

***“Fixed Income Update: Structuring Portfolios
for a Rising Interest Rate Environment”***

IPPFA Regional Seminar

February 16, 2017

SAWYER FALDUTO
ASSET MANAGEMENT, LLC

Thomas S. Sawyer
Sawyer Falduto Asset Management, LLC
630-941-8560
tsawyer@sawyerfalduto.com

Introduction



Introduction

- **Snapshot: The Current Interest Rate Environment.**
- **Basic Concepts.**
- **Portfolio Structure and Risk Management.**
- **Considerations for Articles 3 and 4 funds.**
- **Questions.**

What is a Basis Point?

- **A common unit of measurement when referring to financial instruments.**
- **1 basis point = 1/100th of 1%.**
- **100 basis points in 1%.**

Yield

- **Coupon**: The stated rate of interest for a security.
- **Current Yield**: Ratio of coupon to the current price of the security.
- **Yield-to-Maturity**: Rate of return if the bond is held to maturity.
- **Yield-to-Call**: Rate of Return if the bond is held to its call date.

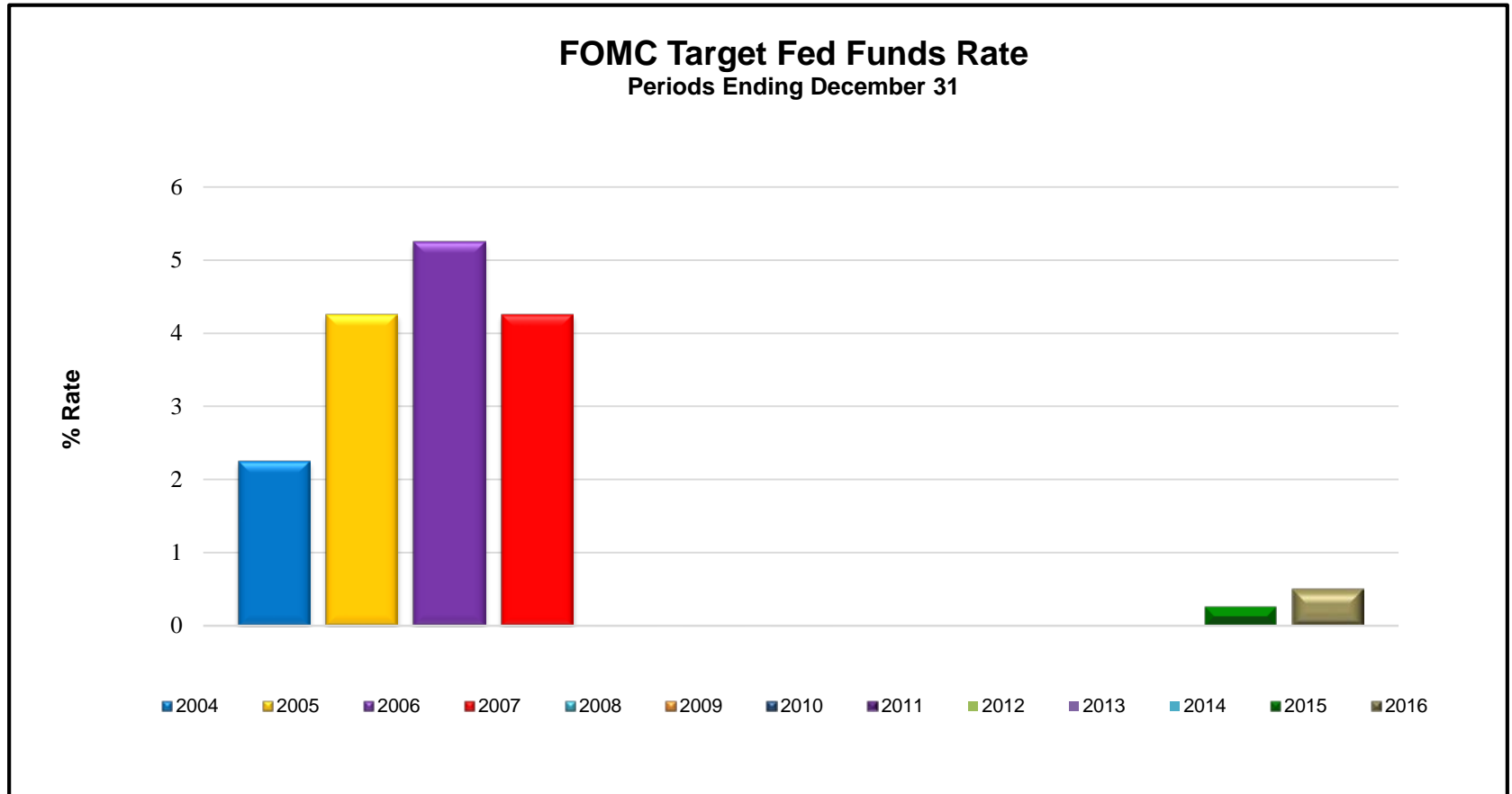
Yield Curve

- **A line that plots the relationship between yield and maturity.**
- **A point-in-time snapshot.**
- **Securities have identical credit quality.**
- **U.S. Treasury Yield curve is most common.**

Post Financial Crisis Environment

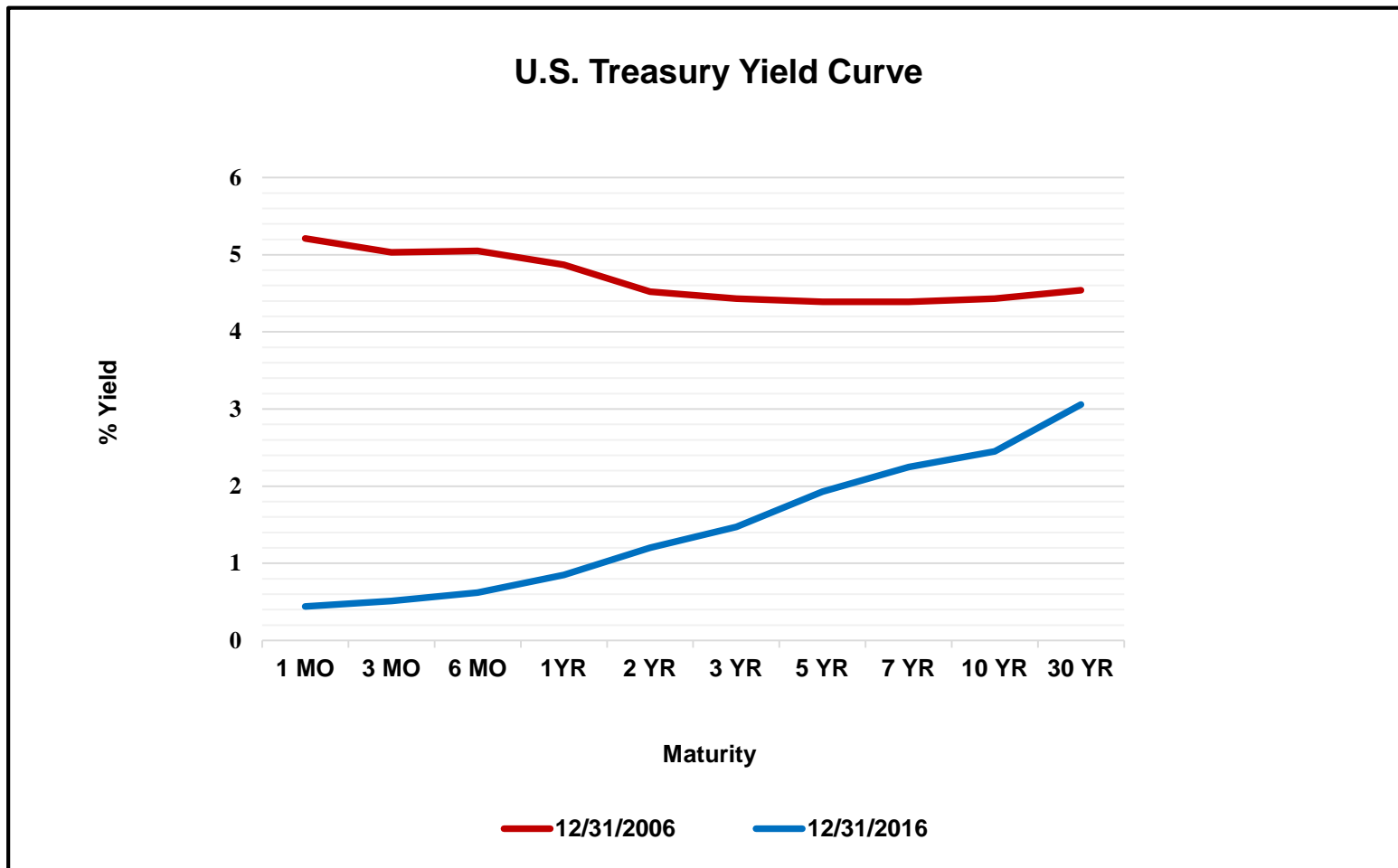
- **Fed Funds rate nudged by 25 basis points in December.**
- **Only second increase since June 2006.**
- **Fed Mandates: Stable Prices and Maximum Employment.**
- **Modest growth and low inflation.**
- **Low yields across the maturity spectrum.**

