FTN FINANCIAL CAPITAL ASSETS CORPORATION

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# Weekly Comments by Mark Cary

## PORTFOLIO ENGINEERING — COMING SOON FROM FTN FINANCIAL CAPITAL ASSETS CORPORATION

*As Jerry Hubbard mentioned in last week's* Weekly Comments, *FTN Financial Capital Assets Corporation ("Capital Assets") is currently working on a new suite of analytics that will comprise a new concept called Portfolio Engineering. One online definition of engineering states: "The action of working artfully to bring something about." So many of our depository customers would like the ability to alter their loan portfolio to achieve their desired risk and reward profile. In this week's* Weekly Comments, *we'll begin the introduction of a new Portfolio Engineering (PE) analysis we are rolling out Q319 that will help you design the ideal portfolio composition, including a strategy to get you there.*

### Solving the Dynamic Loan Portfolio Equation

Many things affect the overall composition of a loan portfolio. Everything from the volume and type of loans your market will allow you to originate, to changes in interest rates, to regulatory issuances affect the loan portfolio.

For example, in some market areas, it's difficult to originate the desired volume of adjustable rate loans. Over time, a portfolio can be too concentrated in fixed rates. Fixed-rate loans can react the opposite of what we need in a rising rate market in that the lower yielding loans tend to hang around that much longer and the yield never changes. As rates fall, the more lucrative note rates prepay. Growth in loans tends to be the desired solution, except adding more fixed-rate loans to a portfolio dominated by fixed rates often results in a very slow yield recovery rate ("YRR") while relative interest rate risk ("IRR") remains constant.

### Using Portfolio Engineering to Design Your Optimum Portfolio

Our new PE analysis process is a series of analytics to design the ideal portfolio composition for you and a plan to get you there. Using the results of a Portfolio Performance Analysis ("PPA"), we will compare status quo to other options.

Step One — PE Mortgage Yield Recovery Analysis (MYRA):

1. What is the current size, composition, yield of my loan portfolio?
2. How much of my current portfolio will remain year by year for five years?
3. Based on my current average monthly originations, how many new loans will I add month by month for five years?
4. Adding the remaining legacy loans to my new production, what is the resulting size, composition, and yield as my current portfolio pays down and I add new loans annually for five years?

If my current portfolio was 80% fixed rate and 20% adjustable today and is 80% fixed/20% adjustable in the future, that indicates status quo is not working in terms of modifying the composition of my portfolio to a more preferable balance.

With the PPA and MYRA results, we then pro forma a series of "what ifs" to explore what's to improve the portfolio composition over time. Using the 80% fixed/20% adjustable example above, here's how we might approach the pro forma modeling:

**Step Two — PE Scenario Modeling**:

1. How many adjustable-rate loans must I add to change the portfolio composition to a desired level?
2. How long will it take to modify the composition to that desired level?
3. What if I reduced my concentration in fixed-rate long/lows?
4. What if my mortgage department begins selling some of the new fixed rates?

If my current portfolio was 80% fixed/20% adjustable and I prefer 60% fixed/40% adjustable, PE Scenario Modeling will tell us how many loans we have to add over what period of time to get there including a variety of ways to make the trip.

## Long-Term Strategy

When it comes to effective loan portfolio management, there is no magic pill. It's a process that takes time. Some institutions can make meaningful adjustments to their portfolio composition in two or three years, while others may require longer. No two situations are the same, but rest assured we have ways to help you accomplish the desired goals. Strategies predicated on PE analysis will include ways to measure and monitor progress along the way. There will be more information later on specific new tools we have that can supplement your organic originations to accelerate the transition to a better risk profile.

## The Mortgage PPA — the Starting Point for Getting your new PE Analysis Completed

In the coming weeks, Capital Assets will unveil more information on a new suite of analytics that you will definitely want to have in your tool kit. In the meantime, if you haven't noticed, the 10yr Treasury is near a two-year low, and the market has provided an opportunity to do some portfolio rebalancing in the portfolio. Don't miss out on this gift the market is giving us. Contact your FTN Financial Rep or Capital Assets directly at 1.800.456.5460.

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