

BREMEN TOWNSHIP

TRUSTEES OF SCHOOLS

ANNUAL INVESTMENT REPORT

FISCAL YEAR ENDING JUNE 30, 2017

Deborah A. Stearns, President
Tina M. Moslander, Vice President
Joanne Keilman, Secretary

Alesia Franklin-Allen, Trustee
Nancy Hullinger, Trustee
Natalie Myers, Trustee
Darlene Washington, Trustee

Joseph J. McDonnell, Treasurer

"An investment in education always pays the best interest"

- Benjamin Franklin

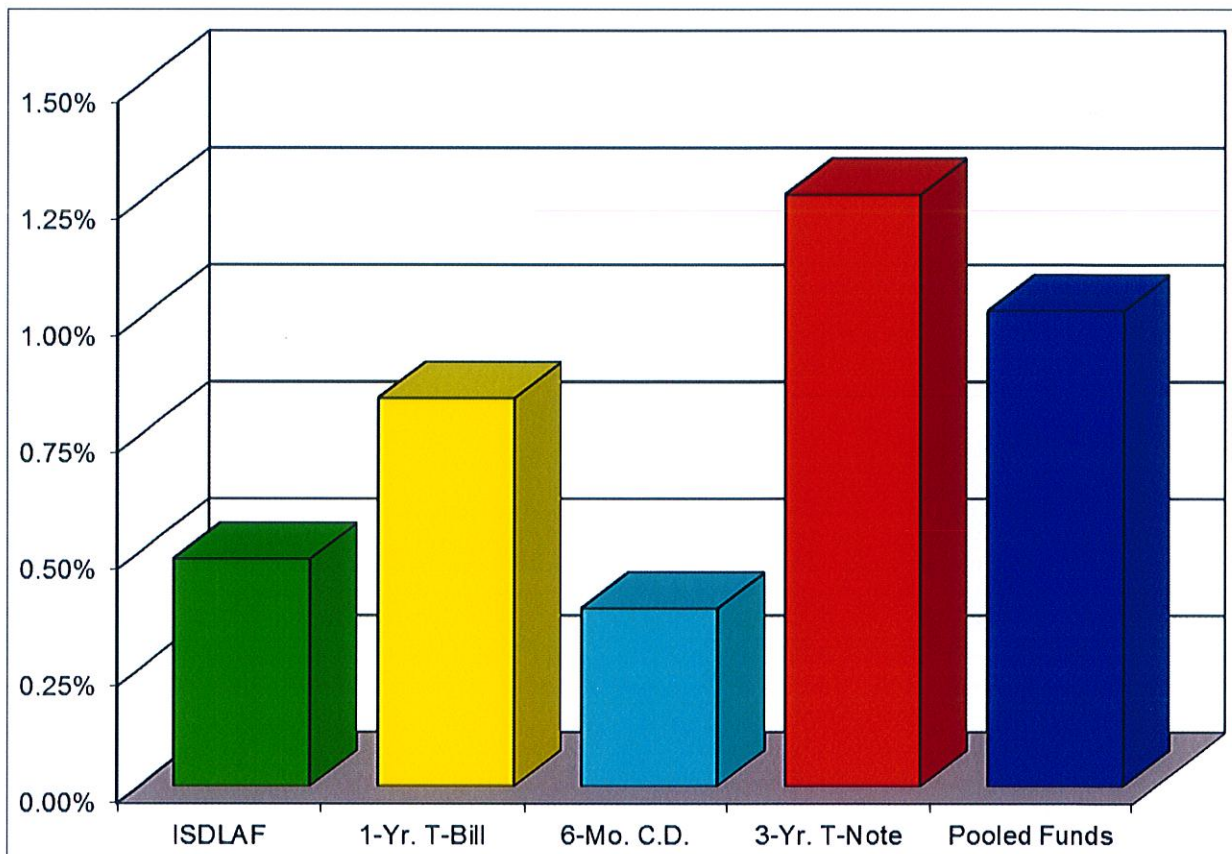
INTRODUCTION

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, 2017. 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, 2017, I am pleased to report that the investment pool managed by the Bremen Township Treasurer's Office generated \$1,428,689 in interest earnings to the school districts serviced by this office. With an average investment portfolio of \$179,344,215 the cash basis rate of return for all the school districts was 0.80%. The yield on short-term investments continued to be at historical low levels, ranging from 0.23% to 0.76% during the fiscal year. Overall, the average yield on pooled funds managed by this office for the fiscal year was 1.02% and the average yield on funds that were held for liquidity purposes were 0.49%. The current yield on the portfolio as of June 30, 2017 is 1.19%, 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 0.49%, the one year Treasury Bill was 0.83%, the six month Certificate of Deposit averaged 0.38%, and the three year Treasury Note averaged 1.26%. The weighted average maturity on the pooled funds managed by this office was 0.60 years (219 days) as of June 30, 2017.