FOMC Target Fed Funds Rate

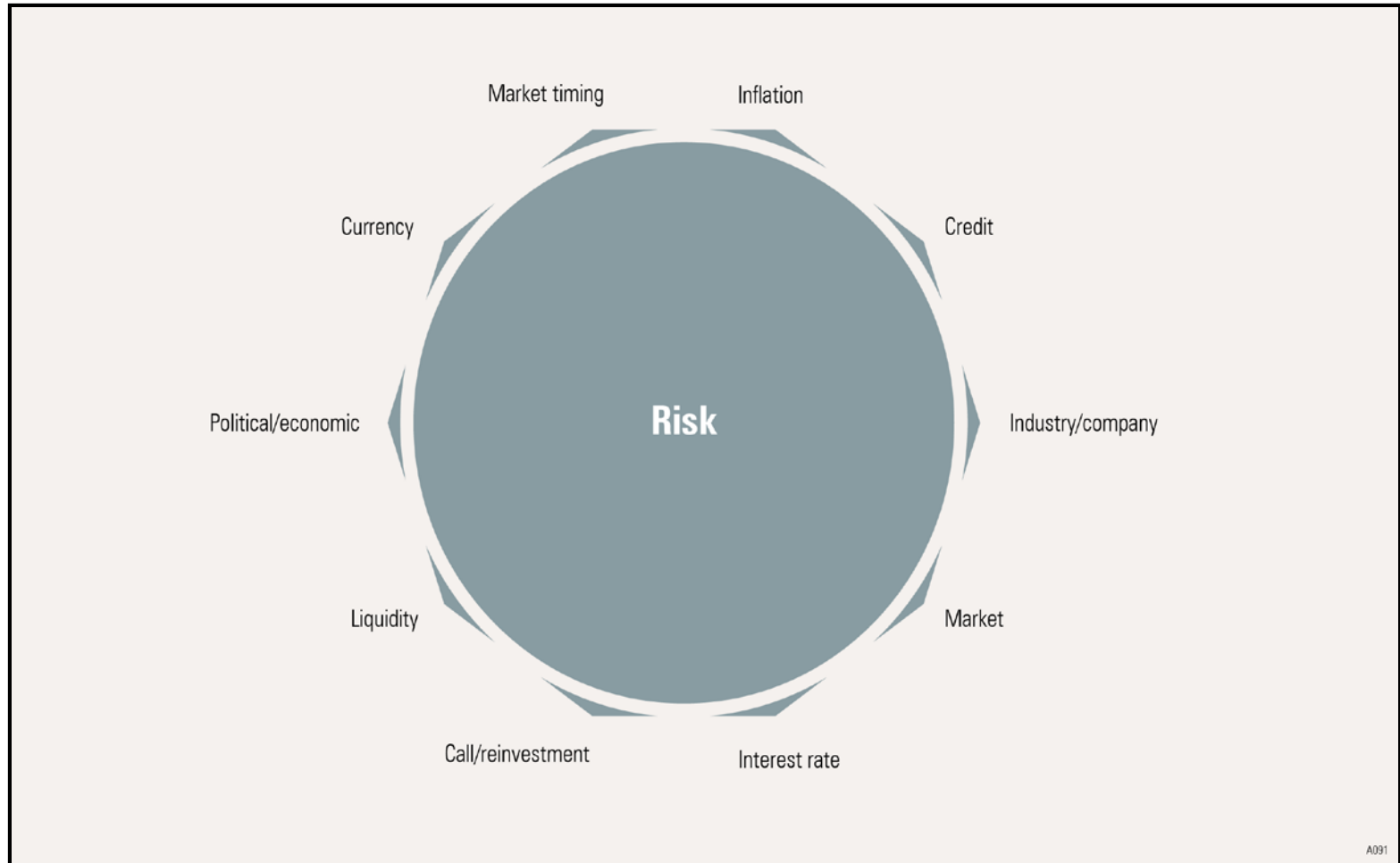


www.federalreserve.gov

Yield Curve – U.S. Treasuries



Types of Risk



Average Maturity and Duration

➤ **Average Maturity:**

- **Weighted average maturity of the underlying bonds.**
- **Expressed in years.**

➤ **Duration:**

- **Measure of the price sensitivity to changes in interest rates.**
- **Expressed as a number of years.**

Average Maturity and Duration

Remember the inverse relationship between interest rates and bond prices.....

