



**DETROIT**

# **Water & Sewerage Department**

## **Investment Review – Fiscal Year 2023**

Brian Quinn, Managing Director

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(616) 802-4459

**pfmam.com**

*PFM Asset Management LLC*

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# **Current Economic Environment**



# Current Market Themes



- ▶ The U.S. economy is characterized by:
  - ▶ Headline inflation numbers trending lower, but the Fed's current focus, "supercore inflation," is showing little sign of slowing
  - ▶ A labor market that has proven to be exceptionally strong
  - ▶ A more optimistic sentiment around economic growth due to resilient consumer spending



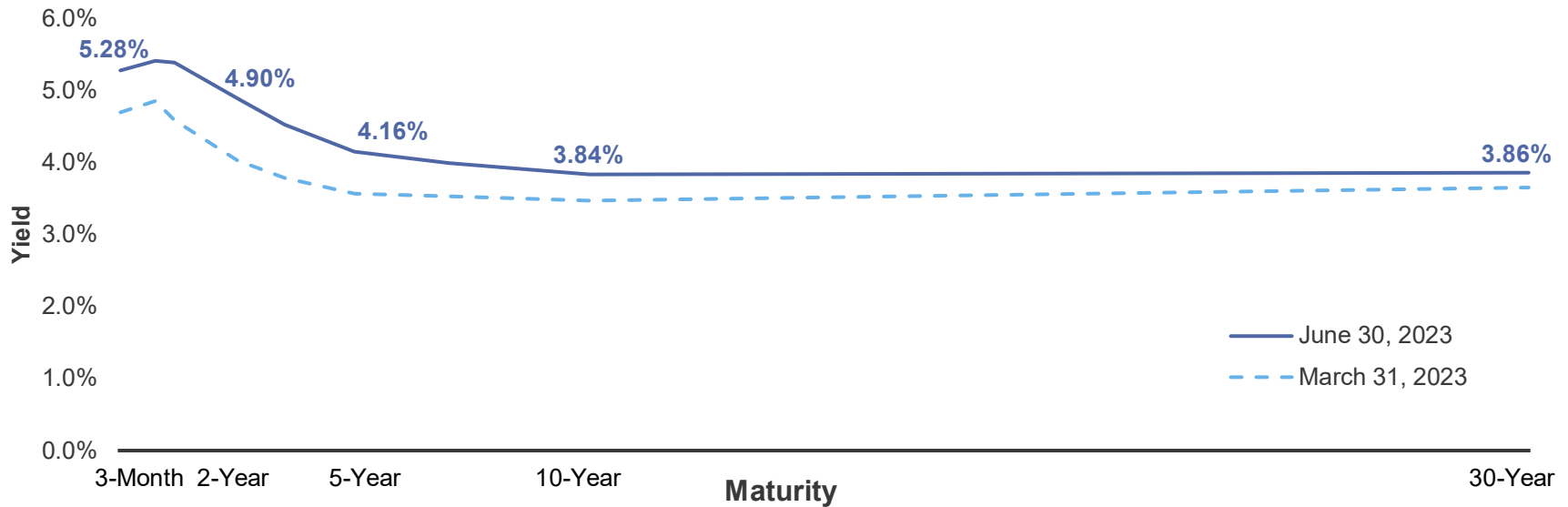
- ▶ Fed temporarily pauses rate hikes
  - ▶ The most aggressive series of interest rate hikes in recent history has come to a temporary pause in June
  - ▶ The Fed's most recent dot plot shows the potential for two additional rate hikes by the end of the year
  - ▶ Rates have moved up due to the Fed's rate trajectory shifting higher, the economy remaining stronger than expected, persistent inflation, and the market's "higher-for-longer" mindset



- ▶ Bond markets see continued volatility
  - ▶ The debt ceiling saga incited a separate spate of market volatility due to concern about a potential U.S. default
  - ▶ After plummeting at the end of Q1 due to volatility in the banking sector, short and medium-term yields steadily climbed throughout the quarter, with the 2-year rising over 100 basis points
  - ▶ The curve inversion fell dramatically at the start of Q2, but moved toward historic levels in June

