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Ventura Regional Sanitation District Fourth Quarter 2017 Portfolio Review

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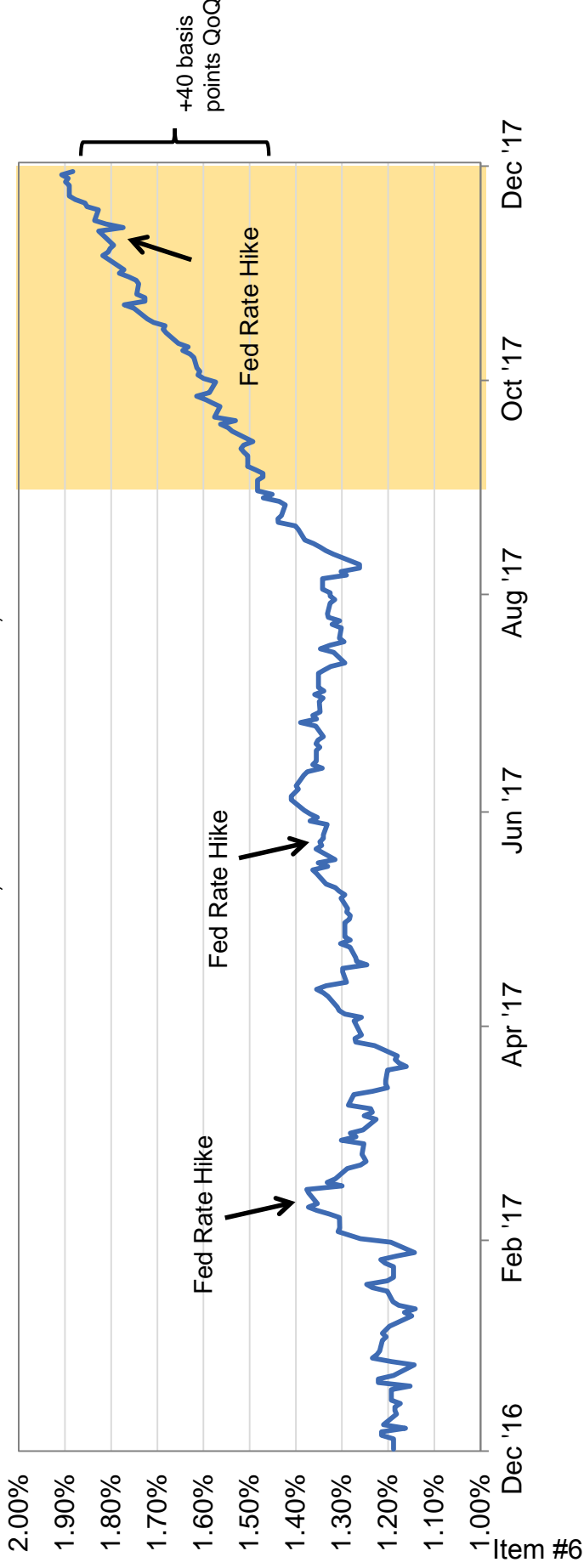
Market Update



Interest Rate Update

- Two-year treasury yields moved notably higher for the year ended December 31, 2017; the increase was most pronounced during the fourth quarter as markets responded to another rate hike by the Federal Reserve and the passage of the largest overhaul of the U.S. tax system in more than 30 years.

2-Year Treasury Yields
December 31, 2016 – December 31, 2017



Source: Bloomberg, as of 12/31/17.

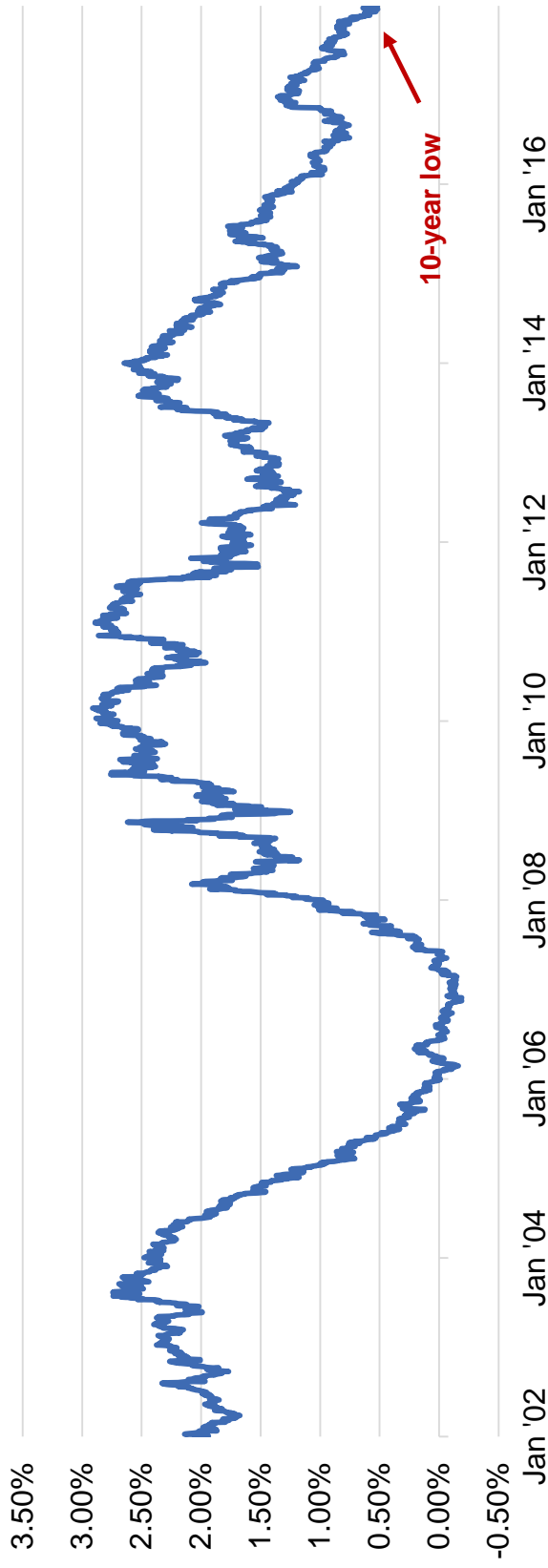


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A Flattening Yield Curve

- The yield on the 2-year U.S. Treasury note has increased by 70 basis points (0.70%) this year, while the yield on the 10-year U.S. Treasury note has decreased by 3 basis points (0.03%) since the beginning of the year as expectations of future growth and inflation prospects have fallen.
- As a result, the spread between the 10-year U.S. Treasury and the 2-year U.S. Treasury is currently near a 10-year low.

