Commentary
Cash

August 2021

Monthly Cash Review

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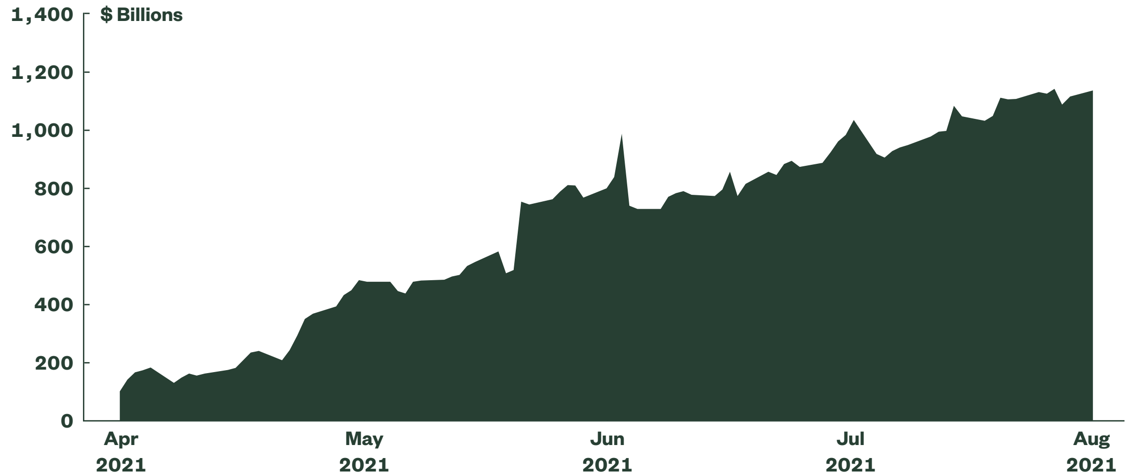
August felt quieter than any other Augusts in recent memory. Quiet like we were in Europe, type of quiet. Perhaps the markets were finally allowing us to truly enjoy the summer weather and take time away. Low volatility and little price action kept short-term rates in a tight channel throughout the month. The highlight of the month was the speech Federal Reserve (Fed) Chair Powell gave at the Jackson Hole Symposium, an event which historically gives the opportunity for open discussion on how monetary policy can shape economic growth and price stability.

This year, Chair Powell used his time to further hint at a taper of the current asset purchase program. Most notably he remarked, "At the FOMC's recent July meeting, I was of the view, as were most participants, that if the economy evolved broadly as anticipated, it could be appropriate to start reducing the pace of asset purchases this year. The intervening month has brought more progress in the form of a strong employment report for July, but also the further spread of the Delta variant. We will be carefully assessing incoming data and the evolving risks." Importantly, he excluded the phrase "a ways off" when describing substantial further progress, indicating he feels we are making strong employment gains. Since the beginning of 2021, we have averaged 586k in non-farm payroll gains, even with August's data coming in at 235k. We will need to see these gains in employment in order to pull the monetary policy rate hike forward, something money market investors so desperately want.

Thus far we have not seen the dreaded "taper tantrum" that was witnessed in 2013 when former Fed Chair Bernanke hinted at the end of the asset purchase program. In 2013, 10-year Treasury yields hit a low of 1.63% before closing out the year at 3.02%. Times were significantly different back then, but it is worth noting that the Fed did not raise its policy rate until two years after the first talk of tapering. I would not expect a similar time frame to unfold given how different this economic shock was versus the last, but worth consideration because of the added emphasis on employment. The question remains: what employment gains must be met before the Fed considers the labor market tight enough to drive inflation sustainably higher?

In the short-term markets the main focus was on the growing demand for the Fed's Reverse Repo Program (RRP). As we have discussed in previous commentaries, this utility is critically important to absorb the excess liquidity (cash) in the capital markets. And it is doing that. Volume at the facility has been over $1 trillion since August 11th and has averaged $905 billion since the Fed's meeting in June. Is this a concern? It's not so much of a concern as evidence the end of quantitative easing should happen soon. As the Fed's asset purchase program injects $120 billion of new liquidity (cash) into the system each month, its RRP is absorbing over $1 trillion of excess liquidity each day.

