



Investing Made Simple

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“Investing” is a word that often stirs up visions of complicated processes. It’s a topic that is typically associated with uncertainty, risk and stress. But the truth is, smart investing is quite simple. When you’re confident your AL model provides measurement of true interest rate risk, how to keep investments within risk tolerance guidelines becomes clear. When you’ve run the what-if scenarios and analyses needed to show how your credit union will perform under varying market conditions, you have the data you need to invest wisely in both good and bad times. When you set performance benchmarks specifically tailored to your credit union’s unique needs and goals and follow those guideposts, investment decision-making is straightforward.

During my recent review of investment articles hailed as the best of 2018, I came across a piece in the October 28th issue of Forbes Magazine that addressed this very topic. The article, [Why Investing is Simple, But Not Easy](#), by financial planner and Forbes contributor Erik Carter, was intended as advice for individuals investing in the equity markets, but the concept espoused by Carter is highly relevant to individual credit unions as well. Investing members’ funds doesn’t have to be complicated or stressful. Investment decisions can be simple if appropriate performance and risk-tolerance benchmarks are well researched, set, and followed.

As Carter notes, professional investors rarely outperform the market (the presumed benchmark for an equity investor). And as we all know, those pros can’t “time” the market either. Determining the best investment entry and exit points is often just educated guesswork. Trying to time a shift in asset allocation in an effort to beat the market is more often than not, a shot in the dark. High-performing managers come and go and market-beating strategies appear and disappear. In essence, trying to predict which new strategy or which new expert will outwit the market is a fool’s exercise. But as Carter goes on to say, following three simple rules can help. If we are to be successful investors of our members’ funds, following these three rules makes a whole lot of sense for credit unions as well as individual investors. Carter suggests that any investor do three simple things:

1. Connect asset allocation to risk tolerance
2. Minimize costs
3. Stick to your plan

Let’s begin with the first point: Connecting assets to risk tolerance. The author speaks to a target date for funds to come back to the investor. For credit unions, this means building performance benchmarks based on what the balance sheet requires. Our funds come from our members, and our members expect to receive their funds back in the future. Some of those funds have been lent to other members. The remainder, our investment portfolio, must work in tandem with the limits put in place by our depositor members and the commitments we have made to our borrowing members. Once we bring these limits into sharp focus with well-devised performance and risk-tolerance benchmarks, we know how to invest because we know our parameters. What we can and can’t do to achieve our goals becomes crystal clear, which in turn, makes investment decision-making much simpler. For more information about appropriate benchmarking and liability-based investing, please see the articles [here](#).

Carter’s second point, which is to minimize costs, is a little trickier. Credit unions investing in fixed-income markets and fixed-income instruments encounter costs that are less transparent. Fixed-income securities do not include disclosed commissions like equities. Rather, commissions are presented after the dealer firm marks up the bond. How much that mark-up is, is rarely seen by the buyer. Many buyers have ended up paying top-tier bond prices *plus* top-tier mark-ups. However, there are two red flags that should steer you away from a



particular fixed-income security. If the security is illiquid, or if the bond comes with a story as to why it will outperform other securities, it's more likely than not that the security has a higher mark-up than you would like. While these red flags are not guaranteed predictors of high mark-ups, most times their heads-up warnings will hold true. We suggest credit unions stick to simple, understandable cash flows. You can't minimize costs if you don't know what they are.

Finally, Carter tells us: Stick to the plan. For credit unions, that means once we've developed income and risk-tolerance benchmarks tailored to our specific credit union's needs and desires, the plan has been put in place. Strategizing to achieve performance goals relative to our individual benchmarks is how we credit unions stick to the game plan. It's how we can play the investment game and win. But it's also important to remember the words of boxing great Mike Tyson: "Everyone has a plan until they get punched in the mouth." Benchmarks are built from current balance sheet structure and current market conditions. Both are highly changeable factors as are your credit union's loan payback rate, the value of loans outstanding and the value of deposits-on-hand. The shape-shifting yield curve is a game-changer too. Therefore, any and all investment plans should be reviewed from time to time. Each significant change in conditions will trigger a change in balance sheet requirements and the plan forward should be adjusted accordingly. If what-if scenarios were run during the planning process, there will be no need to panic, as viable options will be at the investment manager's fingertips.

Which brings me to one last note: Building effective performance and risk-tolerance benchmarks takes time, state-of-the-art technology and trained analysts who can accurately interpret data, effectively strategize, create solid plan options and expertly set the appropriate plan(s) into motion. If a credit union does not have the resources to develop appropriate and effective benchmarks, an investment in outsourcing for those services is recommended.

January is a great time to review historical performance data to help determine future performance plans. The plan for the investment portfolio should be high on that list of reviews. It's the strength, flexibility, and resiliency of the plan you make now that will make investment decisions in the future quite simple.

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