10-Year/2-Year U.S. Treasury Spread
January 1, 2002 – December 31, 2017

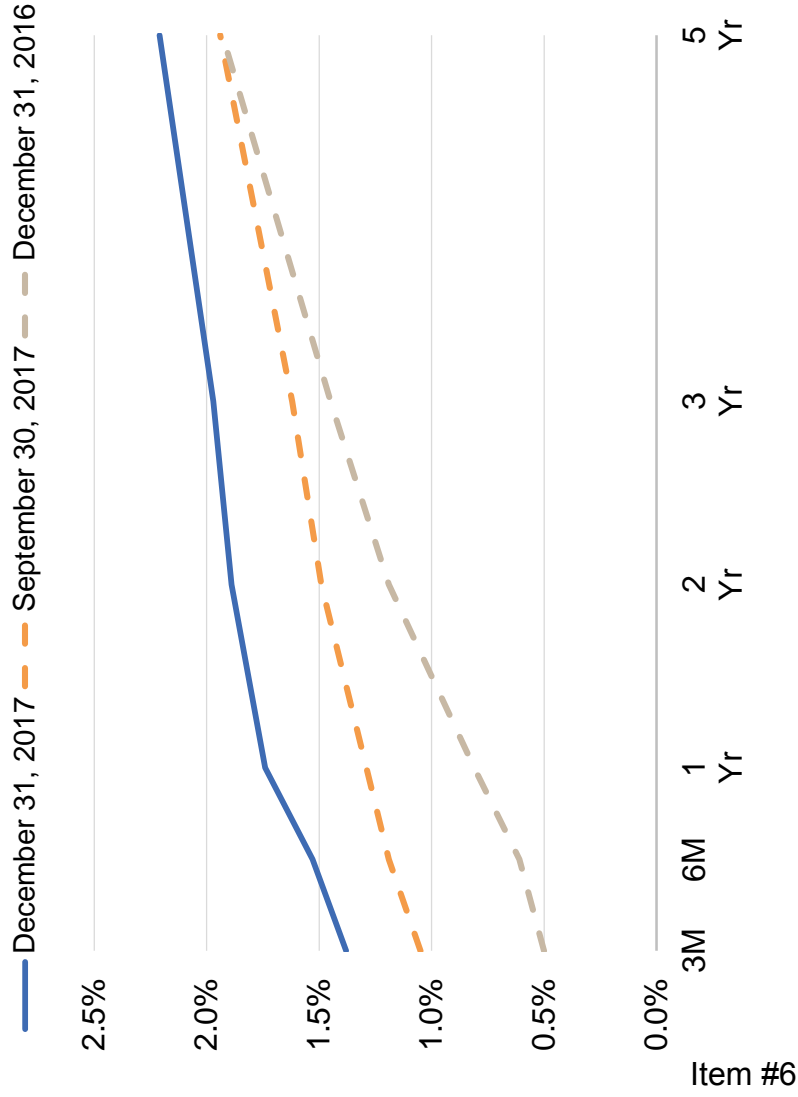


Source: Bloomberg, as of 12/31/17.



Short-Term Yields Rise and Curve Flattens Further in the Fourth Quarter

U.S. Treasury Yield Curve



Yield Curve History

Maturity	9/30/2017	12/31/2017	Change
3-Mo.	1.05	1.38	+0.33
6-Mo.	1.19	1.53	+0.34
1-Yr.	1.29	1.74	+0.45
2-Yr.	1.49	1.89	+0.40
3-Yr.	1.62	1.97	+0.35
5-Yr.	1.94	2.21	+0.27
7-Yr.	2.17	2.33	+0.16
10-Yr.	2.33	2.41	+0.08
30-Yr.	2.86	2.74	-0.12

Source: Bloomberg, as of 12/31/17.

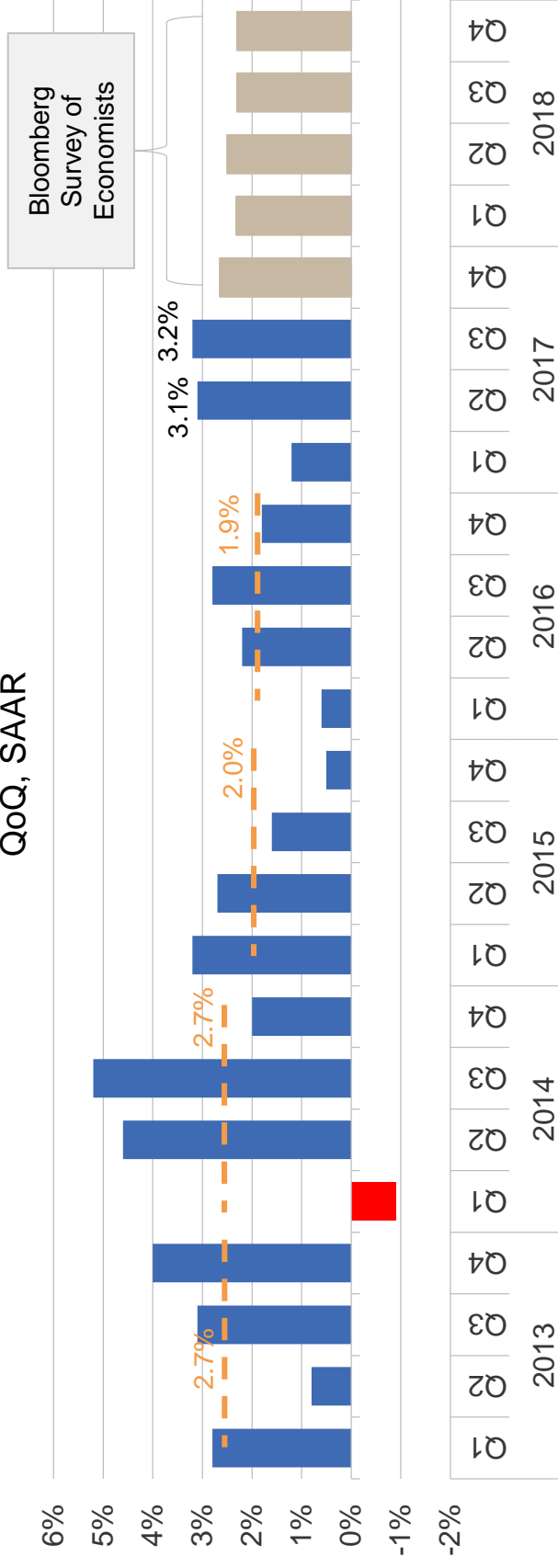


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Economic Growth Remained Strong in the Third Quarter

- Gross domestic product (GDP) increased at an annualized rate of 3.2% in the third quarter of 2017, the fastest pace of expansion over two consecutive quarters since 2014. Growth has averaged 2.3% over the last four quarters.
- The acceleration in third quarter GDP reflected positive contributions from personal consumption and business investment boosted primarily by a rise in private inventories and exports. This acceleration was offset by negative contributions from residential housing.

