Next: Why it may pay to offer international payments

# New year, old tricks

Let's take stock of what we've forgotten over the past 12 months, from the portfolio and beyond. By Jim Reber, ICBA Securities

Photo by Hugh Sitton/Stocksy

Maybe, just maybe, we'll have some normalcy in our professional and personal lives sometime in 2021.

The approaching Ides of March will have some resonance this year, not only for Julius Caesar historians, but also as it marks the first anniversary of an unscheduled Federal Reserve Board meeting at which overnight rates were pegged to a median rate of 0.125%, which is where they sit today. That was a major salvo fired by the Fed to provide stimulus to the economy and ample liquidity for the banking system. It certainly succeeded in the latter objective.

Now that we've been on some amount of lockdown for nearly a year, we've developed a new skill set, and that's not all bad. Who knew how to schedule a Zoom meeting early last year, much less participate, screen share and answer digital polling questions? Virtual coffee breaks and social hours have helped maintain our sanity, however tenuous, through the pandemic.

From a banking standpoint, you've also been doing things you hadn't until recently. It's possible that old practices and routines, circa 2019, have gotten a bit far in the rearview mirror. We'll revisit some old products and strategies to refresh our memories and perhaps create a sense of optimism about the remainder of the year.

### TEFRA and TSA limits

We've been dancing around the municipal bond story for a while, but we've lately ignored the historic tried-and-true tax-free security preferred by community banks: bank qualified (BQ) paper.

There are several good reasons for this. One is that, since 2017, tax rates have been low enough for the resultant tax-equivalent yields to be less than enticing. Another is that the Tax Equity and Fiscal Responsibility Act (TEFRA) penalties that attach to general market paper have been automatically lessened by the minuscule cost of funds that banks are paying these days.

Still another is that, as many community banks have expanded the sizes of their bond portfolios, they prefer larger block sizes, and BQ issues are limited in size to $10 million per year, in spite of ICBA's best efforts to permanently expand the number. Finally, the meteoric growth in the size of the taxable municipal market has provided alternative supply, precisely when industry earnings are such that tax-avoidance needs have been at least temporarily lessened. In 2020, fully 30% of new municipal bond issues were of the taxable variety.

Don't forget: A 3.4-ounce bottle of liquid is the maximum size allowed on domestic flights.

### Floating rate securities and the rule of thumb for tipping

Just as there are good reasons for community banks to move into new subsections of the muni market, so, too, is it logical that portfolio managers have been more interested in fixed-rate securities lately. It's been well-documented that depository institutions are historically, and chronically, low on floating-rate assets.

Until recent times, the most efficient fix to a liability-sensitive rate exposure is to purchase adjustable rate securities, whether we're talking about adjustable rate mortgages (ARMs), collateralized mortgage obligations (CMOs) or even straight agency floaters.

Floaters have a number of moving parts, so as a reminder, when considering adjustable rate securities, pay close attention to the index (the London Interbank Offered Rate, or LIBOR, is still the nominal index for a lot of paper), weighted-average roll (WAR) dates, margins and rate caps (periodic and lifetime).

Your broker will be able to break down the various offerings for comparison. Just don't expect much yield, at least not yet.

And try to remember: The Emily Post Institute recommends a pre-tax tip of 15% to 20% on your bill at a sit-down restaurant.

### Best bonds to sell, plus your weekly physical activity

As banks have been flush with cash recently, it's become a forgotten art to identify bonds that are ripe for sale. The salient variable is the take-out yield. Recall that this is the return that the buyer of your bond will earn, so to the seller, the lower, the better.

If a community bank can improve on the take-out yield with the reinvestment bond, it is better off. Take-out yield is also known as "market yield."

Of course, this being portfolio management, there is an unless: Unless the new bond requires an extension of life and duration that is unpalatable to the investor. Finally, most tax accountants recommend the sale of bonds that have market losses, instead of gains, all things remaining equal. That will delay the tax consequences and potentially improve cash flow.

And finally: The American Heart Association recommends 2.5 hours of moderate-intensity aerobic activity per week for adults. ■

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**2021 webinar series begins**
ICBA Securities and its exclusive broker, Vining Sparks, will launch their 2021 Community Banking Matters webinar series on Feb. 16 at 10 a.m. Central. Daniel Anderson will present Positioning the Investment Portfolio for Performance. To register, visit ***viningsparks.com***

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