Commentary
Cash

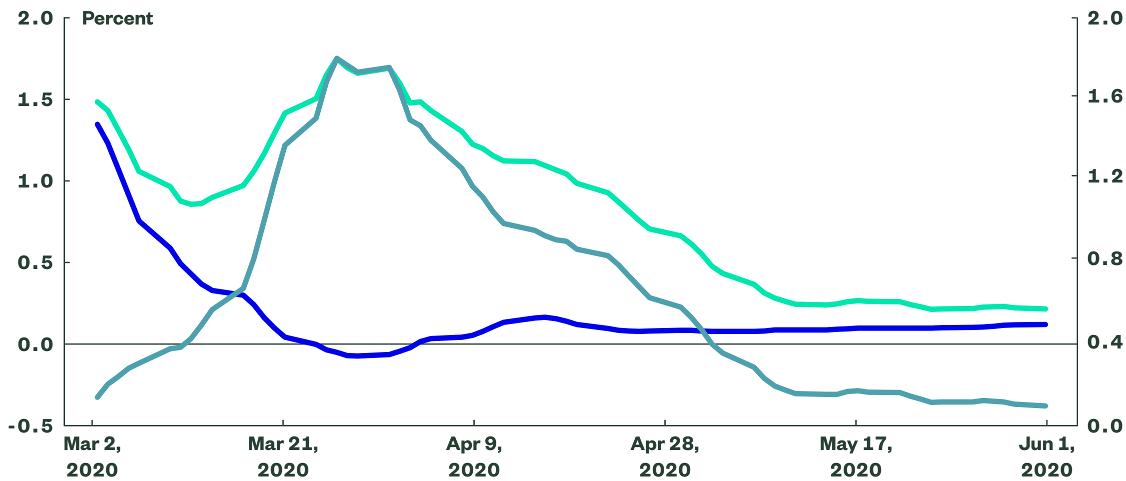
May 2020

Monthly Cash Review

Cash is getting dull again and that's a good thing.

In April, the Federal Reserve (the Fed) flooded the US markets with an unlimited amount of liquidity and the US Treasury. As states across the United States start the slow process of reopening and begin the return to some sense of normalcy, it appears money markets are following suit while remaining highly alert to lingering risks. Two months after the height of market panic, commercial paper yields continue to fall and are currently lingering in the lower double digits (Figure 1).

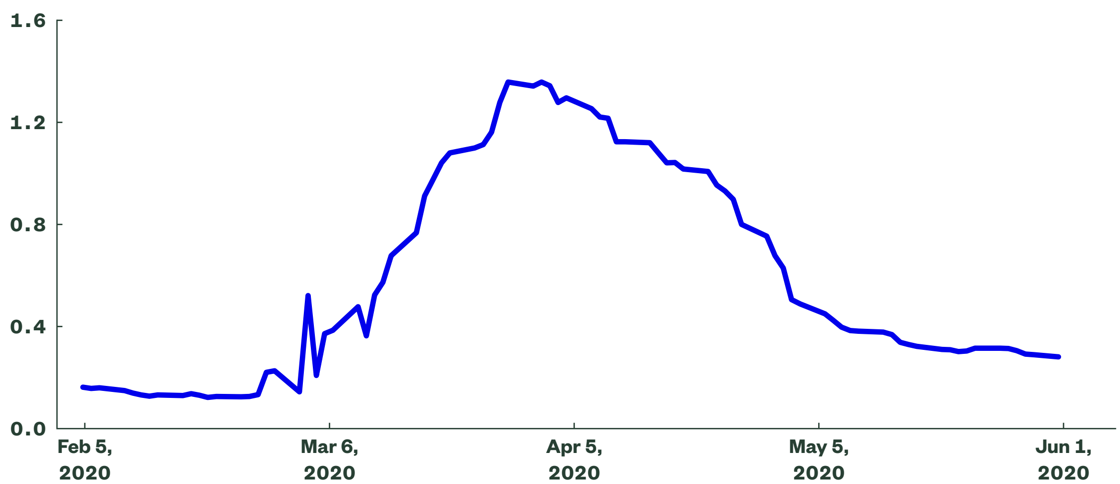
Figure 1
3 Months US T-Bills and A1/P1 Commercial Paper



Source: Federal Reserve, US Treasury, Bloomberg as of June 1, 2020.

Libor Yield versus OIS Yield has also fallen back to a more typical spread differential and is only 15 basis points (bps) away from the tight levels we saw in February (Figure 2).

