

GIOA
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CONFERENCE
2019

ARE CREDIT SECURITIES WORTH THE RISK?

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OVERVIEW

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- Legal & Fiduciary Standard
- Short-Term Corporate Investments: Commercial Paper & Certificate of Deposits
- Corporate Notes
- Corporate Analysis

Legal & Fiduciary Responsibilities County/City Treasurers

California Government Code, Section 53630 et seq

- Vests the authority to select the depository bank to the treasurer of the local agency
- Authorizes the treasurer to enter into agreements with depositories concerning the terms and conditions of any part of the money deposited
- Allows bank overdrafts to not be considered borrowing (otherwise they would be required to be approved by the governing body)
- Allows the treasurer to waive the security (collateralization) for the portion of any deposit insured pursuant to federal law
- May render to the governing body and any oversight body an annual statement of investment policy and quarterly reports with specific requirements submitted within 30 days following the end of the quarter (no longer mandated since 1-1-2010)
- Investment objectives
 - Safety
 - Liquidity
 - Yield

Legal & Fiduciary Responsibilities County/City Treasurers (cont'd)



California Government Code, Section 53600.5

- When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of a trustee shall be:
- Safeguard the principal of the funds under its control.
- The secondary objective shall be to meet the liquidity needs of the depositor.
- The third objective shall be to achieve a return on the funds under its control.

Legal & Fiduciary Responsibilities County/City Treasurers (cont'd)

California Government Code

Examples of Appropriate Investments

- U.S. Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.
- Federal agency or United States government-sponsored enterprise obligations, participations.
- Registered treasury notes or bonds of any of the other 49 states in addition to California.
- Medium-term notes issued by corporations organized and operating within the United States.

Legal & Fiduciary Responsibilities County/City Treasurers (cont'd)

California Government Code

Examples of Appropriate Investments

- Commercial paper of “prime” quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical rating organization (NRSRO) – rated A-1 or higher.
- Investments in repurchase agreements or reverse repurchase agreements or securities lending agreements of any securities authorized by this section.
- A mortgage pass through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass through certificate, or consumer receivable-backed bond of a maximum of five years' maturity.

Short-Term Debt Instruments

Commercial Paper (CP)

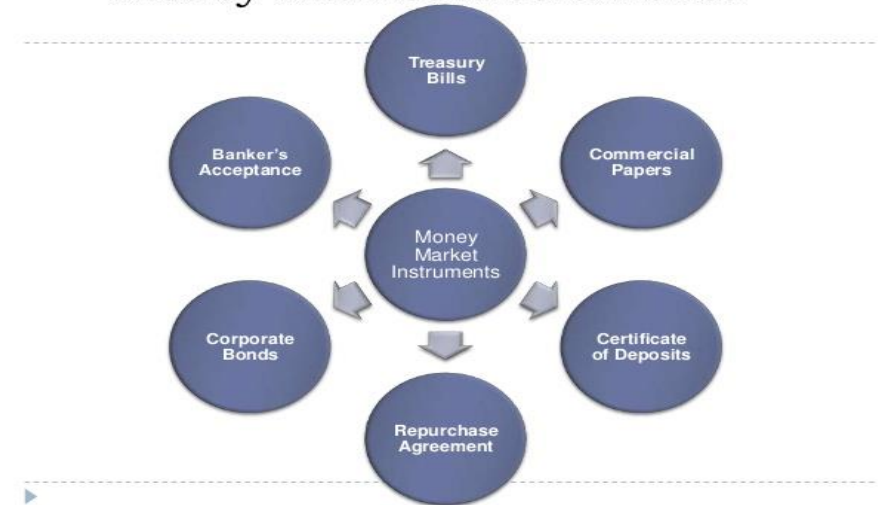
Issued at a discount to face value.

Maturities range from 1 to 270 days.

Offered directly from issuer, or Broker/Dealer.

Several high quality (A1/P1) names available.

