PSDLAF

www.psdlaf.org

East Stroudsburg ASD – Finance Committee Meeting

July 13th, 2020

Market Update, Permissible Investments, & Cash Flow Management

Michael Stramara
VP – Senior Relationship Manager
Tel: 1-866-548-8634 (option 2,2)
E-mail: mike.Stramara@rbc.com

PSDLAF is sponsored by:

PASBO PSBA

PSDLAF
2101 Oregon Pike
Lancaster, PA 17601
Tel: 1-866-548-8634 (option 2)
E-mail: rbc-cmg@rbc.com

East Stroudsburg ASD – Finance Committee Meeting

Market Commentary: June 2020

Economic Overview

The unprecedented turmoil that brought markets to the precipice at the end of March has given way to a tenuous recovery as we enter the second half of 2020. The coronavirus pandemic and ensuing economic shutdown are still largely ongoing three months later. As select states and local economies have begun to reopen, the US has seen a resurgence in the number of people infected with COVID-19 that has officials revisiting their plans to reopen. Indeed, some of the largest spikes in new infections are now happening in states that initially had more lax social distancing measures and approached reopening with less caution, begging the question if some regions have moved too quickly.

Despite all the uncertainty surrounding the pandemic, markets appeared to be recovering during the second quarter. Equity markets reclaimed much of the losses experienced in March, and recent economic data has been positive. However, the actual degree of recovery remains uncertain as long as the economy is being artificially buoyed by monetary and fiscal stimulus that has been unprecedented in scale and scope.

Employment numbers rebounded strongly in May with 2.5 million jobs added, but this contrasts with the unfathomable losses of 20.7 million jobs in April that essentially erased over a decade of job growth. Consumer spending, retail sales and pending home sales all posted similarly encouraging numbers following previously dire data in March and April. However, much of these gains can be attributed to making up for stalled activity from prior months and fiscal stimulus that has provided additional income to American consumers. Much of the current stimulus is scheduled to wind down in July, at which point government officials will have to weigh extending the stimulus or reckoning with another swift drop in economic activity and further job losses.

Federal Reserve

The Federal Reserve (Fed) continues to be an important player in supporting the economy and the smooth functioning of financial markets. Since cutting the fed funds rate to a range of 0-0.25%, officials have focused on launching various facilities aimed at providing support to hard-hit segments of the market and acting as a lender of last resort. These programs have proven monumental in restoring calm to markets and helping to ensure that the economy will be able to weather the current crisis.

Market Commentary: June 2020

At the Fed's most recent meeting of the Federal Open Market Committee (FOMC) in June, officials indicated in their forward guidance that they expect to keep rates near zero through 2022. The FOMC also indicated they expect inflation to remain low due to weaker demand and lower oil prices. Fed Chairman Jerome Powell has emphasized that the US economy continues to face extraordinary uncertainty in the near term, and the Fed is committed to continued efforts to support the economy.

Fixed Income

Fixed income markets have normalized following the turmoil in March that saw many markets bordering on closed. Treasury rates have stabilized after briefly flirting with negative territory on the front end. Treasury bills out to 12 months have settled in a range of 10-15 basis points (bps). Meanwhile, rates in the belly of the curve from 2-10 years declined modestly from 5-10 bps, with the 10-year Treasury ending the quarter little changed at 0.66%.

Investment grade corporate assets recovered during the second quarter. The corporate market stabilized after the Fed announced plans to purchase high quality, short-dated corporate bonds under two facilities for secondary and primary market corporate credits. The Secondary Market Corporate Credit Facility (SMCCF) had purchased $6.9 billion of corporates as of June 18th. Investment grade corporate spreads relative to Treasuries ended the quarter at 150 bps, tightening by 122 bps. Spreads remain wider on the year and have begun drifting sideways as investors work to assess the continued financial health of corporations. While the Fed can offer support by providing liquidity, they can't provide revenue. Amidst these concerns, the sector has also been supported by continued demand from investors searching for higher quality yield in an otherwise low rate environment.

