



Mark H. Smith
I N C O R P O R A T E D

Credit Union Investing Options Beyond CDs

**Presented by: Jason Williams, Managing Partner
at Moreton Asset Management**

(Webinar will begin on the hour)



Investing Beyond CD's

Presenter: Jason Williams, Managing Partner

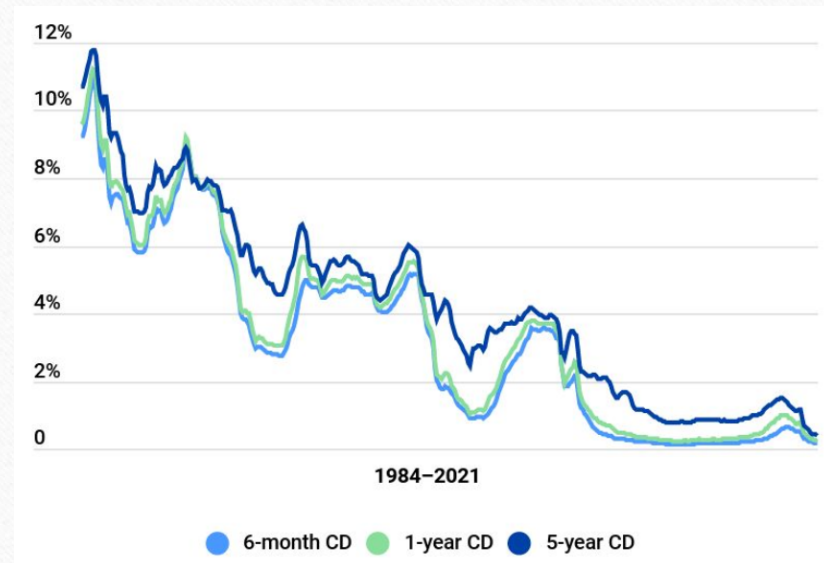
COVID 19 and the Bond Market

- February 1, 2020 sample yields:
 - 2 Year U.S. Treasury 1.58%
 - 5 Year U.S. Treasury 1.69%
 - Fed Funds Rate 1.50%
- April 30, 2021 sample yields:
 - 2 Year U.S. Treasury 0.16%
 - 5 Year U.S. Treasury 0.86%
 - Fed Funds Rate 0.05%



What Happened to CD Rates?

- Estimated \$5 trillion of stimulus funds in 2020-2021
 - Individual stimulus payments
 - Paycheck Protection Program
 - CARES
- Banks and other Depository Institutions have low appetite for deposits. How long does that last?



[Historical CD Interest Rates 1984-2021 | Bankrate](#)

Differences in Types of CD's

- **Direct Certificates of Deposit**
 - Issued in \$250k increments by financial institutions
 - Held on deposit at the bank/CU
 - Low cost (good access from QwikRate, National CD Rateline, etc.
- **Negotiable Certificates of Deposit**
 - Securitized CD's that are issued in large blocks with underwriting and selling fees
 - Easy to track/custody for institutional investors
 - Large secondary market for additional liquidity

9 MO	AMER NATL BK/FOX	2/18/2022	0.050	Monthly
9 MO	1ST FIN BK USA	3/7/2022	0.030	Monthly
9 MO	MIDFIRST BANK	2/28/2022	0.020	MAT
1 YR	GOLDMAN SACHS BK	6/2/2022	0.100	MAT
1 YR	1ST FIN BK USA	6/1/2022	0.050	Monthly
1 YR	BANESCO USA	5/27/2022	0.050	Monthly
1 YR	TIAA FSB	5/26/2022	0.030	MAT
1 YR	SEC ST BK SCOTT	5/27/2022	0.020	Monthly
1 YR	MIDFIRST BANK	5/26/2022	0.020	MAT
18 MO	1ST FIN BK USA	12/14/2022	0.100	Monthly
2YR	BMW BANK OF NA	5/22/2023	0.150	S/A
2YR	AMER NATL BK/FOX	5/19/2023	0.100	Monthly
2YR	COMMERCE ST BANK	5/22/2023	0.100	Monthly
2YR	COMMONW BUS BK	5/30/2023	0.050	Monthly
30MO	BMW BANK OF NA	11/21/2023	0.250	S/A
30MO	CONTINENTAL BANK	11/27/2023	0.150	Monthly
3 YR	BMW BANK OF NA	5/21/2024	0.300	S/A
3 YR	MEDALLION BK UT	5/21/2024	0.250	Monthly
3 YR	LEADER BANK NA	6/3/2024	0.250	S/A
3 YR	FIRST NAT BK AME	5/28/2024	0.200	Monthly
3 YR	COMMONW BUS BK	5/28/2024	0.200	Monthly
3 YR	COMMERCE ST BANK	5/21/2024	0.200	Monthly
3 YR	MEGA BANK	6/24/2024	0.200	S/A
3 YR	ST EXCHANGE BK	5/28/2024	0.150	Monthly
42 MO	GUARANTY ST B&T	11/24/2024	0.200	Monthly

