

Q4 2018 Earnings Call

*A Public-Sector Approach
to ESG Integration*

February 19, 2019

City Treasurer Kurt Summers



AGENDA

01 12:00 - 12:05 PM
Welcome

02 12:05 - 12:10 PM
National Economy

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Local Economy

04 12:15 - 12:25 PM
CTO Investment Portfolio Update

05 12:25 - 12:40 PM
Chicago's ESG Strategy

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Q&A

07 12:55 - 1:00 PM
Debrief and Closing



WELCOME



Audio and Webcast

If you are registered for the call, then you can listen to the call on a computer or a phone—but you can only watch the webcast on a computer.



Need Help?

If you need assistance at any time during the webcast, please call (312) 742-1852 or email Asher.Mayerson@cityofchicago.org.



Have a Question?

If you have a question at any time during the webcast, please type in your question on the webcast by clicking “Q&A” or email your question to Asher.Mayerson@cityofchicago.org. There will be time allotted for Q&A at the end of the call.



WELCOME



Transparency

This is the 16th Quarterly Earnings Call hosted since Treasurer Summers took office. These first-in-the-nation calls are open to the public, the City Council, and anyone interested in Chicago's investment portfolio performance.



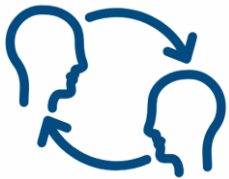
Outreach & Advocacy

During the Treasurer's 77 visits to Chicago's 77 neighborhoods in late 2014 and early 2015, residents voiced their need to be regularly engaged in our outreach and advocacy efforts. These calls are opportunities to learn about those efforts, and about how Chicagoans get involved.



Best Practices

As the primary investment manager for the City of Chicago, the Treasurer seeks to be held as accountable as any other investment management firm is to their investors. These calls have been shaped by established best practices from other investment managers.



Information & Action

These calls provide an overview of the national and local economies, the office's investment portfolio, and more, keeping Chicagoans informed about the economic and fiscal issues that affect them—and empowering them to take action.



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NATIONAL ECONOMY

University of Michigan: Consumer Sentiment (Monthly)

Oct. 2018	Nov. 2018	Dec. 2018
98.6	97.5	98.3

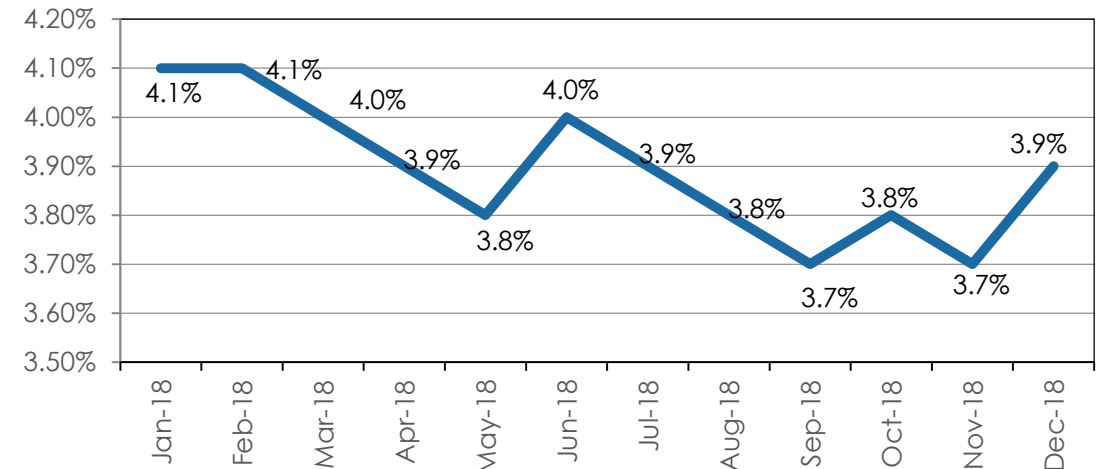
International Monetary Fund Expected Growth Rates (Annualized)

