

Strategies for Today's Investment Portfolio

June 9, 2010

8:30 AM – 10:10 AM

The Past, The Present and the Future

W. Daniel Ebersole
Treasurer
State of Georgia

What Happens In the Past...

LEHMAN BROTHERS

BEAR
STEARNS


Washington
Mutual

AIG

 Merrill Lynch

 Countrywide

 FannieMae


WACHOVIA

 Freddie
Mac

2010: Think Globally and Locally

- Reckless deficit spending coupled with globally uncompetitive economies have created financial crises in Portugal, Italy, Ireland, Greece and Spain.
- Finance ministers from the 16 countries that use the euro agreed to rescue Greece with \$146.1 billion in loans over 3 years to keep it from defaulting on its debts.
- The Federal Reserve re-establishes temporary reciprocal currency arrangements (swap lines) with the Bank of Canada, the Bank of England, the European Central Bank and the Swiss National Bank in response to the re-emergence of strains in U.S. dollar short-term funding markets in Europe.
- The U.S. dollar gains on the risk aversion play, along with the Japanese yen, as nobody wants to buy the euro.
- State and local governments continue to cut jobs and spending as they struggle to close budget gaps. Retrenchment in the government sector, combined with higher taxes, is weighing on the economic recovery just as the private sector has begun adding jobs and showing other signs of a turnaround.

What started out as scattered problems with sketchy subprime loans somehow managed to infect the broader housing market, batter the biggest financial institutions, bring Bear Stearns Cos. down and Fannie Mae and Freddie Mac to their knees, decimate the derivatives market, and cause businesses to cut payrolls and consumers to curtail spending.

Caroline Baum, Bloomberg

USURTOT Last 9.9% APR Next 06/04/10 08:30 Surv 9.8% Index **GP**
 US Unemployment Rate Total in Labor Force Seasonally Adjusted

USURTOT INDEX Advanced Hide GP - Line Chart Page 1/4

Range 05/31/04 - 04/30/10 Upper Latest/Last Revi Mov. Avgs
 Period Monthly Lower None Mov. Avg Events

* Last Price 9.9
 † High on 10/31/09 10.1
 ↗ Average 6.0
 ‡ Low on 10/31/06 4.4



2004 2005 2006 2007 2008 2009 2010
 Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000
 Copyright 2010 Bloomberg Finance L.P.
 SN 725777 6819-446-1 26-May-2010 14:25:13

RSTAMOM Last 0.4% APR Next 06/11/10 08:30 Surv 0.1% Index **GPO**
 Adjusted Retail & Food Services Sales SA Total Monthly % Change

RSTAMOM INDEX Advanced Hide GPO - Bar Chart Page 1/8

Range 05/31/04 - 04/30/10 Upper Latest/Last Re Mov. Avgs Currency USD
 Period Monthly Lower None Mov. Avg Events



2004 2005 2006 2007 2008 2009 2010
 Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000
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**Experience is that marvelous thing
that enables you to recognize a
mistake when you make it again.**

Franklin P. Jones

The Price of Failing to Understand or Appreciate the Risk Undertaken

- Orange County, CA: Its \$7.4 billion fund lost \$1.5 billion on derivatives and reverse repos when the bond market collapsed.
- Charles County, MD: Lost \$8.3 million in mid-1994 by investing 98% of its assets in collateralized mortgage obligations and structured notes.
- Cuyahoga County, OH: Its highly leveraged \$1.8 billion fund lost \$137 million when bond prices fell.
- Odessa College: The Texas school lost \$7 million in mid-1994 after investing \$22 million in collateralized mortgage obligations.
- West Virginia: \$279 million loss in 1986 and 1987 on treasuries, reverse repos and options.
- Florida: Local Government Investment Pool had a run on its assets when it was disclosed that the fund held below-investment grade securities including asset-backed commercial paper issued by structured investment vehicles (SIVs).

In the boom, all that mattered to money market funds was yield, and they did not need help finding it. Now they crave liquidity and sanctity of principal – a welcome rediscovery that short-term holdings should “bore you into a good night’s sleep.”

Reserve Management’s Bruce Bent,
creator of the first money fund in 1970.
The Economist – June 14, 2008

Breaking Buck Was Ironic for Trumpeter of 'Safe'

- In a message on the firm's web site that remains even now, He notes many have “lost sight of the purpose of a money fund” in their “foolhardy quest for a few extra basis points” while the reserve believes cash funds are “definitely not money to take risks with.” On Friday, Mr. Bent, appearing on CNBC discussing the financial crisis sweeping banks, said money funds do a “disservice to the investing public” when they fail to sufficiently research their holdings.
- ...At least a dozen large investors pulled out almost **\$40 billion** of their money Monday and Tuesday, two-thirds of Primary Fund's formidable asset base. This modern-day run on the bank has left a husk of a once-proud money fund.

Source: WSJ - September 18, 2008

The number one objective for corporate short-term investments is preservation of capital, not return.

Jeffrey Wallace, managing
partner at Greenwich Treasury
Advisors

Importance of an Investment Policy

- Promotes long-term discipline in establishing investment goals
- Discourages irrational decisions based on panic or overconfidence
- Provides accountability
- Informs employees, officials, financial institutions and the public of authorized investments
- Clearly sets out the return objectives and risk tolerance over the relevant time horizon along with applicable constraints such as liquidity needs and regulatory requirements
- Ensures that the list of authorized investments includes only those allowed by law and those that the investment officers are trained and competent to handle

Investment Policy 101

- Safety of Capital – Investments should be managed in a manner that seeks to ensure ***preservation of principal***.
- Liquidity – The fund should remain sufficiently liquid to enable the funding of all cash needs reasonably anticipated.
- Yield
- Diversification – To reduce overall portfolio risks while maintaining market rates of return.