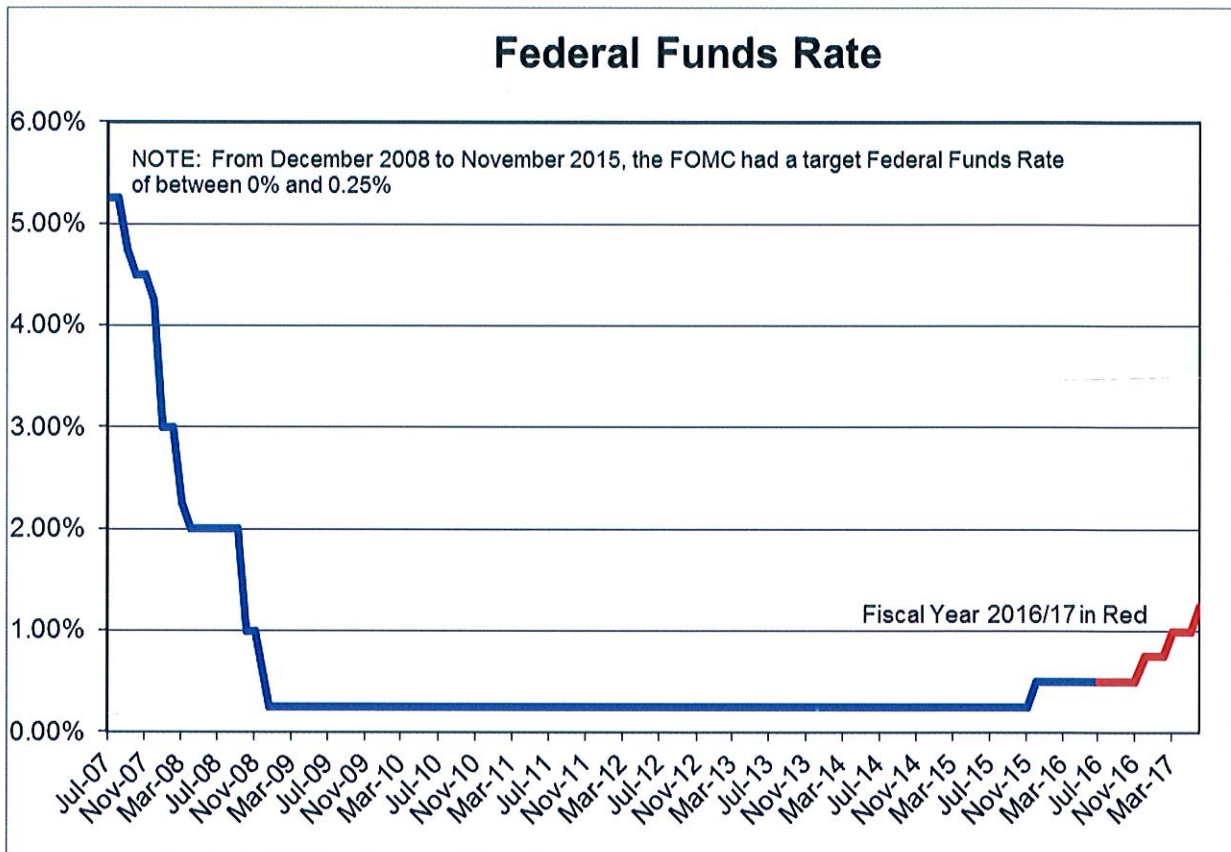
INTEREST RATE MOVEMENT AND ECONOMIC OUTLOOK

On June 14, 2017, the Federal Reserve raised short-term interest rates one-quarter of a percent to 1.25%. This marked the fourth time, since December 2015, that the Fed has hiked its policy rate. Other increases, which have all been at one-quarter of a percent, occurred at the Fed's December 2016 meeting and at the March 2017 meeting.

