BREMEN TOWNSHIP
TRUSTEES OF SCHOOLS

ANNUAL INVESTMENT REPORT
FISCAL YEAR ENDING JUNE 30, 2016

"An investment in education always pays the best interest"

- Benjamin Franklin

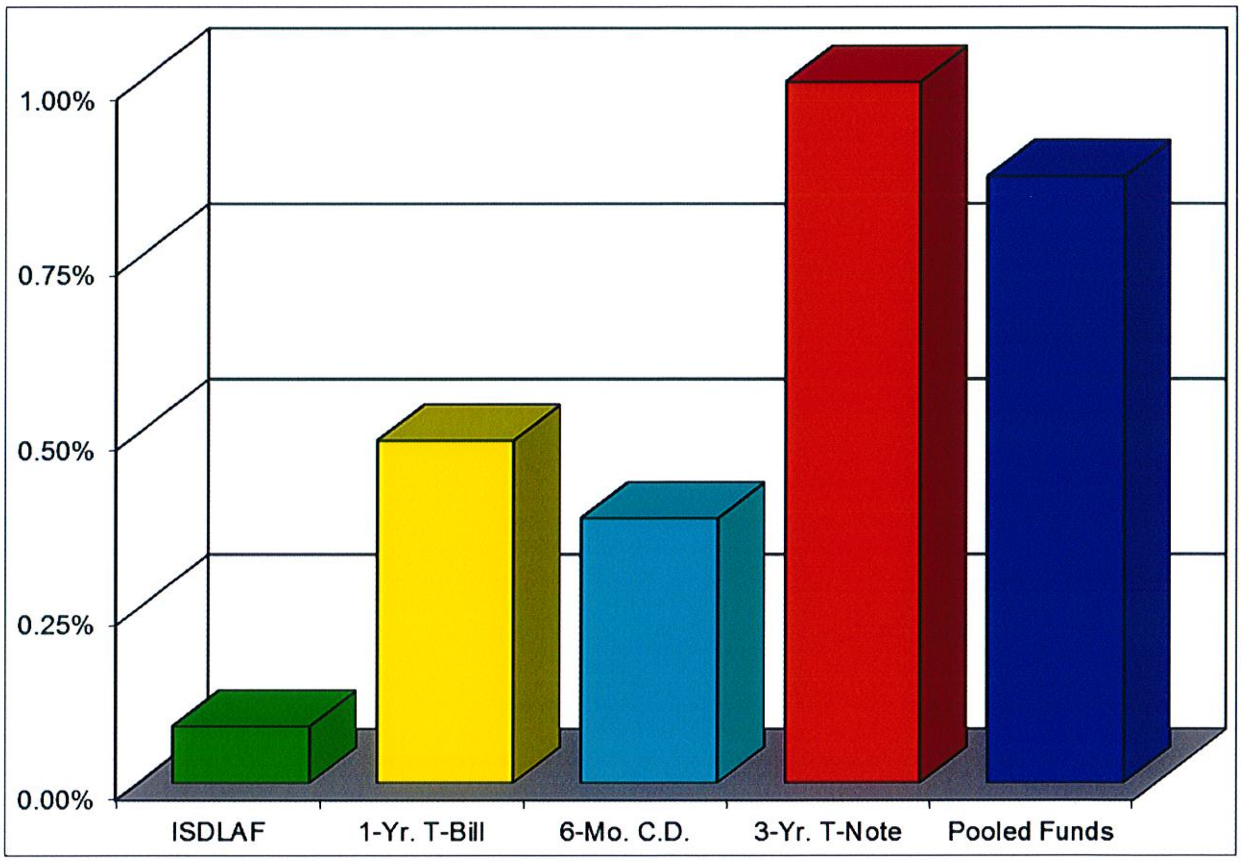
INTRODUCTION

The purpose of this report is to provide information to the administration and board members of the school districts that are serviced by the Bremen Township Trustees of Schools related to their funds for which we serve as custodian. All school districts that receive this report have their general funds invested in a pooled portfolio that consists of the funds of all the districts serviced by this office. Each district 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 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, 2016. The second section will provide a historical review of interest rate trends. The third section will analyze current market conditions and discuss the current portfolio as it relates to these conditions. The final section describes the general investment policy of the Bremen Township Treasurer's Office.