Money Market Instruments



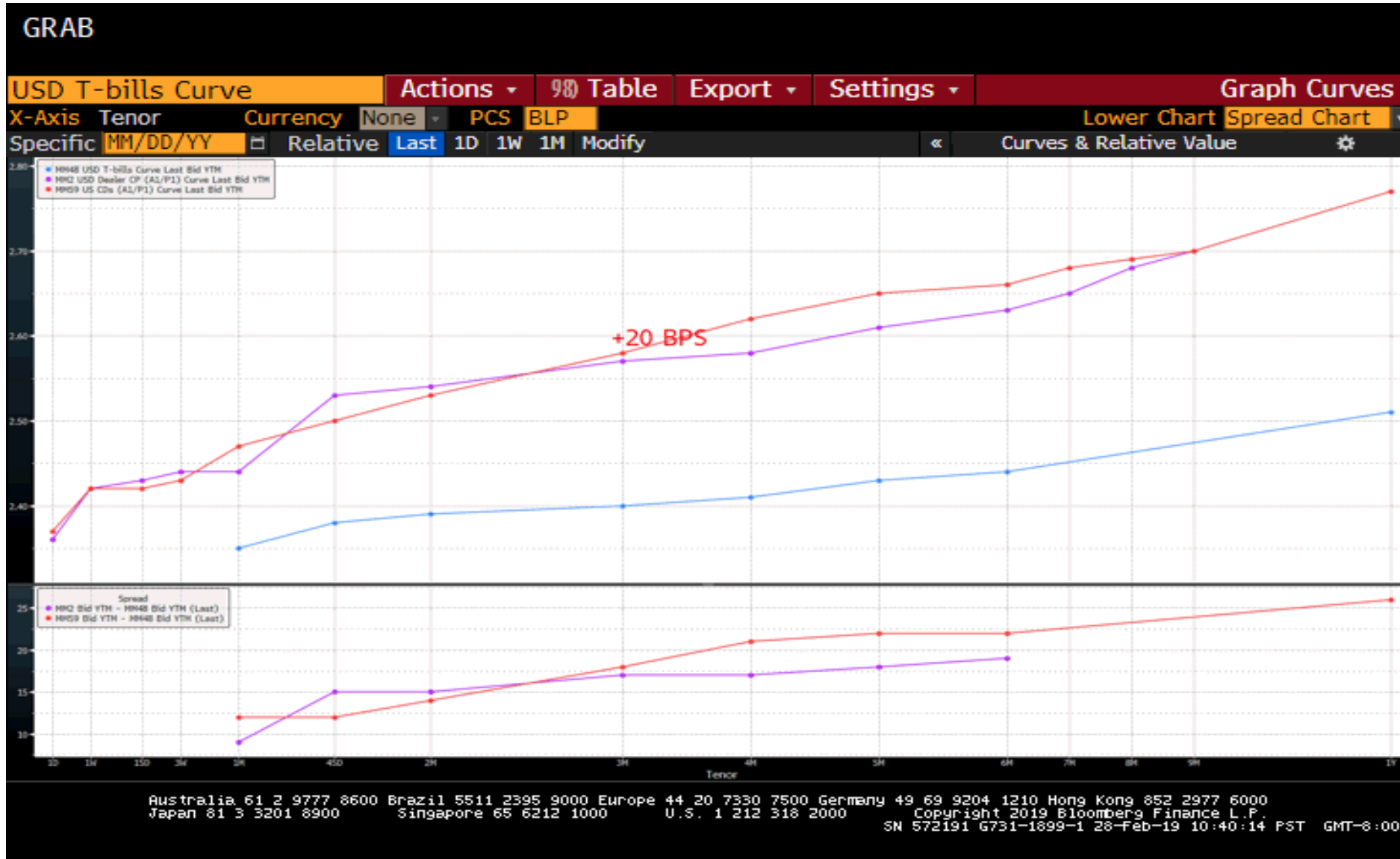
Short-Term Debt Instruments

Negotiable Certificate of Deposits (NCD's)

- ❑ Issued at a discount to face value.
- ❑ Minimum face value of \$100,000.
- ❑ Typical maturity range is two weeks to one-year.
- ❑ Offered directly from the issuing bank.
- ❑ Several high quality (A1/P1) names available.



