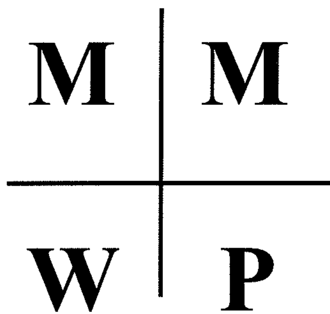

MEMORANDUM

To: Library Board Members

From: Theodore C. Widder, III

Date: May 25, 2010

Re: M&I Managed Bond Fund/Discussions with Dave Gawenda, City Treasurer

At the last Board Meeting, we discussed the report that we had received from M&I Wealth Management regarding the M&I Bond Management fee schedule as well as the M&I Bond investment strategy as relates to approximate $700,000 in accumulated gifts and bequests that the Library Board has responsibility for.

It was the consensus of the Board that I should engage Dave Gawenda, City Treasurer, in a discussion of other possible approaches to the prudent investment of these funds such as low cost index funds, and get his input on an approach for management of these monies.

I did meet with Dave and we discussed a number of potential options that the Board might consider. These break down essentially to these:

1.) Maintain the status quo in the near term. One option is to stay with M&I Wealth Management at least in the near term (i.e. the next year or two), but under the following conditions:

A.) We determine more specifically what their investment strategy is. Namely, (i) their distribution policy (i.e. is it strictly the interest payments on the bonds or is it bond profits that are derived from the sale of bonds-Dave pointed out that bonds were sold in December of 2009-a move that he thinks was a good one, but it is unclear as to what happened to the profits that were realized. Were they distributed or were they reinvested (or a combination)?)

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B.) We ask for a report on how the M&I actively managed fund compared to the benchmark M&I suggested-namely, the Barkley's Capital Intermediate Government Credit Bond Index. If it underperformed the index, we ask further as to why they think it did and what the prospects are for the future.

C.) Ask the M&I folks to come in person to make a presentation to us, at least annually (you will recall that we have now, at Dave's urging, placed this as a permanent annual agenda item). This would simply enhance that discussion by having M&I appear in person (or perhaps by conference call) to explain performance, strategy, changes, and distribution policy.

D.) Ask for a calculation of the annual rate of return on the fund (i.e. cash-on-cash-return) and how that compares to distribution of monies.

2.) Move all of the funds to Low Cost Index Funds. The second option is to move all of the funds to low cost index funds. One possible breakdown would be to invest a third (1/3rd) of the fund each in the following funds:

A.) Vanguard Long-Term Bond Index Fund.
B.) Vanguard Intermediate-Term bond Index Fund.
C.) The Vanguard Short-Term Bond Index Fund.

All of these funds have identical expense ratios of 22 basis points (compared to 58 basis points for the M&I monies) (a basis point is 1/100th of a percent). Since inception (which is more than ten years in each case), the above bond funds have yielded 7.47%, 6.65% and 5.32% respectively going from A to C above).

3.) A combination of 1 and 2. The third option is to move a portion of the M&I funds into one of the index funds (say ten (10%) percent of the corpus (i.e. roughly $75,000)) a year into one or more of the index funds. This would be part of a longer term strategy to move all funds over time (so-called "dollar cost averaging).

From a timing standpoint, it is Dave's view and I concur in this, that all interest rates are likely to move higher over the next two to three years so that investing in either short-term or long-term index funds would not be appropriate at this time (i.e. a long-term fund will decline in value as the long-term rates go up and short-term rates are currently nominal at best). If we were to move any money Dave thinks the appropriate place to put it would be in the intermediate term bond index fund.

Recommendation.

It is my recommendation that we go with option 1 to test how M&I is doing compared to an aggregate bench mark. This has the advantage of us not having to do a whole lot in terms of making a decision as to how much to move and where. Also, the thirty-six (36) basis point premium for the active management (58 vs. 22) may well be worth it (particularly in the next few years) and this is something we can test for on an annual basis. That is, if M&I is not out-performing the bench mark by at least 36-basis points, we are not staying ahead of the game. This is only my recommendation, and I could be persuaded otherwise.