Month in Cash: In search of value

As of 09-02-2011

Some cash yields ticked higher in August as sovereign-debt issues that had been festering on both sides of the Atlantic were resolved, at least temporarily. With investors feeling more confident that another global financial crisis was not imminent—thus reducing the compulsion to horde cash—one-month London interbank offered rates (Libor) Libor closed up 3 basis points at 0.22%, three-month Libor climbed 7.2 basis points to 0.33%, six-month Libor rose 5.6 basis points to 0.49%, and 12-month Libor increased by 4 basis points to 0.80%.

Offsetting those increases, however, were sharp drops at the extreme short- and long-term ends of the cash-yield curve. As the month began, worries over funding stresses on some European banks had caused overnight rates to spike into the mid-teens; the resolution to Greece's debt drama subsequently pushed repo rates back down to the mid single-digits and Treasury bill yields to zero or below. The pattern was similar at the long end of the curve, with the yield on the Treasury's two-year note plunging to a record low of 0.19% in mid-August after the Federal Reserve pledged to keep benchmark interest rates at virtually zero for the next two years. Fed Chairman Ben Bernanke and other central bank officials subsequently tweaked the "free money for longer" message to give policymakers more flexibility in the event that inflation revives or the somnolent U.S. economy perks up faster than many now expect.

Jitters justify liquidity

Not surprisingly, value in the cash market was in short supply. The unusually generous repo and Treasury bill rates that prevailed in early August were compelling while they lasted, but we made only modest forays out of the overnight market in search of longer-term yield pickups due to concerns over possible withdrawals. With investors fearing a reprise of the September 2008 banking crisis, we chose to maintain a high degree of liquidity to meet possible redemptions in the event of another global panic. We are pleased to report that no such rush for the exits occurred. A slight uptick in repo rates near the end of the month—a reflection of renewed jitters over the viability of the latest Greek bailout package—could present an attractive buying opportunity if the trend persists, given our view that most European banks are more than sufficiently capitalized.

Though Fed Chairman Bernanke's presentation at the global economic symposium in Jackson Hole, Wyo., in late August was arguably the most widely anticipated speech in recent financial market history, Bernanke did not announce any additional monetary measures to bolster the faltering recovery. Instead, Bernanke made it clear that fiscal policy now must do its part to restore confidence. Notably, a schism has formed on the Fed's rate-setting committee, with at least three members dissenting from the promise to keep rates at current levels through mid-2013. At a minimum, we expect the Fed to continue reinvesting proceeds of maturing agency and Treasury debt.

We wish to assure our clients that the downgrade of long-term United States sovereign debt by Standard & Poor's will have no material impact on Federated's money market funds. In fact, S&P reaffirmed its highest A-1+ rating for short-term U.S. debt securities, a staple of the cash market. Of course, Federated will continue to monitor the nation's fiscal outlook carefully, and to make adjustments as necessary.

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London interbank offered rate (Libor): The rate at which banks can borrow funds from other banks in the London interbank market. The Libor is fixed on a daily basis by the British Bankers' Association and acts as a benchmark for other short-term interest rates.

The cash-yield curve is a graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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