UNDERSTANDING THE US GOVERNMENT AGENCY SECURITY MARKETPLACE

Presenter Information

MEEDER
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Agenda

- Investment Objectives and Permissible Investments
- Agency Issuers
- Security Types issued by Agencies
- Investment Considerations
- Benefits of Investing in Agencies

Investment Objectives

LEGAL	Legal may not be suitable
SAFETY	Preservation of principal
LIQUIDITY	What are your liquidity needs?
YIELD	Does the investment have a competitive yield?

Permissible Investments

- US Treasuries
- US Government Agencies (GSE)
- Certificates of Deposit
  - FDIC Insured
  - Collateralized
- STAR Ohio
- FDIC Insured cash accounts
  - Government Insured Deposit Program (GIDP)
  - Insured Cash Sweep (ICS)

Additional Training Required

- Commercial Paper
- Bankers Acceptances
- Municipal Securities

- Authorized under ORC 135.35
  - Corporate notes and bonds
  - Foreign government debt

Agency Issuers

Federal National Mortgage Association (FNMA)

- Created by Congress in 1938 under FDR's New Deal
- 1968 – converted to a private corporation
- Provide liquidity, stability and affordability to the mortgage market
  - Buy mortgages from lenders
  - Package the mortgages into Mortgage-Backed Securities (MBS)
  - Guarantee timely payment of principal and interest on the mortgages
- Introduced the 30-year fixed-rate mortgage loan

Fannie Mae

Agency Issuers

Federal Home Loan Mortgage Corporation (FHLMC)

- Chartered by Congress in 1970 as a private corporation
- Provide liquidity, stability and affordability to the mortgage market
  - Buy mortgages from lenders
  - Package the mortgages into Mortgage-Backed Securities (MBS)
  - Guarantee timely payment of principal and interest on the mortgages

FreddieMac

Source: freddiemac.com

Agency Issuers

FNMA & FHLMC Conservatorship

- September 6, 2008
- Conservator - Federal Housing Finance Agency (FHFA)

Agency Issuers

Federal Home Loan Bank (FHLB)

- Created by Federal Home Loan Bank Act of 1932
- Support mortgage lending and community investment
- Provide low-cost funding to nearly 7,000 banks, credit unions, insurance companies and community development financial institutions
- Composed of 11 regional banks owned as cooperatives by their members
- Regulated by Federal Housing Finance Agency (FHFA)

FHLBANKS
A NATION OF LOCAL LENDERS

Source: FHLBANKS.com

Agency Issuers

Federal Farm Credit Bank (FFCB)

- Created by Congress in 1916 under the Federal Farm Loan Act
- Service organization within the Farm Credit System
- Provide loans, leases and services that support rural communities and U.S. agriculture
- Composed of 4 system Banks
- Regulated by Farm Credit Administration (FCA)

FEDERAL FARM CREDIT BANKS
FUNDING CORPORATION

Agency Issuers

Federal Agricultural Mortgage Corporation (FAMCA)

- Chartered by Congress in 1988 as a publicly traded company
- Serve as a secondary market in agricultural loans such as mortgages for agricultural real estate and rural housing
- Regulated by Farm Credit Administration (FCA)

FARMER MAC

Source: farmermac.com

Security Types

Discount notes	Notes	Bonds
Maturities range from 1 – 365 days	Maturities range from 12 months – 10 years	Maturities range from 10 – 30 years
Issued at a discount	Coupon bearing	Coupon bearing
Interest received at maturity	Periodic interest payments • Monthly • Quarterly • Semi-Annually • Annually	Semi-annual interest payments

