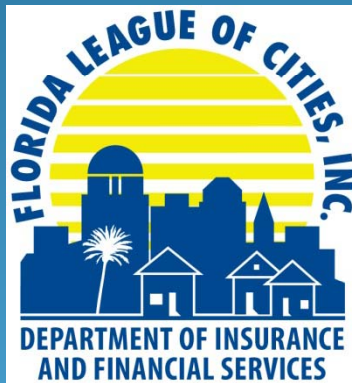


Investments 101

Public Funds Investing

Dustin Heintz





Investments 101: Overview

- Florida Statutes
- Fixed Income Securities
- Risk, Liquidity and Return
- Diversification
- Oversight
- Investment Options
- Questions



Florida Statutes

- 2009 Florida Statutes Chapter 218
 - Financial Matters Pertaining to Political Subdivisions
- Section 415
 - Local Government Investment Policies
 - “Investment Activity by a unit of local government must be consistent with a written investment plan adopted by the governing body”
 - “Such policies shall be structured to place the highest priority on the safety of principal and liquidity of funds. The optimization of investment returns shall be secondary to the requirements for safety and liquidity”



Florida Statutes

- 2009 FL Statutes Chapter 218 Section 415
 - (2) Investment Objectives
 - (6) Maturity and Liquidity Requirements
 - (8) Risk and Diversification
 - (10) Third-Party Custodial Agreements
 - (13) Internal Controls
 - (15) Reporting
 - (22) Audits
 - (23) Authorized Deposits



Fixed Income Securities

- Par Value
- Purchase Price
- Coupon Rate
- Interest Payment Schedule
 - Number of payments per year
- Maturity Date
- Options
 - Call and Put Options



Risk, Liquidity and Return

- First things First: RISK
 - Identify the risks involved
- Types of Risks in Operating Fund Investing
 - Interest Rate Risk
 - Reinvestment Risk
 - Liquidity Risk
 - Credit Risk (Default Risk)
 - Inflation Risk



Risk, Liquidity and Return

- Interest Rate Risk
 - Changes in interest rates cause changes in price
 - Premiums and Discounts
 - Approximated by duration
 - Duration measures the price sensitivity of a bond to changes in interest rates.
 - Example: A bond with a duration of 3 yields 4%. The bond's price will move 3% for every 1% change in interest rates. If interest rates rise 1% over the next 12 months, the return on that bond would be approximately 1% ($4\% - 3\% = 1\%$)



Risk, Liquidity and Return

- Reinvestment Risk
 - CDs and Money Markets
 - Reinvesting returns depends on interest rates in the future



Risk, Liquidity and Return

- Liquidity Risk
 - Supply and Demand
 - Decrease in demand will cause a decrease in price



Risk, Liquidity and Return

- Credit Risk (Default Risk)
 - The ability of the issuer to make interest and principal payments
 - Business Risk
 - Fraud Risk
 - Operational Risk



Risk, Liquidity and Return

- Inflation Risk
 - Opportunity Costs
 - The risk that investment returns do not keep pace with inflation
 - Example: \$1 million is invested to earn 0.25%. At the end of the year, you have \$1,002,500. Inflation, however rise 2%, so that purchasing power declines by \$17,500



Risk, Liquidity and Return

- Next: Liquidity
 - Direct Investments
 - Supply and Demand
 - Changes depending on flight to quality circumstances
 - Pools/Funds
 - Redemption Periods



Risk, Liquidity and Return

- Finally: Return
 - Yield
 - Interest earned on securities
 - Total Return
 - Includes both interest and gain/loss (realized and unrealized)



