Session One:
Portfolio Structure and Diversification

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Government Code and Policy Restrictions

Incorporating the three main tenets of California Government Code into the construction of a portfolio.

- Safety – The return of principal
  - Certainty that upon maturity all funds will be available for the agency
  - Create a process that evaluates the credit worthiness of each investment
- Liquidity – Ability to easily liquidate positions
  - Some securities are not as easy to liquidate as others
  - This is amplified during periods of market stress
- Return – Earn a yield that fairly compensates the agency for increased risk
  - Additional risk might not be worth the extra return
    - Risk can be viewed through several lenses, duration, credit, liquidity, structure, etc.

Portfolio Structure Considerations

Overall duration/benchmark considerations

- Economic view
- Interest Rate Forecasts

Portfolio Structure

- Laddered structure
  - Investment maturities evenly spaced out in the portfolio
    - Reduces need to sell securities
- Barbell structure
  - Portfolio consists of long and short maturity bonds
    - Requires selling to rebalance
- Cash flow directed structure
  - Ad hoc process

Specific sector maturities

- Even distribution of product maturities (when possible)

Best Practices

Have a complete, documented strategy that aligns with the risk tolerance and needs of the agency

- Strategy might be vastly different from approved investment policy
- Have a full understanding of liquidity needs and how they will be served

Concentration limitations and targets

- Specific product concentration limits (Ex. 25% Corporates)
- Specific name concentration limits (Ex. 2%)
- Cross product specific name concentration limits (Ex. 5%)

Distribution of products/specific names across the maturity spectrum

- Diversification of sectors, industries, ratings, specific names
- California Government Code allows for portfolios to become very concentrated

Valuation

- Valuation between sectors, specific names and maturities constantly change
- Portfolio allocations may shift as the market shifts

Disclosure

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Fixed Income investments are subject to interest, credit and market risk. Interest rate risk: the value of fixed income investments will decline as interest rates rise. Credit risk: the possibility that the borrower may not be able to repay interest and principal. Low rated bonds generally have to pay higher interest rates to attract investors willing to take on greater risk. Market risk: the bond market in general could decline due to economic conditions, especially during periods of rising interest rates.