Figure 1
Fed's Reverse Repo Allotment

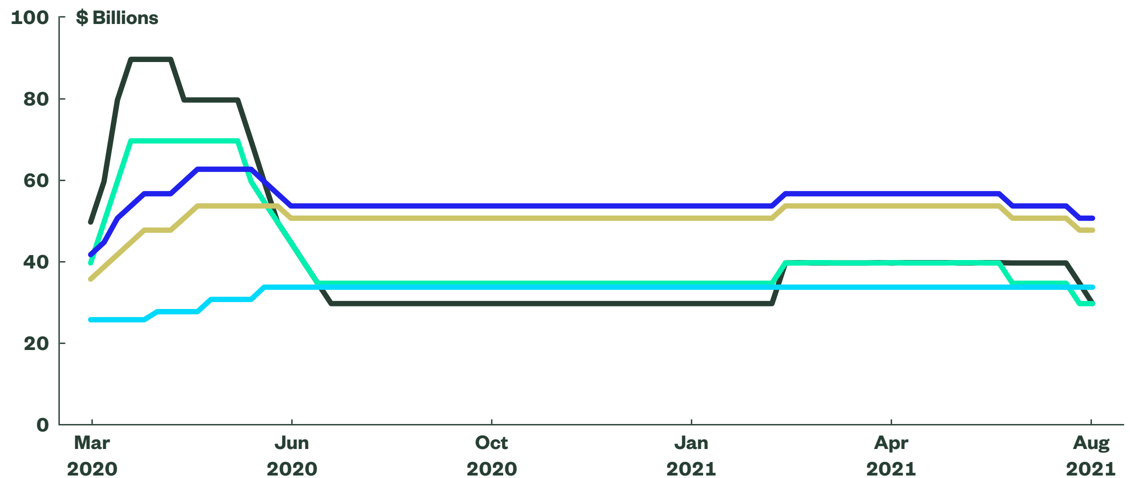


Source: The Federal Reserve as of August 31 2021.

The challenges around the US Treasuries debt limit are now front of mind. The US Treasury's extraordinary measures are in full effect. The suspension of the debt ceiling expired on July 31st and thus began the waiting as politicians play games. Estimates have the Treasury running out of cash (exhausting extraordinary measures) sometime in October or November. (US Treasury's daily cash balance here.) Given the fluidity of the receipts and payments, it is very difficult to pinpoint the exact date the US Treasury would run out of cash. As we have written about in our FAQ Debt Ceiling piece, it is a tricky task to pinpoint the US Treasury debt issue that could be subject to a technical default. Dates can change and owning certain issues could be good one day and problematic the next. Thus, we choose to invest using our historically robust method of relative value on the curve rather than overweighting or underweighting any particular issue, based on potential resolution dates.

Treasury Bill supply continues to be cut. All auctions have been reduced except the 1-year Treasury bill.

Figure 2
US Treasury Bill Total Auction



Source: Federal Reserve as of August 31, 2021.

Credit conditions remain favorable across the curve with 3-month commercial paper (CP) yields within a basis point range throughout the month. CP outstanding balances were slightly lower from the July month-end. There is some concern in the market over CP and other credit holdings by the token currencies, specifically Tether. Tether's market cap is over $60 billion with a reasonable amount of their capital invested in CP. If there is a "run" on this token it could cause hasty selling of CP. Given the amount of liquidity in the system, this author feels that selling would be met with equal demand. Not to say there won't be a repricing to higher yields but there will be smiles on the faces of those investors fortunate enough to buy the higher yields.

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* Pensions & Investments Research Center, as of December 31, 2020.
† This figure is presented as of June 30, 2021 and includes approximately $63.59 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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ID711900-3747653.1.1.GBL.RTL 0921
Exp. Date: 09/30/2022