CMTA Annual Conference

Credit Analysis for Public Investors

County of San Diego Treasurer-Tax Collector  |  1600 Pacific Hwy, San Diego, CA 92101  |  www.sdttc.com

April 26, 2017
TODAY’S AGENDA

- Intro to the San Diego County Investment Pool
- Credit Risk Can Improve Returns
- Credit Analysis Process
- Risk Management Recommendations
- Questions
SAN DIEGO COUNTY INVESTMENT POOL

• Created in 1853
• Invests the funds of the County, 42 K-12 school districts, 5 community colleges, and over 160 other public agencies
• Assets under management range from $7 to $10 billion during the year due to seasonality of tax collections
• Locally managed by full-time, in-house investment team
• AAA rated for the last 18 years
  - Indicates extremely strong protection against losses and credit defaults and low sensitivity to changing market conditions.
San Diego County Pooled Money Fund

- County Funds: 41.03%
- Schools: 41.12%
- Community Colleges: 10.11%
- Non County Funds: 1.97%
- Voluntary Depositors: 5.77%

*As of March 31, 2017

Source: County of San Diego Treasurer-Tax Collector
On April 27, 2016, the Pool reached a new record high balance of $10.1 billion

Growth due to the addition of new participants, bond proceeds, increased tax collections, and increasing confidence in the Pool

Pool Balance (USD: billions)

Source: County of San Diego Treasurer-Tax Collector
POOL DIVERSIFICATION

*As of March 31, 2017

- Limiting the pool’s exposure to each type of security helps meet liquidity needs and lowers the level of risk

Pool Asset Allocation

- Federal Agency 27.98%
- Commercial Paper 22.36%
- Supranational 5.59%
- Treasury Notes 9.76%
- FDIC CDs 0.62%
- Asset Backed Securities 1.89%
- Money Market 3.39%
- Negotiable CDs 28.41%

Source: County of San Diego Treasurer-Tax Collector
POOL DIVERSIFICATION

*As of March 31, 2017

- Limiting the pool’s exposure to each type of security helps meet liquidity needs and lowers the level of risk

**Pool Asset Allocation**

Source: County of San Diego Treasurer-Tax Collector
CREDIT RISK CAN IMPROVE RETURNS

- Even when focusing on highest-quality names, taking on a small amount of credit risk for short-duration investments can add to returns
- Higher yield vs. comparable alternatives with daily liquidity and low fees

**12-Month Historical Returns**

**Comparable Investment Alternatives**

![Graph showing historical returns and comparable investments](image-url)

As of 3/31/2017
CREDIT ANALYSIS PROCESS

Market & Sector Analysis

Issuer Identification

Issuer Approval

Credit Research

Ongoing Monitoring
MARKET & SECTOR ANALYSIS

• Important to stay abreast of trends affecting the markets overall
  • Treasury yields stabilized and have recently rallied following Trump sell-off
    • Market expects Fed to raise rates 1-2 more times in 2017
  • U.S. equities off to a strong start on optimism over Trump’s economic policies
    • Expect market volatility driven by rising interest rates and geopolitics
  • LIBOR affected by supply/demand trends (e.g., money market reform)

• Sector-specific issues must be considered as well
  • For financials, widespread optimism based on expectations for looser regulations and higher interest rates may be overdone
  • For autos, sales have stagnated and used cars are flooding the market

• Search for opportunities along the curve
  • Yield pickup greater for move from 6-month to 9-month term than for overnight to 3-month
  • Monitor spreads to alternative investment options such as repo, discount notes, money market funds, Treasuries, Agencies
ISSUER IDENTIFICATION

- Once sectors are chosen, identify issuers to research for potential investment
  - Minimum LT rating of ‘A’ and ST rating of ‘A-1/P-1/F1’
    - COSD requires same ratings for ultimate parent of ABS issuers
    - U.S.-domiciled and non-4(a)(2) programs
  - Recommend beginning with large, domestic, frequent issuers
    - Securities will have the most liquidity
    - Familiarity with name should help during initial credit research process and when seeking approval from relevant managers/officials
      - Especially with financials, agency may already purchase other securities issued by entity or have broker or banking relationships
CREDIT RESEARCH

- Fundamental research is both an art and a science
  - Most analysts will develop a process and favored metrics over time
  - Data can be obtained from earnings releases, company presentations, etc., if not from a provider (e.g., Bloomberg)

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<th>Estado</th>
<th>OCBC</th>
<th>WF</th>
<th>Westpac</th>
<th>Nordea</th>
<th>TD</th>
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</thead>
<tbody>
<tr>
<td>Net interest margin</td>
<td>3.23%</td>
<td>1.76%</td>
<td>2.85%</td>
<td>2.05%</td>
<td>0.98%</td>
<td>2.01%</td>
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<td>Efficiency ratio</td>
<td>66.37%</td>
<td>44.42%</td>
<td>58.54%</td>
<td>43.98%</td>
<td>48.90%</td>
<td>62.19%</td>
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<tr>
<td>Loans to deposits</td>
<td>93.22%</td>
<td>84.36%</td>
<td>76.11%</td>
<td>129.66%</td>
<td>176.99%</td>
<td>69.08%</td>
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<tr>
<td>NPA/assets</td>
<td>2.00%</td>
<td>0.66%</td>
<td>0.59%</td>
<td>0.26%</td>
<td>0.90%</td>
<td>0.30%</td>
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<tr>
<td>ROE</td>
<td>10.64%</td>
<td>10.64%</td>
<td>11.79%</td>
<td>13.39%</td>
<td>11.87%</td>
<td>13.26%</td>
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<td>Tier 1 capital ratio</td>
<td>7.10%</td>
<td>15.60%</td>
<td>12.60%</td>
<td>11.20%</td>
<td>20.70%</td>
<td>12.20%</td>
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As of 9/30/2016

- Important to look at *trends* in numbers, not just a snapshot in time
  - Revenue/sales & profitability over time, loan growth, leverage ratios, market share, foreign exposure, **liquidity/coverage**
  - Ratings agency reports can provide additional insights and data analysis

- Set maximum maturities for each name based on credit quality tiers
## CREDIT ANALYSIS PROCESS

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<th>Step</th>
<th>Details</th>
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| Market & Sector Analysis | • Economic and market analysis  
• Identification of yield curve opportunities  
• Potential industry and/or legislative issues |
| Issuer Identification | • Insure compliance with California Government Code and Investment Policy  
• Begin with more familiar, higher-quality names |
| Credit Research | • Fundamental analysis of each issuer’s credit quality  
• Determine maximum maturity tier based on risk tolerance |
| Issuer Approval | • Presentation at weekly investment strategy meeting  
• Consensus for addition to approved list and max. maturity |
| Ongoing Monitoring | • Quarterly earnings reports, rating agency updates/changes  
• Monitor news, equity performance, CDS, etc. |
RISK MANAGEMENT RECOMMENDATIONS

• Focus first on assets of high credit quality from familiar names
  • Minimum ‘A’ LT and ‘A-1’ ST ratings
• IPS & Government Code limits on asset classes/concentration
  • CP: 40% of portfolio / 5% each issuer; max. maturity 270 days
  • CDs: 30% of portfolio / 5% each issuer
  • ABS: 20% of portfolio / 5% each issuer
• Begin with shorter-term investments (e.g., up to 3 months) until comfort level develops
• Ongoing credit monitoring is essential

COSD currently tries to maximize use of CP and CDs for investments of less than 1 year (minimum 50% of portfolio) due to incremental yield opportunities relative to other asset classes
QUESTIONS?
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