Segment Your Portfolio to Achieve Your Investment Objectives

For public sector investors, the primary investment objectives are **safety, liquidity, and return—in that order**. The challenge is balancing these objectives while making sure public funds are available when they are needed.

A government that keeps all of its money in highly liquid investments may sacrifice some potential return. Conversely, investing too much in longer-maturity securities can create interest-rate and market risk—and may force the government to sell investments at an unfavorable time if cash is needed unexpectedly.

A practical way to balance these competing considerations is to **segment the portfolio according to the government's cash flow needs and investment objectives**.

Portfolio segmentation does not mean creating rigid silos. Rather, it provides a framework for determining **which funds need immediate liquidity, which funds may be invested for an intermediate period, and which funds can reasonably be invested for longer periods**.

This approach is consistent with GFOA guidance, which recommends that governments understand their cash flow requirements, establish an appropriate risk profile, and structure investments to provide sufficient liquidity while managing market and interest-rate risk.

Start With the Cash Flow Forecast

The starting point for segmentation should be a **cash flow forecast—not the investment product**.

GFOA recommends ongoing cash forecasting to ensure that sufficient liquidity is available to meet disbursement requirements while limiting idle cash. The forecast should generally cover at least a **12-month rolling period** and, for most governments, should be broken into monthly periods. Larger or more complex governments may require weekly or daily forecasting.

A useful cash-flow forecast identifies:

- Beginning cash and investment balances;
- Expected revenues and other cash inflows;
- Payroll, operating expenses, debt service and other disbursements;
- Capital expenditures and other significant one-time payments;
- Expected investment maturities and interest receipts; and
- A reasonable liquidity cushion for unexpected needs.

The forecast does not have to be unnecessarily complicated. A smaller government may be able to begin with a relatively simple spreadsheet showing major categories of inflows and outflows. The important point is to understand **when cash will be needed and how much must remain readily available**.

The forecast should also be updated regularly and compared with actual results. Changes in revenues, expenditures, capital plans, debt issuance or other significant events can change the amount of money that is safely available for investment.

From Cash Flow to Portfolio Segments

Once the government understands its cash-flow requirements, it can determine how much of its portfolio should be maintained for liquidity and how much may be invested for longer periods.

A simple framework is to divide the portfolio into **liquidity and core segments**. Some governments may benefit from adding an intermediate segment when cash-flow patterns or investment objectives warrant it.

Liquidity Segment

The liquidity segment is designed to meet **known and reasonably foreseeable cash requirements**, while also providing a prudent cushion for unexpected needs.

Typical characteristics include:

- Funds needed for operating requirements and near-term obligations;
- High liquidity and minimal market-price volatility;
- Short investment horizons;
- Maturities structured around anticipated cash needs; and
- Primary objectives of safety and liquidity.

Potential investments may include appropriately structured bank deposits, local government investment pools, money market funds, overnight repurchase agreements, and short-term U.S. government securities—**provided they are authorized by applicable law and the government's investment policy**. GFOA specifically identifies money-market-type investments, including LGIPs, money market funds and overnight repurchase agreements, as tools for maintaining portfolio liquidity.

The liquidity segment should not be thought of simply as "cash." Its size should be based on the government's actual and expected cash flow requirements.

Intermediate Segment

Some governments may benefit from an intermediate segment for funds that are not expected to be needed immediately but may be required within the next several months to a few years.

The purpose is to provide a transition between immediate liquidity and longer-term core investments.

This segment can be structured using a ladder of securities with staggered maturities so that investments mature at different points in time. The appropriate maturity and duration should reflect the government’s cash flow forecast, investment policy and tolerance for interest-rate risk.

Core Segment

The core segment consists of funds that the government does **not reasonably expect to need for near-term operating purposes**.

Because these funds have a longer investment horizon, the government may have greater flexibility to use investments with longer maturities or duration, subject to applicable law and its investment policy.

Potential investments could include longer-maturity U.S. government securities, agency securities, GSE securities (government sponsored enterprises), appropriately structured deposits, and other authorized investments. Where permitted by state law and the government’s investment policy, investment-grade corporate securities may also be considered.

The objective of the core segment remains **safety first**, but with greater emphasis on earning a reasonable market-based return over the investment horizon.

Longer maturities can provide additional income, but they also increase exposure to interest-rate and market risk. GFOA therefore recommends that governments establish maturity and/or weighted-average-maturity (WAM) limitations and/or duration targets consistent with cash-flow needs, investment objectives, constraints and risk tolerance.

Match Investments to the Purpose of the Money

Segmentation works because **different money has different jobs**.

A government should not invest money needed next month the same way it invests money that is not expected to be needed for several years.

For example:

Portfolio Segment	Primary Purpose	Typical Horizon	Primary Considerations
Liquidity	Meet near-term obligations and provide a cash cushion	Immediate to short term	Safety, liquidity, minimal volatility
Intermediate	Meet anticipated future needs while earning additional income	Several months to a few years	Safety, liquidity, maturity, duration and return
Core	Invest funds not expected to be needed in the near term	Longer term	Safety, diversification, duration and reasonable return

These are **conceptual categories, not prescribed GFOA time periods**. Each government should determine its own segments based on its unique cash flow forecast, legal requirements, investment policy and risk tolerance.