Model Investment Policies

- State and Local Treasurers' Policies
- Government Finance Officers Association (GFOA)
 - www.gfoa.org/services/documents/sampleinvestmentpolicy.doc
- Government Investment Officers Association (GIOA)
- Association of Public Treasurers of the United States and Canada
 - http://www.apusc.org/common/certification/model_investment_policy.php

Managing Liquidity

- How much liquidity do we have?
- How accessible is it?
- How much liquidity may we need short term and longer term?
- If market or economic conditions change, how could our liquidity needs and cash availability change?
- What actions would we take in the event of a liquidity crisis?

Risky Business



- Credit Risk
 - Credit Spread Risk
 - Downgrade Risk
 - Default Risk
- Interest Rate Risk
 - Call Risk
 - Reinvestment Risk
- Headline Risk (aka Ignorance Risk)
- Counterparty Risk (think Lehman Brothers)
- Political Risk

Monitoring Bank Investments

- FDIC Insurance
- Collateral
 - Type
 - Value
- Reporting
 - Verify Information Reported
 - Frequency

Ratings: What Makes the Security A-1/P-1 or Better?

- We have all learned that we cannot rely solely on the credit rating agencies for our credit analysis.
- Use the rating as a starting point.
- Have your credit team evaluate the creditworthiness of a name.

“There’s no opportunity for return without some risk. If you don’t see or understand the risk, keep looking. It’s there. Once you find it and understand it, it may be acceptable. But until you identify the risks, they are unacceptable.

Marshall Loeb
CBS.Marketwatch.com

“Going forward, we aim to invest only in financial instruments that we understand,” wrote Michael Sabia, President and CEO, Caisse de Depot et Placement du Quebec.

Pension and Investments
February 8, 2010

Know Your Strengths

- If you don't have the staff or the expertise to evaluate credit:
 - Stick to what you know; or
 - Hire an outside manager to manage credit.



Employee

Versus



**Contracting
Out**

The real discipline comes in saying no to the wrong opportunities.

Peter Drucker



“The safest way to double your money is to fold it over once and put it in your pocket.”

Kim Hubbard
American Humorist

Rule No. 1: Never Lose Money
Rule No. 2: Never Forget Rule No. 1

Warren Buffett



Government Finance Officers Association

Strategies for Today's Investment Portfolio

Presented by:
Mark Evans, CFA
Executive Vice President
Director of Investment Strategies



Outline

- Update on key markets
 - GSE's
 - Money markets
 - Others
- The Fed's Exit Strategy
- Avoiding risks following the financial crisis
- Managing in a rising rate environment
 - Security selection
 - Sector and maturity allocation

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GSE Status

- No real change over the past year
- Fannie/Freddie still supported in conservatorship
- Implied guarantee and GSEs still on Congress' agenda
- Market is not showing credit concerns
- Diversification still warranted

Spreads Have Normalized

5/29/09 11/20/09 2/19/10 4/23/10 5/21/10

Treasuries (Yield)	1Y Ago	6M Ago	3M Ago	4W Ago	Current
2 Year Treasury	0.93	0.70	0.92	1.07	0.74
5 Year Treasury	2.38	2.14	2.46	2.59	2.00

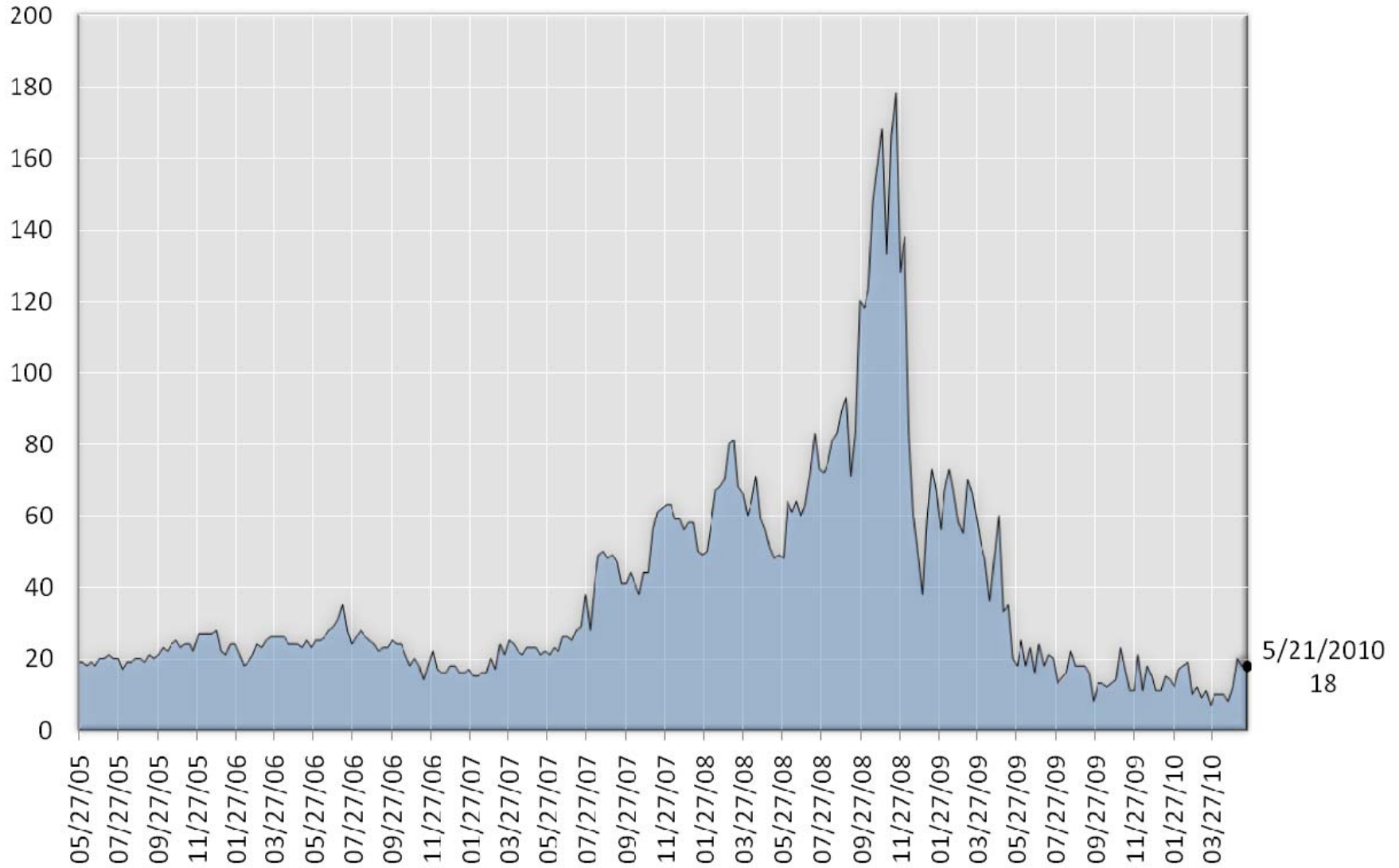
Agency Bullets (Spread)	1Y Ago	6M Ago	3M Ago	4W Ago	Current
2 Year Bullet	18	11	19	8	18
5 Year Bullet	39	27	25	17	35