Security Structures

Bullets

- Principal paid at maturity

Callable

- Issuer may redeem security at par at established dates

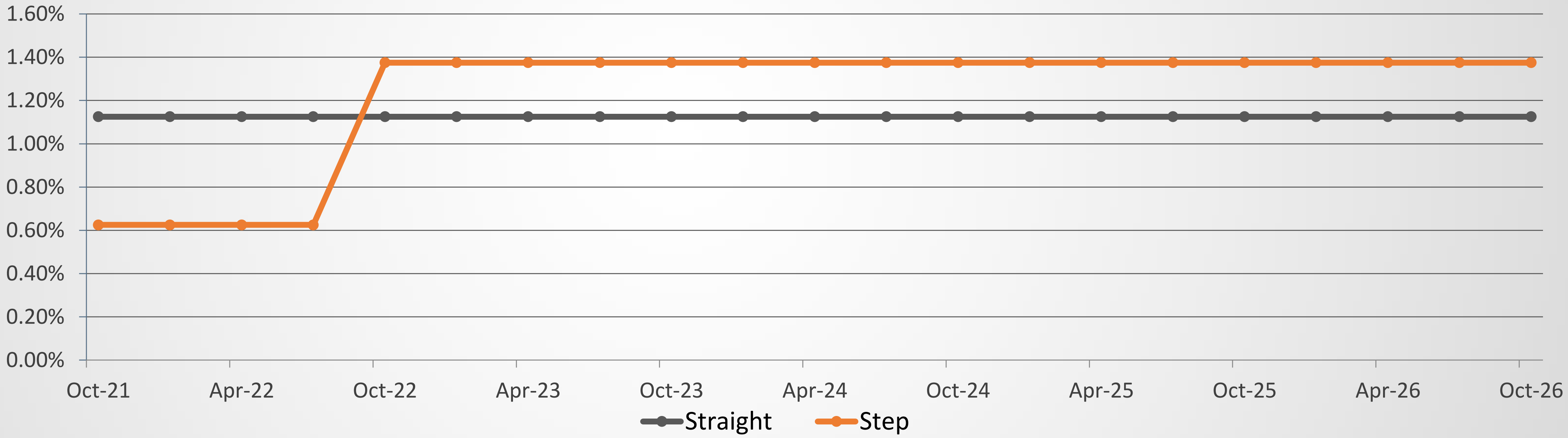
Step-up

- Coupon rate increases at established dates over life of security
- Always callable

