Commentary
Global Cash Management

Q3 2021

Market Forecast

April Borawski
Portfolio Manager
US Traditional Cash Strategies

Will Goldthwait
Portfolio Strategist
Global Cash and Fixed Income Investment Management Teams

Since August 1st, and the expiration of the debt ceiling suspension, the US Treasury has been using extraordinary measures to meet its budget obligations. This has resulted in a reduction of US Treasury debt supply and lower yields at the very front-end of the yield curve. As mentioned in prior writeups, we had anticipated lower rates given the expected paydowns. This supported our strategy of adding Treasury bill (T-bill) positions at or above 5 basis points (bps) coupled with buying SOFR and Treasury floating rate notes that would reset higher once T-bill issuance increased. Although, as we continue to sit in the uncertainty of a debt ceiling resolution, it has become increasingly difficult to find 5 bps yields on the curve. For example, the 6-month T-Bill auction stopped at 4.5 bps the week of September 18th, illustrating the sheer demand for short-dated US Treasuries and the magnitude of cash in the system. Consequently, we have shifted away from purchasing T-bills in any meaningful size, and subsequently have increased our overnight repo orders, which can still offer 5 bps of return. We are able to utilize both dealer offered repo in the open market and the RRP with the Federal Reserve (Fed). We have continued to purchase SOFR floaters and Treasury floaters when attractive. Those positions add a pickup in yield over repo, add some term structure to our portfolios, and will benefit once the debt ceiling issue has been resolved and the reduction in quantitative easing (QE) has begun. But when do we think that will be?

We have made a consistent and deliberate decision to not play the guessing game of when the government **may** exhaust extraordinary measures and run out of money, aka the dreaded 'X date'. There are simply too many factors at play, and it truly remains a moving target. September tax receipts were higher than expected, pushing the Treasury's cash balance higher than previously anticipated. Treasury Secretary Yellen's most recent letter indicated that they will run out of cash by October 18th but also noted that daily cash flows have varied by an average of $50 billion per day over the past year; thus the date of exhaustion could shift forward or backward from October 18th. See here for the latest US Treasury cash balance.

Important but not directly connected, the Fed announced its decision to increase the per counterparty limit in their RRP from $80 billion to $160 billion at the most recent September FOMC meeting. The increase to the per counterparty limit does not have any effect on the Treasury's extraordinary measures. It does, however, give larger money market funds comfort by way of their ability to increase repo allocations at 5 bps with the Fed and potentially reduce allocations to T-bills. It also reinforces the Fed's intent to not let rates go negative by absorbing more cash at 5 bps. On September 30th the RRP saw $1.6 trillion of use from 92 counterparties.

Against that backdrop, the market is pricing the potential dates of 'risk': dates in which the Treasury **may** exhaust extraordinary measures and **delay the payment** (technical default) of a T-bill maturity between late October and early November. Indeed, we saw recent price action in the October T-bills reflect a shift out of some of these bills. As the yield on those issues began to rise, buyers did emerge and prices stabilized. At the time of this writing demand remains strong even in those issues. We continue to operate within our framework: not avoiding any specific T-bill or note, nor creating an overweight or underweight to any specific issue that could be viewed at risk of technical default. We continue to structure our portfolios with ample short-term liquidity that is not overly exposed to any one outcome. Our baseline view is that the Treasury should not experience a delay in payment or what some refer to as a technical default.

It is worth expanding on **delay the payment** term, used above. The Treasury does not lack the means of making a payment. They are constrained by the law. Similar to when the government shuts down, wages are not cancelled or revoked they are simply delayed in being paid. The same would be true in the event.

Amongst that backdrop, the market is pricing the potential dates of 'risk' — dates in which the Treasury could not pay for a bonds maturity. They would make payment when the debt ceiling was resuspended or lifted. It is also important to remember that the impending debt ceiling issue and subsequent reduction in supply is not the only factor putting downward pressure on rates. Even when the Treasury is able to increase their borrowing capacity, once the debt ceiling is resolved, the Fed has not officially announced or begun the taper of its QE program. Chair Powell indicated in his September FOMC press conference that the announcement on tapering could come at the November FOMC meeting and begin in December. He noted the wind down could be complete by the middle of next summer. This, although welcome news, would still have the Fed adding $660 billion of new cash into the system from October to June's end of QE and in some cases, these reserves are being sent right back to the Fed every night via the RRP. Seems a bit counterproductive, doesn't it? Therefore, we need the Fed to begin tapering.

How much higher could short-term Treasury yields move once the debt limit is resolved and QE taper has begun? Unfortunately, this increase will likely be on the margin from current levels, maybe a couple of basis points. Keep in mind, we are in a zero interest rate environment, and there remains well over $1 trillion in cash put at the Fed's RRP each day. Therefore, any meaningful cheapening above 5 bps will be met with strong demand as investors leave the Fed's RRP to chase that yield. But, yes, in general we should see a move higher in yields as the debt ceiling/suspension issue is resolved and the announcement of the QE taper comes to fruition. Until that happens, it is very difficult to beat 5 bps at the RRP.

On the credit front, the story is similar. The abundance of cash is causing credit rates to hover close to new lows, and makes investing in this environment challenging. Additionally, quarter-end preparation had us lightening our maturity schedule over the last week of September in anticipation of a difficult reinvestment period. Many issuers of overnight time deposits were not in the market over the quarter-end. We also saw repo counterparties (dealers) pulling back balances in their typical quarter-end patterns. Therefore, we focused on trades that took us past September 30th, in an effort to lessen our overnight book without giving up too much liquidity. On balance, we continue to add targeted positions further out the curve to add yield (for example, at the time of this writing, 6-months around 15 bps). Yield compression between prime and government strategies will continue in the near-term although there are glimmers of hope. Three-month Libor has pushed higher over the month of September and the Eurodollar market is pricing in higher rates in the forward market. Perhaps the Fed will raise rates in the near future.

About State Street Global Advisors

Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 30 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $3.90 trillion† under our care.

* 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.

ssga.com

State Street Global Advisors Worldwide Entities

Important Information

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor. All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

The views expressed in this material are the views of Will Goldthwait and April April Borawski through the period ended September 28, 2021 and are subject to change based on market and other conditions. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected.

This document may contain certain statements deemed to be forward-looking statements.

Please note that any such statements are not guarantees of any future performance and that actual results or developments may differ materially from those projected in the forward looking statements.

ID748403-3799751.1.1.GBL.RTL 0921
Exp. Date: 10/31/2022