

# New Year Begins Where Last Year Left Off

LIQUIDITY | GLOBAL LIQUIDITY TEAM | INVESTMENT INSIGHT | JANUARY 2021

### Federal Reserve Board<sup>1</sup>

As expected, the Federal Open Market Committee (FOMC) held the range for the federal funds rate steady at 0.00% to 0.25% at the conclusion of its January meeting. In addition, forward guidance and quantitative easing policy were left intact. While much was left unchanged, the Federal Reserve (Fed) tweaked its view on economic conditions. The Fed has continued to acknowledge the ongoing economic recovery in prior language, but its January statement noted, “the pace of the recovery in economic activity and employment has moderated in recent months.” The Fed views its current policy stance as appropriate “until labor market conditions have reached levels consistent with the Committee’s assessments of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time.”

### European Central Bank<sup>1</sup>

At the European Central Bank’s (ECB) policy meeting on January 21, President Lagarde and the policy committee kept the ECB deposit rate unchanged at -0.50%, as expected. After increasing the size of its quantitative easing programs in December, the ECB left the facilities unchanged at its January meeting. While President Lagarde expects gross domestic product to recover somewhat

### DISPLAY 1

### Monthly Interest Rate Summary

As of 1/31/2021

US TREASURY RATES	YIELD (%)	MOM CHANGE (%)
1M UST	0.05	0.02
3M UST	0.05	(0.01)
6M UST	0.07	(0.02)
12M UST	0.08	(0.03)
2Y UST	0.11	(0.01)
5Y UST	0.42	0.06
10Y UST	1.07	0.15
30Y UST	1.83	0.17
USD LIBOR CURVE		
O/N LIBOR	0.08	0.00
1M LIBOR	0.12	(0.02)
3M LIBOR	0.20	(0.04)

Source: Bloomberg

<sup>1</sup> Source: Bloomberg.

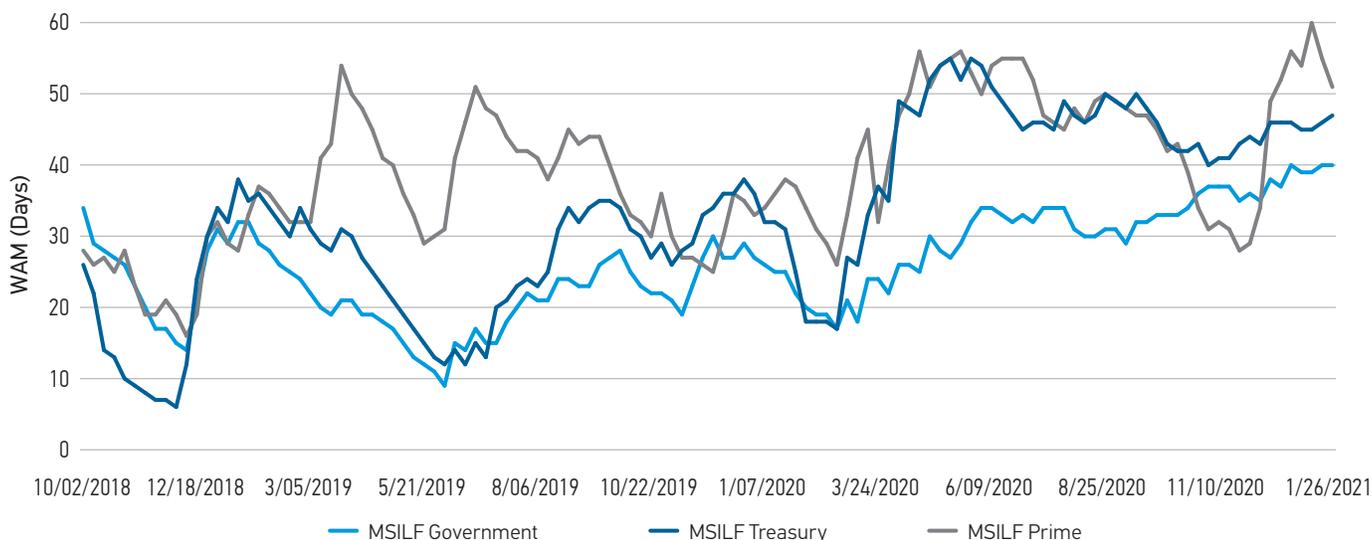
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## DISPLAY 2

Morgan Stanley Institutional Liquidity Funds (MSILF) Weighted Average Maturities (WAM) Summary<sup>2</sup>

As of 1/31/2021



Source: iMoneyNet

in 2021, the ECB reasserted its readiness to act, saying, “The Governing Council continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.”