Step-up Comparison

Straight Callable – 3130APCH6 FHLB 1.125% 9/29/2026

Multi Step – 3130APCE3 FHLB 0.625% 10/14/2026

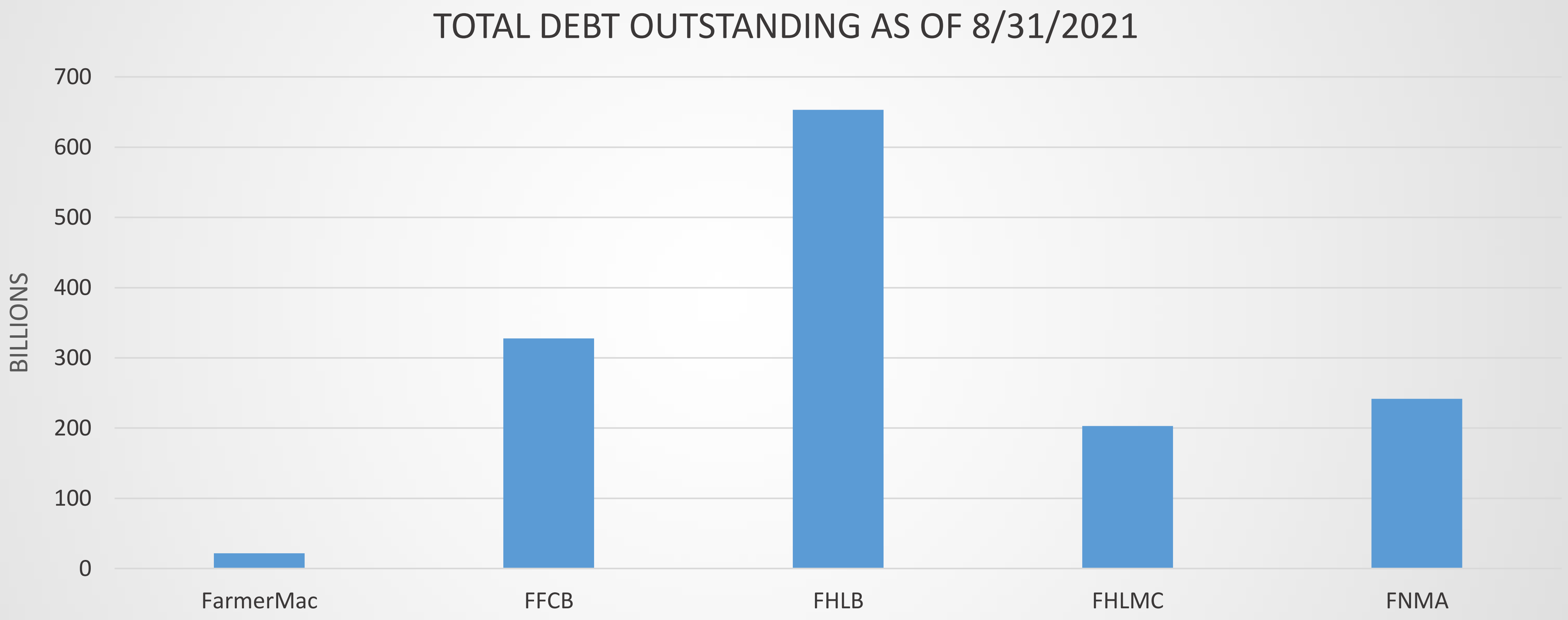


Agency Market

NEW ISSUE MARKET	SECONDAY MARKET
Purchased at par	Purchased at market price • Discount • Par • Premium
Purchased from issuer	Purchased from investor

YIELD AT COST SHOULD BE COMPARABLE FOR SIMILAR MATURITY

Agency Market



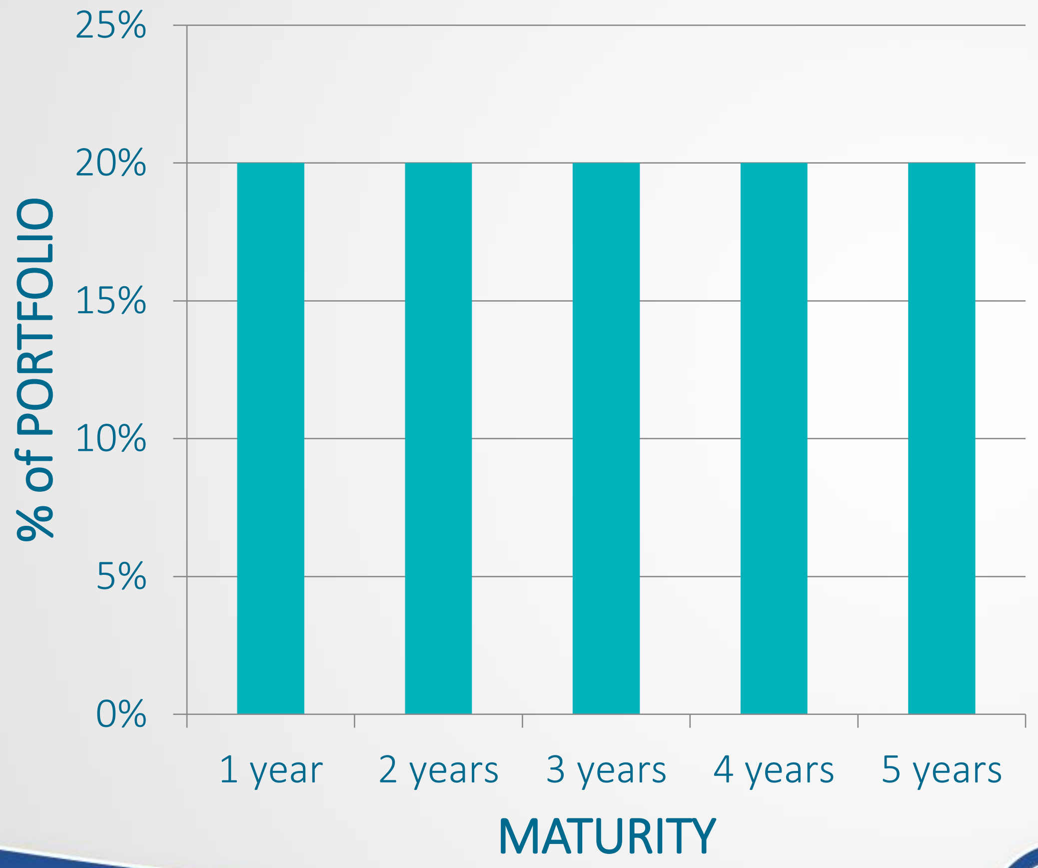
Source: farmermac.com, farmcreditfunding.com, fhlbanks.com, freddiemac.com, fanniemac.com