Outlook

The improved economic prospects during the second quarter are definitely welcome following the turmoil that ended the first quarter. However, we remain cautious as uncertainty around the trajectory and impact of the coronavirus continues to cloud the future. The reliability of economic data remains questionable due to stimulus, and the pandemic in the US is far from contained.

The US was already on the last legs of an over 10-year business cycle and the efforts to battle the pandemic fully pushed the economy into a recession. Our current expectation is for GDP to decline 10.7% in 2020. We also expect rates to remain low for the foreseeable future, with the Fed likely on hold from raising rates for years. Fair value on the 10-year Treasury is likely to remain below 1% in the near term. The US and fixed income markets have staked out a welcome, if tentative, recovery. Further economic improvement will largely depend on how we grapple with the continued effects of the pandemic.

- Wide ranging economic impacts from COVID-19
- The global pandemic has triggered a deep global recession
- Recent resurgence in COVID cases in the South and Southwest adds uncertainty to reopening
- 2020 US GDP expected to decline -7.1%
  - Expecting a “swoosh” recovery, economic activity will be slow to build
  - 2nd Quarter US GDP on path to be worst since the depression

COVID-19 versus prior economic shocks

	COVID-19	Global Financial Crisis	Great Depression
Worst QoQ% decline	-17.9	-2.2	N/A
Worst YoY% decline	-10.6	-2.5	-12.9
Peak-to-trough % decline	-22.5	-4.0	-26.3
Cumulative forgone output*	22.0	28.2	336.1

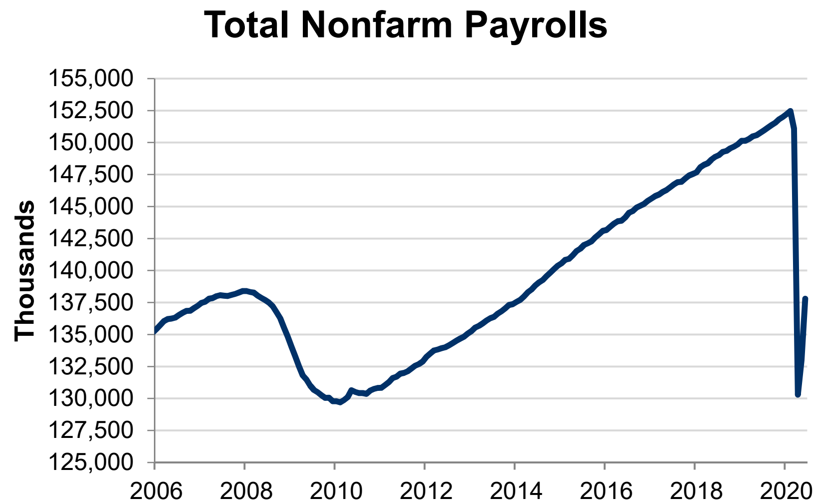
Note: For U.S. as at 2020-04-24. COVID-19 uses medium depth / medium length scenario.
Cumulative forgone output is gap between actual and potential GDP over full period (as % of annual output).
Source: Haver, RBC GAM

