

AFP[®]
Annual Conference



— November 7-10, 2010 | San Antonio —

ORIGINAL
ESSENTIAL
UNBIASED
INFORMATION



Fixed Income Swaps and Riding the Treasury Yield Curve

Speaker Name: Thomas Robben, CTP, CPA

Title: Cash Manager

Company Name: Johnson County, Kansas

Fixed Income Swaps and Riding the Treasury Yield Curve

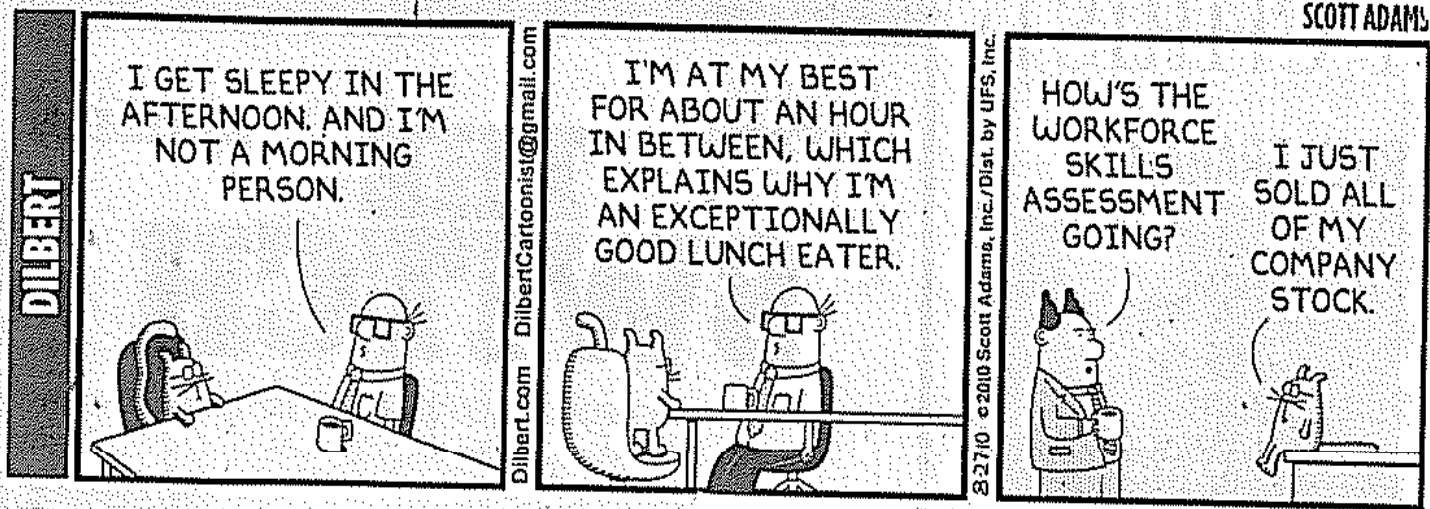
Many presenters say they wish to have an interactive session.....speak up anytime you wish but do not feel obligated!

Fixed Income Swaps and Riding the Treasury Yield Curve

Fixed Income Swaps

Fixed Income Swaps and Riding the Treasury Yield Curve

Fixed Income Swaps



Fixed Income Swaps and Riding the Treasury Yield Curve

Johnson County Kansas government – affluent county – conservative – hold to maturity environment – perfectly aligns with the main objective of preservation of capital.

Fixed Income Swaps and Riding the Treasury Yield Curve

Johnson County Kansas government – \$600M
weighted average portfolio – fixed income

Govt Sponsored Enterprises (GSE) – FHLB,
FNMA, FHLMC, FFEB, US Treasuries, CD's,
Govt Money Market Mutual Funds.

Fixed Income Swaps and Riding the Treasury Yield Curve

Market volatility presents opportunities to profitably sell before maturity and reinvest for greater income than “what we would have had” – key term in the upcoming swap analysis spreadsheet.

