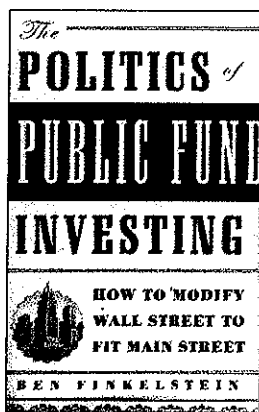


## The “Main Street Way” to Investing

By Sofia Anastopoulos



The Politics of Public  
Fund Investing: How  
to Modify Wall Street  
to Fit Main Street

Public Treasury Institute

www.PublicTreasury  
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The recently published book, *The Politics of Public Fund Investing*, is a welcome addition to the tool chest governmental investors can tap for managing public funds. Benjamin Finkelstein draws upon his years of experience working with governmental investors to create a book chockfull of practical tools—for the novice and the seasoned investor alike.

Yet, the book goes beyond merely providing practical how-to information for those charged with investing public funds. Importantly, it proposes a new way of considering the investment of public funds, one that stands in contrast to the traditional ways of methods of Wall Street. In qualifying the book’s title, *The Politics of Public Fund Investing: How to Modify Wall Street to Fit Main Street*, Finkelstein proposes a dramatic argument. The book suggests the unique circumstances of investing public funds—the politics coupled with the ranking of objectives—render the typical Wall Street ways of structuring portfolios and measuring their performance inappropriate. Instead, Finkelstein suggests an alternative, the Main Street Way, as a distinct perspective that considers issues. Acknowledging politics in the public funds investment management context can have sweeping consequences on how portfolios are structured and their performance measured. At the very least, it provides the reader with another dimension in which to consider public funds management.

The book is divided into two main sections. Part One, Main Street Philosophy,

lays out Finkelstein’s unconventional approach for the investment of public funds. Finkelstein compares traditional Wall Street to Main Street. Finkelstein contends that Wall Street is not subject to election cycles and budget cycles, or political risks, including an array of constituents with varied expectations and occasionally divergent agendas. Main Street investing is about more than economics or quantitative measures.

What follows is a discussion of politics and investment policy. One of the first lessons investors, including investors of public funds, learn is the importance of starting off with an investment policy. However, translating policy into an actionable plan has not received as much attention. Finkelstein provides a framework for transforming investment policies (the “rule book”) into practical, useful plans (the “play book”), which, in turn, can be the basis for creating suitable portfolios.

Notably, chapter 3 considers performance appraisal. According to Finkelstein, Wall Street’s partiality for the total return metric is not relevant to public funds. Finkelstein posits a performance measurement standard should address all objectives, not simply return. Since safety and liquidity typically are assigned greater weighting than the yield or return objective in the public sector, Finkelstein questions the relevance of using a total return or a market return benchmark. Additionally, Finkelstein dismisses use of peer groups for benchmark purposes because there are no direct peers.

Instead he offers an alternative, the fiduciary benchmark, to help public funds managers create suitable portfolios and measure their performance. The fiduciary benchmark focuses on suitability instead of total return. Finkelstein identifies five aspects of suitability: liquidity, interest-rate risk, diversification, legality of portfolio holdings, and appropriate market rate of return. Because each public entity has different politics, economics, priorities, levels of expertise, and risk profile, Finkelstein suggests each is subject to its own unique fiduciary benchmark.

However, a counter argument is that Wall Street does, indeed, provide us with an accepted methodology for structuring portfolios, and established standards for measuring and gauging the performance of those funds. Perhaps, government investors in managing public funds are not really unusual in being unique, contrary to Finkelstein's assertion. Ultimately, portfolio managers hired to manage others' funds also have fiduciary responsibilities. Governmental investors are not alone in having fiduciary obligations and concern with safety of principal. Others face political risks in managing funds under their stewardship. Yet, in each instance, Wall Street, provides us with a way of managing funds, regardless of differing objectives, risk tolerances, and so on. Furthermore, rejecting universal benchmarks or standards ignores accountability. It harkens back to a time when governments were not subject to performance measurement but to a separate set of rules.

Finkelstein offers an outline for considering risk. He suggests that the real risk in a typical public funds portfolio arises from not having sufficient liquidity and not from credit or default problems. Principal is more likely to suffer as a result of forced sales or liquidations rather than from default by a

typical public funds portfolio security (Treasury or agencies). He shows how to create a politically correct portfolio where safety and liquidity are addressed while providing a context for income to be optimized.

Part Two, titled "Technical Tool Kit," turns more to the quantitative side, and provides constructive everyday tools and practical applications for the public funds investor. Finkelstein introduces and explores the concept of opportunity cost. To illustrate this concept, Finkelstein suggests that public funds investors may shy away from optimal maturities, opting instead for maturities that are less likely to result in unrealized losses (GASB Statement No. 31). Finkelstein points out, in so doing, they impose an opportunity cost on their portfolios. He characterizes this as a continual tug-of-war between safety and yield, and reminds the reader of the fiduciary responsibility to pursue both. Finkelstein suggests that opportunity cost is a true cost and shows how it can be calculated and considered in managing the public funds portfolio. He stresses the importance of communicating the concept of opportunity cost to stakeholders. Additionally, Finkelstein introduces the concept of portfolio rebalancing and considers situations where a portfolio can profit from selling and realizing losses. The book provides clear examples and walks the reader through the steps involved in carrying out these analyses and comparisons.

Duration is an intimidating concept that investors of public funds, especially those less seasoned, tend to avoid. Finkelstein devotes an entire chapter to presenting duration. Often passed over in favor of the easier to grasp average life, duration is defined for the reader. Its application as a means of assessing risks, specifically price volatility, of a bond or a fixed income portfolio is illustrated plainly. Finkelstein does

an excellent job, using examples to show how duration is calculated, and how it can be used to structure public funds portfolio.

In the last chapters of Part Two, Finkelstein provides a basic overview of a popular sector for public funds investing, U.S. agency callable securities. Of practical value, he clearly illustrates how Bloomberg can be used to obtain agency information. The discussion of callable securities wraps up with a consideration of value and risk for callable securities.

*The Politics of Public Fund Investing* concludes with the chapter titled Public Funds Analytics, in which Finkelstein brings together the various concepts and tools discussed throughout the book and introduces additional techniques for portfolio management, including relative value analysis, methods of forecasting liquidity, market rate of return, and future income.

*The Politics of Public Fund Investing* is beneficial in a number of ways. First, Finkelstein provides many useful tools. He has a natural talent for simplifying difficult or non-intuitive concepts. As a result, the reader is left with practical tools for managing public funds. By interspersing real-life stories throughout the book, he not only provides a good read, but creates scenarios in which the typical investor can see himself. Further, the importance Finkelstein places on effective communication throughout the book cannot be underestimated. Finally, while the merits of Finkelstein's alternative to structuring portfolios and measuring performance can be argued, this book is indeed a valuable resource, providing practical lessons as well as food for thought. ■

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