Short-Term Debt Instruments



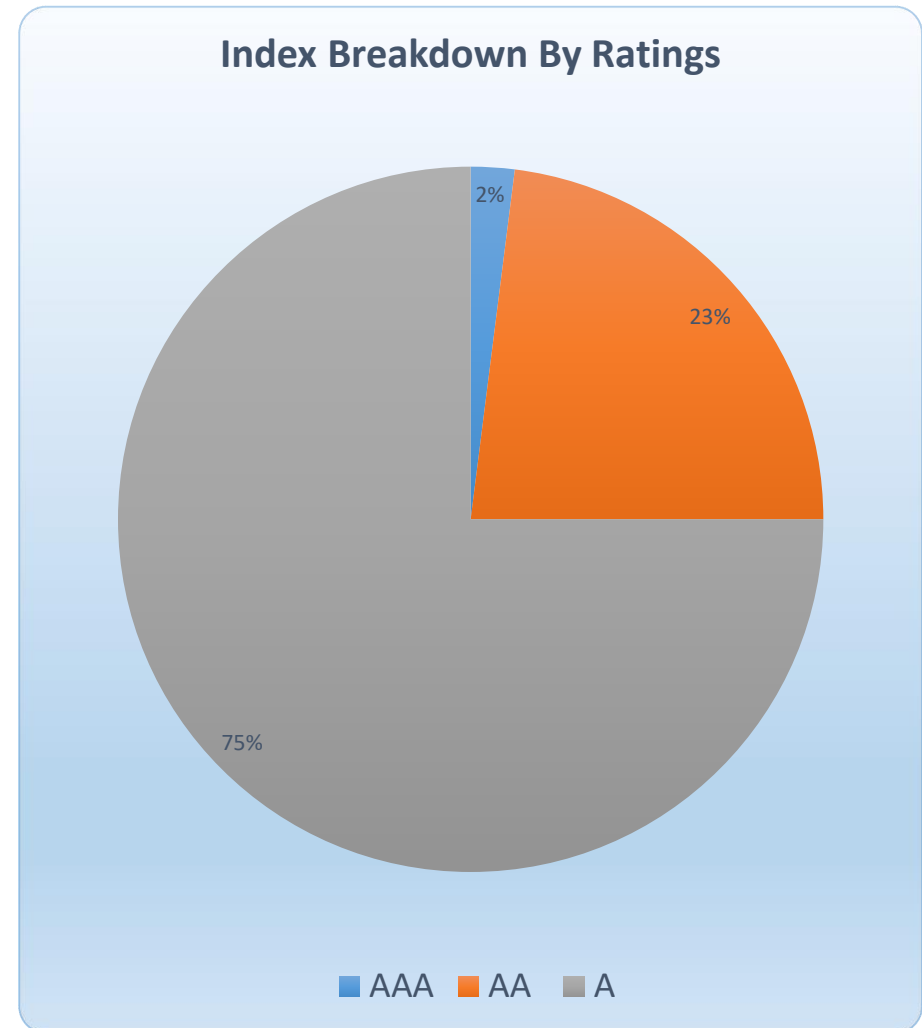
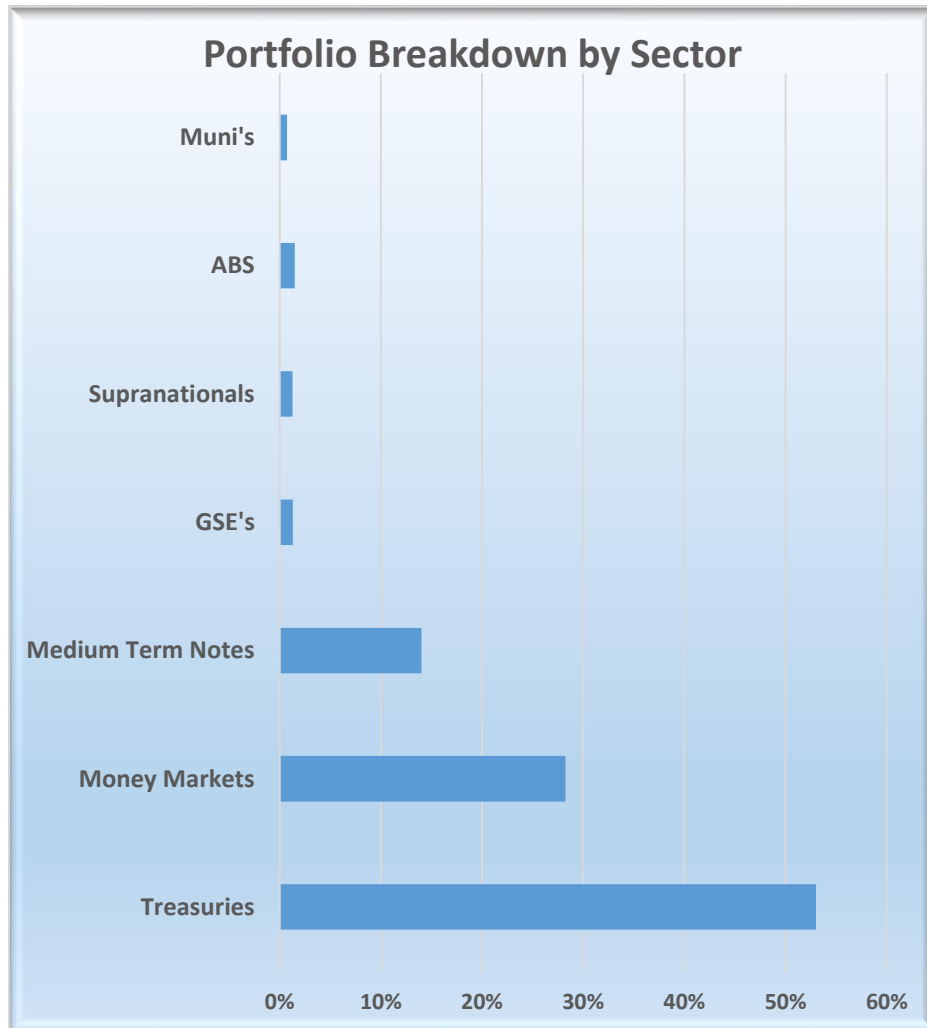
Longer Term Debt

