

Don't Be At A Loss

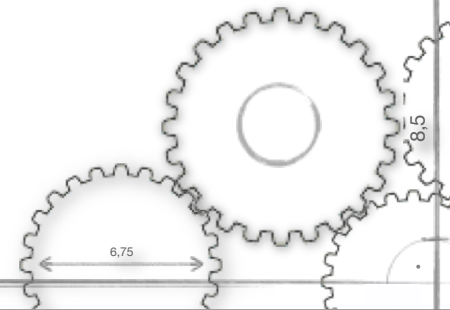
Managing The Discussion Around Portfolio Losses

2018 CACTTC Annual Conference

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The easy part of public fund investing is buying bonds.

The hard part of public fund investing is explaining why!

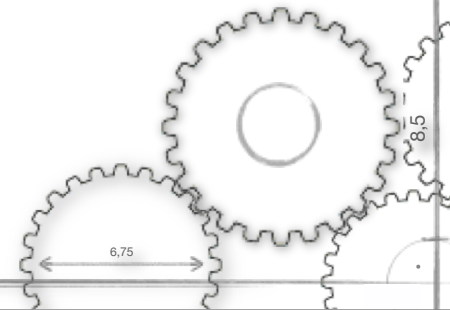
Bonds 101



What do you manage?

Bonds 102

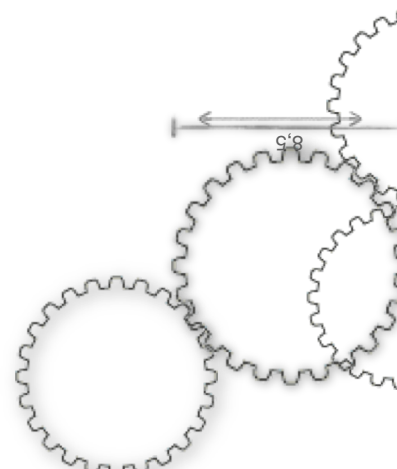
What is the most valuable skill a public fund portfolio manager can develop for managing expectations?




Session Goals

To better to understand the psychology behind losses as well as the myriad roles that losses play in the management of public funds.

So, when the following question is asked, there is not the slightest concern or hesitation regarding how to answer it....





News Reporter: “Madam Treasurer, how can you claim to be a good steward of the public’s money when your financial reports show a loss?”

GASB 31

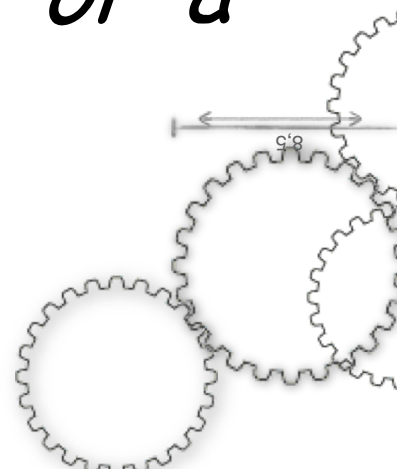


Observation – GASB 31

Is reporting a market value loss indicative of poor stewardship?

Is reporting a market value gain indicative of good stewardship?

Is GASB 31 a reporting standard or a performance measure?



Treasurer: “Board of Supervisors, I am excited to report the County of Sweet Returns is in the top 1% quartile of all professional money managers benchmarked to the BAML 1-3 year Government Index.

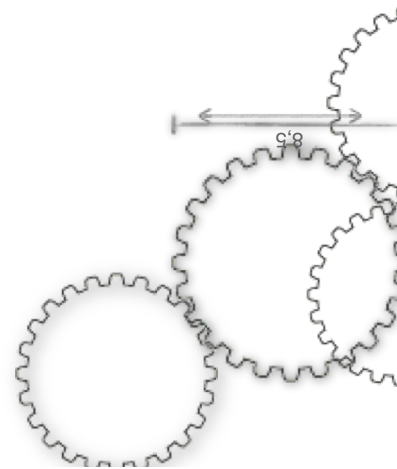
We only lost **2.00%** of our citizens money compared to our benchmark that lost **2.50%.”**

Total Return

Observation #2- Total Return

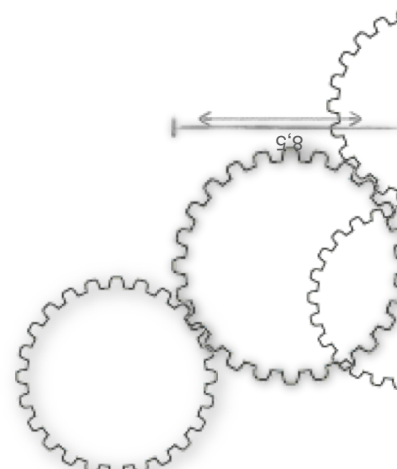
Is beating a market index on a total return basis a measure of good stewardship?