Fixed Income Swaps and Riding the Treasury Yield Curve

C:\Documents and Settings\trobben\Desktop\[SellBuySanAntone.xlsx]swaparoo				
08/27/10				
Sell Date	8/12/2010			
2 bullets close to maturity	Book Price	(a)	10,000,400.00	per Treasury mgmt software or Gen Ledger
	Selling Price	(b)	10,033,235.00	first get indication from broker
	Gain/(loss) on sale	(b) - (a)	32,835.00	
	Net	(c)	32,835.00	(could use purchase price if you are cash basis but then you have to use coupon rate of interest in "would have had" section versus bond equiv yield)
	hold for 14 days			
	reinvest @ 0.10	(d)	388.89	MM fund interest if sale is before reinvestment settlement
	0.001	14.00		
3 yr 1 yr 1x	LT reinvestment maturity			
	1.500%	8/26/2011	call date	call date listed vs. maturity date in this environment
purchase date	8/26/10	(e)	152,083	make sure you multiply times the correct amount invested
days to maturity	365			
(A)	0.000%	8/26/2011		information for more than one purchase
	8/26/11	(f)	0	
	0			
Total sell/buy income (c) + (d) + (e) + (f)			<u>185,307</u>	
	would have had (g)	9/10/2010	5,840	bond equiv. yield for remaining life of "sold" bond
	8/12/2010	1.45%		
		JOCO BEY		
	would have had (h)	1/12/2011	33,575	bond equiv. yield for remaining life of "sold" bond
	8/12/2010	1.58%		
		JOCO BEY		
THE FOLLOWING IS THE INTEREST RATE PROJECTION INFORMATION				
	(i)	8/26/2011	72,917	end date of the reinvestment from above
(A)	9/10/2010	1.50%		date funds are available if the bond went to maturity
	(j)	8/26/2011	47,083	
(A)	1/12/2011	1.50%		date funds are available if the bond went to maturity
Total hold income (g) + (h) + (i) + (j)			<u>159,415</u>	
Difference = Total sell/buy - Total hold			<u>25,892</u>	yahoo
(A) Rates are predicted to not change between now and Jan 11 so it was advantageous to capture the gain on the two sales.				

Fixed Income Swaps and Riding the Treasury Yield Curve

- 1) Have feel for which investments can be sold for a gain – like high coupon items maturing soon and owned near par.
- 2) Receive indication of selling price from a broker.
- 3) If early returns look promising then proceed with the remainder of the analysis
- 4) Start with discovering the reinvestment rate
- 5) Document what you would have had from holding the investments to maturity/call date

Fixed Income Swaps and Riding the Treasury Yield Curve

- 6) Time to tell folks what the future holds for interest rates
 - 7) Utilize Fed Fund futures and analyst consensus on where rates are headed. If a 2 year/1 year callable is at 2.0% now, maybe after the next FOMC meeting it is at 2.25% if a quarter point increase is expected.
 - 8) In the current environment (Aug 2010) rates have been very stable, as in low forever.
-

Fixed Income Swaps and Riding the Treasury Yield Curve

- 9) If you can sell an investment at a gain and reinvest now at the same rate as the maturity date then it is usually better to take the gain
- 10) Follow up – compare reinvestment rates at the time the original maturity date rolls around to your predictions in the wonderful spreadsheet

Fixed Income Swaps and Riding the Treasury Yield Curve

This model works in all interest rate environments

If rates are projected to rise sometimes it is advantageous to sell an instrument at a loss and cut your losses and then hold for a higher reinvestment rate.

If rates are projected to fall it is definitely advantageous to lock in longer bullet rates or extend call protection, even if you have to sell at a loss.

Fixed Income Swaps and Riding the Treasury Yield Curve

This gets even better.

Fixed Income Swaps and Riding the Treasury Yield Curve in Kansas!



Fixed Income Swaps and Riding the Treasury Yield Curve

Riding the Treasury Yield Curve

Fixed Income Swaps and Riding the Treasury Yield Curve

DILBERT



Fixed Income Swaps and Riding the Treasury Yield Curve

TALK ABOUT THIEVES!