	Previous 2019 Forecast	Updated 2019 Forecast
Global Economy	3.7%	3.5%
U.S. Economy	2.9%	2.5%
Advanced Econ.	2.1%	2.0%
Emerging/Dev. Econ.	4.7%	4.5%

Real GDP (% Change, Annualized)

Q2 2018	Q3 2018	Q4 2018
4.2%	3.4%	N/A

Unemployment Rate (Seasonally Adjusted, Monthly)

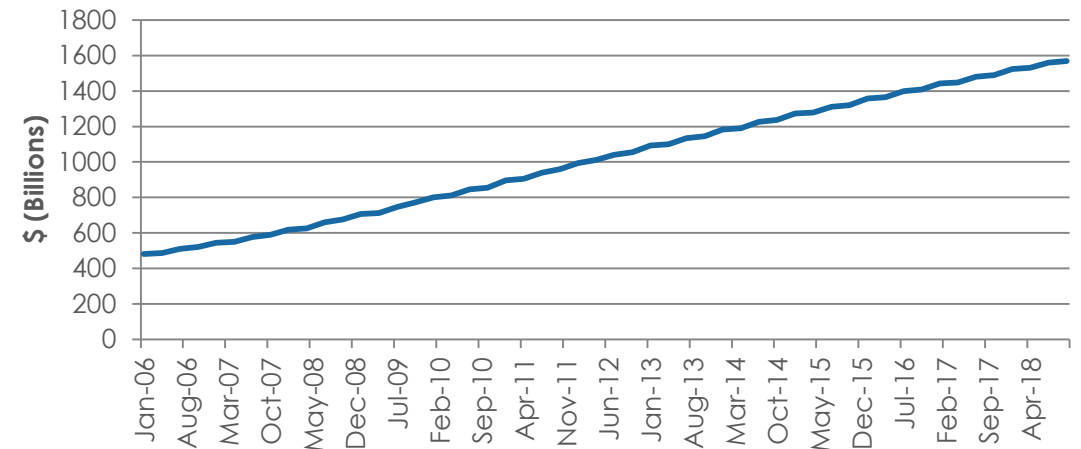


NATIONAL ECONOMY

Spread Between 10-Year and 2-Year Treasury



Total Federal Student Loans Owned and Securitized, Outstanding



It's not just student loan debt that's growing

A record 7 million Americans are 3 months behind on their **car payments**

Leveraged **corporate debt** has doubled from its peak before the financial crisis to almost \$1.2 trillion



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LOCAL ECONOMY

Unemployment Rate (Not Seasonally Adjusted)

	Oct. 2018	Nov. 2018	Dec. 2018
Chicago MSA	4.0%	3.8%	4.0%
United States	3.5%	3.5%	3.7%

- The local and national unemployment rates have largely stabilized since the Great Recession
- These indicators, however, do not fully capture economic well-being locally or nationally

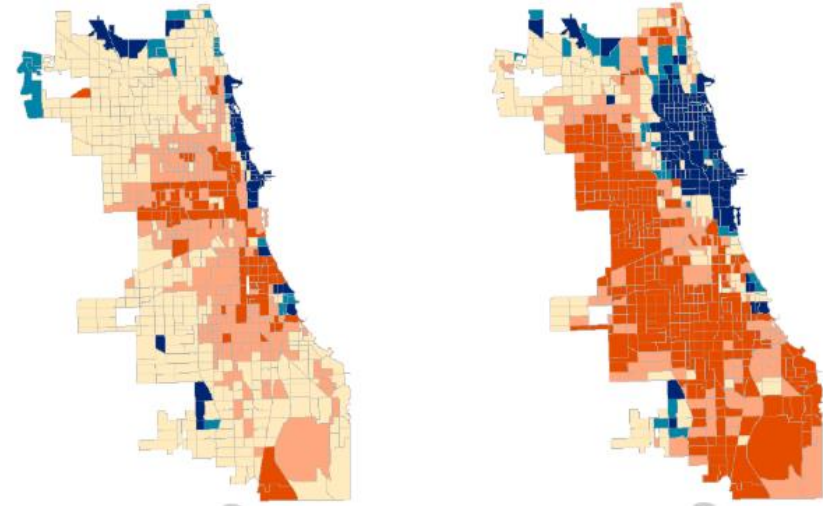
Poverty Rate in the
United States:
11.5%

