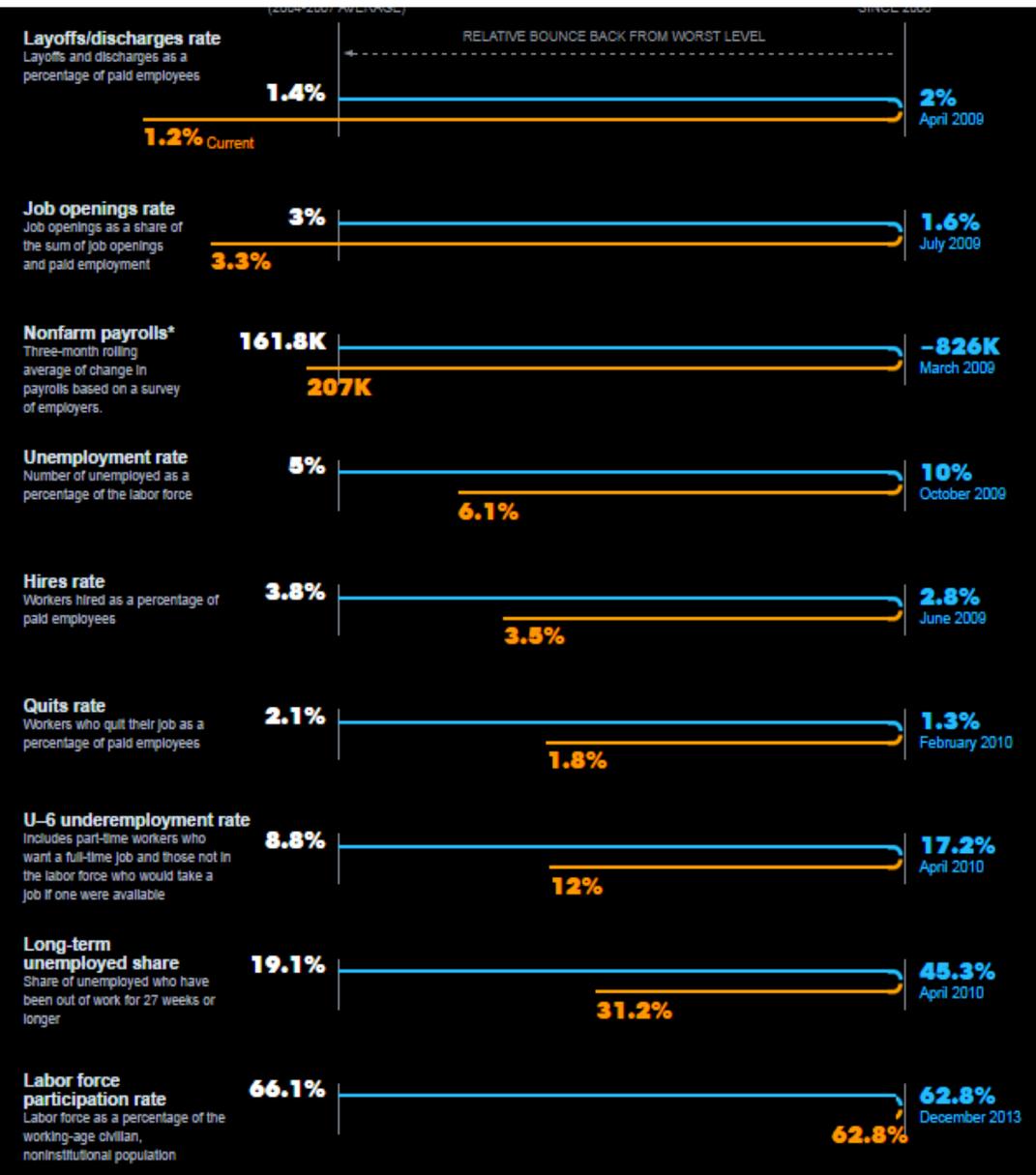


Source: Bureau of Labor Statistics

Fed Chair Yellen's Key Employment Data

Pre-Recession Level

Worst Level Since 2008

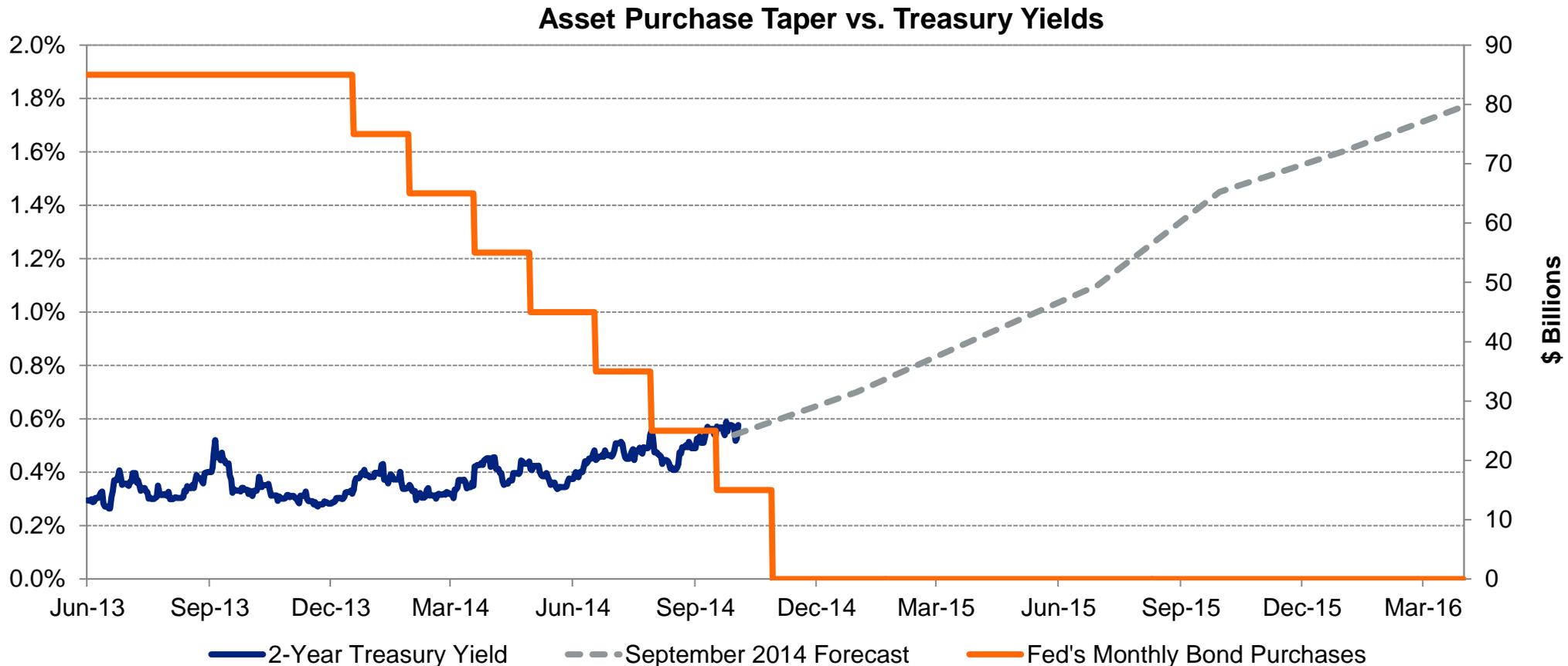


- Janet Yellen uses an “employment dashboard” to help guide monetary policy.
- Signs of strengthening labor market:
 - Increase in job openings.
 - Highest readings for the number of people hired/leaving their jobs since 2008.
- Improvement is still measured and uneven.

Source: Bureau of Labor Statistics, data compiled by Bloomberg and Bloomberg Visual Data.