U.S. Real GDP QoQ, SAAR



Source: Bloomberg, as of Q3 2017. SAAR is seasonally adjusted annualized rate. Orange denotes rolling four-quarter averages.



California Economy



Year-over-Year Changes in California	
Gross State Product ¹	\$2.6 billion (↑4.5%)
Unemployment ²	4.6% (↓0.7%)
Nonfarm Payrolls ²	17.1 million (↑1.7%)
Average Hourly Earnings ²	\$30.28 (↑3.1%)
Population ³	39.5 million (↑0.7%)
Headline News	Attorney General Jeff Sessions' announcement to rescind the Cole Memo may hurt the anticipated \$5 billion marijuana industry in California

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Source: Bloomberg, The Hill, U.S. Census Bureau.

1. Gross state product is as of December 2016.
2. Unemployment, nonfarm payrolls, and average hourly earnings are as of November 2017.
3. Population data as of July 2017.

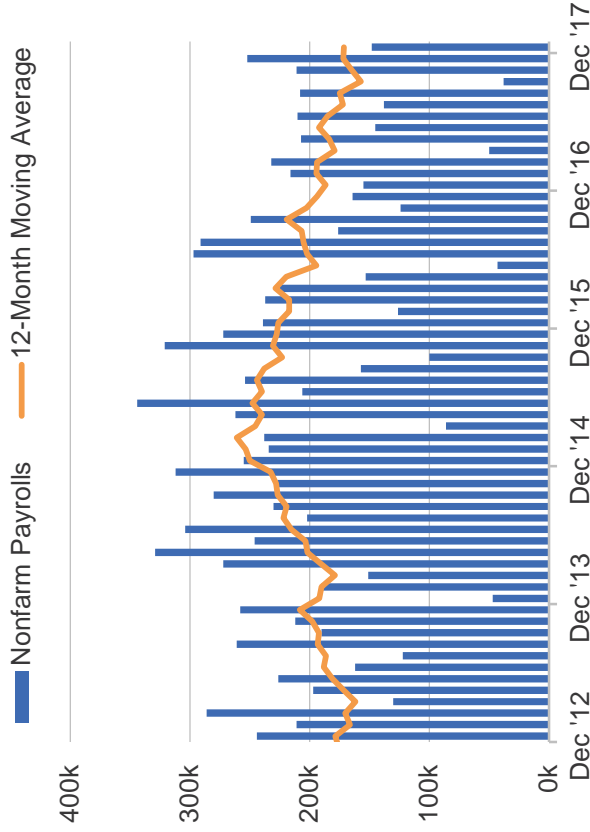


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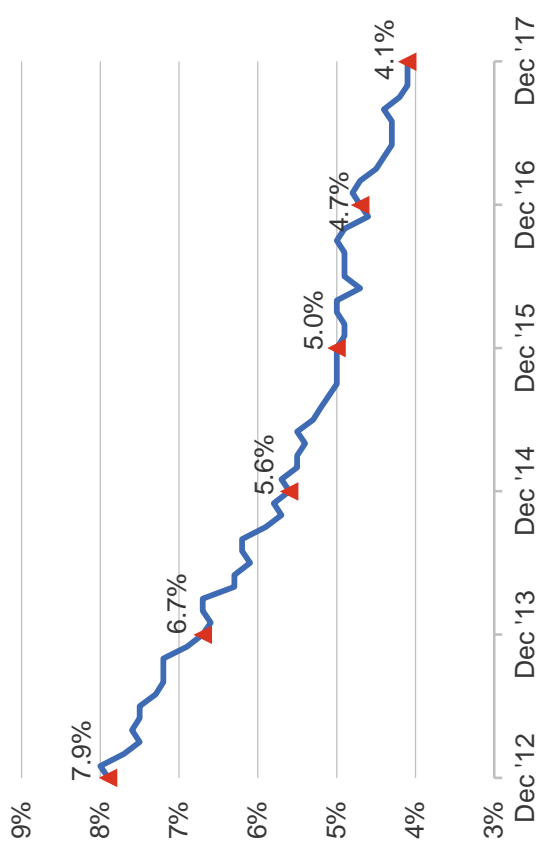
Labor Market Activity During the Quarter

- The U.S. labor market added 611,000 jobs for the quarter ending December 31, 2017, and an average of 171,000 jobs per month over the past year.
- Headline unemployment rate for the fourth quarter remained at 4.1% for the third consecutive month. The U6 unemployment rate decreased from 8.3% in September to 8.1% in December, while the labor force participation rate fell from 63.0% in September to 62.7% in December.
- Average hourly earnings—an important gauge of wage growth—grew 2.5% over the past 12 months.

Monthly Change in Nonfarm Payrolls



Unemployment Rate



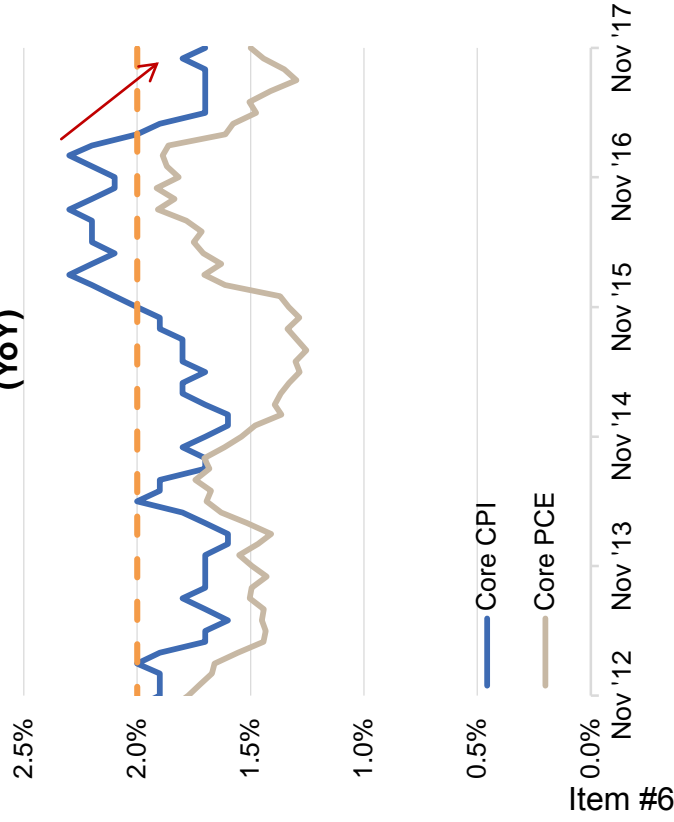
Source: Bloomberg, latest data available as of December 2017.



