



JUNE 5, 2023

# FUNDAMENTALS OF INVESTING

PRESENTED BY EILEEN STANIC, CTP®



MEEDER

1

## Today's Presenter



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2

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## Agenda



- State Statute and Investment Policy
- Permissible Investments
  - Depository Agreements
  - Ohio Pooled Collateral System
- Role of Service Providers
- Investment Strategy

3

3



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## State Statute & Investment Policy

4

## History of Ohio Investment Law



### 3 MAJOR EVENTS

- 1985-1986 OHIO SAVINGS & LOAN CRISIS
- 1990-1994 DERIVATIVES
- 1994 SAFE PROGRAM



### SENATE BILL 81 effective 9/27/96

5

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5

## Current Ohio Investment Laws



### ORC 135.14

- Cities, Villages, Townships, Schools, Libraries

### ORC 135.143

- State

### ORC 135.35

- Counties, Regional Transit Authorities or other agencies

### Charter City exception

- May elect to not follow state guidelines

6

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6

## Investment Objectives and Goals



LEGAL	Legal may not be suitable
SAFETY	Preservation of principal
LIQUIDITY	What are your liquidity needs?
YIELD	Does the investment have a competitive yield?




7

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7

## Investment Policy



	<b>Requirements</b>	Approved by the Treasurer or Governing Board Filed with the Auditor of State Signed-off by all Financial Institutions, Broker/Dealers and Investment Advisors
	<b>Limitations</b> if not filed with Auditor of State	Permitted investments restricted to bank deposits, Money market funds, STAR Ohio
	<b>Exceptions</b> when Investment Portfolio less than \$100,000	Treasurer or Governing Board certifies to Auditor of State will comply and is in compliance with Ohio Revised Code 135.01 through 135.21

8

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8

## Components of an Investment Policy



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Scope

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Statement of Objectives

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Ethics

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Authorized Investments

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Maximum Maturities

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Diversification

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Service Providers

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Reporting

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9

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9

## Internal Controls and Due Diligence



- Written Procedures to Select Financial Institutions
- Organizational Structures
  - Who performs specific investment functions?
- Training Programs
  - Does each employee receive annual training?
- Reconciliation & Monitoring
  - Do you reconcile outside investment reports to internal records?
- Reporting to Board or Council

Sound internal controls safeguard against theft and poor decision making

10

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10

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# Resources



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11

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11

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# Permissible Investments

12

## Yield Measures



Coupon Rate	Annual interest payment to be received
Current Yield	Yield based on market price and coupon rate
Yield at Cost or Yield to Maturity	Yield based on purchase price and coupon rate
Total Return	Return based on purchase price, coupon rate and unrealized gains or losses

13

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13

## Permissible Investments



- Bank Deposits
- US Treasuries
- US Government Agencies
- Municipal Notes and Bonds (additional training required)
- Commercial Paper (additional training required)
- Bankers Acceptances (additional training required)
- Repurchase Agreements
- Money Market Mutual Funds
- STAR Ohio
- Additional under ORC135.35
  - Corporate Notes and Bonds
  - Foreign Government Debt

14

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14

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## Bank Deposits



- Savings and money market savings accounts
- Certificates of deposit
  - Non-negotiable
  - Negotiable
- Requirements for protection
  - FDIC insurance
  - Collateral
- Depository agreement



15

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15

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## Depository Agreements



- Bank application to public entity for public depository designation
  - Submitted at least 30 days prior to accepting deposits
  - Specifies maximum amount of active, interim and inactive deposits for the depositor
    - Subject to maximum of 30% of bank's assets
    - Method of collateralization – specific or pooled
- Public entity awards public depository designation
  - Five year designation period
  - Permitted to add or remove depositories during the five year period if in the best interest of the entity

16

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16



## Ohio Pooled Collateral System



### Ohio Revised Code 135.182

- House Bill 64, House Bill 340 and House Bill 374
- Effective July 1, 2017
- Lien perfection required
- Bank must select one method of collateralization for all public depositors
- Ohio Pooled Collateral System (OPCS)
  - Treasurer of State sole regulator and monitor of program
  - Market value of collateral equal to or greater than
    - 102% of uninsured public deposits , or
    - Amount determined by rules adopted by Treasurer of State
  - Website access for reporting of collateral to public depositor

