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## Short Supply in the Short Term Market

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In October we continued to experience a shrinking supply of money market instruments. There are several reasons why there is a diminishing supply of assets for short-term investment.

First, there has been a dramatic reduction in the amount of commercial paper (CP) outstanding. This is partly due to the reduction in the amount of commercial paper being held by the Fed through its Commercial Paper Funding Facility (CPFF). Since the CPFF program was announced in October 2008, we have seen the Fed's holdings of CP drop 60%. In the past month, total CP outstanding continued to fall from its peak in August 2007. Additionally, 26.3% – or \$307.3 billion – of the total commercial paper market has been placed over year-end. Another factor affecting supply in the CP market is the robust new issue market for investment grade corporate. Market participants' perspectives about credit remain positive, as earnings news and most economic metrics suggest a recovering business landscape. As a result, companies have been able to "term" out their funding needs by issuing longer-dated corporate notes and reducing their dependence on the commercial paper market.

The agency market has also experienced an overall reduction in size. This is a result of two factors: the \$175 billion Fed buyback program, and the lack of funding needs at the three major agencies, Fannie Mae (FNMA), Federal Home Mortgage Corporation (FHLMC) and Federal Home Loan Bank (FHLB). Short term agency debt outstanding has continued to drop since the beginning of 2009. FNMA is down 36% (currently at \$206 billion), FHLMC is down 28% (\$225 billion) and FHLB is down 44% (\$245 billion). In fact, all three government-sponsored enterprises (GSEs) had negative net issuance (that's new issuance minus maturities or calls) for the month of October.

There continues to be considerable money sitting in short-term products. Although we have begun to see monies flow out of money market funds and move into short duration taxable and tax exempt bonds, there continues to be a significant amount of investment money residing in money market funds. This has also served to exacerbate the lack of supply issue in short-term markets.

All players operating in the short end of the market are experiencing the same difficulties and dilemmas. At Horizon, we continue to seek yield and value opportunities while remaining steadfast to our core philosophy of capital preservation. One continuing example of this: callable agency securities. We have recently purchased several different structures that provide yields in excess of 50 to 145 basis points over 3 month T-Bill levels. While we expect all these bonds to be called on their first call date, they do provide substantial yield pickup before they are called. We also have found considerable value in short-dated corporate notes. These are bonds that other institutional holders will sell to make "room" for new issue corporate notes. They usually have less than a year to maturity and offer a yield advantage over commercial paper. Additionally, we have found value in Yankee Certificates of Deposits (YCD). These are CDs issued by non-U.S. banks though their New York- or U.S.- based branches. These securities not only carry the highest short-term ratings, but also offer attractive yields relative to CP.

We expect supply demand inequality to continue to plague the short term market through the balance of the year. Coupled with the Fed's long-term commitment to keeping interest rates extremely low, the landscape will continue to be challenging. Horizon will remain dedicated to providing the most attractive return possible for our separately managed accounts.

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