

CDIAC

**CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION**

SESSION ONE:

**INTRODUCTION: HISTORY OF THE
MARKET AND THE EFFECTS ON
PORTFOLIO MANAGEMENT IN
CALIFORNIA**

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WEDNESDAY, MARCH 12, 2014

History of the Bond Market:
Gaining Perspective on our Current Market
Environment.

**“Those who fail to learn from history
are doomed to repeat it.”**

--Sir Winston Churchill

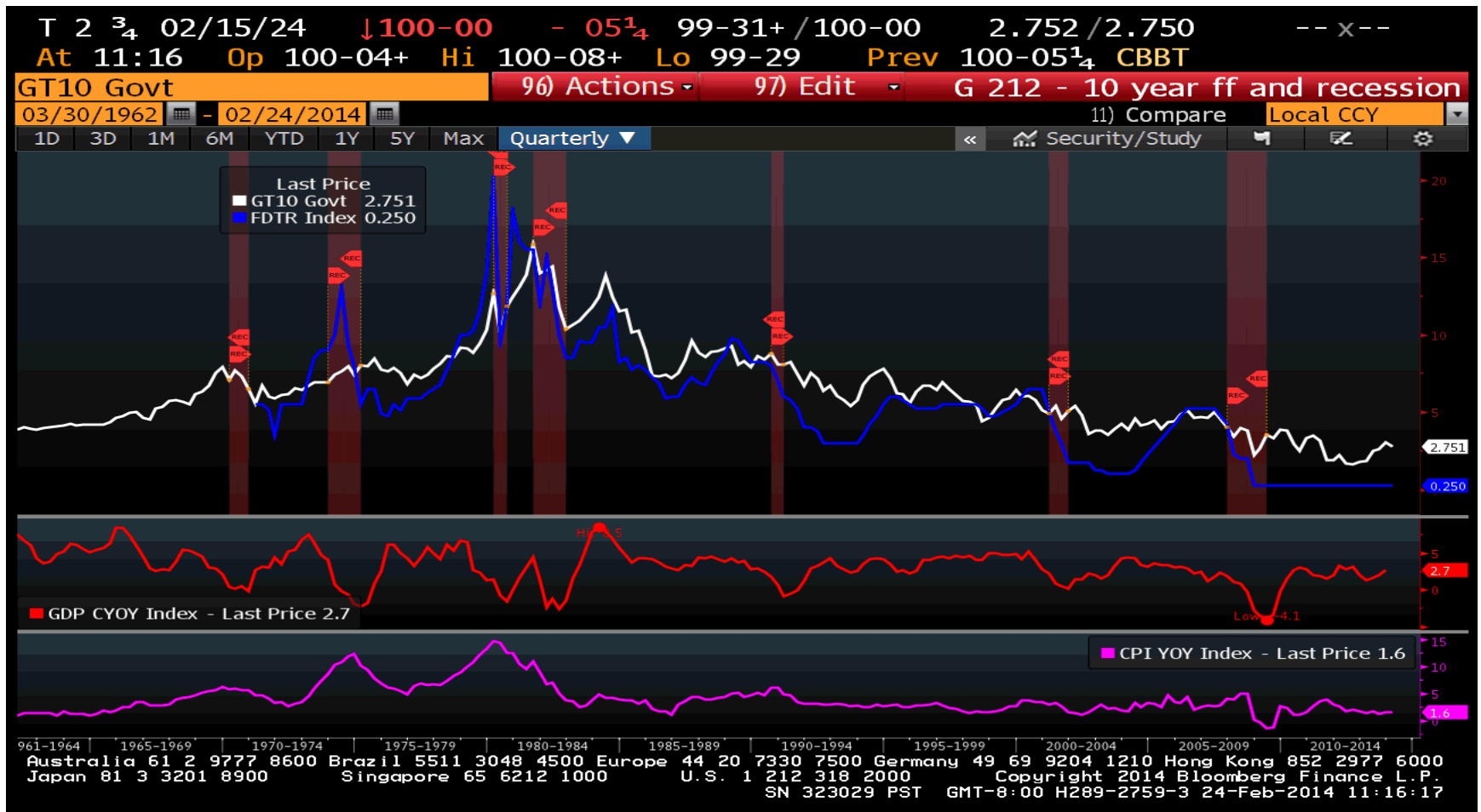
10 Year Government Yield from 1962-Present



