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Observation Deck

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The Future of Money Market Funds

Melina Hadiwono, *CFA, Head of Credit Research*

The month of September 2009 proved to be an important one for money market mutual funds, with rising signs of a return to normalcy for this vital investment segment. Money market funds, a $3.5 trillion industry, are not only important investment vehicles, but also function as important sources of liquidity for corporations and other financing entities.

The U.S. Treasury Temporary Guarantee Program, designed to support money funds, expired on September 18, and the Securities and Exchange Commission (SEC) has submitted and received comments, including ours, on proposed rule changes designed to strengthen money fund safety.

The guarantee program's uneventful expiration reflects yet another step toward short-term credit market normalcy, as demonstrated by the absence of any meaningful outflows during the program's last days. This program was a success, because it bolstered investor confidence and helped alleviate investor concerns about the ability of money market funds to provide full principal safety. The number of funds that use this program has decreased significantly since its inception. Substantial investments have returned to uninsured prime funds this year as market conditions have continued to improve. Additionally, the guarantee program has received no claims.

While the money market guarantee program has expired, it is noteworthy that the Federal Reserve has kept in place until February 2010 two money market funding facilities: the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) and the Commercial Paper Funding Facility (CPFF), which provide support to the money market industry.

To strengthen the regulatory framework for money market funds, the SEC has proposed rule amendments designed to increase their resilience during economic stress and reduce the impact of runs on the funds. Among other things, the SEC proposal includes requiring money market funds to maintain a higher portion of their portfolios in highly liquid investments, reduce their exposure to long-term debt, and limit their investments to only the highest-quality portfolio securities. The proposals also would require monthly reporting for portfolio holdings and allow the suspension of redemptions if a fund "breaks the buck," to allow for the orderly liquidation of fund assets.

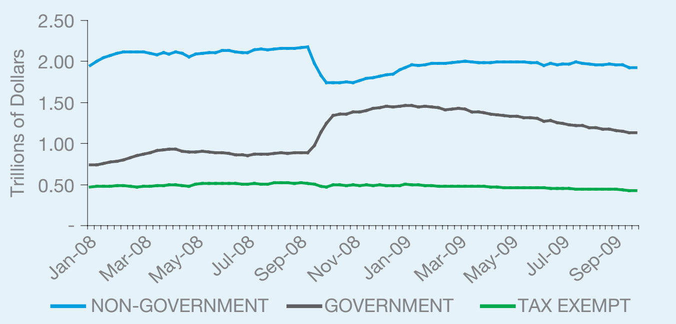
Especially for the JPMorgan and First American Funds (U.S. Bank) — which SVB Asset Management's clients utilize — many of the regulatory changes proposed would be clear positives for investors. Both entities already ascribe to the majority of the proposed rule changes and are well-positioned for the new environment.

Money market funds, like any investment, are not risk-free — investors need to perform on-going due diligence. We believe that prompt, consistent — and simple — risk disclosures for money market funds are vital to investors' ability to make educated investment decisions. SVB Asset Management clients now have visibility into their money market funds' holdings, through reporting tools that evaluate elements including risk analytics, portfolio holdings, and performance metrics. Because money funds play a crucial role in the liquidity strategies of virtually all corporations, such new levels of transparency are all the more valuable.

The next major milestone expected for the money market fund industry comes on December 1, when the President's Working Group on fund regulation is scheduled to announce its final recommendations. However, we expect that it will take some time before any regulatory changes in the money market funds industry are put into practice. In total, we don't expect to see any substantive rule changes until early next year.

SVB Asset Management's comments to the SEC on money market fund regulation can be seen at http://www.sec.gov/comments/s7-11-09/s71109-123.pdf

U.S. Money Market Funds



Source: Investment Company Institute

Markets

Treasury Rates	
3-Month	0.11%
6-Month	0.17%
1-Year	0.38%
2-Year	0.95%
3-Year	1.42%
5-Year	2.31%
7-Year	2.94%
10-Year	3.31%
September Total Returns	
ML 3-Month Treasury	0.02%
ML 6-Month Treasury	0.06%
ML 12-Month Treasury	-0.12%
S&P 500	3.73%
Nasdaq	5.69%

Source: Bloomberg, as of 9/30/09

Economic Vista

Minh Trang, *CFA, Portfolio Manager*

The economy continued to show signs of stabilization through the third quarter of 2009.