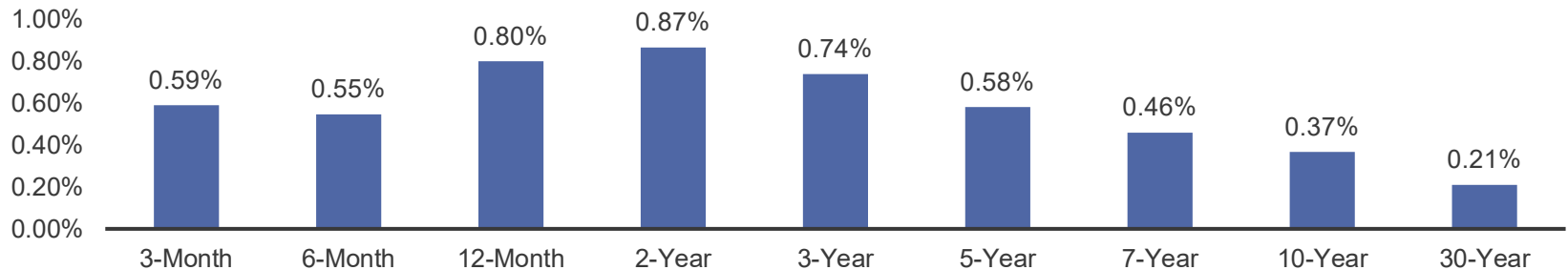
# Interest Rates Rise as “Higher-for-Longer” Mantra Sets In