Pimco's Gross Rolls Down Yield Curve for Non-Normal Returns

2010-07-29 18:51:57.142 GMT

By Daniel Kruger

July 29 (Bloomberg) -- Bill Gross is realizing outsized gains by benefitting from the near record difference in yields between short- and longer-maturity bonds while preaching that investors should prepare for lower-than-average returns.

“What we think is most attractive is the positioning in terms of the curve,” said Gross, the manager of the world’s biggest bond fund at Pacific Investment Management Co. “As long as short rates stay at zero or close to zero, and that’s the key caveat, then an investor can make money simply by buying 5-year Treasuries, watching them roll down the curve to four years and then popping back up to five years again.”

Fixed Income Swaps and Riding the Treasury Yield Curve

Actual quote from a smart broker to you know who:

“What a great strategy... I wonder who might have also deployed it?????”

Fixed Income Swaps and Riding the Treasury Yield Curve

- Below is a simple explanation of Derivatives and a Credit Default Swap,

Chuck moved to Texas and bought a Donkey from a farmer for \$100.

The farmer agreed to deliver the Donkey the next day.

The next day he drove up and said, 'Sorry son, but I have some bad news, the donkey died.'

Chuck replied, 'Well, then just give me my money back.'

The farmer said, 'Can't do that. I went and spent it already.'

Chuck said, 'Ok, then, just bring me the dead donkey.'

The farmer asked, 'What ya gonna do with him?'

Chuck said, 'I'm going to raffle him off.'

The farmer said, 'You can't raffle off a dead donkey!'

Chuck said, 'Sure I can. Watch me. I just won't tell anybody he's dead.'

A month later, the farmer met up with Chuck and asked, 'What happened with that dead donkey?'

Chuck said, 'I raffled him off.'

I sold 500 tickets at two dollars a piece and made a profit of \$998.'

The farmer said, 'Didn't anyone complain?'

Chuck said, 'Just the guy who won. So I gave him his two dollars back.'

- Chuck now works on Wall Street

Fixed Income Swaps and Riding the Treasury Yield Curve

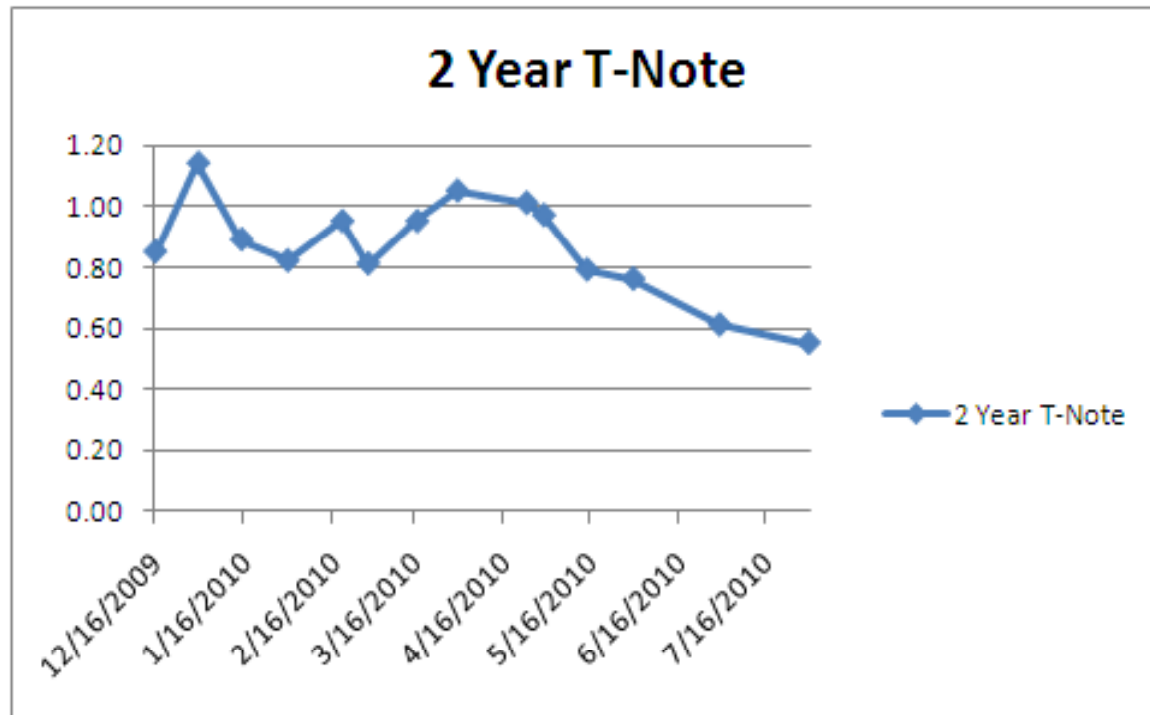
Collect \$450M in “tax seasons”, tax due dates are December 20 and May 10, we hold money until distribution on January 20 and June 5.