Sample CD rates as of 05/17/20 not an offer to buy or sell

Bond Market Asset Classes (other than CD's):

- **U.S. Treasuries**
 - Bonds issued by the United States Department of the Treasury.
- **Corporate Bonds**
 - Bonds issued by corporations that carry an investment grade rating
- **Agency Bonds**
 - Debt issued by the government-sponsored enterprises (GSEs). This includes Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.
- **Municipal Bonds (Munis)**
 - A bond issued by a state, city, or local government
- **Mortgage-Backed Securities (MBS)**
 - A bond collateralized by the cash flows of principal and interest payments from an underlying pool of single family residential mortgages.
- **Asset-Backed Securities (ABS)**
 - A bond collateralized by the cash flows of an underlying pools of assets such as auto loans, credit card receivables, etc.
- **Collateralized Debt Obligations (CDOs)**
 - A type of asset-backed security backed by any on or several other ABS, MBS, bonds or loans.
- **High-Yield (Junk) Bonds**
 - Bonds that carry a rating that falls below investment grade.

Allowed under NCUA investment guidelines/ Some allowed state chartered credit unions

Understanding Risk

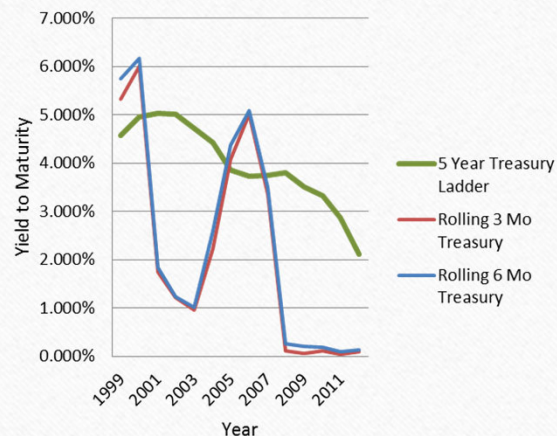
- Default Risk
 - The risk an issuer is unable to meet the interest and principal payments when due.
- Market Risk
 - The risk that interest rates will rise, reducing the value of bonds
- Liquidity Risk
 - The risk that bonds cannot be sold quickly at an attractive price.
- Early Call Risk
 - The risk that high-yielding bonds will be called away early, with the result that the proceeds will have to be reinvested at a lower interest rate.
- Reinvestment Risk
 - The risk that the interest payments and principal you receive may have to be reinvested at a lower rate.
- Event Risk
 - The uncertainty created by the unfolding of unexpected events.
- Tax Risk
 - The possibility that changes in the tax code might adversely affect the tax advantages of bonds.
- Political Risk
 - The likelihood that changes in law will adversely affect the issue
- Inflation Risk
 - The possibility that the fixed value might be eroded with an increased cost of living.