Major Events

- Volker Fed Inflation Fight 1975-1987
- Fed targeted Money Supply (M2) Growth
- Fed Funds peaked at over 20%
- YOY CPI peaked in 1980 at 14.8% and by June of 1983 it had dropped to 2.6%
- Two recessions
- Unemployment rose from 3.5% to 10.5% by 1982
- Alan Greenspan appointed and served from 1987 to 2006
- 1987 Stock Crash

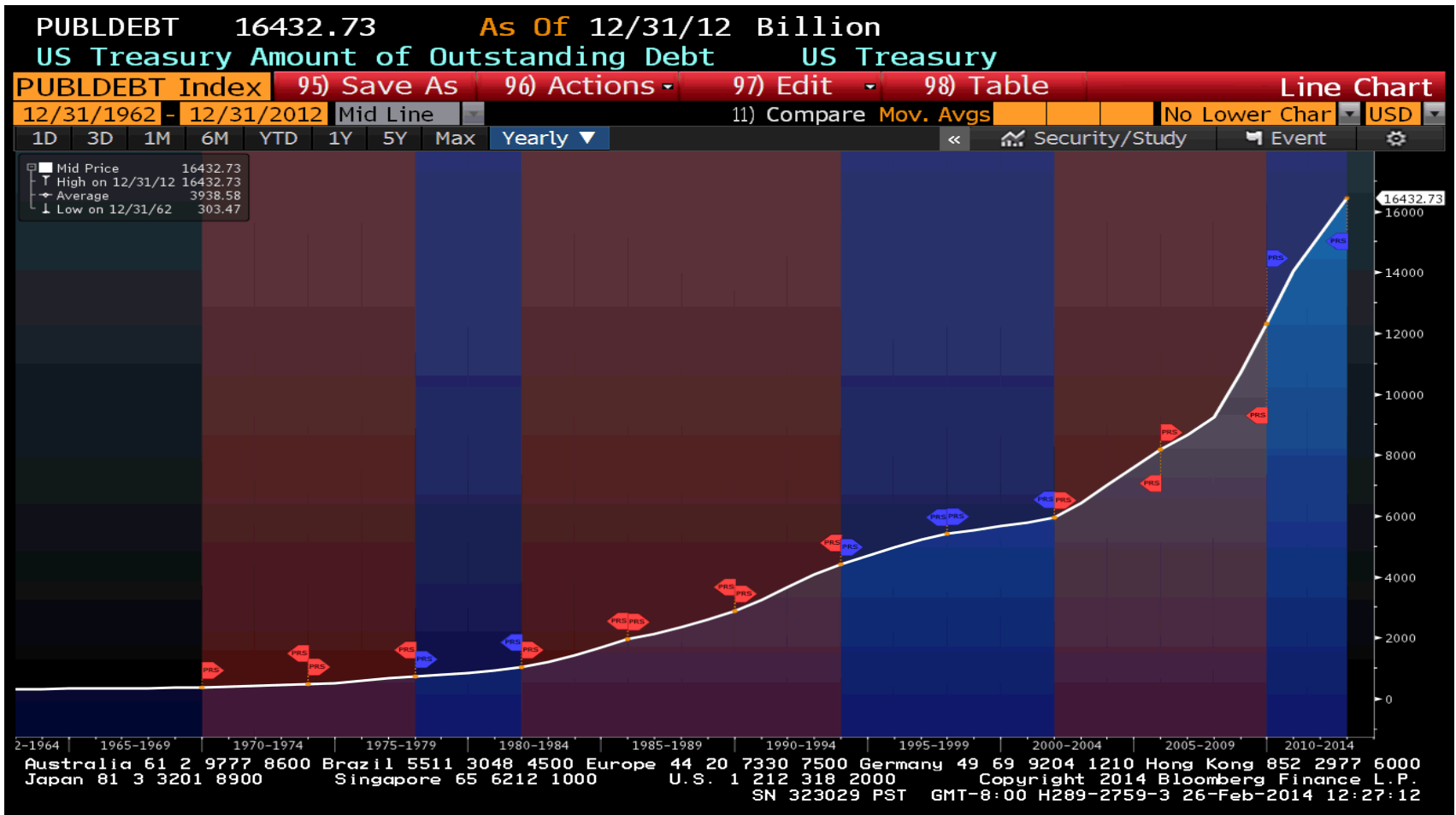
Context: Yields, Fed Funds, GDP and CPI



Consequences of Tight Monetary Policy. Unemployment!



With the 1980s came Government Deficits.



PUBLDEBT 16432.73 As Of 12/31/12 Billion
 US Treasury Amount of Outstanding Debt US Treasury

PUBLDEBT Index 95) Save As 96) Actions 97) Edit 98) Table Line Chart
 12/31/1900 - 12/31/2013 11) Compare Mov. Avgs
 1D 3D 1M 6M YTD 1Y 5Y Max Yearly Security/Study Event



60-1964	1965-1969	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004	2005-2009	2010-2014						
Australia 61	2 9777	8600	Brazil 5511	3048	4500	Europe 44	20 7330	7500	Germany 49	69 9204	1210	Hong Kong 852	2977	6000		
Japan 81	3 3201	8900	Singapore 65	6212	1000	U.S. 1	212 318	2000	Copyright 2014 Bloomberg Finance L.P.							
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Historically Well Known Problems