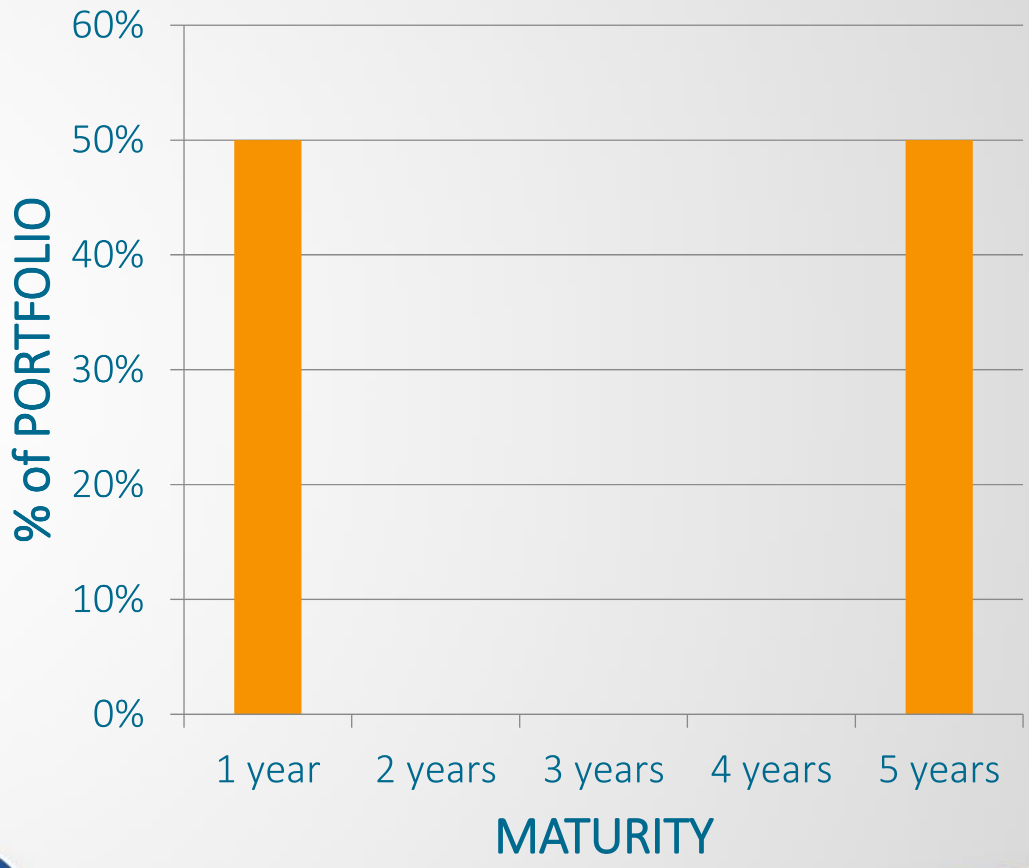
Investment Strategy – Core Portfolio

Factors to consider

- Federal Reserve Policy
- Shape of the Yield Curve
- Evaluate risk/return characteristics of each security, as well as the effect on the total portfolio.
    - The absence of defined parameters is an invitation for speculation and unnecessary risk.
    - Identify yield spreads between asset classes and types.
    - Compare new issues vs. secondary offerings.

Investment Strategy – Core Portfolio





Investment Considerations

Bond Yield = Risk Free Rate + Any Anticipated Risk (If you remember this, you can explain bond markets to anybody)

What are those anticipated risks? Why am I (the investor) getting paid?

1. **Credit Risk:** How likely is the borrower to pay me back?
2. **Term Risk:** What risk do I have that interest rates go higher but I'm locked in at the lower rate? (Duration)
3. **Liquidity Risk:** Can I sell this easily or is it expensive?
4. **Option Risk:** Can the borrower refinance when rates are lower, such that I must reinvest when rates are lower? (Convexity)

Investment Considerations

There is an inverse relationship between bond price and the yield of the bond and bonds can be bought or sold at 3 different price levels:

Par – Bonds are commonly issued at Par or 100.00 (100% of the maturity value).

Discount – Bonds can also trade a price below Par or at a discount. The price of a discounted bond would be below 100.00, increasing your YTM.

Premium – Bonds can also be traded at premium price levels, or a price above Par, decreasing your YTM.

Bond prices can also be expressed as a discount rate:

- No stated coupon is associated with the security.
- Total cost is the Net Present Value, which is determined based on the maturity date and discount rate.

