

Money Market Reform Part II

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Key Takeaways

- The SEC hosted a roundtable of industry participants debating ideas on additional money market fund reform
- Short-term rates continued to trend lower as repo rates remained in the single digits
- The Federal Reserve revised its growth expectations lower despite relative improvements in consumer confidence, employment and industrial production

SEC roundtable on money market fund reform

On May 11, regulators, issuers, investors, academics and fund sponsors, (including Fidelity Money Market President Bob Brown) met in Washington D.C. to discuss additional regulatory reform on the money market fund industry. Industry participants debated the issues laid forth by the President's Working Group (PWG) Report, including a mandatory floating NAV supported by former Federal Reserve Chairman Paul Volcker, a Liquidity Exchange Bank proposed by the Investment Company Institute, and a Reserve Buffer for money market funds originally proposed by Fidelity in its comment letter to the SEC in response to the PWG report. While there was much discussion on various solutions to the appropriate regulations to reduce credit and liquidity risk in money market funds, the meeting ended without a consensus solution as to next steps.

Rates trend even lower

Rates on the short-end of the yield curve continued their downward trend, posting historic lows. Overnight repo has traded in the single digits ever since the FDIC implemented its new assessment on bank deposits. The front-end of the curve subsequently declined, with one-month LIBOR breaching 20 basis points, the 4-week bill yielding 0.01% and the 1-year Treasury bill trading as low as 0.16%. The downward pressure on rates is also attributed to less bill issuance and discount notes from the U.S. Treasury and Government Sponsored Enterprises, respectively.

In addition, monetary policy continues to remain accommodative with the Federal Reserve continuing to remove supply from the marketplace through its second round of quantitative easing which will end in June. The most recent FOMC statement remained dovish due to concerns over the sustainability of the economic recovery. GDP experienced a downward revision to 1.8% compared to last year's GDP expansion of 2.8% despite continued improvement in consumer confidence, employment, and industrial production data. The reduction in GDP was attributed to the higher trade deficit that resulted from spiking oil prices. However, the increased volatility in energy prices is not expected to directly impact monetary policy considering the Federal Reserve's belief that rising commodity prices are transient in nature.

However, the inflationary outlook has become more hawkish overseas as central banks continue to tighten monetary policy to curb inflation. The European Central Bank and the Bank of Norway recently raised their target rates by 25 basis points and the Bank of England revealed plans to raise rates before the end of the year.

Investment strategy & outlook

With the Fed expected to remain on hold at least through the end of the year and overnight rates potentially remaining in single digits for a significant period, Fidelity's money market funds have increased their dollar weighted average maturities, primarily through high quality, fixed and floating rate notes. This strategy has helped lock in yields and insulate the funds from historically low overnight rates. However, investment opportunities remain limited, particularly in the highest quality banks, which are not actively seeking to materially increase their wholesale funding books, even at such attractive rates.

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund.

Interest rate increases can cause the price of money market securities to decrease.

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