Is reporting a negative total return a measure of poor stewardship?



Takeaway

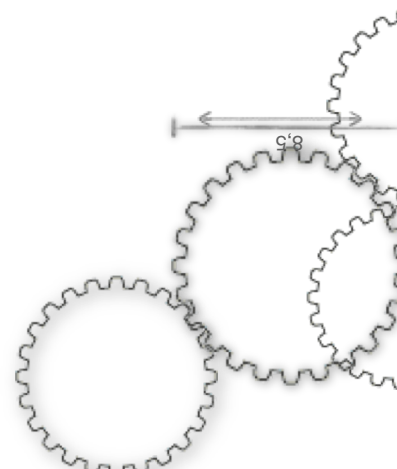
Why is it that the two highest profile measures, GASB 31 and Total Return, provide little if any material information about the stewardship of the entity it is providing information about?



Prospect Theory

Developed by Kahneman and Tversky

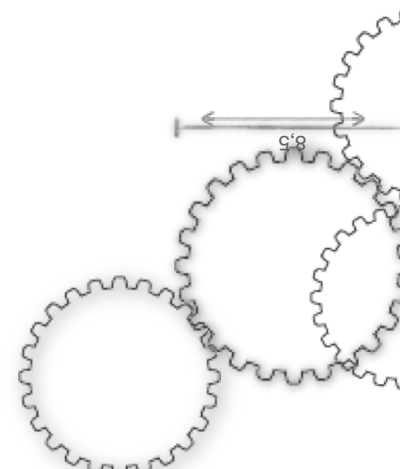
- *What is a loss?*
- *Prospect Theory demonstrated the reference point was a state of mind. It was a psychological state.*



Problem A. In addition to whatever you own, you have been given \$1,000. You are now required to choose between the following options:

Option 1: A 50% chance to win \$1,000.

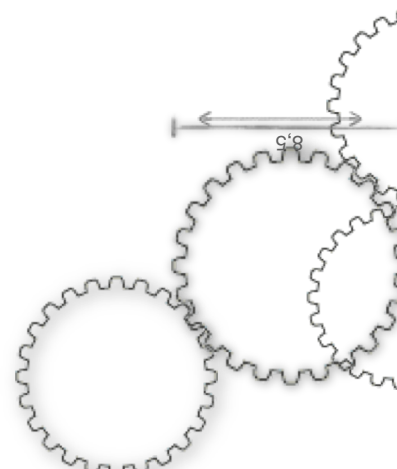
Option 2: A gift of \$500



Problem B. In addition to whatever you own, you have been given \$2,000. You are now required to choose between the following options:

Option 3: A 50% chance to lose \$1,000.

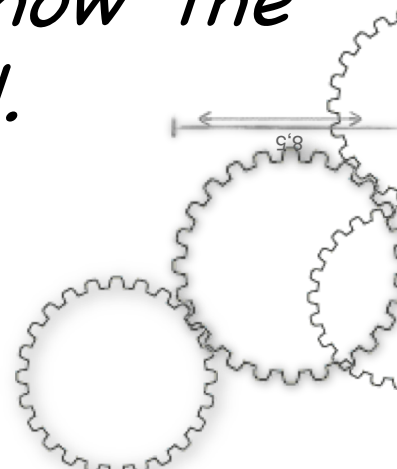
Option 4: A sure loss of \$500




Takeaway

There is a asymmetrical relationship between gains and losses. The pleasure of finding \$50 is less than the regret of losing \$50.

It is imperative to put any discussion of losses in their proper context. As Prospect Theory demonstrates, be careful to understand how the questions are being framed or represented.





News Reporter: “Madam Treasurer, how can you claim to be a good steward of the public’s money when your financial reports show a loss?”

Recall the question





 Your question implies...