## U.S. Treasury Yield Curve



## Yield Changes by Maturity

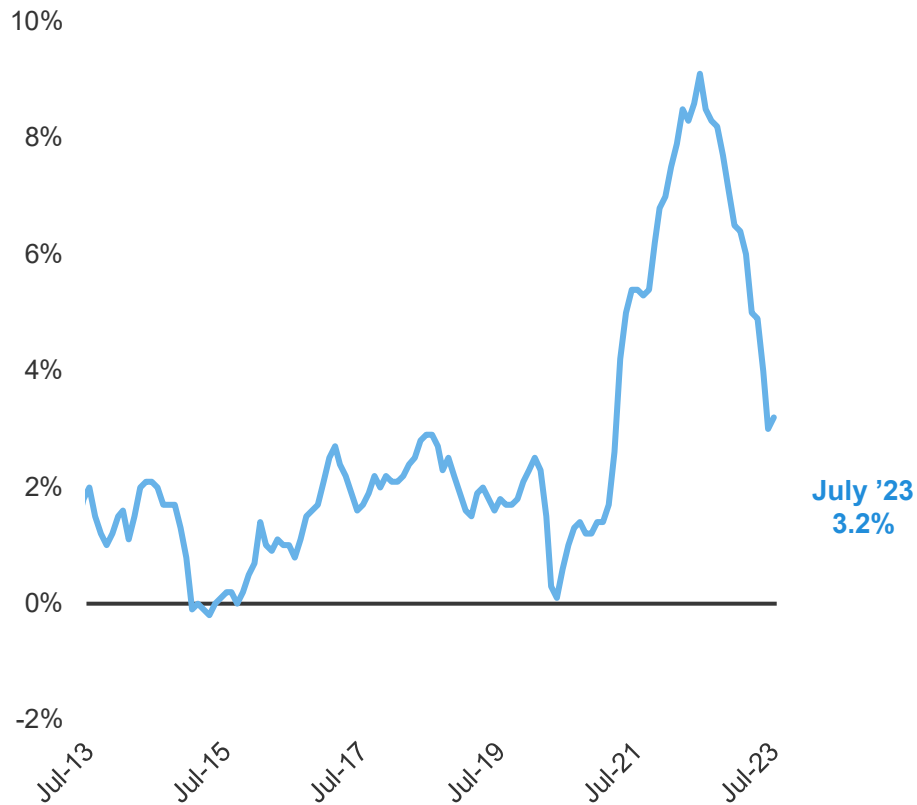
from March 31 – June 30, 2023



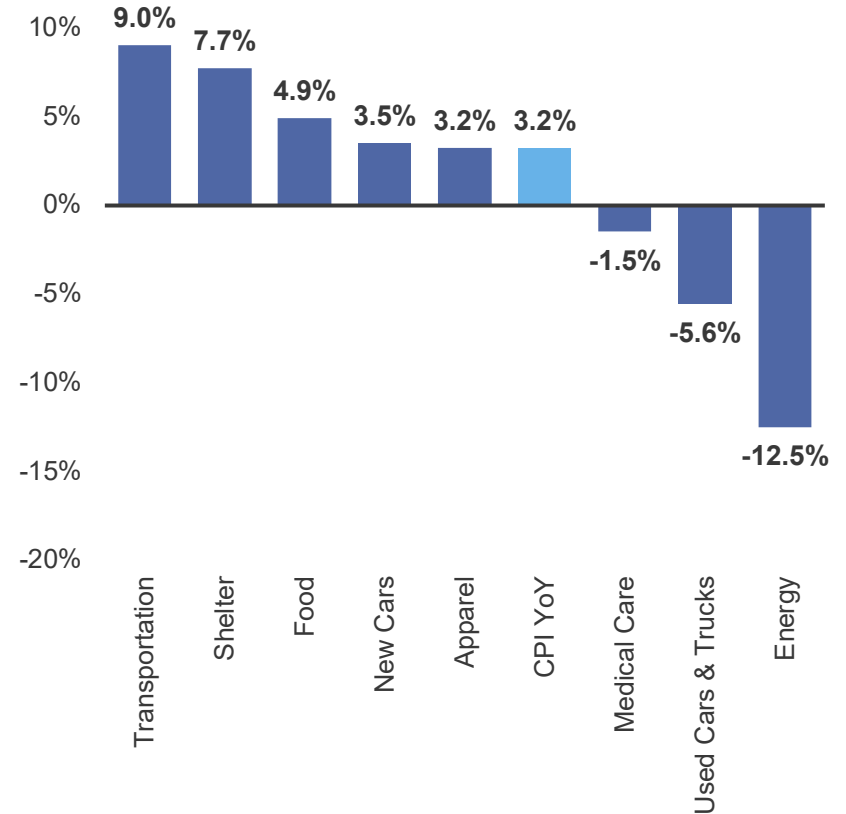
Source: Bloomberg, as of 06/30/2023.

# Consumer Inflation

**Consumer Price Index**  
% Change YoY



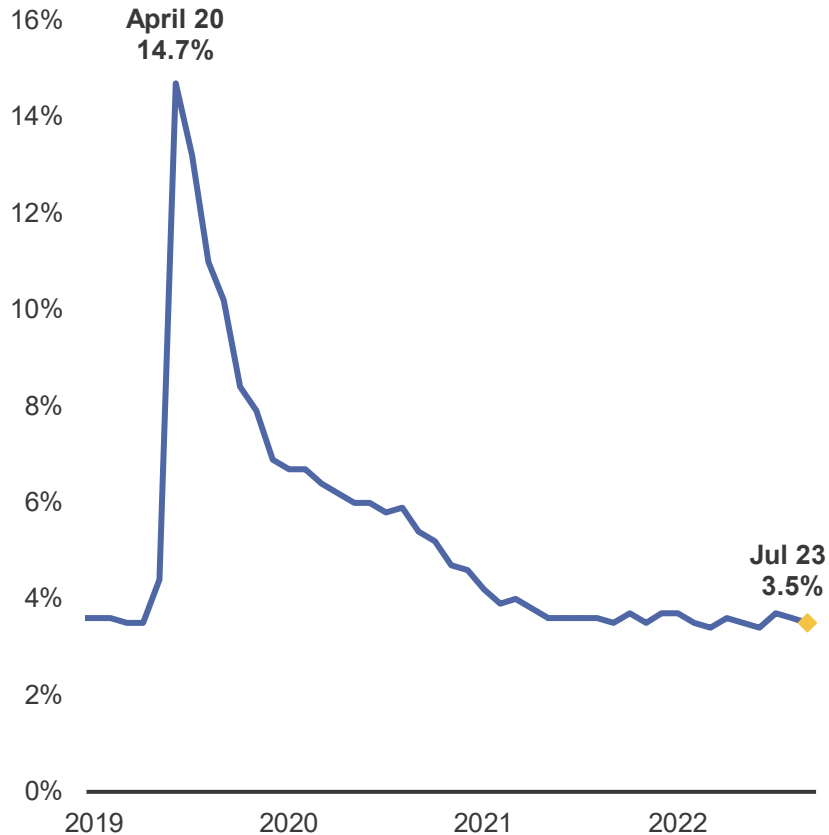
**Key Consumer Price Index Components**  
% Change YoY