Agency Callables (Spread)	1Y Ago	6M Ago	3M Ago	4W Ago	Current
2 Year NC 1 Year	20	22	26	16	33
5 Year NC 1 Year	58	62	60	40	63
5 Year NC 2 Year	50	47	46	34	50

Corporates (Spread)	1Y Ago	6M Ago	3M Ago	4W Ago	Current
2 Year 'A' Rated	370	147	125	115	130
5 Year 'A' Rated	385	153	135	125	160

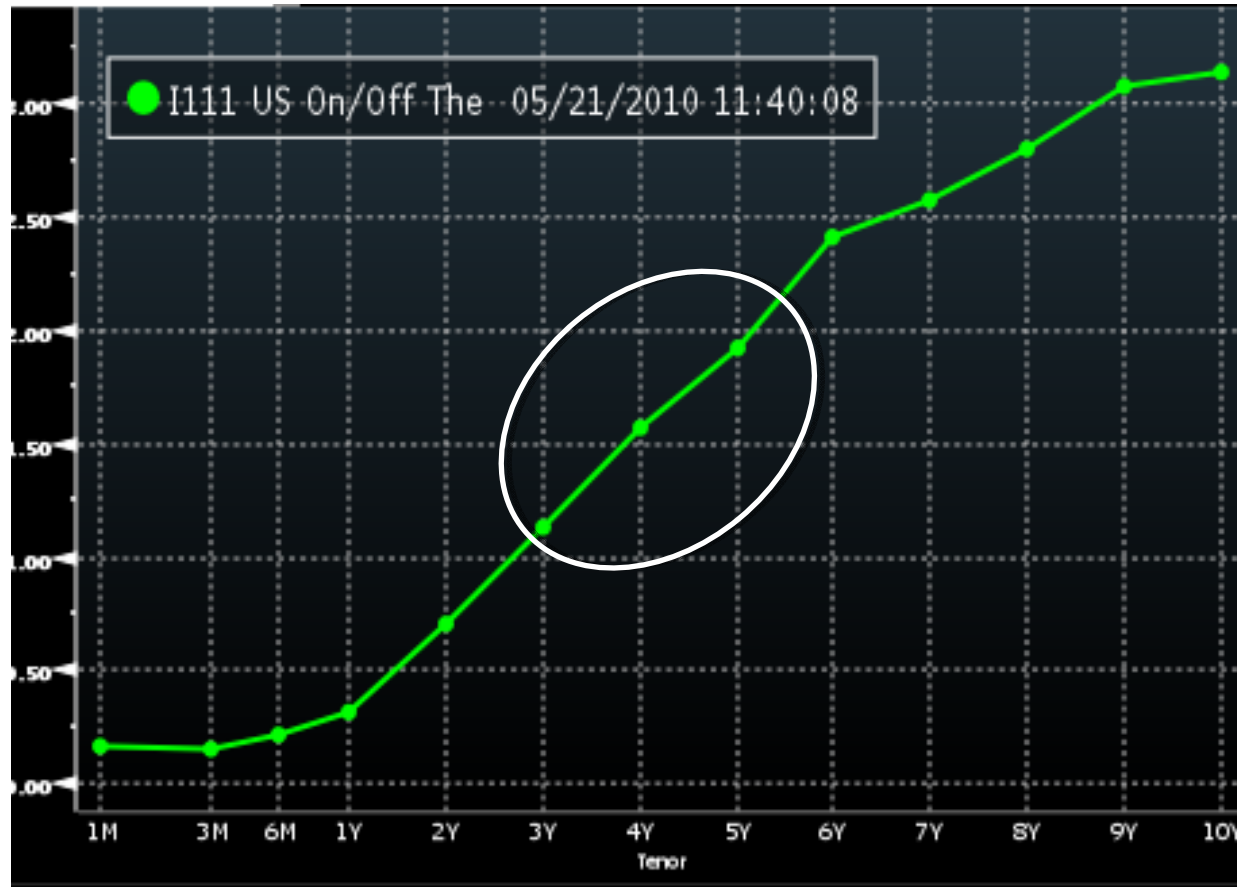
CMOs (Spread)	1Y Ago	6M Ago	3M Ago	4W Ago	Current
2 Year PAC	130	75	72	65	70
2 Year Sequential	180	109	90	87	80