### Bank of England<sup>1</sup>

Although no formal policy meeting was held in January, analysts expect the Bank of England (BOE) to leave policy unchanged in February. While expectations have been subdued, investors will want to pay attention to the BOE’s guidance on how the national lockdown

and vaccine rollout are affecting economic conditions.

### Portfolio Strategy

#### PRIME STRATEGY<sup>3</sup>

Fed officials kept interest rates near zero and made no changes to their asset purchase program at the January FOMC meeting, indicating they would maintain the current pace of buying until “substantial further progress toward its employment and inflation goals have been met.” An abundance of cash in the short end of the curve pushed three-month LIBOR to all-time lows, setting at 0.20188% at month-end. With

spreads remaining tight and LIBOR<sup>4</sup> and SOFR<sup>5</sup> continuing to grind lower, we maintain our strategy of adding fixed-rate investments to the portfolio, avoiding the reset risk associated with floating-rate notes. Weekly liquidity in our portfolios remain elevated, in excess of 50% throughout the month.

#### GOVERNMENT/TREASURY STRATEGY<sup>6</sup>

Front-end yields remained unchanged through most of January, with Treasury bill yields moving 1 basis point lower toward month-end. During the second half of the month, overnight repo rates softened as government-sponsored

<sup>2</sup> **Weighted Average Maturity (WAM):** Measures the weighted average of the maturities of the portfolio’s individual holdings, taking into account reset dates for floating rate securities.

<sup>3</sup> The Portfolio will be required to price and transact in their shares at a floating net asset value (“NAV”) and will be permitted to impose a liquidity fee on redemptions or temporarily restrict redemptions in the event that the Portfolio’s weekly liquid assets fall below certain thresholds.

<sup>4</sup> The **London Interbank Offered Rate (LIBOR)** is the short-term interest rate that banks charge one another and that is generally representative of the most competitive and current cash rates available.

<sup>5</sup> The **Secured Overnight Financing Rate (SOFR)** is a benchmark rate for US dollar-denominated loans and securities based on overnight transactions in the U.S. Treasury repurchase market.

<sup>6</sup> Government and Treasury Funds are Stable NAV funds.

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enterprise cash and other market technicals forced repo and other short rates lower, underscoring the amount of liquidity in the market. SOFR hit a record low of 0.03% before snapping back higher. Our strategy continued to buy U.S. Treasuries across the curve and added some term repurchase agreements. We continue to ensure high levels of liquidity and manage the portfolios to be responsive to changes in market conditions and interest rate levels.

### TAX-EXEMPT STRATEGY<sup>3</sup>

At the short end of the curve, yields for variable rate demand obligations (VRDOs) fell during the month of January after being largely unchanged during December. The SIFMA Index,<sup>7</sup> which measures yields for weekly VRDOs, fell from 0.09% at the end of December to finish the month at 0.04%. Yields at the longer end of the municipal money market maturity range trended lower during the month while supply remained constrained. The Bloomberg

BVAL One-Year Note Index<sup>8</sup> finished the month at 0.11%, down 0.02% from the prior month-end. While technicals have largely been responsible for rich muni market levels, solid revenue performance, federal aid and prospects for added support from the Biden administration and Democratic-controlled Congress have fueled significant spread compression. In the period ahead, we will watch to see how monetary policy unfolds and determine what impact it may have on municipal yields.

<sup>7</sup> The **SIFMA Municipal Swap index** is a 7-day high-grade market index comprised of tax-exempt VRDOs reset rates that are reported to the Municipal Securities Rule Making Board's (MSRB's) SHORT reporting system.

<sup>8</sup> The **Bloomberg BVAL One-Year Note Index** represents tax-exempt municipal bonds that have an average rating of AAA by Moody's and S&P.

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The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment.

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