Figure 2
Libor vs OIS Yield Difference



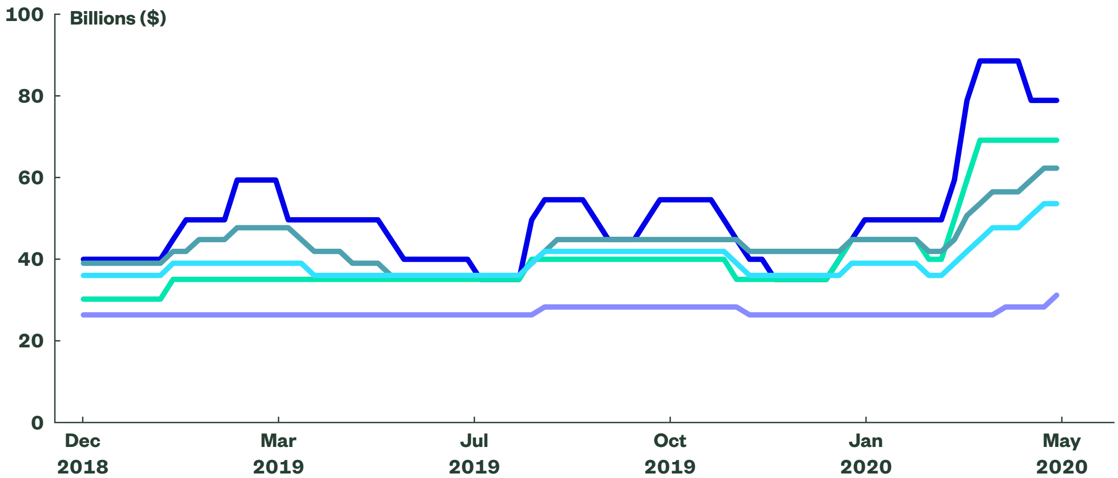
Source: Bloomberg as of June 1, 2020.

Though money markets have shown some recovery, economic data is confusing. Real GDP is tracking at an unpresented -42.5% for the second quarter, while economists predict May's unemployment rate to come in at 19.5%, it came in at 13.3% and non-farm payrolls were up by 2.5 million. While most of the data published has been dismal, there are some glimmers of hope. Although consumer spending fell 13.6% month-over-month in April, there are estimates that May vehicle sales could rise to 10.5 million units, up from 8.6 million in April. Inflation is expected to remain below the 2% target in the near-term, while long-run inflation expectations are harder to gage.

Treasury bill issuance continues at a record pace. Weekly auctions of 1-, 2-, 3-, and 6-month bills, as well as monthly auctions of 1-year bills, have brought almost $300 billion to market per week (Figure 3). This enormous amount of supply does not even include Cash Management bills of which have an additional $1.3 trillion outstanding. Over the past two months we have seen over $2.05 trillion in US bill supply, accounting for 22% of the total Treasury market (Figure 4). We saw a similar increase in supply in 2008 as the US Treasury increased borrowing in order to fund numerous stimulus programs by issuing bills — by far the easiest and quickest way for the US Treasury to borrow. JPMorgan's latest forecasts anticipate over $3.4 trillion in bill supply in 2020. Bills are the best relative value asset for Government and Treasury funds and, with the abundance in supply, these funds are focused on purchasing as much as possible at Treasury auctions.