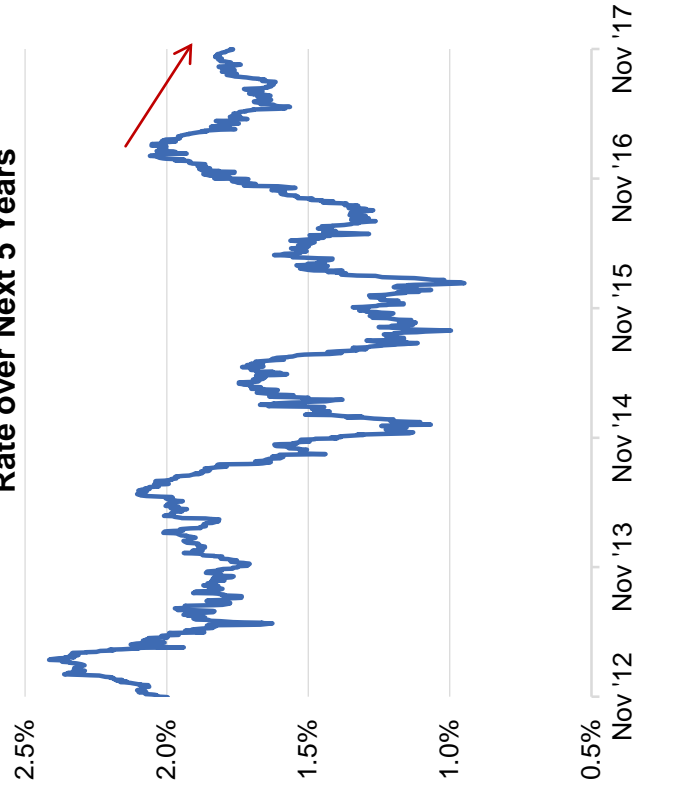
Inflation Remains Muted

- Inflation pressures have declined since the beginning of 2017. The core personal consumption expenditures (PCE) price index, the Fed's preferred measure of inflation, moved slightly higher to 1.5% year-over-year in November.
- The Fed expects inflation to remain subdued in the near term but to reach their 2% target in the medium term.

Inflation Measures (YoY)



Expectations for Average Inflation Rate over Next 5 Years

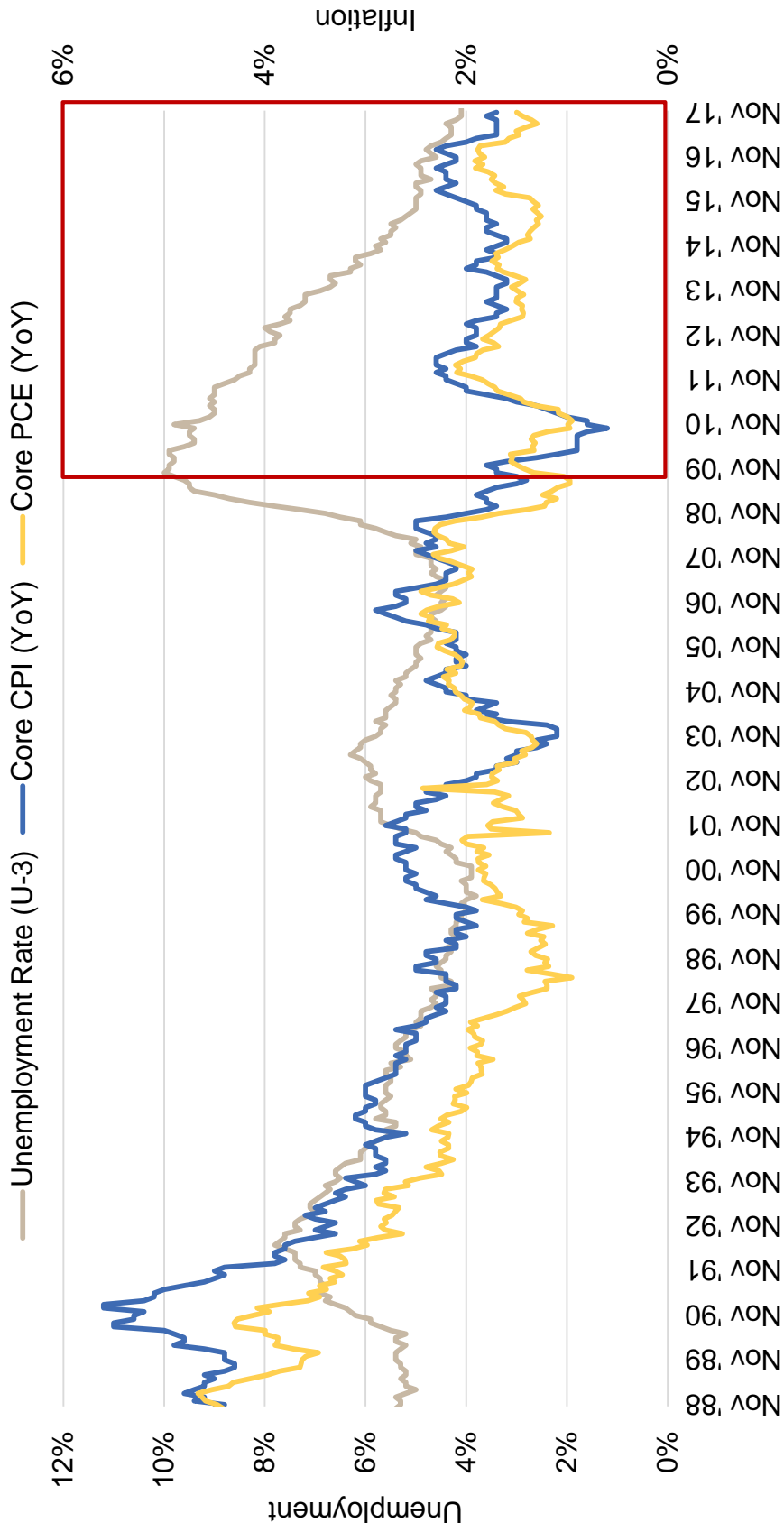


Source: Bloomberg, latest data available as of December 2017. Inflation expectations based on yield difference between 5-year Treasury note and 5-year Treasury Inflation Protected Securities (TIPS).



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Inflation Remains Lackluster Despite a Strong Labor Market



Source: Bloomberg, as of November, 2017.