Poverty Rate in
Chicago:
18.7%

Chicago's Shrinking Middle Class

1970

2017



■ Very high income
 ■ High income
 ■ Middle income
 ■ Low income
■ Very low income



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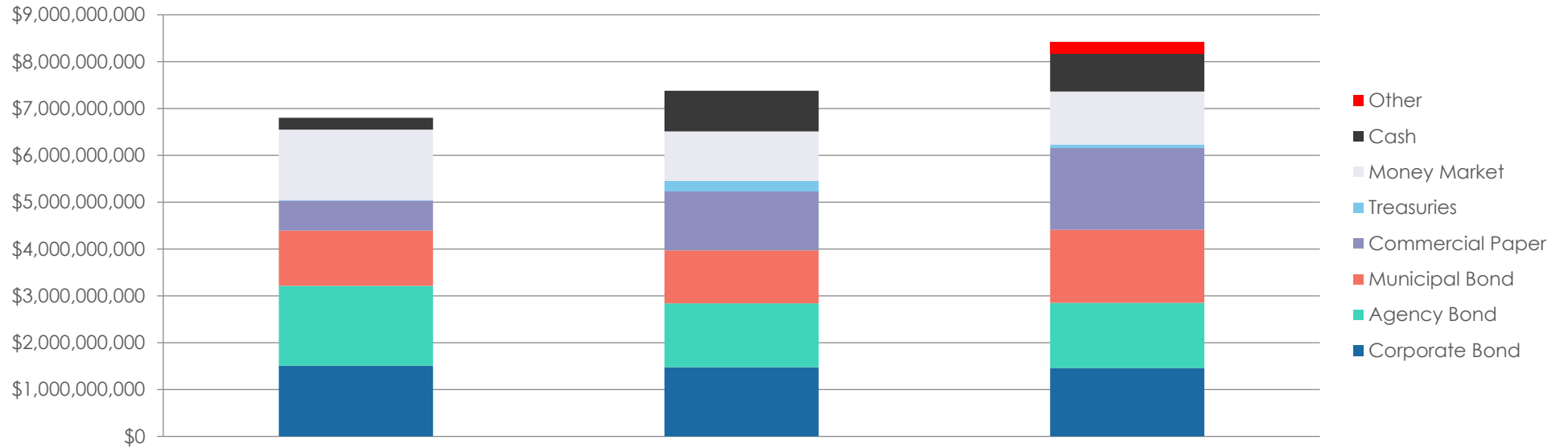
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CTO INVESTMENT PORTFOLIO UPDATE



	2016(Q4)		2017(Q4)		2018(Q4)	
Corporate Bond	\$ 1,509,346,000	22.20%	\$ 1,477,795,000	20.03%	\$ 1,464,660,007	17.07%
Agency Bond	\$ 1,706,630,000	25.10%	\$ 1,361,015,000	18.44%	\$ 1,390,054,227	16.20%
Municipal Bond	\$ 1,181,329,000	17.40%	\$ 1,132,756,337	15.35%	\$ 1,556,781,837	18.14%
Commercial Paper	\$ 633,810,000	9.30%	\$ 1,258,389,000	17.05%	\$ 1,749,121,607	20.38%
Treasuries	\$ 20,000,000	0.30%	\$ 227,500,000	3.08%	\$ 69,682,688	0.81%
Money Market	\$ 1,499,261,960	22.00%	\$ 1,051,056,289	14.24%	\$ 1,133,230,873	13.21%
Cash	\$ 252,725,808	3.70%	\$ 870,953,960	11.80%	\$ 978,078,109	11.40%
Other	\$ -	0.00%	\$ -	0.00%	\$ 239,017,654	2.79%