Two Year Agency Bullet Spreads



Capturing the Benefit of the Curve

- Bloomberg Treasury Curve



Bullets vs. Callables

- Am I getting paid enough?
- Examples:

Bullet	Bullet Yield	Callable	Callable Yield
5yr Bullet	2.35%	5yr/2yr	2.59%
4yr Bullet	1.85%	4yr/3mo	2.35%

- Other Alternatives:
 - 2yr corporates - Finance 1.95%
 - 5yr corporates - Industrials 2.85%, Finance 3.58%
- Corporate structured notes
 - Caution: are you getting the **credit spread** and the **structure spread**?

Step-ups

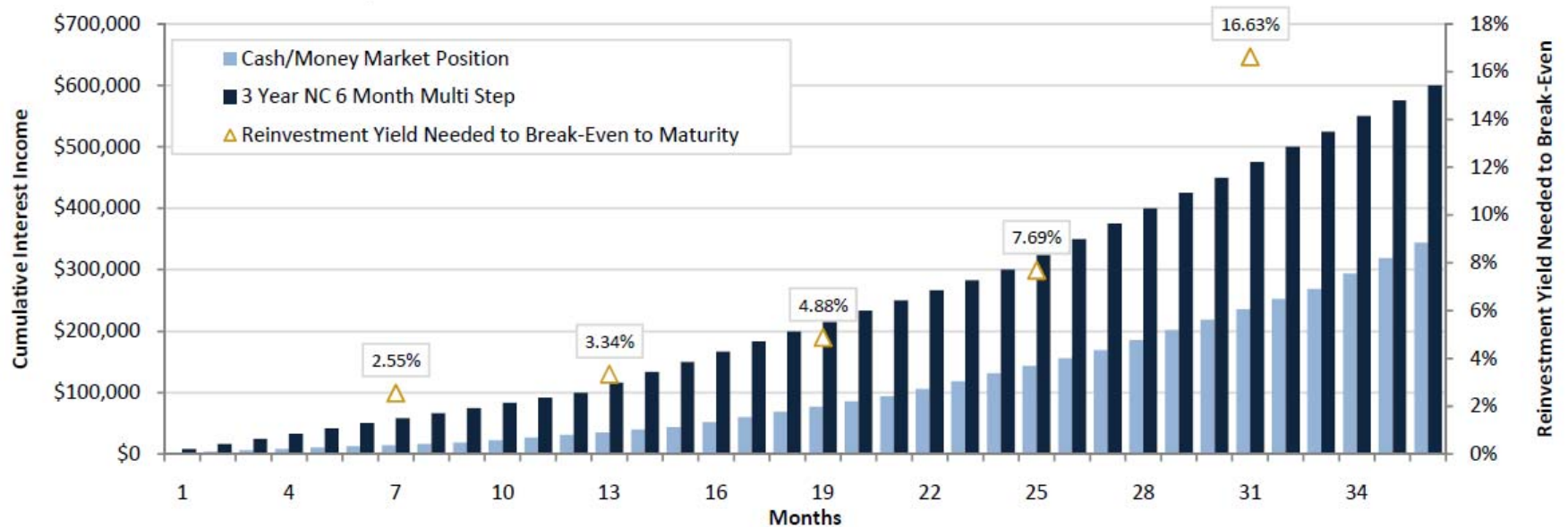
Investment Alternatives - Vectored Rate Summaries

Cash / Money Market Security			3 Year NC 6 Month Multi Step		
	Rate	Period (Mos)		Rate	Period (Mos)
Period 1	0.25%	9 Months	Period 1	1.00%	12 Months
Period 2	0.50%	6 Months	Period 2	2.00%	12 Months
Period 3	1.00%	6 Months	Period 3	3.00%	12 Months
Period 4	1.50%	6 Months	Period 4		
Period 5	2.00%	6 Months	Period 5		
Period 6	3.00%	3 Months	Period 6		

Methodology

1. Analysis assumes all securities go to maturity.
2. Interest income not assumed to be reinvested.
3. Interest calculation based on 30/360 calendar.
4. The Vectored Cost Projection is based upon user inputs. The cost of each asset is input in monthly increments.

