

**BREMEN TOWNSHIP**  
**TRUSTEES OF SCHOOLS**

**ANNUAL INVESTMENT REPORT**  
**FISCAL YEAR ENDING JUNE 30, 2021**

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**Joanne Keilman, Vice-President**  
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**Robert A. Grossi, Treasurer**

**“An investment in education always pays the best interest.”**  
**Benjamin Franklin**

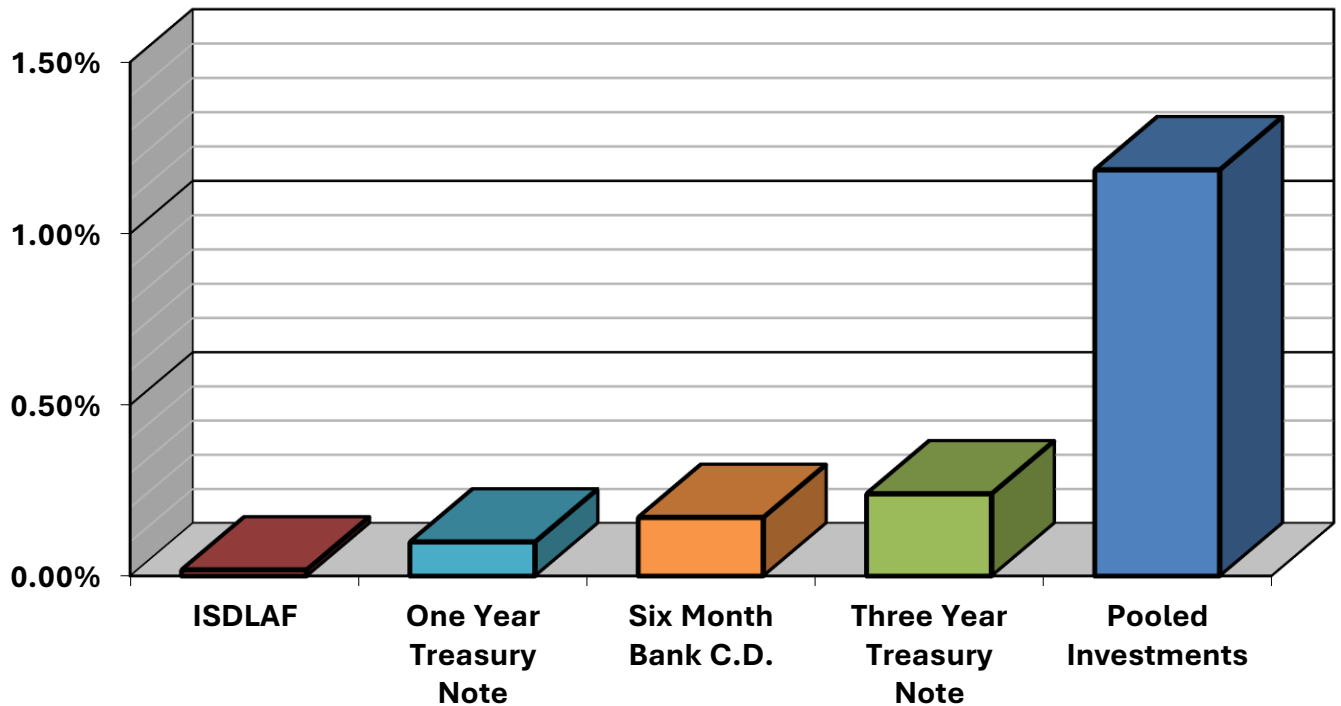
# INTRODUCTION

**T**he purpose of this report is to provide information to the administration and the board of education of the school districts and agencies that are serviced by the Bremen Township Trustees of Schools related to their funds for which we serve as custodian. All school districts and agencies that receive this report have their fund balances invested in a pooled portfolio, which consists of the fund balances of all the entities. Each entity owns a portion of the pool based on their level of cash as a percentage of the entire cash being managed in the pool. There are many benefits to this investment structure such as greater diversification, better liquidity, and higher, more stable interest rates. Interest from the pooled funds is distributed to the districts based on their percentage of the fund.