SUMMARY OF FISCAL YEAR INVESTMENT ACTIVITY

For the fiscal year ending June 30, 2016, I am pleased to report that the investment pool managed by the Bremen Township Treasurer's Office generated $826,256 in interest earnings to the school districts serviced by this office. With an average investment portfolio of $137,376,094 the cash basis rate of return for all the school districts was 0.60%. The yield on short-term investments continued to be at historical low levels, ranging from 0.01% to 0.21% during the fiscal year. Overall, the average yield on pooled funds managed by this office for the fiscal year was 0.87% and the average yield on funds that were held for liquidity purposes were 0.15%. The current yield on the portfolio as of June 30, 2016 is 0.91%, which represents the annualized current rate of return on June 30th. The rate of return produced by the pooled funds compared favorably with that of other investments available in the market as shown in the following chart:



The average yield from the Illinois School District Liquid Asset Fund (ISDLAF) for the same time period was 0.08%, the one year Treasury Bill was 0.49%, the six month Certificate of Deposit averaged 0.38%, and the three year Treasury Note averaged 1.03%. The weighted average maturity on the pooled funds managed by this office was 0.73 years (266 days) as of June 30, 2016.

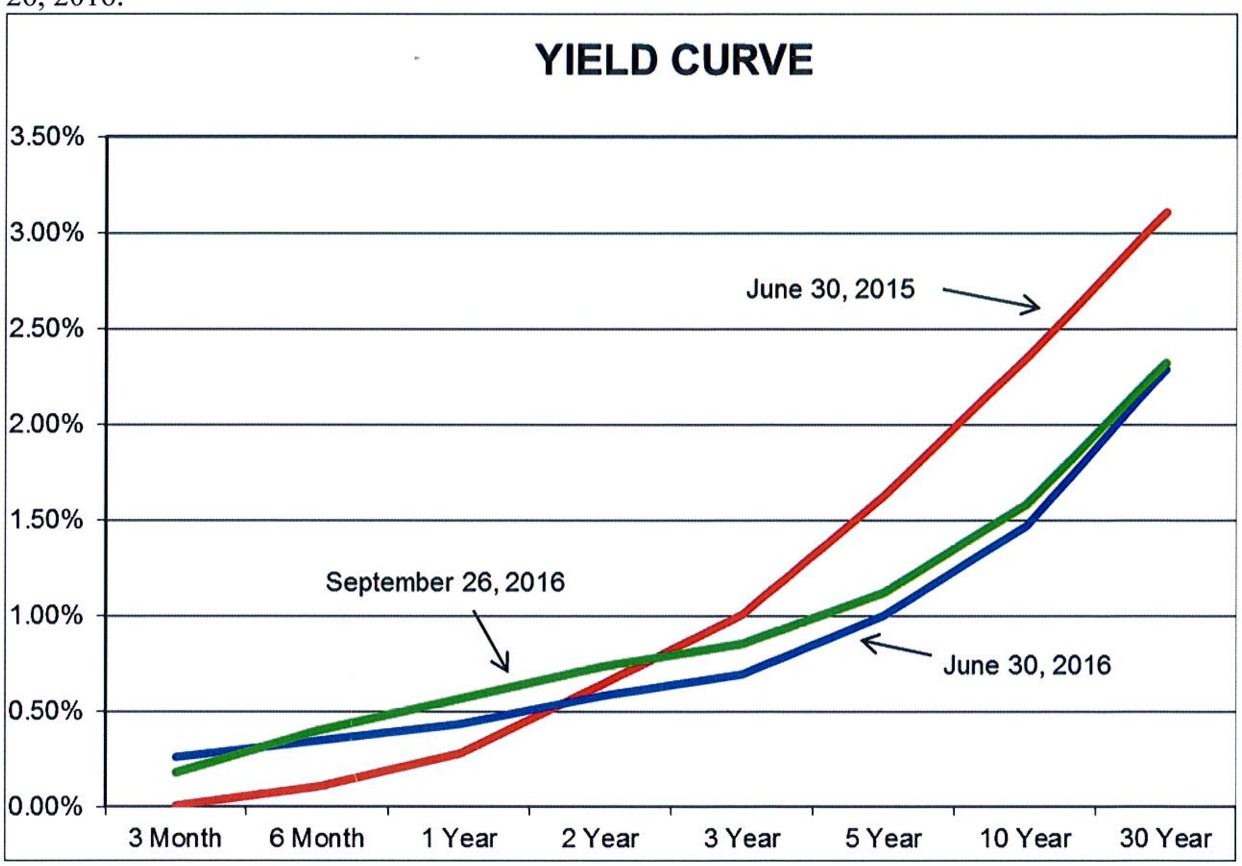
INTEREST RATE MOVEMENT AND ECONOMIC OUTLOOK