Risk, Liquidity and Return

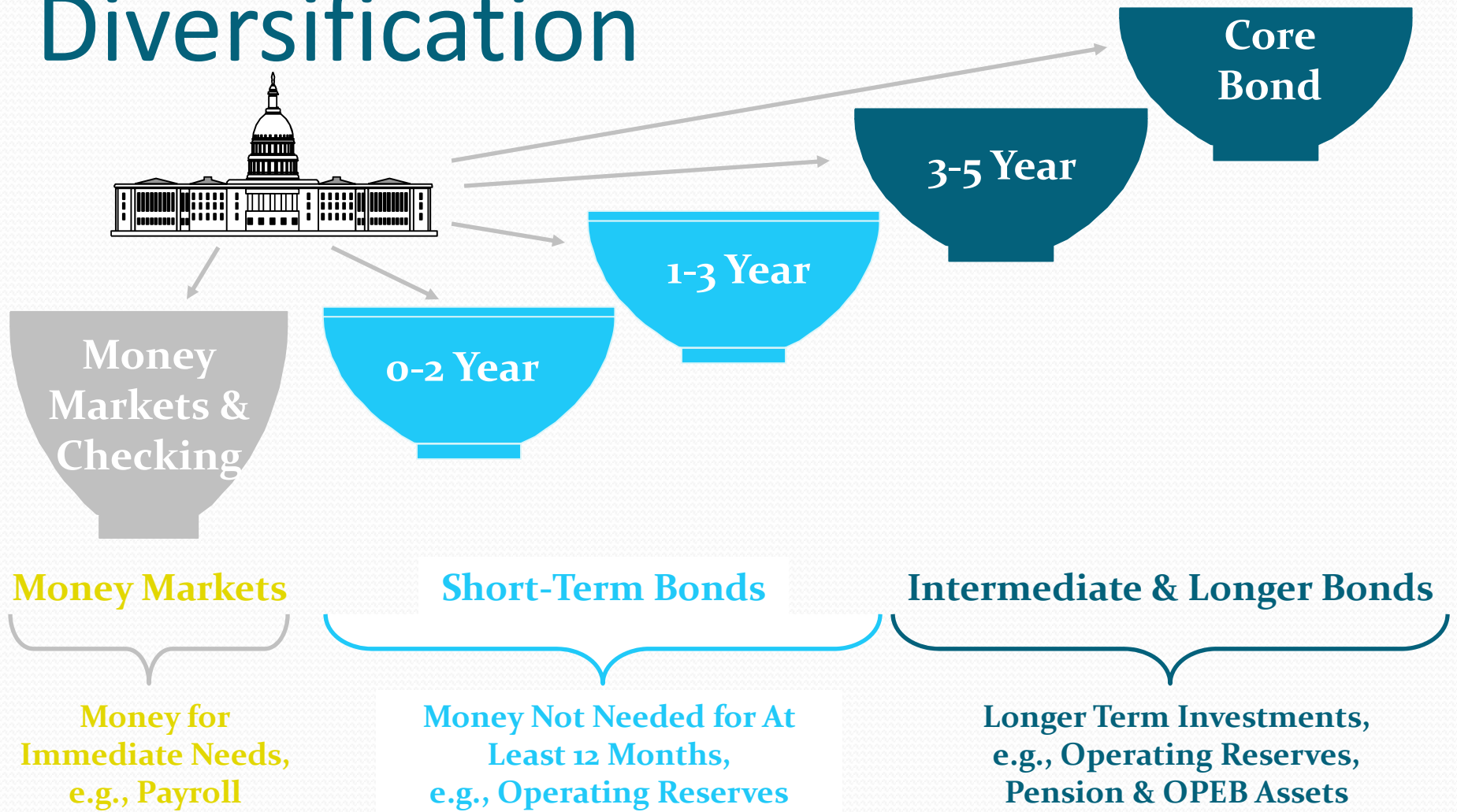
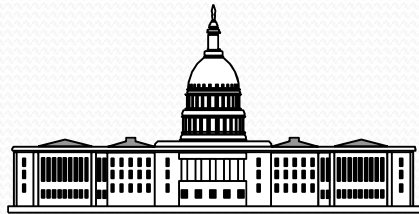
- Returns Overview
 - Gross of Fees
 - Net of Fees
 - Annualized Returns
 - Period Returns
 - Benchmarks



Diversification

- There are different things to consider when diversifying your portfolio
 - Types of Investments
 - Location of Assets
 - Maturity Diversification

