City of Aurora

Investment management quarterly report

October 2017

A BNY MELLON COMPANY℠

Insight INVESTMENT

Table of contents

US economic activity during the third quarter remained supportive, permitting the Federal Reserve (Fed) to further normalize monetary policy. The second quarter GDP reading rebounded to 3.1% from 1.2% in the first quarter. The labor market also remains “tight” with an unemployment rate well below 5%. Manufacturing surveys and confidence indicators are furthermore at or near cycle highs. The lingering challenge for the Fed is that inflationary price pressures have yet to surface. Their dual mandate is to pursue full employment and stable prices. Yet the latest reading for core personal consumption expenditures decelerated to 1.3% annually to close September, compared to their inflation target of 2.0%.

At least for this quarter, the Fed achieved the next step in their normalization quest by initiating the process to shrink balance sheet assets. Under their asset purchase program known as Quantitative Easing, the Fed purchased Treasury, agency and agency mortgage backed securities to stabilize the market during the financial crisis. Nearly ten years later, there is enough economic stability and forward guidance from the Fed so that this action was generally well-received by fixed income markets. Long-term Treasury yields remain low and somewhat range bound, with the 10-year Treasury note closing the quarter at 2.33%.

Rationale for normalizing monetary policy despite the Fed missing the price stability targets mostly leans on the crutch of accommodative "financial conditions". While traditional inflation measurements are low, financial asset inflation as measured by stock market returns and corporate bond risk premiums are making new highs. This is occurring despite two previous rate increases in March and June. The Fed further relied on their narrative that the balance sheet unwind is not intended be used as a policy tool. Therefore removing this element of the emergency policy stance should have little effect on the long run economic outlook or the dual mandate, at least in their view.

The Fed appears committed to policy normalization as the most influential members, such as Fed Chair Yellen and NY Fed Governor Dudley, have been focusing on financial conditions and forward expectations for inflation rather than current inflation. Hurricanes Harvey and Irma will likely provide enough economic noise for the Fed to dismiss inconsistent data by the December meeting. Should the Fed raise rates again, it would be the first year since the financial crisis that their interest rate projections come to fruition.

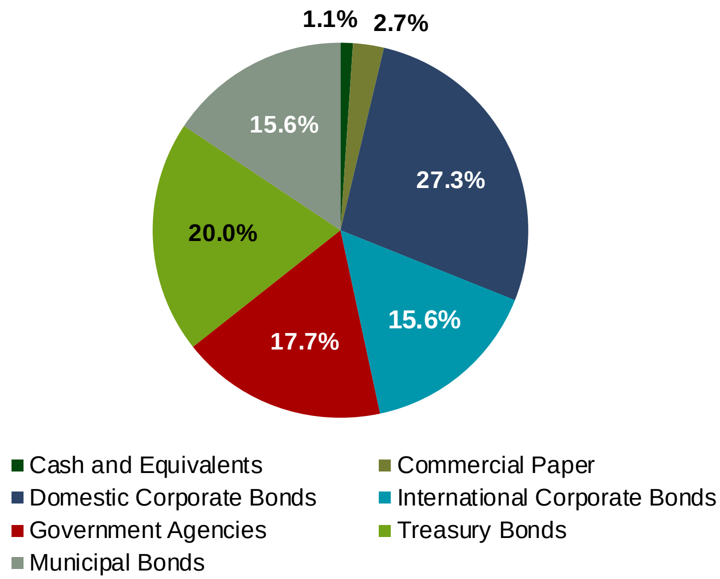
Interestingly and as we think forward, Fed policy changes may be overshadowed by politics in the upcoming quarter. The administration is expected to nominate a new Fed chair and possibly pass corporate and personal income tax reform. Both events may be more market noteworthy. Additionally while geopolitical flash points are difficult to predict, the trend direction has undeniably been deteriorating and could be a source of market volatility. It would not be surprising then if markets in the fourth quarter respond to a different cue before returning to clearer Fed, economic and (hopefully) geopolitical pictures in 2018.

As of September 30, 2017.