17

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17

## Government Insured Deposit Program



Rebranded STAR Plus program



Convenience of one account and one statement



All deposits are demand deposits and are 100% FDIC-insured



Up to \$25 million in deposits per legal entity



Next day liquidity



Daily transparency with 24/7 online access to account information



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18

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18

## Certificates of Deposit



### NEGOTIABLE CERTIFICATE OF DEPOSIT EXAMPLE

CUSIP	ISSUER	COUPON	MATURITY	PURCHASE PRICE	PAR VALUE	PRINCIPAL COST	YIELD AT COST
09582YAF9	Blue Ridge Bank	4.20%	02/28/2028	99.545	\$245,000	\$243,885.25	4.30%



**Full amount of principal and any accrued interest must be insured by federal deposit insurance**

19

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19

## Treasury Securities



- Full faith and credit of the U.S. government
- Structures and Terms
  - US Treasury bills – zero coupon, issued at a discount, mature 1 year or less
  - US Treasury notes or bonds – coupon bearing, semi-annual interest, terms 2, 3, 5, 7, 10, 20 or 30 years
  - Treasury inflation protected securities – coupon bearing, semi-annual interest, par adjusted for changes in inflation, terms of 5,10 or 30 years

### US TREASURY NOTE EXAMPLE

CUSIP	COUPON	MATURITY	PURCHASE PRICE	PAR VALUE	PRINCIPAL COST	YIELD AT COST
91282CFB2	2.75%	07/31/2027	95.1417698	\$125,000	\$116,098.63	4.44%

20

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20

## Government Agencies and Government Sponsored Enterprises



- Government agencies – backed by full faith and credit of U.S. government
  - Issuers include
    - GNMA – Government National Mortgage Association
- Government sponsored enterprises (GSE) – implied backing of U.S. government
  - Issuers include
    - FNMA – Federal National Mortgage Association
    - FHLMC – Federal Home Loan Mortgage Corporation
    - FFCB – Federal Farm Credit Bank
    - FHLB – Federal Home Loan Bank
    - AGN – Federal Agricultural Mortgage Corp
    - TVA – Tennessee Valley Authority
  - Structures and Terms
    - Discount notes – zero coupon, issued at a discount, mature 1 year or less
    - Notes and Bonds – fixed or variable coupons, callable or non-callable, terms 2 – 30 years

21

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## Government Sponsored Enterprises



### GOVERNMENT SPONSORED ENTERPRISE EXAMPLE

CUSIP	ISSUER	COUPON	MATURITY	PURCHASE PRICE	PAR VALUE	PRINCIPAL COST	YIELD AT COST
3133EMQGO	FFCB	0.32%	02/10/2025	90.265	\$125,000	\$112,831.25	4.93%

22

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22

## Municipal Securities



- General obligations of the State or political subdivisions of the State subject to the following:
  - 20% maximum of portfolio
  - Must be rated in three highest categories
  - Cannot be the sole owner of an entire issue
  - Maximum maturity of 10 years
- Must complete additional training approved by Treasurer of State

### MUNICIPAL BOND EXAMPLE

CUSIP	ISSUER	COUPON	MATURITY	PURCHASE PRICE	PAR VALUE	PRINCIPAL COST	YIELD AT COST	RATING Moody's S&P
1864427GS3	City of Cleveland	1.045%	01/01/2026	88.715	\$1,500,000	\$1,330,725	4.90%	Aa2 AA+

23

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23

## Commercial Paper



- Short term corporate debt subject to the following:
  - Maximum maturity of 270 days
  - Highest rating category from two rating agencies
  - 40% maximum of total portfolio
  - 5% maximum of total portfolio in any issuer at time of purchase
- Must complete additional training approved by Treasurer of State

### COMMERCIAL PAPER EXAMPLE

CUSIP	ISSUER	COUPON	MATURITY	PURCHASE PRICE	PAR VALUE	PRINCIPAL COST	YIELD AT COST	RATING Moody's S&P
62479MZV8	MUFG Bank Ltd.	n/a	12/29/2023	96.29636	\$3,594,000	\$3,460,891.21	5.47%	P-1 A-1

24

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24

## Bankers Acceptances



- Bank obligation subject to the following:
  - Maximum maturity of 180 days
  - Bank insured by FDIC
  - 40% maximum of total portfolio combined with commercial paper
- Must complete additional training approved by TOS

25

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## Repurchase Agreements



- Term loan with collateral in the form of securities
- Master Repurchase Agreement outlines procedures
- Reverse repo enables investment officer to leverage the portfolio – **PROHIBITED**