Collections commence in earnest approximately November 20 and April 20 – weighted average holding period is approximately 38.5265487 days

Fixed Income Swaps and Riding the Treasury Yield Curve

The model predicts the yield to be earned on holding the 2 year US Treasury for the approximate 38.5265487 days and then selling for the tax distribution. You earn the Treasury rate (1.0% in June 2010) and then add the gain on the sale (or subtract the loss)

Fixed Income Swaps and Riding the Treasury Yield Curve



Fixed Income Swaps and Riding the Treasury Yield Curve

5 year history of the 2 year



Fixed Income Swaps and Riding the Treasury Yield Curve

Investment Swaps for July 2009 to June 2010						
Date	Sympro Number of Item sold	Sympro Number of Item purchased	New income net of gain/loss	Hold to maturity income	Gain	
6/30 and 7/6/2009	3222	3222	30,014,063	29,976,563	37,500	
6/30 and 7/6/2009	3221	3221	15,036,328	15,008,203	28,125	
6/30 and 7/6/2009	3220	3220	25,066,406	25,015,625	50,781	
7/16 and 7/17/2009	3224	3224	15,045,703	15,033,984	11,719	
7/20 and 7/21/2009	3225	3225	15,043,359	15,038,672	4,687	
7/15 and 7/22/2009	3223	3223	25,103,516	25,087,891	15,625	
7/24 and 7/27/2009	3227	3227	25,052,734	25,041,016	11,718	
7/24 and 7/29/2009	3226	3226	15,029,297	15,025,781	3,516	
7/31 and 8/3/2009	3229	3229	24,941,406	24,945,313	-3,907	
8/4/2009 only	3230	3230	24,921,875	24,910,156	11,719	
8/04 and 8/6/2009	3231	3231	24,914,063	24,902,344	11,719	
8/06 and 8/12/2009	3232	3232	24,900,391	24,898,438	1,953	
7/31 and 8/14/2009	3228	3228	14,971,875	14,963,672	8,203	
8/25/2009 only	3233	3233	24,978,516	24,966,797	11,719	
8/31/2009 only	3234	3234	24,976,563	24,970,703	5,860	
8/31/2009 only	3235	3235	24,980,469	24,972,671	7,798	
9/17 and 9/18/2009	3236	3236	15,014,063	15,010,547	3,516	
9/30 and 10/1/2009	3237	3237	15,014,063	15,010,547	3,516	
10/7 and 10/8/2009	3238	3238	20,046,875	20,042,188	4,687	
10/13 and 10/14/2009	3239	3239	15,021,094	15,016,406	4,688	
10/19 and 10/21/2009	3240	3240	15,015,234	15,011,719	3,515	
10/23/2009 only	3241	3241	15,015,234	15,010,547	4,687	
10/26 and 10/28/2009	3242	3242	15,002,344	15,000,000	2,344	
10/30 and 11/2/2009	3243	3243	13,023,360	13,018,789	4,571	
12/07 and 12/8/2009	3244	3244	9,988,281	9,984,375	3,906	
12/07 and 12/8/2009	3245	3245	9,988,281	9,984,375	3,906	
12/16 and 12/17/2009	3249	3249	14,974,219	14,963,617	10,602	
12/11 and 12/18/2009	3246	3246	9,995,313	9,994,531	782	
12/11 and 12/18/2009	3247	3247	9,993,750	9,993,750	0	.83 int vs .08 mm = 3709-2266-175
12/14 and 12/18/2009	3248	3248	19,987,500	19,975,000	12,500	

