Nuts & Bolts

» PORTFOLIO MANAGEMENT

Shopping list 2017

A guide to year-end portfolio management

By Jim Reber

In the spirit of the holidays, I thought it would be appropriate to convey to you some suggestions about how to efficiently close out the calendar year and perhaps spend some quality time with the family. These ideas hopefully will allow you to take advantage of some temporary market conditions. As I write, 2017 did not turn out to be a year that saw significant declines in value for community bank investment portfolios, thanks to inflation that remained confusingly subdued.

We know that literally thousands of community banks have steeled their balance sheets against rising rates, and we're not suggesting anything different, but the payoff hasn't occurred, at least not yet. Nonetheless, portfolio managers have some options at their disposal. This has to do with the current term structure of interest rates and the ability for most community banks to capture gains or losses through sales. The upshot is that strategic repositioning of your holdings can be accomplished through a review of what you own and what is available.

Tidy up

Investment managers often look to year end to make adjustments to the bond portfolio. We have learned that there are a number of reasons for this seasonality, although one that seems to recur is that the bank's annual earnings figure comes into focus when we're in the fourth quarter.

A common year-end cleanup activity is to consolidate the mortgage securities that have amortized down to a certain principal balance by selling them and reinvesting the dollars into a larger, single block. Each bank has its own idea about the best dollar limit to use when executing, but for a general guide, a remaining balance of about $250,000 of a pool has reasonable liquidity when seeking a bid.

Another popular fourth-quarter action is to review the portfolio's cash flows. Your favorite broker or an interest-rate risk consultant should be able to provide shocked cash flows in quick order, at no incremental cost. The standard rate shocks would range from +400 basis points (up 4.00 percent) to -300 basis points.

What the market's giving

If you've looked at the market values of your holdings lately, you've noticed something odd. The longest maturity investments that you own, which normally mean your municipal bonds, have the biggest gains, while your shorter investments are on balance under water. What has happened?

Well, we can point to the hawkish stance of the Fed. The Fed has tightened rates twice this year and continues to suggest in word and action that it will hike them again in December. In response, short rates have risen, and anything with an expected life of less than four years has lost value this year. Longer rates are slightly lower, as inflation has actually declined, so higher-duration bond values have improved.

If you are so inclined to sell some

ICBA VOICE

Jim Reber (*jreber@icbasecurities.com*) is president and CEO of ICBA Securities, ICBA's institutional, fixed-income broker-dealer for community banks.

of your holdings, keep in mind an axiom of portfolio management: It's okay to sell tax-free securities at a loss, but it's much less advantageous to sell them at a gain. The taxes paid on the income from the sale make the economics virtually untenable. Your broker will be able to quantify the outcomes of selling different securities, at gains and at losses.

$2 billion

Dollar amount of whole loans traded by Vining Sparks in the last two years

Non-bond strategies

Another popular end-of-year activity is to sell the most liquid of your loans. Exhibit A in that regard is, of course, your conforming mortgages, with your favorite housing GSEs ready to give you a bid.

Next easiest to sell are your government-guaranteed loans, such as those backed by the SBA or USDA. Be advised that many sellers are active only at the end of the year, so there's often a supply glut. My advice is to sell in early December or wait until the new year.

Finally, there is investor demand for virtually any type of high-quality, high-performing loans. If your bank has developed some concentration issues, it may be beneficial to package a $5 million or larger pool of loans and seek a bid. You can negotiate with buyers to either retain or sell the servicing rights to the loans.

So there you have it: a shopping list of to-dos that are able to deliver some good cheer for your community bank. Buy or sell, gains or losses, large or small, short or long, portfolio opportunities abound this holiday season. IB

Education on tap

Webinar series

The 2017 webinar series "Community Banking Matters" has concluded, although replays of the eight events have been posted to *viningsparks.com.* ICBA Securities and its exclusive broker, Vining Sparks, are planning the 2018 webinar schedule. Details will be published early next year.

End-of-year strategies research

Vining Sparks has published an interactive research report, "Year-End Balance Sheet Management." This document allows a reader to choose a desired investment outcome and directs him or her to an analysis of that strategy. Contact your Vining Sparks rep for your copy.