Agency Bonds: Fixed Coupon vs Step-Up vs Mortgage Backed

- Fixed Rate
 - Need to understand call structure
 - Bullet
 - European- One Time
 - Bermuda (Berms)- Quarterly
 - American- Anytime after a certain date.
 - The more callable a bond is, the cheaper it should be.
 - Also bonds can have varying call lockouts.
- Step Up
 - Need to understand both the Call Structure and the Step Structure.
 - Bond may step semi-annually, quarterly, or really any other schedule.
 - Step-Up bonds may have all types of call structures.
 - Need to compare both the Yield to Worst with the Yield to Maturity.
- Mortgage Backed
 - Principle and interest is guaranteed by the issuing agency
 - Pay both interest and principle every month
 - Can be purchased in varying maturities or weighted average life

Benefits of a Treasury Bond Ladder Strategy

Historical Performance of US Treasury 5 Year Bond Ladder



- Past performance is no assurance of future results. The graph represents constant maturity Treasury yields. The yields do not reflect any transaction costs. The 3 month T-Bill yield is the yield average of each respective year. The 1 year T-Bill is the average of yields as of Dec. 31 of each year. The yield for the 5 year Treasury ladder is the average of a rolling ladder of Treasury obligations as of Dec 31 beginning with the 1-5 year maturities on Jan 1, 1994. Source Bloomberg Financial

- Higher Average Yields: combines the higher yields of longer term bonds with the liquidity of shorter term bonds
- More Consistent Returns: when interest rates rise or fall generally more consistent yields
- Ongoing Liquidity: bonds mature on a regular basis and you can redirect proceeds for another purpose

Assumptions

Investing today may be similar to 10/1/2012 environment

Investing in 1,2,3 and 5 year treasuries

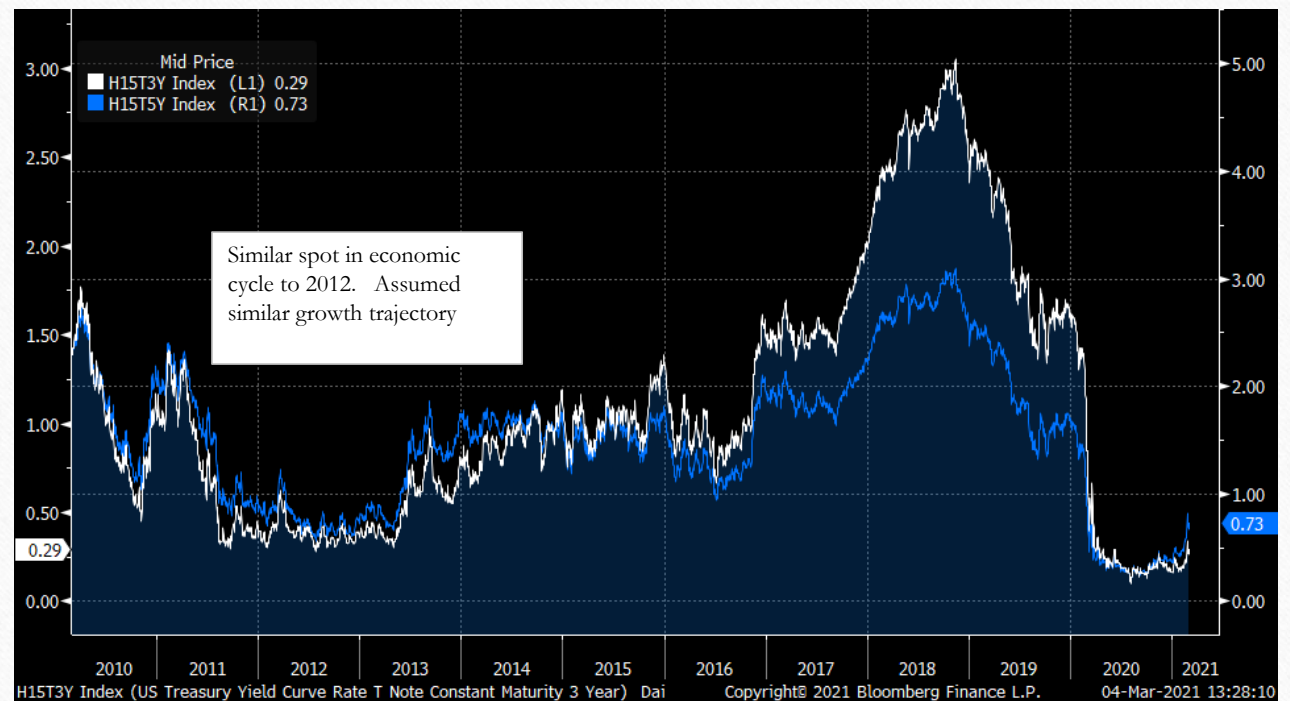
First four rounds spaced 3 months apart.