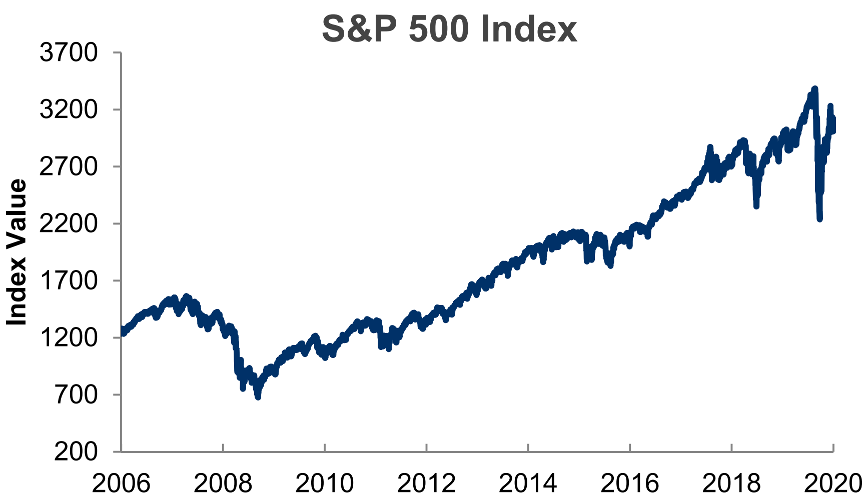
- Monetary and fiscal stimulus has been instrumental in supporting economy, but makes recent positive economic data hard to judge
- Bond market has been helped by the Fed’s actions to support liquidity

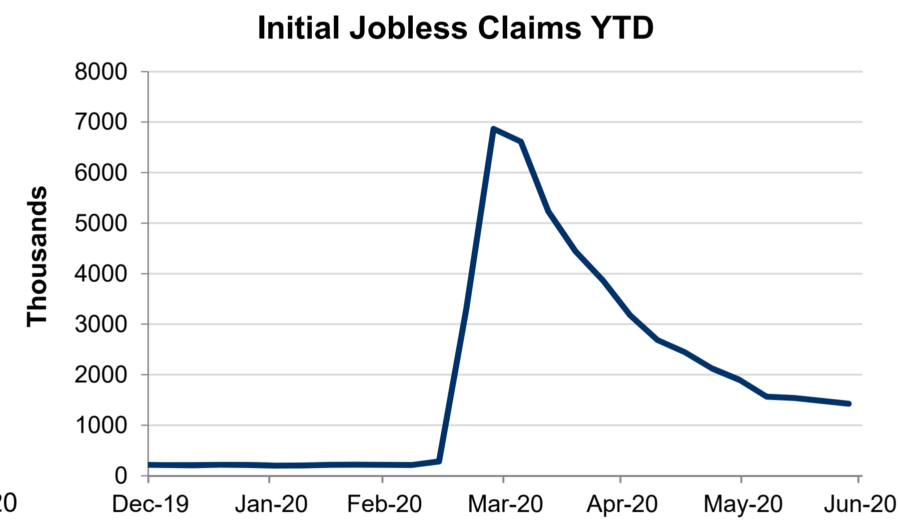
East Stroudsburg ASD – Finance Committee Meeting

US Economy – Deep Recession

- Prior to the Covid-19 outbreak the US economy was on solid footing showing stable fundamentals
- The shutdown ended a historic run of over 10 years of jobs growth
- Jobs have rebounded in recent months as states attempt to reopen
- The potential impacts of Covid-19 injects major uncertainty in the economic picture







As of 6.30.20
Source: Bloomberg, FRED

Federal Reserve – Aggressive Response

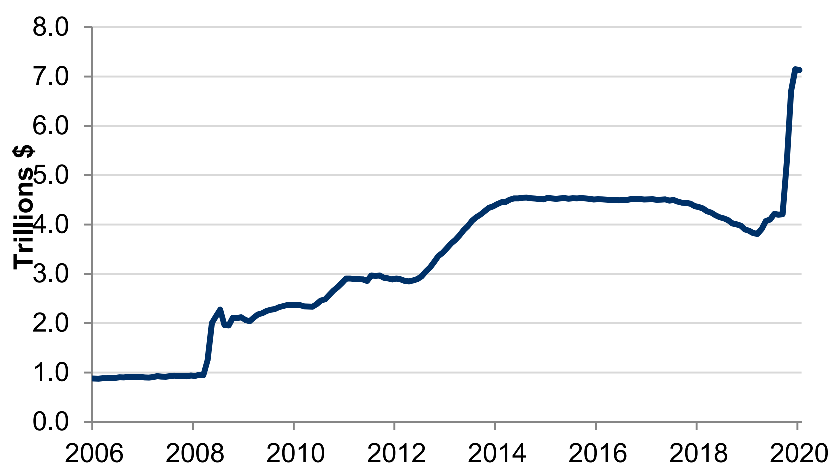
The Fed has taken decisive action to support the functioning of financial markets and encourage lending