The statutory mandate of the Federal Open Market Committee ("FOMC") is to foster maximum employment and price stability. Specifically, at this point in time, the FOMC is looking for maximum employment and two percent inflation. In determining the timing and size of future interest rate adjustments, the Committee assesses realized and expected economic conditions relative to its objectives. This assessment takes into account 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.

The Committee believes, at this point in time, that with gradual adjustments in its stance of monetary policy, economic activity will expand at a moderate pace, and labor market conditions will strengthen somewhat further. Inflation, on a 12-month basis is expected, according to the FOMC, to remain somewhat below two percent in the near term but to stabilize around the Committee's two percent objective over the medium term.

The following graph reflects movement in the Federal Funds Target Rate since July 2007:

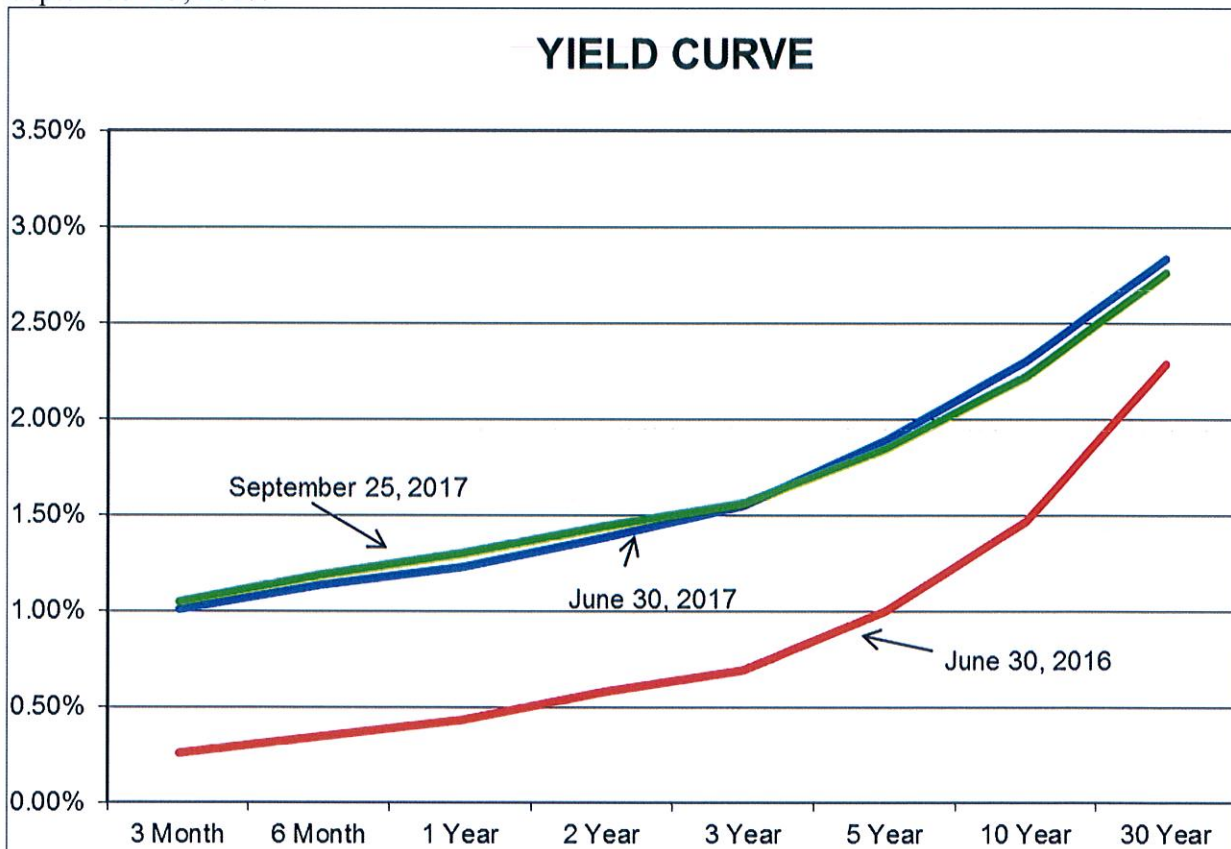


While most experts agree that the Fed Funds Target Rate will continue to increase, there are varying opinions as to the expected number of increases. In September 2017, the Federal Reserve reaffirmed its position that the labor market continues to strengthen as job gains remain solid and that economic activity has been rising moderately, so far this year. They also restated their position that despite an increase in economic activity, it has not produced a corresponding impact on overall inflation. Excluding food and energy prices, inflation levels have declined this year and are running below two percent. With little pressure in inflation, the FOMC voted unanimously at its September 2017 meeting to maintain the Fed Funds Target Rate at 1.25%.

