

# 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*

# Fundamentals of Public Fund Investing

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## Performance Measurement vs Performance Evaluation

<i>(Describes results)</i>	<i>(Judges' appropriateness)</i>
<ul style="list-style-type: none"><li>❖ What happened</li><li>❖ Measured using indices<ul style="list-style-type: none"><li>* Market-based</li><li>* Policy-driven</li></ul></li><li>❖ Produces data and outcomes</li></ul>	<ul style="list-style-type: none"><li>❖ Was it appropriate</li><li>❖ Judged against responsibilities</li><li>❖ Uses Benchmark as standard</li><li>❖ For public funds - Stewardship</li></ul>

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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

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*“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*

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

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



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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

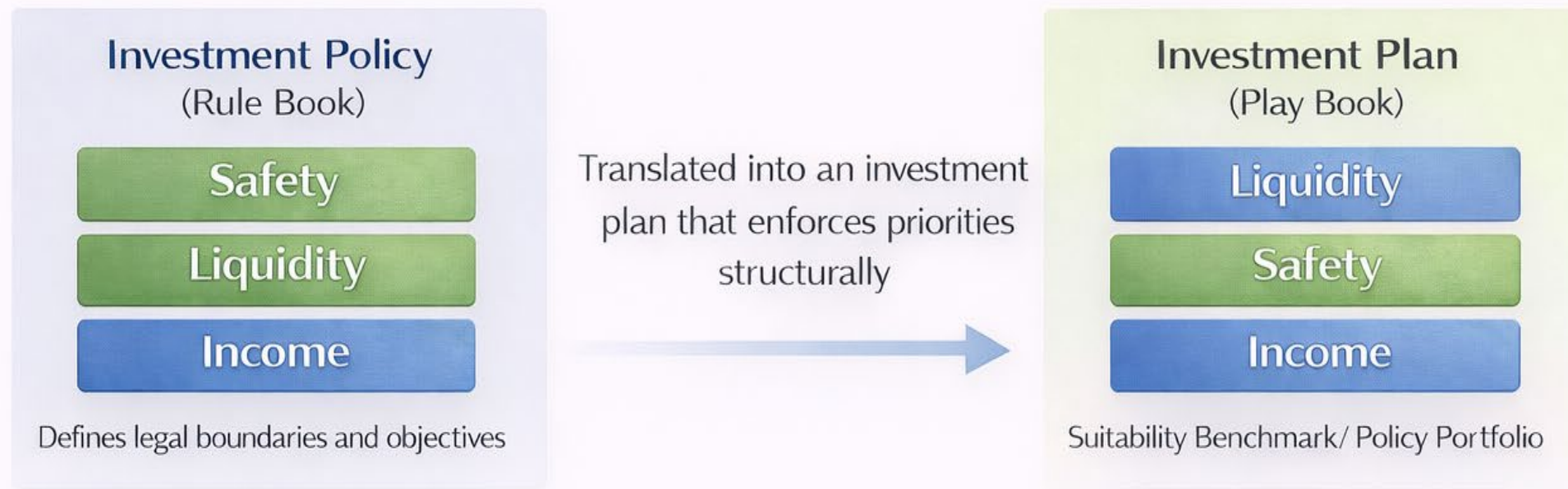
- Uses policy objectives, not market comparisons
- Evaluates all objectives, not just return
- Enforces sequence, not tradeoffs