At its December 2015 meeting, the Federal Reserve raised short-term interest rates for the first time since the financial crisis of 2006. The decision was described as a vote of confidence in the American economy, even as much of the world struggles. Janet Yellen, the Fed's chairwomen, said the decision "recognizes the considerable progress that has been made toward restoring jobs, raising incomes and easing the economic hardships that have been endured by millions of ordinary Americans."

While speculation was high about another rate hike shortly after this first move, the Fed has yet to raise rates in 2016. The decision to not raise rates, according to the Fed, does not reflect a lack of confidence in the economy. However, the slow pace of growth in the labor market played a major role in its decision to wait until further evidence of economic strength is obtained.

Another reason for the Federal Reserve to keep rates unchanged after its move in December 2015 is the exit of Britain from the European Union, known as "Brexit", and the uncertainty surrounding this dramatic action. Some experts believe that the new uncertainty of investing funds in European markets will result in a massive capital flight into U.S. Treasury securities, which could drive interest rates lower in the United States and also boost the value of the dollar. In fact, in the immediate aftermath of Britain's vote, Treasury yields swooned to the lowest levels in years and are partially responsible for the decrease in yields depicted in the yield curve graph below.

Despite an increase in the Fed Funds rate, which impacts the shorter end of the yield curve, longer-term rates have decreased versus their June 30, 2015 levels. The following graph illustrates the yield curve on June 30, 2016, as compared to June 30, 2015 and a more recent date of September 26, 2016.



During the fiscal year, the yield on U.S. Treasury securities maturing in less than one year, increased from near 0% to the 0.3% range. However, it should be noted that interest rate levels out beyond two years actually declined during the fiscal year. In fact, while on June 30, 2015, investors would have had to go out three years in order to get a yield over 1%, an investor on June 30, 2016 would have had to go out five years to get a yield that exceeded 1%. For the fiscal year, the three-year Treasury note decreased 32 basis points from 1.01% to 0.69%, yields on the ten-year Treasury note decreased 88 basis points, from 2.35% to 1.47% and yields on the thirty-year Treasury bond decreased 82 basis points, from 3.11% to 2.29%.

The decline in interest rate levels is primarily due to (1) lower expectations of the Fed raising interest rates significantly in the future, (2) uncertain global events, including Brexit and (3) the fact that interest rate levels in other areas of the world are generally below those rates offered in the United States. In fact, major monetary institutions including the Bank of Japan, The European Central Bank, Sweden, Switzerland and Denmark have interest rates below zero. As of April 2016, over $8 trillion of government bonds worldwide offered yields below zero. Therefore, even though interest rate levels in the United States are at historically low levels, they still are attractive worldwide both in terms of yield and safety of funds.

Statements made and actions 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 the Fed. The major objectives of the Federal Reserve, when making policy, are to maximize employment while keeping a lid on inflation. The Fed's objective is an unemployment rate of around 5%, with inflation levels in the range of 2%.

