

SESSION TWO

Benchmarking: A Public Fund
Guide to Happiness

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CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION



Benchmarking: *A Public Fund's Guide to Happiness*

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Performance Measurement vs Performance Evaluation

(Describes results) *(Judges' appropriateness)*

<ul style="list-style-type: none">❖ What happened❖ Measured using indices<ul style="list-style-type: none">* Market-based* Policy-driven❖ Produces data and outcomes	<ul style="list-style-type: none">❖ Was it appropriate❖ Judged against responsibilities❖ Uses Benchmark as standard❖ For public funds - Stewardship
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“Measurement describes results. Evaluation judges' appropriateness.”

Fiduciary (Legal)

- ❖ Legal obligation
- ❖ Follows the rules
- ❖ Avoids risk of loss
- ❖ Acts to avoid liability

Stewardship (Suitable)

- ❖ Moral obligation
- ❖ Fulfills the mission
- ❖ Optimizes probability of success
- ❖ Acts with long term purpose

“*Being a fiduciary is necessary. Stewardship is what we evaluate.*”

Index (Measurement Tool)

- ❖ Described what happened
- ❖ Quantitative reference point
 - * Market-based index's
 - * Policy-driven objectives

Benchmark (Evaluation Standard)

- ❖ Was it appropriate
- ❖ Judged against responsibilities
- ❖ Uses Benchmark as standard
- ❖ For public funds – Stewardship

“If what we are evaluating is stewardship, then the benchmark must be aligned with purpose — not market behavior.”

Three Core Distinctions

- Performance Measurement vs Evaluation

Describing is not judging

- Fiduciary vs Stewardship

Legal does not mean suitable

- Index vs Benchmark

Informs but does not evaluate

“That’s why public fund stewardship must be evaluated against suitability not market performance.

Learning Outcomes

- **Understand** stewardship-based benchmarking framework and how it moves performance measurement beyond total return.
- **Differentiate** a benchmark from a market index by understanding how stewardship is evaluated through a suitability framework.
- **Construct** and apply policy-driven performance measures, including safety, liquidity, duration, credit, income and legal compliance, to evaluate a portfolio's suitability.
- **Apply** this framework across public funds of all sizes to demonstrate fiduciary accountability and protection of public funds.

Framework for Evaluating Stewardship

What is being evaluated	Stewardship <i>Did the portfolio preserve principal?</i>
How it is evaluated	Suitability <i>Measured using policy-driven measures</i>
What defines suitability	Investment Policy Objectives <ul style="list-style-type: none">• Safety• Liquidity• Income• Credit• Legal

This framework evaluates whether the portfolio did what it was designed to do.

(Nothing here depends on beating a market.)

From Policy to Portfolio: The Suitability Benchmark Blueprint



The benchmark is defined in advance.
The portfolio is evaluated against it over time.

Ensuring Investment Practice Follows Policy

Investment Policy Objectives Are Prioritized



What the Suitability Benchmark Does

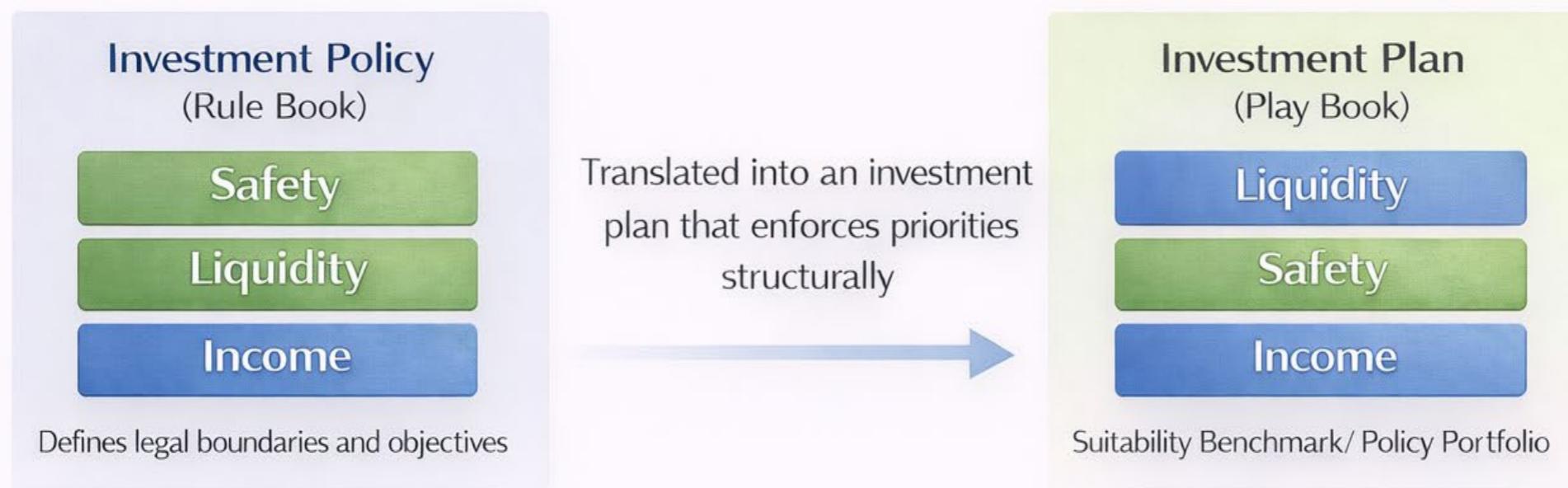
- Uses policy objectives, not market comparisons
- Evaluates all objectives, not just return
- Enforces sequence, not tradeoffs