- Fed Funds cut to range of 0-0.25% – rates likely on hold for foreseeable future
- Introduced or expanded numerous Funding, Credit, Liquidity, and Loan Facilities

The Fed has undertaken unlimited quantitative easing to support markets

- Balance sheet assets have grown by $2.9tn since February to $7.1tn
- Expanded to include Agency CMBS and short-dated, high quality Corporates

Fed Balance Sheet



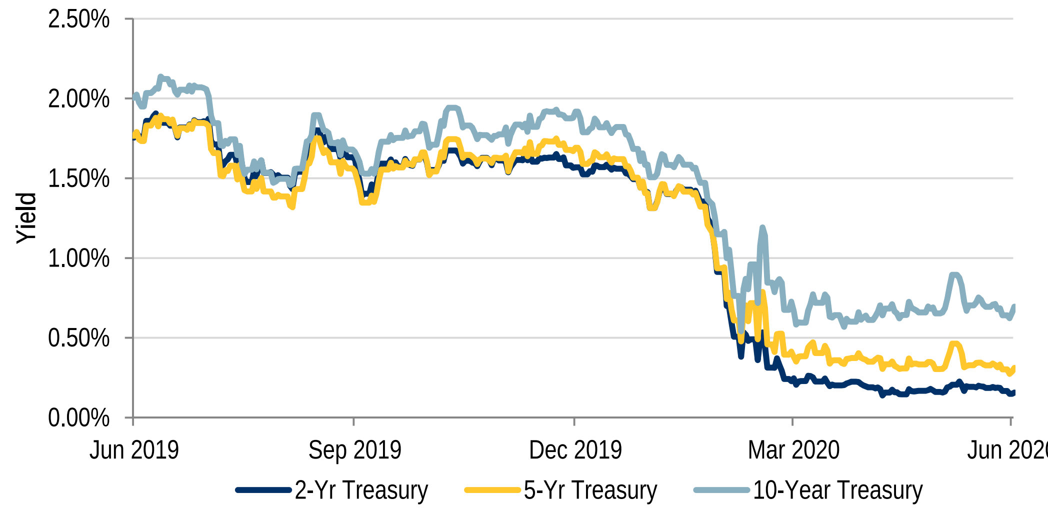
Federal Excess Reserves

As of 6.30.20
Source: Federal Reserve

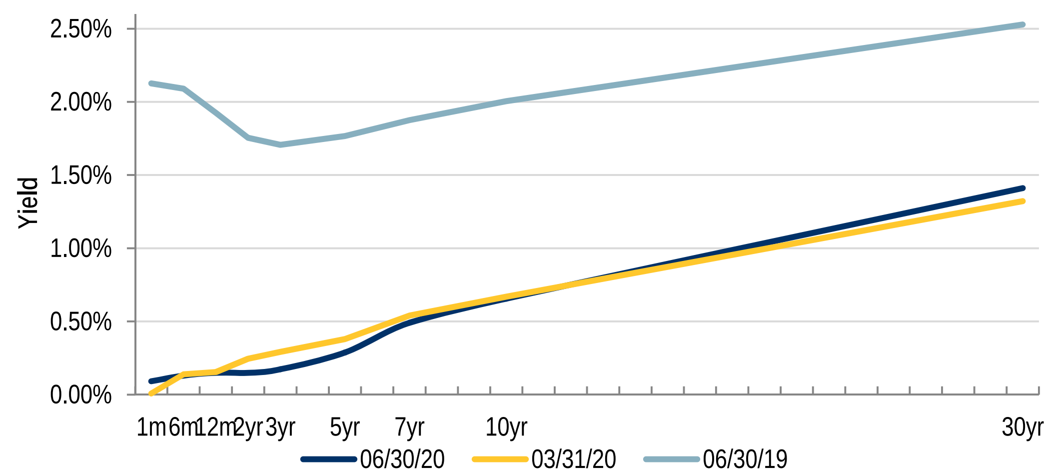
East Stroudsburg ASD – Finance Committee Meeting

