TheINVESTOR

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TheNEWS

Navigating Your Portfolio in a Zero-Interest Rate Environment

In a normal year, you are tasked with trying to predict the future through a very foggy crystal ball as you lead your entity through many challenges. So, what happens when you throw a global pandemic and economic contraction in the mix? That foggy crystal ball seems to get murkier as the future becomes more and more uncertain. While the future is entirely out of our control, how we prepare for and navigate through it is not. This article outlines the best practices for directing your entity's financial portfolio through economic uncertainty.

Performing a Cashflow Analysis

The first and possibly the most important step when looking over your entity's financials is performing a cashflow analysis as it will allow you to forecast and prepare for obligations as they come due. An in-depth review and analysis of the past few years will bring to light the trends of cash inflows and outflows throughout the year, assisting you in planning for the year ahead. Maintaining proper liquidity is crucial to the overall success of your entity's portfolio and requires a robust plan.

Reviewing Your Entity's Investment Policy

Even if no changes are made, it is best practice to review your entity's investment policy at least once a year to ensure your portfolio is in line with the rules set forth by the policy itself. From maturity limit requirements to credit quality, knowing your investments are within your entity's guidelines will give you peace of mind throughout the year.

Further, it is important to keep records of the authorized personnel tasked with making investment decisions and moving or investing money. If there have been personnel changes, remember to document these changes and ensure successors have been assigned proper access to all necessary accounts. Lastly, if your entity has been discussing making changes to the investment policy, an annual review is a great time to open the conversation with your colleagues.

Market/Interest Rate Research

With a solid foundation of cashflow needs throughout the year and a robust review of the rules/guidelines under your belt, we turn our attention to market sentiment, focusing on the potential for sentiment to change. While 2020 has been a year of many firsts, entering a zero-interest rate environment is not one of them. The last time the overnight Federal Funds Target Rate fell to 0.00%- 0.25% was in December of 2008 with rates remaining low through the end of 2015. In 2020, two moves made in the month of March brought us back to these levels: on March 3, the target rate was cut to 1.00%- 1.25%, and less than two weeks later, the target rate was cut yet again down to 0.00%- 0.25% on March 15. Given the current rate environment, the extra return we conservatively plan for has been significantly reduced, but our fundamental principles of safety and liquidity remain intact.

While there is no guarantee of how long the current zero-rate environment will last, the expected timeline that the Federal Open Market Committee(FOMC) has set forth is three to five years. Having an idea of how long to expect to be in this environment can help your entity manage duration - a measure of a fixed-income portfolio's price sensitivity to interest rate changes - to meet expectations and plan for the future. For example, the purchase of a five-year treasury bond at 0.33% holds a significant amount of interest rate risk. If the FOMC were to move the target rate at the front end of the recent expectation of three to five years, the five-year treasury bond will be locked in at 0.33% for another two years while rates potentially rise, surpassing the 0.33%. It is important to manage duration within the portfolio, considering not just liquidity requirements but also interest rate risk when making investment decisions.

Optimizing Cash Management

Many governmental entities utilize local government investment pools (LGIP) as cash management optimizers. If the 2008-2009 crisis taught us anything, it is that research and due diligence are crucial when selecting any security. Key factors to consider when selecting a liquid vehicle (outside of an FDIC insured checking account) include:

Safety - the fundamental principles for public funds investing should align with the goal of the liquid vehicle

Daily liquidity - will you have access to your funds daily? Does the fund have a stable Net Asset Value (NAV) of $1.00?

Competitive yield – should be relative to the current rate environment without compromising safety and liquidity

Transparency - access to past performance, holdings, ratings reports, accounting methodology, investment policy, and program operating documents to name a few

A rating of 'AAA' from a nationally recognized statistical rating organization (NRSRO)

Tenure/track record – ability to successfully navigate through different environments with concrete details on how they navigated through those environments.

While safety and liquidity are the fundamental principles when investing public funds, being comfortable with these parameters can feel daunting during times of economic uncertainty. Reviewing and performing the previously listed actions will provide you the tools and sense of comfort you need to set your entity's financials up for success no matter the economic environment.

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Virginia Investment Pool
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TheECONOMY

Light at the End of the Tunnel?

Recent developments regarding potentially effective vaccines for COVID-19 are a positive for future economic growth and suggest that the end of the pandemic could be in sight. Focus is now beginning to shift from the development of these vaccines to manufacturing and distribution, two highly complex tasks that are likely to take many months. In the near term, COVID-19 cases are spiking across the U.S. as we head into late fall, potentially pressuring economic growth in the immediate future.

Despite the increase in COVID-19 cases nationwide, the October nonfarm payroll report beat expectations as 638k jobs were added over the course of the month. The unemployment rate was another bright spot coming in at 6.9%, ahead of consensus estimates of 7.6%. While recent employment metrics are positive and indicate recovery continues, the labor market has a long way to go before we are back to full strength.

Additional fiscal stimulus has been debated since the passing of the CARES Act in March, but progress has been anemic with both sides opting to hold off until after the election. Now that the election is behind us and a split government remains possible, the prospect of a bill being passed in the near term looks bleak. Any comments and additional information around the timing, size, and scope of further fiscal support are likely to be the top focus for market participants moving forward.

As for the November Federal Open Market Committee (FOMC) meeting, it was largely a non-event as the committee voted to hold rates steady and continued to indicate that it is "committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals."

Treasury Yields

MATURITY	11/10/20	10/9/20	CHANGE
3-Month	0.094%	0.094%	0.000%
6-Month	0.096%	0.114%	-0.018%
1-Year	0.114%	0.127%	-0.013%
2-Year	0.181%	0.153%	0.028%
3-Year	0.253%	0.198%	0.054%
5-Year	0.454%	0.337%	0.116%
10-Year	0.960%	0.774%	0.186%
30-Year	1.742%	1.572%	0.170%

Source: Bloomberg

Agency Yields

MATURITY	11/10/20	10/9/20	CHANGE
3-Month	0.100%	0.105%	-0.005%
6-Month	0.109%	0.119%	-0.010%
1-Year	0.120%	0.125%	-0.005%
2-Year	0.216%	0.193%	0.023%
3-Year	0.293%	0.247%	0.046%
5-Year	0.547%	0.453%	0.094%

Source: Bloomberg

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

MATURITY	11/10/20	10/9/20	CHANGE
1-Month	0.120%	0.100%	0.020%
3-Month	0.180%	0.140%	0.040%
6-Month	0.220%	0.180%	0.040%
9-Month	0.270%	0.230%	0.040%

Source: Bloomberg

Current Economic Releases

DATA	PERIOD	VALUE
GDP QoQ	Q3 '20	33.10%
US Unemployment	Oct '20	6.90%
ISM Manufacturing	Oct '20	59.3
PPI YoY	Sep '20	-1.20%
CPI YoY	Oct '20	1.20%
Fed Funds Target	Nov 12, 2020	0.00% - 0.25%

Source: Bloomberg