Source: Bloomberg, as of July 2023.

# July Jobs Report Shows Solid Labor Market

## Unemployment Rate



## Labor Force Participation Rate



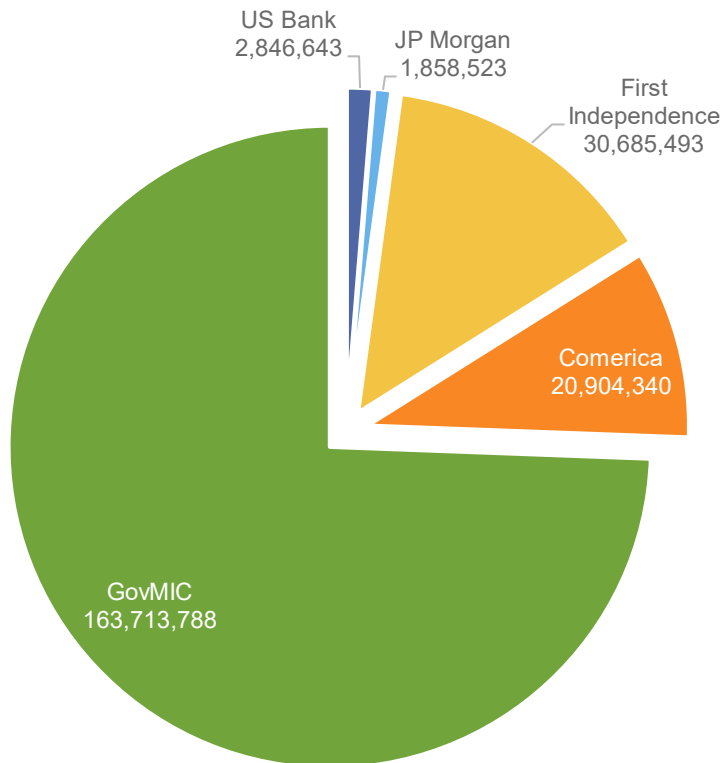
Source: Congressional Budget Office February 2023 economic projections, Bureau of Labor Statistics. Bloomberg, as of July 2023. Data is seasonally adjusted.

