



CITY OF MADISON HEIGHTS
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FINANCE/TREASURER DEPARTMENT

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MEMORANDUM

DATE: April 19, 2022
TO: Mayor and City Council
Melissa Marsh, City Manager
FROM: Linda A. Kunath, Finance Director/Treasurer
SUBJECT: Investment Report 3rd Quarter Fiscal Year 2022

In compliance with the City of Madison Heights Investment Policy and P.A. 20 of 1945, as amended, the following summary of investments as of March 31, 2022, for the City of Madison Heights, is being presented in this memorandum.

Investment Overview

The COVID bear market began in March, 2020, and two years later March 2022 is the beginning of the acceleration of the worst bear market in bonds in 50 years, according to Morgan Stanley wealth management publication. The Federal Reserve policy pivot to adjust interest rates caused long-dated US Treasury indexes to decline more than 10% in the first quarter and the Bloomberg US Aggregate Index fell nearly 6%. As many as nine rate hikes by the Federal Reserve Board are expected in 2022.

Supply chain disruptions and the inflation picture were complicated by commodity markets roiled by the Russia-Ukraine conflict. Moving beyond COVID-related shutdowns, the consumer outlook has been shifting around government stimulus, spending habits, wages, and inventories. Consumers typically spend nearly 70% on services and 30% on goods, but the mix was skewed during the past two years and is now believed to be on track to revert back to historic range, which will help the economy. Tightness in the labor market drove strong wage growth across income ranges. Corporations have been citing rising labor costs as a problem for margins in 2022.

Yields have risen, led by the 2 and 3-year Treasuries, which are nearly 1% higher. 30-year mortgage rates are also 1% higher, as noted by Bakertilly Investment Services Interest rate update publication. Inflation expectations measured by Treasury Inflation Protected Securities (TIPS) have shifted up 30 basis point. The market expects inflation to average 3.4% over the next 5 years and 2.85% over the next 10 years. Investors believe the Fed will be successful in slowing the economy and harnessing the uptick in inflation. Inflation has been steadily increasing and is up 7.5% year-over-year. Unemployment in the U.S. is only 30 bps above the pre-COVID level, but labor participation is significantly below pre-COVID levels as many people fled the job market, according to Michigan Class, March 2022 Economic Update. As the world continues to face supply chain disruptions and shocking commodity prices, CPI readings are expected to continue the upward trend.

The 10-year U.S. Treasury note rate was 1.78% as of January 8, 2022 and is 2.38 at end of this quarter. The daily 5-year Treasury yield rose to 2.560% currently from 1.550% at the beginning of this quarter. The annual inflation rate in the U.S. accelerated to 8.5% in March of 2022, the highest since December of 1981. Energy prices increased 32%, namely gasoline and fuel oil. Food prices jumped 8.8%, most since May, 1981. Excluding volatile energy and food categories, the CPI rose 6.5%, the most in 40 years.

The City of Madison Heights's investments continue to be diversified and maturity dates are balanced with cash flow needs. Following a long term view for fixed rate investments, a higher rate of return is realized by holding fixed rate vehicles, such as bonds and treasuries, until either the call date or maturity. As stated in previous reports, in any given quarter, the method of marking investments to market value (which refers to accounting for the fair value of an asset or liability based on its current market price) may result in loss; however, holding bonds until maturity would result in the total return of investment.

In accordance with the City's investment policy, the City limits its exposure to possible decline in fair market value by maintaining diversification and controlling maturity dates. The table on the following page details the amounts at March 31, 2022. There is a difference between the coupon rate (i.e. yield at issue date) and the estimated quarterly annual yield. When a bond is issued, it has a coupon rate until it matures. This rate is related to the current interest rates. When a bond is sold or called before maturity, the value of the bond, not the coupon, will be affected by the current market interest rates. If current interest rates are higher than the coupon, the bond will sell below its face value. When interest rates are lower, they are sold at a premium or higher than face value. A bond's estimated annual yield is related to the current prevailing interest rates. A bond's yield is its annual interest (coupon) divided by its current market price.

| City of Madison Heights | | Investment Listing, by Security Type | | | | | | | |
|--|--------------|--------------------------------------|--------------|------------------------|------------------|-------------------------|----------------------|------------------------------------|------------------------------------|
| Investment Analysis | | | | | | | | | |
| Qtr End: 3/31/2022 | | | | | | | | | |
| Description | Amount | Adjusted Cost | Market Value | Unrealized Gain (Loss) | Accrued Interest | Estimated Annual Income | % of Total Portfolio | 3/31/2022 Annual Yield to Maturity | 3/31/2021 Annual Yield to Maturity |
| Fixed Income Assets | | | | | | | | | |
| Government Bonds | \$ 3,817,176 | \$ 3,815,371 | \$ 3,690,334 | \$ (125,037) | \$ 5,946 | \$ 49,013 | 12.1% | 1.33% | 1.21% |
| Government Asset Backed/CMO Securities | 5,177,283 | 3,168,496 | 2,949,228 | (219,268) | 103,732 | 77,959 | 9.6% | 1.99% | 2.97% |
| Municipal Bonds | 3,000,000 | 3,105,327 | 3,014,955 | (90,372) | 163,576 | 109,051 | 9.9% | 3.62% | 3.32% |
| Certificates of Deposit | 3,837,965 | 3,831,113 | 3,825,530 | (5,583) | 26,377 | 17,088 | 12.5% | 0.37% | 1.19% |
| Local Government Investment Pool/Money Market | 12,263,785 | 12,263,785 | 12,263,785 | - | 15,128 | 54,560 | 40.1% | 0.84% | 1.44% |
| Total Investments | | | \$25,743,832 | | | | | | |
| Cash and Equivalents | | | 4,836,930 | | | | | | |
| Total Cash and Investments | | | \$30,580,762 | | | | | | |