Partially due to its expectation of subdued inflation, the FOMC cut its projection on the number of rate hikes it expects through 2019 to six, with one increase in December 2017, three increases in 2018 and two increases in 2019, and lowered its ultimate target rate from 3.00% to 2.75%. Note that recent trends have the Federal Reserve increasing rates at a lower pace than their projections. In 2016 for example, the Fed anticipated four rate increases, but only enacted one, and 2017 will mark another year that the Fed has stated it would consistently raise rates, but then backed-off.

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 the Fed.

The action taken by the Federal Reserve and market expectations regarding expected inflation have caused the yield curve to flatten somewhat during the fiscal year, with short-term rates going up more than long-term rates. The yield curve reflects the interest rate investors could receive on a given date for U.S. Government investments with various maturity dates. The following graph illustrates the yield curve on June 30, 2017, as compared to June 30, 2016 and a more recent date of September 25, 2017.



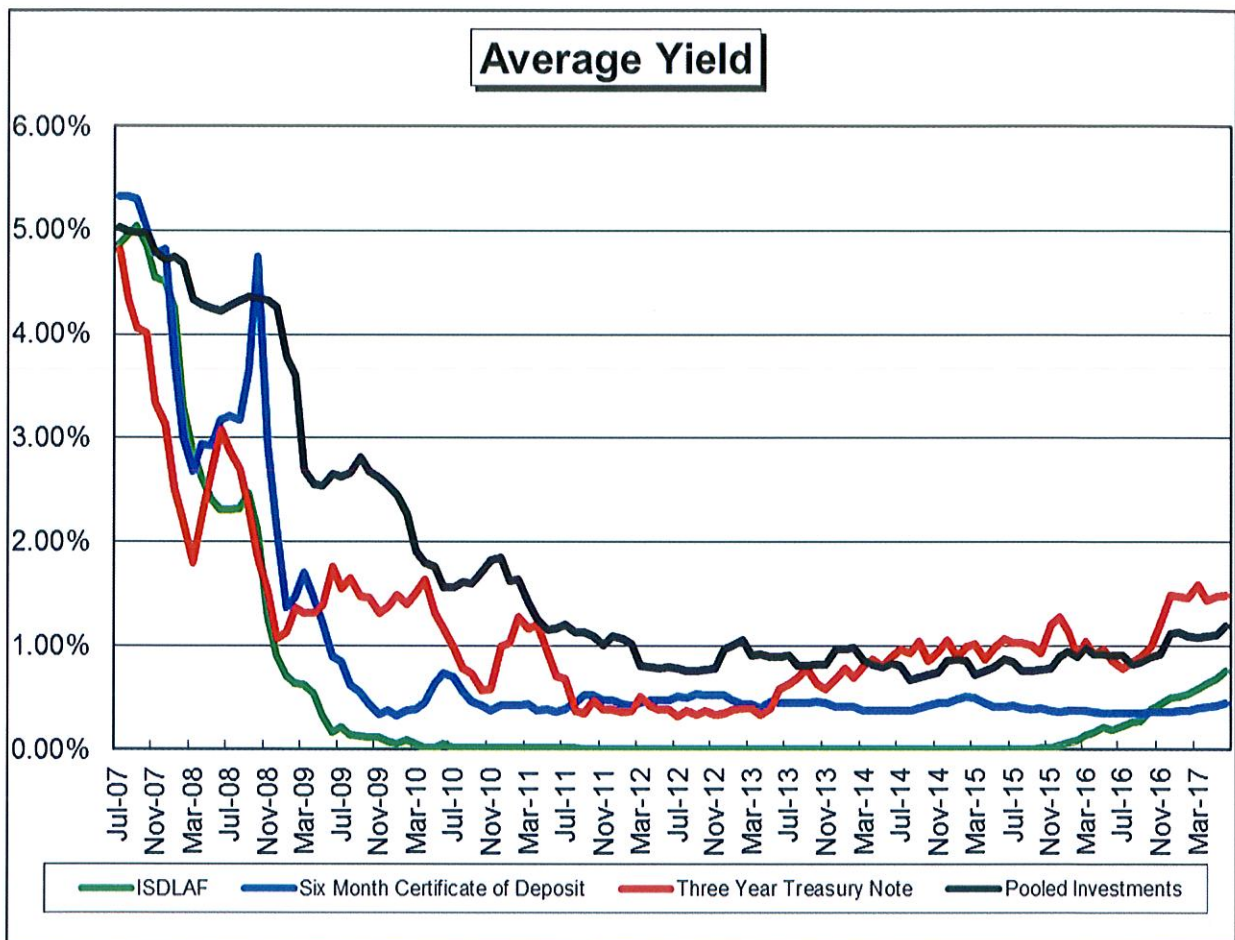
During the fiscal year, the yield on U.S. Treasury securities maturing in less than one year, increased from near 0.40% to the 1.20% range. In fact, the yields for all maturity dates, with the exception of the 30-year bond, increased between 0.75% and 0.89%. Note that the yield curve remains flat, with the difference between an investment maturing in three months and an investment maturing in five years, differing by only 0.80% (1.05% versus 1.85%). The flat yield curve supports the belief that inflation levels will remain low. Since June 30, 2017, the yield curve has continued to flatten out. While investments with a maturity of two years and less have increased approximately five basis points (0.05%), investments maturing ten years and beyond have declined eight basis points (0.08%).