Chart 1. Cumulative Income Comparison



Money Markets & Short-term Investments

- Insatiable demand for short (<1yr, <2yr)
- Result:
 - Incredibly tight spreads
 - Scramble for yield
- Caution:
 - Don't chase yield by taking unknown risks
- Consider all alternatives:
 - Bank deposits
 - Money market funds
 - Discount notes
 - Floating rate securities (uncapped and/or simple structures)

Longer Investment Alternatives

- Agency debt
 - Bullets, callables, step-ups
 - Key: do not buy longer maturities than comfortable, regardless of call or steps.
- Build America Bonds & Taxable Munis
- Larger, more sophisticated portfolios:
 - Floating rate SBA pools
 - Agency mortgage securities

Build America Bonds (BABs)

- Created by the American Recovery and Reinvestment Act of 2009 (ARRA)
- Allows municipal issuers to issue taxable bonds subsidized by a tax credit
- Has allowed increased access to funding markets for state and local government issuers
- Has created a significant opportunity for non-taxable buyers to participate in municipal market

The Fed's Exit Strategy

- Focus
 - Inflation, capacity utilization, unemployment
- Indicators to watch:
 - Fed
 - Discount rate
 - Fed Funds Rate
 - Interest Rate on Excess Reserves
 - Term Deposit Rates
 - LIBOR
 - Treasury yields, especially 2yr
- Crisis vs. normal accommodation

Avoiding Risks Following the Financial Crisis

- Be extra cautious about:
 - Structured products
 - New products
 - Re-emerging products and structures

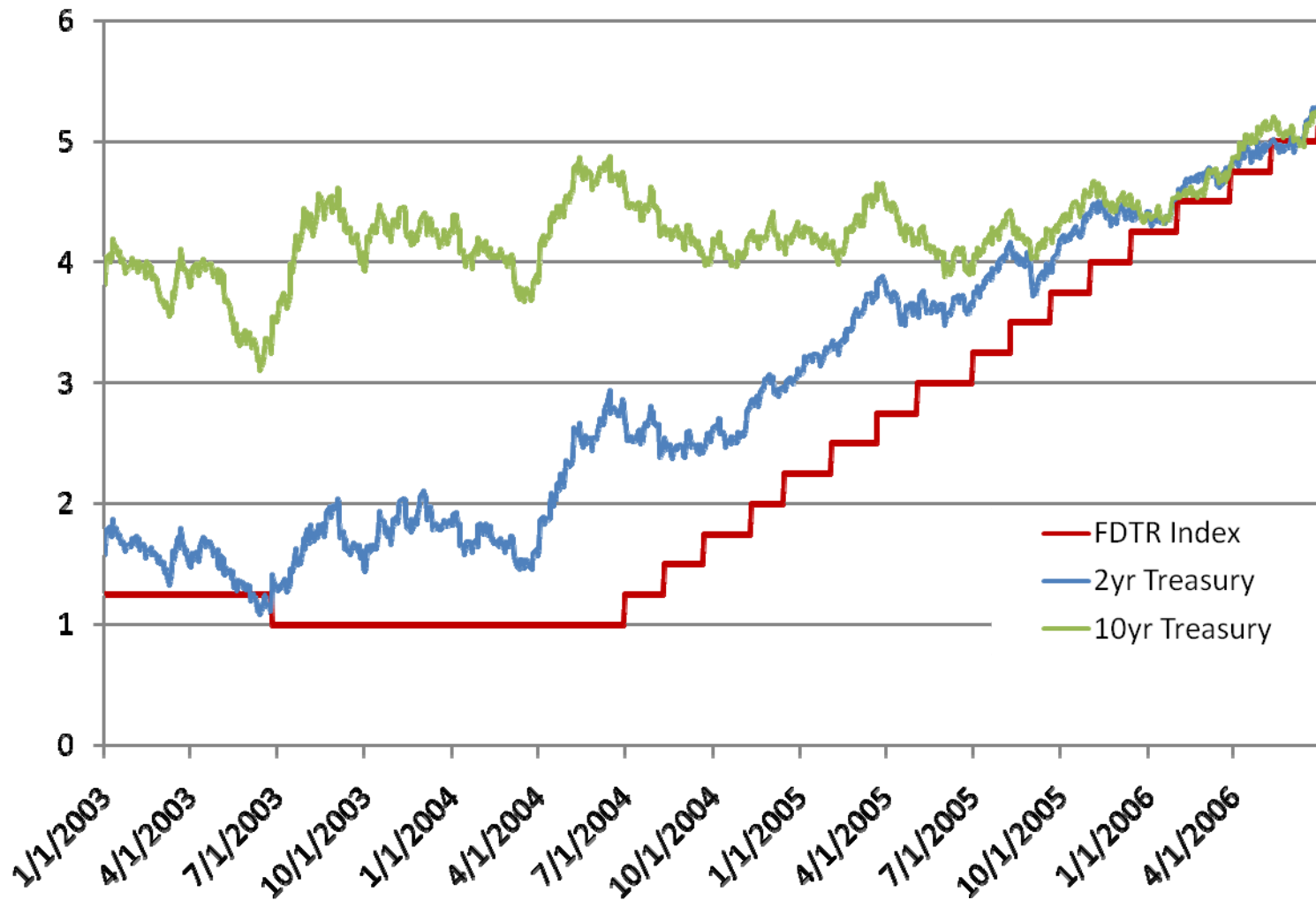
Managing With Rates at Historic Lows

- Be disciplined
 - Understand purpose and duration of funds
 - Maintain investment strategy consistent with objectives & constraints
 - Do not reach for yield
- Evaluate portfolio under rising rate scenarios
 - Cash flows
 - Duration
 - Price risk
- Find a way to invest & have liquidity when rates ultimately rise
 - Cash flows
 - Security sales

1993-94 Cycle



2003-04 Cycle





Strategies For Today's Investment Portfolio

June 9, 2010



GFOA Atlanta 2010

Jerrae' Williams, City of Raleigh Treasury Manager

AGENDA

- City of Raleigh's Investment Policy
- Investment Strategy
- Treasury Market
- Techniques
- Best Practices
- Summary