### 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



## INTEREST RATE RISK

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

## REINVESTMENT RISK

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

## CREDIT RISK

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

**VS.**

### INCOME OPTIMIZATION

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

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

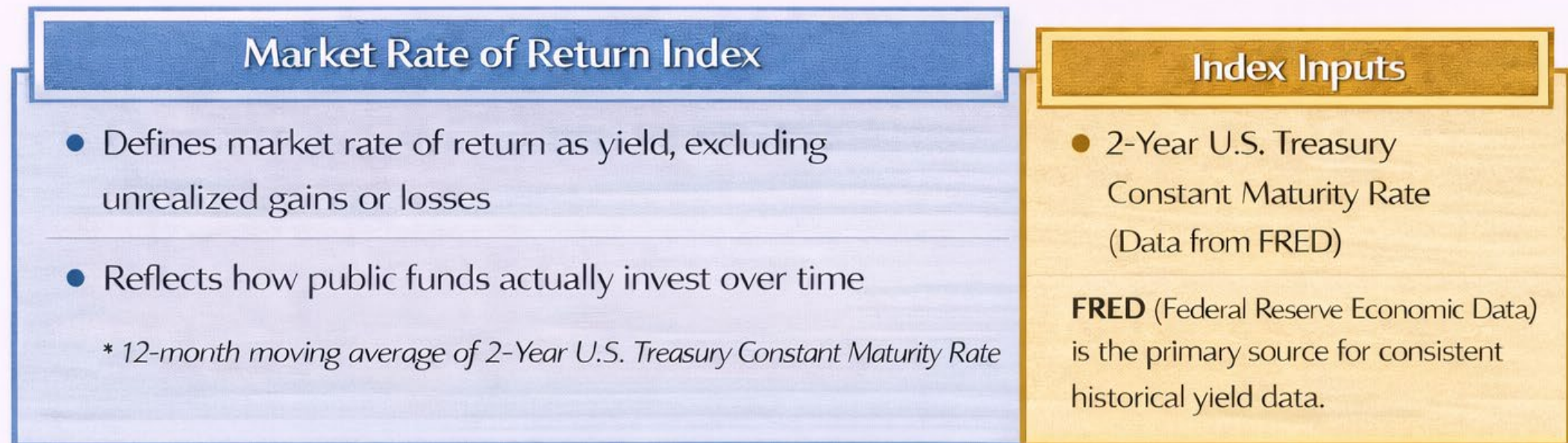
*This is a construction blueprint, not the security selection process.*

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.



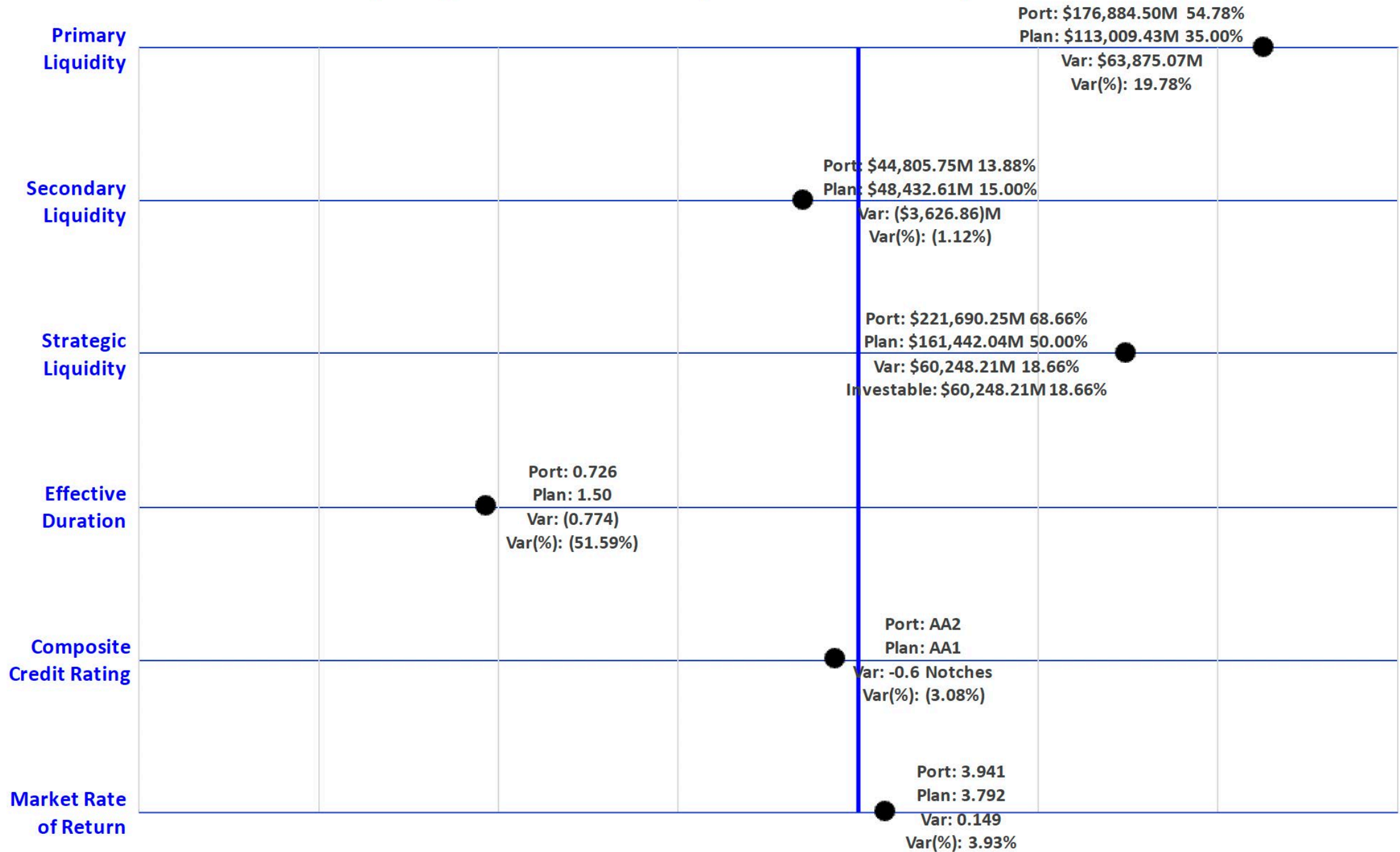
The Market Rate of Return Index provides market-based context for income, allowing the Suitability Benchmark to evaluate stewardship without confusing prudence with market timing.