Market environment and strategies

Asset allocation

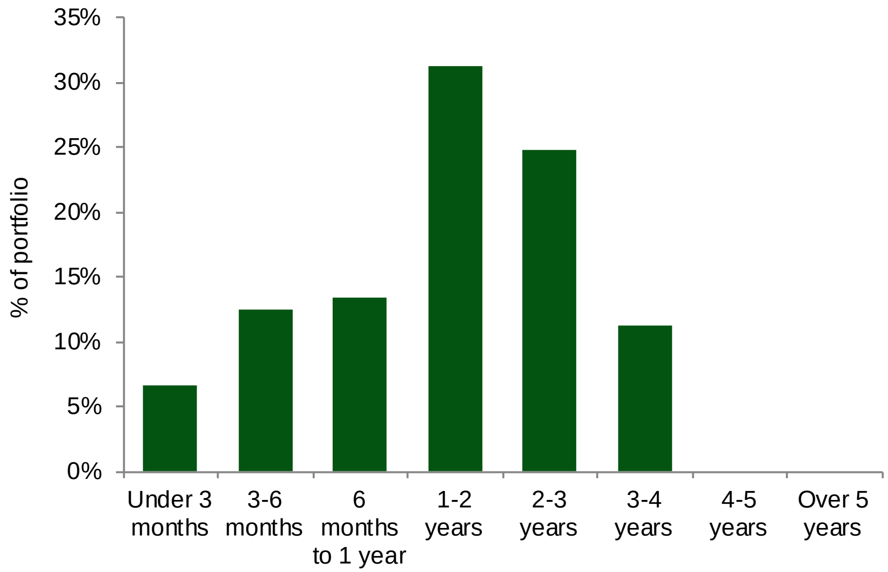
Investment Type	Allocation	Maturity (days)
Cash and Equivalents	1.1%	1
Commercial Paper	2.7%	79
Domestic Corporate Bonds	27.3%	659
International Corporate Bonds	15.6%	481
Government Agencies	17.7%	663
Treasury Bonds	20.0%	582
Municipal Bonds	15.6%	678
Total	**100.0%**	**597**



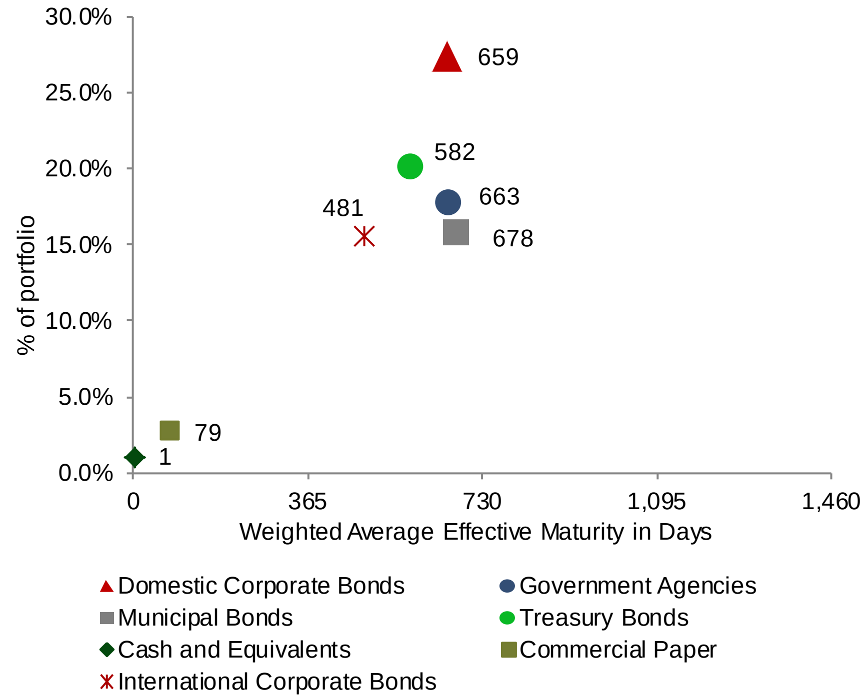
As of September 30, 2017. Asset allocations are subject to change without notice, may not represent current or future decisions and should not be construed as investment recommendations. Please refer to the important disclosures at the back of this presentation

Market environment and strategies

Maturity distribution



Maturity allocation map



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