U.S. Treasury Rates

- After a dramatic flight to quality in March yields have mostly drifted sideways in the second quarter



- Rates are anchored by the Fed's decision to cut the Fed Funds to zero, and also on muted growth and inflation expectations



As of 6.30.20
Source: Bloomberg

Coronavirus adds major uncertainty to global growth

- Key issue in 2020 is coronavirus
  - Major simultaneous supply and demand shocks
- Secondary issues:
  - Oil prices
  - Corporate earnings
  - Presidential election
- Previous outlook in 2020 –1.75-2% US GDP
  - GDP now likely to be negative for the year – expecting -7.1%

COVID-19 scenarios: 2020 U.S. real GDP forecast (annual average % change)

			Recovery		
			Fast	Medium	Slow
Depth	Shallow	-10% trough	-2.8	-3.3	-5.2
	Medium	-18% trough	-6.2	-7.1	-10.6
	Deep	-30% trough	-11.4	-12.9	-18.7

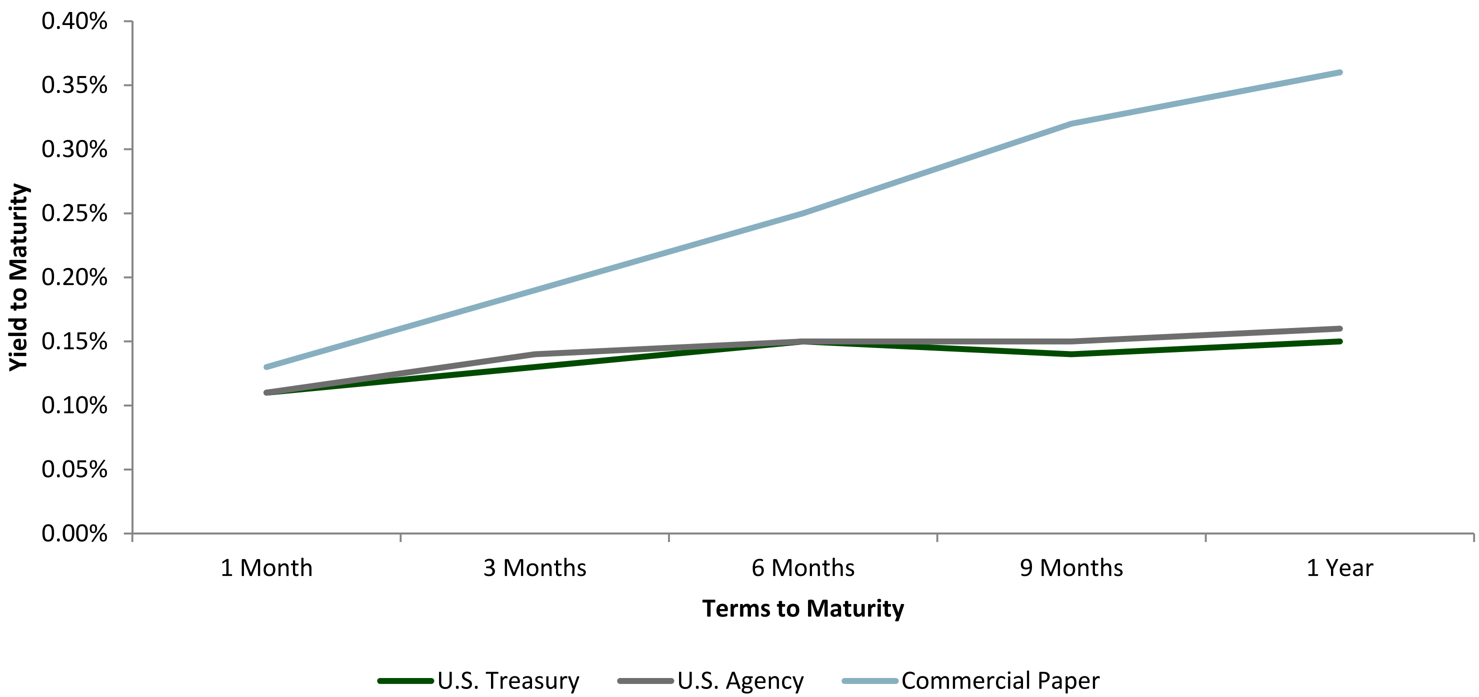
Note: As at 05/21/2020. Assumes rapid decline into trough versus much lengthier recovery period.