GOP Tax Cuts and Jobs Act

Personal Taxes

Income Tax Brackets

Tax Rate	Single	Married
10%	\$9,525	\$19,050
12%	\$38,700	\$77,400
22%	\$82,500	\$165,000
24%	\$157,500	\$315,000
32%	\$200,000	\$400,000
35%	\$500,000	\$600,000
37%	> \$500,000	> \$600,000

Deductions

- Can deduct up to \$10,000 in a blend of state and local property, income, and sales tax. The state and local deduction was previously unlimited.
- Deductible interest on mortgage capped at \$750,000.

Exemptions

- Child tax credit raised from \$1,000 to \$2,000 per child.
- The estate tax exemption will be doubled from \$5.5 million to \$11 million.

Other

- The deduction for interest on education loans, qualified tuition expenses, and expensive medical bills would be maintained.
- No changes will be made to 401 (k) plans.

Business Taxes

Marginal Tax Rate

- Reduced from 35% to 21%.
- Marks the largest one-time decline in U.S. history and amounts to almost \$1 trillion of tax cuts over the next decade.

Deductions

- Pass-through businesses like limited liability corporations allowed to deduct 20% of their earnings. However, this will expire after 2025.

Exemptions

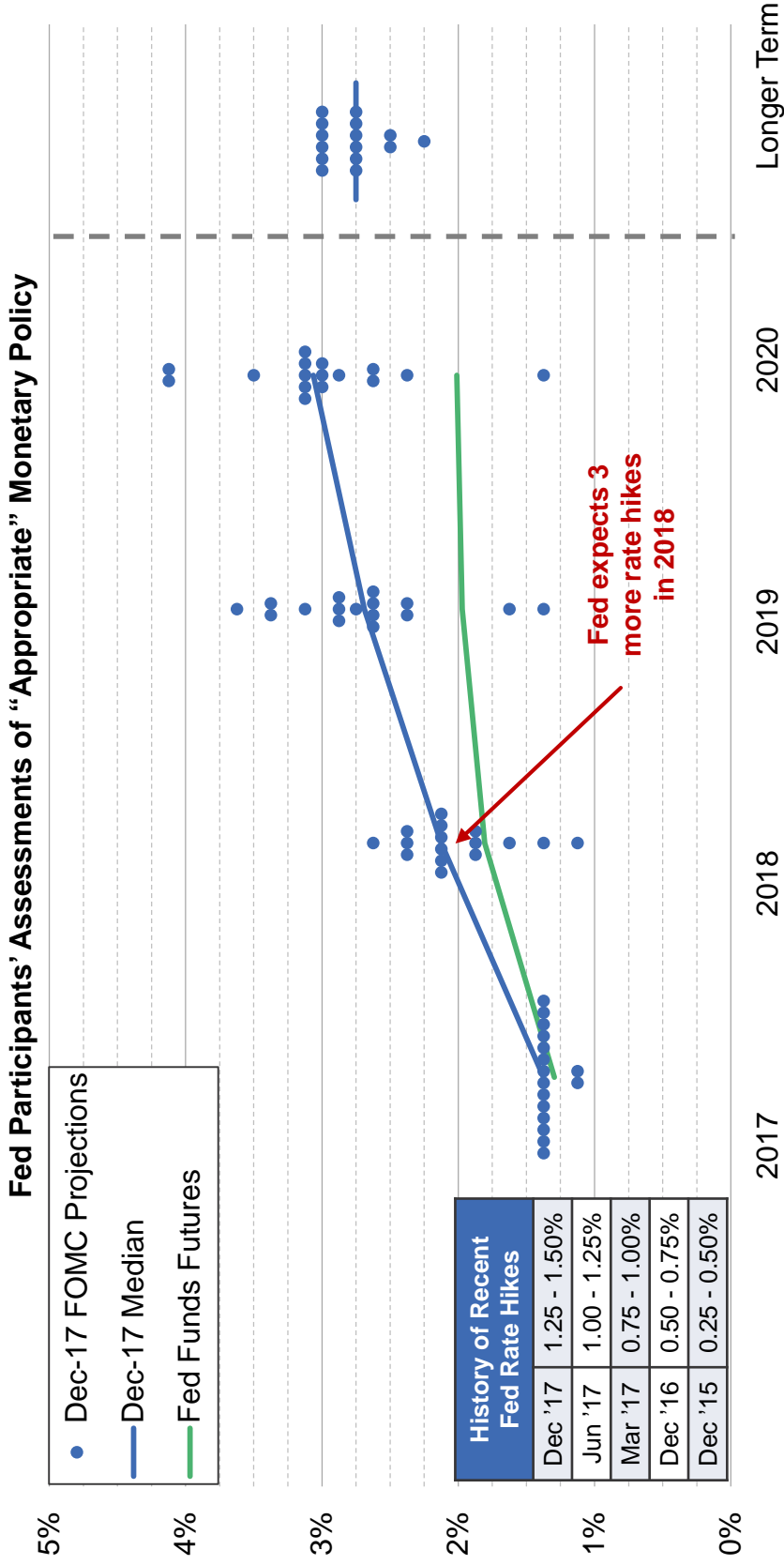
- Businesses will be exempt from paying the corporate alternative minimum tax.

Other

- One-time tax on repatriated cash and profits will be 15.5%, up slightly from the 14% to 14.5% that had been proposed in earlier versions.



FOMC “Dot Plot” – December 2017



Source: Federal Reserve and Bloomberg. Individual dots represent each Fed members' judgement of the midpoint of the appropriate target range for the federal funds rate at each year-end. Fed funds futures as of 12/13/17.



Portfolio Review

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Fourth Quarter 2017 Recap

- Yields continued to climb during the fourth quarter, with some short- and intermediate-term yields reaching highs not seen since 2008. However, in this era of gradually increasing interest rates, new purchases were weighed against the probability for further rate increases and their potential to diminish the market value of portfolio investments. In this flat yield curve environment, we emphasized maturity selection.
- We continued to maintain the portfolio's duration in line with the benchmark's duration to minimize return volatility.
- Strong investor appetite for high-quality alternatives to U.S. Treasuries caused the yield spreads on investment-grade fixed income sectors (relative to U.S. Treasuries) to tighten over the quarter, resulting in positive relative performance for non-Treasury sectors.
- The yield spreads on federal agency securities vs. comparable-maturity Treasuries remained near historic lows, in some cases near zero, leading to diminished value of the agency sector.
- Supranationals carried more yield spread and offered an attractive alternative in the high-quality government agency space.
- Corporate yield spreads also remained near multi-year lows, as investors reaching for yield piled into a limited market supply of investment-grade securities, leading the corporate sector to deliver its ninth straight quarter of outperformance relative to U.S. Treasuries.
- Short-term commercial paper (CP) and negotiable bank certificates of deposit (CDs) continued to offer value during the quarter. Although the Fed's December meeting caused CP/CD spreads to narrow, issuance has picked up and CP/CD yields have risen, widening the spread over similar-dated Treasuries.
- Asset-backed securities (ABS) performed positively relative to Treasuries. Further spread compression in the ABS sector is likely to be limited given that current level spreads sit at historically tight levels.



