

FINANCIAL INSTITUTION INVESTING DURING THE COVID-19 PANDEMIC

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We're living through one of the most turbulent times in modern history and it's currently being reflected in the banking and investment environment. The Fed has taken unprecedented easing steps with rate cuts and extensive open market operations. Municipal bonds, commercial paper and corporate bonds are being purchased by the Fed to maintain stability in financial markets. Financial institutions are experiencing significant inflows of deposits, coupled with low loan demand, leaving everyone searching for a return on their investment.

With that said, *how do financial institutions put this money to work?* With the Fed buying up large portions of fixed income products on the short end of the curve, most traditional options have uncompetitive yields. Treasury yields are barely above zero and, in some cases, even negative. Commercial paper and corporate bonds have higher yields, but not by much, considering they're not directly backed by the full faith and credit of the U.S. government. That's not to say there are no opportunities here, but it will take some searching and willingness to take on some risk. It's a question of whether the risk of reward makes sense in individual situations.

Although the Fed is running a backstop for municipal bonds, there is still some yield to be had. Municipal bonds are generally thinly traded, so even while the Fed backing the market is still inefficient, specific issuances are often scarce. If you see a good rate, it probably won't be available for long. *One strategy* is to bid on bid- wanted offerings in the secondary market. There's a limited amount being shown, but there is opportunity for enhanced yields over the market in general. *Or, try tapping the new issue market.* Look at new issue negotiated deals, and smaller less-known names; this will also open up opportunity for yield pick-up. Be prepared for small allocations or no allocations when bidding on new deals. *Patience is key.* Investors that are consistently bidding new issues will catch some breaks. The more reliable and the bigger the bidder, the more likely they

are to get allocations from these deals. Not surprisingly, the short end of the curve is the most heavily bid. So again, the best strategy is being a consistent market participant.

Another option is to invest with other financial institutions. The DTC brokered CD market can provide some yield up and above treasuries. Depending on the approach, if getting the FDIC insurance is a priority, it would mean buying several different issuing institutions in increments of \$250K, which would take longer to accumulate.

Beyond the DTC brokered CD market, *reciprocal and one-way networks*, like [Promontory Interfinancial Network](#) and others, can offer financial institutions a way to invest excess deposits and pick up some yield. A financial institution can retain their client relationships and earn fee income by "selling" the deposits into the network. This can be done on a term and/or liquid basis. Furthermore, if the financial institution's liquidity needs change, they can easily switch back to receiving reciprocal matching deposits; instead of the fee income. These networks provide the efficiency to invest in larger increments while maintaining FDIC insurance.

One more area for financial institutions to explore for additional yield is *online lending platforms*. Although these platforms may be seen as competition to traditional financial institutions, their growth in popularity and the potential opportunity shouldn't be ignored. Many of these platforms allow investors to target specific credit and performance criteria, which can often mimic their current internal underwriting standards.

Absent the return of loan growth, strong liquidity positions and the hunt for additional yield will be the "new normal" for financial institutions that is reminiscent of the not-so-distant past. However, there is much that is still unknown about this current crisis (i.e. what type of economic recovery, more stimulus, second wave, vaccine?), but it is important to remember that before the outbreak, the economy stood on a strong footing. As the U.S. has been emerging from the lockdowns, economic data has shown (oftentimes a surprising) improvement across various economic data points. That being said, combining the current COVID-19 outbreak with an election year, and increased global trade tension, financial institutions should expect more turbulence throughout the remainder of 2020 and be prepared to seek yield-enhancing strategies.

About D. James Lutter



D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network and PMA Securities where he oversees PMA Funding, a service of both companies that provides over 1,000 financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities and Investment Advisor Representative with PMA Asset Management. Mr. Lutter has the following FINRA licenses with PMA Securities, LLC: Series 7, 24, 50, 53, 63, 65 and 99.

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