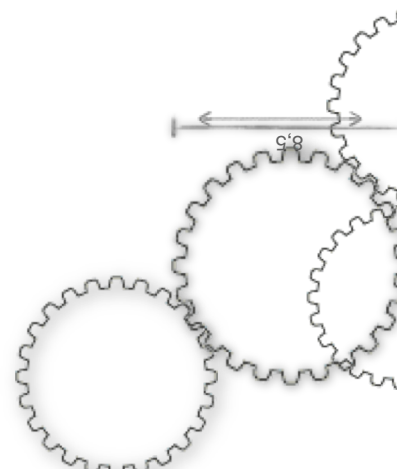
1st of a three part reply



Background

Recognized versus Realized

- *Know the distinction between a recognized gain/loss and a realized gain/loss.*
- *A paper loss is a loss that has been recognized but not realized. You are required to reflect recognized losses or gains on all financial reports regardless of whether they have been actually realized.*



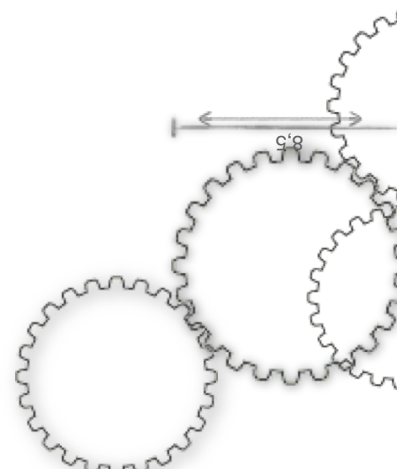
Background - Why A Loss?


Investment Policy Mandates It!

- *Investment policy clearly states, while income is of secondary importance to safety and liquidity, you have a fiduciary obligation to earn a market rate of return **throughout** budgetary and economic cycles.*

Background

A Loss By Itself Means "0"






News Reporter: “Madam Treasurer, how can you claim to be a good steward of the public’s money when your financial reports show a loss?”

Recall the question





The confusion typically arises from....

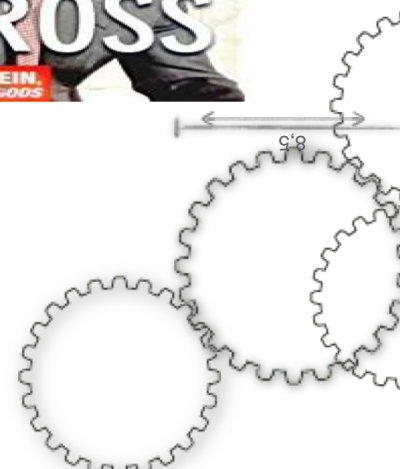
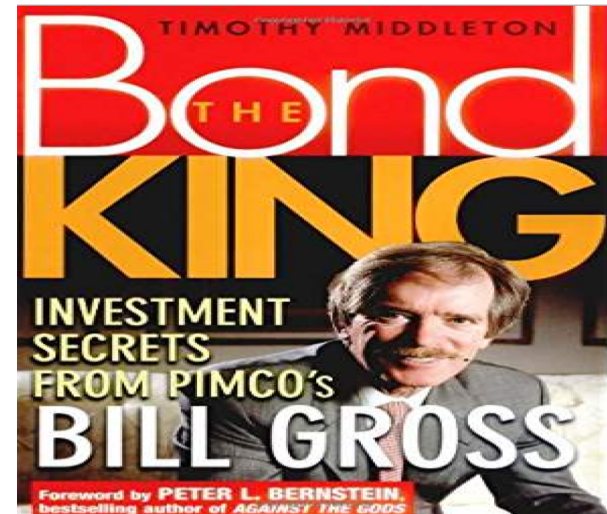
2nd of a three part reply



Background – Masters of the Universe

“The Economy, Interest Rates and Forecast”

- *Federal Reserve Chairman*
- *The Bond King – Bill Gross*
- *Wall Street Journal Survey*

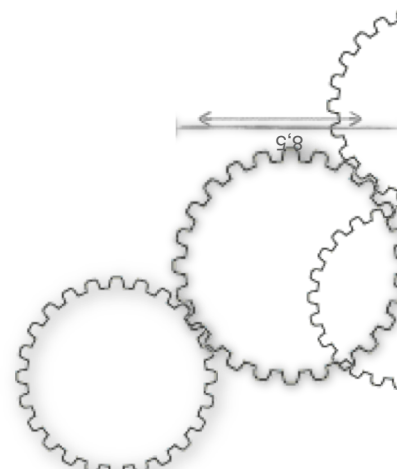



Takeaway



*"Prediction is very difficult,
especially about the future"*

Niels Bohr
Danish physicist (1885 - 1962)






News Reporter: “Madam Treasurer, how can you claim to be a good steward of the public’s money when your financial reports show a loss?”

Recall the question





I would be happy to show you....

3rd of a three part reply



Learning Outcome #1

Learning Outcome #2

Learning Outcome #3

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