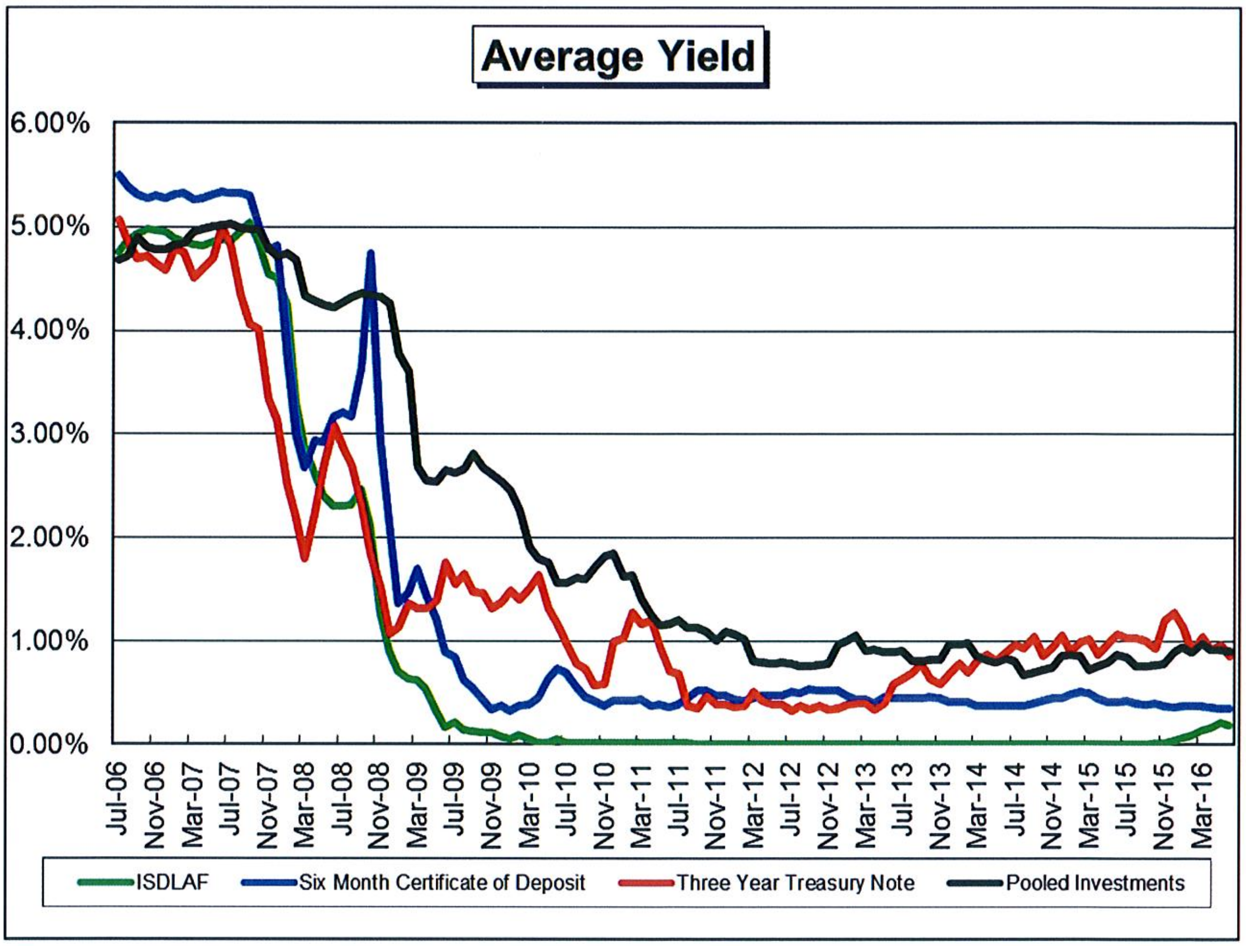
Many experts believe that the Federal Reserve is likely to raise interest rates again in December 2016. Modest increases in inflation signal this action. However, it must be noted that poor manufacturing and retail data, combined with recent slowing of job growth, are causes of concern and will certainly provide weight on this decision. Even with a rate hike, however, interest rates will likely stay low and fluctuate within a narrow range for some time to come. Economists generally believe that only when inflation shows a stronger upward trend, likely from continuing improvement in the labor market, will rates show a sustained upward trend. Inflation, however, is projected by many experts to be low for an extended period of time. While many believe that another rate increase will occur soon, it is important to note that every other developed nation, that has raised rates since the end of the financial crisis, has been forced to backtrack as growth slowed.

Within this framework, most experts expect short-term interest rates to increase, as the Federal Reserve continues to express a desire to raise rates, unless troubling economic data reflecting a weakening or stagnant economy presents itself. Long-term interest rates are more uncertain, as the key risks stated above can dramatically change the direction of these rates, at least in the short run. The traditional factors that would lead to an extended period of rising interest rates, which include economic growth and rising inflation, do not seem to be of major concern at this present time.