CTO INVESTMENT PORTFOLIO UPDATE

Overall Rating	
AA+	
Average Modified Duration (Years)	1.84*
Average Effective Duration (Years)	1.79*

Portfolio Statistics (Market Value Weighted)					
Values	Operating	Bond Proceeds	Operating Reserves	Long-Term Reserves	Whole Portfolio
Unique Position Count	87	269	93	46	479
Avg. Coupon	1.24	1.60	2.31	3.03	1.67
Avg. Current Yield	2.01	2.37	3.15	3.22	2.39
Avg. Yield To Maturity	2.28	2.19	2.29	2.90	2.24
Portfolio Holdings	\$2,723,651,053	\$3,922,566,430	\$1,396,521,012	\$677,736,103	\$8,720,474,598*
Total Earnings	\$51,561,160.69	\$51,001,915.69	\$32,379,265.35	\$21,160,922.55	\$156,103,264.28

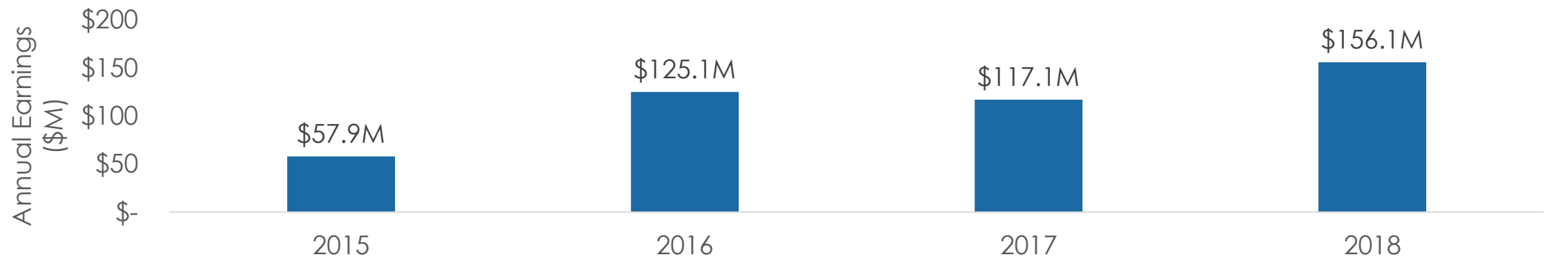


*These numbers are not inclusive of money in depository institutions.

CTO INVESTMENT PORTFOLIO UPDATE

In each successive year, we've found new ways to innovate our portfolio, generating more and more annual earnings—especially compared to 2014's earnings of \$49.7M.

Annual Earnings Generated by the City Treasurer's Office



- Modified the *Investment Policy Statement*
- Procured financial data
- Put additional cash into interest-bearing investments

- Made significant investments in human capital

- Announced ESG initiative
- Improved forecasting model
- Renegotiated interest rates with municipal depositories

- Implemented ESG model
- Improved internal reporting
- Updated cash and investment management strategy



CTO INVESTMENT PORTFOLIO UPDATE

We've improved the quality of the portfolio along metrics beyond just returns, helping lay the groundwork for the more sophisticated nature of our ESG strategy.

