Investment Review Committee

IRC Administrative Coordinator: Mark Thompson (651)-602-1629

Agenda

1. Call to Order
2. Approval of Agenda
3. Approval of Minutes from last meeting — November 10, 2020 (3Q20)
4. Update - Certificate of Deposit (CD) Program
5. 4th Quarter 2020 Investment Presentation

Committee members:

Phillip Sterner, *Committee Chair & Council member*
Chris Ferguson, *Committee Vice Chair & Council member*
Marie Henderson, *Acting CFO*
Cory Kampf, *Appointee*
Michael Solomon, *Appointee*

Reference staff: *(not member of the IRC)*

Mark Thompson, *Senior Manager, Treasury*
Lori Connery, *Recording Secretary*

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Minutes

November 10, 2020 (3Q20) at 1:03 P.M., in WebEx Virtual

Present

Committee members: Phillip Sterner, Committee Chair & Council Member; Christopher Ferguson, Council Member; Marie Henderson, Acting CFO; Cory Kampf, CFO, Finance and Central Services Division Manager – Anoka County; Michael Solomon, City Treasurer, City of Saint Paul

Reference staff: Mark Thompson, Senior Manager, Treasury; Lori Connery, Recording Secretary

Other attendees; Jacob LaVigne, Financial Analyst; Lynn Greiner, Financial Analyst

Absent:

Call to Order

A quorum being present, Committee Vice Chair Christopher Ferguson called the quarterly meeting (3Q20) of the Investment Review Committee to order at 1:03 p.m. on Tuesday, November 10, 2020.

Motion carried on the following roll call vote:

Aye:	5	Ferguson, Henderson, Kampf, Solomon, Sterner
Nay:	0	
Absent:	0	

Approval of Agenda and Minutes

There were no changes to the agenda.

It was moved by Ferguson and seconded by Kampf to approve the Tuesday, August 18, 2020 minutes (2Q20) as submitted.

Motion carried on the following roll call vote:

Aye:	4	Ferguson, Henderson, Kampf, Solomon
Nay:	0	
Abstain:	1	Sterner
Absent:	0	

Topics Discussed

- **Introduction of Mark Thompson, the new Senior Manager Treasury**
- **<u>Certificate of Deposit (CD) Pilot Update:</u> (M. Thompson)**
  - Mark presented the update.
  - Discussion on how the program is doing in the current environment, what we have done to solicit, next steps and CD rates.
- **<u>Financial Institutions List</u>: (M. Thompson)**
  - Mark reviewed the Financial Institutions list; there were no comments or discussion.
- **<u>3Q20 Investment Results Presentation</u>: (M. Thompson)**
  - Mark went through report presentation.
  - Discussion on how Coronavirus outbreak is impacting the hedging program.

For further questions, please contact Mark Thompson directly at: 651-602-1629.

Business completed; the meeting adjourned at 1:42 p.m.

Respectfully submitted,
Lori Connery
Recording Secretary

Report on Investments

Fourth Quarter, 2020

Economic Review

4Q20. There were plenty of economic events to digest in the fourth quarter - a presidential election, which was quickly overshadowed by Pfizer's vaccine announcement November 9th, followed by a spike in COVID cases and lockdowns in a number of states, followed by a Moderna vaccine announcement, followed by Congress trying to come together on a stimulus package, and don't forget possible changes to fiscal and monetary policy, etc.. But most important was progress with COVID. The ebbs and flows of the pandemic continue to drive economic expectations.

Even with the promise of vaccines in the news, another spike in COVID cases and hospitalizations in November and December made consumers more cautious, resulting in a drop in retail sales and more layoffs. Retail sales and incomes fell in November and spending contracted for the first time since April. In December, jobless claims increased to a three-month high. Despite this the markets kept focused on hopes for a recovery.

Interest Rates

In 2020, short-term interest rates dropped from above 1.5% to 0%. Yields on the 10-year Treasury Note went from 1.92% to a low of .50%. The Federal Reserve (Fed) continues to keep short-term interest rates at zero to stimulate and provide liquidity to the COVID economy. Expectations are the Fed will keep rates near zero into 2022 or longer. Yields on bonds two years and shorter did not change to any degree in the fourth quarter but there was a steepening of the U.S. Treasury yield curve 3 years and longer. The primary reason for the bounce in longer-term rates was the expectation of improvement in economic performance with a reopening in 2021.

GDP

Fourth quarter GDP rose 4.0%. The increase reflected both continued economic recovery from the sharp declines earlier in the year. GDP saw big swings during 2020, largely driven by changes in consumption, going from -30% in the second quarter, to up 32% in the third quarter, then settling down to 4.0% in the fourth quarter. Annual growth for 2020 is expected to be -3.5% from 2019. Long-term trend is +2% annually.

Employment

The labor markets had been improving steadily since April until they took a turn for the worse in the fourth quarter. December was the first monthly job loss since April. Half a million people lost their jobs in leisure and hospitality (restaurants and bars) due to new lockdowns. Although the unemployment rate has dropped from a high of 14% in April to 6.7%, nationally there was a net job loss of $9 million jobs in 2020.

Inflation

Inflation expectations did increase slightly during the 4th quarter due to the prospects of more fiscal stimulus, vaccines, and a strong reopening. The loss of income for millions of people should depress demand and spending and reduce inflationary pressures in 2021. Fourth quarter inflation was 1.4%, below the Fed's target of 2.0%.

