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January 22, 2018

The Honorable Members of the Board of Supervisors
County of Solano County
675 Texas Street, Suite 6500
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Honorable Members of the Board:

It is my pleasure to present the quarterly report for the second quarter of FY2017/18.

State of the Treasury

Subsequent to their annual onsite review, Standard and Poor's raised the rating of the Treasurer's Investment Pool (Pool) to the highest fund rating of AAAf, S1, from AAf, S1 (Attachment E).

The Pool continues to be invested in a manner consistent with the balancing of credit, liquidity, and interest rate risks; while maintaining sufficient liquidity to meet the demands of the Pool participants. The California Government Code calls for the investing of these funds in the following order or precedence: safety of principal, liquidity, and finally yield. The $1.1 billion pool is diversified into the following categories as of December 31, 2017: 18% Treasuries, 50% Agencies, 11% Corporates, 8% Municipal securities and 13% in short maturity investments intended to provide liquidity. Seventy percent of the portfolio matures within 1 year and an additional 28% matures in 1 to 3 years. This combination of diversification and duration management should provide the necessary liquidity and safety of principal that prudent management dictates for the Pool.

Current Market Conditions Impacting the Treasury Pool

The President nominated a new chairman for the Federal Reserve in the quarter, Mr. Jerome Powell. It is expected that in the short term he will continue the announced policy of modest increases to the Funds Rate, and reduction of the balance sheet. Current Federal Reserve Chair Yellen has said the recovery is increasingly broad based across sectors in the US and worldwide.

In the longer term, it remains to be seen what policy direction changes Mr. Powell will bring given the rapidly expanding economy. Treasury managers pay close attention to the policy and actions of the Federal Reserve, as its Federal Open Market Committee (FOMC) controls interest rates on the short end of the yield curve where most of our investments are placed.

To determine the appropriate course of action with regards to rates, the FOMC monitors a variety of economic, current event, and fiscal policy information. Treasury managers also monitor this information to remain abreast of changes to ensure the portfolio is properly positioned on the yield curve and not caught off guard by FOMC actions. The information monitored includes labor market data, economic activity, inflation, current event news, fiscal policy changes, and a myriad of other elements that include these data inputs. Some of this information is included in regional reports from the 12 Federal Reserve Districts and compiled in Beige Book reports published eight times a year.

Expectations going forward

The Pool is primarily comprised of fixed income investments. As is the case with most fixed income investments, the price, or current market value, of the investment is inversely correlated to changes in market interest rates. That is to say that as interest rates increase in the market, the value of existing Pool investments is expected to decline. Conversely should market rates fall, the value of existing Pool investments would be expected to increase. At maturity, the price of a given investment will typically return to a known par value. This allows the Pool to earn market rates of return while minimizing the risk of incurring realized losses.

Given the anticipated increases in market rates through 2018, it is expected that the Pool will continue to report market values that are lower than the current book value. The decline in market value will be mitigated over time as current Pool holdings mature and are replaced with higher yielding securities at current market rates of return. Over time the Pool should see a net benefit of approximately $2 million annually in additional earnings per each 0.25% increase in market rates.

Respectfully Submitted,
CHARLES LOMELI
Treasurer – Tax Collector – County Clerk