The pace of job losses slowed in August as employers cut 216,000 from payrolls, following a 276,000 drop the previous month. Total jobs lost reached 6.9 million since the recession began in December 2007. Correspondingly, the unemployment rate reached a 26-year high of 9.7 percent in August, from 9.4 percent in July. It is expected that the jobless rate will continue to rise into double digits, even as economic recovery takes hold.

One of the more positive signs in August was the return of consumer demand. Advance retail sales increased by 2.7 percent, an improvement over a 0.2 percent drop in July. Purchases excluding automobiles climbed 1.1 percent. Consumer spending is expected to provide a greater boost to GDP in the third quarter. Second quarter GDP contracted at 0.7 percent.

Finally, the Federal Reserve's Federal Open Market Committee kept rates unchanged in a range of zero to 0.25 percent in their September meeting. The policy makers commented that they would keep the target rate low for an "extended period," and maintain an accommodative monetary policy as economic conditions improve. It seems that the Fed actions and multiple government programs have helped to end the current recession. Going forward, however, the main focus will be on the sustainability and strength of the recovery.

Credit Vista

Melina Hadiwono, *CFA, Head of Credit Research*

After improving over the past several months, credit-card performance broadly deteriorated in August, according to Moody's Credit Card Index. Notably, the charge-off rate index advanced to a record-high of 11.49 percent. Following a trend of four consecutive months of improvement, early stage delinquencies rose slightly in August. Nonetheless, the excess spread remained robust at 6.15 percent in August 2009. The senior tranche AAA ratings for the major credit-card trusts have been relatively stable during the credit crisis.

As the recession intensified and credit-card-collateral performance deteriorated to record levels, many major credit-card trusts received support from their bank sponsors. Since the beginning of 2009, major credit-card asset-based securities issuers have taken yield-bolstering actions. These actions underscore the importance of the credit-card trusts as critical funding sources. The Big Six credit-card issuers currently securitize 60 to 95 percent of their managed credit-card portfolios. These actions have already begun to push trust yields higher. For example, portfolio yield tracked by Moody's Credit Card Index improved in both May and June, and contributed 110 and 150 basis points to each month's yield, respectively. Moody's expects contributions to grow in the coming months to approximately 350 basis points by year end. This support is expected to enable most trusts to withstand the macroeconomic base-case scenario, which includes unemployment and charge-offs peaking at about 10 and 12 percent respectively in the first half of 2010.

In addition, yields on individual trusts could rise even further if recent major-issuer re-pricing initiatives gain traction. In anticipation for the new credit-card regulations and accounting changes, issuers have been responding by increasing annual percentage rates, lowering credit lines, tightening underwriting standards and recalibrating risk-management models.

In early 2010, the securitized credit-card portfolios are expected to be consolidated on their respective bank sponsor's balance sheets, which will require the issuers to hold more capital and reserves. Hence, from a cost perspective, securitization may be a less-attractive funding alternative going forward, but may remain an important funding diversification source for card issuers.

Trading Vista

Hiro Ikemoto, *Money Market Trader*

In what's becoming a predictable trend every quarter-end, short-term Treasury bill yields went to near zero in September. This time, however, supply may be the driver of the decline rather than fear. In mid-September, the U.S. Treasury announced its plan to shrink its Supplementary Financing Program (SFP), which was used to issue a special class of T-bills to help finance its recent securities repurchasing, from the current $200 billion level to roughly $15 billion. The three-month T-bill ended the month at 0.11percent, the six-month at 0.16 percent and the one-year at 0.38 percent. The two-year Treasury note hovered in the mid-nineties for most of the month, ending at 0.95 percent.

In other sectors, agency securities remained very tight to Treasuries, with six-month discount notes at plus three basis points and one-year at plus five to Treasury equivalents. Financial corporate bonds have tightened further with issues maturing in the one-year area plus 10 to plus 30 to LIBOR, while industrial bond spreads were unchanged at minus 20 to 0. In the two-year area, financials are plus 60 to plus 80 and industrials are plus five to plus 20 to Treasury equivalents. Commercial paper yields have continued to go down, with the three-month yielding 0.21 percent at month-end.

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