Corporate Notes

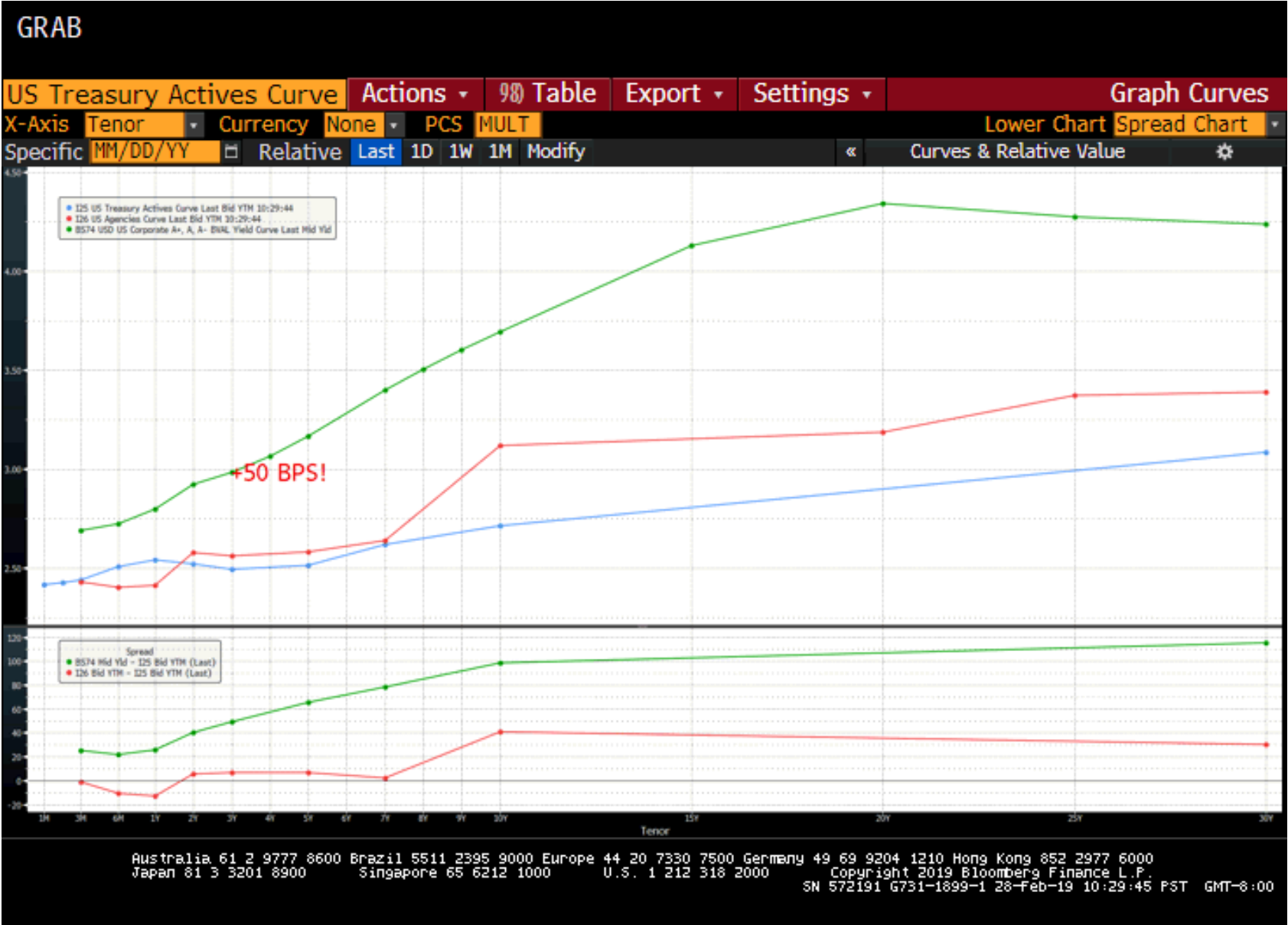
- ❑ Securities issued across various sectors: Finance, Industrial and Utility.
- ❑ Issued with both floating and fixed rates.
- ❑ New Issues: Issued at or near par.
- ❑ Typical maturities range from 2 to 30 years.