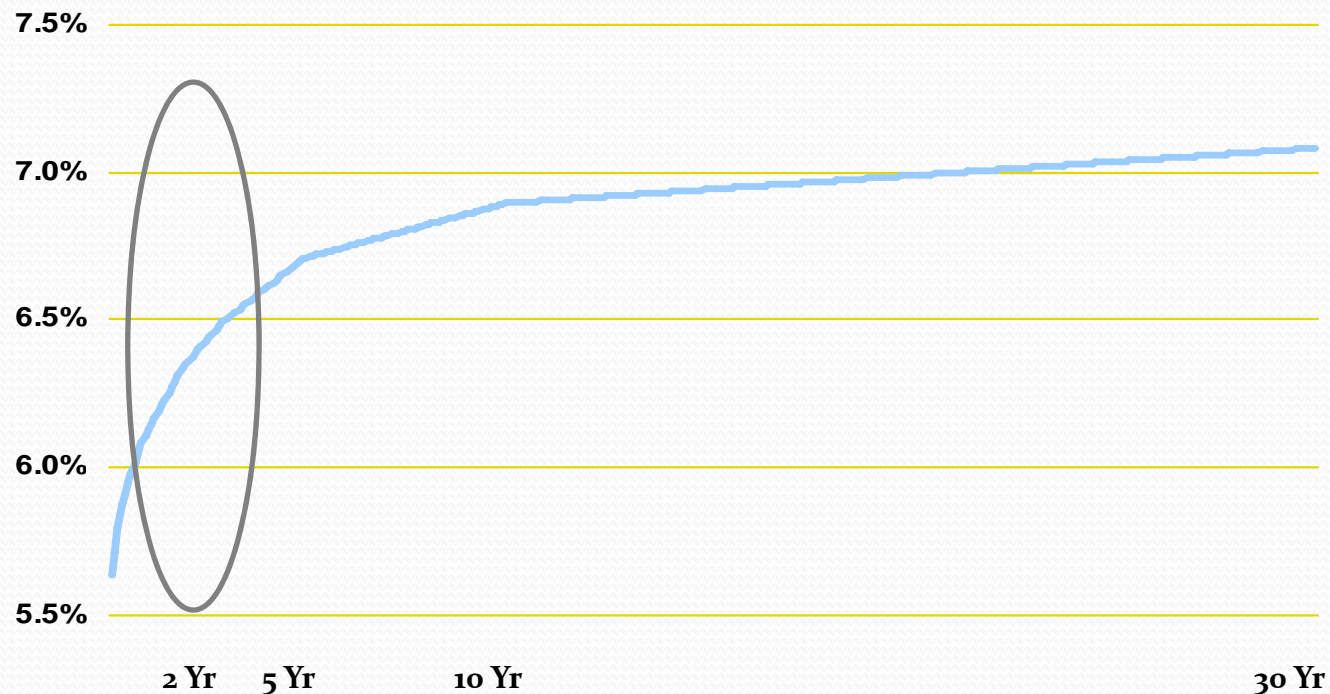
Diversification



Diversification

- Maturity Diversification

- Average Treasury Yield Curve Since 1955



Data as of March 2010 Source: Bloomberg

All data presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed.



Oversight

- Elected Officials
- Investment Committees
- Staff
- Auditors
- Investment/Financial Advisors
- Investment Managers
- Investment Consultants



Investment Options

- Florida Statutes Authorized Investments
 - LGIPs (including SBA/Florida Prime)
 - SEC registered money markets
 - CDs or savings accounts (QPDs)
 - US Treasury direct obligations
 - Federal agencies and instrumentalities
 - Israeli bonds
 - Open/Close ended investment companies (caveats)
 - Other investments authorized by law or ordinance for a county or a municipality



Investment Options

- Direct Investment Securities
 - US Treasury Bills, Notes and Bonds
 - Federal Agency Securities
 - Mortgage Backed Securities
 - Asset Backed Securities
 - Municipal Securities
 - Corporate Bonds and Paper
 - International Bonds



Investment Options

- Direct Investment Securities
 - Benefits
 - Increased direct control over investment portfolio
 - Possibly increased return performance
 - Large portfolios benefit from economies of scale
 - Disadvantages
 - Potential increased costs (custodial fees, accounting fees, increased staff time, etc)
 - Potential headline risk



Investment Options

- Funds and Pools
 - Local Government Investment Pools
 - Designed for local governments
 - Typically conservative in nature
 - Money Markets
 - Many different types
 - Underlying securities are important!
 - Mutual Funds
 - Variable rate share price (NAV)
 - Many different options available



Investment Options

- Funds and Pools
 - Benefits
 - Professional management
 - Simplicity
 - Economies of scale
 - Disadvantages
 - Less direct control
 - Less ease of transparency

Questions?



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