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>
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%
Fall of 2017	0.75% - 1.25%

Concerning the future direction of interest rate levels, there are several major issues that must be closely monitored including (1) potential federal tax reform, (2) the impact of recent natural disasters and (3) geopolitical tensions, primarily with North Korea. Each of these events can change the fixed income market and subsequently change the overall performance of the pooled portfolio. It is important to recognize, however, that while events like these and changes in economic activity and inflation have caused interest rates to fluctuate 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 \$300 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

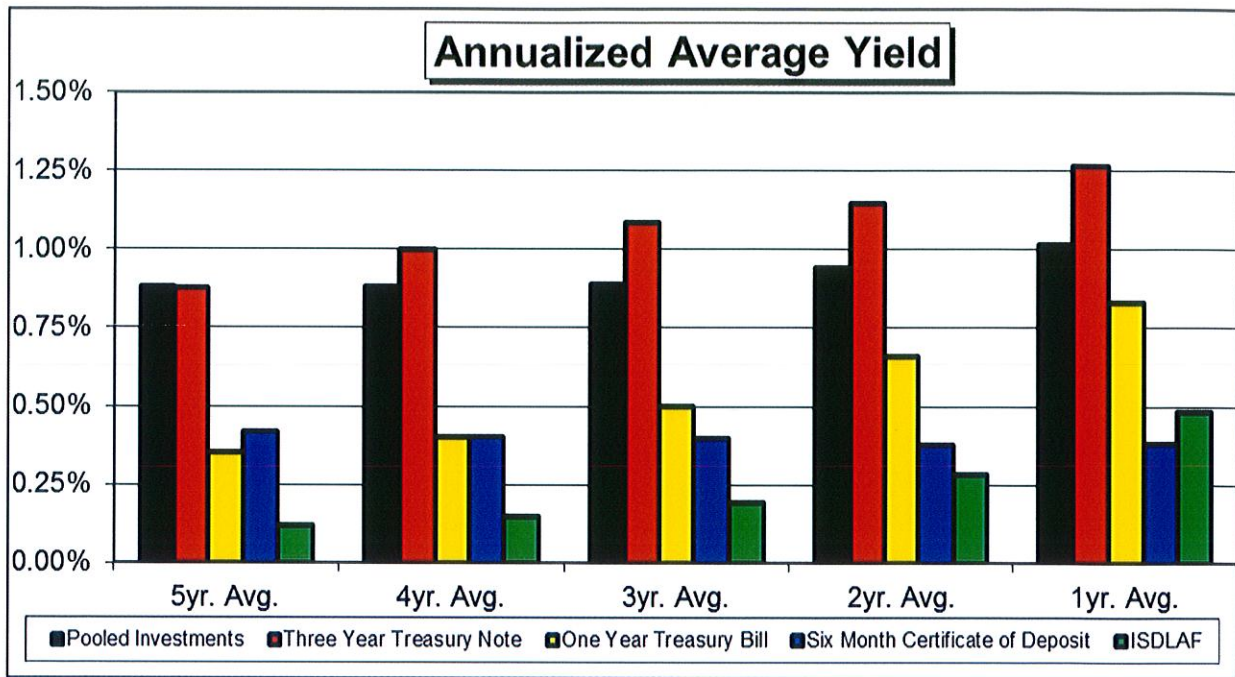
Since a significant percentage of the funds received by this office must be invested to meet short-term cash flow needs, interest rate direction is not the primary factor in investment decisions. It is important, however, to consider current interest rate conditions, yield curves and future interest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