Fed Tapers Bond Purchase Program

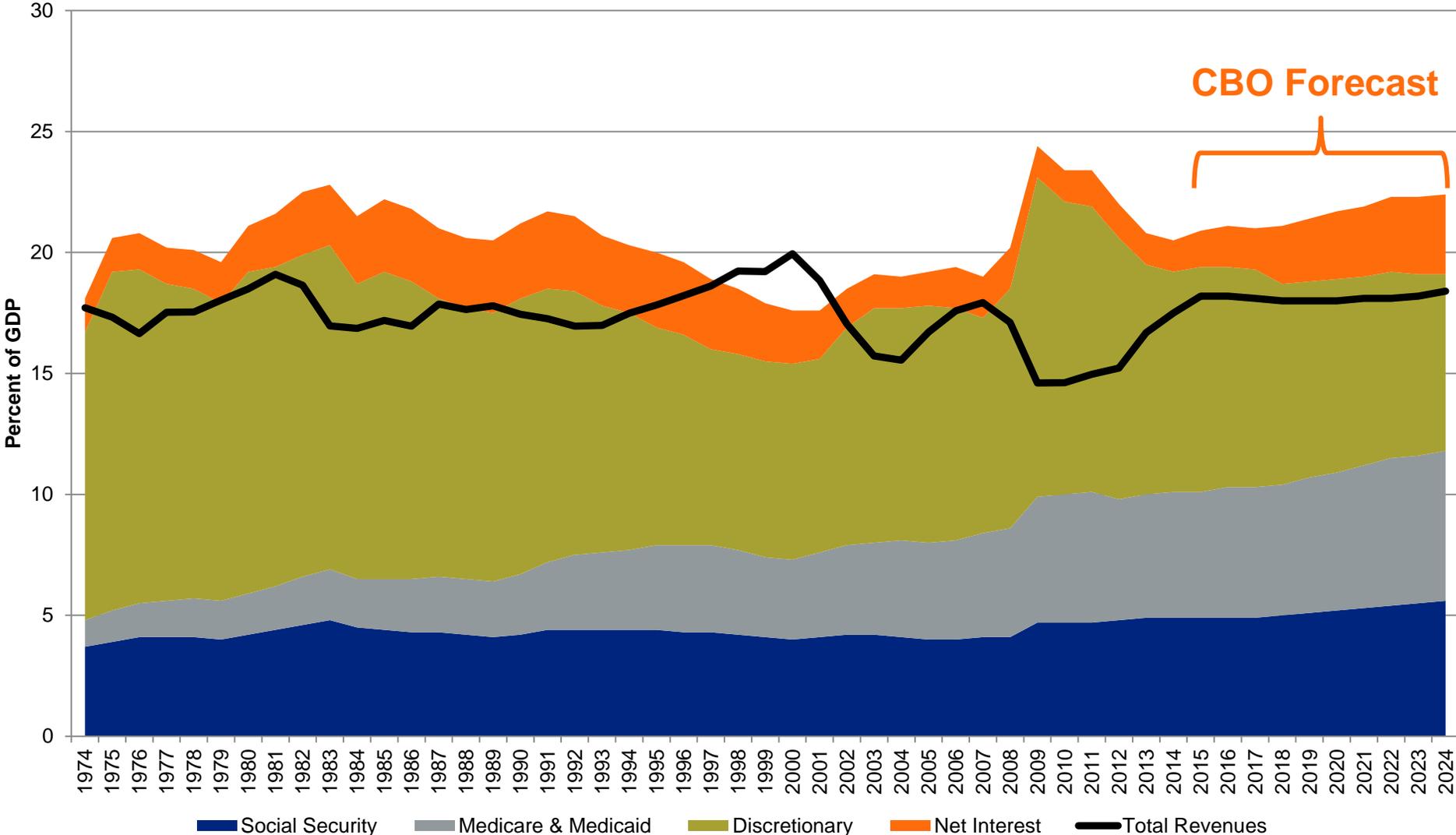
- The Federal Reserve began tapering its \$85 billion a month bond purchase program in December 2013, and has continued to taper at a \$10 billion pace at each subsequent FOMC meeting.
- The FOMC has said it will end the program in October; market participants have now turned their attention to a change in monetary policy as it relates to the Fed Fund's Rate.



Source: Bloomberg, Bloomberg Survey of Economists

US Federal Government Spending Outlook

US Budget: Historical vs. Future Estimates



Source: Congressional Budget Office. Updated through April 2014.

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