OCTA

January 23, 2019

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Subject: Fourth Quarter 2018 Investment and Debt Report

Overview

The California Government Code authorizes the Orange County Transportation Authority Treasurer to submit a quarterly investment report detailing the investment activity for the period. This investment report covers the fourth quarter of 2018, October through December, and includes a discussion on the Orange County Transportation Authority's debt portfolio.

Recommendation

Receive and file the Quarterly Debt and Investment Report prepared by the Treasurer as an information item.

Discussion

The Treasurer is currently managing the Orange County Transportation Authority (OCTA) investment portfolio totaling $1.7 billion as of December 31, 2018. The portfolio is divided into two managed portfolios: the liquid portfolio for immediate cash needs and the short-term portfolio for future budgeted expenditures. In addition to these portfolios, OCTA has funds invested in a debt service reserve fund for the 91 Express Lanes.

OCTA's debt portfolio had an outstanding principal balance of $695 million as of December 31, 2018. Approximately 45 percent of the outstanding balance is comprised of Measure M2 (M2) debt, 14 percent is associated with the 91 Express Lanes Program, and 41 percent accounts for the Transportation Infrastructure Finance and Innovation Act (TIFIA) draws of $287 million for the Interstate 405 Project.

Economic Summary: The Federal Reserve (Fed) raised the Fed Funds rate for a fourth time this year in December 2018 by another 25 basis points to a new range of 2.25 percent to 2.5 percent. At the Fed meeting in December, Fed officials revised the forecast for two hikes in 2019 and one in 2020. The Fed's monetary policy normalization remains on track as evidenced by the strong labor market, higher inflation, and steady growth. Benchmark yields moved lower in December across the curve, with the two-year Treasury yield at 2.50 percent, a decrease of 32 basis points, the five-year Treasury yield at 2.49 percent, a decrease of 46 basis points, and the ten-year Treasury yield at 2.66 percent, a decrease of 40 basis points from the prior quarter.

On the economic data front, economic growth remained on a strong track for the fourth quarter of 2018, with full-year growth expected to reach three percent for the first time since 2005. Fixed-income markets were driven mostly by macro developments, central bank activity, and volatility in the tech market rather than economic data. Trade volatility continued through December due to continued trade tensions between the United States (U.S.) and China.

The unemployment rate rose to 3.9 percent in December, slightly up from November. The U.S. economy added 312,000 jobs in December, the largest gain since February. The Institute of Supply Management reported nonmanufacturing activity at 57.6 in December. This represents continued growth in the non-manufacturing sector, at a slower rate. Oil prices settled below $50 a barrel for the first time since October 2017 on signs of oversupply in the United States. Italy reached an agreement with the European Union to lower its deficit target to 2.04 percent of gross domestic product in 2019.

Debt Portfolio Activity: As of December 31, 2018, $97.8 million is outstanding on the 91 Express Lanes Tax-Exempt Bonds. Principal payments for the M2 Program are paid in February each year. As of December 31, 2018, the M2 Program has $310.2 million in outstanding debt. The outstanding balances for each of OCTA's debt securities are presented in Attachment A. Also, on December 17, 2018, $122 million was drawn on the TIFIA Loan for the 405 Express Lanes.

Investment Portfolio Compliance: There were no compliance violations during the quarter. However, a security held in the portfolio managed by Logan Circle Partners and PFM fell below the minimum credit requirement. On Wednesday, October 31, 2018, Moody's, Standard & Poor's, and Fitch Ratings placed General Electric on Rating Watch Negative with a rating of Baa1/BBB+/BBB+ respectively. The Treasurer reviewed the position and recommended the security be held. The Treasurer presented his recommendation to the Deputy Chief Executive Officer who concurred.

OCTA continues its policy of reviewing the contents of the investment portfolio on a weekly basis to ensure compliance for each day of the week.

Attachment B provides a comparison of the portfolio holdings as of December 31, 2018, to the diversification guidelines of the policy.

Investment Portfolio Performance Versus Selected Benchmarks: OCTA uses Clearwater Analytics to calculate performance for each manager within the respective portfolios. The performance reports calculate monthly total rates of return based upon the market value of the portfolios they manage. The securities are marked-to-market daily based on pricing data provided by the custody banks.

OCTA has calculated the total returns for each of the investment managers for short-term operating monies and has compared the returns to specific benchmarks as shown in Attachment C. Attachment D contains an annualized total return performance comparison by investment manager for the previous two years. Attachment E provides a five-year yield comparison between the short-term investment managers, Orange County Investment Pool, and Local Agency Investment Fund.

The returns for OCTA‘s short-term operating monies are compared to the Intercontinental Exchange (ICE)/Bank of America Merrill Lynch (BAML) 1-3 year Treasury (Treasury) and the ICE/BAML 1-3 year AAA-A U.S. Corporate and Government (Corporate/Government) benchmarks. The ICE/BAML 1-3-year indices are among the most commonly used short-term fixed-income benchmarks. Each of the four managers invests in a combination of securities that all conform to OCTA’s 2018 Investment Policy. For the quarter ending December 31, 2018, the weighted average total return for OCTA’s short-term portfolio was 1.05 percent, underperforming the Treasury benchmark return of 1.30 percent by 25 basis points and underperforming the Corporate/Government benchmark return of 1.23 percent by 18 basis points. For the 12-month period ending December 31, 2018, the portfolio’s return totaled 1.66 percent, exceeding the Treasury benchmark by 8 basis points and outperforming the Corporate/Government benchmark by 3 basis points for the same period.

Continued Fed tightening has resulted in the market price on securities dropping due to the inverse relationship of fixed-income securities and interest rates. Bonds and interest rates have an inverse relationship, meaning that when interest rates go up, existing bond prices go down, and when interest rates decrease, bond prices increase.

OCTA’s investment managers mitigated the impact of rising interest rates by investing in high-quality, non-government fixed-income securities with higher yields during the period. Evidence of this may be seen in a direct comparison of the two benchmarks used by OCTA over the past year. The

Corporate/Government benchmark clearly maintained a performance advantage and was less affected by the rise in interest rates than the treasury-only benchmark due to the additional yield generated by non-government securities. This was the case for each of the four investment managers, as well during the 12-month period.

Investment Portfolios: A summary of each investment manager's investment diversification, performance, and maturity schedule is provided in Attachment F. These summaries provide a tool for analyzing the different returns for each manager.

A complete listing of all securities is provided in Attachment G. Each portfolio contains a description of the security, maturity date, book value, market value, and yield provided by Clearwater Analytics.

Cash Availability for the Next Six Months: OCTA has reviewed the cash requirements for the next six months. It has been determined that the liquid and the short-term portfolios can fund all projected expenditures during the next six months.

Summary

As required under the California Government Code, the Orange County Transportation Authority is submitting its quarterly debt and investment report to the Finance and Administration Committee. The report summarizes the Orange County Transportation Authority's debt and investment activities for the period October 2018 through December 2018.

Attachments

A. Orange County Transportation Authority Outstanding Debt December 31, 2018
B. Orange County Transportation Authority Investment Policy Compliance December 31, 2018
C. Orange County Transportation Authority Short-term Portfolio Performance Review Quarter Ending December 31, 2018.
D. Orange County Transportation Authority Short-term Portfolio Performance December 31, 2018
E. Orange County Transportation Authority Comparative Yield Performance December 31, 2018
F. Investment Manager Diversification and Maturity Schedules December 31, 2018
G. Orange County Transportation Authority Portfolio Listing as of December 31, 2018

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