After that rolling maturities out 5 years.

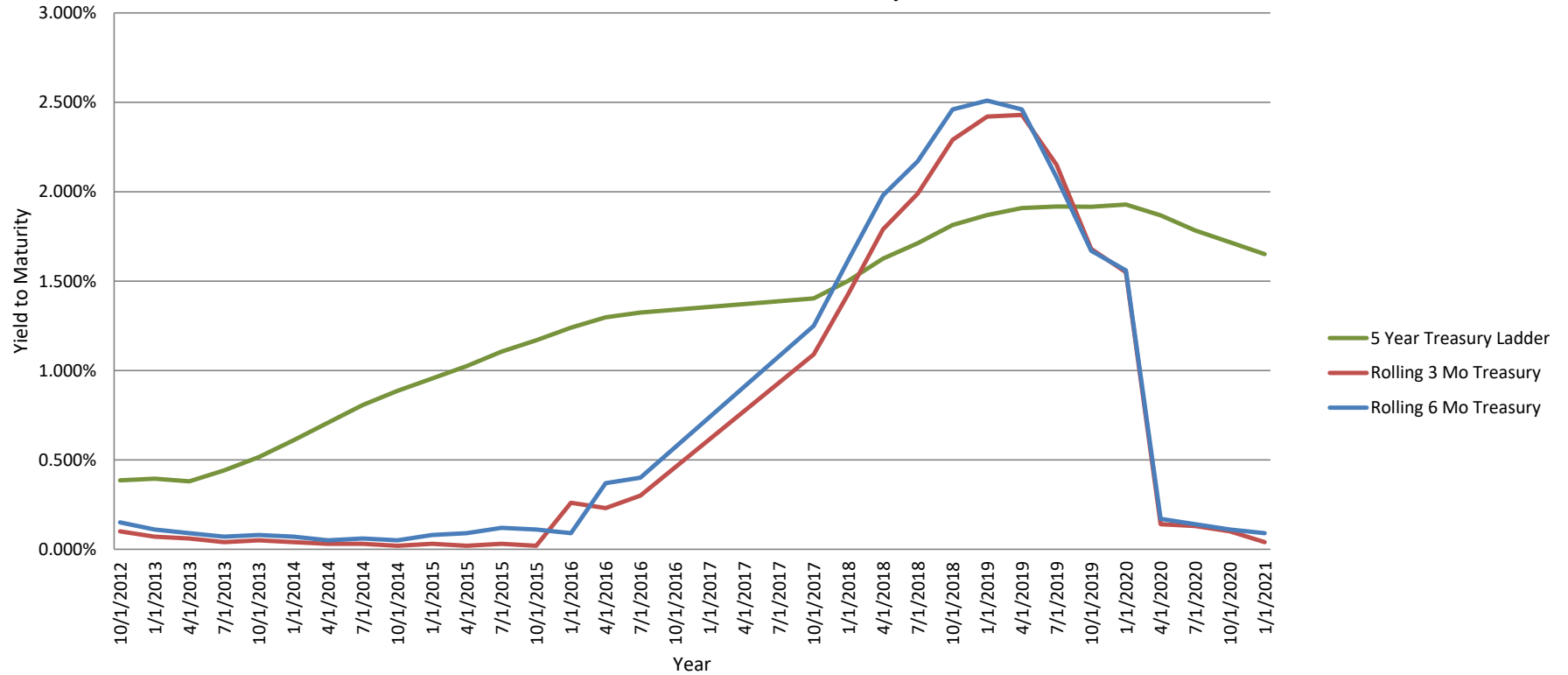
Unknowns

Future path of interest rates

Historical Treasury 3 year and 5 year maturity rates compared




Historical Performance of US Treasury 5 Year Bond Ladder



Benefits of a U.S. Agency MBS Ladder Strategy

- Higher Average Yields: combines the higher yields of longer term bonds with the liquidity of shorter term bonds
- More Consistent Returns: when interest rates rise or fall generally more consistent yields
- Ongoing Liquidity: both principle and interest are paid monthly back to the credit union portfolio