# **Fiscal 2023 Portfolio Review**



# Portfolio Summary

## Investment Allocation – June 30, 2023



## Investment Overview

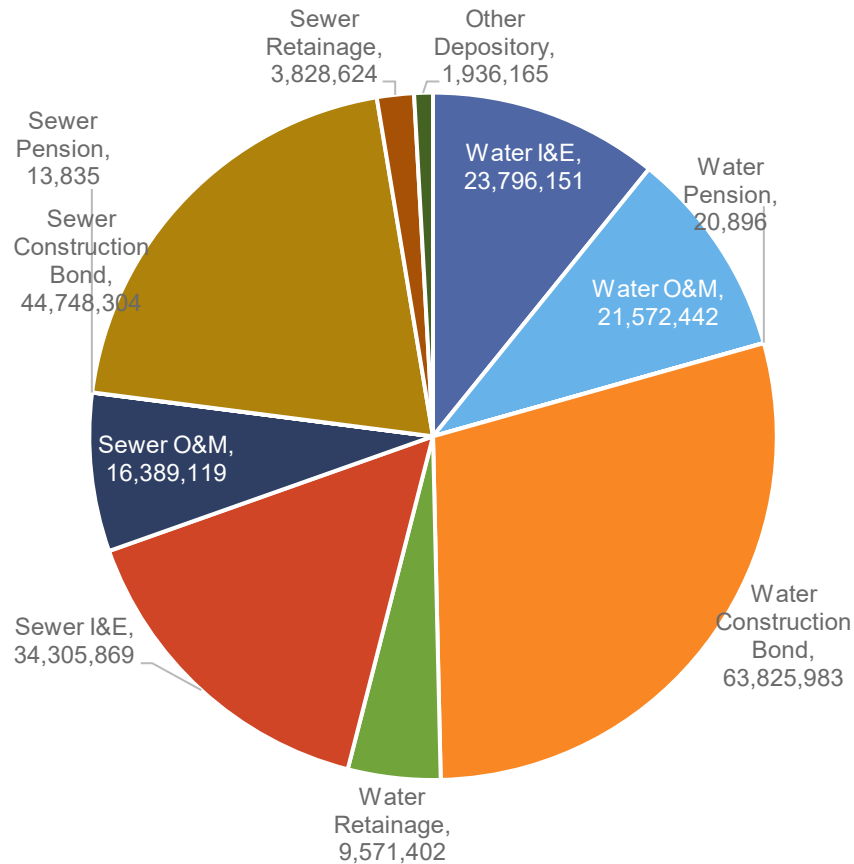
- ▶ At June 30, 2023 all investments had matured and all funds were held in overnight bank deposits or a Local Government Investment Pool (LGIP)
- ▶ Current investment yields vary from near 0% - 5.45%
- ▶ Credit ratings and balances are listed below:

Institution	Bal. June 30, 2023	S&P Rating
US Bank	2,846,643	A+ /A1
JP Morgan	1,858,523	A+ /A1
First Independence	30,685,493	Unrated
Comerica	20,904,340	BBB+ /A2
GovMIC	163,713,788	AAAm
	220,008,788	

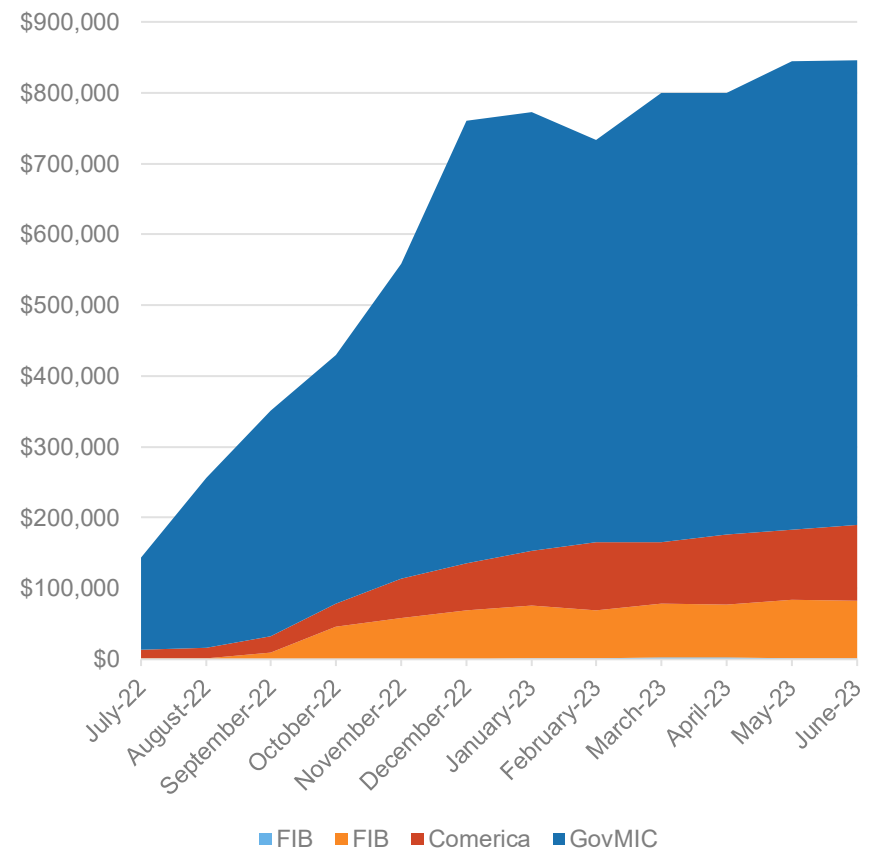
Source: Investment allocation at June 30, 2023 provided by DWSD, Istakur Rahman. Bank credit ratings taken from each bank's Investor Resources webpage. Ratings reflect the Standard and Poor's Long / Short-term credit ratings at the bank level. See important ratings disclosures at end of presentation.