The following report is divided into four sections. The first section will summarize the pooled fund's performance for the fiscal year ending June 30, 2021. The second section will provide a review of interest rate movement during the fiscal year and provide our economic outlook. The third section will discuss our current investment strategy and the positioning of the investment portfolio as it relates to market conditions. The final section describes the general investment policy of the Bremen Township School Treasurer's Office.

## SUMMARY OF INVESTMENT PERFORMANCE

**F**or the fiscal year ending June 30, 2021, I am pleased to report that the investment pool managed by the Bremen Township Treasurer's Office generated \$1,271,000 in interest earnings to the school districts serviced by this office. Real estate tax revenues and state and federal revenues received during the fiscal year were generally placed in investments yielding between 0.05% and 0.50%. With an average investment portfolio size of \$168,000,000 (pooled investment portfolio plus money markets), the cash basis rate of return to the school districts was 0.76%. The return is a combination of interest earned on the pooled investment portfolio, interest earned in money market funds and changes in market value. The average monthly yield of the pooled investment portfolio for the fiscal year was 1.19%. The following graph compares the average monthly yield on the pooled funds with the average monthly yield of other investments available in the market during this same period:



The average monthly yield from the Illinois School District Liquid Asset Fund for the same time period was 0.02%, the one-year Treasury bill was 0.10%, the six-month Certificate of Deposit averaged 0.17%, and the three-year Treasury note averaged 0.24%.

# INTEREST RATE MOVEMENT AND ECONOMIC OUTLOOK

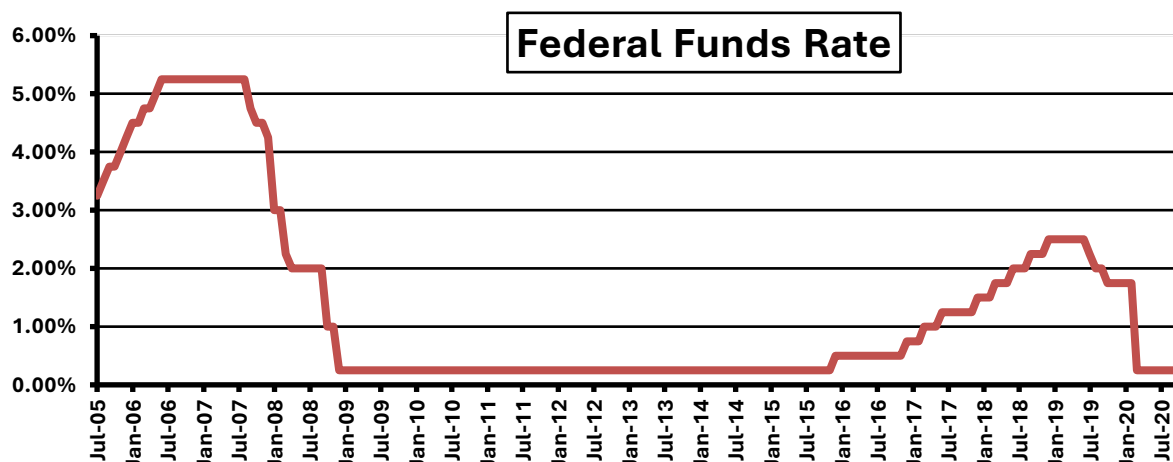
It seems as if everything in our world is moving in extreme patterns and in the wrong direction. The list of those areas trending extremely high includes COVID cases, the crime rate, the cost of almost everything we buy and certainly the emotions of our entire society as we attempt to navigate through this seemingly never-ending pandemic. Trending low are the morale of our citizens, trust and civility, the number of unemployed people willing to enter the work force and interest rate levels. While many articles and books have been written and many arguments have started around the dining room tables across America on these issues, in the small section of our world that focuses on how our school funds are invested, our focus is on interest rates and more specifically, short-term interest rate levels.

To summarize the driving forces of short-term interest rates, we must start by looking at the Federal Reserve. Statements made and action taken by the Federal Reserve primarily impact short and intermediate term rates, and subsequently the yield on our pooled investments. It is therefore relevant to monitor and assess both action and inaction taken by this body. No other variable is more relevant to the amount of interest earnings that are generated from your school district's fund balances than the actions taken by the Federal Reserve.