Benefits of Investing in Agencies

Diversification of Structures

- Discount Notes (DNs, Discos): 1YR or less, zero coupon non-callable structures. Posted on window, auctioned, or occasionally negotiated.
- Bullets: fixed coupon, non-callable bonds from 3MO to 50YRs. “Benchmarks” (Globals/Reference Notes) are brought to the market by lead managers, usually primary dealers. “TAPs” or “Farm Credit MTNs” are auctioned, and the lowest yield bidder wins.
- Callables: term bonds with embedded call options, allowing the issuer to “refinance.” Either come negotiated or auctioned. Auction bonds always have a fixed coupon AND an American (continuous) call structure. Negotiated bonds can be fixed coupon or step coupon with BERM/Canary/Euro call options.
- Floaters: floating rate, typically non-callable bonds. Interest rate paid is tied to a reference index, be it LIBOR, SOFR (repo), T-Bills, Fed Funds, PRIME.

Benefits of Investing in Agencies

Security Swap

Sell Existing Security → Proceeds → Purchase New Security

REASONS TO SWAP SECURITIES	
Adjust portfolio duration	Increase portfolio earnings
Realize capital gains	Purchase additional future value

Investment Accounting Considerations

If a bond matures or is called:

- You receive the par value of the security plus coupon payment.
- Realized gain/loss is par value minus cost.

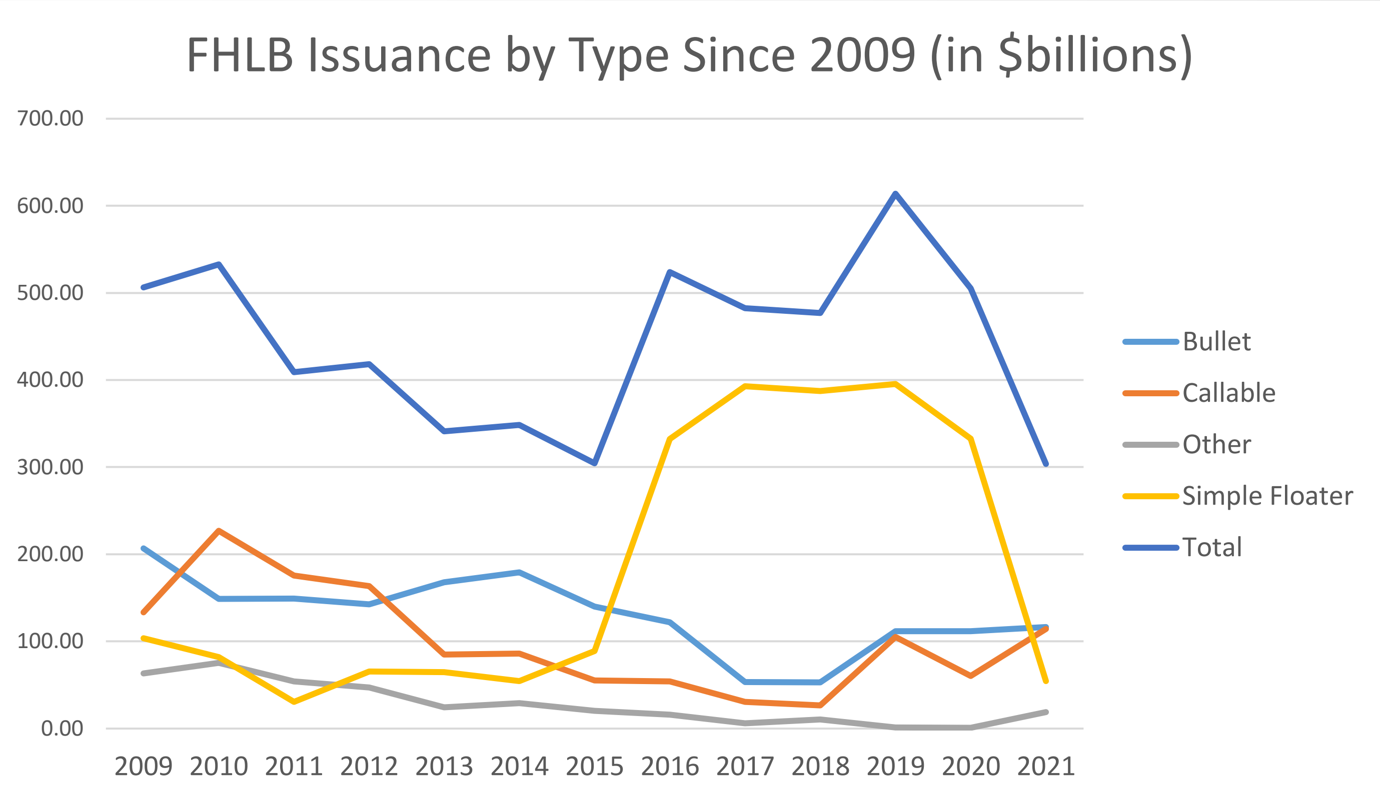
If a bond is sold:

- You receive the sale principal of the security plus accrued interest.
- Realized gain/loss is principal minus cost.

Agency Market

2021 Supply Updates:

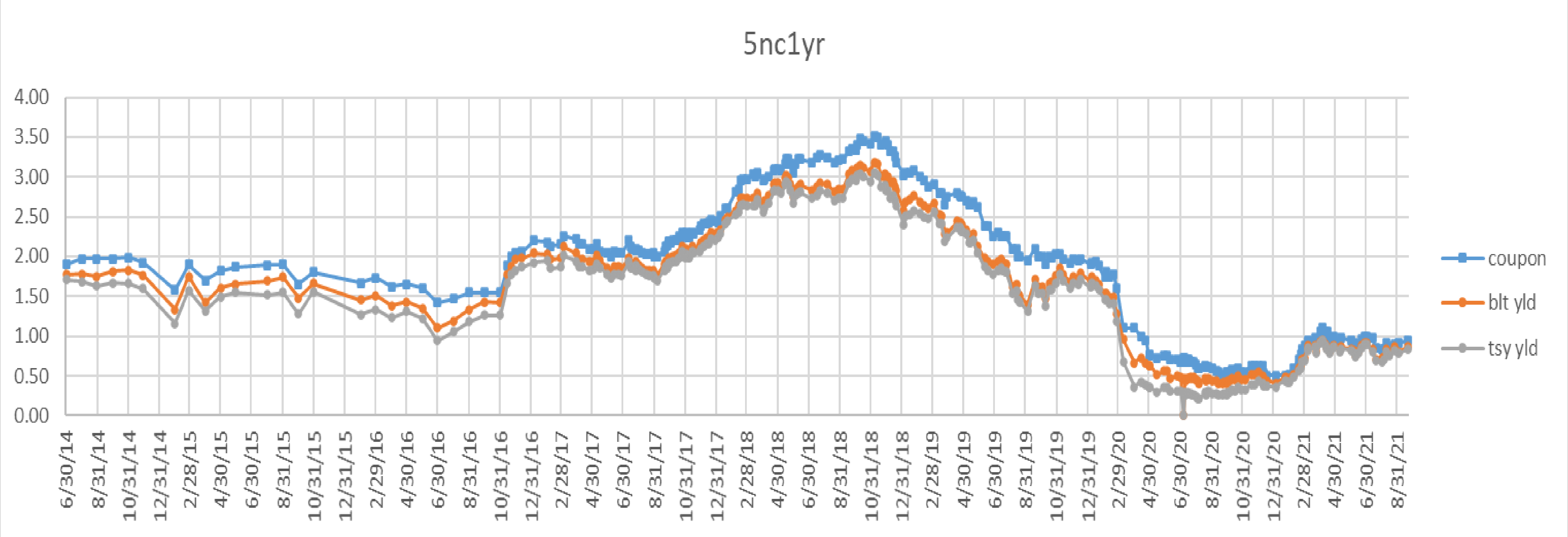
- FNMA and FHLMC have been closed most of the year. Expected to reopen eventually but 2021 not looking promising.
- FHLB has preferred callable funding this year, leading to a corresponding decrease in floaters, which they preferred from 2016-2020.
- FFCB (and recently FAMCA) continue to expand and become larger slices of the overall GSE marketplace.