# Investment Portfolio Review – Fiscal 2023

## Fund Allocation at June 30, 2023



## Monthly Interest Earnings – Fiscal 2023



Source: Fund Allocation & Monthly Interest Earnings provided by DWSD at June 30, 2023 and for the year ended June 30, 2023, respectively (Istakur Rahman)

# Portfolio Recommendations



# PFMAM's Cash Flow Model

- ▶ Analyzes historical portfolio balances
- ▶ Determines “seasonality” and historical seasonal factors
- ▶ The cash flow model helps identify an appropriate allocation between assets invested short term (“liquidity”) to meet cash needs and assets that can be invested longer-term

Portfolio Type	Strategy Components	Uses
Liquidity/Short-term	Overnight to 12 months	<ul style="list-style-type: none"><li>• Highly Liquid for daily needs and unforeseen expenditures</li><li>• Funds are meant to cover specific, predictable cash flows (payrolls, debt service)</li><li>• Can be lower during periods of net cash inflow</li><li>• Comprised of short-term money market instruments, e.g., bank deposits, money market mutual funds, and LGIP</li></ul>
Core	Longer Duration Strategy	<ul style="list-style-type: none"><li>• Funds that are not expected to be spent—may be disbursed in extraordinary circumstances</li><li>• Can be invested in longer-term securities</li></ul>