What This Means for Investment Decisions

- Safety and liquidity targets must be met first
- Only funds above total liquidity become **investable liquidity**
- Income decisions are made after, not alongside

Bottom line: Measures all policy objectives — not just return — to ensure investment practice follows policy priorities.

Step One: Creating the Liquidity Index



Liquidity Structure

(Liquidity is the oxygen of suitability)



Three Types of Risk Public Funds Can Take

Once Liquidity Is Established, Safety Decisions Define Income Strategy

Liquidity Secured



GASB 31 introduces market value volatility into budgets
More market risk = more income for budget
Most politically sensitive—and largest driver of income



Occurs when bonds mature or are called early
Callables can enhance income while keeping duration shorter
Income depends on future market rates when bonds mature or are called



State code sets minimum credit at A or better
Managed through diversification and concentration limits
Downgrades create headlines, not automatic sales

Duration, reinvestment risk, and credit risk define the trade-off between safety and income.

Step Two: Creating Duration Index

Setting the portfolio's duration after liquidity reflects two core approaches:

BUDGET OPTIMIZATION

- Focus on Stability & Certainty
- Estimate Income for Next Year's Budget
- Minimize Impact of Rate Changes

INCOME OPTIMIZATION

- Focus on Risk-Adjusted Returns
- Analyze Historical Yield Curve
- Find the "Sweet Spot" for Income

VS.

Defining Public Funds' Risk Tolerance in Advance Sets the Framework for the Income Strategy

Step Three: Creating a Credit Index

Defining the portfolio's preferred credit profile in advance establishes how credit is used to enhance income.

Credit Index (Portfolio-Level Target)

- Weighted-average portfolio credit rating
- Established before investing in corporates or taxable municipals
- Defines the portfolio's preferred credit posture
- Typical target: AA- / Aa3

What This Enables

- Tactical use of A-rated securities
- Income enhancement without lowering overall portfolio quality
- Flexibility in issuer and sector selection

Safety Embedded in the Credit Index

Headline Risk

- Downgrades anticipated and absorbed at the portfolio level

Default Risk

- Controlled through statutory minimums and higher portfolio target

Concentration Risk

- Managed through diversification consistent with the Prudent Investor Standard

This is a construction blueprint, not the security selection process.

The Credit Index ensures income is enhanced without compromising safety, diversification, or policy

Step Four: Creating a Market Rate of Return Index

The Market Rate of Return Index is an explanatory input into the Suitability Benchmark.

Market Rate of Return Index

- Defines market rate of return as yield, excluding unrealized gains or losses
- Reflects how public funds actually invest over time
 - * 12-month moving average of 2-Year U.S. Treasury Constant Maturity Rate

Index Inputs

- 2-Year U.S. Treasury Constant Maturity Rate (Data from FRED)
FRED (Federal Reserve Economic Data) is the primary source for consistent historical yield data.