Adding Short & Long Term Corporate Exposure to Your Portfolio



Longer Term Debt



Corporate Analysis City of L.A.

Assessment of Current Capital Markets

- Macro economic trend and outlook
- Yield Curve trend and outlook
- Credit spread trend and outlook

Portfolio versus benchmark

- Sector level performance & exposure
- Bond level performance & exposure



Corporate Analysis City of L.A.

Bond level analysis

- Assess appropriate credit spread premium to Treasuries required to buy or sell based on team's analysis of the security, issuer and macro trends.

Tools utilized to mitigate potential losses

- Probability of default model (Merton Model)
- Credit Default Swaps (CDS)
- Bond Analytical software (BondEdge, Yield Book etc.)

Corporate Analysis City of L.A.

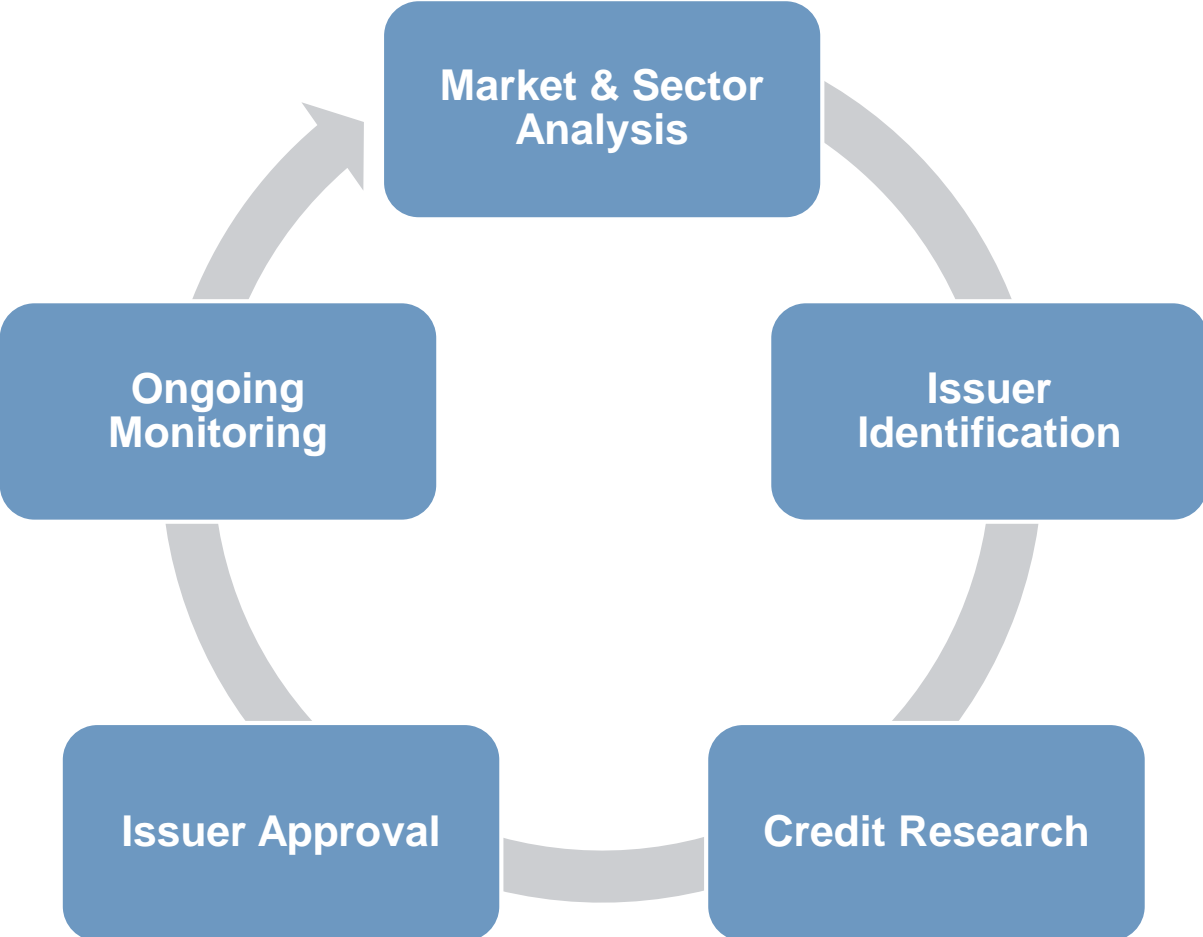


So, are credit securities worth the risk?

Ice BofA ML Index	Composition	Credit Quality	Effective Duration	Avg. Annual Return (12/2008)
GVQ0	1-5 Year US Treasury	AA+	2.6 Years.	1.33%
BU10	1-5 Year AAA-A Corp/Gov	AA+	2.58 Years	1.70%
Variance				37 -BPS

Changing to a strategy as reflected by the BU10 index enhances average annual return by 37-basis points (.37%) or about \$3.7 million on annual basis. (based on a \$1- billion dollar portfolio)

Credit Analysis County of San Diego



Market & Sector Analysis - COSD

Stay Abreast Of Trends Affecting The Markets Overall

- Treasury Curve, Earnings environment, Market Volatility, Geopolitics

Sector-specific Issues Must Be Considered As Well

- Financials
 - ▣ Impact from Changes to Interest Rate Policy or Regulations
- Autos
 - ▣ Sales forecast, Credit Losses

Search For Opportunities Along The Curve

- Where is the Greatest Yield Pickup?
- Monitor spreads to; Repo, Disco's, MMF, Treasuries, Agencies

Issuer Identification - COSD

Identify Issuers To Research For Potential Investment

- Minimum Ratings
- U.S. Domiciled and non-4(a)(2) programs

Begin with Large, Domestic, Frequent Issuers

- Familiarity – easier research & approval from Board
- Often offers better liquidity