With interest rates expected to continue rising, albeit at a slow pace, we will continue to ladder the portfolio with investments that have maturities of under three years. This should allow us to reinvest the proceeds from maturing investments into higher yielding securities. In addition, we continue to look at value amongst the investment vehicle options available to us. We currently are focusing on purchasing bank CD's and short-term taxable municipal bonds. We are also an active investor in the direct purchase of municipal bonds from other school districts in Illinois. These strategies have allowed the portfolio to maintain some yield above the levels that exist in money market accounts and traditional short-term investments, without compromising the objectives of the fund. We are also focused on issues that will provide above two percent yields that are in the three to five year maturity range.

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 the conflict in North Korea. We do believe that the uncertainty of State funding has dissipated for fiscal year 2018, with the passage of school funding reform (SB 1947). We are hopeful that this funding reform will take away the strain of forcing liquidity into the portfolio.

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.

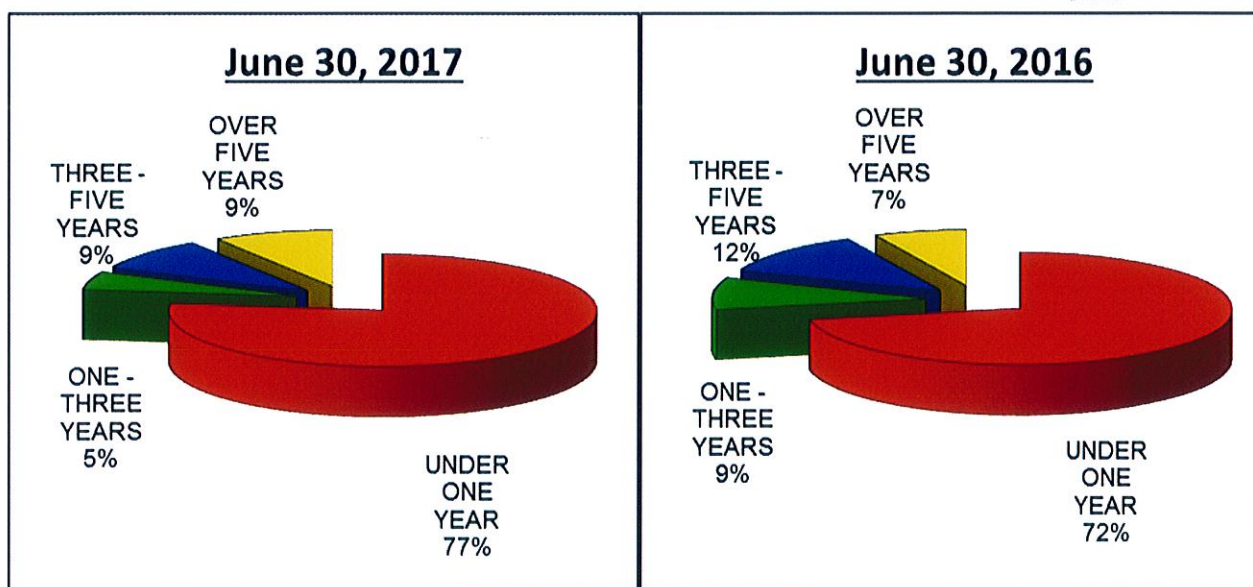


The five-year average yield on the pooled investments was 0.88%, the three-year Treasury Note was 0.87%, the one-year Treasury Bill was 0.36%, the six-month CD was 0.42%, and the ISDLAF was 0.12%. The higher five-year average interest rate yield on the pooled funds of 0.76% above the ISDLAF average rate has generated close to \$3.0 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