Assume the average duration of a portfolio of bonds = 5.

Rates rise by 1% - portfolio value declines by 5%.

Rates decline by 1% - portfolio value increases by 5%.



Bond Quality Ratings Definitions

Moody's	S&P	Fitch	Description
Aaa	AAA	AAA	Highest Quality
Aa	AA	AA	High Quality
A	A	A	Upper Medium
Baa	BBB	BBB	Medium Grade
Ba	BB	BB	Speculative Elements
B	B	B	Weak Assurance of Payments
Caa	CCC	CCC	Default Vulnerability
Ca	CC	CC	Highly Speculative
C	C	C	Lowest Rated Often in Default
D	D	D	In Default

Permitted Fixed Income Investments

- **U.S. Treasury Bills, Notes and Bonds.**
- **Government Agencies.**
- **Municipal Bonds issued in Illinois.**
- **Investment Grade Corporate Bonds.**
- **Other: CD's, GIC's, Money Market Mutual Funds.**

Portfolio Structure and Policy Guidelines

- **Should be a Risk Management Tool.**
- **Provide for Diversification Across Issuing Sectors.**
- **Establish Duration and Maturity Ranged.**
- **Allow for Flexibility.**

Sample Policy Guidelines

Maturity Distribution	% of Fixed Income Securities
0 – 3 years	15%
3 – 5 years	25%
5 – 7 years	30%
7 – 10 years	25%
10 – 15 years	5%

Sample Policy Guidelines

Fixed Income Allocation	Target	Range
Cash Equivalents	0%	0 - 40%
Bank Certificates of Deposit	0%	0 - 40%
US Treasury Securities	20%	0 - 100%
US Government Agency	35%	0 - 70%
US Government Agency – Callable	20%	0 - 30%
US Government Agency MBS	5%	0 - 10%
Investment Grade Corporate Bonds	10%	0 - 30%
Taxable Municipal Securities	10%	0 - 20%

Sample Policy Guidelines

Portfolio Statistics	Duration: 3 to 7	Yield-to Maturity	Current Yield	Average Coupon
Fixed Income Portfolio	5.14 yrs	2.09%	2.98%	3.12%
Benchmark	5.71 yrs	1.72%	2.04%	2.09%

Comments

- **Understand the Types of Risk.**
- **Manage Risk with Policy Controls.**
- **Avoid Chasing Yield and Concentrated Positions.**
- **Remember Your Objectives and Time Horizon.**
- **Questions.**

Biography

Mr. Sawyer has over twenty years of experience in the public fund arena. Mr. Sawyer and his partner, John Falduto, formed their company, Sawyer Falduto Asset Management, LLC, in September 2007. Sawyer Falduto Asset Management, LLC is a registered investment advisory firm specializing in providing investment management services to Illinois police and firefighter pension funds, local units of government and high net worth individuals. Sawyer Falduto currently provides investment management services to over \$1.8 billion in Illinois police and firefighter assets.

Prior to his current position, Mr. Sawyer was Senior Executive Vice President and Head of the Wealth Management Division of Oak Brook Bank (now MB Financial, Inc.), Oak Brook, Illinois from 1998 through 2007. During his tenure at Oak Brook Bank, the Wealth Management Division provided investment management and administrative services to clients with assets exceeding \$1.2 billion including approximately \$800 million in police and firefighter pension fund assets.

From 1988 to 1998, Mr. Sawyer was employed with the Investment Management and Trust Division of Old Kent Bank (now Fifth Third Bank) where Mr. Sawyer was Vice President – Director of Portfolio Management for Old Kent Bank – Illinois located in Elmhurst, Illinois.

Mr. Sawyer began his career as a trader, research analyst and portfolio manager with First Tennessee Investment Management, Inc., a division of First Tennessee Bank, in Memphis, Tennessee.

The information included in this presentation is obtained from sources believed to be reliable. Nothing herein should be construed as specific investment advice. All comments are the opinion of the author and necessarily representative of Sawyer Falduto Asset Management, LLC. Past performance is no guarantee of future returns.