



MONEY MARKET UPDATE

Scott Cabalka, Vice President, Client Service Portfolio Manager • March 31, 2012

Market Overview

Central banks remain committed to ultra-low interest rates, both at the short and long ends of the yield curve. While the recent uptick in economic activity might suggest a possible lull in future stimulus, the Federal Reserve is holding firm on their plan to keep interest rates unchanged from the current zero to 0.25% target range into 2014. In turn, the short end of the yield curve should remain extremely low for at least another year to come, if not longer.

During the quarter, the Libor curve slipped lower by two to five basis points across the term from overnight through one year. Overnight repo levels did improve during the same period, helping to modestly flatten the slope of the short-term yield curve. Market rates on short-term bank debt declined in the last two months – particularly for European banks – as tempering concerns led to improving investor confidence in that sector. Credit spreads narrowed on European financial issuers as the cumulative measures to provide unlimited liquidity to the banking sector seemed to have a calming effect on investor fears. Overall, there was a more positive tone in the credit markets.

Better News on the Economy and from European Banks

The U.S. has enjoyed an impressive economic rebound since the fall of 2011. The consensus economic forecasts have begun to shift higher in response to the recent barrage of good cheer. While there has been an impressive rebound in some areas of the economy, the U.S. housing and job markets have yet to fall in line. Yet, those sectors may be starting to heal. Our own economic forecasts are more modest than the apparent consensus view and largely unchanged relative to where we began the year. We also believe there will be a continued application of the fiscal handbrake and a lingering financial crisis-induced hangover.

In spite of the more positive economic outlook and the recent stability in the European banking system, we do not foresee that the investment climate for money funds will improve in the coming quarter. We expect that short rates will continue to be anchored by accommodative monetary policies, and Libor may continue to drift slightly lower. Credit spreads on the debt of financial institutions may also continue to narrow slightly from here. Overnight repo may not enjoy the recent pop in rates for long as supply of traditional collateral becomes scarcer. The recent calm in the storm of volatile European bank credits may prove to be short-lived if economic or sovereign debt issues and geopolitical events reignite investor fears in the marketplace.

There continues to be a buzz of speculation surrounding the prospects for additional reform measures in the money market industry. While an announcement or change in this arena on its own is unlikely to influence the investment climate, it is unclear how a response from investors to further reform measures could lead money fund managers to alter investment behavior and the composition of money fund portfolios.

Outlook

In light of our market views, we will seek opportunities to positively impact performance using our conservative list of approved issuers, by seeking out fairly-valued industrial issuers, and by maintaining appropriate levels of liquidity. We will also remain proactive in monitoring areas of risk across all market sectors. Our approved list of issuers will continue to reflect the thorough and conservative nature of our credit review process. ■

London Interbank Offered Rate (LIBOR) is an interest rate at which banks can borrow funds, in marketable size, from other banks in the London interbank market. The LIBOR is fixed on a daily basis by the British Bankers' Association.

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