26

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26

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## Money Market Mutual Funds



- No-load fund
- Purchase through eligible institutions under ORC 135.03
- Fund's investments limited to
  - US Treasuries
  - Government agencies or Government Sponsored Enterprises
  - REPOS secured by the above
- Review Principal Investment Strategies in the Fund prospectus
  - Example from First American Funds
    - Government Obligations Fund invests exclusively in short-term U.S. government securities, including repurchase agreements secured by U.S. government securities.*
- Additional provisions under ORC 135.35
  - Fund may also invest in commercial paper
  - Fund rated in the highest category

27

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27

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## STAR Ohio



- AAAM rated by Standard and Poor's (highest)
- Similar to money market fund
- Daily interest income
- Daily liquidity (within guidelines)
- State administered



28

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28

## Corporate Securities



- Permitted under ORC 135.35
- Corporate debt subject to the following:
  - Maximum maturity of 3 years
    - Must be rated in three highest categories
  - 15% maximum of total average portfolio

### CORPORATE BOND EXAMPLE

CUSIP	ISSUER	COUPON	MATURITY	PURCHASE PRICE	PAR VALUE	PRINCIPAL COST	YIELD AT COST	RATING Moody's S&P
24422EWM	John Deere Capital Corporation	4.55%	10/11/2024	99.91	\$1,000,000	\$999,100.00	4.60%	A2 A

29

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29

## Foreign Government Debt



- Permitted under ORC 135.35
- Foreign government debt subject to the following:
  - Issued by foreign nations diplomatically recognized by US government
  - Backed by full faith and credit of that foreign nation
  - Interest and principal denominated and payable in US dollar
    - Must be rated in three highest categories
  - 2% maximum of total average portfolio

### FOREIGN GOVERNMENT DEBT EXAMPLE

CUSIP	ISSUER	COUPON	MATURITY	PURCHASE PRICE	PAR VALUE	PRINCIPAL COST	YIELD AT COST	RATING Moody's S&P
46514AMB2	State of Israel	3.67%	02/01/2024	100	3,000,000	3,000,000.00	3.67%	A-1 AA-

30

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30



# Role of Service Providers

31

31

## Who Will Help You Invest?



KNOW THE TYPES OF SERVICE PROVIDERS			
STAR OHIO	BANKS	INVESTMENT ADVISORS	BROKERS
STAR Ohio • Know the investments of STAR Ohio • Look over the annual report	• Make sure they understand nuances of public entities • Work with banks you know and trust	• Acts as a fiduciary in the client's best interest • Who do they work with? • What are their credentials? • Check them out: <a href="http://www.investor.gov">www.investor.gov</a>	• Recommends suitable investments • Who do they work with? • What do they do and how much do they charge? • Check them out: <a href="http://www.finra.org">www.finra.org</a>
PERFORM THE DUE DILIGENCE BEFORE INVESTING			

32

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32



## Suitability vs. Fiduciary



“People may confuse the terms suitability and fiduciary. Both seek to protect the investor from foreseeable harm or excessive risk. However, the standards of investor care are different. An investment fiduciary is any person who has the legal responsibility for managing someone else’s money. Investment advisors, who are usually fee-based, are bound to fiduciary standards. Broker-dealers, customarily compensated by commission, generally have to fulfill only a suitability obligation.”