Fixed Income Swaps and Riding the Treasury Yield Curve

Investment Swaps for July 2009 to June 2010						
Date	Sympro Number of Item sold	Sympro Number of Item purchased	New income net of gain/loss	Hold to maturity income	Gain	
12/31 and 1/6/2010	3253	3253	19,984,375	19,962,500	21,875	
12/22 and 1/19/2010	3250	3250	29,955,469	29,953,125	2,344	.83 int vs .08 mm = 30907-13599-1167
12/22 and 1/19/2010	3251	3251	9,984,766	9,984,375	391	.83 int vs .08 mm = 10302-4533-389
12/22 and 1/21/2010	3252	3252	9,987,500	9,980,469	7,031	.85 int vs .08 mm = 10714-4533-403
2/1/2010 only	3254	3254	19,996,875	19,987,500	9,375	
1/28 and 2/1/2010	3255	3255	20,064,063	20,056,250	7,813	
2/2 and 2/3/2010	3256	3256	10,005,469	10,000,781	4,688	
2/4 and 2/5/2010	3257	3257	30,014,063	30,002,344	11,719	
12-31-09 to 2-8-10	5034	5034	19,990,467	19,986,098	4,369	over the amortized amount
2/11 and 2/16/2012	3258	3258	20,017,188	20,006,250	10,938	
2/12 and 2/16/2012	3259	3259	10,008,594	10,001,563	7,031	
2/22 and 2/23/2010	3262	3262	14,995,313	14,989,453	5,860	
2/23 and 2/24/2010	3261	3261	10,001,563	9,994,531	7,032	
2/19 and 2/24/2010	3260	3260	20,012,500	20,000,000	12,500	
3/1/10 only	3263	3263	20,003,125	19,996,875	6,250	
3/31/10 only	3267	3267	14,985,938	14,982,437	3,501	
3/31/10 only	3268	3268	4,996,094	4,991,016	5,078	
3/31 and 4/05/2010	3269	3269	7,995,625	7,991,875	3,750	
4/06 and 4/08/2010	3270	3270	19,964,063	19,942,750	21,313	
4/12 and 4/13/2010	3272	3272	14,979,492	14,976,563	2,929	
4/09 and 4/16/2010	3271	3271	19,989,063	19,981,250	7,813	
4/21 and 4/28/2010	3273	3273	30,014,063	29,999,700	14,363	
4/21 and 4/28/2010	3274	3274	25,011,719	25,000,000	11,719	
4/26 and 4/29/2010	3275	3275	15,001,172	14,982,422	18,750	
4/30/10 only	3276	3276	29,995,313	29,983,609	11,704	
3/05 and 5/03/2010	3265	3265	19,995,313	20,007,813	(12,500)	.35 int vs .08 mm = -12500+30435-2378
3/11 and 5/03/2010	3266	3266	14,990,625	14,992,969	(2,344)	.52 int vs .08 mm = -2344+22826-3923
3/04 and 5/06/2010	3264	3264	8,008,125	8,010,000	(1,875)	.74 int vs .08 mm = -1875+12745-761
5/10/10 only	3277	3277	50,175,781	50,171,875	3,906	
5/11/10 only	3278	3278	100,226,563	100,195,313	31,250	
5/12/10 only	3279	3279	100,304,686	100,289,063	15,623	
5/13 and 5/14/10	3280	3280	50,144,531	50,136,719	7,812	
5/13 and 5/14/10	3281	3281	50,144,531	50,136,719	7,812	
5/13 and 5/14/10	3282	3282	50,144,531	50,136,719	7,812	
5/14/10 only	3283	3283	50,146,484	50,130,859	15,625	
5/21 and 5/25/10	3284	3284	50,269,531	50,253,906	15,625	
5/28 and 6/01/10	3288	3288	25,084,961	25,072,266	12,695	
6/01/10 only	3286	3286	49,953,125	49,937,500	15,625	
6/01/10 only	3287	3287	24,964,844	24,957,031	7,813	
5/26 and 6/01/10	3285	3285	50,234,375	50,234,375	0	.99 int vs .08 mm = 0+43478-35326
6/16 and 6/17/10	3289	3289	25,010,742	24,998,047	12,695	
6/30/2010	3290	3290	24,988,266	24,968,765	19,501	
Jul 09 to Jun 10 total					659,166	