While the Federal Reserve was very quiet from 2009 through 2015, they have been quite active since. Between December 2015 and December 2018, the Federal Reserve, sensing that economic growth could finally be achieved without the aid of historically low lending rates, raised short-term interest rates nine times. This action ultimately raised the Fed Funds rate up to 2.50%. Then in a dramatic reversal, with pressure from then President Trump to accelerate economic growth during a period of low inflation, the Federal Reserve lowered rates in one-quarter of one percent intervals three times: in July, August, and October of 2019 down to 1.75% with the stated objective of continuing to strengthen economic growth in the USA. By all accounts, the policy was effective, and several economic indices showed significant improvement.

Then came COVID and with it, all economic growth came to a grinding halt. In response to the economic shutdown, the Federal Reserve slashed the Federal Funds rate by .50% on March 2, 2020 and an additional 1% on March 15, 2020, bringing the rate back to its historically low level of 0.25%. In responding to these actions, Chairman Powell stated "...we have lowered interest rates to near zero in order to bring down borrowing costs. We have also committed to keeping rates at this low level until we are confident that the economy has weathered the storm and is on track to achieve our maximum-employment and price-stability goals."

The Fed has left rates at this bottom figure since then, but for the first time since the advent of COVID, speculation is growing that the Fed will begin increasing rates soon. The following graph reflects movement in the Federal Funds Target Rate since July 2005:

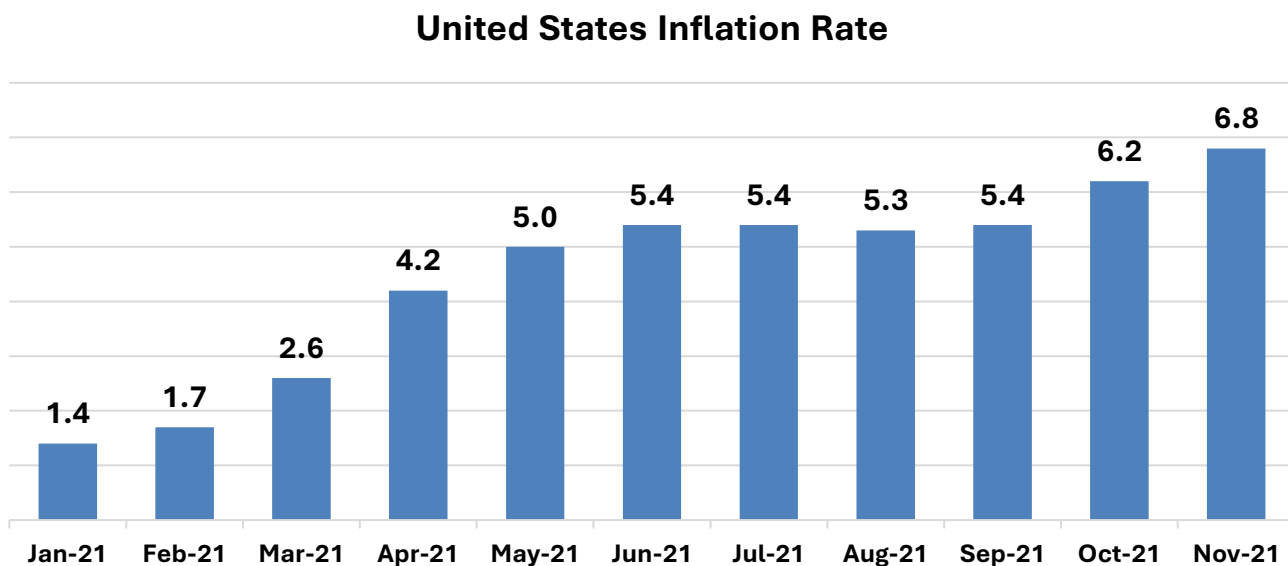


The statutory mandate of the Federal Open Market Committee (“FOMC”) is to foster maximum employment and price stability. At this point in time, the FOMC is looking for maximum employment and two percent inflation. In determining the timing and size of future adjustments, the Committee assesses realized and expected economic conditions relative to its objectives. This assessment considers a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

Part of the challenge of assessing the economy is that the COVID-19 pandemic is different than any prior global shock. When it struck in early 2020, the economy suffered its steepest decline on record as businesses and schools were shuttered. But it also rebounded quickly as businesses reopened, and it has since recouped all the output declines and most job losses. The economy has also experienced the steepest rise in inflation in over thirty years.