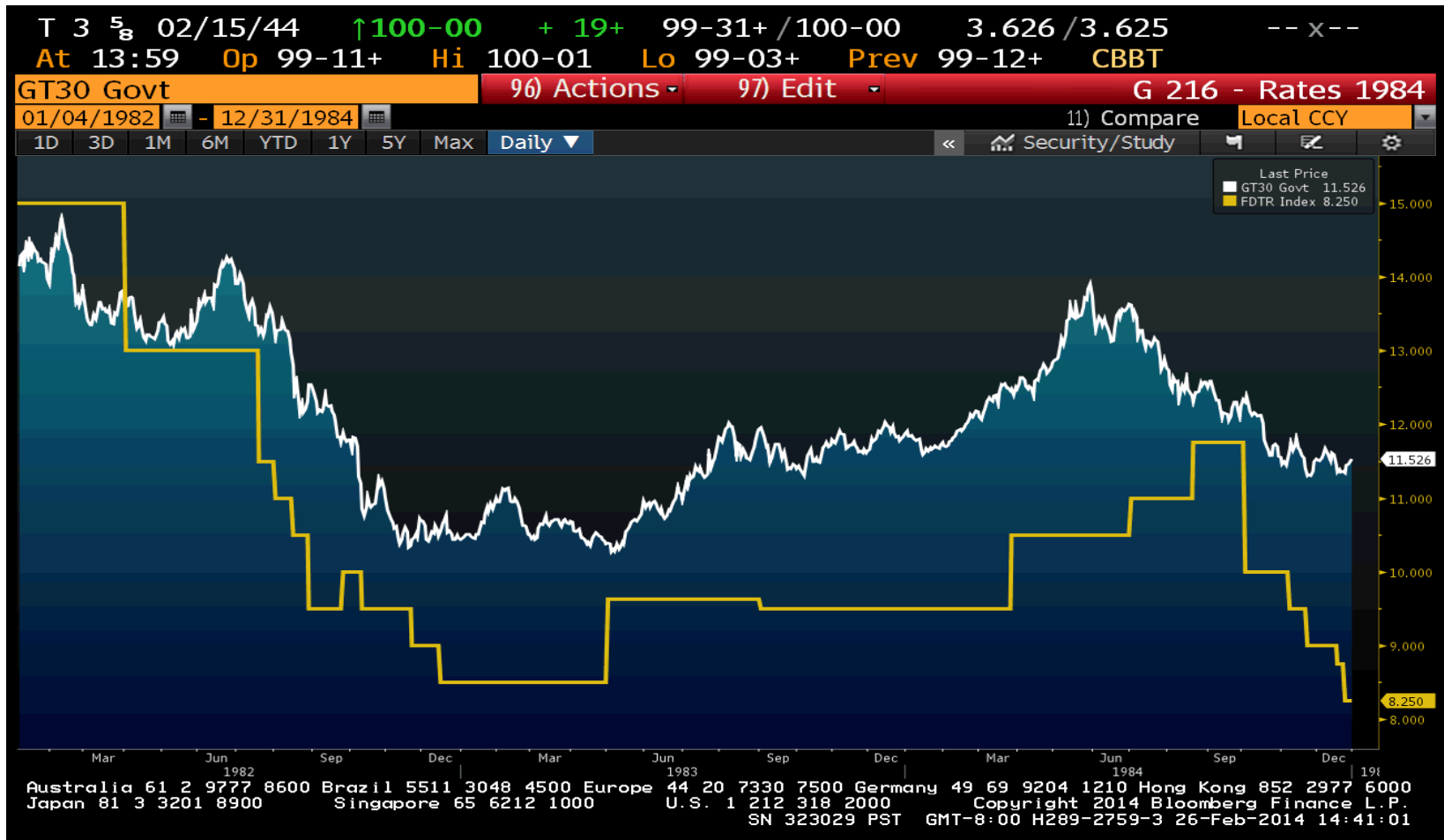
- 1984 San Jose
 - \$60MM in Investment Losses
 - Traded Long Bonds
 - California Investment Code Amended
- 1987 Camarillo
 - \$22MM Loss
 - Purchased \$273MM in securities with <\$25MM
- 1994 Orange County
 - \$1.6B loss on pool of \$7.6B

1984 - San Jose



1984 Reagan Tax Cuts kick in.

What do you think the Fed will do in response?



Math: $1,823 \times 364 = \$663,500$ Per \$1MM
 \$60MM loss equates to a position of \$90MM long bonds

CT30 Govt YA

T 3 ⁵/₈ 02/15/44 Govt 90 Feedback Yield and Spread Analysis

95 Buy 96 Sell 97 Settings

1) Yield & Spread 2) Pricing 3) Descriptive 4) Graphs 5) Custom 6) Yields

T 3 ⁵ / ₈ 02/15/44 (912810RE0)		Risk	
Price	100.181 (100.1810816)	Duration	18.505
Settle	02/27/14	Modified Duration	18.176
	Maturity 02/15/44	Risk	18.231
Street Convention	3.6150000	Convexity	4.499
US Government Equivalent	3.6149456	DV	01 on 1MM
True Yield	3.6146005	PV	0.01
Equiv 1 /Yr Compound	3.6476706	Invoice	
Japanese Yield (Simple)	3.6120000	Face	1,000 M
Mmkt (Act/36)		Principal	1,001,810.00
Current Yield	3.6184480	Accrued (12 Days)	1,201.66
		Total (USD)	1,003,011.66
After T... (Inc 43.40 % CG 23.8 %)	2.0461050		
Issue Price = 98.826. Bond Purchased with Premium.			

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2014 Bloomberg Finance L.P.
 SN 323029 PST GMT-8:00 H289-2759-3 26-Feb-2014 13:46:58

Camarillo – 1987

Just because a loss isn't booked doesn't mean it isn't real.