Investment Policy

- Invest in all funds as provided by the NC General Statutes
- Required Diversification by instrument, financial institution, and maturity
- Scheduled Maturities
- Funding for routine expenditures

Investment Policy

- Recent legislation in 2008 authorized City to invest other funds as approved by Council
 - Employee Benefits held in Trust
 - Risk Reserves
 - Capital Reserves
- Funds can be invested with State of NC Investment Trust, External Managers, Diversified allocation of mutual funds, or a combination of all three

Investment Strategy

- Investment Instruments

- Treasuries
- Agencies (FNMA, FHLMC, FHLB, FFCB)
- CD's/Bankers Acceptance
- Municipal Bonds
- Managed Funds
- Highest Rated Commercial Paper

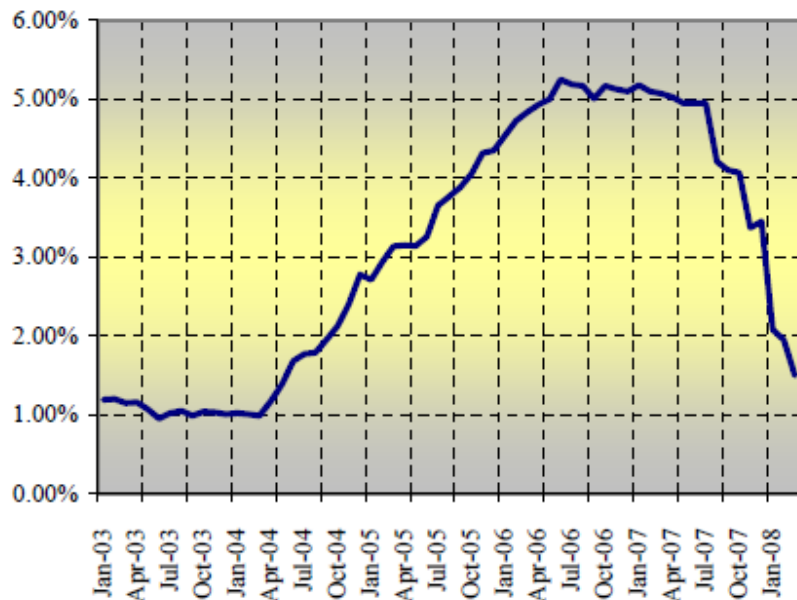


Investment Strategy

- Cash Flow Investment Model
 - Cash Flow Forecasting
- Investment Purchase Plan
- Diversification and Exposure Tracking
- Strategy for Target Portfolio Holdings

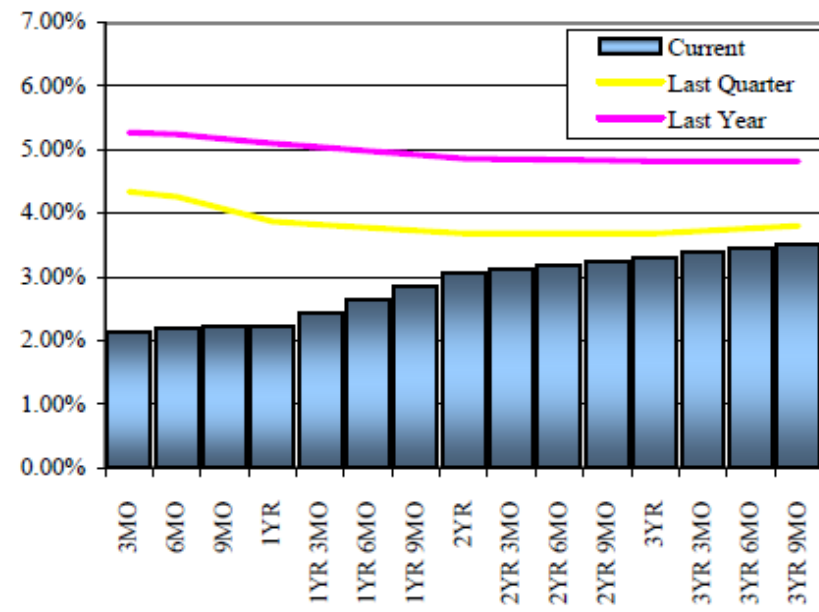
08' Treasury/Agency Market

Treasury Yields
6-Month T-Bill



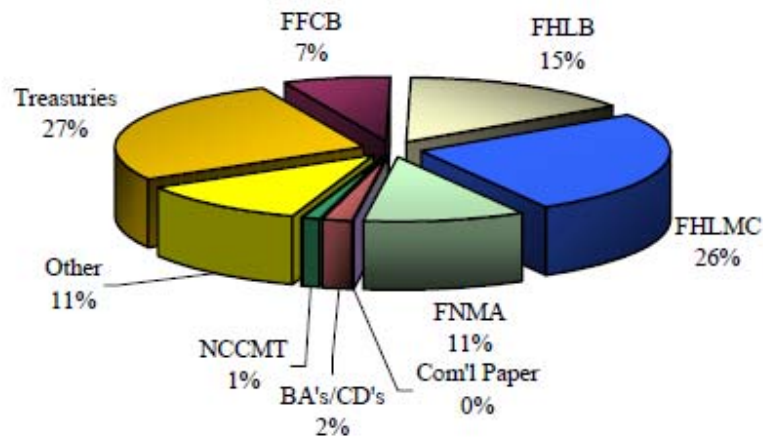
Yield Curves

U.S. Government Agencies



08' Raleigh's Holdings

Current Holdings



Portfolio Statistics

Total Investments:

This Quarter	\$441,324,157.10
Last Quarter	\$461,769,027.75
One Year Ago	\$444,719,820.44

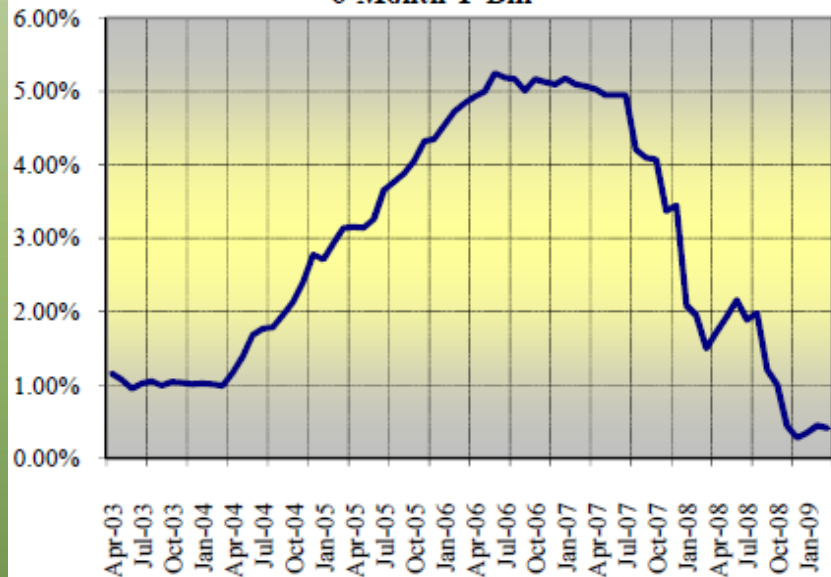
Weighted Average Yield 3.88%

Weighted Average Maturity 269

09' Treasury/Agency Market

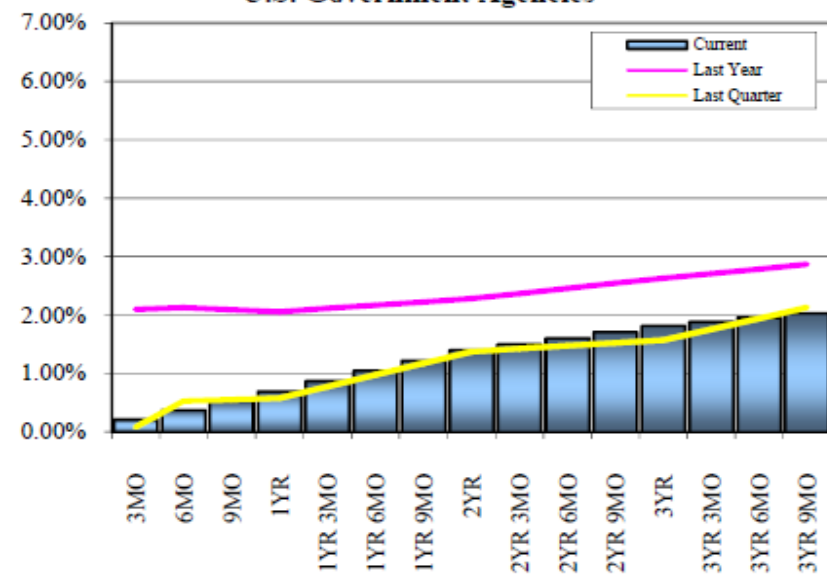
Treasury Yields

6-Month T-Bill



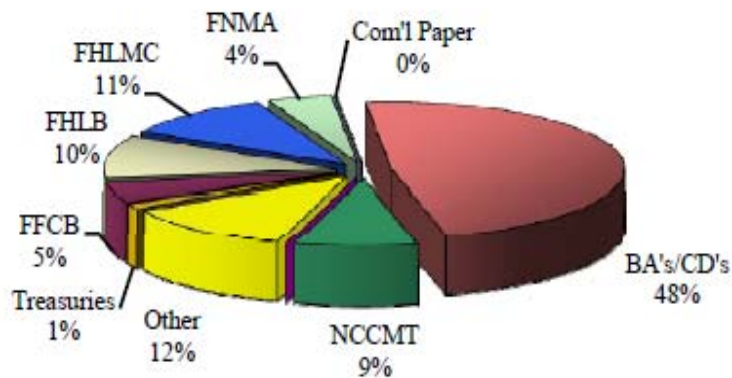
Yield Curves

U.S. Government Agencies



09' Raleigh's Holdings

Current Holdings

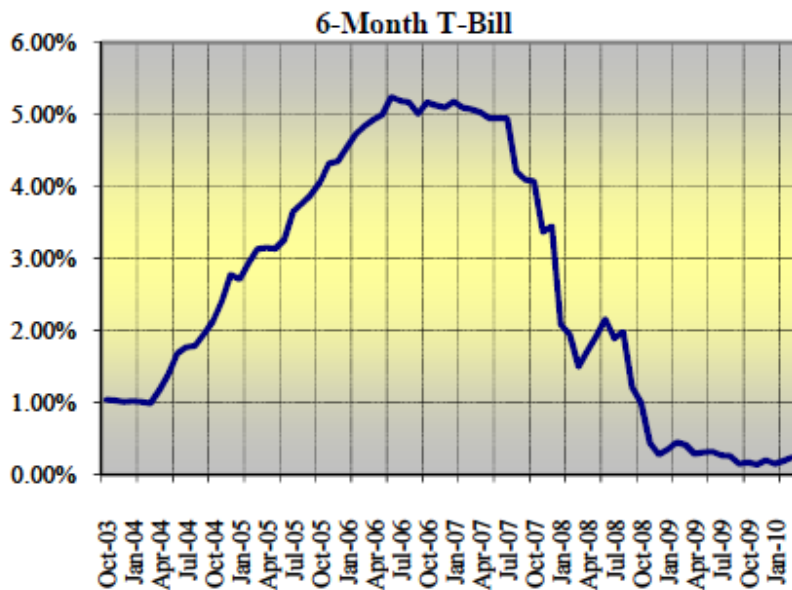


Portfolio Statistics

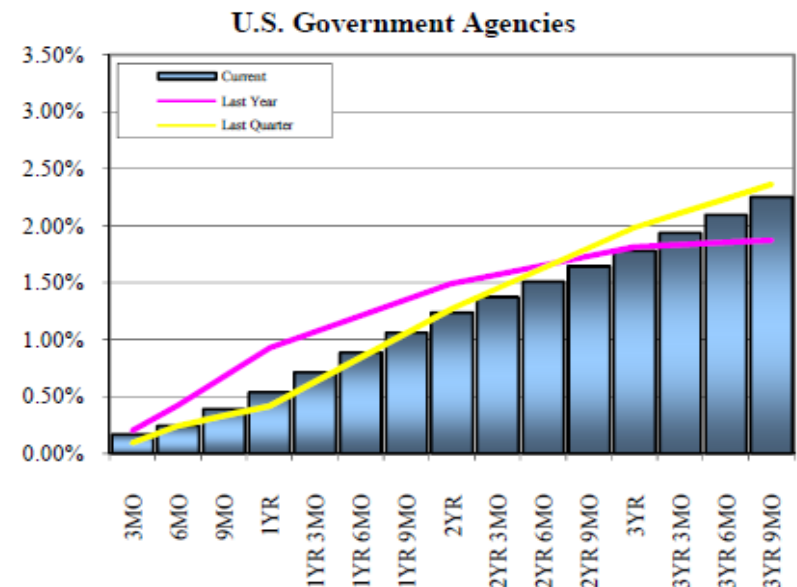
Total Investments:	
This Quarter	\$427,502,310.69
Last Quarter	\$428,832,911.01
One Year Ago	\$441,324,157.10
Weighted Average Yield	2.37%
Weighted Average Maturity	190

10' Treasury/Agency Market

Treasury Yields

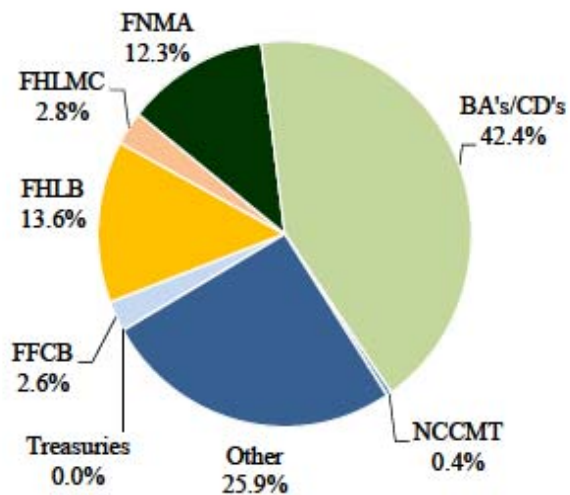