	2015	2018	Δ
Credit Rating	AA+	AA+	No Change
Duration	3.4 Years	1.8 Years	↓ 47%
Yield-to-Maturity	1.3%	2.2%	↑ 69%
Earnings	\$57.9M	\$156.1M	↑ 170%
ESG Rating	N/A	6.7	N/A



CTO INVESTMENT PORTFOLIO UPDATE

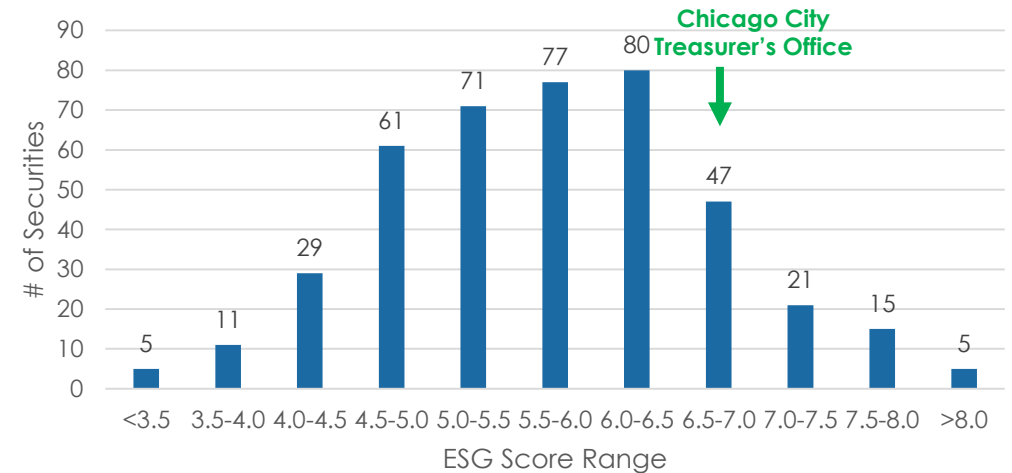
Overall ESG Portfolio Score	
6.7	85th Percentile

Recent Highlights



- \$50M investment in African Development Bank's Green Bonds Program, financing projects like sustainable infrastructure and reducing annual GHG emissions by about 350,000 tons annually after project completion
- \$10M investment in Tesla Asset-Backed Notes, financing leases for Tesla Model S & X electric vehicles and reducing annual GHG emissions by about 470 tons over 10 years

Distribution of ESG Scores for Rated Corporate Bonds in Our Investible Universe



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CHICAGO'S ESG STRATEGY

WHY DID CHICAGO PURSUE AN ESG STRATEGY?

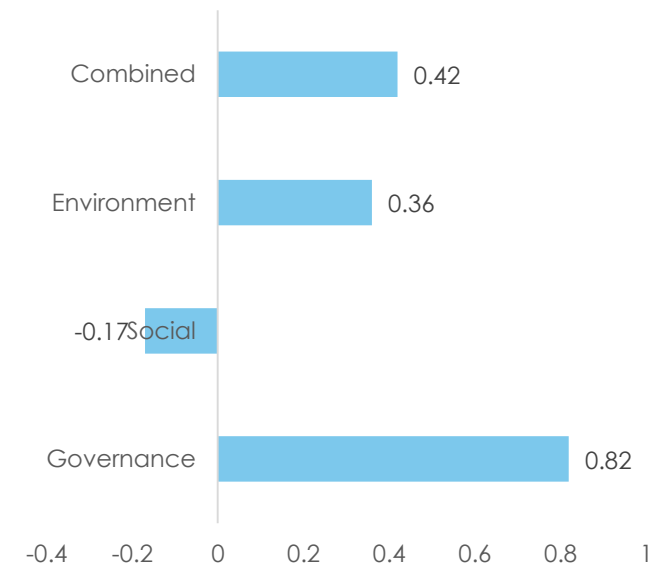
Fiduciary Duty

- As an investor, we are required to evaluate all factors that are material to financial performance, and ESG factors are empirically proven to reflect both financial risks and corporate fundamentals

Responsibility to Constituents

- As a government office, we are charged with serving the public and, as such, need to leverage our portfolio in ways that promote better lives for Chicagoans through investing in our city's neighborhoods and in our city's future

Annual Return Difference between Bond Portfolios with High and Low ESG Scores (Barclays)



CHICAGO'S ESG STRATEGY

WHY DID CHICAGO PURSUE AN ESG STRATEGY?