Figure 3
US Treasury BIll Auctions

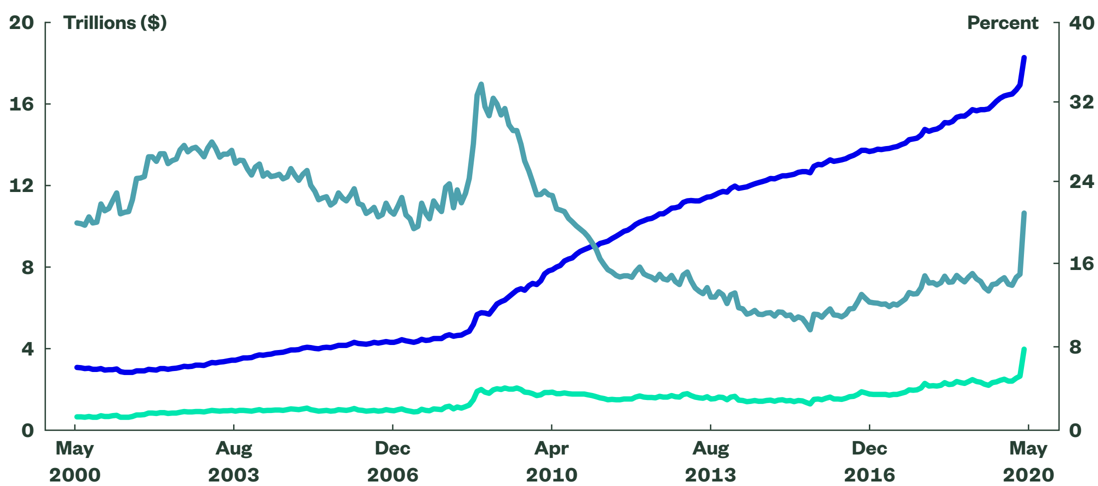
1 Month
2 Month
3 Month
6 Month
1 Year



Source: US Treasury as of June 1, 2020.

Figure 4
Treasury Debt

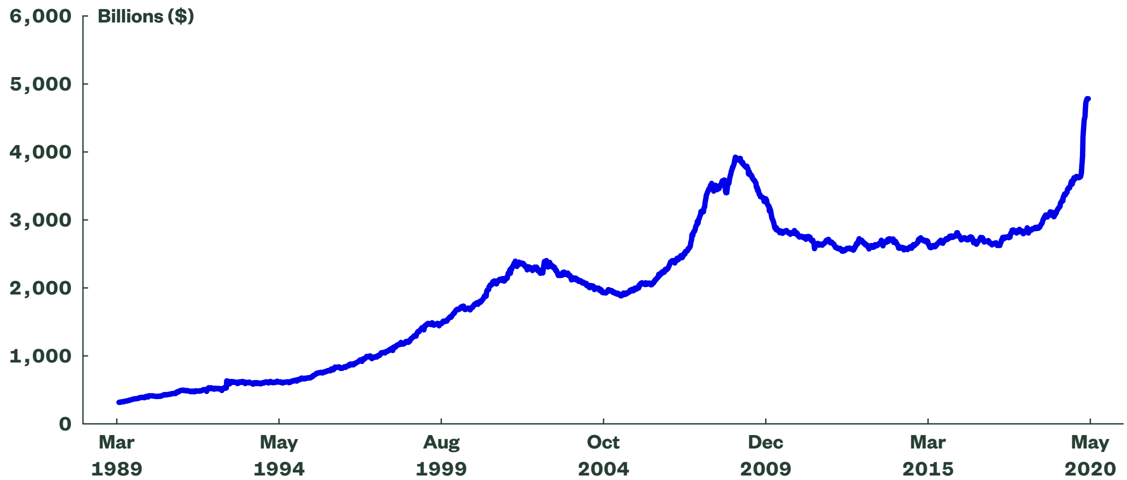
Total Treasury Debt Outstanding
Treasury Bill Debt Outstanding
Treasury Bill as a Percent of Total US Treasury Debt



Source: US Treasury as of June 1, 2020.

Flows into money market funds are stabilizing after massive inflows during March and April, with balances remaining unchanged for the first time in 15 weeks (Figure 5). Current balances come to $4.78 trillion, with $3.9 trillion in Government or Treasury funds, $750 billion in Prime funds and $134 billion in Municipal funds. How slow or fast these balances will take to decline remains to be seen but it warrants stating history shows it takes about a year for the cash to be reabsorbed back into the economy.

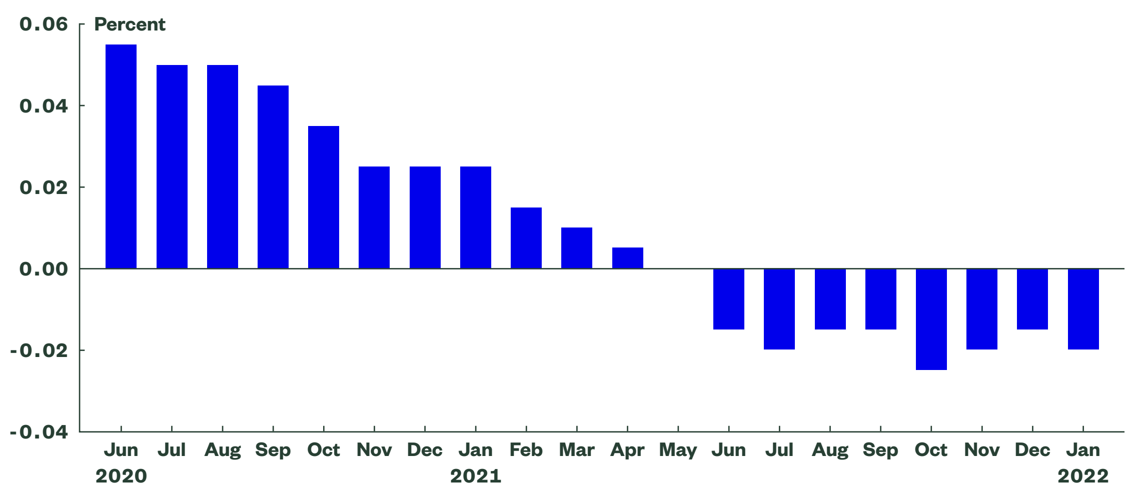
Figure 5
ICI Money Market Funds' Balances