Source: FHLB Office of Finance

Benefits of Investing in Agencies

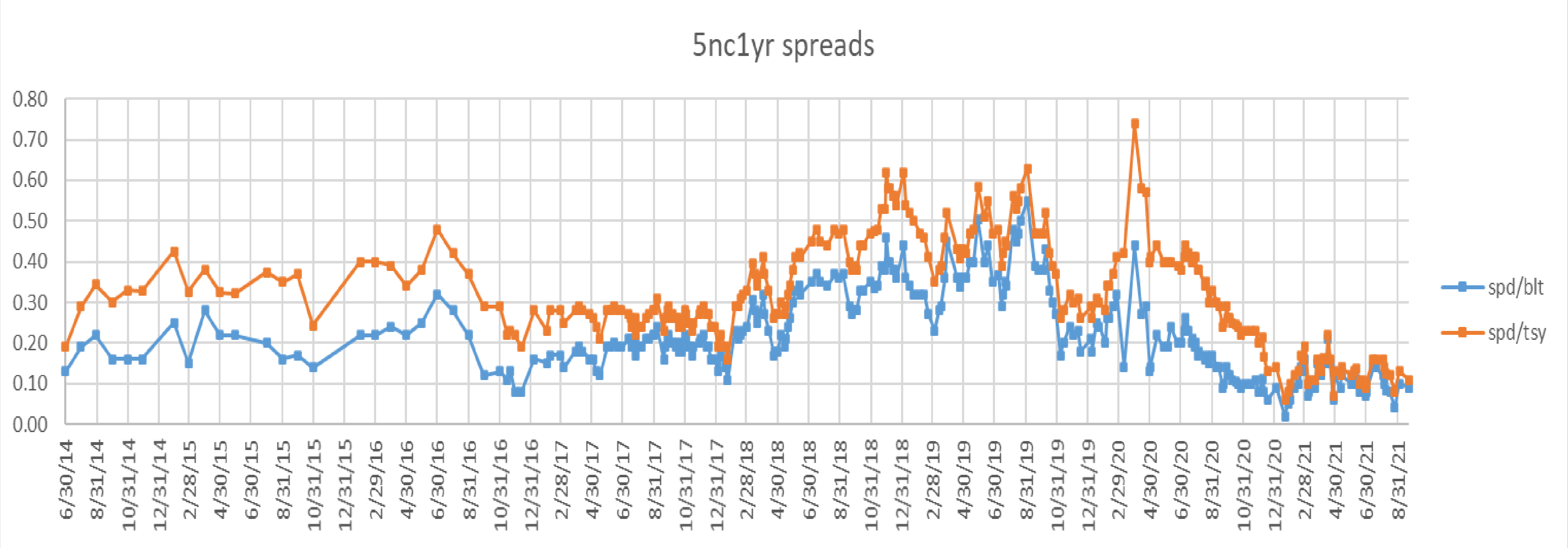
Historical Yields of 5-year Callable vs. Bullet vs. Treasury



Source: StoneX Agency Desk

Benefits of Investing in Agencies

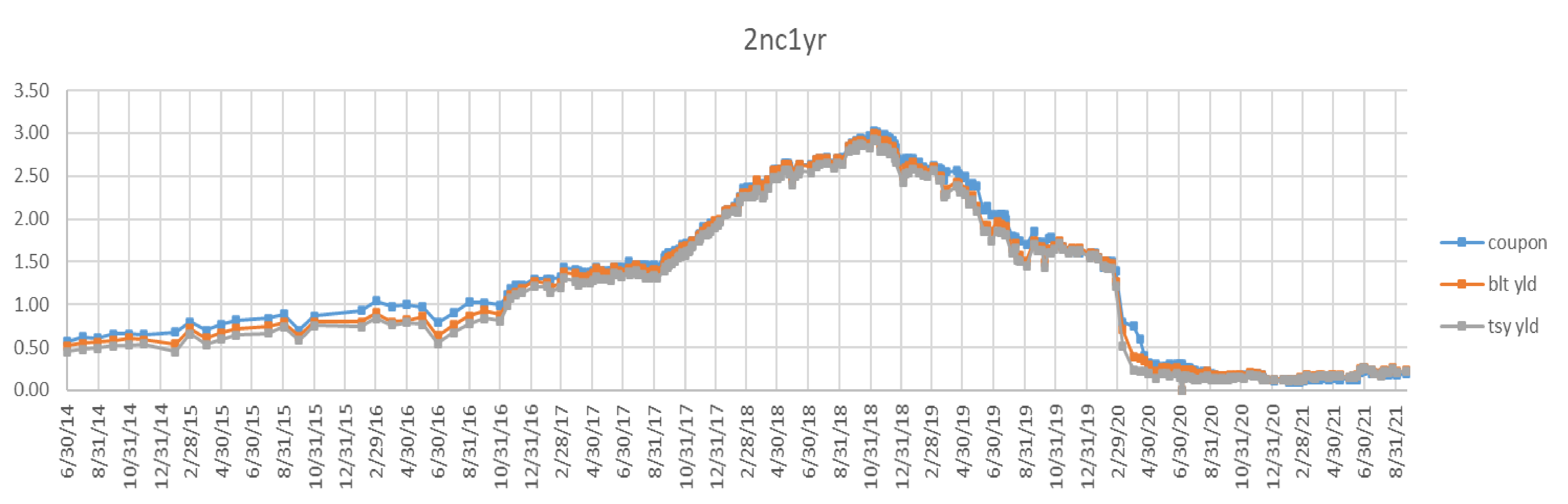
Historical Yield Spreads of 5-year Callable vs. Bullet and 5-year Callable vs. Treasury



