

# Cash Commentary

February 2019 | Market Commentary

In February, the Federal Reserve (Fed) stayed on message and indicated that data dependency will drive its next policy decision. The markets were left to speculate on the future of the US economy. For the most part, the Fed's rhetoric has been interpreted as dovish, with policy rates expected to remain on hold for the foreseeable future. The futures market echoed this sentiment and has priced in less than a 5% chance of a rate hike for the remainder of 2019. At the time of writing (February 28, 2019) the Fed Funds futures market was pricing in a 20% chance of a rate cut in 2020.

With the Fed in the background, the market focused on geopolitical events over the month. But even ongoing trade tariff concerns and the Mueller investigation did not impact the upward path of risk assets, with the S&P 500 Index up 5.5% in February. Credit spreads continued to tighten (3-month Libor versus 3-month OIS [overnight index swaps] tightened by 13 basis points) and US Treasury yields remained in a tight channel (US Treasury 2-year yields were between 2.45%–2.53% and US Treasury 6-month yields were between 2.46%–2.51%). The US Treasury yield curve remained very flat (with the 2y 10y yield spread at 14–19 basis points) but has not inverted, which would be a potential sign of a looming recession.

It has been challenging to find value on the government money market yield curve. The flatness of the curve and elevated repurchase agreement rates make overnight maturity securities a good place to sit and wait.

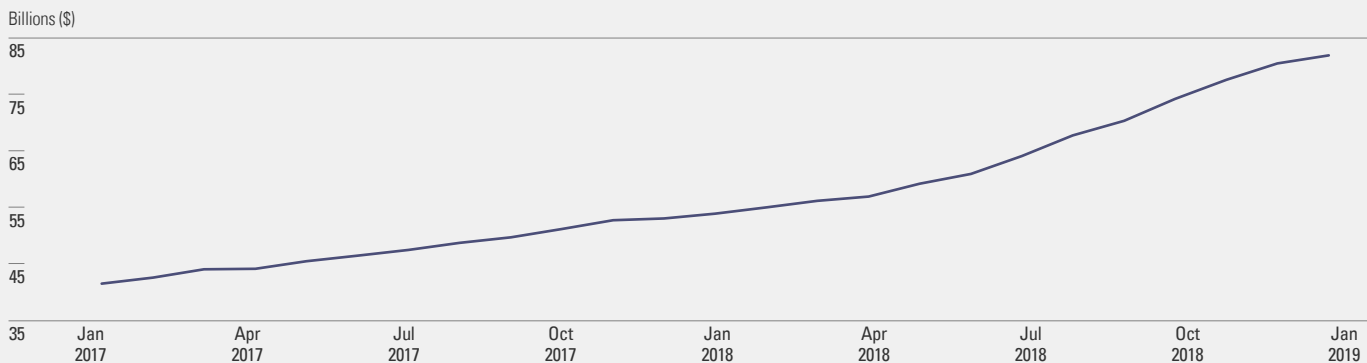
The Secured Overnight Funding Rate (SOFR) has traded above 1-month and 3-month Treasury bill yields, although the potential for softer economic conditions warrants some term investment in case the yield curve inverts.

Credit conditions remain favorable for issuers. Yields on commercial paper and certificates of deposit have tightened versus Treasury yields and it appears that issuers have the upper hand in setting prices, although Libor floating-rate notes remain attractive versus fixed-rate notes, perhaps indicating that the path of rates is lower.

The Fed continued to unwind its balance sheet. On average, since October 2018, the Fed has let \$9.4 trillion mature each week. This is certainly having an impact on short-term rates as dealers, at times, struggle to fund this additional Treasury and mortgage-backed securities supply. Primary dealer positions in US government securities have been noticeably higher over the past five months, increasing by over \$130 billion since October last year.

According to the Investment Company Institute (ICI), money market fund balances increased by \$40 billion over the month. In addition, prime funds continue to grow, with prime fund balances up by over \$50 billion since the beginning of this year. The growth has been steady. Interestingly, also according to the ICI, ultra-short bond funds have seen significant growth over the past six months, up from \$49 billion to \$81 billion, an increase of 40%.

**Figure 1: Ultra-Short Bond Funds' AUM Growth**



Source: Bloomberg as of 01/31/2019.

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