

## Bad Tasting But Good For You ... Maybe

by [Steve Brown](#)

In our experience, it is hard to find someone that doesn't like the taste of orange juice. Yet, we have an older Aunt that absolutely hates orange juice. How can that be? It turns out that when she was growing up in the 1940s, kids were routinely given cod liver oil as a vitamin supplement and her mother tried to hide it in her orange juice each morning. As such, any hint of orange brings to her mind the memory of nasty tasting medicine. The days of cod liver oil dumping are gone, but the memory unfortunately lingers.

Bankers we know also feel like they have been taking cod liver oil by the bucketful the last few years. Despite that, bankers have survived unappetizing flavors to gain strength on their balance sheets, avoid things that undermine the health of their banks and attain better growth. But is a bad taste around the corner?

Buying bonds for the investment portfolio has particularly felt like taking medicine with interest rates on securities so low. CFOs have asked us about an appropriate strategy for the bank's investment portfolio and whether it makes sense to buy securities in the current interest rate environment. Besides the issue of managing risks of all varieties in the portfolio, boards of directors complain about the rate of return. What is a banker to do?

To be sure, an investment portfolio serves many purposes in each bank and from bank to bank, but there are many tried and true approaches. One is that the investment portfolio provides liquidity and securities are used for pledging. Securities offer a reliable means as well for matching funding provided by time deposits and a way to get yield when loan demand is soft. The investment portfolio also provides diversification on the asset side of the balance sheet and a lower credit risk profile than the loan portfolio. Banks use their investment policies to determine the specifics like asset classes, maturity, percentage of the portfolio, ratings etc. These policies in turn, also determine what is purchased and are designed to control risk.

Back to our question though, as we ask what about right now when rates are so low? When others complain about the return on the portfolio they forget certain key things. One is that portfolio managers who reach for yield in any environment are taking on more risk that likely won't pan out over the longer term. Whether it is credit risk or interest rate risk, higher yield than the basic securities in the market will deliver equates to added risk.

For example, many banks we know have purchased municipal bonds to capture higher yield. The problem is that now Detroit has filed for bankruptcy, the whole municipal world is getting turned upside down and the resulting volatility is showing how too much of anything can be problematic. Regulations now require more due diligence for municipals and corporate bonds, so bankers also have that to manage.

Other banks are extending duration in the portfolio by buying longer maturities or taking on structured securities. These are both concerning if the loan portfolio in the bank is extending as well, so care must be taken no matter what the investment.

Loan growth remains stagnant at most banks and in many the loan portfolio is declining, so investments are the safety valve. The key is to make sure the options you choose don't leave an aftertaste of cod liver when rates move around.

## **BANK NEWS**

### **M&A**

Allegiance Bancshares (\$799mm, TX) will acquire Independence Bank (\$219mm, TX) for an undisclosed sum.

### **Deposit Sale**

Baylake Bank (\$956mm, WI) will sell \$26mm in deposits from 2 branches to First National Bank of Berlin (\$304mm, WI) for an undisclosed sum. Baylake will keep the loans and plans to close the physical locations.

### **Competition**

PNC Bank (\$290B, PA) has reached a deal with CVS pharmacies and Cardtronics (will operate the ATMs) to put their brand on 31 ATMs in CVS stores in AL.

### **Sued Again**

Bank of America is being sued by the Department of Justice over allegations it lied to investors that bought some \$850mm in residential mortgage securities. Bloomberg reports BofA has already spent \$45B on litigation, settlements and refunds to investors since 2008 (and the problems with Countrywide and Merrill Lynch).

### **Ag Lending**

The USDA in its annual report finds the average value of all land and buildings on farms and ranches increased to \$2,900 per acre as of Jun vs. \$2,650 a year earlier. The most expensive farmland was NJ as \$12,700 per acre and the least expensive was NM at \$550.

### **Banks vs CUs**

A Moebs study of 1,676 bank and credit union (assets \$500mm+) websites on how easy it is to find answers to 15 questions determine 40% of CUs offered the information on their websites vs. 28% of banks. We aren't exactly sure what questions they were seeking, but it is interesting nonetheless.

### **Worse Off**

A PNC survey finds only 33% of people aged 20 to 29 say they have found a job in their chosen field vs. 71% who had expected to have done so already. In addition, those who said they were able to achieve financial independence slipped 26% from 2011 to 2013.

### **Mobile Alerts**

Montise research finds customer demand for alerts is highest on average across all income segments for suspicious transactions (about 29%), account transactions (26%), balance alerts (24%), password or contact information changes (23%) and payments due (23%).

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