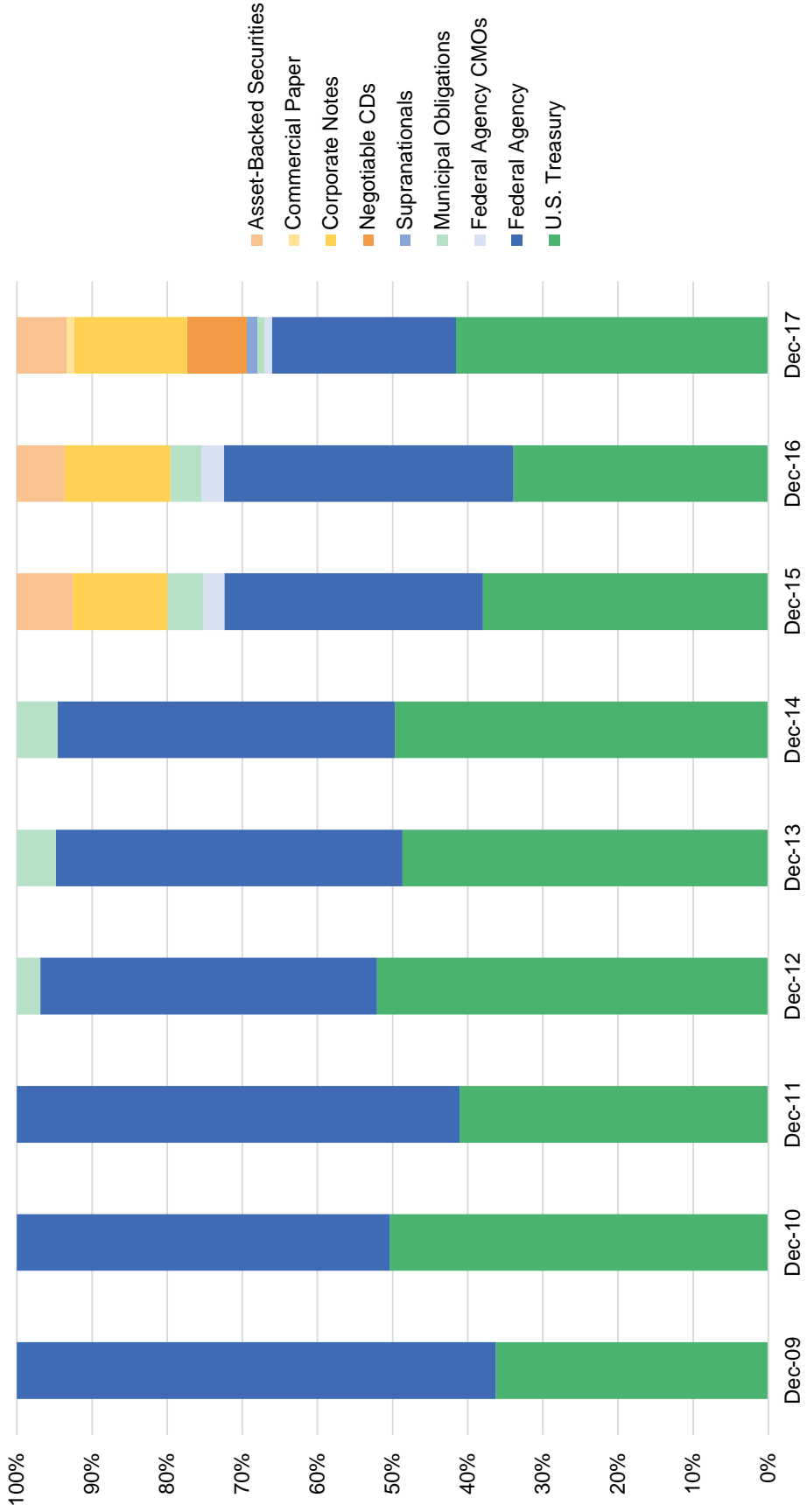
Outlook and Strategy

- The U.S. economy is generally on strong footing heading into the new year, bolstered by expanding economic activity, a strong jobs market, and gains in housing. However, the continued rise of the domestic stock market, coupled with low volatility, may point to investor complacency.
- The Federal Reserve recently reiterated its intentions to continue to gradually increase rates into 2018. However, persistently low inflation readings may derail these plans. In this uncertain environment, we plan to adopt a duration-neutral stance but will continue to carefully monitor the portfolio's duration relative to the benchmark's duration, making adjustments as appropriate.
- Federal Agency issuance is expected to resume in the new year, but the overall level is expected to be slower than 2017. Given the flatness of the yield curve and narrow bullet agency spreads, we may seek value in callable agency securities where we find them advantageous.
- We will continue to focus on exposure to the corporate sector as well as other spread products to add value to the portfolio.
- The mortgage-backed securities (MBS) sector may experience some turbulence once the pace of tapering increases in future months. For that reason, we are generally avoiding additional MBS allocations at this time.
- Broad diversification across all investment-grade sectors remains a key component of our portfolio strategy. We will continue to monitor the markets and will make relative-value trades as appropriate in order to safely enhance portfolio earnings. However, as always, while we continue to seek opportunities to enhance the earnings, our priority will always be to maintain the safety and liquidity of portfolio investments.



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Adding Value Through Sector Allocation





Portfolio Performance

Portfolio Durations, Total Rates of Return, and Yields

For periods ending December 31, 2017

	Duration (years)	Total Returns			Yield to Maturity at Cost
		Past Quarter	Past Year	Past 5 Years	
Total Portfolio	2.13	-0.21%	1.01%	0.77%	1.61%
Main	2.10	-0.23%	0.97%	0.68%	1.61%
Toland	2.14	-0.22%	1.00%	0.81%	1.61%
Coastal	2.13	-0.17%	1.07%	0.83%	1.61%
Bailard	2.15	-0.17%	1.07%	0.82%	1.62%
BAML 0-5 Year U.S. Treasury Index	2.12	-0.25%	0.69%	0.67%	1.86%

- Performance on trade-date basis, gross (i.e., before fees), in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).
- Includes money market fund in performance and duration computations.
- Quarterly returns are presented on an unannualized basis. Performance numbers for periods greater than one year are presented on an annualized basis.
- Bank of America Merrill Lynch (BAML) Indices provided by Bloomberg.
- Inception date is third quarter 2007.