One question that the Federal Reserve must ponder is how future COVID outbreaks will impact the economy. In recent testimony on the omicron variant, Federal Reserve Chair Jerome Powell told lawmakers that the economic effect of the omicron variant would not be “remotely comparable” to what occurred at the onset of the pandemic. But it could influence monetary policy if the economy slowed. A slowing economy would put pressure on the Federal Reserve to keep short term rates low to not create additional headwinds that would exacerbate the slowing.

On the other hand, after being in denial earlier, the Fed now recognizes the pickup in inflation this year is not transitory and could persist into 2022 and 2023. The following graph reflects the monthly inflation rate since January 2021:

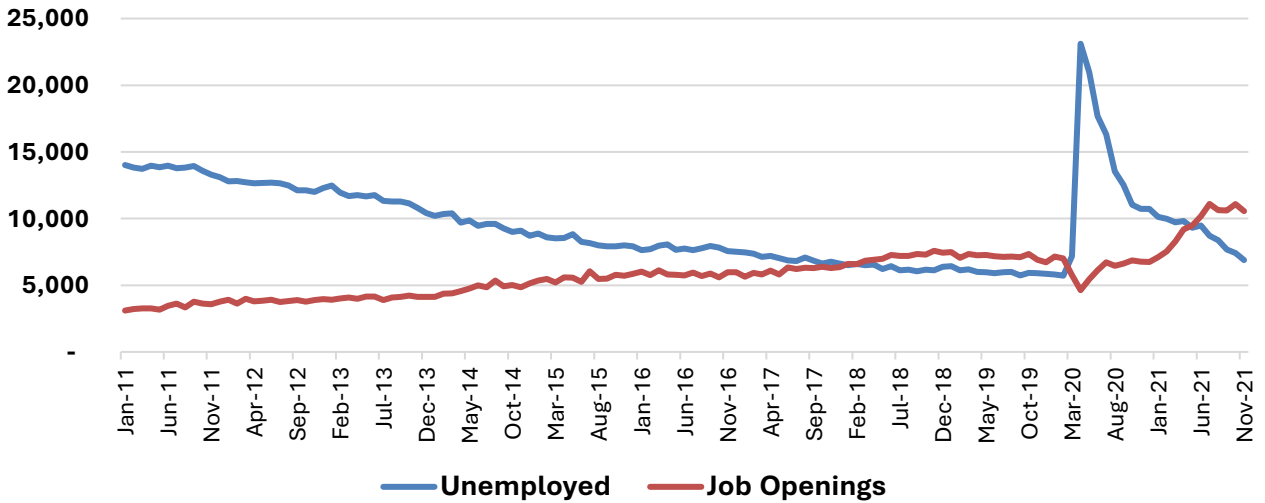


The Federal Reserve is starting to taper its stimulus and might be forced to hike interest rates sooner due to rising inflation, but “rate hikes might not be enough to reverse inflation because the sources of inflation involve supply chain bottlenecks and fiscal spending, which are two areas that the Federal Reserve doesn’t control,” said Nancy Davis, founder of Quadratic Capital Management.

Consumers, then, will likely have to face higher prices for longer than anticipated, and investors will have to hope the Fed doesn’t raise interest rates more quickly than expected, thereby spooking markets. Everyone is now left wondering just how transitory this transitory inflation spike is and how long average Americans can endure it. The median forecast of FOMC members now calls for three rates hikes in both 2022 and 2023, bringing the rate above 2% by 2024. The looming issue is whether this gradual glide path of rate increases will be sufficient to bring inflation back to the Fed’s average annual target of 2 percent.

