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Moving Beyond "Set It and Forget It": Elevating Portfolio Management from Passive to Purposeful

For decades, many credit unions have taken a passive approach to investments, primarily using the portfolio as a place to park liquidity and earn spread income, but not always as a tool in dynamic balance sheet management. This approach worked efficiently during many years of relatively stable interest rate cycles that produced modest unrealized gains and losses. However, the past few years have shown that interest rate cycles can be anything but stable.

In just the last three years, the yield curve whipsawed from steep to deeply inverted and back again in record time. Funding costs spiked, deposit behaviors shifted, and liquidity pressures became more pronounced. The pace of change has undoubtedly accelerated, and the rate environment may well transform again over the next 12–18 months.

In this era of heightened volatility, the "set it and forget it" strategy can leave valuable opportunities — and necessary risk adjustments — on the table. To be clear, strategic portfolio management does not mean actively trading bonds. For credit unions, it simply means making intentional, timely adjustments to align the investment portfolio with evolving interest rate, liquidity, and balance sheet needs.

Where Passive Portfolio Management Falls Short

There is nothing inherently wrong with buying bonds and holding them to maturity. Doing so minimizes earnings volatility and the operational resources needed to manage the portfolio. It aligns with the inherently conservative nature of credit unions and draws little extra attention from examiners. But the drawbacks become clear when the rate environment changes dramatically, especially when it does so as quickly as it has this cycle.

Since the rapid rate run-up of 2022-2023, the investment portfolio has come into sharper focus. Historic unrealized losses combined with liquidity pressures in early 2023 exposed the risks of holding significant underwater assets and forced many institutions to confront the challenges of selling assets at steep losses. In the wake of such volatility, regulators have encouraged institutions to view the portfolio as a central element of asset-liability management and prudent portfolio actions can be considered part of a holistic balance sheet strategy.

Although strategically managing the portfolio may mean taking the occasional loss on an underperforming asset, doing so can also mean locking in stronger earnings potential and better balance sheet positioning for years to come. In aiming to avoid losses, institutions are effectively choosing to continue incurring a loss each day in the form of forgone income. Instead, strategically reallocating an underperforming asset into a better performing one can lock in additional earnings power each day forward. When interest rates are changing dramatically, this more active approach can offer institutions greater flexibility to protect earnings, manage risk, and seize opportunities as conditions change.

More "Active Management" Does Not Mean "Active Trading"

Active management is not about regular turnover; it is about making strategic adjustments. There are many simple tactics that can make meaningful improvements to portfolio performance. These include opportunistic sales of underperforming securities when market conditions improve their pricing, shifting a portion of the portfolio into a sector that offers better relative value, and executing bond swaps to better align the portfolio with asset-liability objectives. Even modest recalibrations can improve earnings and reduce risk without overhauling the portfolio. These moves do not require frequent trading but rather represent deliberate actions to keep the portfolio aligned with broader balance sheet objectives as the rate environment changes.

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A More Balanced Approach

For credit unions, it is key not to abandon a buy and hold approach but to layer in a more flexible strategy. Maintaining a core portfolio of long-term holdings while selectively repositioning at the margins preserves stability and positions institutions to respond as conditions change. The goal is simply to consider which securities no longer align with strategic goals and identify where modest adjustments to the portfolio can pay dividends.

In this new era where interest rates and funding dynamics can change dramatically in a matter of months, prudent portfolio management requires considering occasional strategic adjustments. Not through frequent trading but through thoughtful, deliberate actions that keep the investment portfolio optimized even as conditions change.

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