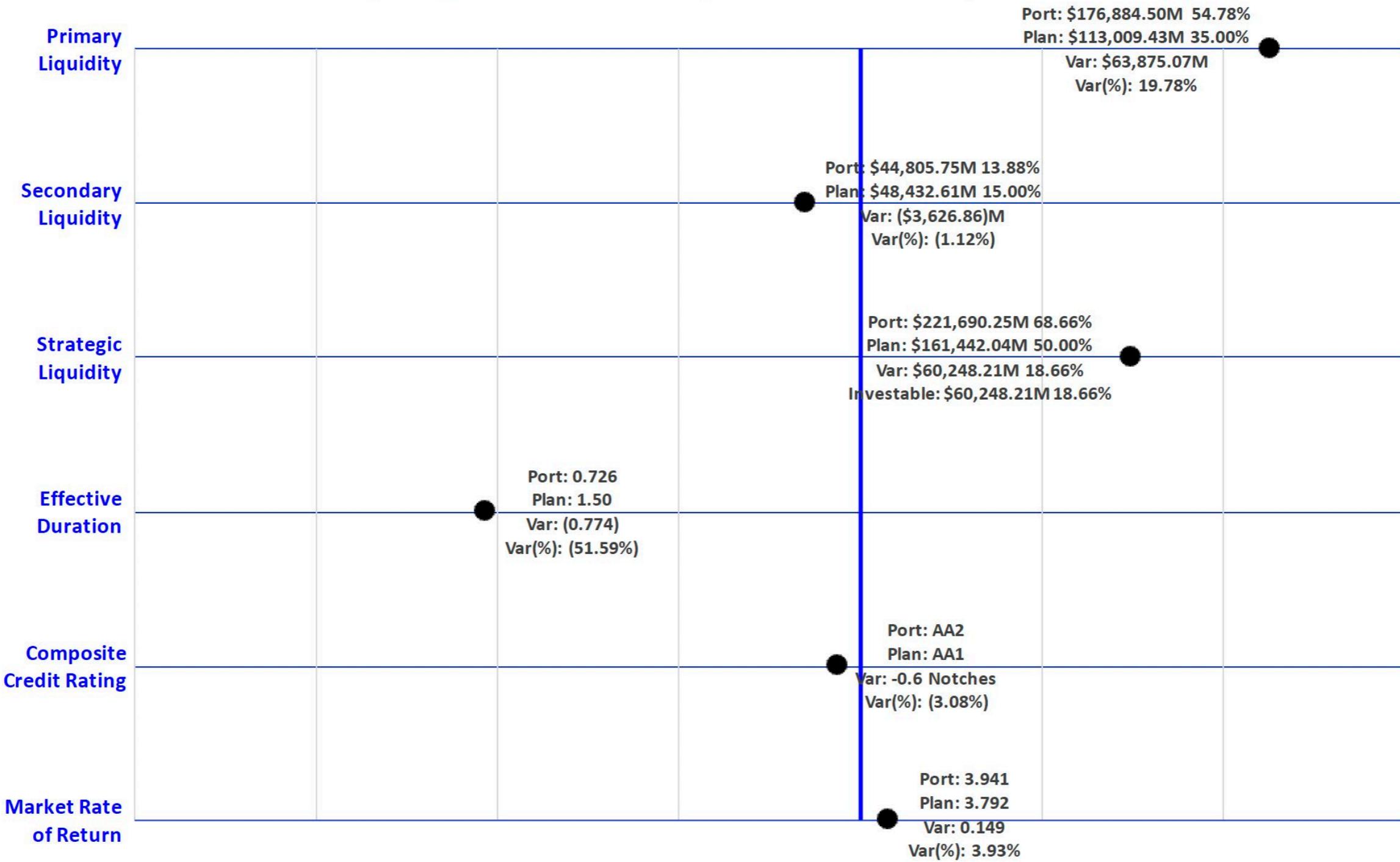
The Market Rate of Return Index provides market-based context for income, allowing the Suitability Benchmark to evaluate stewardship without confusing prudence with market timing.

