



CITY OF GRAND RAPIDS AGENDA ACTION REQUEST

DATE: January 9, 2024

TO: Mark Washington, City Manager

COMMITTEE: Fiscal Committee
LIAISON: Molly Clarin, Chief Financial Officer

FROM: Levi Boldt, Investment Officer

SUBJECT: Treasurer's Report for Period of November 29, 2023 through December 26, 2023

On December 13, the Federal Reserve's Open Market Committee (FOMC) announced that it was holding short-term interest rate target at their current level of 5.25 – 5.50%. Additionally, FOMC released its Summary of Economic Projections, which indicated that members expect inflation to have declined to 2.5% by the end of calendar 2024. In addition, FOMC members project short-term rates will decline to 4.6% by year end, roughly equivalent to three cuts of 0.25% to its interest rate target.

In response, market participants have priced in not three, but seven cuts to 3.50 – 3.75% in 2024, beginning as early as March. This is a clear disconnect between FOMC projections and market expectations.

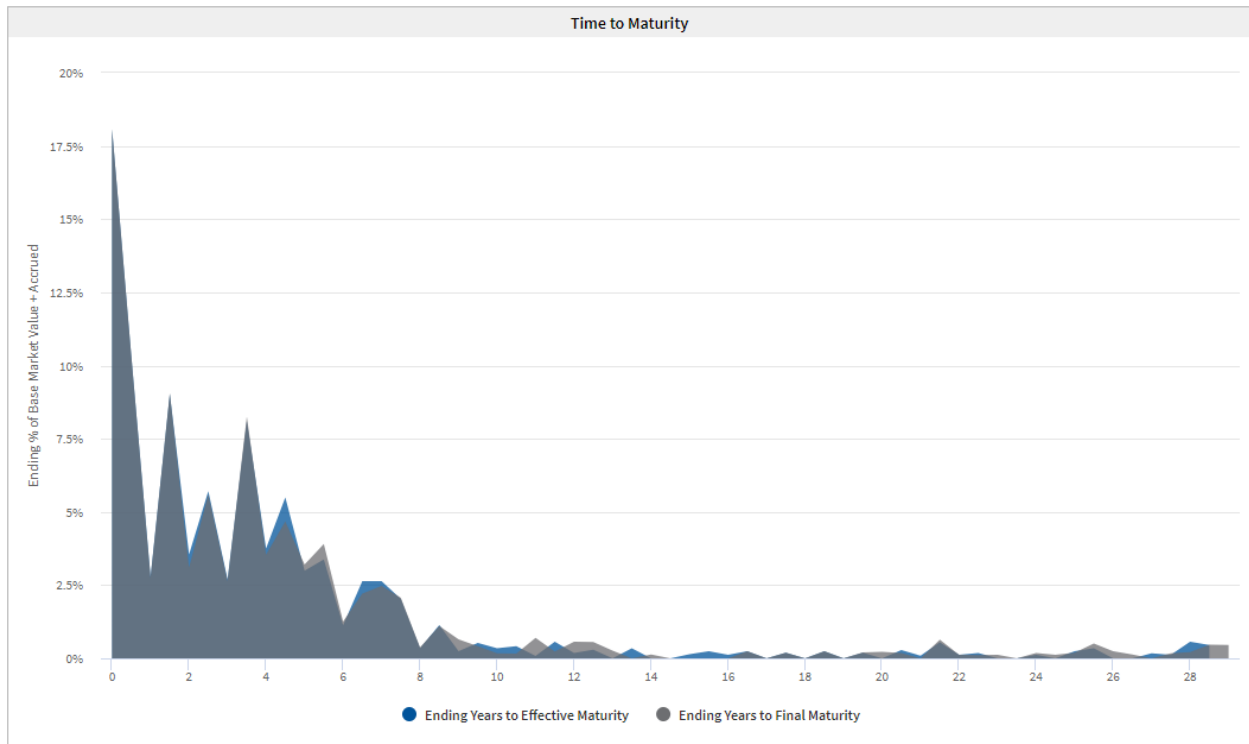
Austan Goolsbee, President of the Chicago Fed (which includes Michigan in its territory) commented on the market response, "It's not what you say, or what the chair says. It's what did they hear, and what did they want to hear. I was confused a bit – was the market just imputing, here's what we want them to be saying? I thought there seemed to be some confusion about how the FOMC even works." Goolsbee went on to quote Paul Volcker's famous description of the roles of the Fed and the market, "Our job is to act. Their job to react."

A well-known aphorism among fixed income investment managers is, "Don't fight the Fed." While the Treasurer's Office considers a great many data points, we give great weight to statements, projections, and public comments by FOMC members. While there are encouraging signs that inflation will be brought to heel, those indicators do not suggest inflation will disappear so rapidly that FOMC can fulfill market expectations.

Markets have lowered borrowing costs from only a couple months ago. The 10-year Treasury peaked at 4.98% in October; it now trades at 3.81%, a decline of over a full point. This eases overall financial conditions, blunting the effect of FOMC's monetary

tightening. This reinforces inflationary pressures. FOMC has repeatedly stated its intention to maintain restrictive monetary policy until inflation is solidly within its target range. Ironically, the market's expectation that FOMC will lower rates quickly may actually delay those same expected interest rate cuts.

The City's investment strategy is to buy high-quality financial assets with expected cash flows broadly matching expected liability needs, with an emphasis on current liabilities. We then hold those assets to maturity. Our Investment Policy prioritizes liquidity over yield. The possibility of large expenditures on major projects has prompted the Treasurer's Office to maintain a higher allocation to short-term assets.



Short-term assets have temporarily boosted portfolio yield due to an inverted yield curve. However, this comes at the expense of sustained yields over longer periods of time.

As interest rates decline, the market price of outstanding fixed-yield bonds and other debt obligations rise. The opposite is also true; market prices drop when interest rates climb. The magnitude of the market price change is roughly proportional to time to maturity. Gains or losses in market value are only realized when portfolio securities are sold prior to maturity. Unrealized gains or losses have no impact on portfolio cash flow or interest earnings.

Governmental accounting standards require the Treasurer's Office to mark the portfolio to current market prices on the City's financial statements. It is important to understand

that unrealized gains and losses exist “on paper” only. Sufficient liquidity is available to fund expected current expenditures without selling portfolio holdings prior to maturity.

The Treasurer’s Office will continue to monitor and respond to the changing market environment. We will do this in accord with the goals stated in our Investment Policy: safety, liquidity, and yield. Obtaining a competitive yield is important but will always take last place in priority behind safety of principal and ensuring the availability of sufficient liquidity.

Portfolio segments and investment returns are listed in the following table.

Investment Manager	Funds Managed	Purchase Yield
City Staff	\$560,131,280	3.05%
Cemetery Perpetual Care	\$5,014,536	4.40%
Bond Proceeds:		
CIB 2017 – Cemeteries	\$169,891	0.20%
CIB 2021 – Street Lighting	\$2,644,669	0.40%
CIB 2023 – Lyon Square	<u>\$9,551,319</u>	6.00%
Total:	<u><u>\$566,451,162</u></u>	3.10%

The attached appendices detail portfolio holdings and recent trading activity. Please contact me at ext. 3285 with any questions on this report. Thank you.

cc: Roberta Cahill, Deputy City Treasurer
John Globensky, City Treasurer