

Play ball!

National pastime gives us some portfolio management guidance.

By Jim Reber, ICBA Securities

As we're getting into the warmer months, it's reassuring that baseball season is well underway. Your correspondent confesses a deep and abiding passion for the sport. While I've been only partially successful in getting my wife engaged in watching live baseball, she has gamely accompanied me to over two dozen major league stadiums. Nothing says "springtime" to me quite like the crack of a wooden bat on horsehide, and the roar of a crowd. Might I add a beer and a hot dog?

It occurs to me that with a little thought there may be some parallels between our national pastime and community banking. Follow along as we see what lessons we might glean from the grand old game. And don't buy what Yogi Berra asked: "Who can think and play baseball at the same time?"

Bunt

This strategy is something of a lost art in this era of home run hysteria. It's intentionally tapping a pitch very softly in front of the plate in hopes of reaching base safely before the defense can react. The ball doesn't travel very far, but it can be very effective. For a portfolio manager in 2024, it can mean a money-market instrument that matures in less than a year. Lately, three-month t-bills out-yield everything on the treasury curve, including the 30-year bond.

Double

The ultimate goal of bond portfolio managers. I've had many astute bankers tell me that they're not trying to maximize yield from their securities collection. They'd much rather have great liquidity and modest price volatility, and they'll leave the riskiness to the loan portfolio. A two-base hit automatically puts the portfolio in scoring position.

Relief pitcher

When the starting pitcher is beginning to tire out (which these days is more like the fifth inning versus the

eighth), a quick fix can often be found by bringing in a fresh arm from the bullpen. For a community bank's balance sheet which suddenly has some interest rate exposure, whether due to a shock in rates, a surge in certain types of credit products, or a shift in deposit makeup, a quick fix can often be found by executing an interest rate swap. A bank can efficiently increase or decrease rate sensitivity as needed, on virtually any segment of the balance sheet.

Umpire

The Federal Reserve. The various branches and broad powers of our central bank can in some ways dictate the tenor and the flow of the whole financial services industry. As a regulator, it acts as the arbiter of balls and strikes, whether a batted ball is foul or fair, and whether a baserunner is safe or out. As the setter of monetary policy, it determines the ground rules that govern play.

Stolen base

This is akin to a tax swap. A runner advancing one base after the pitcher begins his delivery puts the player 90 feet closer to scoring a run, assuming he beats the throw from the catcher. A tax swap is a strategy in which an investor sells a bond, any bond, at a loss, and reinvests the proceeds into a tax-free muni. The loss on sale is recorded at the net-of-tax number; the earnings on the new bond are 100% tax free. This built-in head start helps to advance your earnings closer to home plate. Even better: while "stolen" has a pejorative tone, a tax swap is totally within the rules of the game.

Squeeze play

This combines several of the tactics already mentioned in this column. The batter will attempt a bunt simultaneously with a runner attempting a steal of home. If the ball is successfully put in play by the hitter, the run scores, and hitter is credited with a run batted in. For a community bank, its corollary is a leverage transaction. An institution with adequate capital can purchase assets simultaneously with adding the related debt that result in higher earnings, an acceptable risk profile, and improved return on equity. Just like baseball's squeeze play, a lot of care must be exercised to improve the chances of this strategy having an ideal outcome. And finally...

The long ball

This is not a recommendation! The long ball, a.k.a. the home run, is the single most game-changing play in the sport. Home runs win games, home run hitters are revered, and home run kings have fat contracts. Lost in the glory is that many of the long ball hitters strike out frequently. If a community bank

wants to ramp up its returns by increasing its risk, either by buying long durations, uncertain cash flows, or marginal credit quality, it can expect some swings-and-misses. As Ernest Lawrence Thayer wrote back in 1888: "...there is no joy in Mudville—mighty Casey has struck out."

Batter up!

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Jim Reber (jreber@icbasecurities.com) is president and CEO of ICBA Securities, ICBA's institutional, fixed-income broker-dealer for community banks.

Virtual bond school

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