Source: ICI as of June 1, 2020.

The Fed Funds Futures market is showing no change in policy rate for years to come. In fact, the futures market is showing a negative policy rate in some of the longer dated contracts (Figure 6).

Figure 6
Fed Funds Future Policy Rate

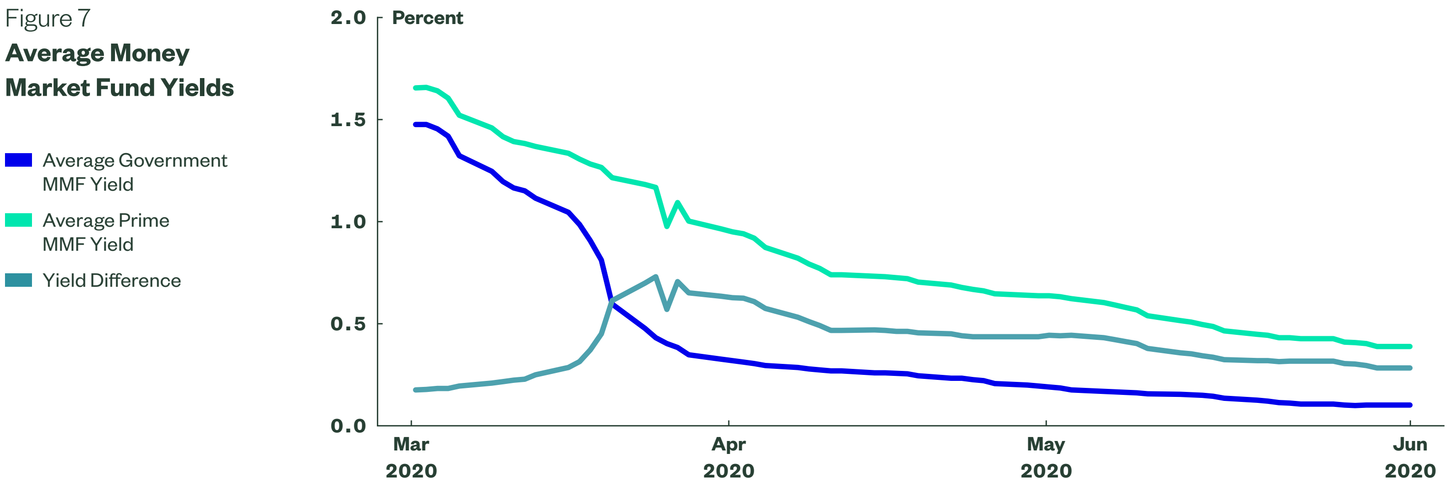


Source: Bloomberg as of June 1, 2020.

Fed officials continue to say they have no plans to implement a negative policy rate. Though tendency falls to the side of believing them, circumstances can change. Case in point: many never thought the Fed would buy High Yield ETFs.

The path to zero interest rates is trending more slowly. Over the past eight weeks, the declines week-over-week have ranged from 1 to 4 bps. This decline has the potential to be slowed further by continued redemptions from Government funds recently. How and if we reach zero will depend on cash flows and market rates. Prime funds have been following a more accelerated pattern as the yield difference indicates (Figure 7). The week-over-week changes have ranged from 2 to 9 bps over the past eight weeks. At present it feels like the tightening in credit spreads has reached its limit with the average yield difference between Prime and Government money market funds coming in at 29 bps.

Figure 7
Average Money Market Fund Yields



Source: Bloomberg as of June 1, 2020.

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