33

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33

## Safekeeping Options



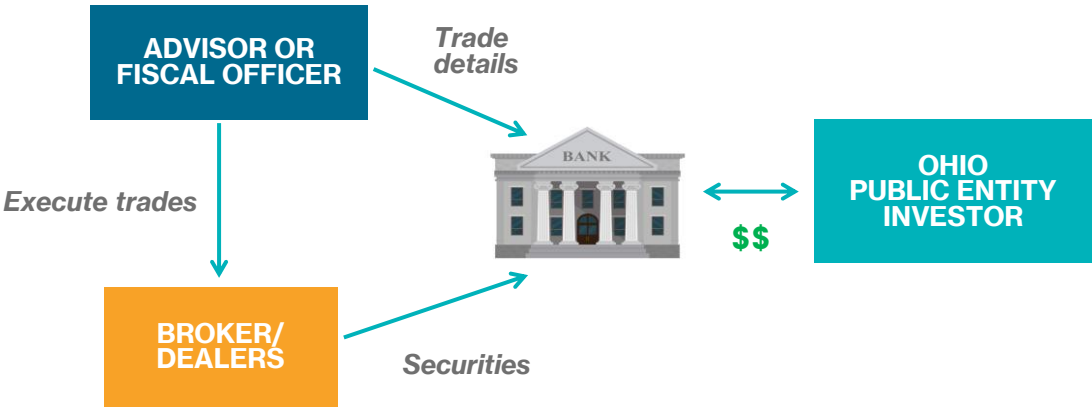
THIRD PARTY CUSTODIAN	BROKER OR BANK ACTING AS BROKER
<ul style="list-style-type: none"><li>• Independent of the security transaction</li><li>• Securities held in public entity’s account at bank trust department</li><li>• Public entity controls account</li><li>• Securities held in public entity’s name</li><li>• Written custodial agreement</li><li>• <b>Best practice</b></li></ul>	<ul style="list-style-type: none"><li>• Executes the security transaction</li><li>• Securities held in brokerage account</li><li>• Broker controls account</li><li>• Securities not held in public entity’s name</li><li>• Safekeeping cost bundled with other services</li></ul>

34

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# Third Party Custodian



35

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# Investment Strategy

36

36

## Factors to Consider



37

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37

## How You Pay for Bank Services

**The choice of the methodology is yours**

The two methods hinge on current rates – **You pay either way!**

### Compensating Balance Basis



- Traditional for public entities and hides the fees
- You leave money in bank which earns \$\$ at ECR and pays the service bill
- You never see the charge – it looks “free”

### Fee Basis



- You pay the fees for the service by debit to the account

38

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38

## Your Decision MUST Hinge on Rates



### Always compare your ECR to outside investment options

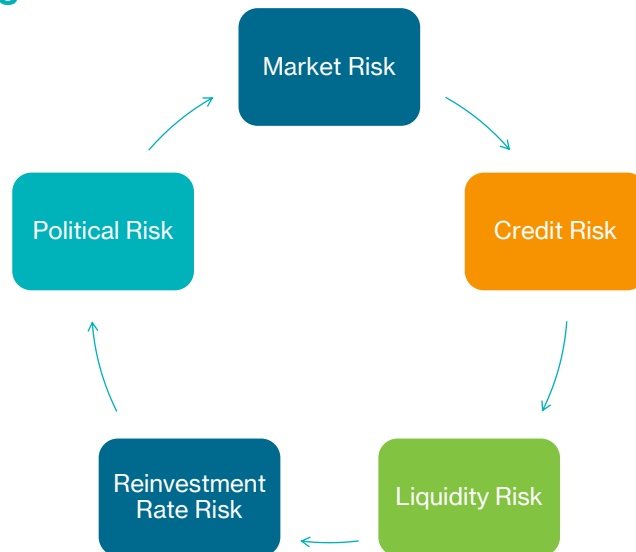
A <b>0.40% ECR</b> on \$10 million balance will generate \$3,333/month	If investment rates give you <b>3.00%</b> the same balance generates \$25,000/month	Invest the funds, pay \$3,333 directly and <b>keep \$21,667/mo (\$260,004/yr)</b>
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39