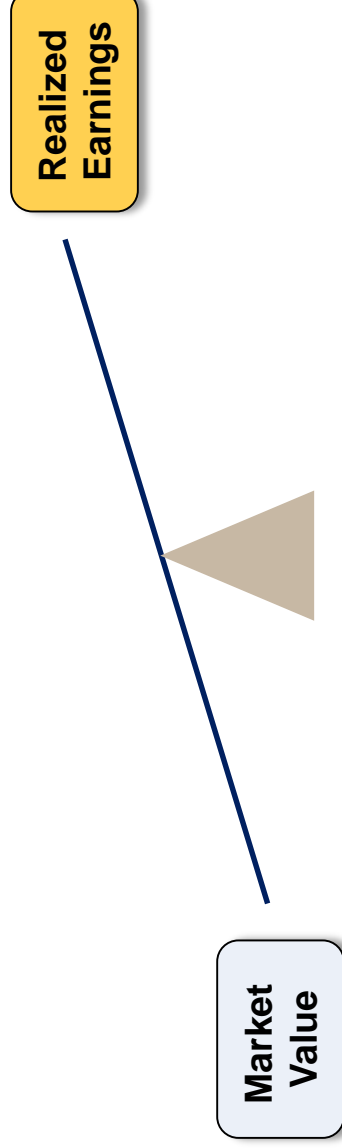
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The Impact of Rising Interest Rates

- For fixed-income holdings, when interest rates rise:
- Market values of existing holdings decline, resulting in *unrealized* market value losses and possibly negative total return.
- *Realized* earnings will increase over time as new securities are added at higher interest rates.

HOWEVER

As Interest Rates Increase . . .





Earning Analysis: Main Portfolio

As of December 31, 2017

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Past Year
Interest Earned	\$5,279	\$17,019	\$18,329	\$34,656	\$75,283
+ Change in Value	\$10,262	\$3,221	(\$1,459)	(\$57,007)	(\$44,983)
= Portfolio Earnings	\$15,541	\$20,239	\$16,870	(\$22,351)	\$30,299
Total Return %	0.66%	0.43%	0.36%	-0.23%	0.97%
Quarter-over-Quarter Change in 2-Year U.S. Treasury Yield	+0.07%	+0.12%	+0.11%	+0.40%	-

Notes:
Performance on trade-date basis, gross (i.e., before fees) in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).
Quarterly returns are presented on an unannualized basis.
May not sum to total due to rounding.



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Portfolio Composition

- The portfolios are in compliance with the District's Investment Policy and the California Government Code.

Security Type	Market Value	% of Portfolio	% Change vs. 9/30/17	Permitted by Policy	In Compliance
U.S. Treasury	\$14,379,320	40.9%	+5.0%	100%	✓
Federal Agency	\$8,472,523	24.1%	-1.7%	100%	✓
Federal Agency CMOs	\$340,443	1.0%	-0.7%	100%	✓
Municipal Bonds	\$330,426	0.9%	+0.9%	30%	✓
Supranationals	\$500,256	1.4%	-0.1%	30%	✓
Negotiable CDs	\$2,729,091	7.8%	-0.3%	30%	✓
Corporate Notes	\$5,201,024	14.8%	-0.6%	30%	✓
Commercial Paper	\$357,341	1.0%	-1.7%	40%	✓
Asset-Backed Securities	\$2,286,112	6.5%	-1.3%	20%	✓
Securities Sub-Total	\$34,596,534	98.5%			
Accrued Interest	\$149,647				
Securities Total	\$34,746,181				
Money Market Fund	\$520,721	1.5%	+0.5%	100%	✓
Total Investments	\$35,266,902	100.0%			

As of 12/31/2017. Detail may not add up to total due to rounding.

*The total amount invested in negotiable CDs, corporate notes, commercial paper, and asset-backed securities may not exceed 35%.



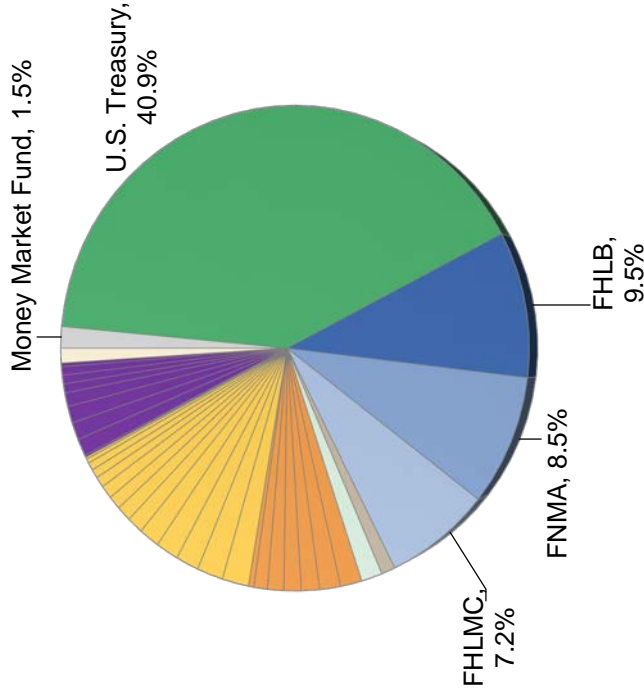
Sector and Issuer Distribution

- The portfolios are diversified across high quality sectors and is composed of securities with excellent credit quality.

Corporate Issuers (14.8%)	
Goldman Sachs	1.8%
Citigroup	1.8%
Morgan Stanley	1.6%
BB&T Bank	1.6%
American Express	1.5%
John Deere Capital Corp	1.2%
IBM	1.0%
Toyota Motor	0.9%
Apple	0.9%
Caterpillar	0.7%
Microsoft	0.6%
American Honda Finance	0.5%
Walt Disney Company	0.3%
Burlington North	0.1%
Comcast	0.1%

Supranational Issuers (1.4%)	
Inter-American Development Bank	1.4%

Municipal Issuers (0.9%)	
CA&T Taxable GO Bonds	0.9%



CP Issuers (1.0%)	
Bank of Tokyo Mitsubishi	1.0%

ABS Issuers (6.5%)	
Nissan Auto Receivables	1.2%
CNH Equipment Trust	1.2%
Ally Auto Receivables	1.1%
Ford Auto Receivables	0.9%
Hyundai Auto Receivables	0.6%
Toyota Auto Receivables	0.6%
Citigroup ABS	0.6%
Honda Auto Receivables	0.2%

CD Issuers (7.8%)	
Sumitomo Mitsui Bank NY	1.5%
Bank of Nova Scotia (Houston)	1.4%
Scandinaviska Enskilda (NY)	1.3%
Bank of Montreal Chicago	1.2%
Svenska Handelsbanken NY	1.1%
Bank of Tokyo Mitsubishi	0.9%
Westpac Banking Corp (NY)	0.4%

As of 12/31/2017. Detail may not add up to total due to rounding.