Credit Research- COSD

Fundamental Research an Art and a Science

- Obtain Data from earnings releases, company presentations, rating agency reports, Bloomberg
- Look at trends, not just a snapshot in time
 - ▣ Revenue/sales & profitability over time, loan growth, leverage ratios, market share, foreign exposure, liquidity/coverage

Set Maximum Maturities Based On Credit Quality Tiers

- What is your risk tolerance?
- Credits change tiering as outlook/performance changes

Issuer Approval and Monitoring - COSD

Issuer Approval

- Create Process to Approve new Issuers
 - ▣ Nimble enough to add names throughout the year
 - ▣ Robust enough to satisfy auditors should they come looking

Ongoing Monitoring

- How will you monitor names?
 - ▣ News, Earnings Reports, CDS, Rating Agency Updates
- What actions will you take, if any?
 - ▣ Reduce Tiering, move to hold, sell

Credit Analysis Process - COSD

Market & Sector Analysis

- Economic and market analysis
- Identification of yield curve opportunities
- Potential industry and/or legislative issues

Issuer Identification

- Insure compliance with California Government Code and Investment Policy
- Begin with more familiar, higher-quality names

Credit Research

- Fundamental analysis of each issuer's credit quality
- Determine maximum maturity tier based on risk tolerance

Issuer Approval

- Presentation at weekly investment strategy meeting
- Consensus for addition to approved list and max. maturity

Ongoing Monitoring

- Quarterly earnings reports, rating agency updates/changes
- Monitor news, equity performance, CDS, etc.

Risk Management Recommendations - COSD

Focus First on High Credit Quality from Familiar Names

- Obtain Data from earnings releases, company presentations, rating agency reports, Bloomberg
- Look at trends, not just a snapshot in time
 - ▣ Revenue/sales & profitability over time, loan growth, leverage ratios, market share, foreign exposure, liquidity/coverage

Set Maximum Maturities based on Credit Quality Tiers

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