By the end of the next month, the Federal Open Markets Committee of the Federal Reserve Board is expected to hike Fed funds to around 3.25 percent. In one 12-month period, that would represent an over 200-basis-point rise. While 300-basis-point hikes in Fed funds during an overall tightening cycle are not uncommon (it happened twice in a seven-year period in the 1980s and 1990s), the last tightening cycle (in 1999 and 2000) saw only a 200-basis-point hike.

Further, as we are a full year into this rate-rising scenario, it would appear that a major portion of the normal time frame required for the Fed to implement a full tightening cycle is behind us. (Rate hike durations of over 18 months are fairly unusual.)

The purpose of this trip down memory lane is to make a case that this tightening scenario is getting fairly long in the tooth, from either of two standpoints: absolute increase in Fed funds, or time elapsed since the first tightening.

A natural assumption one would make given this set of circumstances is that portfolio yields have risen since Fed funds began their ascent. It would appear that one would be correct, but just barely. Using the roughly 500 banks that use Vining Sparks for their bond accounting services as a proxy, portfolio management

Forecasting Earnings

When are your bank portfolio’s yields going to rise?

Tools Needed

I CBA Securities will need the following investment portfolio information to provide you with the Yield Forecaster:
- CUSIP
- FASB 115 Status (AFS/HTM)
- Purchase Date (mm/dd/yy) (optional)
- Purchase Price (optional)
- Original Face
- Current Par
- Book Price
- Book Value
- Book Yield
- Book Date (mm/dd/yy)

Typically, the Security Inventory Report from most bond accounting services will contain most of this data.
portfolio yields.

Now, however, as higher Fed funds rates are producing improved yields over the entire yield curve, currently available yields are reaching levels not seen since mid-2002. ICBA Securities has developed a model that can provide valuable help to a portfolio manager in forecasting future portfolio yields.

**Spreadsheet Salvation**

The Yield Forecaster is a software report system available through ICBA Securities that is specifically designed to quantify future yields, taking into account today’s portfolio (CUSIP by CUSIP) and providing the manager the ability to input his or her own expectations of future reinvestment yields, as well as expected additions or deleotions to the portfolio. The system’s reports also account for amortizing securities based on consensus prepayment estimates. The reports display each successive month’s expected yield, over the next 27 months.

The Yield Forecaster can be used in a number of ways. The most obvious application is for income planning and budgeting. The portfolio’s monthly and annual incomes can be projected using assumed paydowns and reinvestment rates to give monthly and annual portfolio yields and income. The system can also be used to develop “break-even” reinvestment rates.

In other words, as reinvestment rates can be adjusted up or down, one can reliably estimate the required yield of each month’s investments required to keep overall yield stable. In so doing, the manager can determine if a given purchase would cause a rise or fall in expected end-of-period yields.

### How it Works

The Yield Forecaster uses the individual book yields and the individual cash flows for each se-
curity to determine future months’ projected book yield. As individual bonds roll off (via prepayment, maturity or call), the model will remove the income associated with that pay down from the weighted average book yield for that month and replace it with the new reinvestment rate. ICBA Securities will calculate the monthly cash flows for each security in the base case, up 1 percent and down 1 percent scenarios for your portfolio. The user will also be able to determine the duration of the reinvestment for future cash flows.

This can be helpful for institutions that project that the nature of their reinvestment will change over time. For example, in the current rate environment, many institutions maintain a shorter duration and lower investment yield in anticipation of rising rates. In that case, the Yield Forecaster gives them the ability to assume a lower reinvestment rate and shorter duration over the next, say, six to 12 months and, thereafter, use a higher reinvestment rate coupled with a longer duration.

Jim Reber is the newly elected president and CEO of ICBA Securities, a broker-dealer in Memphis and a member of NASD and SIPC. Reach him at jreber@icbasecurities.com.