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:

	Investment Rates
Fall of 2010	0.02% - 0.40%
Fall of 2011	0.02% - 0.20%
Fall of 2012	0.01% - 0.15%
Fall of 2013	0.01% - 0.10%
Fall of 2014	0.01% - 0.10%
Fall of 2015	0.01% - 0.10%
Fall of 2016	0.10% - 0.30%

While interest rates have fluctuated dramatically over the past several years, the yield on the pooled funds investment portfolio has remained relatively stable. The following graph reflects interest rate patterns on the pooled funds and other investment vehicles over the past ten years and illustrates the relative stability of our pooled funds both in times of decreasing and increasing interest rate environments:



In analyzing the relative stability in the weighted average yield of the pooled investments, it is important to note that this is not a stagnant portfolio where rising interest rates have no benefit to our pooled fund holders. We receive in excess of $310 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, new revenues are invested at lower rate levels, driving down the yields. As a result, our returns are less volatile during both rising and decreasing rate environments.

CURRENT INVESTMENT STRATEGY

Since a significant percentage of the funds received by this office 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, yield curves and future interest rate trends in determining the overall desired duration of the portfolio.

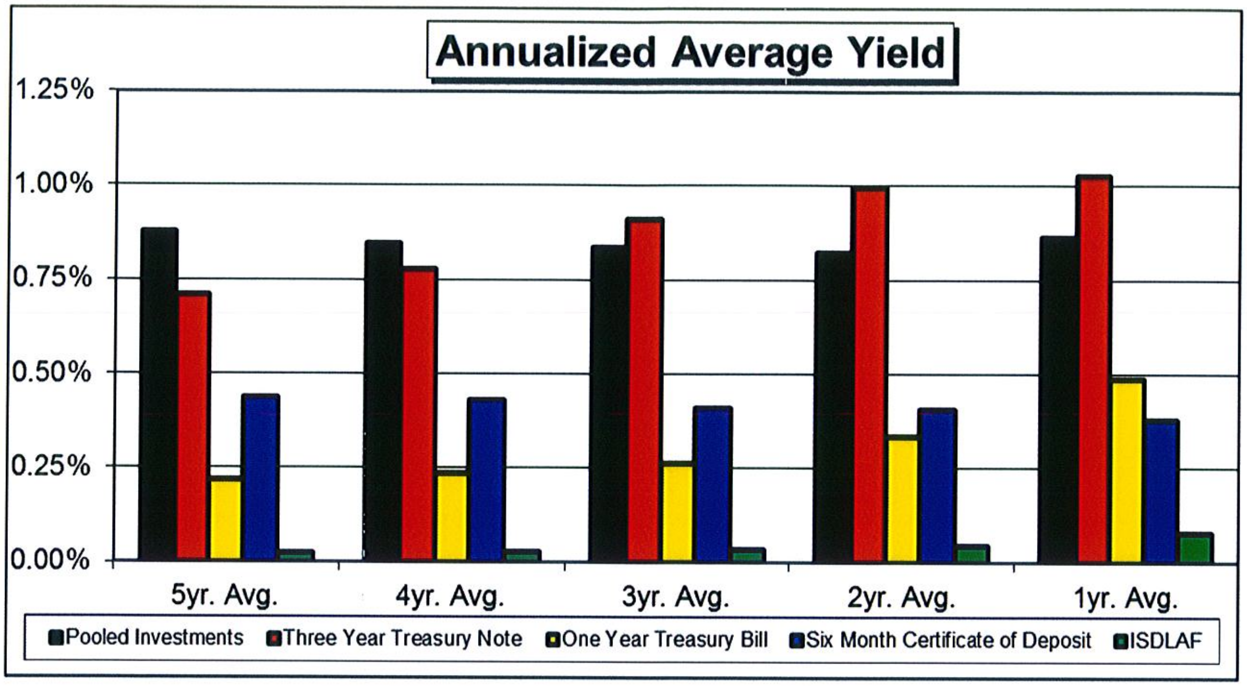
Cognizant of the fact that we are in the midst of an extraordinary time of economic crisis and credit turbulence, we continue our strategy of maintaining liquidity and preserving capital with very low tolerance for risk. Since the Spring of 2008, nearly all revenues have been invested at the shorter end of the yield curve and our emphasis has been predominantly on safety and taking advantage of government guarantees and assurances in making investment decisions.