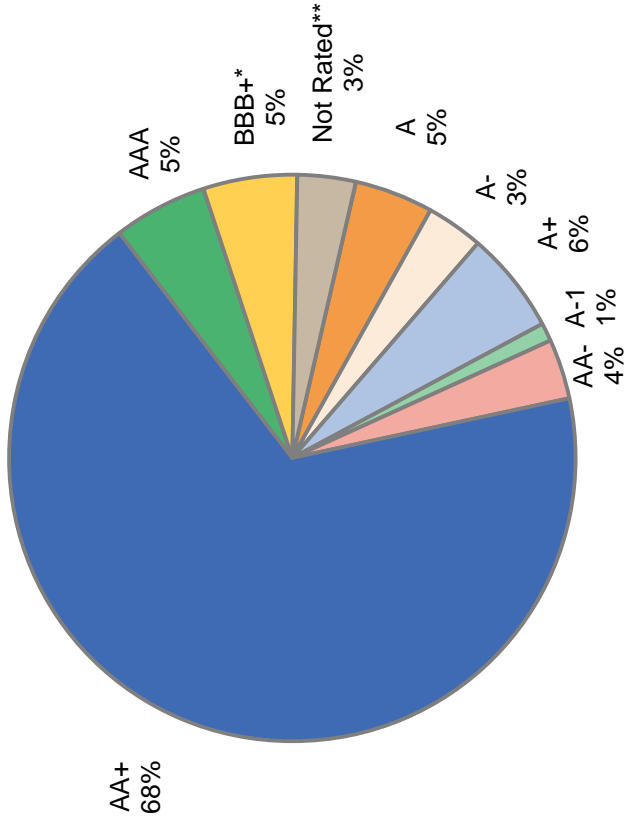


Credit Quality

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- The District's aggregate portfolio has an average credit rating of AA.

Credit Quality



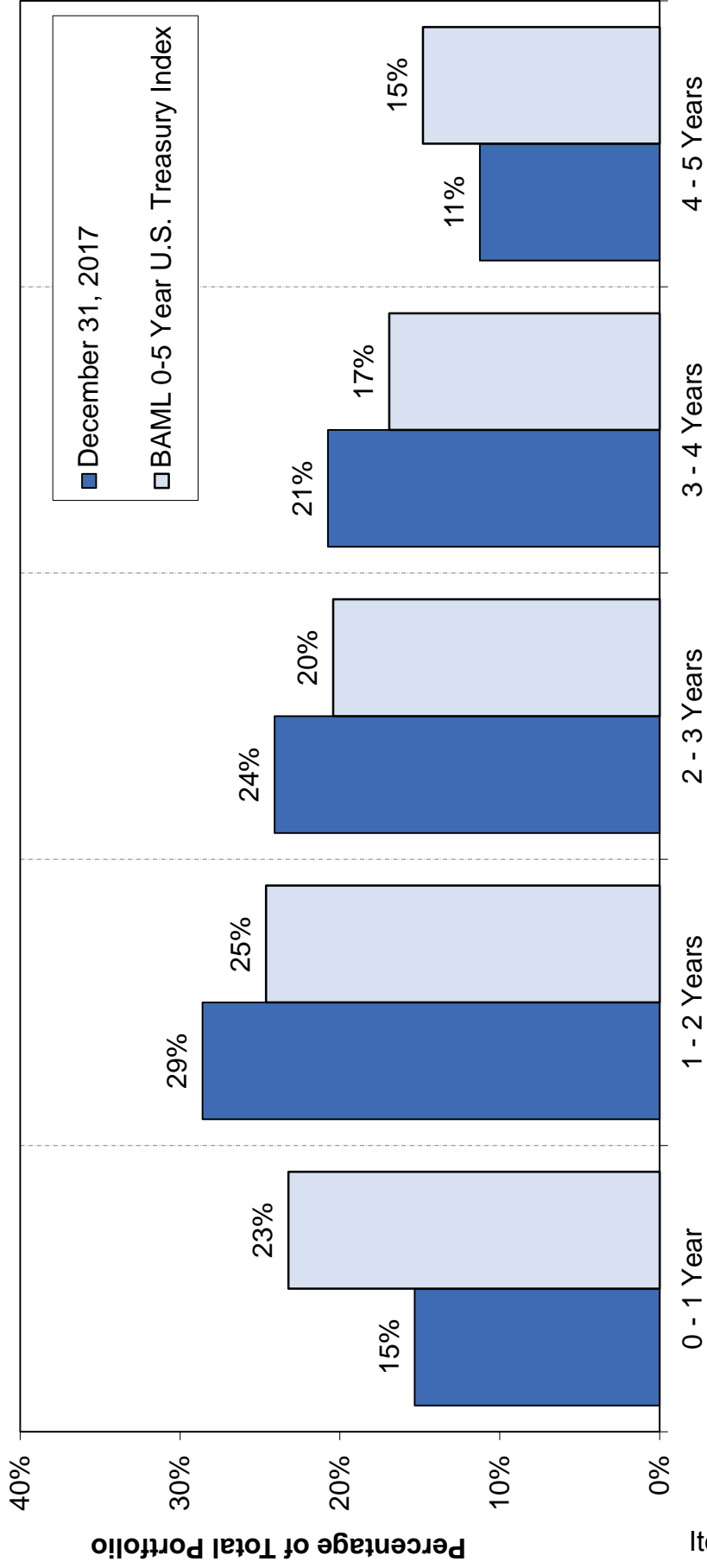
Ratings by Standard & Poor's. Percentages may not add up to 100% due to rounding.

*Securities rated BBB+ by S&P are rated A- or the equivalent or better by Fitch and/or Moody's.

**Securities not rated by S&P are asset-backed securities rated Aaa by Moody's.



Maturity Distribution



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Bank of America Merrill Lynch Indices from Bloomberg.
Detail may not add up to 100% due to rounding.

Callable securities in the portfolio are included in the maturity distribution analysis to their stated maturity date, although they may be called prior to maturity.



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PFM Asset Management LLC has exercised reasonable professional care in the preparation of this performance report. However, information in this report on market indices and security characteristics, as well as information incorporated in the Market Commentary section, is received from sources external to PFM Asset Management LLC.

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