## 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)



The analysis is provided for informational purposes and the accuracy is not guaranteed. Market prices are indications only and subject to change. Market values include accrued interest.

# Summary

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## 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  $\neq$  Evaluation
- Fiduciary obligation  $\neq$  Stewardship
  - Index  $\neq$  Benchmark

## What this delivers

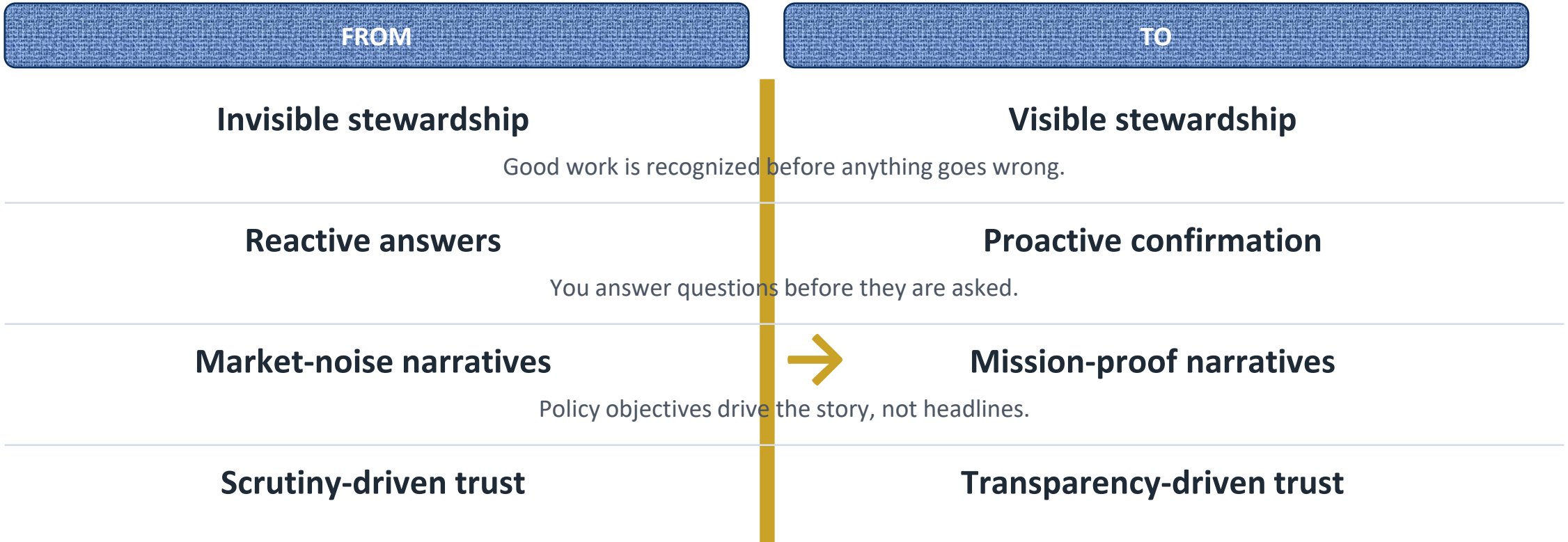
- Built from investment policy objectives—not market indices
- Proof of safeguarding, liquidity readiness, and reasonable book yield
- Clarity for boards, auditors, and the public

**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.



Happiness = purpose + proof + recognition—because stewardship is visible.

# DISCLOSURE

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# QUESTIONS?

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