Fixed Income Swaps and Riding the Treasury Yield Curve



Fixed Income Swaps and Riding the Treasury Yield Curve



Fixed Income Swaps and Riding the Treasury Yield Curve



Fixed Income Swaps and Riding the Treasury Yield Curve

Our Director was trying to quell even the slightest anxiety Board members had concerning the safety of our investments in the midst of the economic crisis with this quote....."this isn't rocket science"...he was not trying to be demeaning to the Cash Manager but the Cash Manager reminded him anyway that fixed income investing may not be rocket science, but a rocket scientist could not be as effective. Passion is the key.

Fixed Income Swaps and Riding the Treasury Yield Curve

In closing, check out this passionate test.

Fixed Income Swaps and Riding the Treasury Yield Curve

Imagine this...



Fixed Income Swaps and Riding the Treasury Yield Curve

What it took to get an 8th grade education in 1895...Remember when grandparents and great-grandparents stated that they only had an 8th grade education? Could any of us have passed the 8th grade in 1895? This is the eighth-grade final exam from 1895 in Salina, Kansas, USA. It was taken from the original document on file at the Smokey Valley Genealogical Society and Library in Salina, and reprinted by the Salina Journal.

Fixed Income Swaps and Riding the Treasury Yield Curve

- Grammar (Time, one hour)
 1. Give nine rules for the use of capital letters.
 2. Name the parts of speech and define those that have no modifications. (8 additional questions.)
 - Arithmetic (Time, 1 hour 15 minutes)
 1. Name and define the Fundamental Rules of Arithmetic.
 2. A wagon box is 2 ft. Deep, 10 feet long, and 3 ft. Wide. How many bushels of wheat will it hold?
 3. If a load of wheat weighs 3,942 lbs., what is it worth at 50cts/bushel, deducting 1,050 lbs. for tare?
-

Fixed Income Swaps and Riding the Treasury Yield Curve

- U.S. History (Time, 45 minutes)
- 1. Give the epochs into which U.S. History is divided
- 2. Give an account of the discovery of America by Columbus
- 3. Relate the causes and results of the Revolutionary War.

Fixed Income Swaps and Riding the Treasury Yield Curve

- Orthography (Time, one hour) [Do we even know what this is??]
- **1.** What is meant by the following: alphabet, phonetic, orthography, etymology, syllabication
- **2.** What are elementary sounds? How classified?
- **3.** What are the following, and give examples of each: trigraph, subvocals, diphthong, cognate letters, linguals

Fixed Income Swaps and Riding the Treasury Yield Curve

- Geography (Time, one hour)
- 1 What is climate? Upon what does climate depend?
- 2. How do you account for the extremes of climate in Kansas ?
- 3. Of what use are rivers? Of what use is the ocean?
- 4. Describe the mountains of North America

- Notice that the exam took FIVE HOURS to complete. Gives the saying 'he only had an 8th grade education' a whole new meaning, doesn't it?!

Fixed Income Swaps and Riding the Treasury Yield Curve

Thank you so much and have a safe trip home,
and remember Veteran's Day.