Integrating a wide range of ESG factors into our investment decisions is both financially prudent and impact driven.

Climate Change Exposure

- PG&E's bankruptcy filing due to ~\$30 billion in potential liability costs stemming from wildfires (2017/2018)

Corporate Board and C-Suite Diversity

- McKinsey study found that a 10 percent increase in racial and ethnic diversity on the senior-executive team is associated with a .8 percent rise in EBIT (2015)

Data Security and Privacy

- Equifax's data breach exposing sensitive personal information of almost 150 million U.S. consumers (2017)

Labor Rights

- XPO Logistics' allegations of turning a blind eye to sexual harassment in Memphis warehouse (2018)

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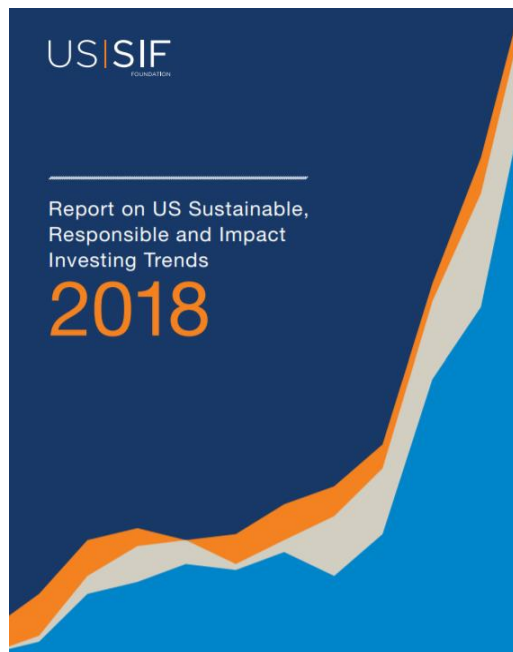
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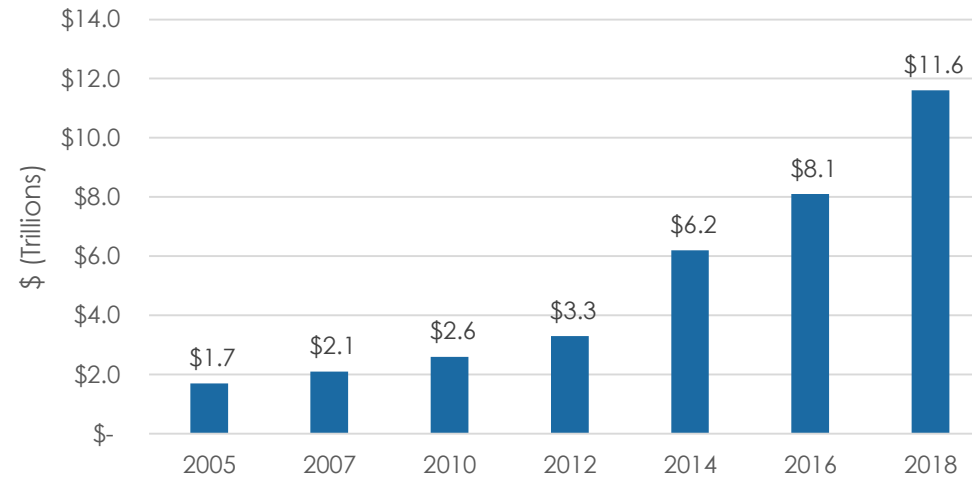
CHICAGO'S ESG STRATEGY

WHY DID CHICAGO PURSUE AN ESG STRATEGY?

US SIF's 2018 Trends Report highlighted how ESG strategies are being increasingly used by institutional investors.



Growth of ESG Integration for U.S.-Domiciled Assets



Top ESG Criteria for Institutional Investors

- Board Issues
- Climate Change/Carbon
- Conflict Risk
- Executive Pay



CHICAGO'S ESG STRATEGY

WHAT IS CHICAGO'S APPROACH?