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39

## Risks of Investing

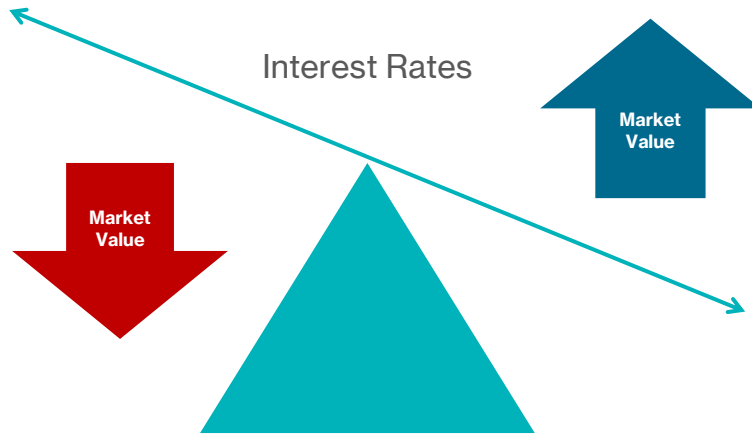


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## Market Values

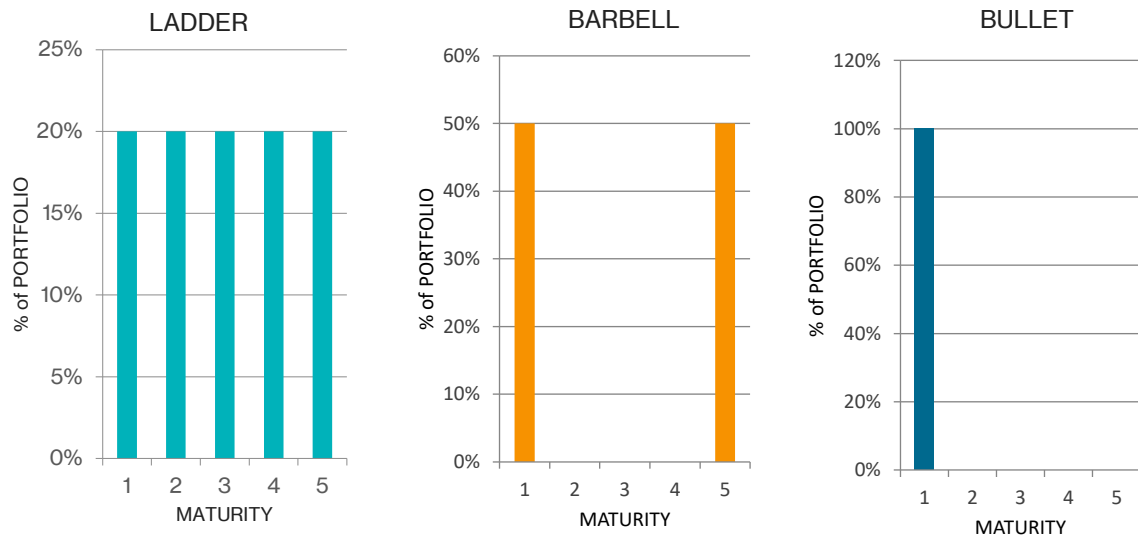


41

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## Maturity Distribution

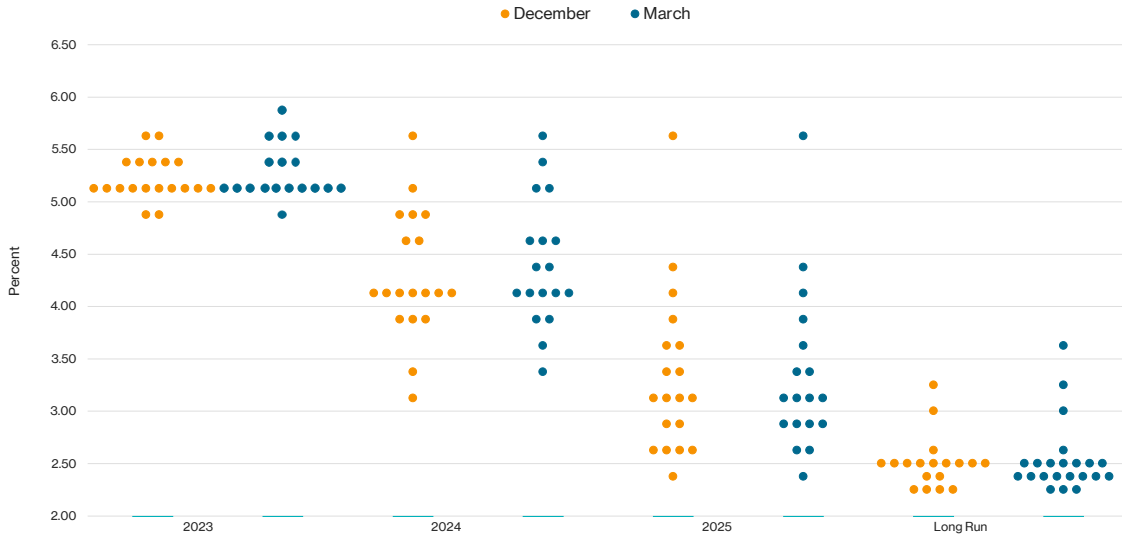


42

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## Federal Reserve Dot Plot Comparison



SOURCE: BLOOMBERG

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## Summary

- Ask questions
- Know the details
- Protect yourself – follow the law
- Seek help when appropriate
- **ULTIMATELY IT IS YOUR RESPONSIBILITY!**

44

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44

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## Questions



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45

45

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46

46