Source: StoneX Agency Desk

Benefits of Investing in Agencies

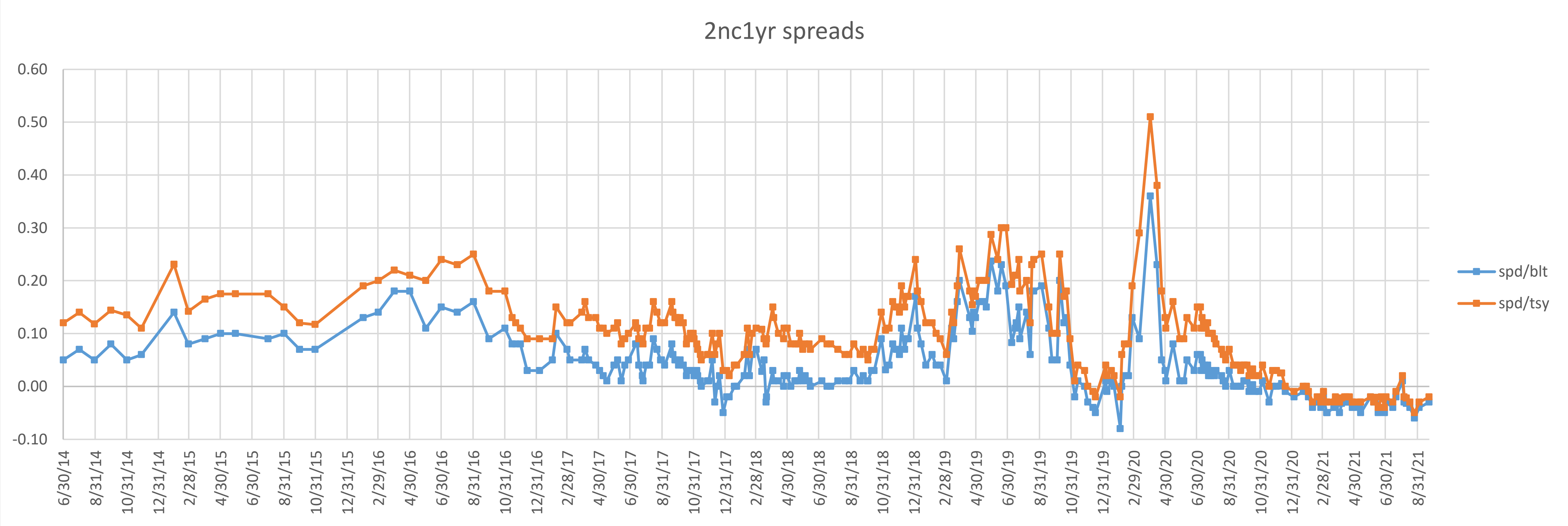
Historical Yields of 2-year Callable vs. Bullet vs. Treasury



Source: StoneX Agency Desk

Benefits of Investing in Agencies

Historical Yield Spreads of 2-year Callable vs. Bullet and 2-year Callable vs. Treasury



Source: StoneX Agency Desk

Review

- Agencies are a permissible investment
- Be familiar with the various Agency Issuers
- Agency securities are issued with different structures and interest payment cycles
- Be aware of market environment and current relative value of Agencies
- Agencies can provide benefits (or drawbacks) to your portfolio

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