Segmentation Does Not Eliminate Risk

Segmentation is not a substitute for diversification or risk management.

Even within each segment, governments should consider:

- **Issuer concentration** — avoiding excessive exposure to any one issuer;
- **Sector concentration** — establishing appropriate limits by sector or security type;
- **Credit risk** — ensuring investments meet the government's credit-quality requirements;
- **Interest-rate risk** — managing maturity, WAM and duration;
- **Liquidity risk** — ensuring investments can provide cash when needed;
- **Structure risk** — understanding call features, amortization and other characteristics that can affect market value; and
- **Policy and legal compliance** — ensuring every investment is permitted under applicable law and the government's investment policy.

GFOA's diversification guidance specifically recommends establishing limits on individual securities and business sectors, developing guidelines for individual security classes, limiting higher-risk investments and structures, and defining maturity and duration parameters.

In other words, **having three buckets does not automatically create a diversified portfolio**.

LGIPs Can Be an Important Part of the Liquidity Strategy

Local government investment pools can be particularly useful for a liquidity segment because they can provide professional management, diversification and liquidity.

But an LGIP should not simply be treated as “cash.” GFOA emphasizes that LGIPs can differ significantly in investment objectives, legal structure, liquidity, maturity and market-value characteristics. Governments should understand the pool’s investment policy, offering materials, financial statements, withdrawal procedures and investment objectives before investing.

Importantly, GFOA notes that an LGIP can be **part of a diversified portfolio**, but a portfolio consisting entirely of an LGIP may not provide appropriate diversification.

For Illinois governments, this means an LGIP can be an important component of a liquidity strategy, but it should be evaluated within the context of **Illinois law, the government’s investment policy and the government’s overall portfolio**.

The Investment Policy Provides the Guardrails

Segmentation should be incorporated into the government’s written investment policy and investment program.

GFOA recommends that governments have a governing-board-adopted investment policy that establishes investment objectives, risk tolerance, portfolio constraints, and how the investment program will be managed and monitored.

The policy can establish parameters such as:

- Minimum liquidity requirements;
- Maximum maturities;
- WAM and/or duration limits;
- Permitted investment types;
- Minimum credit-quality standards;
- Issuer and sector concentration limits;
- Diversification requirements;
- Requirements for collateralization or other protections;
- Benchmark or reference-rate methodology; and
- Reporting and monitoring requirements.

This allows investment decisions to be made within a clearly defined framework rather than on an investment-by-investment basis.

Measure All Three Objectives

A portfolio should not be judged solely by its yield.

GFOA's **2026 Best Practice Performance Measures** makes this point particularly clear: governments should evaluate **safety, liquidity and return**, with safety and liquidity receiving priority over return. GFOA recommends measuring and reporting these objectives at least quarterly.

For example, a quarterly investment report might address:

Safety

- Policy and statutory compliance;
- Credit quality;
- Issuer and sector concentrations;
- Maturity and WAM limits;
- Duration;
- Collateralization or FDIC coverage where applicable.

Liquidity

- Cash-flow forecast;
- Available cash and liquid investments;
- Upcoming maturities;
- Minimum liquidity target;
- Whether investments are appropriately matched to expected cash needs.

Return

- Yield or total return, as appropriate;
- Performance relative to an appropriate benchmark or reference rate;
- Significant variances from expectations; and
- The reasons for those variances.

GFOA's current guidance makes clear that **return is only one measure of a successful public investment program**. A portfolio that earns a high return but fails to meet a cash obligation is not a successful public investment portfolio.

Conclusion

Portfolio segmentation provides a straightforward way to align investment strategy with the government's actual financial needs.

The process is simple:

- **Forecast the cash.**
- **Identify when the money will be needed.**
- **Establish appropriate liquidity reserves.**
- **Segment the remaining funds according to their investment horizons.**
- **Diversify within each segment.**
- **Manage credit, interest-rate and concentration risk.**
- **Monitor safety, liquidity and return.**

The result is not necessarily the portfolio with the highest yield. It is a portfolio in which **each dollar is invested appropriately for the job it needs to perform**—while preserving the government's ability to meet its obligations and protecting public funds.

Additional guidance, check:

GFOA Resources

- **GFOA Best Practice — Investment Policy:** GFOA recommends that all governments establish and have their governing board adopt an investment policy.

- **GFOA Best Practice — Investment Program for Public Funds:** Establishes the framework for investment governance, risk and return objectives, portfolio management and cash-flow forecasting.

- **GFOA Best Practice - Cash Flow Forecasting:** Recommends an ongoing, generally 12-month rolling cash forecast.

- **GFOA Best Practice — Managing Market Risk in Investment Portfolios:** Addresses liquidity, maturity, WAM, duration and security structures.

- **GFOA Best Practice — Diversifying the Investment Portfolio:** Provides guidance on issuer, sector, security-type, maturity, duration and structure diversification.

- **GFOA Best Practice — Performance Measures for Government Investment Portfolio Objectives:** Establishes the current framework for measuring safety, liquidity and return and reporting performance at least quarterly.

- **GFOA Best Practice — Local Government Investment Pools:** Provides guidance on evaluating LGIPs and their role in a government investment portfolio.

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