



Is Now the Time to Increase the Risk in your Investment Portfolio?

The answer is yes, maybe and no.

Now how can that be the answer to the question? Interest rates appear stable, corporate fundamentals are improving, and time has allowed us to forget the most recent credit crisis. You would think the answer should be yes. But, the reason I would not say an immediate yes is the answer depends on the real question and the true goals.

If the reasoning is, “I am really sick and tired of these yield levels, so maybe if I add risk, I can pick up some incremental yield;” then the answer is no. If the reasoning is “we shifted to cash during the credit crisis, we do not require immediate liquidity and have been waiting to jump back in”; then the answer is an absolute yes. Finally if the thinking is “we have the ability to take on more risk per our guidelines, we are a little nervous about adding credit, but, we are concerned about interest rate increases;” then the answer is maybe.

My guess is that if you fall into a bucket, it is the maybe bucket, but chances are it is not so clear-cut. Now, though, is the time to figure out which bucket you belong and make the appropriate decision.

My recommendation is that it is critical to stay true to your investment policy. You worked hard on this document and it should be aligned with the spirit and goals of your company. Many investors removed credit or fled to money market instruments but still maintained the same investment policy. Now is the time to explore removing those temporary bans. If you feel the investment policy no longer accurately reflects the goals and objectives of your corporation, spend time to update the policy.



Meet with your investment manager and ask some important questions. A good investment manager will help you with all of the answers to the following questions, so ask. Remember the manager takes cues from you so give them the opportunity to walk you through the pros and cons of each alternative. Some real money can be left on the table, so, it's critical to take the time to make, the right decision for your corporation, this is not a one size fits all solution.

Here are some questions to pose to your investment managers

Given that rates have been so low for so long, is now the time to increase my interest rate exposure?

Whenever you are looking at a positively sloped yield curve, you must always ask this question. Identify your company's needs. Can you bifurcate a portion of the investment portfolio to take on more interest rate exposure in a portion of the portfolio? Do you need so much liquidity? An informal poll of corporate cash managers found that almost all the managers had a very similar interest rate outlook. . They believe the Federal Reserve will hold rates steady until 2012. All believe the economy to be showing few signs of inflation with both housing and unemployment still remaining a concern. Now might be the time to consider shifting out of money funds or bank deposits, or wherever you have cash sitting.

Another benefit of increasing duration in the investment portfolio is diversification. The investment manager will have an expanded universe that is not money market eligible. With less demand comes an increase in yield. If you are nervous still about an increase in rates, then ask your manager to provide you with a stress test. This will provide you a scenario should interest rates suddenly shift. With the Federal Reserve projected to be on hold for at least the balance of the year, combined with a positive carry, if you have the risk appetite it makes sense to consider moving cash slightly further out on the curve. If you expect rates to increase a good hedge against rising rates is corporate credit. That thought brings me to the next question.

Should we increase our corporate credit exposure?

Yes, a case can be made for adding or increasing a weight to corporate credits. Again, another informal poll of corporate cash managers showed most managers with the ability to use corporate credit in portfolios, are using their maximum allowed exposure. All feel that corporations have healthier balance sheets, most are building cash and in general are poised to perform well. All of these factors are positive for the corporate



bond buyer. You might even want to consider adding BBB credits. How about that for adding risk?

In addition to a yield advantage, the sector diversification improves. For example the portfolio with an A or better restriction would have a higher percentage in Bank and Finance sectors, than a portfolio that could purchase BBB issues, this portfolio has more opportunity to expand into the Utility or Industrial sectors for example. To make this move you do need to feel confident that your investment manager has the expertise to manage the default risk.

Finally, is now the time to jump back into the ABS market?

Wow, this could be scary. Most corporate cash portfolios have banned any form of ABS. Who could blame someone for this? A case can be made for adding non-mortgage ABS issues, such as credit card ABS. Again, here you need to be comfortable that the manager has the proper due diligence process in place. However, given the lack of supply in the market and the negative stigma attached still to this market, if you have limited “chits”, I would recommend using them elsewhere.

So, the short answer to what appears to be a simple question is yes. Fundamentals and current opinion support adding some interest rate exposure, continuing to purchase high quality corporate issues, and yes even considering the dreaded ABS issues. However, this is not a simple question, and you need to do what is best for your corporation’s situation.

If you are sitting on sidelines, now is the time to jump in, or get your toes wet. If you have already made the dive, good for you, you have done well, stay there. Stick to your investment policy, don’t reinvent something simply because yields are low. If need be, think about changing your investment policy.

Decide the best way to use your risk budget, there are several great options.



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