For my latest high-wire act—writing an article on community bank investments that is timely, interesting and original—I thought it high time to try out some poetry. Valentine’s Day may have been my inspiration, but it’s also a good time to brush up on the state of the fixed-income market and revisit investment techniques that may work well if the economy continues to repair itself.

First, an entry about the seminal event of Sept. 7, 2008, that set the current banking situation in motion:

Sister Fannie and Brother Fred
Let debt-gorging go
to their head.
Hank Paulson said, “Whoa,
The stockholders must go!”
And Uncle Sam’s face
is now red.

As of this writing, you and I, via the U.S. Treasury, own $112 billion in Fannie Mae and Freddie Mac preferred stock. God bless us, every one!

Turning now to the subject of interest rates, I don’t think it’s a stretch to opine that the next long-term move will be upward. It is indeed a tough call for bank investment-portfolio managers who want to stay short to take advantage of what they expect to be higher yields soon. The difficulty lies in the fact that money-market yields are well below 50 basis points. Perhaps it’s time to ride the yield curve with bullet agencies:

“Whither bond yields?”
is the question du moment
If the Fed's stimu-plans do inflation foment.
Recall when faced with a curve that is steep,
Noncallable bonds help their value to keep.

Of course, the Federal Reserve has weighed in as well with its quantitative easing strategy. As of the end of December, the Fed had purchased a whopping $1.1 trillion in agency mortgage-backed securities (MBS). This has had the intended effect of pushing down home-mortgage rates, but it has also increased MBS prices and therefore premium risk. Some selective purchasing can insulate an investor from this problem. I feel a haiku or three coming on:

Does prepayment risk
Increase as mortgage rates fall?
Maybe, maybe not.

Depends on factors
Such as WALA and gross WAC
And LTVs, too.

So make it a point
To view your yields in a range
Of prepayment speeds.
This brings us back to the state of community banking. While there are pockets of bank profitability across the country, the industry is probably in for a year or more of below-long-term-average results. A lot of this is due to factors that we all know, mainly depressed asset values and declining borrower solvency.

Some rays of hope are visible, including the beginning of the reemergence of the capital markets and the (finally) improving residential-housing prices. Still, the mood of many ICBA members may be summed up by the following (with apologies to Ernest Lawrence Thayer):

Oh, somewhere in our hallowed trade, the loans are paid on time;

Cheap deposits come from heaven, the customers all prime,

Examiners invisible, the staff is tops, bar none,

But there'll be no joy on Main Street till the ROAs top one.

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