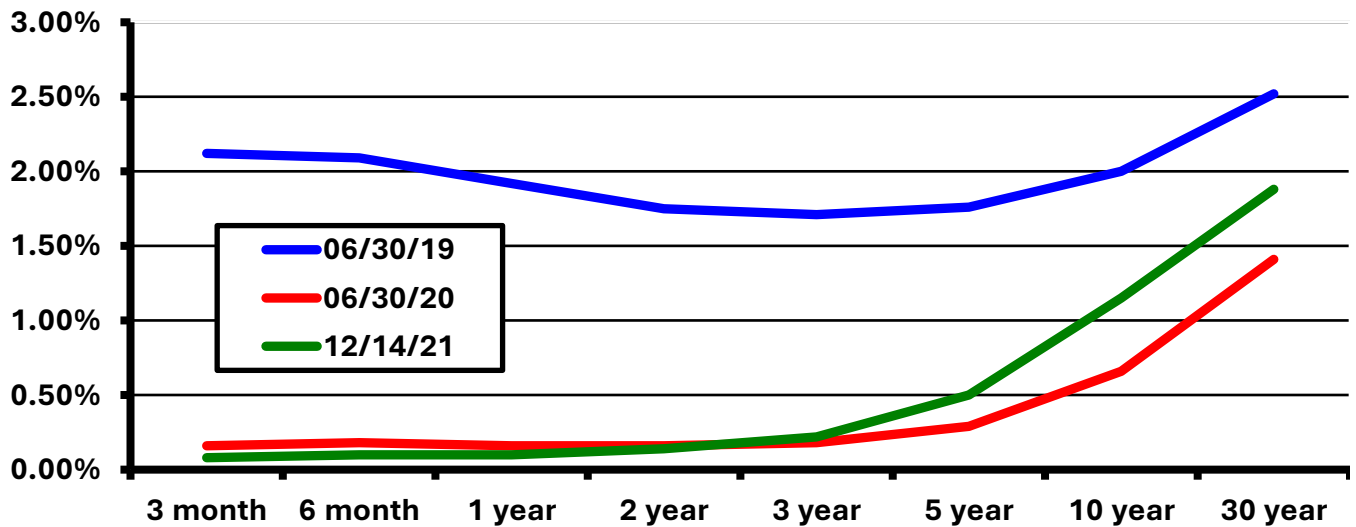
One major concern regarding long-term inflation is labor wages, which have risen steadily and are now approaching 4%. One of the most interesting and alarming graphs I have seen compares the number of people who are unemployed with the number of job openings. Note in the following graph that the number of job openings now exceeds the number of unemployed workers in our Country.

## Unemployment and Job Openings



There are currently over 11 million unfilled jobs. This is referred to as the employment gap. This employment gap has affected every facet of American life during 2021. Every service consumer has felt it, in restaurant waits, hotel service declines, home good backorders and especially in the hiring of skilled tradesmen for any kind of construction or repair project. The labor disruptions materially affect the US economy and will undoubtedly apply inflationary pressure on the labor market for perhaps a long time.

As a result of the expectation of the Fed raising rates, the yield curve has begun to move upward from its levels that existed on June 30, 2020. The following graph compares the yield curve on June 30, 2021, to the yield curve on June 30, 2020, and the yield curve as of the date of this report (December 14, 2021).