Cash and Fixed Income Summary	
Risk Metric	Value
Cash	1.04
MMFund	239,469.14
Fixed Income	4,038,219.54
Duration	2.923
Convexity	-1.481
WAL	3.592
Years to Final Maturity	13.131
Years to Effective Maturity	3.590
Yield	1.054
Book Yield	0.906
Avg Credit Rating	AA-/Aa3/AA-



Report:	Cash Flow Forecast				
Account:	Sample FCU				
Projected Cashflows For:	05/17/2021 - 05/16/2022			\$4.2 million invested in 8 securities	
Base Currency:	USD				
Date Groups	Post Date	Amount	Ending Cash Balance		
05/17/2021 - 05/31/2021	05/25/2021	151,058.57	390,354.41		
06/01/2021 - 06/30/2021	06/25/2021	81,039.96	471,394.37		
07/01/2021 - 07/31/2021	07/26/2021	79,437.00	550,831.37		
08/01/2021 - 08/31/2021	08/25/2021	78,396.92	629,228.29		
09/01/2021 - 09/30/2021	09/27/2021	76,209.45	705,437.73		
10/01/2021 - 10/31/2021	10/25/2021	75,257.68	780,695.41		
11/01/2021 - 11/30/2021	—	73,983.54	854,678.95		
12/01/2021 - 12/31/2021	12/27/2021	73,429.48	928,108.43		
01/01/2022 - 01/31/2022	01/25/2022	71,887.54	999,995.97		
02/01/2022 - 02/28/2022	02/25/2022	71,355.39	1,071,351.35		
03/01/2022 - 03/31/2022	03/25/2022	71,975.44	1,143,326.79		
04/01/2022 - 04/30/2022	04/25/2022	71,092.74	1,214,419.53		
—	—	975,123.69	1,214,419.53		

Summing Up

- Certificate of Deposit market may have some low yields for a period of time. (U.S. Treasuries are higher yielding than many CD's right now for the same maturity!)
- Bond Optionality (i.e. step-ups, and callable bonds generally favor the issuer NOT the credit union)
- Understand credit risk- U.S. Treasuries, U.S. Agencies, U.S. Agency MBS, and FDIC insured CD's
- Laddering/ having discipline to purchase securities over a maturity range over time.



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Thank you

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Disclosures

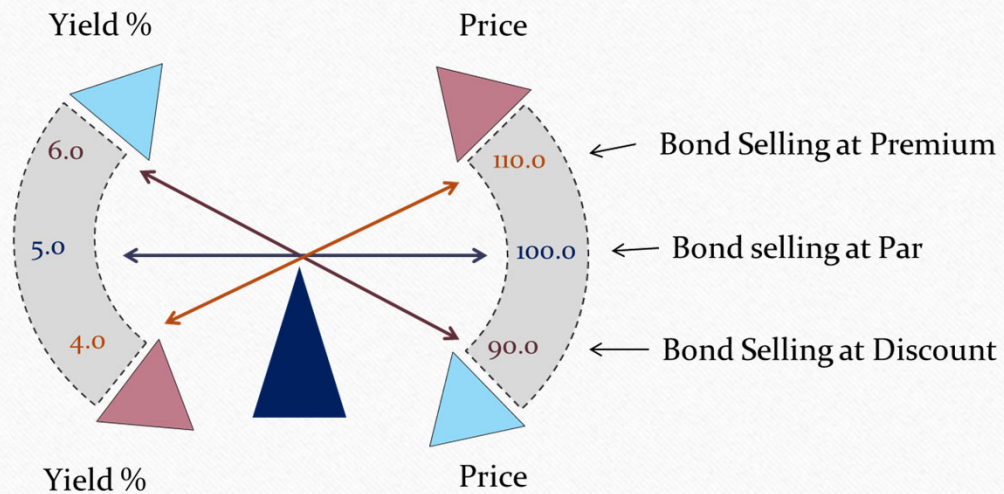
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Bond Trading Terminology

