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Finding Other Safe Harbors: The Case for Government/ Agency Money Funds

Given the current economic environment, we remain highly attuned to the risks of investments that don't have the benefit of an explicit government guarantee, specifically in the realm of corporate debt. There are, however, non-Treasury alternatives that provide firms with a high level of principal protection and liquidity. We believe that the most secure alternative to Treasuries is U.S. government agencies and government agency money market funds.

One option that we are recommending is an allocation towards government agency funds, such as the First American Government Obligation Fund (FVIXX), a 2a-7 fund. First American Funds is wholly owned by U.S. Bank N.A., and their government fund invests primarily in debt issued by government sponsored enterprises (GSEs) such as Fannie Mae, Freddie Mac, and Federal Home Loan Banks. All of these GSEs have benefited recently from multiple assurances, both verbal and financial, that they have the full support of the U.S. government. Their debt issuances, long considered to have an implied government guarantee, have seen their support only grow in the midst of this credit crisis. We believe that government funds that invest in GSE debt serve as an excellent alternative to Treasuries at providing both a high level of safety and credit quality with yields that are currently more compelling.

The main argument behind recommending GSEs as safe investment vehicles is the wide and deep support that the Federal government has provided to these entities, including Fannie Mae and Freddie Mac. Both have been placed under conservatorship, with the government effectively

backing the two entities by providing up to \$200 billion in capital to each organization. Other liquidity supports include a secured lending facility and direct debt purchases by the government (detailed summaries below). The goals of conservatorship are to help restore confidence in the companies, enhance their capacity to fulfill the mission of providing liquidity to the U.S. mortgage market, and to mitigate the systematic risk to the broader global financial markets. The continued support of Fannie and Freddie is vital to the credit markets domestically and internationally. Despite expectations of continued 'headline risks' for the GSE's, specifically around the financial performance, operations, personnel and the uncertain future legal structure of both Fannie and Freddie, the recent actions indicate that the government will take the necessary measures to sustain the viability of these entities.

For clients interested in this fund or wanting to learn more, please read the following FAQ and reference material. As always, we encourage you to contact us directly if we can provide any further perspective on this topic.

What is a GSE?

GSE stands for government sponsored enterprises and they have been created by Congress over time to provide credit to key sectors of the economy such as housing, agriculture, exports and small businesses. The U.S. agency debt market is one of the largest and most important components of the global fixed income market. As of March 2009, the combined debt and obligations of Fannie Mae, Freddie Mac and FHLB totaled \$6.7 trillion, slightly less than the

total publicly held debt of the USA of \$6.8 trillion. The GSEs also purchased or guaranteed 73 percent of new mortgage originations as of the first quarter 2009.

What rating actions have been taken on GSEs?

Both before and after the current credit crisis, all forms of senior GSE debt have been rated Aaa/AAA by both Moody's and S&P with stable outlook. Their maintenance of this rating strength reflects Moody's and S&P's shared view that the GSEs benefit from very strong systemic support because of their central role in mortgage finance in the United States, as well as the importance of housing within the U.S. economy.

What specific U.S. government support have the GSEs received?

While not explicitly guaranteeing the debt of GSEs such as Fannie Mae and Freddie Mac, the government has put in place an extensive array of supports and reaffirmations of support for this all important class of debt.

The most substantive supports are:

1. On September 7, 2008, Treasury and FHFA established a senior preferred stock purchase agreement to which the Treasury will purchase senior preferred stock from Fannie Mae and Freddie Mac on as-need basis, up to \$100 billion per GSE (indefinite in duration) which was subsequently increased to \$200 billion per GSE on May 6, 2009. Under these agreements, Treasury will ensure that each company maintains a positive net worth. These agreements support market stability by providing security and clarity to GSE debt holders and support mortgage availability by providing additional confidence to investors in GSE mortgage backed securities. This commitment ensures that the conserved entities have the ability to fulfill their financial obligations. In exchange for the agreement, the U.S.

Treasury received \$1 billion of senior preferred stock and warrants to purchase common stock representing up to 79.9 percent ownership interest. In addition, the Treasury established a secured lending facility (GSECF) for Fannie Mae, Freddie Mac and the Federal Home Loan Banks with no dollar limit and announced its intention to purchase GSE mortgage backed securities in the open market with the size and timing subject to the discretion of the Treasury Secretary. Both the secured lending facility and the authority to purchase mortgage backed securities will expire on December 31, 2009, unless it is extended by the Congress.

Pursuant to the purchase agreement, Freddie Mac will receive a total of \$51.7 billion including the latest request of \$6.1 billion pursuant to the 1Q09 result announced on May 12, 2009. Fannie Mae will receive a total of \$35.2 billion including the latest request of \$19 billion after the 1Q09 result announced on May 8, 2009.

2. On November 25, 2008, The Federal Reserve announced that it will initiate a program to purchase up to \$100 billion in direct obligations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks and up to \$500 billion in mortgage-backed securities (MBS) backed by Fannie Mae, Freddie Mac, and Ginnie Mae. The goal of the program is to provide support to the mortgage and housing sector and to foster improved conditions in the general financial markets.
3. On March 18, 2009, the Federal Reserve announced that it intends to increase purchases of debt securities of Fannie Mae, Freddie Mac and the FHLBs and of Fannie Mae, Freddie Mac and Ginnie Mae mortgage-backed securities under its program to a total of up to \$200 billion and \$1.25 trillion respectively.

4. On May 6, 2009, Treasury and FHFA entered into an amendment to the Purchase Agreement. Under the amendment, Treasury increased its funding commitment to \$200 billion from \$100 billion each for Fannie Mae and Freddie Mac, increased the size of the mortgage-related investments portfolio allowed under the agreement by \$50 billion to \$900 billion, and increased the allowable debt outstanding to \$1,080 billion until December 31, 2010, for each organization. The increase in debt limits should provide Fannie Mae and Freddie Mac more time to term out debt.

Is the First American Government Obligations Fund (FVIXX) covered under the Temporary Guarantee Program for Money Market Mutual Funds?

As we expected, First American Funds (FAF) decided that they will not extend coverage under the Temporary Guarantee Program for the First American Government Obligations Fund (FVIXX) after April 30, 2009. We agree with this decision, which is in line with most other major fund providers in the industry. The management of the funds believes that this move is in the best interests of fund shareholders. This is primarily because it removes a costly insurance provision from Treasury and agency money market funds that are already among the safer investment options available to institutional investors. The funds that SVB Asset Management currently utilize invest primarily in agencies which carry implicit government guarantee and/or are direct obligations of the U.S. government that carry the full faith and credit of the U.S. government. In the current low interest rate environment, participation in the extension would result in additional costs to the funds, potentially lowering yields. We believe that the non-participation of the First American Government Obligation Fund in the extension has minimal impact on your portfolio.

Further Information

For additional analysis of the U.S. government's underlying support of government agency securities, refer to [Federated Investor's December 17, 2008 analysis](#) and our [presentation slides about GSE investment](#)

For further information on the First American Government Obligation Fund (FVIXX), please refer to:

° [Most recent fact sheet](#)

° [Most recently reported holdings](#)

° [Prospectus](#)

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