- Federal Reserve – Rates near zero for foreseeable future and unlimited QE
- Interest Rates collapse – 10-year Treasury fair value below 1% over the medium term
- Risk assets – uncertain and uneven path ahead
  - Equity market rebound supported by a strong technical tailwind (the Fed and QE), but fundamentals suggest further weakness
  - The Fed can provide liquidity, but not revenue (increased defaults and bankruptcies)
  - Some sectors will fare better than others

Current Investment Environment

Current Yield Indications (Annual %)

Sector	1 Month	3 Months	6 Months	9 Months	1 Year
U.S. Treasury	0.11%	0.13%	0.15%	0.14%	0.15%
U.S. Agency	0.11%	0.14%	0.15%	0.15%	0.16%
Commercial Paper	0.13%	0.19%	0.25%	0.32%	0.36%
Repurchase Agreements (Overnight)	0.09%				



As of 07.02.20
Source: Bloomberg, Tradeweb, RBC GAM-US

Investment Guidelines

Safety

– Legality
– Policy

Liquidity

– Strategy
– Cash Flow

Yield

– Risk vs. Return
– Yield Curve

Permissible Investments in PA

- Public School Code of 1949
- 24 P.S. 4-440.1
- Act 72 of 1971
- Act 10 of 2016

Security and Collateralization

- Federal Insurance (FDIC)
- Pooled Collateral (Act 72)
- Specifically pledged securities
- FHLB Letter of Credit

Permissible Investment Landscape

Section 440.1

- Direct obligations of the U.S. Government
- Obligations of U.S. Agencies & Instrumentalities (short term)
- Banking Product
  - FDIC Insured (Tax I.D.)
  - Collateralized
- Local Government Investment Pools (LGIPs)
- Municipal Debt
  - PA Issuer (General Obligation)
  - No Credit Rating Requirement

Both

- Repurchase Agreements
- Shares of an Investment Co. (Money Market Funds)
- Pooled FDIC Insured CD Redeposit Program

Act 10 of 2016

Effective as of May 24, 2016

- Debt obligation of any Federal Agency, Instrumentality, or GSE
- Bankers Acceptances (aka “Bills of Exchange” or “Time Drafts”)
- Commercial Paper
- Negotiable CD’s

Four Components of Strategy

- Risk and Return
- Cash Flow Profile
- Diversification
- The Yield Curve

The Greater the Return - The Greater the Risk…

If It Sounds Too Good To Be True – It Isn't True

School District Operating Cash Flow

- Revenue
  - Taxes
  - State Aid
- Expenditures
  - Payroll, Debt Service, PSERS
  - Healthcare, Payables, Etc.