Pillar 1: Use a customized ESG model that takes into account the unique priorities of Chicago's residents.

Step 1: Procure ESG Data

- Data provider was selected for high level of coverage across securities in the investible universe

Step 2: Select Key Factors

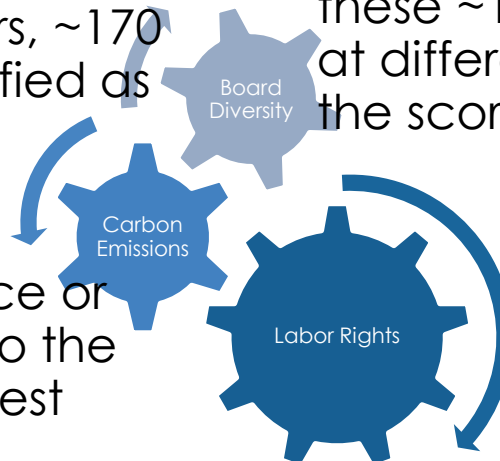
- Out of 700+ raw data factors, ~170 were identified as particularly material to financial performance or important to the public interest

Step 3: Develop Weighting Mechanism

- Model overweights these ~170 factors at different levels in the scoring process

Step 4: Implement Model in Decision-Making Process

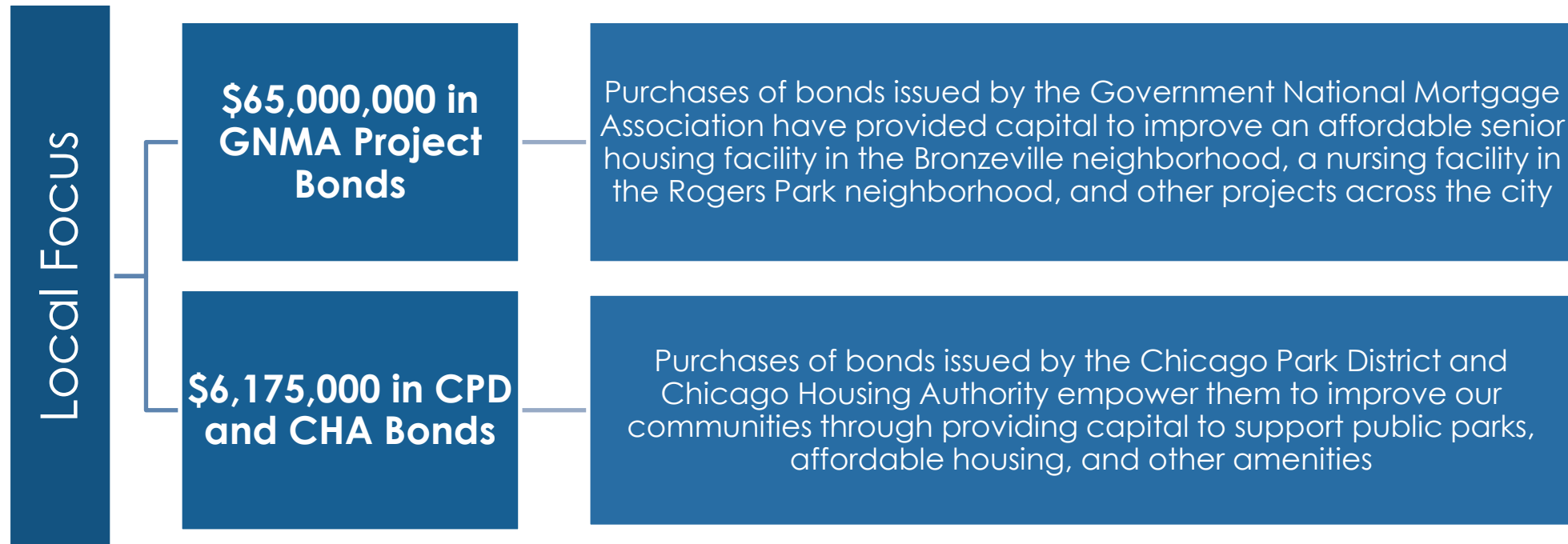
- Model integrated into investment decision-making process on 100% of corporate bonds as of summer 2018



CHICAGO'S ESG STRATEGY

WHAT IS CHICAGO'S APPROACH?