# Identifying Investable Funds

## Liquidity

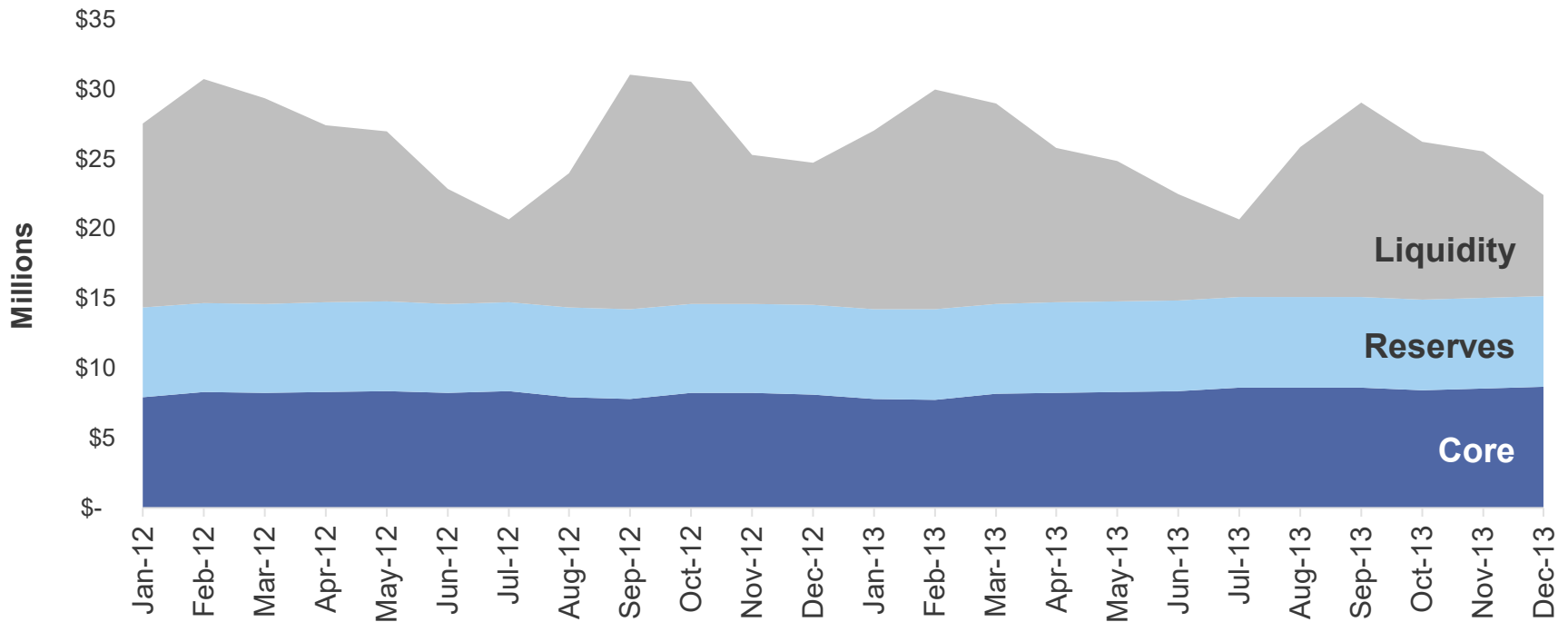
- ▶ Tailored to liquidity needs
- ▶ Lower risk
- ▶ Lower expected earnings
- ▶ Cash and equivalents

## Reserves

- ▶ Supplement to Liquidity funds
- ▶ Highly liquid
- ▶ Matched to potential liabilities
- ▶ High quality intermediate-term fixed income

## Core

- ▶ Funds not expected to be spent in foreseeable future
- ▶ More volatile
- ▶ High quality longer-term fixed income investments



For illustrative purposes only.

# Investment Strategy Considerations

- ▶ **Consistent Core** – DWSD has steady historical core balances and could benefit from investing funds farther out on the yield curve.
- ▶ **Extend Duration** – The investment policy allows average duration of up to three years on the overall portfolio; DWSD could increase duration to capture higher expected returns.
- ▶ **Diversification** – A large portion of the current portfolio is invested in bank accounts, which will continue to trend towards in the current near-zero rate environment; DWSD could consider further diversifying and increasing allocations in other types of permitted investments, such as U.S. Treasury notes and Agency MBS.
- ▶ **Segmentation** – Based upon historical cash flows, O&M funds could be invested to increase earnings but still meet future liquidity demands; commercial paper, CDs, and Treasury Bills currently provide incremental income relative to bank accounts.
- ▶ **Active Management** – PFM utilizes active management strategies to improve returns relative to benchmarks; active management techniques include swapping sectors to take advantage of changes in spreads and rolling down the yield curve.



# Implementation Steps

- ✓ **Investment Program Review**

- Review investment portfolio strategies and practices

- ✓ **Cash Flow Analysis**

- Determined an appropriate allocation to a short-term liquidity portfolio to meet ongoing liquidity needs
- Identified the core balance that is available for longer term investments to capture higher expected returns

- ✓ **Investment Policy**

- Review for policy in Compliance with Public Act 20 and Government Finance Officer's Association Best Practices

- ✓ **Portfolio Segmentation**

- Determine amounts to be invested in each portfolio strategy

- ✓ **Strategy Approval and Implementation**

# Important Rating Disclosures

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