



Portfolio Management By Jim Reber, ICBA Securities

Shop talk, part three

Our conversation with a community banker continues.

Jim Reber speaking."

"Hi, Jim, this is Charlie Brown with Community Trust Bank. How are you?"

"Hi, Charlie, I'm fine! How are things at the bank?"

"I hope I'm not jinxing us, but it's hard to imagine things going better. We keep getting these loan requests, and the borrowers are solid. We're

paying more to fund the bank than we have for a long time, but margins are tolerable. We could be posting another record for earnings this year."

"Well, it doesn't sound like you need my help."

"Not so. I can see some things looming on the horizon that I want to stay out in front of. Our bond portfolio has been providing some liquidity for loans, but I need you ask you some questions about it. It's taken a back seat in the last couple of years, and I sense it's about to become more important again."



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“Charlie, the average bank has had its bond portfolio shrink from about 23% of assets to 18% in five years, but that’s still larger than a decade ago. A lot of community banks are making good use of the liquidity being created by their collection of bonds.”

“Sounds like I’ve got company. Are bankers happy with their bond portfolios now?”

“A couple of things are different now than the last time rates peaked. For one, you don’t have big unrealized losses. Most community bankers are glad for that, but that leads into my second point: Your yields aren’t nearly as high now as they were in 2007.”

“So, is that good or bad?”

“To quote the legendary Jim Vining, it’s mostly good. If you’ve got some bonds at gains and some at losses, you can pick and choose which ones to take off the table. And I haven’t to remind you that it’s almost always better to sell your losers than your winners. So, while you may not be terribly proud of your portfolio’s yield, it probably is throwing off a net margin of about 200 basis points, or 2%, to your pre-tax income.”

“So, is that good or bad?”

“Charlie, here are a few more statistics, which are just below the ‘damned lies’ category of relevance. The average community bank’s portfolio yields about 2.75% at the moment. Cost of funds is still well below 1%. There’s your 200 basis point margin. In 2007, when bond yields were in the 5s, you were paying in the 3s to fund them. Same spread today, with less market loss. Good for you.”

“But suddenly it looks like interest rates may start to fall, or at least won’t be going up. Regulators have been hammering us about our exposures to rising rates. What are community banks supposed to be doing about that?”

“Well, it should not be a mystery to you, or them, what your asset/liability position is. In fact, most community banks had no exposure to rising rates even before the Fed turned more dovish earlier this year. If anything, banks were slightly asset sensitive. So, you’ve got at least the ability, if not the incentive, to lock in some yields on the asset side of your balance sheet for an intermediate term. At the same time, some short-term or floating rate advances may make some sense over the next couple of years.”

“Jim, it is a humbling experience to manage a bond portfolio. If you’ve got gains, the directors are happy but rates are going down. If you’ve got losses, you and the directors wish you’d have waited to buy.”

“That’s why there’s a finite number of community banks. Not many people are as smart as you are. Since you’re heading for a really good earnings number this year, I know you’re considering deferring income. That’s tax

Education on Tap



Rate cut white paper

ICBA Securities’ exclusive broker Vining Sparks has produced a document that discusses balance sheet-wide strategies for a secular falling rate environment. The “Fed Easing Playbook” is available at viningsparks.com or by contacting your Vining Sparks sales representative.

2019 webinar series resumes

ICBA Securities and Vining Sparks have announced the next segment of their 2019 webinar series Community Banking Matters for Sept. 17 at 10 a.m. CDT. Kevin Smith, CFA will present “Mortgage Market Update and Opportunities.” Free CPE is available. To register, visit icbasecurities.com.

accountant-speak for realizing some losses this year, and pushing the income into 2020 and beyond.”

“I reserve the right to both quote you and call back next year to remind me what you’ve just said. I’ll have some friendly examiners here soon.”

“Charlie, it’s always a pleasure. And I know you’ll be a gracious host to your visitors.” ■

Shop talk continues

Want answers to even more community banking-focused investment questions? Go to bit.ly/shoptalkpart1 and bit.ly/shoptalkpart2 to find the first two parts of this annual question and answer series from Jim Reber on *Independent Banker’s* website.

