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DATE: August 13, 2019

TO: Board of Supervisors

FROM: Alan Minato, Director, Finance Agency

SUBJECT: Quarterly Investment Report for Period Ended June 30, 2019

RECOMMENDED ACTION

Receive the Quarterly Investment Report for the quarter ended June 30, 2019.

REASONS FOR RECOMMENDATION

The County's Investment Policy requires that a quarterly investment summary report be submitted to the Board of Supervisors.

Government Code 53607 allows the Board of Supervisors to authorize the Treasurer of the local agency to invest or reinvest funds. This authorization is renewed annually by the Board. The Treasurer is to provide a quarterly report to the Board of Supervisors of the transactions enacted under this provision. The attached report provides detailed information relating to security transactions conducted by the Treasury Division of the Controller-Treasurer Department during the quarter ended June 30, 2019.

A summary of the status of the investment program is also included with this report.

CHILD IMPACT

The recommended action will have no/neutral impact on children and youth.

SENIOR IMPACT

The recommended action will have no/neutral impact on seniors.

SUSTAINABILITY IMPLICATIONS

The recommended action will have no/neutral sustainability implications.

BACKGROUND

Current Economic Outlook

Escalating trade tensions, so far, have not seriously hindered the U.S. domestic economy. Consumer strength continues to support the economy bolstered by a strong labor market and steady wage growth. With current unemployment at 3.7 percent, the lowest since 1969, the

U.S. by most measures is at or very close to full employment. In June, U.S. retail sales and factory output exceeded expectations and underscored steady economic growth. Most of the slowing in world growth is coming from outside of the U.S., those economies not resilient enough to withstand headwinds from tariff disputes between the U.S. and China.

Insulated from global trade frictions, domestic service sectors including health care, finance and education remain solidly in expansion mode. U.S. manufacturing and factory output, while still expanding, has decelerated in the past year. New and proposed tariffs have forced domestic producers to contemplate alternative supply chains through other low wage countries, impacting production. But more importantly, the uncertainty over resolution of current trade spats have delayed big spending decisions including capital expenditures and eroded business sentiment. Of note, other issues have also weighed on American manufacturers including the strength of the dollar which has made domestic goods less competitive abroad.

In June 2019, President Donald Trump decided, pending upcoming negotiations, to temporarily hold off imposing higher tariffs on $300 billion of imported goods from China, the world's second largest economy. Since the onset of this trade dispute, the U.S. had previously increased tariffs by 25 percent on approximately half of all Chinese exports to the U.S.

Evidence of slower growth has been found in widespread weakness in manufacturing and factory output contraction from Europe to Asia. Tariffs have been a heavy burden on China's export sector. In the April-June period, China's economy slowed to the weakest pace since quarterly data began in 1992. Germany with close to 50 percent of its gross domestic product (GDP) coming from exports (mostly autos), is on the verge of a recession, a circumstance exacerbated by U.S. tariffs and faltering global trade. Waning demand for electronics is affecting an industry vital to numerous Asian economies who are export dependent. South Korean exports now have fallen 13.5 percent over the past year.

Federal Reserve Bank (Fed) policy makers have clearly expressed they are prepared to reduce the bank's benchmark interest rate to mitigate risks stemming from slower global growth, uncertainty related to the President's trade policies and a potential stall in business investment impacting GDP. It is not clear how more global weakness and negative business sentiment would ultimately mean for growth domestically. Investors fully expect policy makers to cut rates by at least one quarter of one percent during the July 30th through 31st Federal Open market Committee meetings. In response, equity markets, generally a beneficiary of lower rates, strongly rebounded, further underscoring the strength of financial conditions. This is a sharp reversal by the Fed whose policy stance since the end of 2015 had been a bias towards hiking rates. Policy makers lifted borrowing costs four times in 2018, albeit in a backdrop of tepid inflation. The Fed would be lowering interest rates for the first time since 2008.

By reducing interest rates, the Fed would also be bringing U.S. bond yields into closer alignment with bond yields in other sovereign debt markets. They are substantially lower than in the U.S., and even in some cases, below zero. The United Kingdom 10-year note is around multi-year lows at 81 basis points while the German benchmark yield has pushed significantly below zero and currently yields – 36 basis points. In contrast, as of June 30, 2019, the U.S. Treasury ten-year and two-year note yielded 2 percent and 1.756 percent, respectively. Bloomberg L.P, a provider of financial markets news and data estimates that the current global stockpile of negative yielding debt is approximately $13 trillion.

The portfolio strategy continues to focus on the:

(1) acquisition of high-quality issuers;

(2) identifying and selecting bonds with attractive valuations;

(3) appropriately sizing the liquidity portion of the portfolio to ensure adequate cash for near term obligations; and

(4) ensuring that monies targeted for longer term investments are deployed in vehicles with favorable risk-adjusted yields.

Broker-dealers have generally down-sized the amount of securities carried in inventories in response to risk-curbing rules crafted after the 2008 financial crisis. These risk curbing rules include the international regulatory framework for banks called Basel III and the U.S. 2010 Dodd-Frank Law. The Treasury Division has increased its capability to review a larger volume of inventory listings to find attractive bonds. Portfolio structuring does not solely rely on interest rate anticipation strategies, which primarily speculate on the direction of interest rates to earn favorable returns.

CONSEQUENCES OF NEGATIVE ACTION

Failure to receive this report will result in the organization being out of compliance with Board of Supervisors' policy.

STEPS FOLLOWING APPROVAL

The Clerk of the Board of Supervisors will electronically notify Fixed Income Portfolio Manager Jacqueline A. Flippin.

ATTACHMENTS:

- June 2019 Quarterly Investment Report (PDF)