While maintaining this emphasis, we recognize that the longer the Fed remains passive, the more we can benefit from incremental curve extension and benefit from yield curve roll-down. In addition, we continue to look at value amongst the investment vehicle options available to us. We have recently begun purchasing short-term municipal bonds from taxing bodies in Illinois by placing above market interest rate bids on new issues that are not being offered in the global market arena. These strategies have allowed the portfolio to maintain some yield, above the anemic levels that exist in money market accounts and traditional short-term investments, without compromising the objectives of the pooled funds.

We anticipate that we will continue to keep the portfolio in the shorter end of the yield curve, in the near future, as we monitor action taken by the Federal Reserve, the direction of our economy and external events, such as Brexit and the economy of other major countries such as China. Also, because our revenue stream from State and local sources is as uncertain as ever, we feel like we must maintain a higher level of liquidity to ensure that funds are available to cover expenditure needs.

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 until we are confident in the overall direction of our Federal, State and local economies.

A major benefit of pooling funds for investment purposes is the ability to invest in longer term maturities that enhance the yield on the portfolio. Although most of our investments have been in the shorter end of the yield curve, the flexibility to invest in longer term maturities has proven beneficial to the investment pool. This strategy has consistently allowed the pooled funds to compare favorably to other investment alternatives. As seen in the following graph, the five-year average interest rate yield on the pooled investments has outperformed all other investment vehicles presented below.

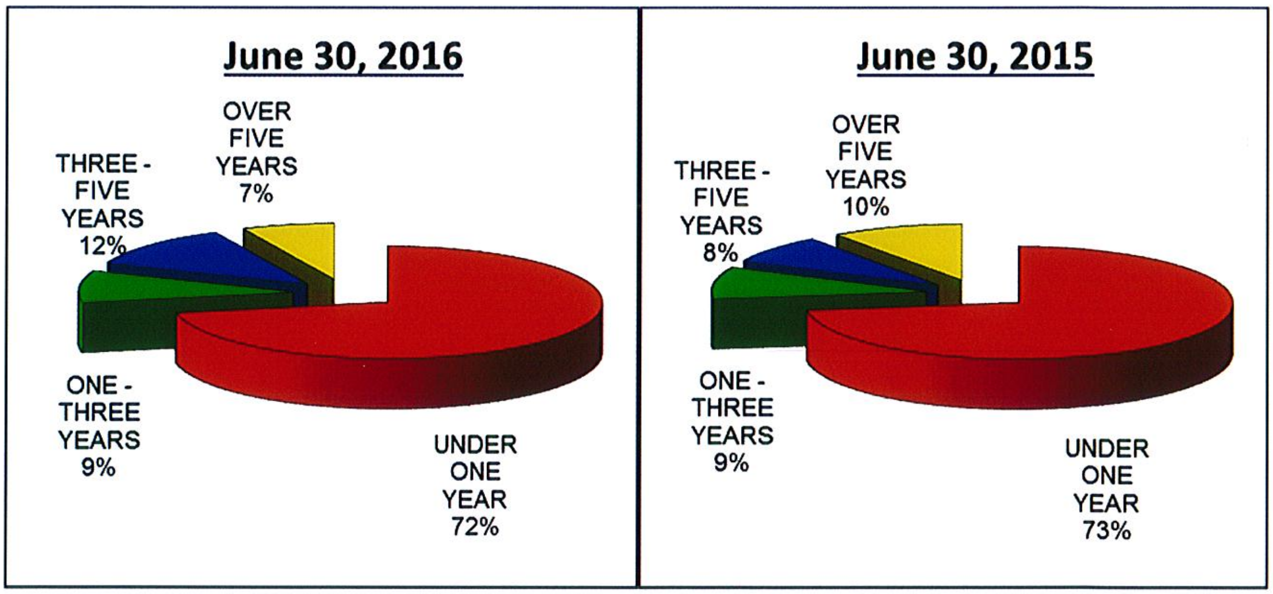


The five-year average yield on the pooled investments was 0.88%, the three-year Treasury Note was 0.71%, the one-year Treasury Bill was 0.22%, the six-month CD was 0.44%, and the ISDLAF was 0.03%. The higher five-year average interest rate yield on the pooled funds of 0.85% above the ISDLAF average rate has generated over $3.1 million of additional interest earnings over the five-year period. This higher interest rate yield is primarily due to our strategy in managing the pooled investments.