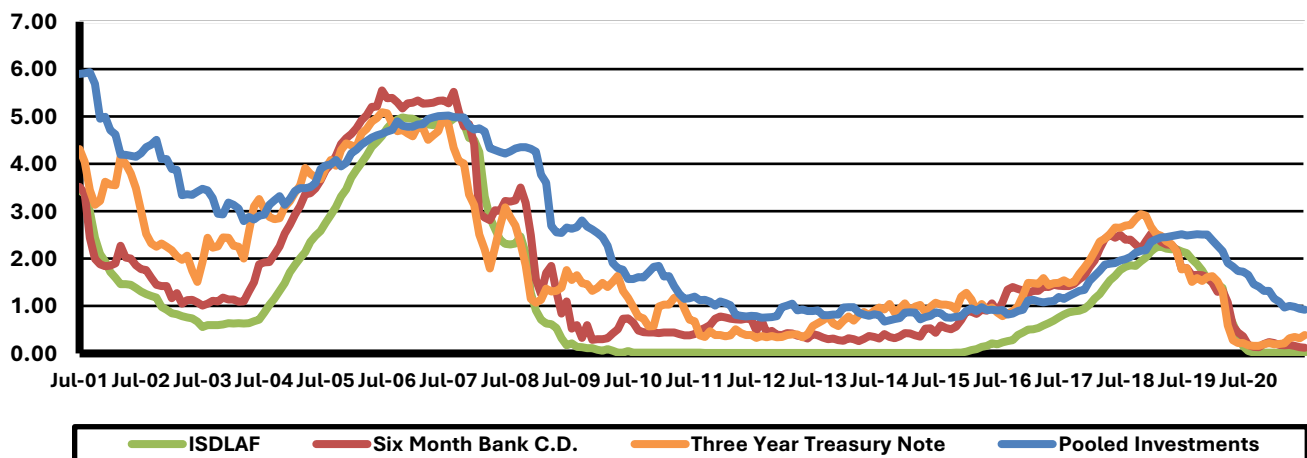
From June 30, 2020 to December 14, 2021, the yield on U.S. Treasury securities maturing on the shortest end of the curve remained virtually flat. Starting in about year three, the yield curve began to steepen. In June 2020, the pickup in interest rates between the 3-month yield and the 3-year yield was zero. By December 14, 2021, the pickup in yield between those two points on the yield curve was just under 1% (.05% vs. .98%). On the longer end of the curve, the ten-year yield increased from .66% to 1.46% and the thirty-year yield increased from 1.40% to 1.86%.

Putting the change in interest rates over the past few years in perspective, the following summarizes the approximate short-term rates available in the marketplace for investing second installment real estate tax collections:

<u>Investment Rates</u>		<u>Investment Rates</u>	
Fall 2006	4.80% - 5.40%	Fall 2014	0.01% - 0.10%
Fall 2007	3.80% - 4.50%	Fall 2015	0.01% - 0.10%
Fall 2008	1.00% - 3.00%	Fall 2016	0.10% - 0.30%
Fall 2009	0.10% - 0.80%	Fall 2017	0.75% - 1.25%
Fall 2010	0.02% - 0.40%	Fall 2018	1.80% - 2.10%
Fall 2011	0.02% - 0.20%	Fall 2019	1.80% - 2.20%
Fall 2012	0.01% - 0.15%	Fall 2020	0.02% - 0.20%
Fall 2013	0.01% - 0.10%	Fall 2021	0.05% - 0.15%

As we ponder interest rate levels in 2022, there are both unforeseen economic and non-economic events that could produce great volatility and uncertainty in both our economy and our fixed income markets. It is important to recognize, however, that while markets constantly change and interest rates have moved rather dramatically over the past several years, the yield on the pooled funds investment portfolio has remained relatively stable.

The following graph illustrates interest rate patterns on pooled funds and other investment vehicles since 2001 and illustrates the relative stability of our funds both in times of decreasing and increasing interest rate periods:





In analyzing the relative stability of the weighted average yield of the pooled investments it is important to note that this is not a stagnant portfolio where rising and falling interest rates have no benefit to our pool holders. We receive more than \$250 million in revenues annually into the pooled funds. While our core portfolio is affected adversely by rising interest rates, this same rise in rates provides us the opportunity to invest new funds at higher rates of interest. The reverse is true in times of declining rates. While the value of our portfolio rises in a declining interest rate environment, new revenues are invested at lower rate levels, driving down the yields but the core portfolio buffers the decline. As a result, our returns are generally less volatile during both rising and decreasing rate periods.

## **CURRENT INVESTMENT STRATEGY**

**S**ince a significant percentage of the funds received by this office during the fiscal year must be invested to meet short-term cash flow needs, interest rate direction is not the primary factor in investment decisions. It is important, however, to consider current interest rate conditions, the yield curve and interest rate trends in determining the overall desired duration of the portfolio.

With a backdrop of (1) historically low interest rate levels out at least two years on the yield curve; (2) money market yields at almost zero percent and (3) the prospects of the Federal Reserve raising interest rates to curb thirty-year high inflation levels, our primary investment duration target has been in the six-month to three-year range. This allows us to earn yields greater than money market funds yet also allows us sufficient liquidity in the future to capitalize on rising interest rate levels.