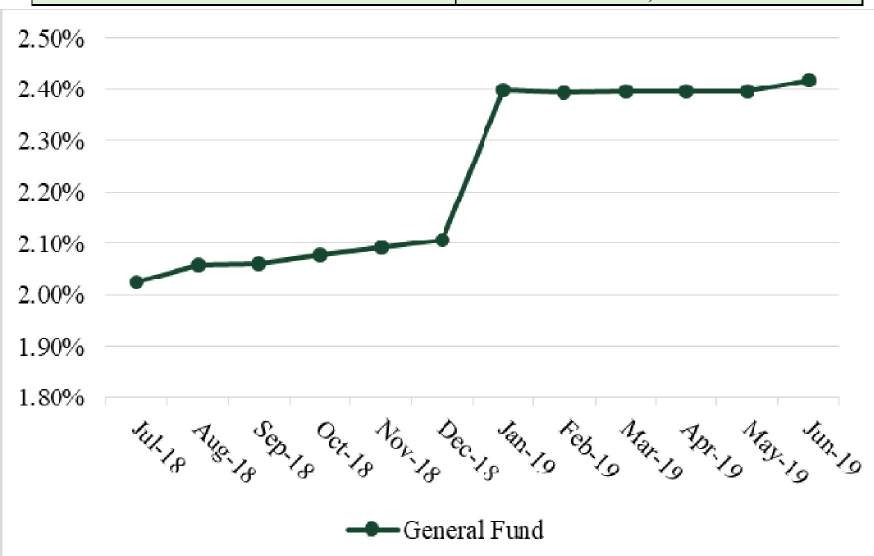
School District Capital Project Cash Flow