Equity Markets

The equity markets kept pushing higher during the quarter. The markets seemed to focus on an extremely accommodating Fed, optimism over more stimulus, the arrival of vaccines and a strong recovery. The equity market's push higher was faster than the pace of actual economic growth, leading some experts to think equity prices had become over valued and predict a correction in 2021. Nonetheless stocks recorded a more than solid gain in the quarter. The S&P 500 finished up 11.7% for the 4th quarter and 16.3% for 2020.

Present. There were spikes in COVID cases during the fourth quarter which resulted in new lockdowns and jobs losses. There are still millions of people out of work and many small businesses continue to struggle. More stimulus seems to be coming to help those in need. Despite these issues, the market continues to be focused on vaccines and recovery prospects. The Fed is very accommodative, keeping short-term rates near zero. Long-term rates have bumped higher on economic expectations but are still very low. Corporate earnings have mostly beaten expectations and the housing market is very strong. The economy is recovering, and the equity market was still be in a bull market.

Future. The progress of the vaccine rollout and the strength of recovery will dictate the markets in 2021. With an accommodative Fed, low interest rates and low inflation the economy has a base for solid growth. The Fed is expected to keep short-term rates near zero for at least the next 12 months. The story to watch is how the vaccine and stimulus stories unfold in 2021.

Council Impact. The Council's short-term portfolio is directly impacted by Fed policy and low rates interest rates continue to reduce earnings. A strong economic recovery in 2021 could result in an uptick in inflation and more steepening of the yield curve. The Council's long-term portfolio will continue to take advantage of bumps in intermediate yields to increase portfolio earnings. Although, the long-term portfolio may experience price depreciation on holdings if interest rates increase. To minimize total return losses on paper, we intend to maintain duration slightly shorter than the benchmark. Strong equity market performance has benefitted the OPEB Trust.

Investment Results & Strategy

MCOA—Short-Term

4Q20 Results*:* The Short-term portfolio generally matched the performance of its benchmark during the fourth quarter. Total return was 0.011% versus the Crane Government Money Fund index total return of 0.005%. This demonstrates how very low short-term interest rates are. At the end of the fourth quarter, the portfolio was invested in government money market funds (43.7%), U.S. Government Agency Discount Notes (27.2%) and U.S. Treasury Bills (29.1%). Earnings in this portfolio continue to be hurt by the extremely low short-term interest rates. The average yield of the portfolio remained at .05%, same as the third quarter. A stark difference from the 1.65% average yield at the end of 2019.

1Q21 Strategy: This portfolio will continue to be managed using a short duration laddered strategy, providing liquidity and timing investment maturities to large cash flow needs such as payroll, capital expenditures and debt service payments. Investments will be made in allowable short-term liquid securities such as Treasury Bills, Government Agency Discount Notes, government class money market funds, and possibly the highest rated Commercial Paper. Purchases will be diversified amongst security types with maturities less than on year. Short-term interest rates are expected to remain near zero for all of 2021. At their 1/27/2021 meeting, the Fed stated they expect to maintain their very accommodative monetary policy until the labor market has reached maximum employment and inflation exceeds 2% for some time. The Fed's target rate is 0-.25%. Most economists do not expect the economy to reach the Fed's employment and inflation goals in 2021 given the current unemployment level, low inflation, and uncertainty around economic recovery from COVID-19.

MCOA—Long-Term

4Q20 Results*:* The Long-term portfolio outperformed its benchmark for the fourth quarter. Portfolio total return was .36% versus the BAML Agency Master index return of .037%. The portfolio had a defensive position against rising interest rates with a duration (1.53 years) shorter than its benchmark (3.89 years), this benefited the portfolio total return as intermediate yields increased and the curve steepened. At the end of the quarter, the portfolio was invested in U.S. Government Agency securities (79%), government money market funds (10%), municipal bonds (6%), Certificate of Deposits with local community banks (3.0%), U.S. Treasury Notes (2.0%) and less than 1% in securitized mortgage backed securities.

1Q21 Strategy: For the past 12 months this portfolio has maintained a defensive stance with a duration short of the benchmark. This made sense as we began 2020 with a very flat yield curve, economic and budget uncertainty around COVID-19, and low interest rates. Yields continue to be at low levels in the short and intermediate parts of the curve where the Council invests. But we have seen some steepening in the 3-7 year part of the curve. This creates an opportunity to pick up yield in the portfolio by investing to that part of the curve. We continue to add select high quality General Obligation taxable municipal bonds, U.S. Government Agencies, and Treasuries. In support of our community, we will also invest in Certificates of Deposits with qualifying community banks and credit unions that have a successful track record of supporting minority, female and other small businesses, affordable housing, community development, and equity.

OPEB Trust

4Q20 Results: The OPEB Trust outperformed its index during the 4th Quarter. The OPEB Trust returned 9.24% for the quarter versus a return of 7.18% for the Trust's blended index. The value of the OPEB Trust increased from $288.7 million to $315.8 million, an increase in value of $27.1 million. Currently, the Council's OPEB portfolio is managed by the State Board of Investment. The portfolio is allocated 78% to an S&P 500 equity index pool, 18% to U. S. Treasury securities, and 4% to a money market pool.

1Q21 Strategy: The OPEB Trust portfolio is a long-term investment which will experience positive and negative market movements over time. We experienced this in 2020 with the historic volatility in the equity markets caused by the economic effects of the COVID-19 pandemic. Over the long term, staying the course in tough markets is a good strategy. The Council's future OPEB liabilities are in a strong funding position. The Council has targeted an allocation of 60% equities and 40% fixed income/cash. Because of the strong performance of the equity markets, the current allocation of 78% equity and 22% fixed income/cash is not in alignment with the target allocation and will be adjusted.