Suitability Benchmark Executive Summary: City of Sweet Returns

CASH: 54.78% | Tsy:0.95% | AgyBlt:3.47% | AgyStep:1.24% | AgyClbl:7.19% | Corp:7.21%

Par Amount (\$000): \$322,290.49 | Mkt Vlu (\$000): \$322,884.08 | Gain/Loss (\$000) Using Amort Cost: \$1,017.08

Years To Maturity: 0.86 | Modified Duration: 0.82 | Effective Duration: 0.73 | Effective Convexity: (0.07)



Summary

How we built the Suitability Benchmark

- Step 1 — Liquidity Index: targets + investable liquidity after targets
 - Step 2 — Duration Index: intentional interest-rate posture
- Step 3 — Credit Index: portfolio-level posture + diversification discipline
- Step 4 — Market Rate of Return Index: income context (not a performance contest)

What we clarified

- Measurement ≠ Evaluation
- Fiduciary obligation ≠ Stewardship
 - Index ≠ Benchmark

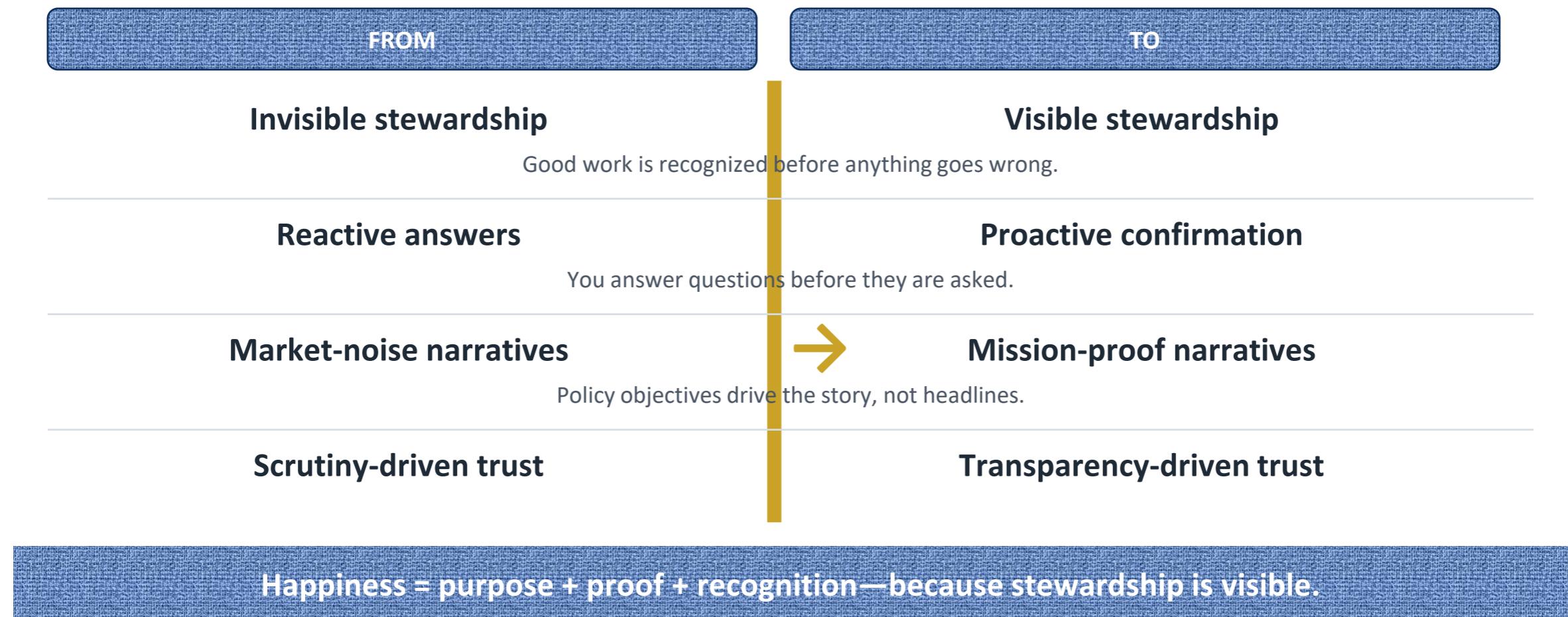
What this delivers

- Built from investment policy objectives—not market indices
- Proof of safeguarding, liquidity readiness, and reasonable book yield
- Clarity for boards, auditors, and the public

Stewardship is evaluated through suitability— so the benchmark must come from investment policy objectives.

Flipping the Dynamic

A Suitability Benchmark changes the PM's role from reactive defense to proactive stewardship—making purpose and performance visible.



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QUESTIONS?

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