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TheNEWS

How Does Your Investment Policy Stack Up?

When it comes to investing for your local government, having an investment policy or "rule book" in place is a crucial first step. Like traffic laws keeping us safe, investment policies provide established guidelines of safety. However, just as traffic laws aren't a road map to get to where you're going, investment policies alone don't accomplish the objective. Each entity's policy needs to be unique to its size, risk tolerance, time horizon, and many other specifications. In this article, we detail the most common investment policy characteristics and provide several tips to help keep your policy up to date.

Statement of Scope

The statement of scope is the introduction for the policy. Typically, this statement identifies the types of funds that are contemplated in the policy; examples of funds that are often included in a governmental entity's investment policy are reserve, general, operating, capital projects, and bond proceeds. Alternatively, monies held in retirement or pension funds are likely to have different restrictions/allowable investments and therefore will typically have a separate set of policies. Additional provisions may be considered within the statement of scope, as well. For example, some entities include requirements with respect to specific bond projects. Finally, incorporating state statutes will lay the groundwork for the remainder of the policy.

Investment Objectives

The investment objectives should be clearly stated in the policy. In order of importance, the objectives for public funds investing are:

1. **Safety** of principal: state statutes provide a guideline of permissible investments; due diligence to ensure return of principal is crucial before making an investment decision.
2. **Liquidity** in the portfolio: ensuring the local entity can meet upcoming obligations will protect the entity from being forced to sell a position prior to maturity.
3. **Yield:** providing a rate of return for the entity's funds without taking on excessive risk.
4. **Transparency:** allowing the public to easily access the entity's financial reporting.
5. **Compliance:** the ability to show that the entity's investments align with the policy (asset allocation, maturity limits, credit restrictions, etc.).

Standards of Care

Allocations of Authority

No matter the size of your local government, having a list of persons with investment authority and responsibilities will streamline the investment process. Implementing these internal controls also helps minimize fraud, employee error, and misrepresentation.

Ethics/Conflicts of Interest

Have a set of guidelines in place to prevent officers/employees from engaging in personal business or advances when investing for the entity. If there is a potential conflict of interest, require a statement in writing of each conflict.

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Safekeeping/Custody

Establishing the method in which the entity will settle transactions should be outlined in the policy. Address Delivery vs. Payment (DVP) and reference how and where securities will be held. Standard policies state transfer of securities will be made upon receipt of payment (DVP) and note where the securities will be held. When selecting a custodian, there are a few questions to answer first. Is the custodian an independent third party? Do they provide statements on a frequent basis (quarterly at a minimum)? Are they registered with the SEC? If the entity utilizes a third party to trade and settle for their account, it will help to mitigate risk. If there are any additional internal controls, they should be discussed here as well. These controls should be designed to add extra protection to the entity's account and the public's dollars.

Suitable/Authorized Investments

A list of authorized investments should be stated in the policy. These investments usually mirror allowable public funds investments under state statutes and may be even more conservative based on the investment goals of the entity.

Investment Requirements

The addition of specific investment requirements can further define the investing process when selecting investment vehicles. Diversification specifications can be made here (i.e., not more than X of the entity's funds can be invested in X at any given time).

Reporting

Investment policies should outline the required items for the entity to report. The entity will determine the matters to report upon, but the list should include current holdings, security type or description, all transaction details, and the market value for each holding. If the entity chooses to follow a benchmark for certain funds, the portfolio performance vs. benchmark performance may be included in reporting, as well.

Review

Whether facing a financial crisis, a global pandemic, or a change of board members, it is critical to review investment policies on a relatively frequent basis. Industry standards recommend a review every one to three years. Having a review process in place allows for updates when state statutes have changed or as the entity grows and goals begin to shift. Peer-to-peer sharing of policies is a great way to share ideas and improve current policies as well as implement new ones. While having the policy and review in place doesn't guarantee the entity against loss/fraud/error in any situation, having a "rule book" to follow will vastly help in circumventing the possibility of that happening.