CURRENT PORTFOLIO

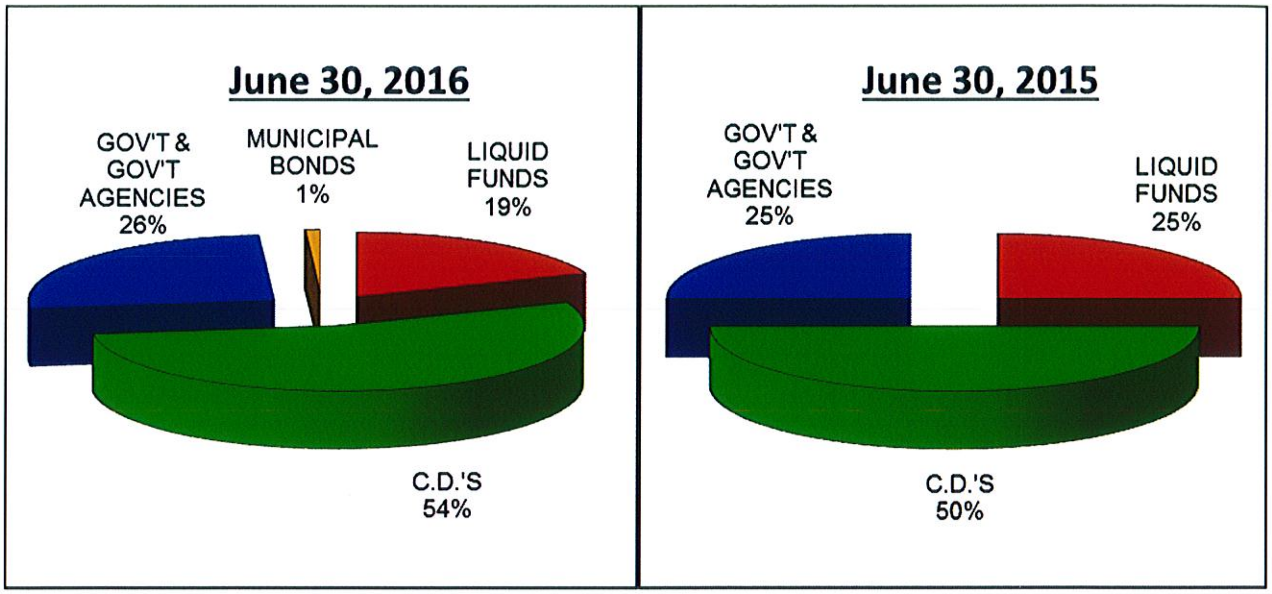
Over the past fiscal year, we have continued to maintain a significant position in the shorter end of the yield curve, due to the uncertainty in market risk, the flattening of the yield curve and revenue collections from the State to the districts. As can be seen in the graph below, we continue to maintain a significant percentage of the portfolio maturing in under one year at 72% of the portfolio. Investments in the one-three year range were unchanged at 9%. Investments maturing in the three-five year range increased from 8% to 12% of the portfolio and the over five year range decreased from 10% to 7% of the portfolio.

The following graph reflects the allocation of the portfolio by expected maturity date on June 30, 2016 as compared to June 30, 2015:



Although funds received by this office must be invested to meet short-term cash flow needs, we have a portfolio that gives us the opportunity to consider current interest rate conditions, yield curves and interest rate trends in determining an overall desired duration of the portfolio. As of June 30, 2016, these indicators implied the use of a more liquid portfolio, which would afford us more flexibility in implementing our investment strategy. As such, we have slightly increased investments within the one-three year duration range, in order to capture rising interest rate levels in these maturity ranges. The decrease in the duration range above five years reflected several bonds being called and principal payments on investments. The weighted average maturity of the portfolio was 0.73 years (266 days) on June 30, 2016, compared to 0.89 years (325 days) on June 30, 2015.

