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January 15, 2019

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 FY2018/19.

State of the Treasury

The $1.2 billion Treasurer's pool is managed in accordance with the tenets of California Government Code §53600.5 to provide for the safety of principal, adequate liquidity for all anticipated cash flow requirements, and a consistent rate of return commensurate with the established risk profile.

The 544.0 million currently held in cash and investments with six months or less left to maturity should provide adequate funding for all anticipated cash needs, while also affording the Treasury an opportunity to invest excess liquidity at higher rates.

To mitigate various risks identified below, the treasury pool is maintained with a duration designed to stabilize yields and prevent rapid increases or decreases in earnings. The treasury pool is also diversified from a credit risk perspective by maintaining a mix of investments that includes 15.6% in cash and cash equivalents, 15.0% in US Treasuries, 39.1% in Government Sponsored Enterprises, 13.4% in US Corporations, and 10.7% in Municipals; with the balance of 6.2% held in a variety of assets including mutual funds, commercial paper, and other holdings allowable under §53600.5.

Current Market Conditions Impacting the Treasury Pool

At the December meeting, the Federal Open Market Committee (FOMC) by unanimous vote raised the Federal Funds rate by .25% which currently stands at 2.5% citing continued strong employment data, moderate inflation and a strong economy. The committee also signaled additional rate increases in 2019 which will be data dependent. In the minutes of the meeting, concerns were raised and discussed regarding signs of slowing global growth and financial market volatility. These concerns were cited as reasons to be "patient" with the announced normalization of interest rates and continued reduction of the balance sheet or holding of treasury and mortgage backed securities.

Treasury Managers monitor FOMC releases, and other data, to remain abreast of economic changes that may potentially impact the performance of the Treasurer's pool to ensure the portfolio is properly positioned on the yield curve to balance risk and return. A material portion of the monitored information from the FOMC can be found in the regional reports from the 12 Federal Reserve Districts that are compiled in Beige Book reports published 8 times a year.

Expectations going forward

The FOMC has announced it expects funds rates to continue to increase in 2019; therefore, the market value of the portfolio will likely remain lower than the book value for the foreseeable future. This difference is recognized in the Treasury accounting as an unrealized mark to market loss. Additionally, the interest earning on the investment pool are anticipated to increase accordingly. The weighted average yield on investments maturing in the next six months is 2.0% with a reasonable replacement yield for projection purposes of 2.5%. Should the funds replacement take place as anticipated, the treasury pool should produce an additional $2.7 million in earnings on an annualized basis when the benefits of repricing are fully realized.

In addition to the expectation for rising rates, a number of macro-economic and political issues are monitored by treasury managers to detect any impacts on elements of the portfolio. A trade dispute with China is impacting our corporations and banks due to the imposition of sanctions on Chinese goods into the US and US goods into China. Additional sanctions have been announced and are scheduled to be imposed this quarter. Additionally, the Brexit or United Kingdom withdrawal from the European Union is expected to cause some degree of uncertainty and disruption in European markets. These events are not expected to have significant lasting impacts but can result in short term volatility in our markets in the coming quarters.

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