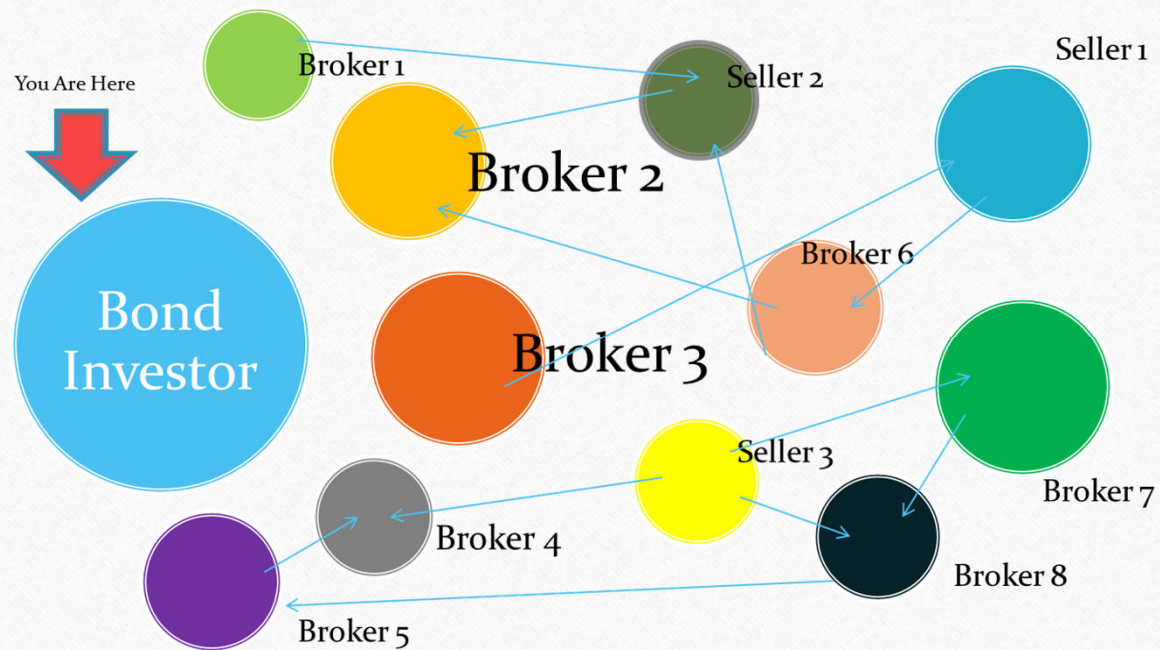
- Bonds generally trade anywhere in the world that a buyer and seller can strike a deal. ***There is no central place or exchange for bond trading, as there is for publicly traded stocks.***
- Bond Dealers: occupy the central role in the vast network of telephone and computer links that connect interested players. The dealers “make a market” to provide liquidity for bond investors.
- Bond Investors: major bond investors are financial institutions (including credit unions), pension funds, mutual funds, and governments from anywhere in the world.
- Bid-Offer Spread: The price difference between what the trader will buy a bond at, and the price at which the trader will sell a bond
- Basis Point: is a hundredth of a percentage point. Example if a yield moves from 3.5% to 3.0% it has moved 50 basis points.
- Spread: Non-federal government bonds are quoted on the basis of a yield spread over a similar maturity government bond. “This CD is 25 bps over treasuries.”

Bond Price vs. Yield

- Bond Prices and Yields are **INVERSELY** related.



How Bonds Trade



The Price of a Bond: What's the Difference to You?

- U.S. Bank 11/15/2018 Floater A1, A+, AA
- Price Offered At:
- Broker 1: +75DM or 99.306
- Broker 2: +81 DM or 99.145
- Broker 3: +83 DM or 99.091
- Purchase Amount \$250,000
- How to figure the price:

99.306	\$993.06 per \$1000	\$993.06 x 250 = \$248,265
99.145	\$991.45 per \$1000	\$991.45 x 250 = \$247,862.50
99.091	\$990.91 per \$1000	\$990.91 x 250 = \$247,727.50

Difference between high and low: \$248,265 - \$247,727.50 = \$537.50

Bond Terminology

- Coupon(The Interest Rate)
 - Stated interest rate at the time the bond is issued
 - Can be paid quarterly, semi-annually, annually, etc.
- Face Value/Par Value
 - The amount of money a holder will get back once the bond matures.
- Maturity Date
 - The date on which the issuer must repay the borrowed amount.
- Yield to Maturity
 - Advance yield calculation that shows the total return you will receive if you hold the bond to maturity.
- Yield to Worst
 - The lowest potential yield that can be received on a bond without the issuer actually defaulting.