Risk

Interest rate risk is the risk that interest rates will change and adversely affect the fair value of the investment of the government's cash flows. The City attempts to limit exposure to a possible decline in fair market value by diversifying maturity dates.

Credit risk is the risk that the investment will not fulfill its promise to pay the investor when required. There is a credit risk associated with all financial institutions, brokers and investment vehicles. The City attempts to limit exposure to credit risk by diversifying the holders of investments, maintaining a high credit rating for investments, and restricting Certificates of Deposit investments to those with financial institutions that are members of the Federal Deposit Insurance Corporation (FDIC).

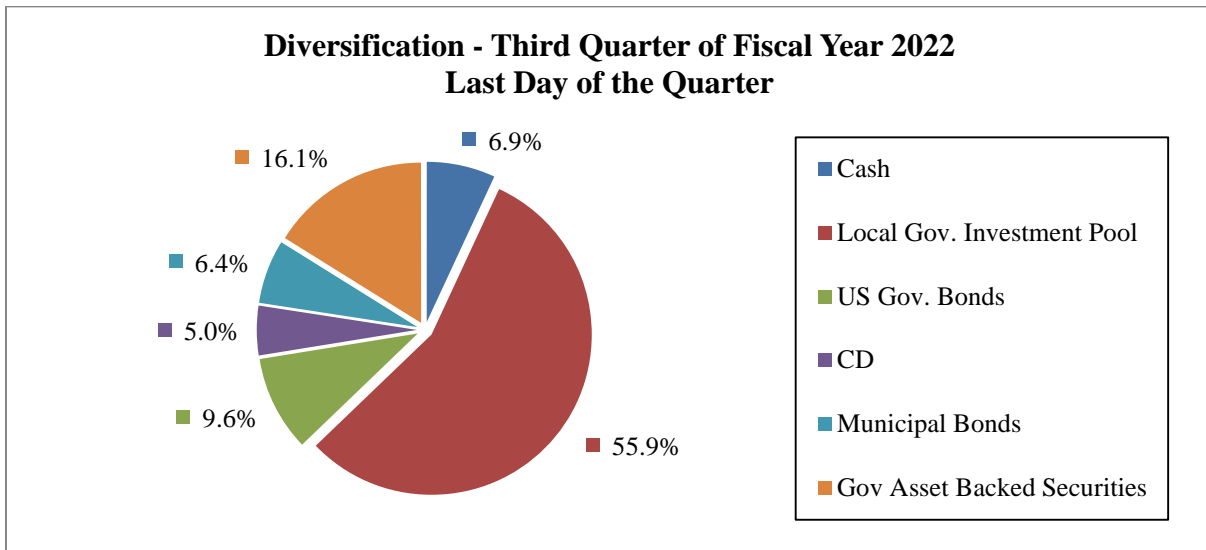
Concentration of risk occurs when the municipality is heavily invested in one issuer. The city's largest issuer is the Local Government Investment Pool managed by Oakland County. This pool is diversified with other County investments.

Quarter Investments

As of March 31, 2022, the City has the following Cash and Investment balances (combination of all funds, excluding pension and health care savings funds).

| | |
|---|-------------------|
| Total amount in the cash accounts | \$ 4,711,326 |
| Total amount in the investment accounts | <u>25,869,436</u> |
| | \$ 30,580,762 |

The following chart details the diversification of City investments as of March 31, 2022.



| Fund | Amount at 03/31/2022 | Amount at 03/31/2021 |
|-----------------------------------|-------------------------|-------------------------|
| General Fund | \$20,134,002 | \$14,450,329 |
| Major Road | 2,325,038 | 1,116,908 |
| Local Road | 3,182,385 | 3,117,892 |
| Downtown Development Authority | 242,811 | 221,638 |
| Drug Forfeiture | 159,248 | 274,886 |
| Community Development Block Grant | (5,335) | (24,670) |
| Special Assessment | 254,746 | 255,762 |
| Fire Station Bond | 463,820 | 429,519 |
| Water and Sewer | 3,564,882 | 7,490,877 |
| Escrow | 259,165 | 191,649 |
| Total Cash and Investments | \$30,580,762 | \$27,524,790 |

* Amounts of cash/investments by fund are prior to year-end closing and subject to change with necessary month-end adjustments.