

# CITY OF RIO RANCHO QUARTERLY INVESTMENT REPORT

QUARTER ENDING SEPTEMBER 30, 2011

#### **Market Commentary**

During the quarter ending September 30, 2011, economic data released continued to show the overall strength of the U.S. economic recovery to be less than robust. Gross domestic product in the third quarter (July through September) expanded at a 2.5 percent annual rate according to the "advance" estimate released by the Bureau of Economic Analysis. That is nearly double the 1.3 percent rate of growth in the second quarter and much faster than the first quarter's small increase of 0.4 percent. According to Patterson & Associates, third quarter U.S. GDP growth is traditionally the weakest quarter of the year as consumers turn from buying TV's and cars to taking vacations, trying to stay cool and get ready for the fourth quarter, which includes back to school and the holidays. Over the quarter, a total of 287,000 jobs were added to nonfarm payroll, however this was not enough to lower the overall unemployment rate, which ended the quarter basically unchanged at 9.1 percent.

During the quarter, on August 5<sup>th</sup>, the AAA rating of the U.S. government's sovereign debt was downgraded to AA+. In its rationale for the downgrade, S&P cited the brinksmanship employed by Congress during the recent debt ceiling debates as one of the primary reasons for its decision, suggesting that the rating action was more a reflection of the U.S. political system and less a reflection of the ability to pay its debts as a nation. The ratings of most U.S. government sponsored enterprises (GSEs), including FNMA, FHLMC, FFCB, and FHLB were downgraded as well. At the time of this downgrade, the City held \$9,180,000 in Federal Home Loan Mortgage Corp Agency (Freddie Mac) Step Notes. Pursuant to the City Investment Policy, the City was not required to sell these securities upon downgrade, as the policy does not set rating criteria for U.S. Treasuries or U.S. Agencies. As such, there was no impact of the downgrade to our investment holdings. Furthermore, those agencies were called at par in early September. Subsequently, several major US banks had the credit rating on their debt downgraded at least one level, including Citigroup, Wells Fargo and Bank of America. According to Patterson & Associates, this ratings action does not affect their safety as a depository.

Adding to the uncertainty surrounding the US economic recovery was the risk to global markets from several central European nations near insolvency (including Portugal, Ireland, Greece & Spain) and the lack of unanimity in Europe on how to resolve these fundamental issues.

## **Outlook for Monetary Policy Changes**

During the quarter, the Federal Reserve Open Market Committee surprised the markets with an announcement that they expected to keep interest rates "exceptionally low" through mid-2013. It is

unprecedented that the FOMC include such a specific timeframe on any aspect of U.S. monetary policy action. Operation "Twist", as it is being called, will entail selling 3-year notes and buying the 10-Year Treasuries. While one would expect yields on the 3-year sector of the Treasury curve to increase (or prices to decline due to the selling pressure), a continued flight to quality offset these pressures during the quarter, leaving rates near historic lows. As of September 30, 2011, the 3-month U.S. Treasury bill was trading at a yield of 0.02 percent; the one-year bill was yielding 0.09 percent; the two-year note was yielding 0.24 percent; and the 10-year Treasury note was trading at yield of 1.91 percent.

## **Investment Strategy**

With little change in expectations towards higher interest rates, the City's Investment strategy remained unchanged throughout the quarter. The use of a checking account at Wells Fargo (the City's primary depository) continues provide the City a an earnings credit (ECR) equivalent to 75 basis points, which can be used to offset banking and merchant services fees (credit card fees). During the quarter, Wells Fargo notified the City that it was unable to continue to pay an ECR of 75 basis points, and that it would be paying 50 basis points starting in January of 2012. Deposits in "non-interest bearing" checking accounts are fully insured by FDIC with no limit on the amount in the account. The use of "step-up" agency notes for debt reserve funds provided a method to achieve some higher levels of income over other short term rates while still providing a measure of liquidity. These notes, with interest rates higher than money market funds to the first call have continued to be called. Lastly, the City remains committed to placing funds in FDIC insured certificates of deposit issued by local banks. Rates offered by some regional banks were a further improvement over levels paid by fully liquids accounts.

### **Portfolio Performance**

The City's investment portfolio book value balance on September 30, 2011 was \$47,587,907. There was one marketable U.S. Agency security in the portfolio, which was called in September. The average yield on the portfolio (including the credit for services) for the period was 0.347 percent compared to the benchmark (365 day US T-Bill) which was .09 percent. The portfolio earned \$22,080.74 over the period.

Investment Portfolio Summary, Quarter Ending September 30, 2011

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			General Fund		Interest
		% of Total	Portion	Policy Max	Rate
Wells Fargo Checking	\$ 42,982,164	90.32%	\$ 3,391,515	N/A	0.500%
Wells Fargo Savings	1,349	0.00%	1,349	N/A	0.220%
Wells Fargo NOW Savings	299	0.00%	299	N/A	0.230%
Local Gov. Investment Pool (LGIP)	104,095	0.22%	32,179	75.00%	0.233%
NM Bank & Trust (CD)	4,500,000	9.46%	1,800,000	50.00%	0.550%

Total Portfolio	\$ 47,587,907	100.00% \$ 5,225,342

<sup>\*</sup> Checking Account Balance shown reflects net deposits in transit and checks outstanding and the interest rate shown represents the rate used by the Bank to provide a credit for services rendered. This Earnings Credit Rate eliminates the fees charged on City accounts.