In addition, we continue to look at value amongst the investment vehicle options available to us. We currently are focusing on purchasing commercial paper, bank and corporate notes and short-term taxable municipal bonds. We are also active players in the direct purchase of municipal bonds from other school districts and municipalities in Illinois. These strategies have allowed the portfolio to maintain yields above the levels that exist in money market accounts and traditional short-term investments without compromising the objectives of the fund.

While risk in the credit markets seems to have diminished, we still respect the uncertainty that exists in the near future and are concerned about the possible effects of unforeseen events on our economy and our fixed income markets. We will continue to strongly weigh all investment decisions towards maximum safety and liquidity.

## CURRENT PORTFOLIO

Over the past year, we have been investing in an interest rate environment that was characterized by flat unattractive rate levels throughout the area yield curve where we normally invest funds. During that time, there was little incentive to extend much beyond money market vehicles. As the yield curve begins to steepen, however, we look to cautiously extend the portfolio in areas of value.

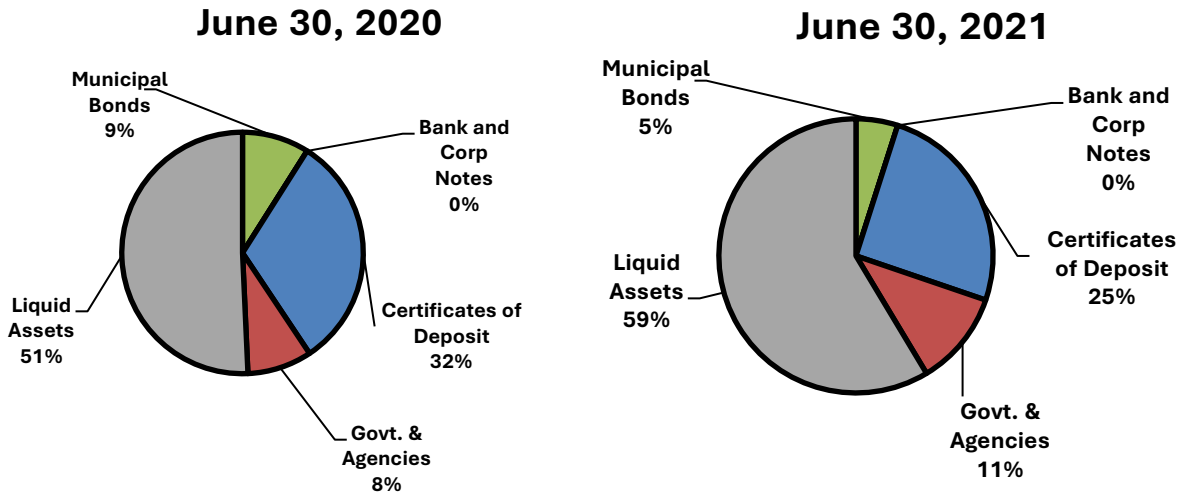
Not only is diversification of maturities essential to the performance of the pool, but also diversification of investment types is equally important. Diversification not only minimizes the risk in the pool but also allows us the ability to consider the entire investment arena in determining which investments will maximize yields while emphasizing safety.

There are six major categories of investments in which the Treasurer's Office considers:

- 1) Certificates of Deposit - These are direct obligations of a United States bank that are fully insured by the FDIC up to \$250,000 per entity for which this office serves as custodian of funds. Since the Bremen Township Trustees of Schools service 9 entities, the fund is covered for up to \$2,250,000 per banking institution.
- 2) Commercial Paper - Commercial paper is a direct obligation of United States corporations having more than \$500 million in assets. The maturity of such obligations must be under 180 days. The corporations must also be rated in one of the three highest categories by the major rating agencies.
- 3) Bank and Corporate Notes - Bank notes are direct obligations of United States banks which are members of the FDIC. The banks must achieve size and profitability requirements in order to be eligible for investment. Corporate Notes are direct obligations of large U. S. Corporations that meet the stringent criteria established in the Illinois Public Funds Investment Act.
- 4) Government and Government Agency Guaranteed and Collateralized Obligations - These are investments, which are guaranteed by the United States Government or its agencies.
- 5) Municipal Bonds - Bonds issued by a city or other local government, or their agencies. Municipal bonds may be general obligations of the issuer or secured by specified revenues.

