Commentary
Cash

February 2021

Monthly Cash Review

February was a tale of two sides. Inflation concerns had long-end rates moving higher while supply and liquidity concerns had short-term rates moving lower. Over the course of the month yields on 10-year US Treasury were higher by 34 basis points (bps) and 3-month Treasury-bills (T-bills) were lower by 2bps and SOFR lower by 4bps. Those amounts may not sound like a lot but for cash investors it represents 50% and 80% of the return.

Federal Reserve

Chairman Powell made attempts to sooth market concern during the large US Treasury sell off. He commented we are "a long way from full recovery" and that inflationary risks are contained. He confirmed that monetary policy will be accommodative for some time and did not give any hint that the US Treasury and mortgage-backed securities purchase program would be reduced. They stand at $80 billion and $40 billion per month, respectively.

Outlook

Many unknowns remain relating to the path forward on rates. Most notably is the speed at which the Treasury reduces the balance of its cash and the size of the next stimulus bill. The downward pressure on yields was most acute the last week of the month and expectations still remain as liquidity continues to overwhelm investors looking to put money to work. We expect the Fed to raise Interest on Reserves and overnight reverse repurchase rate (RRP) as soon as March or perhaps as late as this summer.

Economic Data

It's remarkable that there is such a lack of focus on economic data but given the volatility in data series it is hard to see the trends. February started with weaker payroll data and previous month downward revisions. The unemployment rate declined but was attributable to a decline in the participation rate and those no longer looking for work. Producer Price Index was much larger than expected and reflected supply chain disruptions. Retail sales data was very strong and housing continues to be a bright spot in economic activity.

Politics and Policy

The Treasury released their refunding announcement and made a few changes on how they issue debt. They will increase the size of the TIPS auctions, leave the size of the coupon auctions as is and reduce the percent of T-bills versus total outstandings to 15–20%. They also noted, they will eliminate the cash management bill auctions. These typically serve as a funding bridge between the time when the Treasury pays tax refunds and collects taxes on April 15th. Given how flush the Treasury is with cash at $1.4 trillion and the need to pay this down, it makes sense they are eliminating these auctions.

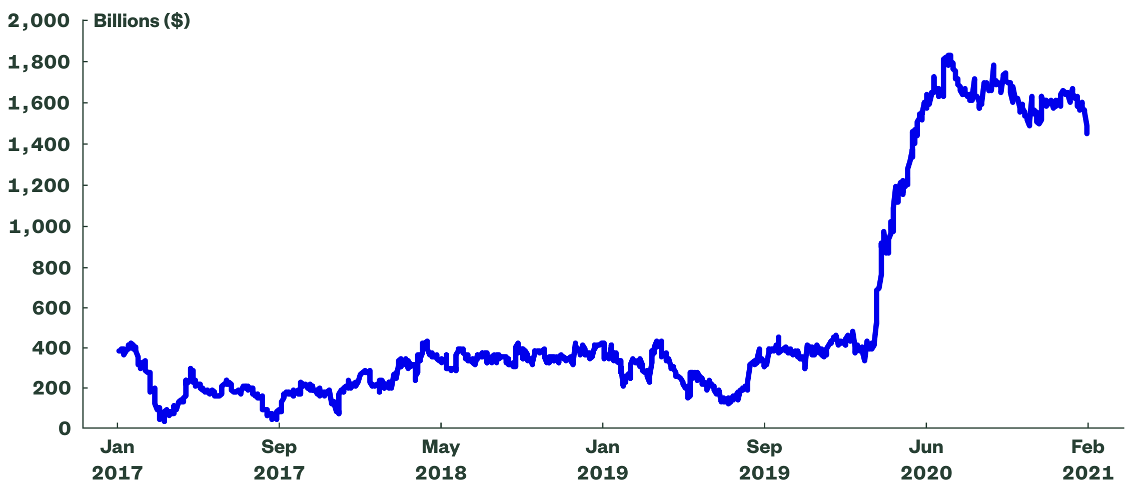
Money Markets

Technical factors (i.e. supply & demand) will be tilted toward issuers for some time. T-bill paydowns are resulting in negative issuance and we expect this to continue as long as the stimulus bill is delayed and the US Treasury reduces the balance in the general account. Their account was $220 billion smaller over the course of February. Interestingly enough commercial paper outstandings are slightly higher since the beginning of the year but only by $100 billion. This could be attributed to season flows over year-end but we have seen some previously absent issuers come back into the market. Perhaps potential reopening's is causing loan demand? Also worth noting is the amount of floating rate debt outstanding. The Bloomberg Barclays Floating Rate Note Index is now $278 billion, smaller by $32 billion since the beginning of the year. While some of this is due to the termination of Libor, it is also a reflection of the relative low cost to issue fixed rate debt further out the curve.

Funds

The funds had a very quiet month. Duration and yield was more or less unchanged over the course of the month. We continue to focus on keeping durations extended given lower yield risks. We are cautious about investing in yields below 5bps given the potential for the Fed to raise RRP as soon as their March meeting. Credit conditions remain solid and liquidity is good.

Figure 1
US Treasury General Account



Source: Bloomberg as of March 2, 2021.

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Marketing communication

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