- Bond Issuance
- Draw Schedule
- Spend Requirements

Return

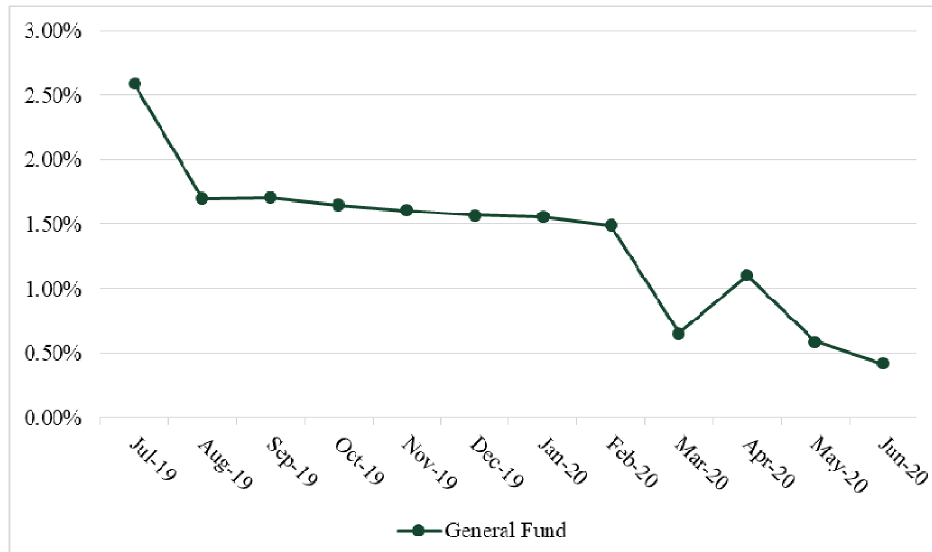
2018-2019 CFO Fiscal Year Performance

Interest Earnings	
MAX	$122,500.29
Fixed	$839,612.46
Total:	**$962,112.75**



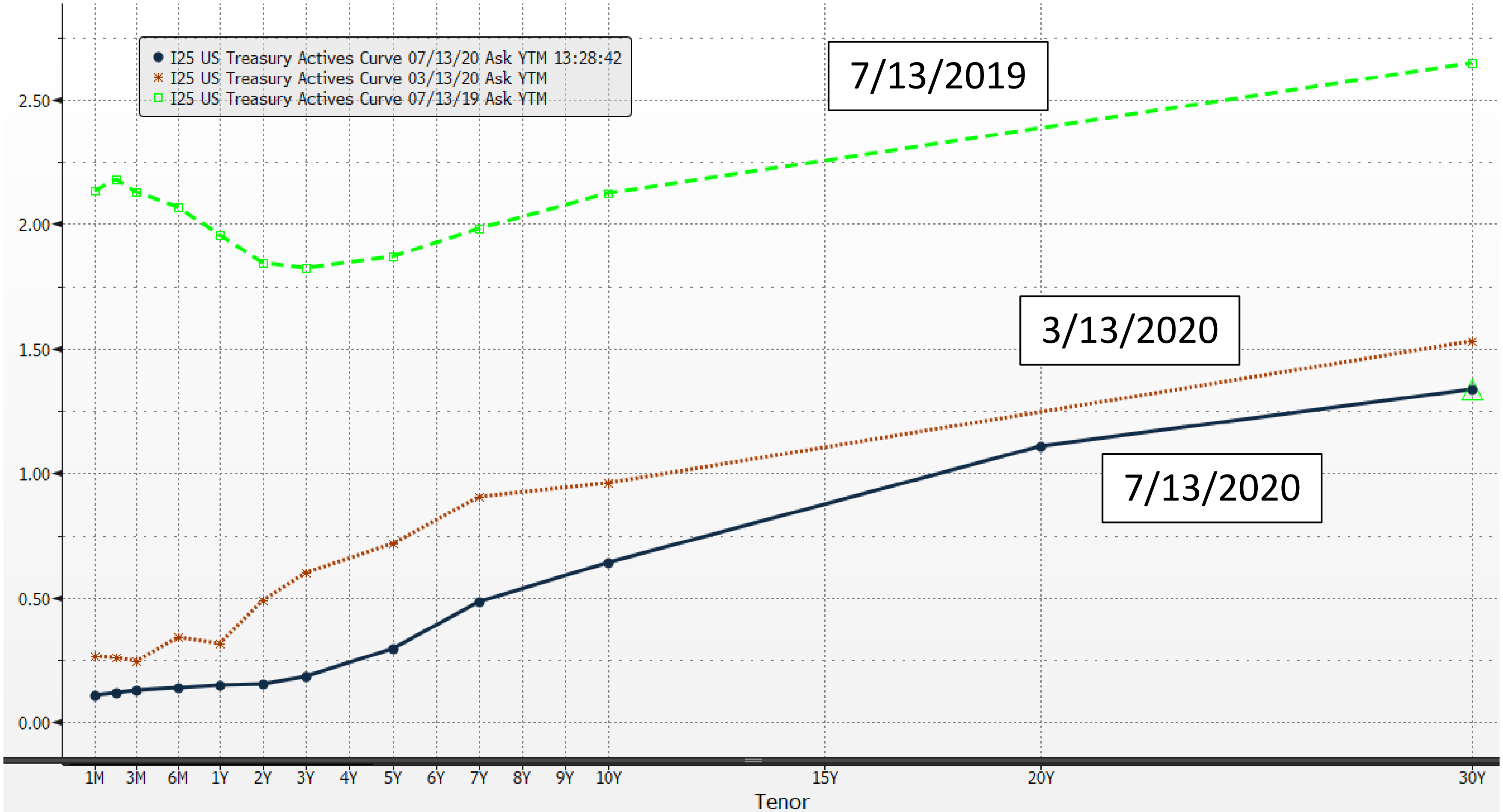
2019-2020 CFO Fiscal Year Performance

Interest Earnings	
MAX	$90,223.60
Fixed	$508,973.71
Total:	**$599,197.31**



East Stroudsburg ASD – Finance Committee Meeting

Yield Curve



As of 07.13.20
Source: Bloomberg

Questions?