Yield Curves



10' Raleigh's Holdings

Current Holdings



Portfolio Statistics

Total Investments:

This Quarter	\$389,518,346.11
Last Quarter	\$395,435,492.13
One Year Ago	\$427,502,311.69

Weighted Average Yield	1.47%
Weighted Average Maturity	257

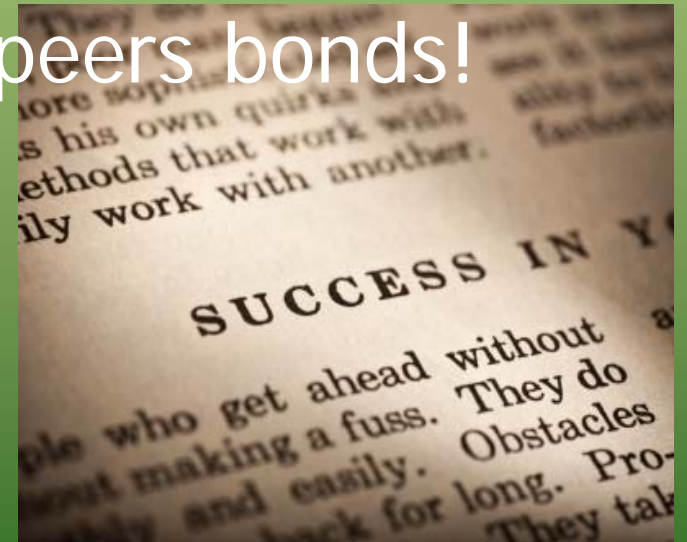
Techniques

- Diversification
 - Use of Regional/Community Banks
- Risk
- Liquidity
- Investment Instruments
- Broker Relationships



Best Practices

- Hire former Brokers/Portfolio Managers
- Using Callable Securities
- Using Certificate of Deposits/Bullets
- Municipal Bonds-Buy your peers bonds!



Summary

- Always follow Board/Council Approved Investment Policy
- Consult GFOA Best Practices
- Be prepared to React Quickly

Questions?

Thank You!!