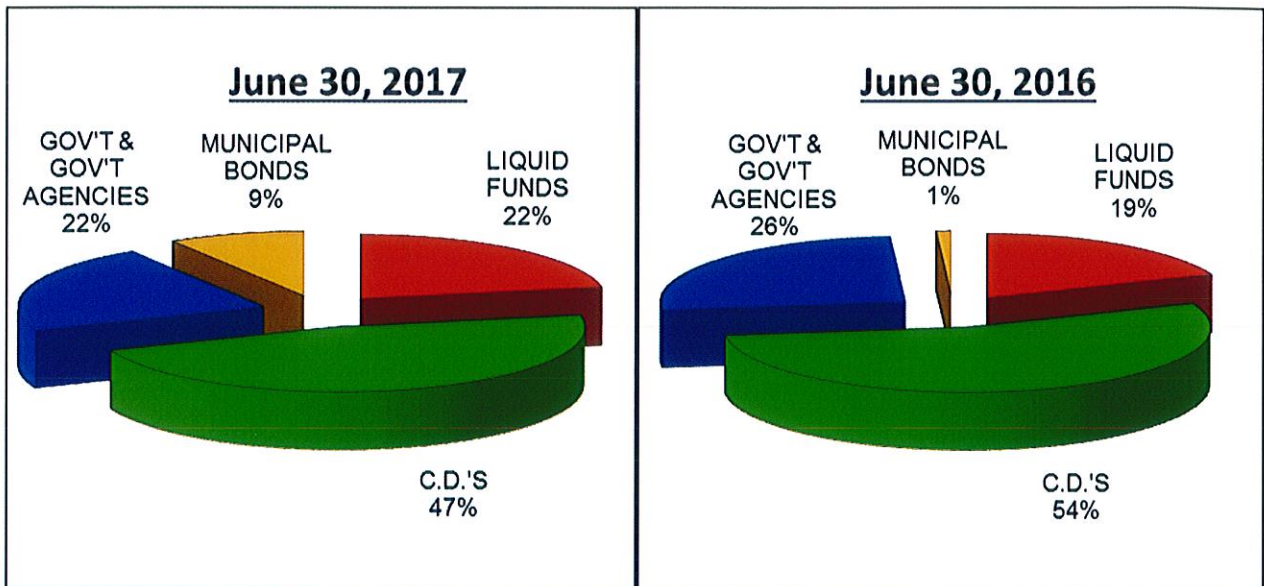
Over the past fiscal year, we have focused on the significant uncertainty that existed in school funding in Illinois. This included the fact that the State collectively owed our school districts approximately \$10 million on June 30, 2017 and that there was a significant threat of a delay in General State-Aid payments beginning August 2017. In order to ensure that sufficient funds were liquid to cover expenses made by the school districts, we altered our investment strategy accordingly. The percentage of the portfolio maturing in less than one year increased from 72% on June 30, 2016 to 77% on June 30, 2017. This was the highest percentage of short-term investments ever held in the portfolio. The percentage of investments maturing in the one-three year range decreased from 9% to 5%. Investments maturing in the three-five year range decreased from 12% to 9% of the portfolio. Investments maturing in excess of five years increased from 7% to 9% of the portfolio.

The following graph reflects the allocation of the portfolio by expected maturity date on June 30, 2017 as compared to June 30, 2016:



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, 2017, these indicators implied the use of a more liquid portfolio, which would afford us more flexibility in implementing our investment strategy. The weighted average maturity of the portfolio was 0.60 years (219 days) on June 30, 2017, compared to 0.73 years (266 days) on June 30, 2016.

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, 2017, the pooled funds consisted of over 100 different investments that are regularly monitored. The following pie chart reflects the investment composite of the pooled funds as of June 30, 2017 as compared to June 30, 2016:



As can be seen from the pie chart above, 22% of the pooled funds were invested in liquid funds, 47% in C.D.'s, 22% in government/government agency obligations and 9% in municipal bonds. The composition of the portfolio in terms of investment type remained relatively stable. Our percentage of C.D.'s and government/government agency obligations decreased, due to the shifting of funds into municipal bond investments and the need for more liquid funds. 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 also continued our focus 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, 2017:

- 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, 2017. 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 22 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 \$64.5 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 be at similar levels to those realized in fiscal year 2017 for two primary reasons: (1) interest rates, although rising, are still near historic low levels and (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.

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