Pillar 2: Maintain an intense focus on putting taxpayer dollars back into neighborhoods to increase quality of life for Chicago's residents, while also earning market-rate returns.



CHICAGO'S ESG STRATEGY

WHAT IS CHICAGO'S APPROACH?

Pillar 3: Create accountability mechanisms through meaningful benchmarks.

Carbon-Neutrality

- Offset legacy investments in top publicly-owned coal, oil, and gas reserve owners with investments in environmentally-friendly securities

Overall Portfolio Score

- An ESG rating for the portfolio, akin to an average credit quality rating

UNPRI

- A lasting commitment to the United Nations-supported Principles for Responsible Investment

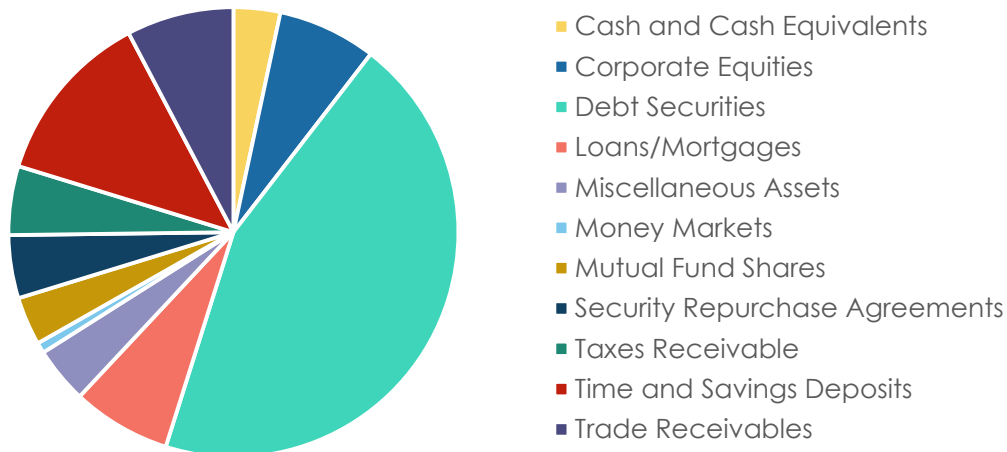


CHICAGO'S ESG STRATEGY

WHAT WOULD BE THE COLLECTIVE IMPACT IF ALL PUBLIC TREASURIES TOOK STEPS TOWARD ESG INTEGRATION?

With almost 100,000 governmental bodies in the U.S. holding \$3.1 trillion in assets, we have a unique opportunity to leverage our collective financial power to shape the future of corporate behavior.

Breakdown of Financial Assets Held by State and Local Governments (Q3 2018)



Public treasury assets, which are primarily short-term and fixed-income, have an inordinate impact on financial markets

11x more fixed-income issuances than equity underwriting in 2017 (\$7.6T vs. \$0.7T)

60% of fixed-income issuances in 2017 had **duration under 5 years**



CHICAGO'S ESG STRATEGY

WHAT ARE MY OPTIONS, AND HOW CAN I LEARN MORE?

What are my options?

- Find individual securities with strong ESG benefits
- Place ESG requirements on outside investment managers
- Procure standard ESG model from existing data provider
- Build customized ESG model

How can I learn more?

- Contact us at City.Treasurer@cityofchicago.org
- Get engaged with organizations like CII, UNPRI, and US SIF
- Save the date for a March 27th US SIF Trends event in Chicago, IL
- Look ahead to our forthcoming release of a white paper on ESG integration for public treasuries



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QUESTIONS?



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THANK YOU FOR JOINING