- 6) Liquid Assets – Money market accounts in which funds are immediately assessable to the Districts.

The following pie charts reflects the investment composite of the pooled funds as of June 30, 2021, as compared to June 30, 2020:



## INVESTMENT POLICY

The following is a list of various policies, which are followed by the Bremen Township Treasurer's Office when implementing its investment decisions:

### **MAXIMIZING INTEREST REVENUES**

I. In order to maximize interest revenues on the funds received by this office, it is essential that all revenues earn interest as soon as this office receives them. We have streamlined our communications with the county, the state, and the brokers we deal with to ensure that funds due to the districts are received promptly by our banks. We have increased the use of wiring funds wherever possible rather than dealing with checks, which greatly reduce interest earnings. At the same time, we have established agreements with the banks that service our office to allow us to earn interest on the funds on the same day that a wire is received.

II. Through the pooling of the revenues of nine school districts/school agencies serviced by this office, we can invest in \$1,000,000+ blocks. This allows the districts' funds to be invested in investment types that may not otherwise be available in smaller lot sizes. Also, investing in \$1,000,000 lots often gives us greater liquidity than if investing in smaller sizes.

III. The Treasurer's Office works with several different brokers who have access to investments throughout the country. This allows for more thorough investment decisions to be made.

IV. The Treasurer's Office has established relationships with a large amount of trading desks which contact this office if a seller of an investment desires to liquidate an odd-lot (small size) investment. Odd-lot investments tend to offer higher yields because they are less liquid. Due to the fact that the trading desks already have a buyer for these investments, they will offer them at higher yields to this office, taking less spread out of the transaction.

V. Although local banks may offer rates which are slightly lower than rates offered by other institutions, consideration is given to those local institutions which provide needed assistance to our Districts. This includes banks, which lend Districts funds in times of financial hardship, as well as those banks, which provide scholarships and loans to the students of this community.

VI. The Treasurer's Office consistently updates cash flow projections to allow pooled funds to be invested at higher yields for the longest duration possible.

VII. The Treasurer closely monitors the investment and economic arena working with both fundamental and technical analysts to determine when investments should be purchased and sold as well as to determine the desired weighted average maturity of the portfolio.

### **MINIMIZING RISK**

I. All funds invested by the Treasurer's Office are invested pursuant to the Public Funds Act of the Illinois Revised Statutes and all legislation, which has affected such Act.

II. When Certificates of Deposits are purchased by this office, an effort is made to ensure that the purchase is within the aggregated FDIC insurance limits of this office, which is \$2,250,000. (9 entities x \$250,000 FDIC insurance amount)

## SUMMARY

**T**here were two major objectives I had when preparing this report. The first objective was to provide an update to the administration and trustees on the investment performance of the districts' funds during the fiscal year ending June 30, 2021. The second objective was to provide a partial list of the strategies, procedures and policies used by this office in order to ensure maximum investment performance of these funds.

We have been annually reporting our fund performance to the school districts we service for the past 26 years. In each of these years, we have performed well compared to all major financial indices we track. During that time, we have returned \$76.1 million in interest earnings to the school districts we service. We take the responsibility of managing your district's funds seriously and know that the partnership we have developed over the years, combined with the inherent value of a pooled funds system and the consolidation of fiscal services, has provided benefits to the taxpayers we all service.

In projecting interest earnings for the upcoming fiscal year, I expect returns to be below FY 2021 for two primary reasons: (1) Interest rates, and consequently reinvestment rates, are now at near historic low levels; and (2) investments that were purchased during a higher interest rate environment have generally been called or matured over the past few years. Should the Federal Reserve begin increasing short term rates, the increased earnings will generally not be realized until FY 2023.

I would appreciate any suggestions or comments the districts may have. This report will continue to be produced annually. If at any time during the year information pertaining to the investment portfolio is desired, it will gladly be provided.

I thank you for letting us serve your district.

Robert A. Grossi  
Bremen Township School Treasurer