Modeled Portfolio

<HELP> for explanation, <MENU> for similar functions.
6<GO> to reload screen, 7<GO> to reprocess portfolio

1) Reports

2) Scenarios

3) Options

5) Feedback

Scenario Analysis

Portfolio
Scenario Set

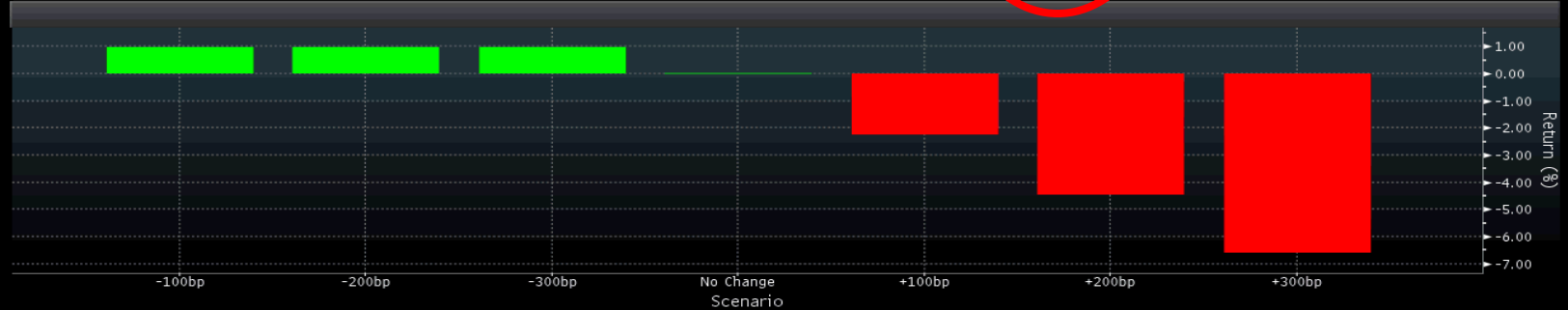
LADDERED ON THE RUNS.
+/- 100, 200, 300bp

Time Horizon 0 Days

Currency USD
As of 2/26/2014

Scenario Results (+/- 100, 200, 300bp)

Scenario Name	Principal (M)	AI (M)	Cash Flow (M)	Hrz Val (M)	Dur	Conv	YTW	Ret (%)
Current Portfolio	250,525.39	127.42	-	250,652.81	2.30	0.07	0.44	-
-100bp	252,974.16	127.42	0.00	253,101.58	2.30	0.07	0.05	0.98
-200bp	252,974.16	127.42	0.00	253,101.58	2.30	0.07	0.05	0.98
-300bp	252,974.16	127.42	0.00	253,101.58	2.30	0.07	0.05	0.98
No Change	250,525.39	127.42	0.00	250,652.81	2.30	0.07	0.44	0.00
+100bp	244,849.20	127.42	0.00	244,976.62	2.28	0.07	1.44	-2.26
+200bp	239,334.22	127.42	0.00	239,461.64	2.27	0.07	2.44	-4.46
+300bp	233,974.99	127.42	0.00	234,102.41	2.26	0.06	3.44	-6.60



Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2014 Bloomberg Finance L.P.
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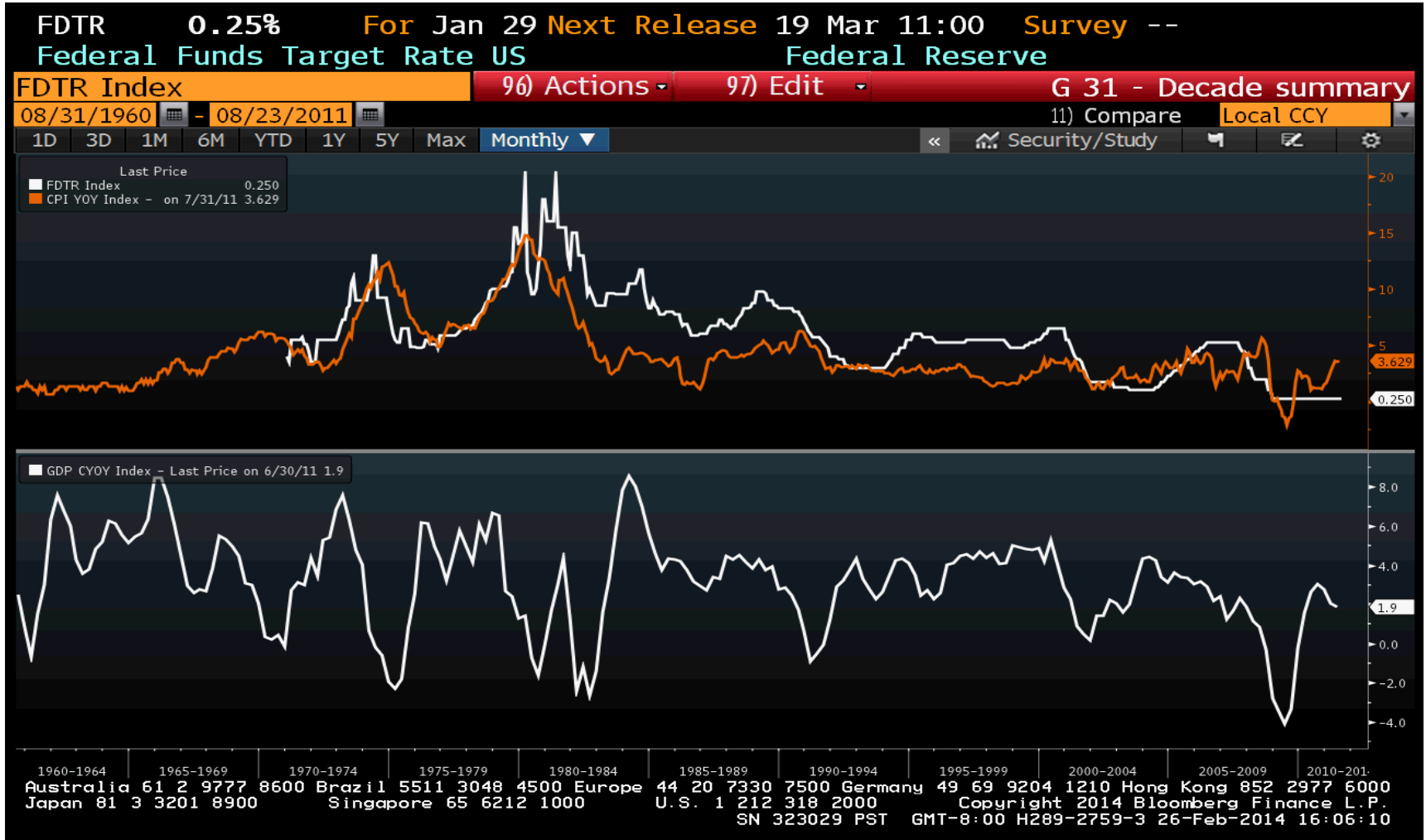
T 3 5/8 02/15/44 ↑100-00 + 19+ 99-31+ / 100-00 3.626 / 3.625 -- x --
 At 13:55 Op 99-11+ Hi 100-00+ Lo 99-03+ Prev 99-12+ CBBT
 GT30 Govt 95) Save As 96) Actions 97) Edit 98) Table Line Chart
 01/04/1993 - 12/31/1995 Last Price 11) Compare Mov. Avgs No Lower Chart USD
 1D 3D 1M 6M YTD 1Y 5Y Max Daily Security/Study Event

A pause in the bond market rally amounting to 238 basis points



Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2014 Bloomberg Finance L.P.
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What's Ahead?



Questions & Answers

Thank You