An important distinction is that an investment policy for the entity is not a plan for investing. This is simply setting the rules for the entity to follow when implementing the investment plan. While earning a reasonable rate of return is a duty of the fiduciary, it should not be at the cost of undue risk. The first and foremost priority is to keep the entity's money safe while maintaining liquidity to meet demands and obligations.

For help establishing, reviewing, or updating an investment policy, please feel free to contact us.

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Virginia Investment Pool
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TheECONOMY

Unprecedented Times

As confirmed cases of COVID-19 in the U.S. more than doubled during April from 600k to over 1.3 million, economic data covering the early stages of the "Great Shutdown" was released and proved to be as catastrophic as anticipated. To be sure, phrases such as "unprecedented" and "worst on record" have become all too common and will remain frustratingly unavoidable in economic commentary in the weeks and months ahead as the brunt of the pandemic's economic costs are realized.

Reflecting the early impact of pandemic-related lockdowns, the advance estimate of first-quarter GDP showed the U.S. economy contracted at a -4.8% annualized pace, marking the end of the longest economic expansion in U.S. history and signaling the beginning of what will likely be the deepest U.S. recession since the Great Depression. According to a Bloomberg survey of 63 economists, the median forecast for second-quarter growth is an unsettling -27.5%.

Amongst the most startling economic data released in recent weeks is that from the labor markets. Mirroring the unprecedented increases in weekly claims for unemployment benefits, the Bureau of Labor Statistics reported that the U.S. economy lost a staggering 20.5 million jobs in April. For perspective, U.S. firms shed a total of 19 million jobs during the last seven recessions combined. The magnitude of April's job losses pushed unemployment to 14.7%, far surpassing the previous post-WWII era high of 10.8% set in November of 1982.

Reflecting the global nature of the COVID-19 pandemic, oil prices turned briefly negative for the first time in history as the collapse in demand accentuated by the "sudden stop" in world economic activity collided with growing oversupply issues and strained storage capacities. While oil prices have since rebounded back into positive territory, the plunge below zero reinforces the initial deflationary impulse of COVID-19 that policymakers struggle to combat. Looking ahead, the economic and market outlook remains heavily tied to the evolution of the virus and the actual public response to re-opening efforts. These efforts must be balanced against the public health concerns related to the premature lifting of mandatory business closures, shelter-in-place orders, and other social distancing policies.

Treasury Yields

MATURITY	5/12/20	4/13/20	CHANGE
3-Month	0.123%	0.193%	-0.071%
6-Month	0.150%	0.242%	-0.092%
1-Year	0.150%	0.218%	-0.069%
2-Year	0.169%	0.245%	-0.076%
3-Year	0.214%	0.321%	-0.107%
5-Year	0.329%	0.449%	-0.120%
10-Year	0.670%	0.771%	-0.101%
30-Year	1.377%	1.407%	-0.030%

Source: Bloomberg

Agency Yields

MATURITY	5/11/20	4/13/20	CHANGE
3-Month	0.085%	0.205%	-0.120%
6-Month	0.176%	0.254%	-0.078%
1-Year	0.189%	0.295%	-0.106%
2-Year	0.237%	0.374%	-0.137%
3-Year	0.323%	0.462%	-0.139%
5-Year	0.571%	0.735%	-0.164%

Source: Bloomberg

Commercial Paper Yields (A-1/P-1)

MATURITY	5/12/20	4/13/20	CHANGE
1-Month	0.110%	0.440%	-0.330%
3-Month	0.290%	1.110%	-0.820%
6-Month	0.370%	1.120%	-0.750%
9-Month	0.480%	0.980%	-0.500%

Source: Bloomberg

Current Economic Releases

DATA	PERIOD	VALUE
GDP QoQ	Q1 '20	-4.80%
US Unemployment	Apr '20	14.70%
ISM Manufacturing	Apr '20	41.50
PPI YoY	Mar '20	-0.90%
CPI YoY	Apr '20	0.30%
Fed Funds Target	May 12, 2020	0.00% - 0.25%

Source: Bloomberg