Not only is diversification of maturities essential to the performance of the portfolio, but diversification of investment types is equally important. Diversification not only minimizes the risk in the portfolio, but also allows us the ability to consider the entire investment arena in determining which investments will maximize yields while emphasizing safety. As of June 30, 2016, the pooled funds consisted of approximately 100 different investments that are regularly monitored. The following pie chart reflects the investment composite of the pooled funds as of June 30, 2016 as compared to June 30, 2015:



As can be seen from the pie chart above, 19% of the pooled funds were invested in liquid funds, 54% in C.D.'s, 26% in government/government agency obligations and 1% in municipal bonds. The composition of the portfolio in terms of investment type remained relatively stable. Our percentage of C.D.'s has increased, due to the shifting of liquid funds into longer maturity investments, in order to capture higher interest rate levels. We continue to remain active in the government agency securities market, which gives the pooled funds the credit strength of U.S. Government backed securities, with higher rates of return. As mentioned previously, we have recently focused on purchasing short-term municipal bonds from taxing bodies in Illinois.

There are six major categories of investments available to the pool as of June 30, 2016:

1) **Liquid Funds** - These comprise funds readily available for withdrawal at any given notice and include regular checking, deposit, and money market fund accounts.

2) **Certificates of Deposit** - These are direct obligations of a United States bank which are fully insured by the FDIC up to $250,000 per entity or $2,250,000 of this pool per banking institution.

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) **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 less than 180 days. The corporations must also be rated in one of the three highest categories by the major rating agencies.

5) **Government and Government Agency Guaranteed and Collateralized Obligations** - These are investments that are guaranteed by the U. S. Government or its agencies. This also includes investments in which government/agency collateral has been pledged, as well as municipal bonds that are either insured or at the highest of rating categories.

6) **Municipal Bonds** - These are 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.

INVESTMENT POLICY

The following is a list of various policies that 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 that 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 the wire is received.

II. Through the pooling of revenues of eight school districts serviced by this office, we have the ability to invest in $1,000,000+ blocks. This allows the districts' funds to be invested in instruments that would not otherwise be available in smaller lot sizes. Also, investing in $1,000,000 lots often gives us the ability to earn higher yields than if investing in smaller lot 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. Although local banks may offer rates that are slightly lower than rates offered by other institutions, consideration is given to those local institutions which provide needed assistance to our school districts.

V. The Treasurer's Office consistently updates cash flow projections to allow pooled funds to be invested at higher yields for the longest duration possible. The balance in the liquid funds is targeted to be around 5% of the total pool.

VI. The Treasurer constantly monitors the investment and economic arena working with both fundamental and technical analysts in order 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 that has affected such act.

II. When Certificates of Deposits are purchased by this office, the CD's are designated as "multiple taxpayer ID deposits" to ensure that the purchase is within the aggregated FDIC insurance limits of this office, which is $2,250,000. If this is not sufficient to fully insure the investments, the CD's will be collateralized by the banking institution.

SUMMARY

There were two major objectives I had when preparing this report. The first objective was to provide an update to the administration and board members on the investment performance of the school districts' funds during the fiscal year ending June 30, 2016. The second objective was to assure the districts that all revenues, which are received by this office, are closely managed and 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 21 years. In each of these years, we have performed well compared to all major financial indices we track. During that time, we have returned over $63.1 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 substantial benefits to the taxpayers we all service.

In projecting interest earnings for the upcoming fiscal year, I expect returns on a cash basis to continue to be low for three primary reasons: (1) interest rates continue to be at historic low levels; (2) several of the callable bonds with higher yields have been or should be called during the upcoming fiscal year, and reinvestment of these funds will most likely be at lower rates; and (3) the State of Illinois' budget uncertainty and its threat on school funding requires us to place a heightened focus on liquidity and shorter term, lower yielding investments.

Our plans are to continue to produce this report on an annual basis. I would appreciate any suggestions or comments you may have. As always, 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.

Joseph J. McDonnell
Bremen Township School Treasurer